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Accounting for General Contractors

BY AUSTIN SAVAGE

The accounting problems of the general contractor and their peculiar features have been discussed from time to time. In some instances the discussion has been indefinite and the student is left in some confusion as to what is the best method of determining the state of affairs of a general contractor's business on a given date.

Many problems call for careful consideration as to what constitutes good practice. For example, the question of anticipating profits on uncompleted contracts is one that can not be finally determined hypothetically. The practical issues will be discussed, but prudence and careful consideration of all the facts must govern the ultimate settlement in actual practice. Much has been written against anticipating profits and some very cogent reasons have been urged in its favor.

A general contractor's business may cover a comprehensive undertaking, where the erection of large and expensive buildings is in progress, or it may apply specifically to one branch of the industry.

Consideration will be given to the books and accounts reflecting the work performed under the terms of a contract. A contractor engaged in construction work undertakes to perform certain services and to furnish materials in accordance with the terms of the specifications and quantities called for in the contract. The work may cover the erection of a building complete or, as a subcontractor, he may be responsible for any one of the following duties: preparation of a site, excavating, foundations, erection of structural steel work, masonry, cut stone, fire-proofing, sheet-metal work and roofing, carpentry, painting, glazing, tiling, plumbing, heating, electrical wiring and installation of electrical plant, elevators—passenger, freight, electric or hydraulic.

The contract may call for a lump sum or it may be on a cost-plus basis. By a lump-sum contract is meant a contract whereby a contractor undertakes to perform certain work such as the erection of a building or a specific part thereof for a certain sum

of money. If it subsequently develops that the cost thereof is more than the specified amount, the owner is not liable for the excess. From an owner's point of view it is claimed that the disadvantages of this class of contract arise by reason of the fact that a contractor to insure his profit will frequently take advantage of the specifications by installing materials inferior in quality or by evading the terms in other ways, such as the omission of details in construction work. Opponents of these contracts assert that the objections justify the adoption of contracts on a cost-plus basis, notwithstanding the obvious advantages of a known cost determined by the selection of one of several bids submitted by competitors. Under cost-plus contracts it is claimed that the quality and quantity of the materials demanded by the specifications will be supplied, unnecessary expenditures will be avoided and the architect as a representative of the owner may supervise the construction or a job superintendent may be appointed to work under the supervision of the architect.

It is not unusual to find that a guaranteed cost is stipulated. By this is meant a maximum amount which includes the construction cost and the contractor's commission; and the owner is not further liable, irrespective of the actual amount of the construction cost. Where the commission of a contractor is fixed at a certain percentage of the cost and there is a specified maximum, it would appear to be advantageous to the contractor to increase the cost of construction up to the amount stipulated as the maximum, and thus increase the amount upon which his commission will be computed. To avoid the possibility of this and as an inducement to effect economies where possible, a clause is sometimes inserted whereby if any saving is effected by the contractor, he shall be paid a certain percentage of the difference between the completed cost and the guaranteed cost.

The actual accounting problems of the contractor arise when he has obtained a contract and commences operations. There is no difference in the problems, whether the operations are conducted on a large or small scale. The question is one of degree.

It is assumed that the internal organization as applied to routine duties and staff organization are functioning. This discussion relates to the financial records as reflected in the books and accounts.

Where contracts are numerous it is customary upon receipt of the working plans and specifications to give each contract a

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standing order number. This establishes the identity of the contract for future reference and thereafter all records and correspondence relative to the contracts should bear the standing order number. In practice, the following books satisfactorily meet the conditions and requirements of a general contractor, where numerous contracts are concurrent:

1. *Journals*

- Purchase journal
- Materials journal
- Transfer journal
- Charges journal—current contracts
- Do. —completed contracts

2. *Wages book*

Salaries book

3. *Cash books*

- Cash receipts book
- Cash payments book
- Petty cash disbursements book

4. *Ledgers*

- General ledger
- Contract ledger
- Accounts payable ledger

5. *Cost book*

Purchase journal

This book contains a record of all credit purchases for the account of specific contracts and for the general conduct of the business of the contractor. The ruling is as follows:

Date	Name	Particu- lars	Invoice No.	Fo.	Amount	Con- tract No.	Particu- lars	Fo.	Cost Book Amount	Particu- lars	Fo.	General Led. Amount

All invoices received are entered in the journal. Suitable analyses thereof are first made on the invoices or upon a voucher

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attached, allocating the charges to the correct accounts. There will be two dispositions of the purchase invoices:

- (a) In cost book account column.
- (b) In general ledger column.

All purchases for the account of current contracts are entered in the cost book column and the details are posted to the debit of the respective contract accounts in the cost book. The footings of the cost book account column are posted to the debit of a cost book account in the general ledger. The items recorded in the general ledger column will relate to revenue expenditures and also to additions to plant equipment, etc. Further analytical columns can be provided if necessary. The expenditures will be posted to the debit of the respective accounts in the general ledger.

In some instances details will be required to show the costs of specific parts of a complete contract, such as clearing and preparing ground, excavating, foundations, etc. The additions to the headings of analytical columns in the cost book will usually meet these requirements.

The entries in the purchase journal should furnish sufficient explanation to facilitate posting to the cost book, provided care is taken in journalizing the invoices in the first instance.

Accounts to be credited: Personal accounts of the creditors will be opened in the accounts payable ledger and postings will be made thereto from the left side of the purchase journal. The total thereof will be posted to the control account in the general ledger. Modifications of this form of journal are frequently substituted in the form of a voucher register. The economy effected lies in the time saved by dispensing with the accounts payable ledger. Since this form of journal functions in place of the purchase journal, a ruling of a voucher register is submitted, as follows:

Date	Voucher No.	Name	Vouchers Payable	Payment of		Cost Book				General Ledger				
				Voucher	Chk No.	Particulars	Cont. No.	Fo.	Amount	Particulars	Fo.	Amount		

The totals of the vouchers payable column are posted to the credit of payable control account in the general ledger and the

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routine for posting the cost book and general ledger postings is followed as previously described. Credits for materials returned can be taken up at the end of the purchase journal.

Materials journal

The general contractor usually carries supplies, stores and equipment for the conduct of his business. The accounts recording the materials in the nature of supplies and stores should be suitably grouped and classified and when materials are withdrawn for use on specific contracts it is necessary that the charges therefor should be recorded and debited to the respective contracts. To meet this condition a materials journal is used, a suitable ruling of which will provide a sufficient number of columns to take care of the various classes of materials carried on hand and charged out:

Date	Particulars	Cont. No.	Fo.	Total	Stores	Materials	Particulars	Fo.	Sundries	Loose Plant Equipment

The record is written up from duplicate copies of material charges to contracts issued from the stores department. The postings are made in detail to the various contracts in the cost book, care being taken to avoid the erroneous posting of debits in respect to plant and equipment into materials columns.

The entries in the analyses columns are posted in detail to the debit of the contract accounts and the totals thereof to the debit of the cost book account in the general ledger, and to the credit of the respective stores and plant and equipment accounts in the general ledger. Credits for materials returned may be passed through the materials book by using the end pages.

Transfer journal

The following ruling of the transfer journal will cover the requirements of the accounting system:

	Cost Book	Accts. Rec.	Accts. Pay.	Genl. Led.					Genl. Led.	Accts. Pay.	Accts. Rec.	Cost Book

The cost book column will take care of the transfers from one contract account to another.

Charges journal—current contracts

Payments received by the contractor on account in respect to work performed are primarily in the nature of instalments against work partly completed and also in respect to materials delivered to the job for work in progress. They are dealt with as follows: The amount received by the contractor is usually expressed by a percentage of the value of the work performed and authorized by an architect's certificate. Cash is debited and a personal account is opened in the accounts receivable ledger and credited with the amount received.

A method for taking up the periodical charges is to open a charges journal, which is composed of duplicate copies of bills rendered by the contractor filed in a binder, covering the particulars of the work passed for payment by the architect or bills rendered where arrangements have been made for payments on account.

The postings are passed through the following books: accounts receivable (or contract ledger, as it is sometimes called), cost book and general ledger. Personal accounts are opened in the accounts receivable ledger which are debited with the respective charges from the journal. The respective contract accounts are credited in the cost book. The totals of the journal are credited to the cost book account in the general ledger.

Charges journal—completed contracts

The object of the charges journal is to record all completed contracts. Upon completion of a contract a summary statement is prepared by the contractor showing the total contract cost of the work less the payments received on account. The balance represents the amount due the contractor. It should be understood that this statement is prepared on the basis of the terms of the contract, which may be lump-sum or cost-plus. The purpose of the statement is to furnish an account for use in final settlement. The duplicates of these statements are segregated and filed separately in the completed contracts binder. The postings of the balances due on completion are made to the debit of the personal accounts in the accounts receivable ledger and to the credit of the contract accounts in the cost book. The

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monthly totals of the amounts are posted to the credit of the cost book account in the general ledger.

Wages book

The wages paid by the contractor are passed through the wages book. To facilitate the posting and to avoid unnecessary analyzing, the use of subsidiary wages books is sometimes adopted and the totals are summarized in a summary wages book. Where a single wages book is kept the details are analyzed in columns headed with the contract numbers if chargeable to contracts. Wages not so chargeable are extended to a sundries column.

Where the contracts are not numerous, an analysis of the expenditures is made in summary form. The total chargeable to each contract is posted to the debit of the respective contract in the cost book and the total in the summary to the cost book account in the general ledger. Where subsidiary wages books are kept, the postings to the cost book ledger may be made either from these wages books or from the summary wages book, but preference is usually given to the latter method.

Following are examples of rulings of wages books:

Week Ending		Wages book Contract Accounts								Sundries			
Date Paid	Name	No.	Fo.	Amount	No. of Contract	No. of Contract	No. of Contract	No. of Contract					Amt.

Week Ending		Summary wages book											
Subsidy Wages Book Ref.	Cont. No.	Particulars	Fo.	Total	Week End-ing	Sundries	Fo.	Amount					

Salaries book

Salaries paid are summarized periodically and the amounts chargeable to contracts will relate to direct supervision. The postings will be to the debit of the particular contracts in the

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cost book and to the debit of the cost book account in the general ledger. Administrative salaries will be debited to salaries account in the general ledger.

Cash receipts book

Cash receipts will be entered in the cash receipts book and all amounts will be deposited in the bank. The following ruling will furnish all the necessary information required:

Date	Particulars		Fo.	Bank	Disc.	Accts. Rec.	Accts. Payable	General Ledger	Sundries	Fo.	Amount
	Name	Details									

The cash receipts in respect to amounts received against contracts are posted from the cash book to the credit of the respective personal accounts in the accounts receivable ledger. The monthly total thereof will be posted to the accounts receivable control account in the general ledger.

Adjustments covering refunds from sundry creditors on accounts payable will be passed through the accounts payable column, details will be posted to the accounts payable ledger and the totals to the credit of accounts payable control account in the general ledger.

Receipts affecting accounts in the general ledger (which are not taken up in the personal ledger columns) will be extended to the general ledger column.

Cash payments book

All payments, with the exception of petty cash disbursements, should be made by cheque and in accordance with the customary practice the ruling of the cash payments book will be such as to meet the requirements, of which the following is an example:

Date	Chk. No.	Vo. No.	Name	Particulars	Fo.	Bank	Disc.	Accts. Rec.	Accts. Pay.	General Ledger	Sundries	Fo.	Amt.

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It should be remarked that where the use of a voucher register is adopted in preference to a purchase journal, the detail postings to the accounts payable ledger will not be necessary, but the respective items covering the disbursements will be extended into the accounts payable column and the total thereof will be posted to the debit of the accounts payable control account in the general ledger. To conform with the ruling of the cash receipts book, provision is made for the cash adjustments on accounts receivable.

Petty cash disbursements

The imprest fund system is the most suitable and satisfactory method of handling the cash. The amount of the fund will depend upon the conditions and size of the business.

General ledger

The ledger will contain the usual accounts, suitably classifying in detail the assets, liabilities and expense accounts of the business.

The controlling accounts will be: bank account, petty cash account, accounts receivable, accounts payable and cost book account. The balance shown by the cost book account should agree with the net difference of the balances abstracted from the cost book.

Cost book

The cost book should be designed to contain a complete record of all the direct costs of construction of the various contracts undertaken by the contractor and all credits and charges against them. The ruling of this book will vary somewhat in details, but the following suggested form will convey the principal requirements desirable:

Debits							Credits									
Date	Particu- lars	In. or Vo. No.	Fo.	Tot.	Matls.	Wages		Date	Particu- lars	Fo.	Credits	Bills Rend.	Tot.	Fo.	Work in Prog- ress	Prof. or Loss

Upon closing the cost book and abstracting the balances the status of the contracts at a given date will be disclosed. Primarily they may be classified as:

- (a) Completed contracts.
- (b) Uncompleted contracts.

Arising out of an examination of the accounts of completed contracts, particularly those closed just prior to the date of drawing off the balances, it will sometimes be found that additional expenditures have to be incurred involving amounts varying in degree. This will necessitate setting up reserves to cover the estimated amount of expenditures, which will take care of the expenditures.

An examination of uncompleted contracts in determining the profits and losses may necessitate the segregation of these contracts into two classes, as follows:

- (a) Contracts nearly completed, upon which an estimate may be made of the amount required to cover cost of completion.
- (b) Contracts extending over a long period of time, upon which it is desired to take credit for the estimated profit thereon at the time of closing the books.

There are well known fundamental objections to the anticipation of profits on uncompleted contracts. Reserves, made for the purpose of closing out contracts by debiting estimated charges thereon, may be understated by omitting charges of some specified work or where the estimate is insufficient to cover actual work subsequently to be performed. What may appear to be a most conservative estimate at the time of closing the books by the contractor may subsequently be found, upon conclusion of the work, to have been overstated; and not infrequently losses are eventually disclosed where profits were expected. Unusual conditions may arise which could not be foreseen, such as defects in construction or in the quality of the materials furnished, and the cost of correcting any one of the defects may override whatever profit was anticipated and more.

It should be borne in mind that in passing upon reserves of this description made by a contractor covering anticipated profits, his estimates are based on his experience which is something better than a guess but something worse than actual knowledge itself. Where a contract has a long time to run, the possibility of correctly determining profits on completed work may be so prob-

lematical that taking all known facts into consideration, it finally devolves into a guess.

Notwithstanding the danger and disadvantages of anticipating profits, the practice is nevertheless sometimes condoned, with qualifications, where, for instance, it appears there is some substantial evidence of its justification, as in the case of contracts which are on the verge of completion and the work thereon has been approved by the architect up to this point as evidenced by the approval certificates and the accounts in the cost book. Examination of the terms of the contract and the supporting evidence of the approved certificates of the architect should furnish confirmation of the status of such contracts as are stated to be approximately completed.

In the reserves for the estimated amounts required to complete specified contracts, the journal entries will set up the debits to the particular contracts and the corresponding credits to reserve account for cost of completing contracts. The total of the debits will be posted to the cost book account in the general ledger and the details will be posted to the debit of the particular contract accounts in the cost book. The reserve account opened in the general ledger will be credited with the total amount thereof.

Reserves created for purposes of anticipating the estimated amounts of profits to be earned on uncompleted contracts will be passed through the transfer journal, crediting the specified contracts with the estimated amounts and debiting a reserve account for profit on uncompleted contracts. The respective contracts in the cost book will be credited with the particular amounts so reserved and the total will be credited to the cost book account in the general ledger. The reserve account for profit on uncompleted contracts in the general ledger will take up the debit therefor.

The list of cost book balances subject to the foregoing adjustments will then reflect the status of the various contracts according to the cost book and the balance of the profit or loss column will disclose the gross profit or loss. This amount must agree with the balance of the cost book account in the general ledger, which is the control account of the cost book balances.

It is not unusual in businesses of this description to find that the contractor has received payments on account for which no bills have been rendered. These are reflected by credit balances on the accounts receivable or contract ledger. The usual method

of treating items of this description in cases of this kind is to set up a separate schedule and for balance-sheet purposes to deduct the total from the amount of work in progress.

Loose plant and equipment

In some cases a contractor has to carry a valuable quantity of loose plant and equipment. This may be acquired for specific contracts on hand or may represent part of his loose plant and equipment carried for the general conduct of his business. Where acquired for specific purposes and where the asset will have no further value beyond its realizable scrap value on completion of the contract, the cost is chargeable to the contract and any amount realized on sale of surplus stock remaining after completion is credited to the cost of the contract.

Where the loose plant and equipment used on contracts form part of the contractor's equipment, it is sometimes considered desirable to charge the value of the asset to the contracts. In that case, while not forming part of the cost, the entries are a memorandum record showing the disposition of the asset.

Provision will be made for depreciation, which is chargeable to the particular contracts, where these are of considerable value and occupy a long time in execution. Instances arise, however, in which depreciation of loose plant and equipment is charged against the general revenue of the business, and not against specific contracts, the reason for this being that numerous contracts of similar nature are carried on simultaneously and the problem is simplified if the total depreciation is dealt with in one amount and deducted from the book value of this asset, as shown in the general ledger.

In the treatment of repairs and renewals to loose plant and equipment, different methods are applied which are not always correct from an accounting aspect. If the contract is originally charged with the value of loose plant and equipment forming part of the cost of the job it is usual to debit the contract with the cost of the renewals. Where the asset value is charged to the contract as a memorandum record, the cost of renewals may be found to have been incorrectly charged to repairs and renewals account, and not to the contract as above stated. This will be misleading when the loose plant and equipment are returned from the contract to the contractor's yard, as upon recording the value of the plant returned the amount thereof will not reflect

the amount originally charged, but the amount plus the value of those items taken in and charged as renewals, some of which may be additions and still have an asset value. This necessitates an additional charge transferring the cost of these additions to loose plant and equipment account and crediting renewals account.

Where the value of loose plant and equipment account is maintained at a certain value, the usual practice is to charge off all renewals against revenue; but there is sometimes a difficulty in determining what are renewals and what are additions, unless there is a detailed inventory available, which is not always the case. If there is no means of ascertaining the nature of the expenditures, an examination of the items is desirable to determine what are renewals and what constitute additions. Disposition of them will be made accordingly.

Where the value of loose plant and equipment is considerable, an accurate record can be kept by classifying the expenditures into representative groups, on the following lines:

<i>Transportation and lifting apparatus</i>	<i>Gages and mechanical measuring appliances</i>
Barrows	Bevels
Blocks—chain	Compasses
Blocks and falls—rope	Gages—depth and height
Chains and chain slings	Indicators—measuring
Cords	Plumb bobs
Crane hooks and shackles	Rules—standard and contraction
Hand carts	Squares
Horses	Straight edges
Horse carts, vans and wagons	Tapes—measuring
Jacks—hydraulic	
Jacks—screw	<i>Hand tools</i>
Lifting dogs	Chisels
Lifting screws	Drill braces—breast
Motor trucks	Drill braces—rabbet
Motor vans	Files and rasps
Ropes—hemp and manilla	File handles
Ropes—wire	Hack-saws—frames and blades
Steam wagons	Hammers—hand and sledge
Tongs—lifting	Mallets
Tongs—timber	Oilstones
Trolleys—hand sack	Pipe cutters
Trolleys—flat	Pipe wrenches
Weighing machines platform	Punches
<i>Portable mechanical appliances</i>	Reamers
Boring appliances	Spanners—adjustable
Drills—electric	Spanners—plain
Flexible shafts and tools	Stocks and dies
Pneumatic hammers	Stud extractors
Press—arbor and straightening	Taps
Pumps	Tap wrenches
	Wrenches—pipe