2010

Checklist supplement and illustrative financial statements, real estate ventures and construction contractors, September 2010

American Institute of Certified Public Accountants (AICPA)

0089210

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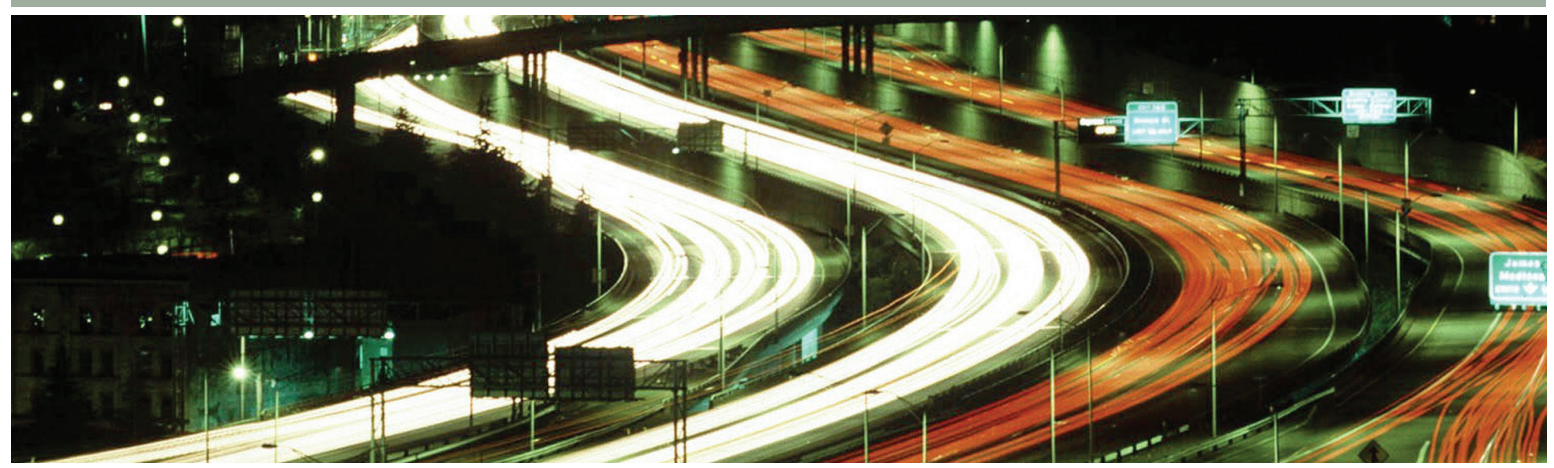
Real Estate Ventures and Construction Contractors September 2010 AICPA

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 2010



AICPA

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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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ISBN 978-0-87051-918-5

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FSP Section 5000

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

General

.01 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)

.02 These checklists and illustrative materials 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.

.03 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 accounting principles generally accepted in the United States of America (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 unlikely.

.04 Note that the *Checklist and Illustrative Financial Statements: Corporations* (product no. 0089310 [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.

.05 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.

.06 The AICPA Accounting and Auditing Publications staff has included guidance from the Financial Accounting Standards Board (FASB) *Accounting Standards Codification*™ (ASC) as of September 30, 2010. Questions are derived primarily from the content of the "Presentation" (section 45) and "Disclosure" (section

50) sections of FASB ASC. The AICPA Accounting and Auditing Publications staff has included presentation and disclosure items deemed most likely to be encountered when reporting on the financial statements of a commercial corporation prepared in conformity with U.S. GAAP. Thus, not all paragraphs of the "Presentation" and "Disclosure" sections of FASB ASC have been included. Users should evaluate whether circumstances exist for which the relevant presentation and disclosure guidance is not provided in these checklists and illustrative materials and refer directly to FASB ASC as appropriate. These checklists and illustrative materials note significant areas where "Presentation" and "Disclosure" paragraphs were deemed too specific for this general publication and, where noted, users are urged to consult FASB ASC as necessary.

.07 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.

.08 In some cases, this checklist uses the term *additional presentation information* or *additional disclosure information* to further illustrate an item. In such cases, the information contained under those headings continues to be authoritative guidance and is included to further clarify a presentation or disclosure requirement or to add additional useful information.

.09 Relevant financial statement reporting and disclosure guidance issued through September 30, 2010, 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, 2010
- Statement on Auditing Standards No. 120, *Required Supplementary Information* (AICPA, *Professional Standards*, vol. 1, AU sec. 558)
- Interpretation No. 4, "Appropriateness of Identifying No Significant Deficiencies or No Material Weaknesses in an Interim Communication," of AU section 325, *Communicating Internal Control Related Matters Identified in an Audit* (AICPA, *Professional Standards*, vol. 1, AU sec. 9325 par. .11-.13)
- Interpretation No. 31, "Preparation of Financial Statements for Use by an Entity's Auditors," of AR section 100, *Compilation and Review of Financial Statements* (AICPA, *Professional Standards*, vol. 2, AR sec. 9100 par. .136-.137)
- Statement of Position 09-1, *Performing Agreed-Upon Procedures Engagements That Address the Completeness, Accuracy, or Consistency of XBRL-Tagged Data* (AICPA, *Technical Practice Aids*, AUD sec. 14,440)

.10 Any guidance issued subsequent to September 30, 2010, has not been included in this checklist; therefore, if your entity has a fiscal year-end after September 30, 2010, you should evaluate the applicability of such guidance. When determining the applicability of newly issued guidance, you should evaluate its effective date.

.11 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 became 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 superseded 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 became nonauthoritative. This statement was effective for financial statements issued for interim and annual periods ending after September 15, 2009. See the FASB website at www.fasb.org for further information.

Instructions

.12 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 that are common to most real estate ventures and construction contractors.

.13 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 the following:

- ***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.

.14 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 AICPA Accounting and Auditing Publications staff recommends 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).

.15 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 regarding 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 regarding why the disclosure was not made (for example, because the item was not considered to be material to the financial statements)

.16 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.

.17 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 should 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

.18 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

AICPA Staff

Dave Arman, CPA
Technical Manager
Accounting and Auditing Publications

Note: This publication was extracted from sections 5000–5400 of the AICPA *Financial Statement Preparation Manual*.

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	*N/A*
I.	**Real Estate—General**			
	A.	Statement of Cash Flows (Financial Accounting Standards Board [FASB] *Accounting Standards Codification* [ASC] 970-230)	________	________
	B.	Consolidation (FASB ASC 970-810)	________	________
II.	**Common Interest Realty Associations**			
	A.	Presentation of Financial Statements (FASB ASC 972-205)	________	________
	B.	Notes to Financial Statements (FASB ASC 972-235)	________	________
	C.	Property, Plant, and Equipment (FASB ASC 972-360)	________	________
	D.	Revenue Recognition (FASB ASC 972-605)	________	________
	E.	Income Taxes (FASB ASC 972-740)	________	________
	F.	Related Party Disclosures (FASB ASC 972-850)	________	________
III.	**Real Estate Investment Trusts**			
	A.	Revenue Recognition (FASB ASC 974-605)	________	________
IV.	**Real Estate—Retail Land**			
	A.	Receivables (FASB ASC 976-310)	________	________
	B.	Inventory (FASB ASC 976-330)	________	________
V.	**Real Estate—Time-Sharing Activities**			
	A.	Statement of Cash Flows (FASB ASC 978-230)	________	________
	B.	Receivables (FASB ASC 978-310)	________	________

I. Real Estate—General

Yes *No* *N/A*

A. Statement of Cash Flows (FASB ASC 970-230)

Presentation[1]

1. Has the entity properly presented the cash payments to purchase real estate acquired by a real estate developer to be subdivided, improved, and sold in individual lots, as an operating cash flow (that is, the real estate is acquired specifically for resale and is similar to inventory)? _____ _____ _____
   [FASB ASC 970-230-45-1]

B. Consolidation (FASB ASC 970-810)

Presentation

1. Has the entity properly presented an investment in real property by recording the undivided interest in the assets, liabilities, revenue, and expenses of the venture? If the entity so elects, have all of the following required conditions been met:
   a. The real property is owned by undivided interests? _____ _____ _____
   b. The approval of two or more of the owners is not required for decisions regarding the financing, development, sale, or operations of real estate owned? _____ _____ _____
   c. Each investor is entitled to only its pro rata share of expenses? _____ _____ _____
   d. Each investor is responsible to pay only its pro rata share of expenses? _____ _____ _____
   e. Each investor is severally liable only for indebtedness it incurs in connection with its interest in the property? _____ _____ _____
   [FASB ASC 970-810-45-1]

II. Common Interest Realty Associations

A. Presentation of Financial Statements (FASB ASC 972-205)

Presentation

Fund Reporting

1. Has the entity properly presented assets transferred to the common interest realty association by the developer and recognized in the balance sheet been presented as additions to the operating fund balance (or property fund, if such a fund is established)? (Note that a common interest realty association may not need to use fund reporting if it does not assess for future major repairs and replacements.) _____ _____ _____
   [FASB ASC 972-205-45-1]

[1] Note that the definitions of *operating* and *investing activities* in Financial Accounting Standards Board (FASB) *Accounting Standards Codification* (ASC) 230, *Statement of Cash Flows*, provide flexibility for the appropriate classification of cash receipts and payments for assets that generally are productive assets but in certain cases may be inventory. For example, real estate generally is considered a productive asset, and a cash payment to purchase real estate generally is an investing cash outflow.

	Yes	No	N/A
2. Has the entity properly presented amounts assessed annually to owners, for portions of future major repairs and replacement, separately from amounts assessed for normal operations (that is, in the major repair and replacement fund separately from transactions in the operating fund), if the entity uses fund reporting? Transfers between funds that are not part of the current-period operating revenues should be presented only in a statement of changes in fund balances or in a statement of changes in members' equity. [FASB ASC 972-205-45-2]	_____	_____	_____
3. Has the entity properly presented activities, in addition to their primary activities, such as conducts commercial operations or separate business activities, for instance rental operations, as one or more additional funds? [FASB ASC 972-205-45-3]	_____	_____	_____

Nonfund Reporting

Additional Presentation Information

Per FASB ASC 972-205-45-4, nonfund reporting is an acceptable alternative to fund reporting. However, fund reporting is considered more informative to users.

Entities that use nonfund reporting should substitute the term *members' equity* for the term *fund balance*. Furthermore, in nonfund reporting financial statements, the fund for major repairs and replacements (addressed in question 2) should be presented as an appropriation of retained earnings.
[FASB ASC 972-205-45 par. 4–5]

Financial Statement Requirements

	Yes	No	N/A
4. Has the entity properly presented all of the following financial statements:			
a. A balance sheet?	_____	_____	_____
b. A statement of revenue and expenses?	_____	_____	_____
c. A statement of changes in fund balances or a statement of changes in members' equity if nonfund reporting is used?	_____	_____	_____
d. A statement of cash flows?	_____	_____	_____
e. Notes to financial statements? [FASB ASC 972-205-45-6]	_____	_____	_____
5. Has the entity properly presented information about the operating fund, including assets, liabilities, and the fund balance specifically associated with the entity's normal maintenance and service activities? (For example, the operating fund should include information about cash, assessments receivable, prepaid expenses, and trade payables, whereas property and equipment, if reported as assets, are generally reported in the operating fund, or in a separate fund, if significant.) [FASB ASC 972-205-45-7]	_____	_____	_____

	Yes	No	N/A
6. Has the entity properly presented in information regarding the fund for major repairs and replacements (the *replacement fund*), information about assets, liabilities, and the fund balance specifically associated with the entity's long-term major repair and replacement activities? (For example, the fund includes all assets that are held for future replacement of roofs, roads, and furniture, and those assets usually consist of cash, marketable securities, and short term investments, whereas liabilities are generally for work done on contracts for major repairs and replacements.) [FASB ASC 972-205-45-8]	____	____	____
7. Has the entity properly presented in the statement of revenues and expenses, information about all assessments, other revenues, and expenses? (Note that all common interest realty association activities, except for replacement fund activities, should be presented in the operating fund in the statement of revenues and expenses unless the entity has other funds such as a deferred maintenance fund or a capital improvement fund, for example. Depreciation should be presented as an expense of the fund in which the asset is reported.) [FASB ASC 972-205-45-9]	____	____	____
8. Has the entity properly presented in the statement of changes in fund balances, a reconciliation of beginning and ending fund balances with the results of operations for the period? (Note that the statement may be presented separately or may be combined with the statement of revenues and expenses. Further, permanent transfers between funds should be presented as interfund transfers in the statement of fund balances, not as revenues.) [FASB ASC 972-205-45-10]	____	____	____
Interfund Receivables and Payables			
9. Has the entity properly presented corresponding inferfund receivables and payables in order to highlight the transactions resulting in those balances and to provide information about amounts assessed and collected that were not used in accordance with the budget? [FASB ASC 972-205-45-12]	____	____	____
Unclassified Balance Sheets			
10. Has the entity properly presented an unclassified balance sheet? (Note that if the entity has significant commercial operations, it should consider presenting a classified balance sheet.) [FASB ASC 972-205-45-13]	____	____	____
Cooperatives			
11. If the entity is a cooperative, has the entity properly presented the following:			
a. A balance sheet?	____	____	____
b. A statement of operations?	____	____	____
c. A statement of changes in shareholders' equity?	____	____	____
d. A statement of cash flows?	____	____	____

Yes *No* *N/A*

e. Notes to financial statements? ____ ____ ____

f. Supplementary information required by FASB ASC 972-235-50-3 (see question 3 under "Notes to Financial Statements [FASB ASC 972-235]")? ____ ____ ____
[FASB ASC 972-205-45-14]

12. Has the entity properly presented information about all revenues and expenses in the statement of operations? (Reported revenues should include all charges to tenant-shareholders and other income and per-share data, if deemed useful.) ____ ____ ____
[FASB ASC 972-205-45-15]

13. Has the entity properly presented the combined the statement of retained earnings (deficit) with the statement of operations, if there is not activity in paid-in-capital? Otherwise has the entity properly presented a separate statement of shareholders' equity? ____ ____ ____
[FASB ASC 972-205-45-16]

Disclosure

Cooperatives

14. Has the entity properly not disclosed components of retained earnings or deficit? (Allocating a portion of retained earnings to an amount equal to accumulated depreciation is an unacceptable practice.) ____ ____ ____
[FASB ASC 972-205-50-1]

B. **Notes to Financial Statements** (FASB ASC 972-235)

Disclosure

1. Has the entity properly disclosed in the notes to the financial statements, in addition to disclosures required by U.S. generally accepted accounting principles (GAAP) for other entities, all of the following:

a. The entity's legal form (for example, 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? (Note that in 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.) ____ ____ ____

b. Services, such as maintenance, and subsidies provided by the developer? ____ ____ ____

c. The number of units, or shares for cooperative housing corporations, or weeks for timeshare associations, owned by the developer? ____ ____ ____
[FASB ASC 972-235-50-1]

	Yes	No	N/A
Future Major Repairs and Replacements			
2. Has the entity properly disclosed information in the notes to the financial statements about its funding for future major repairs and replacements? Such disclosures should include all of the following: (Note that common interest realty associations that fund future major repairs and replacements by special assessments or borrowings when needs occur should disclose that information.)			
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]			
Required Supplementary Information			
3. Has the entity properly disclosed the following as unaudited supplementary information:			
a. Estimates of current or future costs of future major repairs and replacements of all existing components, such as roofs, including the following: (Note that 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.)			
i. Estimated amounts required?	____	____	____
ii. Methods used to determine the costs?	____	____	____
iii. 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]	____	____	____

C. Property, Plant, and Equipment (FASB ASC 972-360)

Disclosure

General Information

	Yes	*No*	*N/A*
1. Has the entity properly disclosed all of the following in the notes to the financial statements related to the common interest realty association's common property:			
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]	____	____	____
2. Has the entity properly disclosed on the balance sheet all property owned by the cooperative? [FASB ASC 972-360-50-2]	____	____	____

Depreciation

	Yes	*No*	*N/A*
3. Has the entity properly disclosed the following information for property and equipment recognized as assets:			
a. Depreciation expense for the period?	____	____	____
b. Balances of major classes of depreciable assets, by nature or function, at the reporting date?	____	____	____
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]	____	____	____

	Yes	No	N/A

D. Revenue Recognition (FASB ASC 972-605)

Presentation

1. Has the entity properly presented, in the replacement fund in statements of revenue and expenses in the periods in which they were assessed, any periodic assessments for funding future major repairs and replacements, regardless of whether they have been collected or expended? ____ ____ ____
[FASB ASC 972-605-45-1]

2. Has the entity properly presented information about revenues properly that includes 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, and so on? (Note that individual categories of revenues may be combined if not material. Also note that interest earned should be presented as revenue of the appropriate fund unless the entity has a specific policy to treat it otherwise.) ____ ____ ____
[FASB ASC 972-605-45-2]

Disclosure

3. Has the entity properly disclosed, in addition to disclosures required by U.S. GAAP for other entities, the following in the notes to the financial statements:
   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]

Significant Sources of Revenue

4. Has the entity properly disclosed, if 10 percent or more of the entity's revenues are derived from any 1 source, that fact and the amount of revenue from each source? ____ ____ ____
[FASB ASC 972-605-50-2]

E. Income Taxes (FASB ASC 972-740)

Presentation

1. Has the entity properly presented income taxes in the same manner as other operating expenses in the statement of revenues and expenses? (Note that because income taxes are generally not related to the excess of revenues over expenses as in a commercial entity, this presentation is appropriate. Common interest realty associations should follow the guidance in FASB ASC 740, *Income Taxes*.) ____ ____ ____
[FASB ASC 972-740-45-1]

Disclosure

2. Has the entity properly disclosed, in addition to disclosures required by U.S. GAAP for other entities, the following in the notes to the financial statements:

	Yes	No	N/A
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 (FASB ASC 972-850)

Disclosure

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

III. Real Estate Investment Trusts

A. Revenue Recognition (FASB ASC 974-605)

Presentation

Operating Support of the Real Estate Investment Trust by the Adviser

	Yes	No	N/A
1. Has the entity properly presented the effects of the operating support transactions described in FASB ASC 974-605-25-2 and FASB ASC 974-605-50-1 (question 2) separately in the income statement?[2] [FASB ASC 974-605-45-1]	____	____	____

Disclosure

Operating Support of the Real Estate Investment Trust by the Adviser

	Yes	No	N/A
2. Has the entity properly disclosed information regarding the relationship between the parties and the nature and amount of the transactions if the real estate investment trust receives operating support from its adviser? [FASB ASC 974-605-50-1]	____	____	____

IV. Real Estate—Retail Land

A. Receivables (FASB ASC 976-310)

Disclosure

1. Has the entity properly disclosed all of the following if it has retail land sales operations:

	Yes	No	N/A
a. Maturities of accounts receivable for each of the five years following the date of the financial statements?	____	____	____

---

[2] FASB ASC 974-605-25-2 states that 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) that 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

	Yes	No	N/A

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** (FASB ASC 976-330)

Disclosure

1. Has the entity properly disclosed all of the following if it has 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]

V. Real Estate—Time-Sharing Activities

A. **Statement of Cash Flows** (FASB ASC 978-230)

Presentation

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

B. **Receivables** (FASB ASC 978-310)

Presentation

1. Has the entity properly presented gross notes receivable from time-sharing sales, net of deductions for the allowance for uncollectibles (see paragraphs 5–6 of FASB ASC 978-310-35), and for any deferred profit under FASB ASC 360-20? ____ ____ ____
   [FASB ASC 978-310-45-1]

Disclosure

2. Has the entity properly disclosed the effects of changes in estimate in the relative sales value method in accordance with FASB ASC 250, *Accounting Changes and Error Corrections*? ____ ____ ____
   [FASB ASC 978-310-50-1; FASB ASC 978-330-50-1]

3. Has the entity properly disclosed, in addition to disclosures required by U.S. GAAP for other entities, the following in the notes to the financial statements, if it has 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? (Note that the total of the notes receivable balances displayed with the various maturity dates should be reconciled to the balance sheet amount of notes receivable.) ____ ____ ____

	Yes	No	N/A
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? (Note that if the developer sells receivables with recourse, the seller should provide the same disclosure of activity on receivables sold.)	____	____	____
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]

FSP Section 5200

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

.01 The following sample financial statements of a real estate venturer 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 real estate ventures, the notes to a real estate venture's financial statements should include information concerning other matters that are not unique to real estate ventures, 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.

.02 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.

.03 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.

Example 1: Format Without Current Value Information

.04

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. 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 controls over*

[1] The illustrative financial statement formats included in this section have been updated to reflect the Financial Accounting Standards Board (FASB) *Accounting Standards Codification*™ (ASC). However, in FASB ASC'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 2010 editions as a learning tool to familiarize constituents with FASB ASC.

financial reporting. Accordingly, we express no such opinion.][2] 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*]

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[2] This optional wording may be added in accordance with 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, *Reports on Audited Financial Statements* (AICPA, *Professional Standards*, vol. 1, AU sec. 9508 par. .85-.88), 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.

.05

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.

.06

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.

.07

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.

.08

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 Internal Revenue Code. 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

Claims and actions are 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

.09

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. 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.*][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 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.

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*]

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[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.

.10

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.

.11

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.

.12

REAL ESTATE JOINT VENTURE COMPANY

Statements of Cash Flows

Years Ended December 31, 20X1 and 20X0

	Year Ended December 20X1	*Year Ended December 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.

.13

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 40 year term.

c. Income Taxes

The joint venture pays no income taxes and is taxed as a partnership under provisions of the Internal Revenue Code. 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

Claims and actions are 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

Instructions

.01 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	N/A
I. Financial Accounting Standards Board (FASB) *Accounting Standards Codification* (ASC) 910, *Contractors—Construction*		
A. Construction Costs (FASB ASC 910-20)	________	________
B. Notes to Financial Statements (FASB ASC 910-235)	________	________
C. Receivables (FASB ASC 910-310)	________	________
D. Other Assets and Deferred Costs (FASB ASC 910-340)	________	________
E. Liabilities (FASB ASC 910-405)	________	________
F. Revenue Recognition (FASB ASC 910-605)	________	________
II. FASB ASC 605, *Revenue Recognition*		
A. Construction-Type and Production-Type Contracts (FASB ASC 605-35)	________	________

I. FASB ASC 910, *Contractors—Construction*[1]

	Yes	No	N/A
A. Construction Costs (FASB ASC 910-20)			
Disclosure			
1. Has the entity properly disclosed all of the following amounts included in contract costs:			

[1] Financial Accounting Standards Board (FASB) *Accounting Standards Codification* (ASC) 810-10-45-14 explains that a proportionate gross financial statement presentation is not appropriate for an investment in an unincorporated legal entity accounted for by the equity method of accounting unless the investee is in either the construction industry or an extractive industry.

	Yes	No	N/A
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]	____	____	____

B. Notes to Financial Statements (FASB ASC 910-235)

Disclosure

Accounting Policies

1. Has the entity properly disclosed, in addition to the disclosure requirements of FASB ASC 235-10, all of the following policy items:

	Yes	No	N/A
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]	____	____	____

Liquidity Characteristics

	Yes	No	N/A
2. Has the entity properly disclosed information 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]	____	____	____

C. Receivables (FASB ASC 910-310)

Presentation

	Yes	No	N/A
1. Has the entity properly presented the portion of retainages not collectible in one year, or within the operating cycle if it is longer than one year, as noncurrent in the classified balance sheet? [FASB ASC 910-310-45-1]	____	____	____

Disclosure

2. Has the entity properly disclosed all of the following, either in the balance sheet or in a note to the financial statements, regarding billed or unbilled amounts under contracts representing unapproved change orders, claims, or similar items subject to uncertainty concerning their determination or ultimate realization:

	Yes	No	N/A
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]	____	____	____

	Yes	No	N/A
3. Has the entity properly disclosed all of the following 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 amounts?	_____	_____	_____
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]	_____	_____	_____
4. Has the entity properly disclosed the following for receivable amounts maturing after one year:			
a. The amount maturing after one year and, if practicable, the amounts maturing in each year?	_____	_____	_____
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]	_____	_____	_____
5. Has the entity properly disclosed, if receivables include amounts representing balances billed but not paid by customers under contract retainage provisions, either in the balance sheet or in a note to the financial statements:			
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]	_____	_____	_____
D. Other Assets and Deferred Costs (FASB ASC 910-340)			
Disclosure			
1. Has the entity properly disclosed the policy of deferral and the amounts involved for costs deferred either in anticipation of future sales (precontract costs that are not within the scope of FASB ASC 720-15) or as a result of an unapproved change order? [FASB ASC 910-340-50-1]	_____	_____	_____
E. Liabilities (FASB ASC 910-405)			
Presentation			
Advances on Cost-Plus Contracts			
1. Has the entity properly presented advances received on cost-plus contracts that are payments on account of work in progress as an offset against accumulated costs? (Note that such advances are made to provide a revolving fund and are not applied as partial payment until the contract is nearly or fully completed.) [FASB ASC 910-405-45-1]	_____	_____	_____

	Yes	No	N/A
2. Has the entity properly presented advances received on cost-plus contracts that *are not* payments on account of work in progress as excluded from the offset of accumulated costs? [FASB ASC 910-405-45-1]	_____	_____	_____
3. Has the entity properly presented advances that are payments on account of work in progress as a deduction from the related asset? [FASB ASC 910-405-45-2]	_____	_____	_____

Disclosure

	Yes	No	N/A
4. Has the entity properly disclosed amounts of retentions to be paid after one year and, if practicable, the year in which the amounts are expected to be paid? [FASB ASC 910-405-50-1]	_____	_____	_____
5. Has the entity properly disclosed amounts of advances that are payments on account of work in progress? [FASB ASC 910-405-50-2]	_____	_____	_____

F. Revenue Recognition (FASB ASC 910-605)

Disclosure

	Yes	No	N/A
1. Has the entity properly disclosed the method of recognizing income (percentage of completion or completed contract)? [FASB ASC 910-605-50-1]	_____	_____	_____
2. Has the entity properly disclosed, if it uses the completed-contract method, the reason for selecting that method? (Note that acceptable reasons for selecting the completed-contract method include [*a*] 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 the use of the percentage-of-completion method, or [*b*] inherent hazards or undependable estimates that cause forecasts to be doubtful.) [FASB ASC 910-605-50-2]	_____	_____	_____

II. FASB ASC 605, *Revenue Recognition*

A. Construction-Type and Production-Type Contracts (FASB ASC 605-35)

Presentation

Provisions for Anticipated Losses on Contracts

	Yes	No	N/A
1. Has the entity properly presented provisions for losses on contracts 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? (Note that unless the provision is material in amount or unusual or infrequent in nature, the provision should not be presented separately in the income statement [that is, it should be included in contract cost]. If it is shown separately, it should be shown as a component of the cost included in the computation of gross profit.) [FASB ASC 605-35-45-1]	_____	_____	_____

	Yes	No	N/A
2. Has the entity properly presented provisions for losses on contracts separately as liabilities on the balance sheet, if significant? (Note that except in circumstances in which related costs are accumulated on the balance sheet, losses should be presented as a deduction from the related accumulated costs. Also note that in a classified balance sheet, a provision for losses liability should be presented as a current liability.) [FASB ASC 605-35-45-2]	____	____	____

Percentage-of-Completion Method

	Yes	No	N/A
3. Has the entity properly presented, as current assets, under the percentage-of-completion method, costs and recognized income not yet billed, with respect to other contracts? [FASB ASC 605-35-45-3]	____	____	____
4. Has the entity properly presented, as a liability (in most cases a current liability), under the percentage-of-completion method, billings in excess of costs and recognized income, with respect to other contracts? [FASB ASC 605-35-45-3]	____	____	____

Completed Contract Method

	Yes	No	N/A
5. Has the entity properly presented, as an asset, under the completed contract method, the excess of accumulated costs over the related billings, and as a liability (in most cases a current liability), the excess of accumulated billings over the related costs? (Note that if costs exceed billings on some contracts, and billings exceed costs on others, the contracts should be segregated so that the figures on the asset side include only those contracts on which costs exceed billings, and those on the liability side include only those on which billings exceed costs.) [FASB ASC 605-35-45-4]	____	____	____

Additional Presentation Information

It is suggested that the asset item be described as costs of uncompleted contracts in excess of related billings rather than as inventory or work in process, and that the item on the liability side be described as billings on uncompleted contracts in excess of related costs.
[FASB ASC 605-35-45-5]

Disclosure

Accounting Policy

	Yes	No	N/A
6. Has the entity properly disclosed in the note on accounting policies, in accordance with the requirements of FASB ASC 235-10-50, 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]	____	____	____

	Yes	No	N/A
Percentage-of-Completion Method			
7. Has the entity properly disclosed, if the entity is using the percentage-of-completion method, the method or methods (for example, cost to cost, labor hours) of measuring the extent of progress towards completion? [FASB ASC 910-605-50-2]	____	____	____
8. Has the entity properly disclosed a departure from the percentage-of-completion method, if the entity is using the percentage-of-completion method and departs from that basic accounting policy in the circumstances described in FASB ASC 605-35-25-61?[2] [FASB ASC 605-35-50-3]	____	____	____
Completed Contract Method			
9. Has the entity properly disclosed, if the entity is using the completed-contract method, the specific criteria used to determine when a contract is substantially completed and is that methodology followed consistently? [FASB ASC 605-35-50-4]	____	____	____
10. Has the entity properly disclosed any departure from the completed-contract method, if the entity is using the completed-contract method and departs from that basic accounting policy in the circumstances described in FASB ASC 605-35-25-95?[3] [FASB ASC 605-35-50-5]	____	____	____
Contract Claims			
11. Has the entity properly disclosed in the notes to the financial statements any revenue amounts from claims, which have been recorded only to the extent that the contract costs relating to the claim have been incurred? [FASB ASC 605-35-50-6]	____	____	____
12. Has the entity properly disclosed any amounts in the notes to the financial statements, if the entity uses a practice such as recording revenues from claims only when the amounts have been received or awarded? [FASB ASC 605-35-50-7]	____	____	____

[2] FASB ASC 605-35-25-61 states that an entity using the percentage-of-completion method as its basic accounting policy should use the completed-contract method for a single contract or a group of contracts for which reasonably dependable estimates cannot be made or for which inherent hazards make estimates doubtful.

[3] FASB ASC 605-35-25-95 states that an entity using the completed-contract method as its basic accounting policy shall depart from that policy for a single contract or a group of contracts not having the features described in paragraphs 92–93 of FASB ASC 605-35-25, with regards to the rationale for using the completed-contract method, and should use the percentage-of-completion method.

	Yes	*No*	*N/A*
13. Has the entity properly disclosed, in accordance with FASB ASC 450-30-50-1, a contingent asset, 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?[4] [FASB ASC 605-35-50-8]	_____	_____	_____
Revision of Estimates			
14. Has the entity properly disclosed the effects of any revisions to estimates, if material, in accordance with FASB ASC 250-10-50-4?[5] [FASB ASC 605-35-50-9]	_____	_____	_____
15. Has the entity properly disclosed events as subsequent events and not as refinements to the estimating process of the prior year, if those events have occurred after the date of the financial statements that are outside of the normal exposure and risk aspects of the contracts of the entity? [FASB ASC 605-35-50-10]	_____	_____	_____

[4] FASB ASC 605-35-50-8 discusses the requirements of FASB ASC 605-35-25-31, which states 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.

Further, FASB ASC 605-35-50-8 discusses the disclosure requirements of FASB ASC 450-30-50-1, which states that adequate disclosure should be made of a contingency that might result in a gain, but care should be exercised to avoid misleading implications concerning the likelihood of realization.

[5] 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 should 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. If a change in estimate does not have a material effect in the period of change but is reasonably certain to have a material effect in later periods, a description of that change in estimate should be disclosed whenever the financial statements of the period of change are presented.

	Yes	*No*	*N/A*
Commitments to Complete Contracts in Process			
16. Has the entity properly disclosed any extraordinary commitments? (Note that in special cases disclosure of extraordinary commitments may be required, but generally commitments to complete contracts in process are in the ordinary course of a contractor's business and are not required to be disclosed in a statement of financial position. Such commitments partake of the nature of a contractor's business, and generally do not represent a prospective drain on cash resources since they will be financed by current billings.) [FASB ASC 605-35-50-11]	____	____	____

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.

.02 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.

[1] The illustrative financial statement formats included in this section have been updated to reflect the Financial Accounting Standards Board (FASB) *Accounting Standards Codification™* (ASC). However, in FASB ASC'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 2010 editions as a learning tool to familiarize constituents with FASB ASC.

.03

PERCENTAGE CONTRACTORS, INC.

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.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. 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.*][2] 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

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[2] This optional wording may be added in accordance with 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, *Reports on Audited Financial Statements* (AICPA, *Professional Standards*, vol. 1, AU sec. 9508 par. .85–.88), 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.

.04

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
Total assets	$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 noncontrolling interests	154,200	26,200
Deferred tax liability (note 15)	619,200	408,000
Total liabilities	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
Total liabilities and shareholders' equity	$5,738,900	$5,138,200

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

.05

PERCENTAGE CONTRACTORS, INC.

Consolidated Statements of Income[3] 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)
Total other expense	(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[4]	2.09	.77
Retained earnings, beginning of year	649,500	569,100
	1,276,100	799,500

(continued)

[3] 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 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.

[4] 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 guidance 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.

In August 2008, FASB issued a revised exposure draft of a proposed statement titled *Earnings Per Share—an amendment of FASB Statement No. 128*. This proposed statement would amend the computational guidance in FASB Statement No. 128, *Earnings Per Share*, as codified in FASB ASC 260, for calculating the number of incremental shares included in diluted shares when applying the treasury stock method. Also, this proposed statement would eliminate the provisions of FASB Statement No. 128, as codified in FASB ASC 260, that allow an entity to rebut the presumption that contracts with the option of settling in either cash or stock will be settled in stock. In addition, this proposed statement would require that shares that will be issued upon conversion of a mandatorily convertible security be included in the weighted average number of ordinary shares outstanding used in computing basic earnings per share from the date when conversion becomes mandatory. Readers should be alert to the issuance of the final standard.

In December 2004, FASB issued FASB Statement No. 123 (revised 2004), *Share-Based Payment*, primarily codified in FASB ASC 718, *Compensation—Stock Compensation*, which requires that the compensation cost relating to share-based payment transactions be recognized in financial statements. That cost will be measured based on the fair value of the equity or liability instruments issued. Additionally, in March 2005, the Securities and Exchange Commission (SEC) released Staff Accounting Bulletin (SAB) No. 107, *Share-Based Payment*. SAB No. 107 expresses views of the SEC staff regarding the application of FASB Statement No. 123(R), primarily codified in FASB ASC 718, by public companies, and provides interpretive guidance related to the interaction between FASB Statement No. 123(R), primarily codified in FASB ASC 718, and certain SEC rules and regulations.

	20X1	20X0
Less: Dividends paid (per share $.50 (20X1); $.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.

.06

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 noncontrolling 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.

.07

PERCENTAGE CONTRACTORS, INC.

Notes to Consolidated Financial Statements

December 31, 20X1 and 20X2

1. Nature of Operations and Significant Accounting Policies[5]

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

Operating cycle. The company'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 company or its wholly owned subsidiary alone or in partnership with other contractors through joint ventures. The company also manages, for a fee, construction projects of others. The length of the company'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 company's majority-owned entities, a wholly owned corporate subsidiary and a 75 percent-owned joint venture (a partnership). All significant intercompany transactions are eliminated. The company has a noncontrolling interest in a joint venture (partnership), which is reported on the equity method.

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[5] 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 became the authoritative source of U.S. accounting and reporting standards for nongovernmental entities, in addition to guidance issued by the SEC. At that time, FASB ASC superseded 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 became nonauthoritative. This statement is effective for financial statements issued for interim and annual periods ending after September 15, 2009.

[6] In January 2010, FASB issued Accounting Standards Update (ASU) No. 2010-02, *Consolidation (Topic 810): Accounting and Reporting for Decreases in Ownership of a Subsidiary—a Scope Clarification*. ASU No. 2010-02 provides amendments to FASB ASC 810-10 and related guidance within U.S. generally accepted accounting principles (GAAP) to clarify that the scope of the decrease in ownership provisions of the subtopic and related guidance applies to the following:

a. A subsidiary or group of assets that is a business or nonprofit activity

b. A subsidiary that is a business or nonprofit activity that is transferred to an equity method investee or joint venture

c. An exchange of a group of assets that constitutes a business or nonprofit activity for a noncontrolling interest in an entity (including an equity method investee or joint venture)

The amendments in this ASU also clarify that the decrease in ownership guidance in FASB ASC 810-10 does not apply to (*a*) sales of in substance real estate and (*b*) conveyances of oil and gas mineral rights, even if these transfers involve businesses.

The amendments in this ASU expand the disclosures about the deconsolidation of a subsidiary or derecognition of a group of assets within the scope of FASB ASU 810-10. In addition to existing disclosures, an entity should disclose the following for such a deconsolidation or derecognition:

a. The valuation techniques used to measure the fair value of any retained investment in the former subsidiary or group of assets and information that enables users of its financial statements to assess the inputs used to develop the measurement

b. The nature of continuing involvement with the subsidiary or entity acquiring the group of assets after it has been deconsolidated or derecognized

(continued)

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 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 company 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.

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c. Whether the transaction that resulted in the deconsolidation of the subsidiary or the derecognition of the group of assets was with a related party or whether the former subsidiary or entity acquiring the group of assets will be a related party after deconsolidation

The entity also should disclose the valuation techniques used to measure an equity interest in an acquiree held by the entity immediately before the acquisition date in a business combination achieved in stages.

The amendments are effective beginning in the period that an entity adopts FASB Statement No. 160, *Noncontrolling Interests in Consolidated Financial Statements—an amendment of ARB 51*, as codified in FASB ASC 810-10. If an entity has previously adopted FASB Statement No. 160, the amendments are effective beginning in the first interim or annual reporting period ending on or after December 15, 2009. The amendments in ASU No. 2010-02 should be applied retrospectively to the first period that an entity adopts FASB Statement No. 160.

[*] In December 2009, FASB issued ASU No. 2009-17, *Consolidations (Topic 810): Improvements to Financial Reporting by Enterprises Involved with Variable Interest Entities—an interpretation of ARB No. 51*. ASU No. 2009-17 represents a revision to former FASB Interpretation No. 46 (revised December 2003), *Consolidation of Variable Interest Entities*, and changes how a reporting entity determines when an entity that is insufficiently capitalized or is not controlled through voting (or similar rights) should be consolidated. The determination of whether a reporting entity is required to consolidate another entity is based on, among other things, the other entity's purpose and design and the reporting entity's ability to direct the activities of the other entity that most significantly impact the other entity's economic performance.

ASU No. 2009-17 requires a reporting entity to provide additional disclosures about its involvement with variable interest entities and any significant changes in risk exposure due to that involvement. The reporting entity will be required to disclose how its involvement with a variable interest entity affects the reporting entity's financial statements. ASU No. 2009-17 is effective for annual periods beginning after November 15, 2009, and interim periods within those fiscal years. Readers should see transition guidance located at FASB ASC 810-10-65-2 for additional effective date information regarding disclosures. Early adoption is not permitted.

[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 (for example, labor dollars, units of output, and the cost-to-cost method and its variations).

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 Financial Accounting Standards Board (FASB) *Accounting Standards Codification* (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.

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

The Company adopted guidance issued by FASB with respect to accounting for uncertainty in income taxes as of January 1, 2009. A tax position is recognized as a benefit only if it is "more likely than not" that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50 percent likely of being realized on examination. For tax positions not meeting the "more likely than not" test, no tax benefit is recorded. The adoption had no effect on the Company's financial statements.

The Company recognizes interest and penalties related to unrecognized tax benefits in interest and income tax expense, respectively (if different, insert company's policy). The Company has no amounts accrued for interest or penalties as of December 31, 2009.

Due to its pass-through status; the Company is not subject to U.S. federal income tax or state income tax. The Company is no longer subject to examination by U.S. federal taxing authorities for years before [*insert date*] and for all state income taxes [*or indicate by tax jurisdiction if different*] through [*insert date*]. The Company does not expect the total amount of unrecognized tax benefits to significantly change in the next 12 months.

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

3. Fair Value of Financial Instruments[8, 9, 10, 11, †]

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.

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[8] In September 2006, FASB issued FASB Statement No. 157, *Fair Value Measurements*, as codified in FASB ASC 820, *Fair Value Measurements and Disclosures*, which defines *fair value*, establishes a framework for measuring fair value in GAAP, and expands disclosures about fair value measurements. This statement applies under other accounting pronouncements that require or permit fair value measurements, FASB having previously concluded in those accounting pronouncements that fair value is the relevant measurement attribute. Accordingly, this statement does not require any new fair value measurements but the application of it will change current practice. Refer to chapter 2 in Audit and Accounting Guide *Construction Contractors* (guide) for additional discussion of this statement, including information pertaining to the effective date.

In February 2007, FASB issued FASB Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities—Including an amendment of FASB Statement No. 115*, as codified in FASB ASC 825, *Financial Instruments*, which permits all entities, including not-for-profit organizations, to choose to measure eligible items at fair value at specified election dates. Notable eligible items include recognized financial assets and financial liabilities (except for those specifically prohibited), written loan commitments, and rights and obligations under a warranty that is not a financial instrument (because it requires or permits the insurer to provide goods or services rather than a cash payment) but whose terms permit the insurer to settle by paying a third party to provide those goods or services. Entities shall report assets and liabilities that are measured at fair value pursuant to the fair value option in this statement in a manner that separates those reported fair values from the carrying amounts of similar assets and liabilities measured using another measurement attribute. Refer to chapter 2 of the guide for additional discussion of this statement, including information pertaining to the effective date.

[9] FASB ASC 825-10-50-3 notes that for annual reporting periods, the disclosures about fair value of financial instruments prescribed in FASB ASC 825-10 are optional for entities that meet all of the following criteria:

a. The entity is a nonpublic entity.

b. The entity's total assets are less than $100 million on the date of the financial statements.

c. The entity has no instrument that, in whole or in part, is accounted for as a derivative instrument under FASB ASC 815, *Derivatives and Hedging*, other than commitments related to the origination of mortgage loans to be held for sale, during the reporting period.

[10] AU section 328, *Auditing Fair Value Measurements and Disclosures* (AICPA, *Professional Standards*, vol. 1), contains significantly expanded guidance on the audit procedures for fair value measurements and disclosures. Please refer to chapter 9 of the guide for a discussion of AU section 328.

[11] In September 2009, FASB issued ASU No. 2009-12, *Fair Value Measurements and Disclosures (Topic 820): Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)*. ASU No. 2009-12 provides guidance on using the net asset value per share provided by investees to estimate the fair value of an alternative investment. ASU No. 2009-12 provides amendments to FASB ASC 820 for the fair value measurement of investments in certain entities that calculate net asset value per share and requires disclosures by major category of investments about the attributes of those investments. Readers should consult ASU No. 2009-12 for further guidance.

ASU No. 2009-12 requires disclosures by major category of investment about the attributes of investments within the scope of ASU No. 2009-12. ASU No. 2009-12 is effective for interim and annual periods ending after December 15, 2009. Early application is permitted in financial statements for earlier interim and annual periods that have not been issued. If an entity early adopts the measurement amendments of ASU No. 2009-12, the entity is permitted to defer the adoption of the disclosure provisions of paragraph 6A of FASB ASC 820-10-50 until periods ending after December 15, 2009. Refer to chapter 2 of the guide for additional discussion of this ASU.

This guidance is located in FASB ASC 820-10-15, FASB ASC 820-10-35, FASB ASC 820-10-50, and FASB ASC 820-10-55 and is labeled as "Pending Content" due to the transition and effective date information discussed in FASB ASC 820-10-65-6. Refer to chapter 2 of the guide for additional discussion of this ASU.

[†] In January 2010, FASB issued ASU No. 2010-06, *Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements*. ASU No. 2010-06 provides amendments to FASB ASC 820-10 that require new disclosures as follows:

a. Transfers in and out of levels 1 and 2. A reporting entity should disclose separately the amounts of significant transfers in and out of level 1 and level 2 fair value measurements and describe the reasons for the transfers.

b. Activity in level 3 fair value measurements. In the reconciliation for fair value measurements using significant unobservable inputs (level 3), a reporting entity should present separately information about purchases, sales, issuances, and settlements (that is, on a gross basis rather than as one net number).

(continued)

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 in accordance with paragraphs 20–29 of FASB ASC 310-10-35 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 in conformity with paragraphs 20–29 of FASB ASC 310-10-35, 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 1 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.

ASU No. 2010-06 further provides amendments to FASB ASC 820-10 that clarify existing disclosures as follows:

a. Level of disaggregation. A reporting entity should provide fair value measurement disclosures for each class of assets and liabilities. A class is often a subset of assets or liabilities within a line item in the statement of financial position. A reporting entity needs to use judgment in determining the appropriate classes of assets and liabilities.

b. Disclosures about inputs and valuation techniques. A reporting entity should provide disclosures about the valuation techniques and inputs used to measure fair value for both recurring and on recurring fair value measurements. Those disclosures are required for fair value measurements that fall in either level 2 or level 3.

ASU No. 2010-06 also includes conforming amendments to the guidance on employers' disclosures about postretirement benefit plan assets (FASB ASC 715-20). The conforming amendments to FASB ASC 715-20 change the terminology from major categories of assets to classes of assets and provide a cross reference to the guidance in FASB ASC 820-10 on how to determine appropriate classes to present fair value disclosures.

The new disclosures and clarifications of existing disclosures are effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances, and settlements in the roll forward of activity in level 3 fair value measurements. Those disclosures are effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. Refer to chapter 2 of the guide for additional discussion of this ASU.

The retained and unbilled contracts receivable at December 31, 20X1, included $38,600 that was not expected to be collected within 1 year.

Contracts receivable include approximately $800,000 due under 1 contract.[12]

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 company has a noncontrolling 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 company. 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.)

[12] FASB ASC 825 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.

7. Transactions With Related Party

The note receivable, related company, 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 company, whose principal activity is leasing land and buildings. Percentage Contractors, Inc., rents land and office facilities from the related company on a 10-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	$7,500
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 is shown in the following paragraph:

> *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, pursuant to the provisions of FASB ASC 360,* Property, Plant, and Equipment, *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 1 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 company 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 1 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 company, 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 company and its bonding company arising out of the failure of a subcontractor of the company to pay its suppliers. In the opinion of counsel and management, the outcome of this claim will not have a material effect on the company's financial position or results of operations.

14. Management Contracts

The company 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[13, 14]

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

(continued)

[13] 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 shall be the regular tax rates if there are alternative tax systems. The estimated amount and the nature of each significant reconciling item shall be disclosed. A nonpublic enterprise shall disclose the nature of significant reconciling items but may omit a numerical reconciliation.

The guidance in FASB ASC 740 applies to all entities that prepare financial statements in accordance with GAAP. FASB ASC 740 establishes, among other matters, a recognition threshold defining a criterion that an individual tax position must meet for any part of the benefit of that position to be recognized. FASB ASC 740 requires that an analysis of all material tax positions be done as of each reporting date and prescribes separate reporting of (*a*) the deferred tax balance, based on the sustainable book or tax differences, or both, pursuant to the model adopted by this interpretation, and (*b*) the liability for any unrecognized benefit. FASB ASC 740 states that the use of a valuation allowance is not an appropriate way to recognize this type of liability. Additional guidance on measurement, derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition is also provided.

[14] In September 2009, FASB issued ASU No. 2009-06, *Income Taxes (Topic 740)—Implementation Guidance on Accounting for Uncertainty in Income Taxes and Disclosure Amendments for Nonpublic Entities*. The amendments in ASU No. 2009-06 provide implementation guidance, through examples, to address questions regarding how to apply the standards for uncertainty in income taxes. In addition, the amendments eliminate the disclosures required by paragraphs 15(a)–(b) of FASB ASC 740-10-50. FASB ASC 740-10-50-15(a) requires a tabular reconciliation of the total amount of unrecognized tax benefits at the beginning and end of the periods presented. FASB ASC 740-10-50-15(b) requires the disclosure of the total amount of unrecognized tax benefits that, if recognized, would affect the effective tax rate. For entities that are currently applying the standards for accounting for uncertainty in income taxes, the guidance and disclosure amendments are effective for financial statements issued for interim and annual periods ending after September 15, 2009. For those entities that have deferred the application of accounting for uncertainty in income taxes in accordance with FASB ASC 740-10-65-1(e), the guidance and disclosure amendments are effective upon adoption of those standards. FASB ASC 740-10-65-1(e) notes that the effective date for FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes—an interpretation of FASB Statement No. 109*, for entities meeting the conditions of and electing to use the deferral in FASB Staff Position FIN 48-3, *Effective Date of FASB Interpretation No. 48 for Certain Nonpublic Enterprises*, is for annual financial statements for fiscal years beginning after December 15, 2008.

	December 31, 20X1	December 31, 20X0
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 company 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.[15]

Contract revenues on uncompleted contracts at December 31, 20X0	$24,142,600
Contract adjustments	1,067,100
Contract revenues for new contracts, 20X1	3,690,600
	28,900,300
Less: Contract revenue earned, 20X1	22,432,500
Backlog at December 31, 20X1	$6,467,800

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

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, and approximately 40 percent of the company's labor force is covered by collective bargaining agreements that will expire within 1 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.

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

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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

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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[16]		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

[16] 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 requirements; however, the disclosure requirements described in paragraphs 6 and 8 of FASB ASC 460-10-50 are applicable.

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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, 20X1*		
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.

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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.

.12 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.

.13

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. 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*].[17] 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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[17] See footnote 2.

.14

COMPLETED CONTRACTORS, INC.

Balance Sheets

December 31, 20X1 and 20X0

Assets	*20X1*	*20X0*
Current assets		
Cash and cash equivalents	$242,700	$185,300
Contracts receivable (notes 1 and 3)	893,900	723,600
Costs in excess of billings on uncompleted contracts (note 4)	418,700	437,100
Inventories, at lower of cost or realizable value on first-in, first-out basis (note 5)	463,600	491,300
Prepaid expenses	89,900	53,900
Total current assets	2,108,800	1,891,200
Cash value of life insurance	35,800	32,900
Property and equipment, at cost		
Building	110,000	110,000
Equipment	178,000	163,000
Trucks and autos	220,000	200,000
	508,000	473,000
Less: Accumulated depreciation	218,000	203,200
	290,000	269,800
Other assets	21,500	21,500
Total assets	$2,456,100	$2,215,400

Liabilities and Stockholders' Equity	*20X1*	*20X0*
Current liabilities		
Current maturities, long-term debt (note 6)	$37,000	$30,600
Accounts payable	904,900	821,200
Accrued salaries and wages	138,300	155,100
Accrued and other liabilities	169,400	91,750
Billings in excess of costs on uncompleted contracts (note 4)	34,500	43,700
Total current liabilities	1,284,100	1,142,350
Long-term debt, less current maturities (note 6)	245,000	241,000
Total liabilities	1,529,100	1,383,350
Stockholders' equity		
Common stock—$10 par value, 50,000 authorized shares, 23,500 issued and outstanding shares	235,000	235,000
Additional paid-in capital	65,000	65,000
Retained earnings	627,000	532,050
Total stockholders' equity	927,000	832,050
Total liabilities and stockholders' equity	$2,456,100	$2,215,400

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

.15

COMPLETED CONTRACTORS, INC.

Statements of Income[18] 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[19]	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.

[18] See footnote 3.

[19] See footnote 4.

.16

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
Decrease in contracts receivable	(170,300)	(36,500)
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.

.17

Completed Contractors, Inc.

Notes to Financial Statements

December 31, 20X1 and 20X0

1. Nature of Operations and Significant Accounting Policies[20]

Nature of operations. The company 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 paragraphs 20–29 of FASB ASC 310-10-35 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,

[20] See footnote 5.

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[†, 21, 22, 23, 24]

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 1 contract.[25]

[†] See footnote †.

[21] See footnote 8.

[22] See footnote 9.

[23] See footnote 10.

[24] See footnote 11.

[25] See footnote 12.

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
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. Income Taxes

For the years ended December 31, 20X1 and 20X0, the Company had no amounts recorded for unrecognized tax benefits.

8. 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 company, of $2,460,000 at December 31, 20X1, and $2,170,000 at December 31, 20X0.[26]

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[26] See footnote 15.

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