Consider a different route

4 accounting alternatives that may reduce financial reporting costs

Many privately held construction companies prepare audited financial statements that comply with Generally Accepted Accounting Principles (GAAP) as established by the Financial Accounting Standards Board (FASB). They do so, at least in part, to satisfy the requirements of lenders, sureties and other business partners.

Many of GAAP's requirements benefit private businesses and their financial statement users. But, for some contractors, the limited value doesn't justify the additional cost and complexity. Recognizing this, the FASB's parent organization, the Financial Accounting Foundation, established the Private Company Council (PCC) in 2012. The PCC's mission is to recommend exceptions or modifications to GAAP that respond to the needs of private companies.

So far, the PCC has recommended four FASB-accepted accounting alternatives that private construction businesses may use to ease the burden of complying with GAAP. Let's take a look at each one.

1. Accounting for certain leasing arrangements

Construction companies often set up separate leasing entities to accomplish a variety of tax planning, estate planning and risk management purposes. These entities, which typically have an ownership structure identical or similar to that of the construction business itself, hold equipment or real estate and lease it back to the contractor.

Ordinarily, GAAP may require the two entities to be consolidated for financial reporting purposes, a costly and time-consuming process that adds little value to the financial statements. But Accounting Standards Update (ASU) No. 2014-07 permits private companies to opt out of consolidation if the following requirements are met:

- The construction company and leasing company are under common control.
- The construction business has a lease arrangement with the leasing company.
- Substantially all activities between the contractor and the leasing company are related to leasing activities.
- If the construction company guarantees or provides collateral for any obligation of the leasing company related to a leased asset, the principal amount of the obligation doesn't exceed the value of the leased asset.

If the leasing company isn't consolidated, its revenues and expenses won't appear on the contractor's income statement, nor will its assets and liabilities appear on the balance sheet of the construction business.

2. Accounting for goodwill

Construction companies involved in acquisitions or other business combinations may acquire goodwill, which is the excess of the purchase price over the fair value of the identifiable assets acquired and liabilities assumed. Under GAAP, acquired goodwill must be tested annually for impairment — a complex, costly and time-consuming process — and written down only if its fair value has dropped below its carrying amount.

To ease the burden on private companies, the FASB issued ASU 2014-02. It gives them the option of amortizing acquired goodwill over a period of 10 years or less and testing goodwill for impairment (using a simplified analysis) only if there's a "triggering event," such as an economic downturn, which is likely to cause an impairment.

3. Accounting for other intangibles

GAAP also requires companies involved in business combinations to identify and separately account for acquired intangible assets other than goodwill — also a potentially complex, costly and time-consuming process.

Under ASU 2014-18, private businesses may elect not to separately recognize certain intangible assets and to simply include them in goodwill. This accounting alternative applies to noncompetition agreements, as well as customer-related intangible assets that cannot be sold or licensed independently of other assets (such as nontransferable contracts or customer relationships). Note that, to take advantage of this accounting alternative, the company must also elect to amortize goodwill under the preceding alternative.

4. Interest rate swaps

Smaller construction businesses often have trouble qualifying for fixed-rate loans. To avoid the uncertainty associated with variable-rate loans, some contractors enter into interest rate swap agreements that effectively convert them into fixed-rate loans. Ordinarily, these arrangements are subject to complex hedge accounting rules but, in ASU 2014-03, the FASB offered a simplified option for private companies other than financial institutions.

This alternative essentially permits a company to account for an arrangement as if it had obtained a fixed-rate loan directly rather than a variable-rate loan and an interest rate swap. To qualify for this treatment, a swap agreement must satisfy several criteria, but most are "plain vanilla" swaps — that is, those designed solely to convert variable-rate loans into fixed-rate loans.

Evaluate the impact

Contractors should consider using private company accounting alternatives to simplify their financial reporting and reduce their expenses. But if you're contemplating one or more of these options, consult your CPA to evaluate the potential impact on loan covenants and other business relationships. Also, run it by your lenders and surety to ensure an alternative accounting method is acceptable to them.

Sidebar: Ask the right questions when reviewing accounting methods

Every construction company should review its accounting methods periodically to identify opportunities to improve financial reporting, reduce costs and better manage tax liability. Examples of questions to ask as part of such a review include:

- Do we qualify for the cash method of accounting? If so, would it provide advantages over the accrual method?
- Are we using the most advantageous method of accounting for inventory? Long-term contracts? Retainage? Expensing, depreciating or capitalizing fixed or operating assets?
- Do we qualify for simplified accounting alternatives for private companies?
- Are we making the most of underused tax credits, such as the research credit and the domestic production activities deduction?
- Are we timing the deduction of accrued bonuses properly?
- Do we qualify for deferred recognition of advance payments?