UHY LLP Certified Public Accountants

CONSTRUCTION INSIDER

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YOU'RE INVITED!

UHY LLP's Annual Construction Outlook

Join us in Farmington Hills for Construction Outlook 2015 on Wednesday, October 22, 2014!

7:00AM—7:20AM	Registration, breakfast and networking
7:20AM—7:30AM	Opening commentary
7:30AM—8:00AM	Legislative update – What's going on in Lansing?
8:00AM—8:30AM	How contractors can take advantage of the R&D tax credit
8:30AM—8:40AM	Refreshment break
8:40AM—9:00AM	State and local tax issues encountered by contractors
9:00AM—9:20AM	Congress coming down to the wire – Tax updates you need to know
9:20AM—9:30AM	Interactive discussion

CPE credit will be offered.

Pre-registration for this complimentary program is required. Breakfast will be provided. Space is limited. Multiple registrations are welcome. To RSVP contact Jessica Dalessandro via email jdalessandro@uhy-us.com or phone 586 843 2507.

The next level of service

REVENUE RECOGNITION STANDARDS – WHERE DID PERCENTAGE OF COMPLETION GO?

Recently, the Financial Accounting Standards Board issued Accounting Standards Update 2014-09, Revenue from Contracts with Customers (Topic 606), which will result in substantial changes in revenue recognition under US GAAP. This Accounting Standards Update (ASU) supersedes industry specific guidance including ASC 605-35, *Revenue Recognition–Construction Type and Production Type Contracts*.

The impact for many construction contractors will be minimal as the percentage of completion method has not been eliminated. However, the process and terminology will be different.

The ASU provides the following five steps to assist companies in recognizing revenue from contracts with customers:

1. **Identify the contract with a customer.** A contract is defined as "an agreement between two or more parties that creates enforceable rights and obligations." A contract must meet the following criteria:
   a. Approval and commitment of the parties.
   b. Identification of the rights of the parties.
   c. Identification of the payment terms.
   d. The contract has commercial substance.
   e. It is probable that the entity will collect the consideration to which it will be entitled in exchange for the goods or services that will be transferred to the customer.

In some cases, an entity should combine contracts and account for them as one contract if:
   a. The contracts are negotiated with a single commercial objective.
   b. The amount of consideration to be paid in one contract depend on the price or performance of the other contract.
   c. The goods or services promised in the contracts are a single performance obligation.

The ASU also recognizes contract modifications/change orders and provides detailed guidance for recognition depending on the type of modification. These could be treated as either an adjustment to original contract or as a separate contract.

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REVENUE RECOGNITION STANDARDS – WHERE DID PERCENTAGE OF COMPLETION GO?

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2. **Identify the performance obligations in the contract.** A performance obligation is defined as "a promise in a contract with a customer to transfer a good or service to the customer." If an entity promises to transfer more than one good or service, the entity should account for each promised good or service as a performance obligation only if it is (1) distinct or (2) a series of distinct goods or services that are substantially the same and have the same pattern of transfer. A good or service is distinct if both the following are met:
   a. The customer can benefit from the good or service either on its own or together with other resources that are readily available to the customer.
   b. The promise to transfer the good or service is separately identifiable from other promises in the contract.

Most contractors currently account for contracts at the contract level, meaning the entire project as a whole. Accounting for a contract at the contract level is still permitted; however, it will require judgment to determine if all the promises in the contract should be combined.

3. **Determine the transaction price.** Transaction price is defined as "the amount of consideration (for example, payment) to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer, excluding amounts collected on behalf of third parties." Variable consideration (for example, awards or incentives) will be included in the transaction price at their expected value or the most likely amount.

4. **Allocate the transaction price to the performance obligations in the contract.** The transaction price is allocated across each performance obligation's standalone selling price at contract inception.

5. **Recognizing revenue when (or as) the entity satisfies a performance obligation.** Revenue is recognized when a performance obligation has been satisfied by transferring a promised good or service to a customer. This may happen over time or as of a point in time. The entity satisfies the performance obligation over time and recognizes revenue over time if at least one of the following criteria is met:
   a. The customer simultaneously receives and consumes the benefits provided by the entity's performance as the entity performs.
   b. The entity's performance creates or enhances an asset that the customer controls as the asset is created or enhanced.
   c. The entity's performance does not create an asset with an alternative use to the entity, and the entity has an enforceable right to payment for the performance completed to date.

Many construction contracts will transfer control of a good or service over time and therefore will recognize revenue in a similar way as percentage of completion. However, this is a not a given and each contract will need to be carefully evaluated.

The updated standard will also require new and potentially complex disclosures related to revenue recognition.

For non-public companies, the effective date is for periods beginning after December 15, 2017, and interim reporting periods beginning after December 15, 2018. Early application is permitted for non-public entities with some limitations.

The revenue recognition standards are lengthy and complex. For more information on how these new standards will affect your financial reporting, please contact a member of the firm's Construction Practice in Farmington Hills 248 355 140 or Sterling Heights 586-254-1040, or visit is on the web at www.uhy-us.com.

> "The impact for many construction contractors will be minimal as the percentage of completion method has not been eliminated."

"WIN" FOR TAXPAYER IN TAX COURT

In a recent court case, the United States Tax Court determined that a residential developer and its affiliates may continue their method of accounting under the completed contract method.

The Tax Court determined that Shea Homes Inc. ("Shea Homes") and its subsidiaries may account for individual home sales in a residential development after the final road is paved and the last bond is released. The Internal Revenue Service (IRS) had claimed this accounting method was incorrect, contending that the home sale should be counted in the year when the escrow on the home closed.

Shea Homes, a California-based residential developer, and its subsidiaries build residential developments and planned communities ranging in size from 100 homes to more than 1,000. They have sold more than 114 developments across three states: Colorado, California and Arizona.

Shea Homes and its subsidiaries enter into individual contracts with homebuyers for houses within a larger planned development containing certain amenities. Before the sale can be closed, the seller was required by law to construct all of the "common improvement areas for the development" or post a bond to ensure the improvements would be completed. In some cases, the buyers paid the full contract price before all of the improvements and promised amenities of the residential development were completed.

The issue was whether Shea Homes and its subsidiaries properly reported the income from the sale of individual homes within their residential developments under the completed contract method of accounting.

In February 2014, the Tax Court held that Shea Homes' use of the completed-contract method of accounting was appropriate. The Court concluded that the home sale contracts included the development amenities and were not, as the IRS claimed, limited simply to the house and the lot on which the house sat.

Shea Homes applied the following theories for recognizing tax revenue:

1. Contracts for developments (not individual homes) were completed when they meet the use and 95% test described in the Internal Revenue Code which was incurring 95% of the costs of the development.
2. Final completion and acceptance did not occur until the last road was paved and the final bond was released.

The Company recognized income under the completed-contract method on each residential community or phase completion within the residential communities. Each community or phase includes added features and amenities that were an integral part of what the Company sold to potential buyers. Therefore the individual home sales were not recognized as they were part of the development contract.

The IRS argued that each home sold within the residential community constituted a completed contract. Thus, as the homes were sold within the residential community a contract was completed and revenue should be recognized. However, the Tax Court did not agree with this interpretation, instead ruling that the contract included the completion of the development.

In the Court's opinion, "The subject matter of the contract includes the house, the lot, and improvements to the lot as well as the common improvements in the development."

"We agree with [Shea Homes] that the contracts consist of more than just the purchase and sale agreements and that the subject matter of the contracts includes the costs of common improvements for the purpose of testing their completion date."

The Tax Court concluded that Shea Homes and its subsidiaries may continue to defer the income and loss to later years after the development has been substantially completed. Accordingly, it was held that the Company was allowed to report income on each community or phase completion based on the completed-contract method of accounting.

CONSTRUCTION OF THE FUTURE

In an era where seven-year-olds are walking around with cell phones and texting their grandparents that are in their 70's and 80's, technology is inevitably becoming the way of the future. More and more businesses in many industries are implementing new technology into their operations. As technology continues to evolve and become more affordable, construction contractors are looking for cost effective ways to implement mobile applications into the field.

Many contractors that have succeeded with limited use of technology find it difficult to see the need for change going forward. The reality is, as all industries are leaning more heavily on the use of technology, contractors are no exception and adaptation is vital to success going forward. There are many reasons mobile applications can be useful for construction contractors including securing top talent in a younger technology driven workforce, cost control, more accurate bidding, and so on.

As the labor force continues to age, employers are starting to find what attracts the best young talent. People, young and old, want to work at a place that offers the tools designed best for them to succeed and that make their jobs easier. With heavy use of laptops and tablets in schools, the generation entering the workforce now has become so reliant on technology that it is the best way for them to work efficiently. Employers that offer the use of technology on the job have the best chance of securing top talent.

In addition to appealing to the workforce, there are also benefits to mobile applications that can positively affect the bottom line. As all contractors know, the largest cost driver in the industry is labor. With large hourly wages, anything that can be done to promote efficiency in the field helps. Mobile apps can keep job costs up-to-date so that project managers that may be in the office or at other job sites are well aware of what is going on in the field and where each job stands. These efficiencies can help limit unnecessary phone calls, conference calls and even face-to-face meetings. While companies like to believe that all their employees are honest and ethical, some contractors are also using mobile apps to more effectively track the time of field workers. There are mobile applications that require the foreman to take a picture of each worker with and iPad in the field to effectively "clock-in". This prevents the foreman or another employee from punching or signing in or out another employee that may be arriving late or leaving early.

While the most prevalent use of mobile applications for construction contractors is to control costs and in an effort to improve the bottom line, this can also lead to more accurate bidding in an industry where the margin for profit continues to shrink. Having applications in the field that track a job real-time helps prevent uncaptured costs, or costs applied to incorrect jobs. These applications can help offer more accurate information more timely to gain an advantage over competitors. More accurate information can also prevent contractors from underbidding on jobs that may lead to losses if not all costs are accounted for.

While there are many reasons why increasing numbers of contractors are implementing mobile applications into the field, they are all intertwined. Newer, superior technology helps secure top talent and also helps that talent work more efficiently. Efficiency limits costs and leads to more accurate bidding. Some mobile applications and software used by contractors include:

- **FieldLens**: If you're looking to have all your jobsite communication in one place, shared with every member of the construction project team, FieldLens is a viable solution. This product offers mobile and web application that improves project communication between a general contractor, subcontractor, architect and owner. It also offers the ability to document job issues with photos and punch lists, and communicate "to-do" items.
- **PlanGrid**: PlanGrid is a mobile construction blueprint replacement app and platform that provides real-time updates and seamless file synching over Wi-Fi and cellular radio. Everyone on a project team is instantly updated when there are changes made to any documents. It offers the ability to always work up-to-date plans and improve communication via the field, project engineering and architect teams.
- **HeavyJob**: Want a better way to streamline your job management and payroll processes? This mobile app is an easy-to-use job costing and time entry system offering real-time data on production levels. HeavyJob can be used offline or online, from your phone, tablet or PC.
- **Bim360Field (previously Vela)**: Bim360Field combines mobile technologies at the construction site with cloud-based collaboration and reporting. This software enables users to share plans and drawings, hammer out punch lists, share critical data to those in the field, and improve quality, safety and profitability.

While all of these technological solutions offer different features, they can all lead to efficiency in an industry where that is the ultimate goal.

> "More and more businesses in many industries are implementing new technology into their operations."

CONSTRUCTION INDUSTRY INSIGHT

UHY LLP's National Construction Practice is comprised of the country's foremost experts in regards to audit and assurance, tax planning and compliance, and business advisory services for the construction industry. We work with a wide range of key industry segments including general contractors, underground contractors, underwater construction, tunnel, and bridge and heavy highway contractors.

As active members of various national, state and local construction associations, state housing councils and specialty trade groups, our team keeps alert to industry trends and opportunities. Our professionals are leaders in the industry and take the steps necessary to ensure our client's future success by identifying and addressing new accounting requirements and regulations. You can depend on us to anticipate major industry issues that might impact your company and help you structure workable solutions.

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