2009

Checklist supplement and illustrative financial statements, real estate ventures and construction contractors, September 2009

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CHECKLIST SUPPLEMENT & ILLUSTRATIVE FINANCIAL STATEMENTS

Real Estate Ventures and Construction Contractors

To be used in conjunction with *Checklists and Illustrative Financial Statements for Corporations*

SEPTEMBER 2009

Checklist Supplement and Illustrative Financial Statements for Real Estate Ventures and Construction Contractors has not been approved, disapproved, or otherwise acted upon by any senior technical committees of the American Institute of Certified Public Accountants or the Financial Accounting Standards Board and has no official or authoritative status.

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TABLE OF CONTENTS

FSP Section 5000

Checklist Supplement and Illustrative Financial Statements: Real Estate Ventures and Construction Contractors

Introduction

.01 Real estate joint ventures are entities organized to accomplish a business purpose for the benefit of the members of the group. They are formed in a variety of legal ways. There are, for example, corporate joint ventures, partnerships (general or limited), undivided interests, and limited liability companies.

.02 Real estate joint ventures ordinarily are formed to accomplish various activities, such as to sell homes and home sites, to complete development of commercial or residential real estate, or to operate and maintain those facilities.

.03 The AICPA issues paper *Joint Venture Accounting* describes certain characteristics common to joint ventures: The entities are "(1) owned, operated, and jointly controlled by a small group as a separate and specific business project; (2) operated for the mutual benefit of the ownership group; (3) frequently organized to share risks and rewards in developing a new market, product, or technology by pooling resources and facilities; (4) operated under arrangements by which each venturer may participate in overall management regardless of the percentage of ownership; (5) usually of limited duration; (6) usually operated as an extension of the business or investment of one or more of the venturers; and (7) owned by a small number of venturers." In addition to real estate activities, joint ventures are used for various purposes including to explore for oil and gas and construct and operate manufacturing facilities.

Accounting Literature

.04 Historically, the accounting literature has given little attention to the accounting by a joint venture. Most literature in this area deals with the accounting by the investor for an investment in a joint venture. For example, the following all deal primarily with the accounting and disclosure by an investor in a joint venture or investee:

- AICPA issues paper *Joint Venture Accounting*, issued July 17, 1979
- AICPA issues paper *Accounting by Investors for Distributions Received in Excess of Their Investment in a Joint Venture* (an addendum to the AICPA issues paper *Joint Venture Accounting*), issued October 8, 1979
- Statement of Position (SOP) 78-9, *Accounting for Investments in Real Estate Ventures* (AICPA, *Technical Practice Aids*, ACC sec. 10,240) (as amended by Financial Accounting Standards Board (FASB) Staff Position SOP 78-9-1, *Interaction of AICPA Statement of Position 78-9 and EITF Issue No. 04-5*, and codified primarily in FASB *Accounting Standards Codification* [ASC] 970-323)
- AICPA Accounting Principles Board Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock*, which was codified primarily in FASB ASC 323-10

In December 2003, FASB issued FASB Interpretation No. 46(R), *Consolidation of Variable Interest Entities (revised December 2003)—an interpretation of ARB No. 51*, which interprets Accounting Research Bulletin No. 51, *Consolidated Financial Statements*, and addresses the consolidation of variable interest entities. Both of these pieces of guidance were codified primarily in FASB ASC 810, *Consolidation*.

Financial Accounting and Reporting Standards

.05 Presented are certain accounting pronouncements which may be of interest to practitioners engaged in the real estate venture industry:

- FASB Statement No. 13, *Accounting for Leases*, codified in several topics in FASB ASC; primarily FASB ASC 840, *Leases*
- FASB Statement No. 23, *Inception of the Lease—an amendment of FASB Statement No. 13*, codified in FASB ASC 840
- FASB Statement No. 66, *Accounting for Sales of Real Estate*, codified in several topics in FASB ASC, including FASB ASC 360, *Property, Plant and Equipment*, and FASB ASC 976, *Real Estate—Retail Land*
- FASB Statement No. 67, *Accounting for Costs and Initial Rental Operations of Real Estate Projects*, codified in FASB ASC 970, *Real Estate—General*
- FASB Statement No. 91, *Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases—an amendment of FASB Statements No. 13, 60, and 65 and a rescission of FASB Statement No. 17*, codified primarily in FASB ASC 310, *Receivables*
- FASB Statement No. 98, *Accounting for Leases: Sale-Leaseback Transactions Involving Real Estate, Sales-Type Leases of Real Estate, Definition of the Lease Term, and Initial Direct Costs of Direct Financing Leases—an amendment of FASB Statements No. 13, 66, and 91 and a rescission of FASB Statement No. 26 and Technical Bulletin No. 79-11*, codified primarily in FASB ASC 840
- FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities—a replacement of FASB Statement No. 125*, codified in several topics in FASB ASC, including FASB ASC 860, *Transfers and Servicing*
- FASB Statement No. 152, *Accounting for Real Estate Time-Sharing Transactions—an amendment of FASB Statements No. 66 and 67*, codified in several topics in FASB ASC, including FASB ASC 360 and 970
- FASB Statement No. 153, *Exchanges of Nonmonetary Assets—an amendment of APB Opinion No. 29*, codified primarily in FASB ASC 845, *Nonmonetary Transactions*
- FASB Statement No. 156, *Accounting for Servicing of Financial Assets—an amendment of FASB Statement No. 140*, codified in FASB ASC 860
- FASB Interpretation No. 19, *Lessee Guarantee of the Residual Value of Leased Property—an interpretation of FASB Statement No. 13*, codified in FASB ASC 840
- FASB Interpretation No. 21, *Accounting for Leases in a Business Combination—an interpretation of FASB Statement No. 13*, codified in FASB ASC 840
- FASB Interpretation No. 23, *Leases of Certain Property Owned by a Government Unit or Authority—an interpretation of FASB Statement No. 13*, codified in FASB ASC 840
- FASB Interpretation No. 24, *Leases Involving Only Part of a Building—an interpretation of FASB Statement No. 13*, codified in FASB ASC 840
- FASB Interpretation No. 26, *Accounting for Purchase of a Leased Asset by the Lessee during the Term of the Lease—an interpretation of FASB Statement No. 13*, codified in FASB ASC 840
- FASB Interpretation No. 27, *Accounting for a Loss on a Sublease—an interpretation of FASB Statement No. 13 and APB Opinion No. 30*, codified in the FASB ASC glossary
- FASB Interpretation No. 43, *Real Estate Sales—an interpretation of FASB Statement No. 66*, codified in FASB ASC 360

- FASB Interpretation No. 46(R), codified in several topics in FASB ASC, including FASB ASC 810
- SOP 78-9, codified primarily in FASB ASC 970
- SOP 92-1, *Accounting for Real Estate Syndication Income* (AICPA, *Technical Practice Aids*, ACC sec. 10,500), codified in FASB ASC 970
- SOP 04-2, *Accounting for Real Estate Time-Sharing Transactions* (AICPA, *Technical Practice Aids*, ACC sec. 10,910), codified in FASB ASC 978, *Real Estate—Time-Sharing Activities*

General

.06 This publication includes the following information:

- **Financial Statements and Notes Checklist—Real Estate Ventures** (section 5100)—For use by preparers of financial statements and by practitioners who audit, review, or compile them as they evaluate the adequacy of disclosures.
- **Illustrative Financial Statements, Notes, and Auditor's Report—Real Estate Ventures** (section 5200).
- **Financial Statements and Notes Checklist—Construction Contractors** (section 5300)—For use by preparers of financial statements and by practitioners who audit, review, or compile them as they evaluate the adequacy of disclosures.
- **Illustrative Financial Statements, Notes, and Auditor's Report—Construction Contractors** (section 5400).

.07 These checklists are intended to be used in connection with engagements of nonpublic entities and are not intended to be used in connection with audits of public entities that are required to be audited under standards set by the Public Company Accounting Oversight Board.

.08 These checklists and illustrative materials have been developed by the AICPA Accounting and Auditing Publications Staff to serve as nonauthoritative practice aids for use by preparers of financial statements and by practitioners who audit them. The financial statements and notes checklists include disclosure considerations applicable to real estate ventures and construction contractors in preparing financial statements in conformity with generally accepted accounting principles (U.S. GAAP). The checklist does not include disclosures that are generally applicable to all commercial corporations, only to the entities in the noted specific industries; nor does it include disclosures prescribed by pronouncements whose applicability to the noted specific industries is considered to be remote.

.09 Note that the *Checklist and Illustrative Financial Statements: Corporations* (product no. 0089309 [paperback] or WCP-CL [online]) contains auditor and accountant's report checklists that address those requirements most likely to be encountered when reporting on financial statements of a commercial corporation prepared in conformity with U.S. GAAP. They do not include reporting requirements relating to other matters such as internal control or agreed-upon procedures.

.10 Users of the financial statements and notes checklists should remember that they are supplemental disclosure checklists only and not a comprehensive U.S. GAAP application or measurement checklist. Accordingly, application and measurement issues related to preparing financial statements in conformity with U.S. GAAP are not included in these checklists.

.11 The checklists and illustrative financial statements should be used by, or under the supervision of, persons having adequate technical training and proficiency in the application of U.S. GAAP, generally accepted auditing standards, and other relevant technical guidance.

.12 In some cases, this checklist uses the term *common practice* or provides additional *practice tips* to describe a disclosure item. In such cases, while there is no authoritative guidance to support such a disclosure, it has become a common practice (sometimes due to SEC requirements) that such disclosures are made. Entities should evaluate whether such items warrant disclosure in their financial statements.

.13 Relevant financial statement reporting and disclosure guidance issued through September 30, 2009 has been considered in the development of this edition of the checklist. This includes relevant guidance issued up to and including the following:

- FASB Accounting Standards Updates issued through September 30, 2009

.14 The checklists and illustrative financial statements should be modified, as appropriate, for subsequent guidance. In determining the applicability of newly issued guidance, its effective date should also be considered.

.15 These checklists contain numerous references to authoritative accounting and auditing guidance. Abbreviations and acronyms used in such references include the following:

AAG =	Reference to section number or appendix in AICPA Audit and Accounting Guide *Construction Contractors* (with conforming changes as of May 1, 2009)
FASB ASC =	Reference to a topic, subtopic, section, or paragraph in FASB *Accounting Standards Codification*™

.16 The accounting guidance in this guide has been conformed to reflect reference to FASB ASC as it existed on September 30, 2009.

.17 On June 30, 2009, FASB issued FASB Statement No. 168, *The* FASB Accounting Standards Codification *and the Hierarchy of Generally Accepted Accounting Principles—a replacement of FASB Statement No. 162*, which is codified in FASB ASC 105, *Generally Accepted Accounting Principles*. On the effective date of this statement, FASB ASC is the authoritative source of U.S. accounting and reporting standards for nongovernmental entities, in addition to guidance issued by the Securities and Exchange Commission (SEC). At that time, FASB ASC supersedes all then-existing, non-SEC accounting and reporting standards for nongovernmental entities. Once effective, all other nongrandfathered, non-SEC accounting literature not included in FASB ASC is nonauthoritative. This statement is effective for financial statements issued for interim and annual periods ending after September 15, 2009. See the FASB Web site at www.fasb.org for further information.

Instructions

.18 Within these checklists are a number of questions or statements that are accompanied by references to applicable authoritative guidance. The financial statements and notes checklists are organized into several discrete sections which are common to most real estate ventures and construction contractors.

.19 The checklists provide spaces for checking off or initialing each question or point to indicate that it has been considered. Carefully review the topics listed and consider whether they represent potential disclosure items for the reporting entity for which you are preparing or auditing financial statements. Users should check or initial

- ***Yes***—If the disclosure is required and has been made appropriately.
- ***No***—If the disclosure is required but has not been made.
- ***N/A (Not Applicable)***—If the disclosure is not applicable to the entity.

.20 It is important that the effect of any "No" response be considered on the auditor's or accountant's report. For audited financial statements, a "No" response that is material to the financial statements may warrant a departure from an unqualified opinion as discussed in paragraphs .20–.64 of AU section 508, *Reports on Audited Financial Statements* (AICPA, *Professional Standards*, vol. 1). If a "No" response is indicated, the authors recommend that a notation be made in the margin to explain why the disclosure was not made (for example, because the item was not considered to be material to the financial statements).

.21 Users may find it helpful to use the right margin for certain other remarks and comments as appropriate, including the following:

a. For each disclosure for which a "Yes" is indicated, a notation as to where the disclosure is located in the financial statements and a cross-reference to the applicable working papers where the support to a disclosure may be found

b. For items marked as "N/A," the reasons for which they do not apply in the circumstances of the particular report

c. For each disclosure for which a "No" response is indicated, a notation as to why the disclosure was not made (for example, because the item was not considered to be material to the financial statements)

.22 These checklists and illustrative materials have been prepared by the AICPA staff. They have not been reviewed, approved, disapproved, or otherwise acted on by any senior technical committee of the AICPA and do not represent official positions or pronouncements of the AICPA.

.23 The use of these or any other checklists requires the exercise of individual professional judgment. These checklists are not substitutes for the original authoritative guidance. Users of these checklists and illustrative materials are urged to refer directly to applicable authoritative guidance when appropriate. The checklists and illustrative materials may not include all disclosures and presentation items promulgated, nor do they represent minimum standards or requirements. Additionally, users of the checklists and illustrative materials are encouraged to tailor them as required to meet specific circumstances of each particular engagement. As an additional resource, users may call the AICPA Technical Hotline at (877) 242-7212.

Recognition

.24 The AICPA gratefully appreciates the invaluable assistance Dave Arman provided in updating and maintaining the guidance in this checklist.

.25 We hope you find this checklist helpful as you perform your audit engagements. We would greatly appreciate your feedback on this checklist. You may e-mail these comments to A&APublications@aicpa.org or write to

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Note: This publication was extracted from sections 5000 through 5400 of the AICPA *Financial Statement Preparation Manual* (FSP).

FSP Section 5100

Financial Statements and Notes Checklist—Real Estate Ventures

.01 This financial statement disclosure checklist is organized into the following sections listed. Carefully review the topics listed and consider whether they represent potential disclosure items for the real estate venture for which you are preparing or auditing financial statements. Place a check mark by the topics or sections that are applicable and complete those sections of the checklist. Other sections may be marked "N/A" or left blank. For example, if the real estate venture is a common interest realty association, place a check mark by the section "Common Interest Realty Associations" and complete that section of the checklist. On the other hand, if the real estate venture is not a common interest realty association, do not place a check mark by "Common Interest Realty Associations" and skip that section when completing the checklist.

	Place ✔ by Applicable Sections
I. Common Interest Realty Associations	
A. Presentation of Financial Statements	______
B. Notes to Financial Statements	______
C. Property, Plant, and Equipment	______
D. Revenue Recognition	______
E. Income Taxes	______
F. Related Party Disclosures	______
II. Real Estate Investment Trusts	
A. Revenue Recognition	______
III. Retail Land Operations	
A. Receivables	______
B. Inventory	______
IV. Time-Sharing Activities	
A. Statement of Cash Flows	______
B. Receivables	______
C. Inventory	______

I. Common Interest Realty Associations

A. Presentation of Financial Statements	*Yes*	*No*	*N/A*
1. Have components of retained earnings or deficit properly not been included in the financial statements? [FASB ASC 972-205-50-1]	____	____	____
2. Has the funding policy, if any for future major repairs and replacements, as discussed in FASB ASC 972-235-50 (question 2 under section B, "Notes to Financial Statements") been disclosed? [FASB ASC 972-205-50-2]	____	____	____

	Yes	No	N/A
3. If the common interest realty association uses fund reporting and assesses owners for portions of future major repairs and replacements, have those assessed amounts been presented separately from amounts assessed for normal operations? For nonfund reporting has the fund for major repairs and replacements been presented as an appropriation of retained earnings? [FASB ASC 972-205-45-2; FASB ASC 972-205-45-5]	_____	_____	_____

Practice Tip

Either fund reporting on nonfund reporting may be used to present the financial statements of a common interest realty association. Fund reporting is more informative to users than nonfund reporting because financial statements using nonfund reporting often do not disclose whether assessments have been used for purposes other than those for which they were designated. For example, if nonfund reporting is used, a user of financial statements may be unable to determine whether assessments for future major repairs and replacements have been used in current operations.
[FASB ASC 972-205-45-4]

	Yes	No	N/A
4. In conformity with generally accepted accounting principles (U.S. GAAP), have the following been included in the full presentation of financial statements for the common interest realty association:			
a. A balance sheet (balance sheets are generally unclassified; entities with significant commercial operations should consider presenting classified balance sheets)? [FASB ASC 972-205-45-6; FASB ASC 972-205-45-13]	_____	_____	_____
b. A statement of revenues and expenses?	_____	_____	_____
c. A statement of changes in fund balances (fund reporting) or a statement of changes in members' equity (nonfund reporting)?	_____	_____	_____
d. A statement of cash flows?	_____	_____	_____
e. Notes to financial statements? [FASB ASC 972-205-45-6]	_____	_____	_____

Practice Tip

The following should be considered regarding the presentation in FASB ASC 972-205-45-6 (question 4):

- Information about the operating fund shall present assets, liabilities, and the fund balance specifically associated with the common interest realty association's normal maintenance and service activities.
- The presentation of information about the fund for major repairs and replacements (the replacement fund) shall include information about assets, liabilities, and the fund balance specifically associated with the common interest realty association's long-term major repair and replacement activities. The fund includes all assets that are held, for example, for the future replacement of roofs, roads, and furniture (some common interest realty associations may have a deferred maintenance fund which is used for painting or refinishing of building exteriors). Those assets usually consist of cash, marketable securities, and short-term investments. Liabilities in that fund generally are for work done on contracts for major repairs and replacements.

(continued)

	Yes	No	N/A

- The statement of revenues and expenses shall present information about all assessments, other revenues, and expenses. All common interest realty association activities, except for replacement fund activities, shall be presented in the operating fund in the statement of revenues and expenses unless the common interest realty association has other funds such as a deferred maintenance fund or a capital improvement fund, and so forth. Depreciation shall be reported as an expense of the fund in which the asset is reported.
- The financial statements shall include a statement of changes in fund balances, which reconciles beginning and ending fund balances with results of operations for the period. The statement may be presented separately or may be combined with the statement of revenues and expenses. Permanent transfers between funds shall be presented as interfund transfers in the statement of changes in fund balances, not as revenues. For example, if the board of directors transfers excess operating funds to the replacement fund at the end of an operating year, the interfund transfer shall be shown in the statement of changes in fund balances, not by reclassifying revenues.

[FASB ASC 972-205-45 par. 7–10]

5. If using fund reporting, has the common interest realty association presented interfund receivables and payables to highlight the causal transaction and to provide information about amounts assessed and collected that were not used in accordance with the initial budget? [FASB ASC 972-205-45-12] _____ _____ _____
6. In conformity with U.S. GAAP, have the following been included in the full presentation of financial statements if the common interest realty association is a cooperative housing corporation:
   a. A balance sheet? _____ _____ _____
   b. A statement of operations? _____ _____ _____
   c. A statement of changes stockholders' equity? _____ _____ _____
   d. A statement of cash flows? _____ _____ _____
   e. Notes to financial statements? _____ _____ _____
   f. Supplementary information as required by FASB ASC 972-235-50-3 (question 4 under section B, "Notes to Financial Statements")? [FASB ASC 972-205-45-6] _____ _____ _____

Practice Tip

The following should be considered regarding the presentation in FASB ASC 972-205-45-14 (question 6):

- Statements of operations of cooperatives should present information about all revenues and expenses. Reported revenues should include all charges to tenant-shareholders and other income.
- If per-share data are deemed useful, they shall be considered for disclosure in the notes to the financial statements.
- The statement of retained earnings (deficit) may be combined with the statement of operations. If there is activity in paid-in capital, a separate statement of shareholders' equity should be prepared.

[FASB ASC 972-205-45 par. 15–16]

B. Notes to Financial Statements

1. In addition to disclosures required by U.S. GAAP for other entities, have the following been disclosed:

	Yes	No	N/A
a. The common interest realty association's legal form (corporation or association) and that of the entity for which it provides services (for example, condominium, homeowners association, cooperative), areas it controls, and the number of units?	____	____	____
b. Services (such as maintenance) and subsidies provided by the developer?	____	____	____
c. The number of units owned by the developer? [FASB ASC 972-235-50-1]	____	____	____

Practice Tip

In the place of the number of units, cooperative housing corporations may disclose the number of shares and time-share associations may disclose the number of weeks.
[FASB ASC 972-235-50-1]

	Yes	No	N/A
2. Has the common interest realty disclosed information about its funding for future major repairs and replacements? Such disclosures should include all of the following:			
a. Requirements, if any, in statutes or the common interest realty association's documents (or mortgage or governmental bodies funding requirements; for example, Federal Housing Administration often has such requirements) to accumulate funds for future major repairs and replacements and the common interest realty association's compliance or lack of compliance with them?	____	____	____
b. A description of the common interest realty association's funding policy, if any, and compliance with that policy?	____	____	____
c. A statement that funds, if any, are being accumulated based on estimated future (or current) costs, that actual expenditures may vary from these estimates, and that the variations may be material?	____	____	____
d. Amounts assessed for major repairs and replacements in the current period, if any?	____	____	____
e. A statement indicating whether a study was conducted to estimate the remaining useful lives of common property components and the costs of future major repairs and replacements? [FASB ASC 972-235-50-2]	____	____	____
3. If the common interest realty association funds future major repairs and replacements by special assessments or borrowings when needs occur, has this fact been disclosed? [FASB ASC 972-235-50-2]	____	____	____
4. Has the following unaudited supplementary information been disclosed:			
a. Estimates of current or future costs of future major repairs and replacements of all existing components, such as roofs, including estimated amounts required, methods used to determine the costs, the basis for calculations (including assumptions, if any, about interest and inflation rates), sources used, and the dates of studies, made for this purpose, if any?	____	____	____

	Yes	No	N/A
b. A presentation of components to be repaired and replaced, estimates of the remaining useful lives of those components, estimates of current or future replacement costs, and amounts of funds accumulated for each to the extent designated by the board? [FASB ASC 972-235-50-3]	____	____	____

Practice Tip

Note that for the disclosure requirement in (question 4[a]) there is no requirement for common interest realty associations to obtain studies prepared by professional engineers. The estimates may be made by the board of directors or estimates obtained from licensed contractors.
[FASB ASC 972-235-50-3]

C. Property, Plant, and Equipment

	Yes	No	N/A
1. Have the following related to the common interest realty association's common property been disclosed:			
a. The accounting policy for recognition and measurement of common property?	____	____	____
b. A description of common property recognized as assets in the common interest realty association's balance sheet?	____	____	____
c. A description of common property to which the common interest realty association has title, or other evidence of ownership, that is not recognized as assets in the common interest realty association's balance sheet?	____	____	____
d. The common interest realty association's responsibility to preserve and maintain the common property?	____	____	____
e. Terms and conditions of existing land or recreation leases?	____	____	____
f. Restrictions on the use or disposition of the common property? [FASB ASC 972-360-50-1]	____	____	____

Practice Tip

Common property, as used in this checklist, includes a common interest realty association's real or personal property to which title or other evidence of ownership is held by either

- individual members in common, or
- the common interest realty association directly.

[FASB ASC glossary]

	Yes	No	N/A
2. Has all property owned by the cooperative been presented on the balance sheet? [FASB ASC 972-360-50-2]	____	____	____
3. Has the following information regarding depreciation for property and equipment owned by the common interest realty association been disclosed:			
a. Depreciation expense for the period?	____	____	____
b. Balances of major classes of depreciable assets, by nature or function, at the reporting date?	____	____	____

	Yes	No	N/A
c. Accumulated depreciation, either by major classes of depreciable assets or in total, at the reporting date?	____	____	____
d. A general description of the method or methods used in computing depreciation for major classes of depreciable assets? [FASB ASC 972-360-50-3]	____	____	____

D. Revenue Recognition

	Yes	No	N/A
1. In addition to disclosures required by U.S. GAAP for other entities, have the following been disclosed:			
a. The proposed use for funds collected in special assessments?	____	____	____
b. Assessments that were used for purposes other than those for which they were designated? [FASB ASC 972-605-50-1]	____	____	____
2. If 10 percent or more of a common interest realty association's revenues are derived from any one source, has that fact and the amount of revenue from each source been disclosed? [FASB ASC 972-605-50-2]	____	____	____
3. Have periodic assessments for funding future major repairs and replacements been reported in the period in which they were assessed, regardless of whether they have been collected or expended? [FASB ASC 972-605-45-1]	____	____	____
4. Does information about revenues presented include amounts for regular and special assessments from members and amounts for such items as assessments charged to the developer, developer contributions and subsidies, lawsuit settlements, interest income, laundry and vending machine income, or special-use charges from members and nonmembers? [FASB ASC 972-605-45-2]	____	____	____

E. Income Taxes

	Yes	No	N/A
1. In addition to disclosures required by U.S. GAAP for other entities, have the following been disclosed:			
a. The common interest realty association's income tax filing status and its liability for income taxes?	____	____	____
b. Credits from taxing authorities that will be phased out in future reporting periods [FASB ASC 972-740-50-1]	____	____	____

F. Related Party Disclosures

	Yes	No	N/A
1. Have services provided by board members, officers, or other developers (for example, insurance, maintenance, or management services) been disclosed in conformity with FASB ASC 850, *Related Party Disclosures*? [FASB ASC 972-850-50-1]	____	____	____

	Yes	No	N/A

II. Real Estate Investment Trusts

A. Revenue Recognition

1. If the real estate investment trust has operating support from its advisor, have disclosures been made of the relationship between the parties and the nature and amount of the transactions? ____ ____ ____
[FASB ASC 974-605-50-1]

2. Have the effects of the operating support transactions described in FASB ASC 974-605-25-2 and FASB ASC 974-605-50-1 (in question 1) been presented separately in the income statement? ____ ____ ____
[FASB ASC 974-605-45-1]

Practice Tip

Per FASB ASC 974-605-25-2, appropriate accounting by a real estate investment trust for operating support from its adviser would include either of the following:

- Adjustment of any assets (or liabilities) which will be transferred between the entities to current market value as of the date of the transaction
- Recognition, as income or as a reduction of advisory fees, of the operating support effectively obtained

[FASB ASC 974-605-25-2]

III. Retail Land Operations

A. Receivables

1. Have the following been disclosed for an entity with retail land sales operations:
   a. Maturities of accounts receivable for each of the five years following the date of the financial statements? ____ ____ ____
   b. Delinquent accounts receivable and the method(s) for determining delinquency? ____ ____ ____
   c. The weighted average and range of stated interest rates of receivables? ____ ____ ____
   [FASB ASC 976-310-50-1]

B. Inventory

1. Have the following been disclosed for an entity with retail land sales operations:
   a. Estimated total costs and estimated dates of expenditures for improvements for major areas from which sales are being made over each of the five years following the date of the financial statements? ____ ____ ____
   b. Recorded obligations for improvements? ____ ____ ____
   [FASB ASC 976-330-50-1]

Yes No N/A

IV. Time-Sharing Activities

A. Statement of Cash Flows

1. Have changes in time-sharing notes receivable, including sales of the notes, been reported in the statement of cash flows as cash flows from operating activities? ____ ____ ____
[FASB ASC 978-230-45-1]

B. Receivables

1. In addition to disclosures required by U.S. GAAP for other entities, have the following been disclosed in the financial statements of the entity with time-sharing transactions:
   a. Maturities of notes receivable for each of the five years following the date of the financial statements and in the aggregate for all years thereafter? ____ ____ ____
   b. The weighted average and range of stated interest rates of notes receivable? ____ ____ ____
   c. The estimated cost to complete improvements and promised amenities? ____ ____ ____
   d. The activity in the allowance for uncollectibles, including the balance in the allowance at the beginning and end of each period, additions associated with current-period sales, direct writeoffs charged against the allowance, and changes in estimate associated with prior-period sales? ____ ____ ____
   e. The seller's policies with respect to meeting the criteria for buyer's commitment and collectibility of sales prices in FASB ASC 360-20-40-5(b) and FASB ASC 360-20-40-50(b), respectively? ____ ____ ____
   [FASB ASC 978-310-50-1]

Practice Tip

Additionally for the disclosure required by FASB ASC 978-310-50-1(a), in (question 1[a]), the total of the notes receivable balances displayed with the various maturity dates shall be reconciled to the balance-sheet amount of notes receivable.

Additionally for the disclosure required by FASB ASC 978-310-50-1(d), (in question 1[d]), if the developer sells receivables with recourse the seller shall provide the same disclosure of activity on receivables sold.
[FASB ASC 978-310-50-1]

2. Have gross notes receivable from time-sharing sales been recorded, including a deduction for the allowance for uncollectibles and any deferred profit? ____ ____ ____
[FASB ASC 978-310-45-1]

C. Inventory

1. Have disclosures been made for changes in estimates used to perform the relative sales value method? ____ ____ ____
[FASB ASC 978-330-50-1]

Yes No N/A

Practice Tip

Per FASB ASC 978-330-35-1, for accounting for cost of sales and time-sharing inventory, at least quarterly, both total revenue and total costs estimates should be recalculated. The estimate of total revenue (actual to-date plus expected future revenue) should incorporate factors such as incurred or estimated uncollectibles, changes in sales prices or sales mix, repossession of intervals that the seller may or may not be able to resell, effects of upgrade programs, and past or expected sales incentives to sell slow-moving inventory units. The cost-of-sales percentage should be similarly recalculated each time estimated revenue or cost is adjusted, using the new estimate of total revenue and total cost (including costs to complete, if any).

The effects of changes in estimate shall be accounted for in each period using a current-period adjustment, that is, the time-share seller should account for a change in estimate in the period of change so that the balance sheet at the end of the period of change and the accounting in subsequent periods are as they would have been if the revised estimates had been the original estimates. The effects of changes in estimate shall be disclosed in accordance with FASB ASC 250-10-50-4.
[FASB ASC 978-330-35-1]

FSP Section 5200

Illustrative Financial Statements, Notes, and Auditor's Report—Real Estate Ventures[1]

.01 The illustrative financial statements have been presented in two different formats. The first set of illustrative financial statements is a traditional presentation. The second set of illustrative financial statements includes current value information. Practitioners may find this additional information useful as guidance in appropriate circumstances. The illustrative financial statements are intended to provide sample financial statement formats and disclosures, and are not intended to provide sample financial statement formats and disclosures, or all of the disclosures covered in the financial statement checklist. Other forms of financial statements are acceptable. More or less detail should appear either in the financial statements or in the notes, depending on the circumstances.

.02 Certain disclosures required by Securities and Exchange Commission rules and regulations are not presented in the illustrative financial statements. Furthermore, the illustrative financial statements do not include all disclosures and presentation items promulgated.

> ***Note:*** The illustrative financial statements and footnote disclosures included in this checklist have been updated to reflect the Financial Accounting Standards Board (FASB) *Accounting Standards Codification™* (ASC). However, in FASB's notice to constituents, it suggests the use of plain English in financial statement footnotes to describe broad FASB ASC topic references. They suggest a reference similar to "as required by the Derivatives and Hedging Topic of the FASB *Accounting Standards Codification*." Entities might consider revising their financial statement references to reflect this plain English referencing, rather than the use of specific FASB ASC references. We have provided these detailed references in the 2009 editions as a learning tool to familiarize constituents with FASB ASC.

Example 1: Format Without Current Value Information

.03 Independent Auditor's Report

To the Management of Real Estate Joint Venture Company:

We have audited the accompanying balance sheets of Real Estate Joint Venture Company as of December 31, 20X1 and 20X0, and the related statements of income and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America.[2] Those standards require that we plan and perform the audit to obtain reasonable assurance about

[1] The Sarbanes-Oxley Act of 2002 authorizes the Public Company Accounting Oversight Board (PCAOB) to establish auditing and related attestation, quality control, ethics, and independence standards to be used by registered public accounting firms in the preparation and issuance of audit reports for entities subject to the act or the rules of the Securities and Exchange Commission (SEC). Accordingly, public accounting firms registered with the PCAOB are required to adhere to all PCAOB standards in the audits of *issuers*, as defined by the Sarbanes-Oxley Act, and other entities when prescribed by the rules of the SEC.

For those entities not subject to the Sarbanes-Oxley Act or the rules of the SEC, the preparation and issuance of audit reports remain governed by generally accepted auditing standards as issued by the Auditing Standards Board (ASB).

[2] For audits of issuers, as defined by the Sarbanes-Oxley Act, and other entities when prescribed by the rules of the SEC (collectively referred to as *issuers*), PCAOB Auditing Standard No. 1, *References in Auditors' Reports to the Standards of the Public Company Accounting Oversight Board* (AICPA, *PCAOB Standards and Related Rules*, Rules of the Board, "Standards"), replaces this sentence with the following sentence: "We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United

(*continued*)

whether the financial statements are free of material misstatement. [*Optional: An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal controls over financial reporting. Accordingly, we express no such opinion.*][3] An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to in the preceding paragraphs present fairly, in all material respects, the financial position of Real Estate Joint Venture Company as of December 31, 20X1 and 20X0, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

[*Firm Signature*]
Certified Public Accountants
[*City, State*]
[*Date*]

Additional Guidance When Performing Integrated Audits of Financial Statements and Internal Control Over Financial Reporting

When performing an integrated audit of financial statements and internal control over financial reporting in accordance with the standards of the Public Company Accounting Oversight Board (PCAOB), the auditor may choose to issue a combined report or separate reports on the entity's financial statements and on internal control over financial reporting. Refer to paragraphs 85–98 of PCAOB Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That is Integrated with an Audit of Financial Statements* (AICPA, *PCAOB Standards and Related Rules*, Rules of the Board, "Standards"), for direction about reporting on internal control over financial reporting. In addition, see paragraphs 86–88 of PCAOB Auditing Standard No. 5, which include an illustrative combined audit report.

If the auditor issues separate reports on the entity's financial statements and on internal control over financial reporting, the following paragraph should be added to the auditor's report on the entity's financial statements in accordance with paragraph 88 of PCAOB Auditing Standard No. 5:

> We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), X Company's internal control over financial reporting as of December 31, 20X3, based on [*identify control criteria*] and our report dated [*date of report, which should be the same as the date of the report on the financial statements*] expressed [*include nature of opinions*].

States)." In June 2004, the ASB issued two auditing interpretations of AU section 508, *Reports on Audited Financial Statements* (AICPA, *Professional Standards*, vol. 1), which provide reporting guidance for audits of nonissuers. Interpretation No. 17, "Clarification in the Audit Report of the Extent of Testing of Internal Control Over Financial Reporting in Accordance With Generally Accepted Auditing Standards," of AU section 508 (AICPA, *Professional Standards*, vol. 1, AU sec. 9508 par. .85–.88), addresses how auditors may expand their independent auditing report to explain that their testing was sufficient to test the procedures of internal control over financial reporting, but not the effectiveness of the internal control. Interpretation No. 18, "Reference to PCAOB Standards in an Audit Report of a Nonissuer," of AU section 508 (AICPA, *Professional Standards*, vol. 1, AU sec. 9508 par. .89–.92), provides guidance on the appropriate referencing of PCAOB standards in auditing reports for those auditors who choose to follow PCAOB standards when auditing nonissuers. The ASB also has undertaken a project to determine what amendments, if any, should be made to AU section 508.

[3] This optional wording may be added in accordance with Interpretation No. 17 of AU section 508, which provides reporting guidance for audits of nonissuers. Interpretation No. 17 of AU section 508 addresses how auditors may expand their independent audit report to explain that their consideration of internal control was sufficient to provide the auditor sufficient understanding to plan the audit and determine the nature, timing, and extent of tests to be performed, but was not sufficient to express an opinion on the effectiveness of the internal control. If this optional language is added then the remainder of the paragraph should read as follows:

> An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

When issuing separate reports on the entity's financial statements and on internal control over financial reporting, the auditor also should add the following paragraph to the report on internal control over financial reporting in accordance with paragraph 88 of PCAOB Auditing Standard No. 5:

> We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the [*identify financial statements*] of X Company and our report dated [*date of report*] expressed [*include nature of opinion*].

When performing an integrated audit of financial statements and internal control over financial reporting in accordance with the standards of the PCAOB, paragraph 89 of PCAOB Auditing Standard No. 5 states that the auditor's report on the entity's financial statements and on internal control over financial reporting should be dated the same date.

.04

REAL ESTATE JOINT VENTURE COMPANY

Balance Sheets

December 31, 20X1 and 20X0

	December 31, 20X1	*December 31, 20X0*
Assets		
Property:		
Operating	$ 5,300,000	$ 4,700,000
Less: accumulated depreciation	(2,320,000)	(2,200,000)
Net	2,980,000	2,500,000
Properties held for sale	1,200,000	1,150,000
Properties held for development	500,000	400,000
Land	250,000	250,000
Total Property	4,930,000	4,300,000
Cash and cash equivalents	425,000	318,000
Marketable securities	225,000	225,000
Notes receivable	350,000	260,000
	$ 5,930,000	$ 5,103,000
Liabilities and Capital		
Current maturities of long-term debt (note 3)	$ 550,000	$ 550,000
Accounts payable	220,000	220,000
Accrued expenses and other liabilities	140,000	140,000
Mortgage loans (note 3)	5,500,000	4,500,000
Construction loans (note 3)	320,000	150,000
Land loans (note 3)	125,000	125,000
Total liabilities	6,855,000	5,685,000
Capital (Deficit)		
ABC Company	(291,000)	(289,700)
XYZ Company	(291,000)	(289,700)
	(582,000)	(579,400)
Loss	(158,800)	(2,600)
Partnership Distributions	(184,200)	—
Total (Deficit)	(925,000)	(582,000)
	$ 5,930,000	$ 5,103,000

The accompanying notes are an integral part of the financial statements.

.05

REAL ESTATE JOINT VENTURE COMPANY

Statements of Income

Years Ended December 31, 20X1 and 20X0

	December 31, 20X1	*December 31, 20X0*
Net rental income	$ 714,000	$ 660,000
Interest income	45,200	32,400
Total revenue	759,200	692,400
Operating expenses	(340,000)	(238,000)
Interest expense	(458,000)	(357,000)
Depreciation and amortization	(120,000)	(100,000)
Total expenses	(918,000)	(695,000)
Net income	$(158,800)	$ (2,600)

The accompanying notes are an integral part of the financial statements.

.06

REAL ESTATE JOINT VENTURE COMPANY

Statements of Cash Flows

Years Ended December 31, 20X1 and 20X0

	Year Ended December 31, 20X1	*Year Ended December 31, 20X0*
Cash flows from operating activities:		
Cash received from rentals	$ 714,000	$ 671,000
Cash paid for operations	(340,000)	(246,000)
Purchase of operating properties	(600,000)	(400,000)
Purchase of properties held for sale	(50,000)	—
Purchase of properties held for development	(100,000)	—
	(376,000)	25,000
Cash flows from investing activities:		
Interest income	45,200	32,400
Cash flows from financing activities:		
Borrowings	1,170,000	—
Interest payments	(458,000)	(350,000)
Distribution to partners	(184,200)	—
Receipt of note	(90,000)	—
	437,800	(350,000)
Net increase in cash and cash equivalents	107,000	(292,600)
Cash and cash equivalents at beginning of year	318,000	610,600
Cash and cash equivalents at end of year	$ 425,000	$ 318,000
Reconciliation of net income to net cash provided by operating activities:		
Net income	$(158,800)	$ (2,600)
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	120,000	100,000
Purchase of properties	(750,000)	(400,000)
Interest expense	458,000	357,000
Interest income	(45,200)	(32,400)
Net change in receivables and payables	—	3,000
Net cash provided by operating activities	$(376,000)	$ 25,000

The accompanying notes are an integral part of the financial statements.

.07

REAL ESTATE JOINT VENTURE COMPANY

Notes to the Financial Statements

December 31, 20X1 and 20X0

Note 1: The Company

In 20X0, the ABC Company entered into a joint venture agreement with XYZ Company to form the Real Estate Joint Venture Company (joint venture). The joint venture was formed to acquire land for development, develop said land for residential and commercial uses and to operate and sell individual properties.

Note 2: Significant Accounting Policies

a. Sales of Property

Gains from sales are recognized when numerous criteria relating to the sale are met. If sales are made that do not meet said criteria, sales are not recognized until criteria are met using the installment or cost recovery methods as appropriate under the circumstances.

b. Depreciation

Depreciation is recorded for all operating properties over a 40 year term.

c. Income Taxes

The joint venture pays no income taxes and is taxed as a partnership under provisions of the IRC. Individual participants include their distributive share of profits and losses on their own taxable entities.

d. Cash and Cash Equivalents

The Company considers all short-term investments with an original maturity of three months or less to be cash equivalents.

Note 3: Loans Payable

Mortgage, construction, and land loans payable as of December 31, 20X1, consist of the following:

	Interest Rate	*Total*	*20X2*	*20X3*	*20X4*	*20X5*	*20X6 or later*
Mortgage	7–9%	$6,050,000	$550,000	$550,000	$550,000	$550,000	$3,850,000
Construction	Floating 3% over prime	320,000	320,000				
Land	12%	125,000	125,000				
		$6,495,000	$995,000	$550,000	$550,000	$550,000	$3,850,000

Note 4: Commitments

As of December 31, 20X1, the joint venture had remaining commitments of approximately $400,000 on construction contracts and was contingently liable for approximately $75,000 of notes discounted with banks.

Note 5: Contingencies

There are claims and actions pending against the joint venture. In the opinion of management, the amounts, if any, that may be awarded for those claims and actions would not be material to the Company's financial position.

Example 2: Format With Current Value Information

.08

Independent Auditor's Report

We have audited the accompanying historical cost-balance sheets of Real Estate Joint Venture Company as of December 31, 20X1 and 20X0 and the related historical-cost statements of income and cash flows for each of the years ended December 31, 20X1 and 20X0. We also have audited the supplemental current-value balance sheets of Real Estate Joint Venture Company as of December 31, 20X1 and 20X0. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America.[4] Those standards require we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. [*Optional: An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal controls over financial reporting. Accordingly, we express no such opinion.*][5] An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the historical-cost financial statements referred to in the preceding paragraphs present fairly, in all material respects, the financial position of Real Estate Joint Venture Company as of December 31, 20X1 and 20X0, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As described in note 3, the supplemental current-value financial statements have been prepared by management to present relevant financial information that is not provided by the historical-cost financial statements and are not intended to be a presentation in conformity with generally accepted accounting principles. In addition, the supplemental current-value financial statements do not purport to present the net realizable, liquidation, or market value of the Company as a whole. Furthermore, amounts ultimately realized by the Company from the disposal of properties may vary significantly from the current values presented.

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[4] For audits of issuers, as defined by the Sarbanes-Oxley Act, and other entities when prescribed by the rules of the SEC (collectively referred to as *issuers*), PCAOB Auditing Standard No. 1, *References in Auditors' Reports to the Standards of the Public Company Accounting Oversight Board* (AICPA, *PCAOB Standards and Related Rules*, Rules of the Board, "Standards"), replaces this sentence with the following sentence: "We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States)." In June 2004, the ASB issued two auditing interpretations of AU section 508, *Reports on Audited Financial Statements* (AICPA, *Professional Standards*, vol. 1), which provide reporting guidance for audits of nonissuers. Interpretation No. 17, "Clarification in the Audit Report of the Extent of Testing of Internal Control Over Financial Reporting in Accordance With Generally Accepted Auditing Standards," of AU section 508 (AICPA, *Professional Standards*, vol. 1, AU sec. 9508 par. .85–.88), addresses how auditors may expand their independent auditing report to explain that their testing was sufficient to test the procedures of internal control over financial reporting, but not the effectiveness of the internal control. Interpretation No. 18, "Reference to PCAOB Standards in an Audit Report of a Nonissuer," of AU section 508 (AICPA, *Professional Standards*, vol. 1, AU sec. 9508 par. .89–.92), provides guidance on the appropriate referencing of PCAOB standards in auditing reports for those auditors who choose to follow PCAOB standards when auditing nonissuers. The ASB also has undertaken a project to determine what amendments, if any, should be made to AU section 508.

[5] This optional wording may be added in accordance with Interpretation No. 17 of AU section 508, which provides reporting guidance for audits of nonissuers. Interpretation No. 17 of AU section 508 addresses how auditors may expand their independent audit report to explain that their consideration of internal control was sufficient to provide the auditor sufficient understanding to plan the audit and determine the nature, timing, and extent of tests to be performed, but was not sufficient to express an opinion on the effectiveness of the internal control. If this optional language is added then the remainder of the paragraph should read as follows:

> An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the supplemental current-value financial statements referred to in the preceding paragraphs present fairly, in all material respects, the information set forth in them on the basis of accounting described in note 3.

[*Firm Signature*]
Certified Public Accountants
[*City, State*]
[*Date*]

.09

REAL ESTATE JOINT VENTURE COMPANY

Balance Sheets

December 31, 20X1 and 20X0

	20X1 Cost Basis	*20X0 Cost Basis*	*20X1 Current Value*	*20X0 Current Value*
Assets				
Property:				
Operating	$ 5,300,000	$ 4,700,000	$ 7,200,000	$ 6,600,000
Less: accumulated depreciation	(2,320,000)	(2,200,000)		
Net	2,980,000	2,500,000	7,200,000	6,600,000
Properties held for sale	1,200,000	1,150,000	1,300,000	1,250,000
Properties held for development	500,000	400,000	500,000	400,000
Land	250,000	250,000	250,000	250,000
Total property	4,930,000	4,300,000	9,250,000	8,500,000
Cash and cash equivalents	425,000	318,000	425,000	318,000
Marketable securities	225,000	225,000	225,000	225,000
Notes receivable	350,000	260,000	350,000	260,000
Total	$ 5,930,000	$ 5,103,000	$ 10,250,000	$ 9,303,000
Liabilities and Capital				
Current maturities of long-term debt (note 4)	$ 550,000	$ 550,000	$ 550,000	$ 550,000
Accounts payable	220,000	220,000	220,000	220,000
Accrued expenses and other liabilities	140,000	140,000	140,000	140,000
Mortgage loans (note 4)	5,500,000	4,500,000	5,500,000	4,500,000
Construction loans (note 4)	320,000	150,000	320,000	150,000
Land loans (note 4)	125,000	125,000	125,000	125,000
Total loans	6,855,000	5,685,000	6,855,000	5,685,000
Capital, (Deficit)				
ABC Company	(291,000)	(289,700)	(291,000)	(289,700)
XYZ Company	(291,000)	(289,700)	(291,000)	(289,700)
	(582,000)	(579,400)	(582,000)	(579,400)
Gain (loss)	(158,000)	(2,600)	(158,000)	(2,600)
Partnership distributions	(185,000)	—	(185,000)	—
Revaluation equity			4,320,000	4,200,000
Total	(925,000)	(582,000)	3,395,000	3,618,000
	$ 5,930,000	$ 5,103,000	$ 10,250,000	$ 9,303,000

The accompanying notes are an integral part of the financial statements.

.10

REAL ESTATE JOINT VENTURE COMPANY

Statements of Income

Years Ended December 31, 20X1 and 20X0

	December 31, 20X1	*December 31, 20X0*
Net rental income	$ 714,000	$ 660,000
Interest income	45,200	32,400
Total revenue	759,200	692,400
Operating expenses	(340,000)	(238,000)
Interest expense	(458,000)	(357,000)
Depreciation and amortization	(120,000)	(100,000)
Total expenses	(918,000)	(695,000)
Net income	$(158,800)	$ (2,600)

The accompanying notes are an integral part of the financial statements.

.11

REAL ESTATE JOINT VENTURE COMPANY

Statements of Cash Flows

Years Ended December 31, 20X1 and 20X0

	Year Ended December 31, 20X1	*Year Ended December 31, 20X0*
Cash flows from operating activities:		
Cash received from rentals	$ 714,000	$ 671,000
Cash paid for operations	(340,000)	(246,000)
Purchase of operating properties	(600,000)	(400,000)
Purchase of properties held for sale	(50,000)	—
Purchase of properties held for development	(100,000)	—
	(376,000)	25,000
Cash flows from investing activities:		
Interest income	45,200	32,400
Cash flows from financing activities:		
Borrowings	1,170,000	—
Interest payments	(458,000)	(350,000)
Distribution to partners	(184,200)	—
Receipt of note	(90,000)	—
	437,800	(350,000)
Net increase in cash and cash equivalents	107,000	(292,600)
Cash and cash equivalents at beginning of year	318,000	610,600
Cash and cash equivalents at end of year	$ 425,000	$ 318,000
Reconciliation of net income to net cash provided by operating activities:		
Net income	$(158,800)	$ (2,600)
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	120,000	100,000
Purchase of properties	(750,000)	(400,000)
Interest expense	458,000	357,000
Interest income	(45,200)	(32,400)
Net change in receivables and payables	—	3,000
Net cash provided by operating activities	$ (376,000)	$ 25,000

The accompanying notes are an integral part of the financial statements.

.12

REAL ESTATE JOINT VENTURE COMPANY

Notes to the Financial Statements

December 31, 20X1 and 20X0

Note 1: The Company

In 20X0, the ABC Company entered into a joint venture agreement with XYZ Company to form the Real Estate Joint Venture Company (joint venture). The joint venture was formed to acquire land for development, develop said land for residential and commercial uses and to operate and sell individual properties.

Note 2: Significant Accounting Policies

a. Sales of Property

Gains from sales are recognized when numerous criteria relating to the sale are met. If sales are made that do not meet said criteria the result of sales, sales are not recognized until criteria are met using the installment or cost recovery methods as appropriate under the circumstances.

b. Depreciation

Depreciation is recorded for all operating properties over a forty year term.

c. Income Taxes

The joint venture pays no income taxes and is taxed as a partnership under provisions of the IRC. Individual participants include their distributive share of profits and losses on their own taxable entities.

d. Cash and Cash Equivalents

The company considers all short-term investments with an original maturity of three months or less to be cash equivalents.

Note 3: Current Value Reporting

Management of the Company believes that properties have appreciated in value and therefore current value substantially exceeds cost basis. In estimating current values of the company's assets and liabilities estimates and judgments have been made, however, they are not subject to precise quantification or verification and may change over time due to economic factors.

Current values of operating properties have been determined by calculating the present value of future net cash flows factoring in an expected vacancy rate.

Current values of operating properties held for sale have been estimated based upon comparable sales, where available, negotiated contracts and other relevant data.

Current values of properties in development and raw land are carried at cost.

Revaluation Equity

The difference between cost and current values of assets is reported in the revaluation section of participant's equity. The components of revaluation are as follows:

	20X1	*20X0*
Value of interest in operating properties	$ 7,200,000	$ 6,600,000
Value of properties held for sale	1,300,000	1,250,000
Depreciated cost of properties	(4,180,000)	(3,650,000)
Total Revaluation Equity	$ 4,320,000	$ 4,200,000

Note 4: Loans Payable

Mortgage, construction, and land loans payable as of December 31, 20X1, consist of the following:

	Interest Rate	*Total*	*20X2*	*20X3*	*20X4*	*20X5*	*20X6 or later*
Mortgage	7–9%	$6,050,000	$550,000	$550,000	$550,000	$550,000	$3,850,000
Construction	Floating 3% over prime	320,000	320,000				
Land	12%	125,000	125,000				
		$6,495,000	$995,000	$550,000	$550,000	$550,000	$3,850,000

Note 5: Commitments

As of December 31, 20X1, the joint venture had remaining commitments of approximately $400,000 on construction contracts and was contingently liable for approximately $75,000 of notes discounted with banks.

Note 6: Contingencies

There are claims and actions pending against the joint venture. In the opinion of management, the amounts, if any, that may be awarded for those claims and actions would not be material to the Company's financial position.

FSP Section 5300

Financial Statements and Notes Checklist—Construction Contractors

Information

.01 The range of size and sophistication of entities in the construction industry has produced a variety of construction-type contracts and types of business entities that use them.

.02 The organizational structure, resources, and capabilities of contractors tend to vary with the type of construction activity.

.03 Common accounting and reporting practices by contractors include the following:

- The predominant practice is to present balance sheets with assets and liabilities classified as current and noncurrent on the basis of one year or the operating cycle. An unclassified balance sheet is also acceptable.
- Costs and estimated earnings in excess of billings are classified as current assets, and billings in excess of costs and estimated earnings are classified as current liabilities.
- Net debit balances for certain contracts should not be offset against net credit balances of other unrelated contracts.
- Contractors frequently participate in joint ventures and have investments in corporations and general or limited partnerships. These may be reported as investments or combined or consolidated in the financial statements, depending on the various factors that dictate the applicable accounting treatment.
- Generally, when estimates of costs to complete and extent of progress toward completion of long-term contracts are reasonably dependable, the percentage-of-completion method of contract accounting is preferable. When lack of dependable estimates or inherent hazards cause forecasts to be doubtful, the completed-contract method is generally preferable. The two methods should be used in specified circumstances and should not be used as acceptable alternatives for the same circumstances.
- The method of revenue recognition should be disclosed.
- A provision for losses on a contract should be made as soon as the losses become evident, regardless of the method of accounting for the contract. Provisions for losses on contracts should be shown separately as liabilities on the balance sheet, if significant, except in circumstances in which related costs are accumulated on the balance sheet, in which case the provisions may be deducted from the related accumulated costs. In a classified balance sheet, a provision shown as a liability should be shown as a current liability.
- Contractors are encouraged to present backlog information.

Financial Accounting and Reporting Standards

.04 Presented are certain accounting pronouncements which may be of interest to practitioners engaged in the construction contractor industry:

- Financial Accounting Standards Board (FASB) Statement No. 66, *Accounting for Sales of Real Estate*, codified in FASB *Accounting Standards Codification* (ASC). 976, *Real Estate—Retail Land*, and FASB ASC 360, *Property, Plant and Equipment*
- Statement of Position 81-1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts* (AICPA, *Technical Practice Aids*, ACC sec. 10,330), codified primarily in FASB ASC 605, *Revenue Recognition*
- Accounting Research Bulletin No. 45, *Long-Term Construction-Type Contracts*, codified primarily in FASB ASC 605

Instructions

.05 This financial statement disclosure checklist is organized into the sections listed. Carefully review the topics listed and consider whether they represent potential disclosure items for the construction contractor for which you are preparing or auditing financial statements. Place a check mark by the topics or sections that are applicable and complete those sections of the checklist. Other sections may be marked "N/A" or left blank. For example, if the construction contractor has affiliated entities, place a check mark by the section "Financial Reporting by Affiliated Entities" and complete that section of the checklist. On the other hand, if the contractor does not have affiliated entities, do not place a check mark by "Financial Reporting by Affiliated Entities" and skip that section when completing the checklist.

	Place ✓ by Applicable Sections
I. Construction Contractors	
A. Significant Accounting Policies	____
B. Financial Reporting by Affiliated Entities	____
C. Contract Costs	____
D. Notes to Financial Statements	____
E. Receivables	____
F. Other Assets and Deferred Costs	____
G. Liabilities	____
H. Revenue Recognition	____
I. Backlog on Existing Contracts	____

I. Construction Contractors

	Yes	*No*	*N/A*
A. Significant Accounting Policies			
1. In accordance with the disclosure sections of FASB ASC 323, *Investments—Equity Method and Joint Ventures*, has the method of reporting joint venture investments been disclosed? [AAG 6.26(4)]	____	____	____

Practice Tip

Per paragraph 3.41 of the Audit and Accounting Guide *Construction Contractors*, the following are additional items that a venturer should consider for disclosure:

- Any important provisions of the joint venture agreement
- If the joint venture's financial statements are not fully consolidated with those of the venturer, separate or combined financial statements of the ventures in summary form, including disclosure of accounting principles of the ventures that differ significantly from those of the venturer

(continued)

Yes No N/A

- Intercompany transactions during the period and the basis of intercompany billings and charges
- Liabilities and contingent liabilities arising from the joint venture arrangement, including venturer's obligations under guarantees

Further, per paragraph 6.14 of the guide, if a joint venture investment is presented on the cost or equity basis, the investment should be classified as noncurrent unless the venture is expected to be completed and liquidated during the current operating cycle of the investor. Losses in excess of an investment should be presented as a liability, and the classification principle for assets should apply.
[AAG 3.41; AAG 6.14]

B. Financial Reporting by Affiliated Entities

1. If material related party transactions have occurred, are the following disclosures made:
   a. The nature of the relationship(s) involved? ____ ____ ____
   b. A description of the transactions, including transactions to which no amounts or nominal amounts were ascribed, for each of the periods for which income statements are presented, and such other information deemed necessary to an understanding of the effects of the transactions on the financial statements? ____ ____ ____
   c. The dollar amounts of transactions for each of the periods for which income statements are presented and the effects of any change in the method of establishing the terms from that used in the preceding period? ____ ____ ____
   d. Amounts due from or to related parties as of the date of each balance sheet presented and, if not otherwise apparent, the terms and manner of settlement? ____ ____ ____
   e. The information required by FASB ASC 740-10-50-17 related to deferred taxes? ____ ____ ____
   [FASB ASC 850-10-50-1; AAG 4.09]

Practice Tip

Consolidated or combined financial statements of affiliated companies as the primary financial statements of an economic unit are normally recommended, but the needs of specific users may sometimes necessitate the presentation of separate financial statements for individual members of an affiliated group. The issuer of separate financial statements for a member of an affiliated group should make appropriate disclosures on related parties.

Presentation in a note to the financial statements of the condensed consolidated or combined balance sheet and statement of income of the members of the affiliated group that constitute the economic unit is also recommended.
[AAG 4.07 and 4.10]

2. If consolidated financial statements are presented, are the following additional disclosures made:
   a. A statement to the effect that combined financial statements are not those of a separate legal entity? ____ ____ ____
   b. The names and year-ends of the major entities included in the combined group? ____ ____ ____

	Yes	No	N/A
c. The nature of the relationship between the companies?	_____	_____	_____
d. The capital of each entity (on the face of the financial statements or in a note, either in detail by entity if the number of entities is small or, if detailed disclosure is not practicable, in condensed form with an explanation about how the information was accumulated)? [AAG 4.06]	_____	_____	_____

Practice Tip

Nonaccounting considerations, including taxation and exposure to legal liability, dictate the organizational structure and operating arrangements of many entities in the construction industry. As a result, many construction operations, when viewed as economic units, include several affiliated entities that are *related parties* as defined in the FASB ASC glossary, such as

- affiliates of the entity.
- entities for which investments in their equity securities would be required, absent the election of the fair value option in FASB ASC 825-10-15, to be accounted for by the equity method by the investing entity.
- trusts for the benefit of employees, such as pension and profit-sharing trusts that are managed by or under the trusteeship of management.
- principal owners of the entity and members of their immediate families.
- management of the entity and members of their immediate families.
- other parties with which the entity may deal if one party controls or can significantly influence the management or operating policies of the other to an extent that one of the transacting parties might be prevented from fully pursuing its own separate interests.
- other parties that can significantly influence the management or operating policies of the transacting parties or that have an ownership interest in one of the transacting parties and can significantly influence the other to an extent that one or more of the transacting parties might be prevented from fully pursuing its own separate interests.

For the purpose of presenting financial condition, results of operations, and cash flows of a group of commonly controlled entities that generally conduct their construction operations as, in effect, a single economic entity, FASB ASC 810-10-55-1B establishes that combined financial statements (as distinguished from consolidated financial statements) are likely to be more meaningful. The FASB ASC glossary defines *combined financial statements* as financial statements prepared for entities among which common control exists but for which the parent-subsidiary relationship does not exist. Combination requires elimination of intraentity transactions and balances. Examples of circumstances in which combined financial statements may be useful, as provided in FASB ASC 810-10-55-1B, include the existence of several entities that are related in their operations or the existence of entities that are under common management.

FASB ASC 810-10-45-10 establishes, in the presentation of combined financial statements for a group of related entities such as a group of unconsolidated subsidiaries or a group of commonly controlled entities, that intraentity transactions and profits or losses should be eliminated and that minority interests, foreign operations, income taxes, and different fiscal periods should be treated in the same manner as consolidated financial statements.
[AAG 4.01 and 4.04–.05]

	Yes	No	N/A

C. Contract Costs

1. Have the following amounts included in contract costs been disclosed:

   a. The aggregate amount included in contract costs representing unapproved change orders, claims, or similar items subject to uncertainty concerning their determination or ultimate realization, plus a description of the nature and status of the principal items comprising such aggregate amounts and the basis on which such items are recorded (for example, cost or realizable value)? ____ ____ ____

   b. The amount of progress payments netted against contract costs at the date of the balance sheet? ____ ____ ____
   [FASB ASC 910-20-50-1]

D. Notes to Financial Statements

1. In addition to the disclosure requirements of FASB ASC 235-10, have the following accounting policy disclosures been made:

   a. Information relating to the method of reporting by affiliated entities? ____ ____ ____

   b. The range of contract durations, if the operating cycle of the entity exceeds one year? ____ ____ ____
   [FASB ASC 910-235-50-1]

2. Has the entity made disclosures regarding the liquidity characteristics of specific assets and liabilities if (*a*) the entity's operating cycle exceeds one year or (*b*) the entity uses an unclassified balance sheet? ____ ____ ____
   [FASB ASC 910-235-50-2]

E. Receivables

1. Have the following disclosures been made regarding billed or unbilled amounts under contracts representing unapproved change orders, claims, or similar items subject to uncertainty concerning their determination or ultimate realization:

   a. The amount? ____ ____ ____

   b. A description of the nature and status of the principal items comprising the amount? ____ ____ ____

   c. The portion, if any, expected to be collected after one year? ____ ____ ____
   [FASB ASC 910-310-50-1]

2. Have the following disclosures been made regarding amounts representing the recognized sales value of performance under contracts that have not been billed and were not billable at the date of the balance sheet:

   a. The amount? ____ ____ ____

   b. A general description of the prerequisites for billings? ____ ____ ____

   c. The portion, if any, expected to be collected after one year? ____ ____ ____
   [FASB ASC 910-310-50-2]

3. For receivable amounts maturing after one year, have the following been disclosed:

   a. The amount maturing after one year and, if practicable, the amounts maturing in each year? ____ ____ ____

	Yes	No	N/A
b. Interest rates on major receivable items, or on classes of receivables, maturing after one year or an indication of the average interest rate or the range of rates on all receivables? [FASB ASC 910-310-50-3]	____	____	____
4. If receivables include amounts representing balances billed but not paid by customers under contract retainage provisions, have the following been disclosed:			
a. The amounts?	____	____	____
b. The portion, if any, expected to be collected after one year?	____	____	____
c. If practicable, the years in which the amounts are expected to be collected? [FASB ASC 910-310-50-4]	____	____	____
5. Are the portion of retainages not collectable in one year, or within the operating cycle if it is longer than one year, presented as noncurrent in the balance sheet? [FASB ASC 910-310-45-1]	____	____	____
6. Have services provided by officers, employees, or other affiliated entities been disclosed in conformity with FASB ASC 850, *Related Party Disclosures*? [AAG 6.34]	____	____	____

Practice Tip

Related party receivables are common in the construction industry. In accordance with FASB ASC 210-10-45-4, the concept of the nature of current assets contemplates the exclusion from current assets of loans or advances to affiliates, officers, and employees that are not expected to be collected within 12 months. FASB ASC 850-10-50-2 states notes or accounts receivable from officers, employees, or affiliated entities must be shown separately and not included under a general heading such as *notes receivable* or *accounts receivable*. If the reporting entity and one or more other entities are under common ownership or management control, and if the existence of that control could result in operating results or financial position of the reporting entity significantly different from those that would have been obtained if the entities were autonomous, the nature of the control relationship should be disclosed even though there are no transactions between the entities. This guidance specific to control relationships is found in FASB ASC 850-10-50-6.

Further, as provided in FASB ASC 850-10-50-1, financial statements should include disclosures of material related party transactions, other than compensation arrangements, expense allowances, and other similar items in the ordinary course of business. However, disclosure of transactions that are eliminated in the preparation of consolidated or combined financial statements is not required in those statements. The disclosures should include

- the nature of the relationship(s) involved.
- a description of the transactions, including transactions to which no amounts or nominal amounts were ascribed, for each of the periods for which income statements are presented, and such other information deemed necessary to an understanding of the effects of the transactions on the financial statements.
- the dollar amounts of transactions for each of the periods for which income statements are presented and the effects of any change in the method of establishing the terms from that used in the preceding period.

(continued)

Yes No N/A

- amounts due from or to related parties as of the date of each balance sheet presented and, if not otherwise apparent, the terms and manner of settlement.
- the information required by FASB ASC 740-10-50-17 for entities that issue separate financial statements but are members of a consolidated tax return.

[FASB ASC 210-10-45-4; FASB ASC 850-10-50 par. 1–2 and 6]

F. Other Assets and Deferred Costs

1. Has the policy of deferral and the amounts involved been disclosed for costs deferred either in anticipation of future sales or as a result of an unapproved change order? ____ ____ ____
   [FASB ASC 910-340-50-1]
2. Under the percentage-of-completion method, are costs and recognized income not yet billed shown as current assets? ____ ____ ____
   [FASB ASC 605-35-45-3]
3. Under the completed contract method, if there is an excess of accumulated billings, or if billings exceed costs on some contracts and costs exceeded billings on some contracts, are the contracts segregated so that amounts classified as current assets include only those on which costs exceeded billings? ____ ____ ____
   [FASB ASC 605-35-45-4]

Practice Tip

Although the suggested mechanics of segregating contracts between those on which costs exceed billings and those on which billings exceed costs do not indicate whether billings and related costs should be presented separately or combined (netted), separate disclosure in comparative financial statements is preferable because it shows the dollar volume of billings and costs (but not an indication of future profit or loss). In addition, grantors of credit, such as banks and insurance companies, have expressed a preference for separate disclosure. Disclosure may be made by short extension of the amounts on the balance sheet or in the notes to the financial statements. Thus, under the percentage-of-completion method, the current assets may disclose separately total costs and total recognized income not yet billed for certain contracts, and current liabilities may disclose separately total billings and total costs and recognized income for other contracts. The separate disclosure of revenue and costs in statements of income is the generally accepted practice. Only through comparable presentation of such data in the balance sheet can the reader adequately evaluate the contractor's comparative position.
[AAG 6.22]

G. Liabilities

1. For accounts and retentions payable, have the amounts of retentions to be paid after one year and, if practicable, the year in which amounts are expected to be paid been disclosed? ____ ____ ____
   [FASB ASC 910-340-50-1]

Practice Tip

Circumstances may be such that retentions payable will not be paid within an entity's normal operating cycle (for example, the existence of special arrangements with subcontractors or vendors), and these payables should be classified as noncurrent in a classified balance sheet.
[AAG 6.13]

	Yes	No	N/A
2. Have amounts of advances that are payments on account of work in progress disclosed? [FASB ASC 910-405-50-2]	____	____	____

Practice Tip

With regards to advances on cost-plus contracts,

- an advance received on a cost-plus contract shall not be offset against accumulated costs unless it is a payment on account of work in progress. Such advances are made to provide a revolving fund and are not applied as partial payment until the contract is nearly or fully completed.
- advances that are payments on account of work in progress shall be shown as a deduction from the related asset.

[FASB ASC 910-405-45 par. 1–2]

	Yes	No	N/A
3. Under the percentage-of-completion method, are billings in excess of costs and recognized income with respect to other contracts included as liabilities? [FASB ASC 605-35-45-3]	____	____	____
4. Under the completed contract method, if there is an excess of accumulated billings, or if billings exceed costs on some contracts and costs exceeded billings on some contracts, are the contracts segregated so that amounts classified as current liabilities include only those on which billings exceeded costs? [FASB ASC 605-35-45-4]	____	____	____

H. Revenue Recognition

	Yes	No	N/A
1. In accordance with the requirements of FASB ASC 235-10-50, has the entity disclosed the method or methods of determining earned revenue and the cost of earned revenue, including the policies relating to combining and segmenting, if applicable? [FASB ASC 605-35-50-1; FASB ASC 910-605-50-1]	____	____	____
2. If the completed-contract method is used by the entity, has the reason for selecting that method been disclosed? [FASB ASC 910-605-50-2]	____	____	____

Practice Tip

Examples for reasons for the use of the completed-contract method may include the following:

- Numerous short-term contracts for which financial position and results of operations reported on the completed-contract basis would not vary materially from those resulting from use of the percentage-of-completion method
- Inherent hazards or undependable estimates that cause forecasts to be doubtful

[FASB ASC 910-605-50-2]

	Yes	No	N/A
3. If the entity is using the percentage-of-completion method, have disclosures been made to disclose the method or methods (for example, cost to cost, labor hours) of measuring the extent of progress towards completion? [FASB ASC 605-35-50-2]	____	____	____
4. If the entity is using the percentage-of-completion method and a departure is made from that policy, has this departure been disclosed? [FASB ASC 605-35-50-3]	____	____	____
5. If the entity is using the completed-contract method, have the specific criteria used to determine when a contract is substantially completed disclosed (and followed consistently)? [FASB ASC 605-35-50-4]	____	____	____
6. If the entity is using the completed-contract method and a departure is made from that policy, has this departure been disclosed? [FASB ASC 605-35-50-5]	____	____	____
7. Have any revenue amounts from claims, which have been recorded only to the extent that the contract costs relating to the claim have been incurred disclosed in the notes to financial statements? [FASB ASC 605-35-50-6]	____	____	____
8. If the entity uses a practice such as recording revenues from claims only when the amounts have been received or awarded have the amounts shall be disclosed in the notes to financial statements? [FASB ASC 605-35-50-7]	____	____	____
9. If the requirements of FASB ASC 605-35-25-31 are not met or if those requirements are met but the claim exceeds the recorded contract costs, has a contingent asset been disclosed in accordance with FASB ASC 450-30-50-1? [FASB ASC 605-35-50-6]	____	____	____

Practice Tip

FASB ASC 605-35-50-6 (question 9) discusses the requirements of paragraph 31 of FASB ASC 605-35-25. This paragraph notes that recognition of amounts of additional contract revenue relating to claims is appropriate only if it is probable that the claim will result in additional contract revenue and if the amount can be reliably estimated. Those two requirements are satisfied by the existence of all of the following conditions:

- The contract or other evidence provides a legal basis for the claim; or a legal opinion has been obtained, stating that under the circumstances there is a reasonable basis to support the claim.
- Additional costs are caused by circumstances that were unforeseen at the contract date and are not the result of deficiencies in the contractor's performance.
- Costs associated with the claim are identifiable or otherwise determinable and are reasonable in view of the work performed.
- The evidence supporting the claim is objective and verifiable, not based on management's feel for the situation or on unsupported representations.
- If the foregoing requirements are met, revenue from a claim should be recorded only to the extent that contract costs relating to the claim have been incurred. Costs attributable to claims should be treated as costs of contract performance as incurred. However, a practice such as recording revenues from claims only when the amounts have been received or awarded may be used.

(continued)

Yes No N/A

Further, FASB ASC 605-35-50-6 (question 9) discusses the disclosure requirements of paragraph 1 of FASB ASC 450-30-50. This paragraph notes that adequate disclosure shall be made of a contingency that might result in a gain, but care shall be exercised to avoid misleading implications concerning the likelihood of realization.
[FASB ASC 605-32-25-31; FASB ASC 450-30-50-1]

10. Have the effects of any revisions to estimates been disclosed, in accordance with FASB ASC 250-10-50-4, if the effect is material? _____ _____ _____
[FASB ASC 605-35-50-9]

Practice Tip

FASB ASC 250-10-50-4 indicates that the effect on income from continuing operations, net income (or other appropriate captions of changes in the applicable net assets or performance indicator), and any related per-share amounts of the current period shall be disclosed for a change in estimate that affects several future periods, such as a change in service lives of depreciable assets. Disclosure of those effects is not necessary for estimates made each period in the ordinary course of accounting for items such as uncollectible accounts or inventory obsolescence; however, disclosure is required if the effect of a change in the estimate is material.
[FASB ASC 250-10-50-4]

11. If events have occurred after the date of the financial statements that are outside of the normal exposure and risk aspects of contracts of the entity, have those events been disclosed as subsequent events and not as refinements to the estimating process of the prior year? _____ _____ _____
[FASB ASC 605-35-50-10]

Practice Tip

Provisions for Anticipated Losses on Contracts

The provision for loss arises because estimated cost for the contract exceeds estimated revenue. Consequently, the provision for loss should be accounted for in the income statement as an additional contract cost rather than as a reduction of contract revenue, which is a function of contract price, not cost. Unless the provision is material in amount or unusual or infrequent in nature, the provision should be included in contract cost and shall not be shown separately in the income statement. If it is shown separately, it should be shown as a component of the cost included in the computation of gross profit.

Provisions for losses on contracts should be shown separately as liabilities on the balance sheet, if significant, except in circumstances in which related costs are accumulated on the balance sheet, in which case the provisions may be deducted from the related accumulated costs. In a classified balance sheet, a provision shown as a liability should be shown as a current liability.
[FASB ASC 605-35-45 par. 1–2]

I. Backlog on Existing Contracts

1. Has backlog information for signed contracts on hand whose cancellation is not anticipated been disclosed? _____ _____ _____
[AAG 6.28]

Yes *No* *N/A*

Practice Tip

In the construction industry, one of the most important indexes is the amount of backlog on uncompleted contracts at the end of the current year as compared with the backlog at the end of the prior year. Backlog can be reported by industry or type of facility and by location (domestic or foreign). Additional disclosures that an entity may want to make include backlog on letters of intent and a schedule showing backlog at the beginning of the year, new contract awards, revenue recognized for the year, and backlog at the end of the year. The presentation of backlog information is desirable only if a reasonably dependable determination of total revenue and a reasonably dependable estimate of total cost under signed contracts or letters of intent can be made. Information on signed contracts should be segregated from information on letters of intent if both types of information are presented.
[AAG 6.28]

FSP Section 5400

Illustrative Financial Statements, Notes, and Auditor's Report—Construction Contractors[1]

.01 The following sample financial statements of a construction contractor are included for illustrative purposes only and are not intended to establish reporting requirements. Furthermore, the dollar amounts shown are illustrative only and are not intended to indicate any customary relationship among accounts. The sample financial statements do not include all of the accounts and transactions that might be found in practice. The notes indicate the subject matter generally required to be disclosed, but they should be expanded, reduced, or modified to suit individual circumstances or materiality considerations. In addition to the illustrative notes that are presented, some of which are more or less peculiar to construction contractors, the notes to a construction contractor's financial statements should include information concerning other matters that are not unique to construction contractors, for example, subsequent events, pension plans, postretirement benefits other than pensions, postemployment benefits, stock options, lease commitments, extraordinary items, accounting changes, or off-balance-sheet risks.

> ***Note:*** The illustrative financial statements and footnote disclosures included in this checklist have been updated to reflect the Financial Accounting Standards Board (FASB) *Accounting Standards Codification*™ (ASC). However, in FASB's notice to constituents, it suggests the use of plain English in financial statement footnotes to describe broad FASB ASC topic references. They suggest a reference similar to "as required by the Derivatives and Hedging Topic of the FASB *Accounting Standards Codification*." Entities might consider revising their financial statement references to reflect this plain English referencing, rather than the use of specific FASB ASC references. We have provided these detailed references in the 2009 editions as a learning tool to familiarize constituents with FASB ASC.

.02

Independent Auditor's Report

The Shareholders and Board of Directors
Percentage Contractors, Inc.

We have audited the accompanying consolidated balance sheets of Percentage Contractors, Inc., and subsidiaries as of December 31, 20X1 and 20X0, and the related consolidated statements of income and retained earnings and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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[1] The Sarbanes-Oxley Act of 2002 authorizes the Public Company Accounting Oversight Board (PCAOB) to establish auditing and related attestation, quality control, ethics, and independence standards to be used by registered public accounting firms in the preparation and issuance of audit reports for entities subject to the act or the rules of the Securities and Exchange Commission (SEC). Accordingly, public accounting firms registered with the PCAOB are required to adhere to all PCAOB standards in the audits of *issuers*, as defined by the Sarbanes-Oxley Act, and other entities when prescribed by the rules of the SEC.

For those entities not subject to the Sarbanes-Oxley Act or the rules of the SEC, the preparation and issuance of audit reports remain governed by generally accepted auditing standards as issued by the Auditing Standards Board (ASB).

We conducted our audits in accordance with auditing standards generally accepted in the United States of America.[2] Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. [*Optional: An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion.*][3] An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Percentage Contractors, Inc., and subsidiaries as of [at] December 31, 20X1 and 20X0, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

(*Firm Signature*)
Certified Public Accountants
City, State
February 18, 20X2

Additional Guidance When Performing Integrated Audits of Financial Statements and Internal Control Over Financial Reporting

When performing an integrated audit of financial statements and internal control over financial reporting in accordance with the standards of the PCAOB, the auditor may choose to issue a combined report or separate reports on the entity's financial statements and on internal control over financial reporting. Refer to paragraphs 85–98 of PCAOB Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That is Integrated with an Audit of Financial Statements* (AICPA, *PCAOB Standards and Related Rules*, Rules of the Board, "Standards"), for direction about reporting on internal control over financial reporting. In addition, see paragraphs 86–88 of PCAOB Auditing Standard No. 5, which include an illustrative combined audit report.

If the auditor issues separate reports on the entity's financial statements and on internal control over financial reporting, the following paragraph should be added to the auditor's report on the entity's financial statements in accordance with paragraph 88 of PCAOB Auditing Standard No. 5:

---

[2] For audits of issuers, as defined by the Sarbanes-Oxley Act, and other entities when prescribed by the rules of the SEC (collectively referred to as *issuers*), PCAOB Auditing Standard No. 1, *References in Auditors' Reports to the Standards of the Public Company Accounting Oversight Board* (AICPA, *PCAOB Standards and Related Rules*, Rules of the Board, "Standards"), replaces this sentence with the following sentence: "We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States)." In June 2004, the ASB issued two auditing interpretations of AU section 508, *Reports on Audited Financial Statements* (AICPA, *Professional Standards*, vol. 1), which provide reporting guidance for audits of nonissuers. Interpretation No. 17, "Clarification in the Audit Report of the Extent of Testing of Internal Control Over Financial Reporting in Accordance With Generally Accepted Auditing Standards," of AU section 508 (AICPA, *Professional Standards*, vol. 1, AU sec. 9508 par. .85–.88), addresses how auditors may expand their independent auditing report to explain that their testing was sufficient to test the procedures of internal control over financial reporting, but not the effectiveness of the internal control. Interpretation No. 18, "Reference to PCAOB Standards in an Audit Report of a Nonissuer," of AU section 508 (AICPA, *Professional Standards*, vol. 1, AU sec. 9508 par. .89–.92), provides guidance on the appropriate referencing of PCAOB standards in auditing reports for those auditors who choose to follow PCAOB standards when auditing nonissuers. The ASB also has undertaken a project to determine what amendments, if any, should be made to AU section 508.

[3] This optional wording may be added in accordance with Interpretation No. 17 of AU section 508, which provides reporting guidance for audits of nonissuers. Interpretation No. 17 of AU section 508 addresses how auditors may expand their independent audit report to explain that their consideration of internal control was sufficient to provide the auditor sufficient understanding to plan the audit and determine the nature, timing, and extent of tests to be performed, but was not sufficient to express an opinion on the effectiveness of the internal control. If this optional language is added then the remainder of the paragraph should read as follows:

> An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

> We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), X Company's internal control over financial reporting as of December 31, 20X3, based on [*identify control criteria*] and our report dated [*date of report, which should be the same as the date of the report on the financial statements*] expressed [*include nature of opinions*].

When issuing separate reports on the entity's financial statements and on internal control over financial reporting, the auditor also should add the following paragraph to the report on internal control over financial reporting in accordance with paragraph 88 of PCAOB Auditing Standard No. 5:

> We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the [*identify financial statements*] of X Company and our report dated [*date of report*] expressed [*include nature of opinion*].

When performing an integrated audit of financial statements and internal control over financial reporting in accordance with the standards of the PCAOB, paragraph 89 of PCAOB Auditing Standard No. 5 states that the auditor's report on the entity's financial statements and on internal control over financial reporting should be dated the same date.

.03

PERCENTAGE CONTRACTORS, INC.

Consolidated Balance Sheets

December 31, 20X1 and 20X0

Assets	*20X1*	*20X0*
Cash and cash equivalents	$ 304,400	$ 221,300
Contracts receivables (notes 1 and 4)	3,789,200	3,334,100
Costs and estimated earnings in excess of billings on uncompleted contracts (note 5)	80,200	100,600
Inventory, at lower of cost, on a first-in first-out basis, or market	89,700	99,100
Prepaid charges and other assets	118,400	83,200
Advances to and equity in joint venture (note 6)	205,600	130,700
Note receivable, related company (note 7)	175,000	150,000
Property and equipment, net of accumulated depreciation and amortization (note 8)	976,400	1,019,200
	$5,738,900	$5,138,200

Liabilities and Shareholders' Equity	*20X1*	*20X0*
Notes payable (note 10)	$ 468,100	$ 578,400
Lease obligations payable (note 11)	197,600	251,300
Accounts payable (note 9)	2,543,100	2,588,500
Billings in excess of costs and estimated earnings on uncompleted contracts (note 5)	242,000	221,700
Other accrued liabilities	88,600	114,600
Due to consolidated joint venture minority interests	154,200	26,200
Deferred tax liability (note 15)	619,200	408,000
	4,312,800	4,188,700
Contingent liability (note 13)		
Shareholders' equity		
Common stock—$1 par value, 500,000 authorized shares, 300,000 issued and outstanding shares	300,000	300,000
Retained earnings	1,126,100	649,500
Total shareholders' equity	1,426,100	949,500
	$5,738,900	$5,138,200

The accompanying notes are an integral part of these consolidated financial statements.

.04

PERCENTAGE CONTRACTORS, INC.

Consolidated Statements of Income[4] and Retained Earnings

Years Ended December 31, 20X1 and 20X0

	20X1	*20X0*
Contract revenues earned	$22,554,100	$16,225,400
Cost of revenues earned	20,359,400	14,951,300
Gross profit	2,194,700	1,274,100
Selling, general, and administrative expense	895,600	755,600
Income from operations	1,299,100	518,500
Other income (expense)		
Equity in earnings from unconsolidated joint venture	49,900	5,700
Gain on sale of equipment	10,000	2,000
Interest expense (net of interest income of $8,800 in 20X1 and $6,300 in 20X0)	(69,500)	(70,800)
	(9,600)	(63,100)
Income before taxes	1,289,500	455,400
Provision for income taxes (note 15)	662,900	225,000
Net income	626,600	230,400
Basic and diluted earnings per share[5]	2.09	0.77
Retained earnings, beginning of year	649,500	569,100
	1,276,100	799,500
Less: Dividends paid (per share $0.50 (20X1); $0.50 (20X0))	150,000	150,000
Retained earnings, end of year	$ 1,126,100	$ 649,500

The accompanying notes are an integral part of these consolidated financial statements.

[4] Financial Accounting Standards Board (FASB) *Accounting Standards Codification* (ASC) 220, *Comprehensive Income*, establishes standards for the reporting and display of comprehensive income and its components. FASB ASC 220 requires that all items that are required to be recognized under accounting standards as components of comprehensive income be reported in a financial statement that is displayed with the same prominence as other financial statements. The topic does not require a specific format for that financial statement but requires that an enterprise display an amount representing total comprehensive income for the period in that financial statement. FASB ASC 323-10-35-18 addresses the recording of an investor's share of the investee's other comprehensive income. The topic does not apply to an enterprise that has no items of other comprehensive income in any period presented.

[5] FASB ASC 260, *Earnings Per Share*, requires presentation of earnings per share by all entities that have issued common stock or potential common stock if those securities trade in a public market either on a stock exchange (domestic or foreign) or in the over-the-counter market, including securities quoted only locally or regionally. The topic also requires presentation of earnings per share by an entity that has made a filing or is in the process of filing with a regulatory agency in preparation for the sale of those securities in a public market.

.05

PERCENTAGE CONTRACTORS, INC.

Consolidated Statements of Cash Flows

(Indirect Method)

Years Ended December 31, 20X1 and 20X0

	Years Ended December 31, 20X1	*20X0*
Cash flows from operating activities:		
Net income	$626,600	$230,400
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	167,800	153,500
Provision for losses on contract receivables	6,300	1,100
Gain on sale of equipment	(10,000)	(2,000)
Increase (decrease) in deferred taxes	211,200	(75,900)
Equity earnings from unconsolidated joint venture	(49,900)	(5,700)
Increase in joint venture minority interest	128,000	26,200
Increase in contract receivables	(461,400)	(10,200)
Net increase in billings related to costs and estimated earnings on uncompleted contracts	40,700	10,500
Decrease (increase) in inventory	9,400	(3,600)
Decrease (increase) in prepaid charges and other assets	(35,200)	16,100
Increase (decrease) in accounts payable	(45,400)	113,200
Increase (decrease) in other accrued liabilities	(26,000)	18,800
Net cash provided by operating activities	562,100	472,400
Cash flows from investing activities:		
Proceeds of equipment sold	25,000	5,000
Acquisition of equipment	(140,000)	(175,000)
Advances to joint venture	(25,000)	(9,700)
Increase in note receivable related company	(25,000)	(50,000)
Net cash used in investing activities	(165,000)	(229,700)
Cash flows from financing activities:		
Principal payments on notes payable	(110,300)	(90,300)
Principal payments under capital lease obligations	(53,700)	(9,700)
Cash dividends paid	(150,000)	(150,000)
Net cash used in financing activities	(314,000)	(250,000)
Net increase (decrease) in cash and cash equivalents	83,100	(7,300)
Cash and cash equivalents at beginning of year	221,300	228,600
Cash and cash equivalents at end of year	$304,400	$221,300

Supplemental data:

Cash equivalents include certificates of deposit with original maturities of one to three months—

Interest paid—20X1, $73,500; 20X0, $75,100

Income taxes paid—20X1, $478,300; 20X0, $313,200

The accompanying notes are an integral part of these consolidated financial statements.

.06

PERCENTAGE CONTRACTORS, INC.

Notes to Consolidated Financial Statements

December 31, 20X1 and 20X2

1. Nature of Operations and Significant Accounting Policies

Nature of operations. The entity is engaged in the construction of industrial and commercial buildings primarily in the Southwestern region of the United States.

Operating cycle. The entity's work is performed under cost-plus-fee contracts, fixed-price contracts, and fixed-price contracts modified by incentive and penalty provisions. These contracts are undertaken by the entity or its wholly owned subsidiary alone or in partnership with other contractors through joint ventures. The entity also manages, for a fee, construction projects of others. The length of the entity's contracts varies but is typically about two years. Therefore, assets and liabilities are not classified as current and noncurrent because the contract-related items in the balance sheet have realization and liquidation periods extending beyond one year.

Use of estimates. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Principles of consolidation.[6] The consolidated financial statements include the entity's majority-owned entities, a wholly owned corporate subsidiary and a 75 percent-owned joint venture (a partnership). All significant interentity transactions are eliminated. The entity has a minority interest in a joint venture (partnership), which is reported on the equity method.

Revenue and cost recognition. Revenues from fixed-price and modified fixed-price construction contracts are recognized on the percentage-of-completion method, measured by the percentage of labor hours incurred to date to estimated total labor hours for each contract.[7] This method is used because management considers expended labor hours to be the best available measure of progress on these contracts. Revenues from cost-plus-fee contracts are recognized on the basis of costs incurred during the period plus the fee earned, measured by the cost-to-cost method.

Contracts to manage, supervise, or coordinate the construction activity of others are recognized only to the extent of the fee revenue. The revenue earned in a period is based on the ratio of hours incurred to the total estimated hours required by the contract.

Contract costs include all direct material and labor costs and those indirect costs related to contract performance, such as indirect labor, supplies, tools, repairs, and depreciation costs. Selling, general, and administrative costs are charged to expense as incurred. Provisions for estimated losses on uncompleted contracts are made in the period in which such losses are determined. Changes in job performance, job conditions, and estimated profitability, including those arising from contract penalty provisions, and final contract settlements may result in revisions to costs and income and are recognized in the period in which the revisions are determined. Profit incentives are included in revenues when their realization is reasonably

[6] FASB Interpretation No. 46(R), *Consolidation of Variable Interest Entities (revised December 2003)—an interpretation of ARB No. 51*, codified primarily in FASB ASC 810, *Consolidation*, may impact the way construction contractors account for and report their investments in construction joint ventures.

[7] There are various other alternatives to the percentage of labor hours method for measuring percentage of completion, which, in many cases, may be more appropriate in measuring the extent of progress toward completion of the contract (labor dollars, units of output, and the cost-to-cost method and its variations).

assured. An amount equal to contract costs attributable to claims is included in revenues when realization is probable and the amount can be reliably estimated.

The asset, "Costs and estimated earnings in excess of billings on uncompleted contracts," represents revenues recognized in excess of amounts billed. The liability, "Billings in excess of costs and estimated earnings on uncompleted contracts," represents billings in excess of revenues recognized.

Contracts receivable. Contracts receivable from performing construction of industrial and commercial buildings are based on contracted prices. The entity provides an allowance for doubtful collections which is based upon a review of outstanding receivables, historical collection information, and existing economic conditions. Normal contracts receivable are due 30 days after the issuance of the invoice. Contract retentions are due 30 days after completion of the project and acceptance by the owner. Receivable past due more than 120 days are considered delinquent. Delinquent receivables are written off based on individual credit evaluation and specific circumstances of the customer.

Property and equipment. Depreciation and amortization are provided principally on the straight-line method over the estimated useful lives of the assets. Amortization of leased equipment under capital leases is included in depreciation and amortization.

Long-lived assets. Long-lived assets to be held and used are tested for recoverability whenever events or changes in circumstances indicate that the related carrying amount may not be recoverable. When required, impairment losses on assets to be held and used are recognized based on the excess of the asset's carrying amount over the fair value of the asset. Certain long-lived assets to be disposed of by sale are reported at the lower of carrying amount or fair value less cost to sell.

Income taxes. Provisions for income taxes are based on taxes payable or refundable for the current year and deferred taxes on temporary differences between the amount of taxable income and pretax financial income and between the tax bases of assets and liabilities and their reported amounts in the financial statements. Deferred tax assets and liabilities are included in the financial statements at currently enacted income tax rates applicable to the period in which the deferred tax assets and liabilities are expected to be realized or settled as prescribed in FASB ASC 740, *Income Taxes*. As changes in tax laws or rate are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes.

Construction contracts are reported for tax purposes on the completed-contract method and for financial statement purposes on the percentage-of-completion method. Accelerated depreciation is used for tax reporting, and straight-line depreciation is used for financial statement reporting.

Investment tax credits are applied as a reduction to the current provision for federal income taxes using the flow-through method.

Basic earnings per common share. Basic earnings per common share were computed by dividing income available to common stockholders by the weighted average number of common share outstanding during the year. Diluted earnings per share are not presented because the Company has issued no dilutive potential common shares.

2. Cash and Cash Equivalents

The entity maintains cash and cash equivalent balances at several financial institutions. Accounts at each institution are insured by the Federal Deposit Insurance Corporation (FDIC) up to $100,000. As of December 31, 20X1, the entity's uninsured bank balances totaled $95,000.

3. Fair Value of Financial Instruments

The carrying amounts of the Company's cash and cash equivalents, note receivable, and lease obligations payable approximate their fair value. The fair value of the Company's notes payable is estimated at $490,500 based on the future cash flows associated with each note discounted using the Company's current borrowing rate for similar debt.

4. Contracts Receivable

	December 31, 20X1	*December 31, 20X0*
Contracts receivable		
Billed		
Completed contracts	$ 621,100	$ 500,600
Contracts in progress	2,146,100	1,931,500
Retained	976,300	866,200
Unbilled	121,600	105,400
	3,865,100	3,403,700
Less: Allowances for doubtful collections	75,900	69,600
	$ 3,789,200	$ 3,334,100

The total recorded investment in impaired contracts receivable recognized, as required by the *Receivables* topic of FASB ASC, was $125,000 in 20X1 and $103,000 in 20X0. These amounts also approximate the average recorded investment in impaired contracts receivable during the related periods. The allowance for credit losses associated with these receivables was $41,000 in 20X1 and $38,000 in 20X0. It is management's policy not to accrue interest income on impaired contracts receivable given past difficulties in collecting such amounts. Interest income on impaired contracts receivable of $1,452 and $1,107 was recognized for cash payments received in 20X1 and 20X0, respectively. For impairment recognized, as required by the *Receivables* topic of FASB ASC, the entire change in present value of expected cash flows is reported as bad debt expense in the same manner in which impairment initially was recognized or as a reduction in the amount of bad debt expense that otherwise would be reported.

Analysis of the changes in the allowance for doubtful collections:

	20X1	*20X0*
Balance at January 1	$ 69,600	$ 68,000
Additions charged to operations	6,300	1,100
Direct write-downs	—	500
Recoveries	—	—
Balance at December 31	$ 75,900	$ 69,600

Contracts receivable at December 31, 20X1, include a claim, expected to be collected within one year, for $290,600 arising from a dispute with the owner over design and specification changes in a building currently under construction. The changes were made at the request of the owner to improve the thermal characteristics of the building and, in the opinion of counsel, gave rise to a valid claim against the owner.

The retained and unbilled contracts receivable at December 31, 20X1, included $38,600 that was not expected to be collected within one year.

Contracts receivable include approximately $800,000 due under one contract.[8]

[8] FASB ASC 825, *Financial Instruments*, requires disclosure of concentrations of credit risks of all financial instruments. Concentrations can be geographical areas, types of contracts, owners or others. Additionally, the contractor should disclose, for each significant concentration, the policy of requiring collateral or other security to support financial instruments subject to credit risk, information about the contractor's access to that collateral or other security, and the nature and a brief description of the collateral or other security supporting those financial instruments.

5. Costs and Estimated Earnings on Uncompleted Contracts

	December 31, 20X1	December 31, 20X0
Costs incurred on uncompleted contracts	$15,771,500	$12,165,400
Estimated earnings	1,685,900	1,246,800
	17,457,400	13,412,200
Less: Billings to date	17,619,200	13,533,300
	$ (161,800)	$ (121,100)
Included in accompanying balance sheets under the following captions:		
Costs and estimated earnings in excess of billings on uncompleted contracts	$ 80,200	$ 100,600
Billings in excess of costs and estimated earnings on uncompleted contracts	(242,000)	(221,700)
	$ (161,800)	$ (121,100)

6. Advances to and Equity in Joint Venture

The entity a minority interest (one-third) in a general partnership joint venture formed to construct an office building. All of the partners participate in construction, which is under the general management of the entity. Summary information on the joint venture follows:

	December 31, 20X1	December 31, 20X0
Current assets	$ 483,100	$ 280,300
Construction and other assets	220,500	190,800
	703,600	471,100
Less: Liabilities	236,800	154,000
Net assets	$ 466,800	$ 317,100
Revenue	$ 3,442,700	$ 299,400
Net income	$ 149,700	$ 17,100
Company's interest		
Share of net income	$ 49,900	$ 5,700
Advances to joint venture	$ 50,000	$ 25,000
Equity in net assets	155,600	105,700
Total advances and equity	$ 205,600	$ 130,700

(For the purposes of illustrative financial statements, the one-line equity method of presentation is used in both the balance sheet and the income statement. However, the pro rata consolidation method is acceptable if the investment is deemed to represent an undivided interest.)

7. Transactions With Related Party

The note receivable, related entity, is an installment note bearing annual interest at 9 percent, payable quarterly, with the principal payable in annual installments of $25,000, commencing October 1, 20X3.

The major stockholder of Percentage Contractors, Inc. owns the majority of the outstanding common stock of this related entity, whose principal activity is leasing land and buildings. Percentage Contractors, Inc., rents land and office facilities from the related entity on a ten-year lease ending September 30, 20X9, for an annual rental of $19,000.

8. Property and Equipment

	December 31, 20X1	*December 31, 20X0*
Assets		
Land	$ 57,500	$ 57,500
Buildings	262,500	262,500
Shop and construction equipment	827,600	727,600
Automobiles and trucks	104,400	89,100
Leased equipment under capital leases	300,000	300,000
	1,552,000	1,436,700
Accumulated depreciation and amortization		
Buildings	140,000	130,000
Shop and construction equipment	265,600	195,500
Automobiles and trucks	70,000	42,000
Leased equipment under capital leases	100,000	50,000
	575,600	417,500
Net property and equipment	$ 976,400	$ 1,019,200

Note: FASB ASC 360, *Property, Plant, and Equipment*, requires certain disclosures if an impairment loss is recognized for assets to be held and used. An example of such a disclosure follows:

Recently adopted environmental legislation has placed significant restrictions on the use of certain heavy equipment owned and operated by the Company. This circumstance has called into question the recoverability of the carrying amounts of these assets. As a result, as required by the Property, Plant, and Equipment *topic of FASB ASC, an impairment loss of $X,XXX has been recognized for this equipment and included as a component of income before income taxes under the caption "Selling, general and administrative expenses." In calculating the impairment loss fair value was determined by reviewing quoted market prices for current sales of similar equipment.*

9. Accounts Payable

Accounts payable include amounts due to subcontractors, totaling $634,900 at December 31, 20X1, and $560,400 at December 31, 20X0, which have been retained pending completion and customer acceptance of jobs. Accounts payable at December 31, 20X1, include $6,500 that are not expected to be paid within one year.

10. Notes Payable

	December 31, 20X1	*December 31, 20X0*
Unsecured note payable to bank, due in quarterly installments of $22,575 plus interest at 1% over prime	$388,100	$478,400
Note payable to bank, collateralized by equipment, due in monthly installments of $1,667 plus interest at 10% through January, 20X6	80,000	100,000
	$468,100	$578,400

Principal payments on note payables are due as follows:

Year ending December 31,	
20X2	$110,300
20X3	$110,300
20X4	$110,300
20X5	$110,300
20X6	$26,900

11. Lease Obligations Payable

The entity leases certain specialized construction equipment under leases classified as capital leases. The following is a schedule showing the future minimum lease payments under capital leases by years and the present value of the minimum lease payments as of December 31, 20X1:

Year ending December 31,	
20X2	$76,500
20X3	76,500
20X4	76,500
Total minimum lease payments	229,500
Less: Amount representing interest	31,900
Present value of minimum lease payments	$197,600

At December 31, 20X1, the present value of minimum lease payments due within one year is $62,250.

Total rental expense, excluding payments on capital leases, totaled $86,300 in 20X1 and $74,400 in 20X0.

12. Surety Bonds

The entity, as a condition for entering into some of its construction contracts, had outstanding surety bonds as of December 31, 20X1 and 20X0.

13. Contingent Liability

A claim for $180,000 has been filed against the entity and its bonding entity arising out of the failure of a subcontractor of the entity to pay its suppliers. In the opinion of counsel and management, the outcome of this claim will not have a material effect on the entity's financial position or results of operations.

14. Management Contracts

The entity manages or supervises commercial and industrial building contracts of others for a fee. These fees totaled $121,600 in 20X1 and $1,700 in 20X0 and are included in contract revenues earned.

15. Income Taxes and Deferred Income Taxes[9]

The provision for taxes on income consists of the following:

	December 31, 20X1	*December 31, 20X0*
Current	$451,700	$300,900
Deferred	211,200	(75,900)
Total	$662,900	$225,000

The following represents the approximate tax effect of each significant type of temporary difference giving rise to the deferred income tax liability:

	December 31, 20X1	*December 31, 20X0*
Deferred tax asset:		
Employee benefits	$44,300	$38,100
Other	10,100	10,600
Total	$54,400	$48,700
Deferred tax liability:		
Earnings on uncompleted contracts	$594,000	$389,800
Property, plant, and equipment	64,300	54,100
Other	15,300	12,800
Total	$673,600	$456,700
Deferred tax liability, net	$619,200	$408,000

16. Backlog

The following schedule shows a reconciliation of backlog representing the amount of revenue the entity expects to realize from work to be performed on uncompleted contracts in progress at December 31, 20X0 and 20X1 and from contractual agreements on which work has not yet begun.[10]

Balance December 31, 20X0	$24,142,600
Contract adjustments	1,067,100
New contracts, 20X1	3,690,600
	28,900,300
Less: Contract revenue earned, 20X1	22,432,500
Balance, December 31, 20X1	$ 6,467,800

In addition, between January 1, 20X2 and February 18, 20X2, the entity entered into additional construction contracts with revenues of $5,332,800.

[9] In addition to the information presented, FASB ASC 740, *Income Taxes*, requires that a public enterprise disclose a reconciliation using percentages or dollar amounts of (*a*) the reported amount of income tax expense attributable to continuing operations for the year to (*b*) the amount of income tax expense that would result from applying domestic federal statutory tax rates to pretax income from continuing operations. The "statutory" tax rates should be the regular tax rates if there are alternative tax systems. The estimated amount and the nature of each significant reconciling item should be disclosed. A nonpublic enterprise should disclose the nature of significant reconciling items but may omit a numerical reconciliation.

[10] The presentation of backlog information, although encouraged, is not a required disclosure.

17. Vulnerability Due to Certain Concentrations

In response to competitive pressures, and in line with current industry trends, the Company has embarked upon an aggressive cost-cutting program. Efforts to incorporate cost reductions in the collective bargaining agreements due to expire in the coming year are expected to meet with resistance from several labor guilds (approximately 75 percent of the Company's labor force is covered by collective bargaining agreements, while approximately 40 percent of the Company's labor force is covered by collective bargaining agreements that will expire within one year). Given these circumstances, and the Company's past experience with work stoppages, management believes that it is reasonably possible that a protracted strike may take place thus resulting in a severe impact in the near term.

.07

SAMPLE ACCOMPANYING INFORMATION

Percentage Contractors, Inc.

Independent Auditor's Report on Accompanying Information

The Shareholders and Board of Directors
Percentage Contractors, Inc.

Our audits were made for the purpose of forming an opinion on the basic financial statements taken as a whole. The (identify *accompanying* information) is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audits of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

(*Firm Signature*)
Certified Public Accountants
City, State
February 18, 20X2

.08

PERCENTAGE CONTRACTORS, INC.

Schedule 1

Earnings from Contracts

Year Ended December 31, 20X1

	20X1			*20X0*
	Revenues earned	*Cost of revenues earned*	*Gross profit (loss)*	*Gross profit (loss)*
Contracts completed during the year	$6,290,800	$5,334,000	$956,800	$415,300
Contracts in progress at year-end	16,141,700	14,636,900	1,504,800	921,400
Management contract fees earned	121,600	51,800	69,800	1,700
Unallocated indirect and warranty costs[1]		46,700	(46,700)	(38,100)
Minority interest in joint venture		128,000	(128,000)	(26,200)
Charges on prior year contracts		162,000	(162,000)	
	$22,554,100	$20,359,400	$2,194,700	$1,274,100

[1] FASB ASC 460, *Guarantees*, elaborates on the disclosures to be made by a guarantor in its interim and annual financial statements about its obligations under certain guarantees that it has issued. It also clarifies that a guarantor is required to recognize, at the inception of a guarantee, a liability for the fair value of the obligation undertaken in issuing the guarantee. Product warranties are excluded from the initial recognition and initial measurement, however the disclosure requirements described in FASB ASC 460-10-50-8 are applicable.

.09

PERCENTAGE CONTRACTORS, INC.

Schedule 2

Contracts Completed

Year Ended December 31, 20X1

Contract		*Contract totals*			*Before January 1, 20X1*			*During the year ended December 31, 20X0*		
Number	*Type*	*Revenues earned*	*Cost of revenues*	*Gross profit (loss)*	*Revenues earned*	*Cost of revenues*	*Gross profit (loss)*	*Revenues earned*	*Cost of revenues*	*Gross profit (loss)*
1511	B	$5,475,300	$4,802,500	$672,800	$3,223,400	$2,932,700	$290,700	$2,251,900	$1,869,800	$382,100
1605	A	695,000	880,900	(185,900)	596,100	558,100	38,000	98,900	322,800	(223,900)
1624	A	140,700	150,700	(10,000)	29,600	31,800	(2,200)	111,100	118,900	(7,800)
1711	A	2,725,100	2,391,700	333,400	1,654,100	1,510,000	144,100	1,071,000	881,700	189,300
1791	B	4,770,100	4,288,900	481,200	3,028,500	2,929,600	98,900	1,741,600	1,359,300	382,300
1792	A	635,000	457,900	177,100				635,000	457,900	177,100
Small contracts		413,400	349,500	63,900	32,100	25,900	6,200	381,300	323,600	57,700
		$14,854,600	$13,322,100	$1,532,500	$8,563,800	$7,988,100	$575,700	$6,290,800	$5,334,000	$956,800

Contract types
A—Fixed-price.
B—Cost-plus-fee.

.10

PERCENTAGE CONTRACTORS, INC.

Schedule 3

Contracts in Progress

December 31, 20X1

Contract		*Total contract*		*From inception to December 31, 20X1*						*At December 31, 20X1*		*For the year ended December 31, 20X1*		
Number	*Type*	*Revenues*	*Estimated gross profit (loss)*	*Revenues earned*	*Total costs incurred*	*Cost of revenues*	*Gross profit (loss)*	*Billed to date*	*Estimated cost to complete*	*Costs and estimated earnings in excess of billings*	*Billings in excess of costs and estimated earnings*	*Revenues earned*	*Cost of revenues*	*Gross profit (loss)*
1845	A	$ 6,750,200	$ 877,000	$ 5,890,500	$ 5,244,500	$ 5,143,900	$ 746,600	$ 5,976,000	$ 628,700	$15,100		$ 5,664,200	$ 4,984,500	$ 679,700
1847	B	1,471,800	127,100	1,250,400	1,139,800	1,139,800	110,600	1,195,800	204,900	54,600		962,800	899,000	63,800
1912	A	451,800	(130,100)	108,600	238,700	238,700	(130,100)	98,100	343,200	10,500		98,600	191,500	(92,900)
1937	B	11,125,000	847,900	7,337,900	7,045,500	6,721,100	616,800	7,808,000	3,231,600		$145,700	6,981,900	6,469,900	512,000
1945	A	3,650,100	497,000	2,395,200	2,061,300	2,061,300	333,900	2,491,500	1,091,800		96,300	2,395,200	2,061,300	333,900
Small contracts		51,300	8,400	49,800	41,700	41,700	8,100	49,800	1,200			39,000	30,700	8,300
		$23,500,200	$2,227,300	$17,032,400	$15,771,500	$15,346,500	$1,685,900	$17,619,200	$5,501,400	$80,200	$242,000	$16,141,700	$14,636,900	$1,504,800

Contract types
A—Fixed-price.
B—Cost-plus-fee.

.11 The following sample financial statements of a construction contractor are included for illustrative purposes only and are not intended to establish reporting requirements. Furthermore, the dollar amounts shown are illustrative only and are not intended to indicate any customary relationship among accounts. The sample financial statements do not include all of the accounts and transactions that might be found in practice. The notes indicate the subject matter generally required to be disclosed, but they should be expanded, reduced, or modified to suit individual circumstances or materiality considerations. In addition to the illustrative notes that are presented, some of which are more or less peculiar to construction contractors, the notes to a construction contractor's financial statements should include information concerning subsequent events, pension plans, postretirement benefits other than pensions, postemployment benefits, stock options, lease commitments, extraordinary items, accounting changes, off-balance-sheet risks, and other matters that are not unique to construction contractors.

.12

COMPLETED CONTRACTORS, INC.

Independent Auditor's Report

The Stockholders and Board of Directors
Completed Contractors, Inc.

We have audited the accompanying balance sheets of Completed Contractors, Inc., as of December 31, 20X1 and 20X0, and the related statements of income and retained earnings and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America.[11] Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. [*Optional: An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion*].[12] An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Completed Contractors, Inc., as of [at] December 31, 20X1 and 20X0, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

(*Firm Signature*)
Certified Public Accountants
City, State
February 18, 20X2

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[11] For audits of issuers, as defined by the Sarbanes-Oxley Act, and other entities when prescribed by the rules of the SEC (collectively referred to as *issuers*), PCAOB Auditing Standard No. 1, *References in Auditors' Reports to the Standards of the Public Company Accounting Oversight Board* (AICPA, *PCAOB Standards and Related Rules*, Rules of the Board, "Standards"), replaces this sentence with the following sentence: "We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States)." In June 2004, the ASB issued two auditing interpretations of AU section 508, *Reports on Audited Financial Statements* (AICPA, *Professional Standards*, vol. 1), which provide reporting guidance for audits of nonissuers. Interpretation No. 17, "Clarification in the Audit Report of the Extent of Testing of Internal Control Over Financial Reporting in Accordance With Generally Accepted Auditing Standards," of AU section 508 (AICPA, *Professional Standards*, vol. 1, AU sec. 9508 par. .85–.88), addresses how auditors may expand their independent auditing report to explain that their testing was sufficient to test the procedures of internal control over financial reporting, but not the effectiveness of the internal control. Interpretation No. 18, "Reference to PCAOB Standards in an Audit Report of a Nonissuer," of AU section 508 (AICPA, *Professional Standards*, vol. 1, AU sec. 9508 par. .89–.92), provides guidance on the appropriate referencing of PCAOB standards in auditing reports for those auditors who choose to follow PCAOB standards when auditing nonissuers. The ASB also has undertaken a project to determine what amendments, if any, should be made to AU section 508.

[12] This optional wording may be added in accordance with Interpretation No. 17 of AU section 508, which provides reporting guidance for audits of nonissuers. Interpretation No. 17 of AU section 508 addresses how auditors may expand their independent audit report to explain that their consideration of internal control was sufficient to provide the auditor sufficient understanding to plan the audit and determine the nature, timing, and extent of tests to be performed, but was not sufficient to express an opinion on the effectiveness of the internal control. If this optional language is added then the remainder of the paragraph should read as follows:

> An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

Additional Guidance When Performing Integrated Audits of Financial Statements and Internal Control Over Financial Reporting

When performing an integrated audit of financial statements and internal control over financial reporting in accordance with the standards of the PCAOB, the auditor may choose to issue a combined report or separate reports on the entity's financial statements and on internal control over financial reporting. Refer to paragraphs 85–98 of PCAOB Auditing Standard No. 5 for direction about reporting on internal control over financial reporting. In addition, see paragraphs 86–88 of PCAOB Auditing Standard No. 5, which includes an illustrative combined audit report.

If the auditor issues separate reports on the entity's financial statements and on internal control over financial reporting, the following paragraph should be added to the auditor's report on the entity's financial statements in accordance with paragraph .08 of AU section 508, *Reports on Audited Financial Statements* (AICPA, *PCAOB Standards and Related Rules*, PCAOB Standards, As Amended):

> We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), X Company's internal control over financial reporting as of December 31, 20X3, based on [*identify control criteria*] and our report dated [*date of report, which should be the same as the date of the report on the financial statements*] expressed [*include nature of opinions*].

When issuing separate reports on the entity's financial statements and on internal control over financial reporting, the auditor also should add the following paragraph to the report on internal control over financial reporting in accordance with paragraph 88 of PCAOB Auditing Standard No. 5:

> We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the [*identify financial statements*] of X Company and our report dated [*date of report*] expressed [*include nature of opinion*].

When performing an integrated audit of financial statements and internal control over financial reporting in accordance with the standards of the PCAOB, paragraph 89 of PCAOB Auditing Standard No. 5 states that the auditor's report on the entity's financial statements and on internal control over financial reporting should be dated the same date.

.13

COMPLETED CONTRACTORS, INC.

Balance Sheets

December 31, 20X1 and 20X0

Assets	*20X1*	*20X0*	*Liabilities and Stockholders' Equity*	*20X1*	*20X0*
Current assets			Current liabilities		
Cash and cash equivalents	$ 242,700	$ 185,300	Current maturities, long-term debt		
Contracts receivable (notes 1 and 3)	893,900	723,600	(note 6)	$ 37,000	$ 30,600
Costs in excess of billings on			Accounts payable	904,900	821,200
uncompleted contracts (note 4)	418,700	437,100	Accrued salaries and wages	138,300	155,100
Inventories, at lower of cost or realizable			Accrued and other liabilities	169,400	91,750
value on first-in, first-out basis (note 5)	463,600	491,300	Billings in excess of costs on		
Prepaid expenses	89,900	53,900	uncompleted contracts (note 4)	34,500	43,700
Total current assets	2,108,800	1,891,200	Total current liabilities	1,284,100	1,142,350
Cash value of life insurance	35,800	32,900	Long-term debt, less current maturities		
Property and equipment, at cost			(note 6)	245,000	241,000
Building	110,000	110,000	Stockholders' equity	1,529,100	1,383,350
Equipment	178,000	163,000	Common stock $10 par value, 50,000		
Trucks and autos	220,000	200,000	authorized shares, 23,500 issued and		
	508,000	473,000	outstanding shares	235,000	235,000
Less: Accumulated depreciation	218,000	203,200	Additional paid-in capital	65,000	65,000
	290,000	269,800	Retained earnings	627,000	532,050
Land	21,500	21,500		927,000	832,050
	311,500	291,300		$2,456,100	$2,215,400
	$2,456,100	$2,215,400			

The accompanying notes are an integral part of these financial statements.

.14

COMPLETED CONTRACTORS, INC.

Statements of Income[13] and Retained Earnings

Years Ended December 31, 20X1 and 20X0

	20X1	*20X0*
Contract revenues	$9,487,000	$8,123,400
Costs and expenses		
Cost of contracts completed	8,458,500	7,392,300
General and administrative	848,300	643,100
Interest expense	26,500	23,000
	9,333,300	8,058,400
Net income	153,700	65,000
Basic and diluted earnings per share[14]	6.54	2.77
Retained earnings		
Balance, beginning of year	532,050	525,800
	685,750	590,800
Dividends paid ($2.50 per share)	58,750	58,750
Balance, end of year	$ 627,000	$ 532,050

The accompanying notes are an integral part of these financial statements.

[13] FASB ASC 220, *Comprehensive Income*, establishes standards for the reporting and display of comprehensive income and its components. FASB ASC 220 requires that all items that are required to be recognized under accounting standards as components of comprehensive income be reported in a financial statement that is displayed with the same prominence as other financial statements. The topic does not require a specific format for that financial statement but requires that an enterprise display an amount representing total comprehensive income for the period in that financial statement. FASB ASC 323-10-35-18 addresses the recording of an investor's share of the investee's other comprehensive income. The topic does not apply to an enterprise that has no items of other comprehensive income in any period presented.

[14] FASB ASC 260, *Earnings Per Share*, requires presentation of earnings per share by all entities that have issued common stock or potential common stock if those securities trade in a public market either on a stock exchange (domestic or foreign) or in the over-the-counter market, including securities quoted only locally or regionally. The topic also requires presentation of earnings per share by an entity that has made a filing or is in the process of filing with a regulatory agency in preparation for the sale of those securities in a public market.

.15

COMPLETED CONTRACTORS, INC.

Statements of Cash Flows

	Years Ended December 31,	
	20X1	*20X0*
Cash flows from operating activities:		
Net income	$153,700	$65,000
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	54,800	50,300
Provisions for losses on contracts receivable	2,000	1,000
Increase in contracts receivable	(172,300)	(37,500)
Decrease in billings in excess of costs on uncompleted contracts	(9,200)	(16,300)
(Increase) decrease in costs in excess of billings on uncompleted contracts	18,400	(49,100)
Decrease (increase) in inventories	27,700	(3,400)
(Increase) decrease in prepaid expenses	(36,000)	16,500
Increase in cash value of life insurance	(2,900)	(2,685)
Increase in accounts payable	83,700	24,600
(Decrease) increase in accrued salaries and wages	(16,800)	24,300
(Decrease) increase in accrued and other liabilities	77,650	(39,400)
Net cash provided by operating activities	180,750	33,315
Cash flows from investing activities:		
Purchase of property and equipment	(75,000)	(53,500)
Net cash used in investing activities	(75,000)	(53,500)
Cash flows from financing activities:		
Proceeds from issuance of long-term debt	44,000	68,000
Principal payments on long-term debt	(33,600)	(15,500)
Cash dividends paid	(58,750)	(58,750)
Net cash used in financing activities	(48,350)	(6,250)
Net increase (decrease) in cash and cash equivalents	57,400	(26,435)
Cash and cash equivalents at beginning of year	185,300	211,735
Cash and cash equivalents at end of year	$242,700	$185,300

Supplementary data:

Cash equivalents include certificates of deposit with original maturities of one to three months—

Interest paid—20X1, $28,000; 20X0, $25,000

The accompanying notes are an integral part of these financial statements.

.16

COMPLETED CONTRACTORS, INC.

Notes to Financial Statements

December 31, 20X1 and 20X0

1. Nature of Operations and Significant Accounting Policies

Nature of operations. The entity is a heating and air-conditioning contractor for residential and commercial properties serving the eastern region of New Hampshire. Work on new structures is performed primarily under fixed-price contracts. Work on existing structures is performed under fixed-price or time-and-material contracts.

Use of estimates. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Revenue and cost recognition. Revenues from fixed-price construction contracts are recognized on the completed-contract method. This method is used because the typical contract is completed in two months or less and financial position and results of operations do not vary significantly from those which would result from use of the percentage-of-completion method. A contract is considered complete when all costs except insignificant items have been incurred and the installation is operating according to specifications or has been accepted by the customer.

Revenues from time-and-material contracts are recognized currently as the work is performed.

Contract costs include all direct material and labor costs and those indirect costs related to contract performance, such as indirect labor, supplies, tools, repairs, and depreciation costs. General and administrative costs are charged to expense as incurred. Provisions for estimated losses on uncompleted contracts are made in the period in which such losses are determined. Claims are included in revenues when received.

Costs in excess of amounts billed are classified as current assets under costs in excess of billings on uncompleted contracts. Billings in excess of costs are classified under current liabilities as billings in excess of costs on uncompleted contracts. Contract retentions are included in contracts receivable.

Contracts receivable. Contracts receivable from servicing heating and air-conditioning systems for residential and commercial properties are based on contracted prices. Contracts receivable consist primarily of large groups of smaller-balance homogeneous accounts that are collectively evaluated for impairment, accordingly, the provisions of FASB ASC 310, *Receivables*, do not apply. Allowance for doubtful accounts is based upon a review of outstanding receivables, historical collection information, and existing economic conditions. Normal contracts receivable are due 30 days after the date of the invoice. Contract retentions are due 30 days after completion of the project and acceptance by the owner. Receivable past due more than 120 days are considered delinquent. Delinquent receivables are written off based on individual credit evaluation and specific circumstances of the customer.

Inventories. Inventories are stated at cost on the first-in, first-out basis using unit cost for furnace and air-conditioning components and average cost for parts and supplies. The carrying value of furnace and air-conditioning component units is reduced to realizable value when such values are less than cost.

Property and equipment. Depreciation is provided over the estimated lives of the assets principally on the declining-balance method, except on the building where the straight-line method is used.

Long-lived assets. Long-lived assets to be held and used are tested for recoverability whenever events or changes in circumstances indicate that the related carrying amount may not be recoverable. When required, impairment losses on assets to be held and used are recognized based on the excess of the asset's carrying amount over the fair value of the asset. Certain long-lived assets to be disposed of by sale are reported at the lower of carrying amount or fair value less cost to sell.

Income taxes. The Company has elected subchapter S status for income tax purposes. Accordingly, a provision for income taxes has not been established.

Basic earnings per common share. Basic earnings per common share were computed by dividing income available to common stockholders by the weighted average number of common share outstanding during the year. Diluted earnings per share are not presented because the Company has issued no dilutive potential common shares.

2. Fair Value of Financial Instruments

The carrying amounts of the Company's cash and cash equivalents, and current maturities of long-term debt approximate their fair value. The fair value of the Company's long-term debt is estimated at $300,500 based on the future cash flows associated with each note discounted using the Company's current borrowing rate for similar debt.

3. Contracts Receivable

	December 31, 20X1	*December 31, 20X0*
Completed contracts, including retentions	$438,300	$408,600
Contracts in progress		
Current accounts	386,900	276,400
Retentions	78,700	46,600
	903,900	731,600
Less Allowance for doubtful accounts	10,000	8,000
	$893,900	$723,600

Retentions include $ 10,300 in 20X1, which are expected to be collected after 12 months.

Contracts receivable include approximately $200,000 due under one contract.[15]

4. Costs and Billings on Uncompleted Contracts

	December 31, 20X1	*December 31, 20X0*
Costs incurred on uncompleted contracts	$2,140,400	$1,966,900
Billings on uncompleted contracts	1,756,200	1,573,500
	$ 384,200	$ 393,400

[15] FASB ASC 825, *Financial Instruments*, requires disclosure of concentrations of credit risks of all financial instruments. Concentrations can be geographical areas, types of contracts, owners or others. Additionally, the contractor should disclose, for each significant concentration, the policy of requiring collateral or other security to support financial instruments subject to credit risk, information about the contractor's access to that collateral or other security, and the nature and a brief description of the collateral or other security supporting those financial instruments.

Included in accompanying balance sheets under the following captions:		
Costs in excess of billings on uncompleted contracts	$ 418,700	$ 437,100
Billings in excess of costs on uncompleted contracts	(34,500)	(43,700)
	$ 384,200	$ 393,400

5. Inventories

	December 31, 20X1	*December 31, 20X0*
Furnace and air-conditioning components	$303,200	$308,700
Parts and supplies	160,400	182,600
	$463,600	$491,300

Furnace and air-conditioning components include used items of $78,400 in 20X1 and $71,900 in 20X0 that are carried at the lower of cost or realizable value.

6. Long-Term Debt

	December 31, 20X1	*December 31, 20X0*
Notes payable, bank		
Notes due in quarterly installments of $2,500, plus interest at 8%	$140,000	$150,000
Notes due in monthly installments of $1,500, plus interest at prime plus 1½%	87,000	58,000
Mortgage payable		
Due in quarterly payments of $3,500, including interest at 9%	55,000	63,600
	282,000	271,600
Less: Current maturities	37,000	30,600
	$245,000	$241,000

Principal payments on long-term debt are due as follows:

Year ending December 31,	
20X2	$ 37,000
20X3	37,000
20X4	37,000
20X5	37,000
20X6	34,000
Later years	100,000

7. Backlog

The estimated gross revenue on work to be performed on signed contracts was $4,691,000 at December 31, 20X1, and $3,617,400 at December 31, 20X0. In addition to the backlog of work to be performed, there was gross revenue, to be reported in future periods under the completed-contract method used by the entity, of $2,460,000 at December 31, 20X1, and $2,170,000 at December 31, 20X0.[16]

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[16] The presentation of backlog information, although encouraged, is not a required disclosure.

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