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Blue Gilia Construction, Inc.: A Revenue Recognition Case Study

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Abstract

This case emulates a real business situation in the construction industry providing students the opportunity to critically think about revenue recognition for long-term contracts. The case also includes an error in the financial reports as a result of weaknesses in accounting procedures giving students the opportunity to review the COSO framework, evaluate internal controls procedures, and make recommendations regarding accounting processes. This case is designed for use in courses that cover revenue recognition and/or internal controls such as graduate level financial accounting and undergraduate intermediate accounting, advanced financial, and auditing.

Accounting concepts for revenue recognition using percentage-of-completion for long-term contracts can be challenging for students to comprehend. This case study takes the approach that students need to think critically about the implications of revenue recognition and be able to analyze the effects of a change (correction) to the financial reports. By providing students with a completed Excel spreadsheet for a percentage-of-completion schedule, students are able to quickly make a change (correction) to the Excel spreadsheet and analyze the effect of the change on the revenue recognized during the period as well as the effect on the assets and liabilities.

Keywords: revenue recognition; percentage-of-completion; internal controls; construction industry; written communication.

Introduction

"How can a job be 116% complete on the percentage-of-completion schedule? That's right…it can't be, Tom…but that is what we reported last year!" commented Bernadette Gutierrez, Chief Financial Officer (CFO). She tried to keep her voice calm during her telephone conversation with the Senior Construction Accounting Manager, Tom Philips, since he did not seem to understand the significance of this error in financial reporting from the prior year. Bernadette was ultimately responsible for the company's finance and accounting functions and knew the importance of accurate financial reporting, especially now as the company is making plans to seek a credit line extension with the bank for its planned geographical expansion.

Blue Gilia's business was booming, and last year there were more jobs in progress at year-end than ever before. Although the business was growing, behind-the-scenes, the accounting department was struggling with many challenges as the company expanded. Mike Watson, company President and Chief Executive Officer (CEO) of Blue Gilia Construction, Inc. knew they had rushed to get the company's financial statements prepared last year, but at the same time, he was sure the company had procedures in place to accurately report revenues. Now, he was not so sure. The discovery of a problem with reporting last year for the percentage-of-completion schedule added to his sense of urgency to review the company's procedures for accounting and financial reporting.

Mike had called a meeting with his management team, including Bernadette, Tom, and Georgia, the Construction Department Manager, and also invited their external certified public accountant (CPA), Susan. He wanted to address his accounting concerns quickly to ensure accurate company financial reporting for a clean audit prior to seeking the credit line extension.

Company Background and Management Team

Blue Gilia Construction, Inc. had been experiencing revenue growth over recent years, with 75% of revenues generated from long-term construction contracts and 25% from building maintenance contracts, the company had a good mix of income sources that provided some stability. The building maintenance contracts produce a consistent revenue stream of short-term projects such as painting and replacing carpet for large office buildings. The revenue from long-term construction projects was more volatile with changes in the economy.

Properly recognizing revenue for financial reporting is sometimes challenging since performance obligations may extend over multiple reporting cycles. In addition, when customers request changes to job scope (referred to as job change orders), the company must determine if the change order should be reported as a modification to the existing job or if it should be reported a separate performance obligation.

As Blue Gilia customers are billed in the accounting system, revenue is recorded and the job cost for the customer is moved to cost of goods sold. Because the timing of billings and work performed may not reflect the appropriate amount of profit earned on the job, an adjusting entry is necessary to properly recognize revenue based on the jobs' percentage complete. The best indication of the "percentage complete" is the comparison of actual costs incurred to total projected costs for each job. The percentage-of-completion schedule is used to compare actual costs to date to expected costs for each job, then an adjusting journal entry is made to appropriately recognize revenue based on projected earnings and percentage complete or "earned" for financial statement purposes.

The most recent year's financial statements (i.e., year ending December 31, 2020) are provided in Exhibit 1 (Statement of Income and Retained Earnings) and Exhibit 2 (Balance Sheet). In addition, the supplemental schedule of percentage-of-completion for jobs in progress is provided in Exhibit 3.

Mike was ready to proceed with plans for expansion of operations to a new geographical territory so that he could justify hiring a new estimator and project superintendent. The growth of the company seemed to be at a crossroad. The current estimators were not able to keep up with the demand for new bids and the superintendents were struggling to manage the ongoing jobs, yet Mike was concerned about the commitment of hiring additional management personnel and needed more space to accommodate expanded operations. Mike viewed the recent revelation about the error with the percentage-of-completion schedule as another growing pain for the company and was determined to improve their internal reporting processes. Mike asked his external accountant, Susan Lowery, CPA, to meet with his management team to review their financials. It was crucial for them to understand the errors identified by Bernadette and any resulting restatement of financial reports from an accounting perspective.

President and CEO: Mike Watson

Mike Watson began in the construction industry as a young boy, working for his family's privately-owned construction business, Blue Gilia Construction, Inc. He succeeded his father as President and CEO of the company in 2004. When business faltered after the declining economy in 2008, the new construction business suffered tremendously. To turn this challenge into an opportunity, Mike decided to create a building maintenance division within the company to meet short-term cash flow needs and keep his key employees working during slow times in the economic lull of the recession. As a result, the business experienced growth despite the economic downturn. Mike knows that additional investment is needed to keep both divisions functioning effectively and that accurate financial reporting is a prerequisite for growth.

Chief Financial Officer: Bernadette Gutierrez, MBA, CMA

The CFO of Blue Gilia, Bernadette Gutierrez, has been working at this company for six months. After obtaining a master's degree in business administration, she worked for five years as an Assistant Controller for a publicly traded construction company and is a certified management accountant (CMA). As a relatively new employee, she is still trying to find her footing at the company, and she knows that procedural changes to ensure accurate financial reporting are going to have to be made sooner rather than later.

Construction Department Manager: Georgia Cavanaugh

Georgia is an experienced manager with more than 20 years of experience in the construction industry. Georgia was hired from a competitor construction company by Mike shortly after he became President of Blue Gilia. As the Construction Department Manager, she is responsible for managing all jobs and reporting all change orders. Georgia was a little perplexed as to why one of the jobs (CHA-2209) was reported at over 100% complete. She had documentation showing that she had submitted the job change order to Tom for the upgrade in light fixtures and stone flooring. She was confident that she did not miss a job change order but what else would cause the percentage-of-completion schedule to show over 100% complete? This puzzled her.

Senior Construction Accounting Manager: Tom Phillips

Tom began working for Blue Gilia as an accounts payable clerk during college, and his responsibilities have grown over the years. Two years ago, he was promoted to Senior Construction Accounting Manager. Tom is responsible for coding costs, reviewing job cost records to verify costs have been correctly assigned to specific jobs by comparing actual costs to estimated costs for direct materials and direct labor. He then reviews the allocation of manufacturing overhead costs.

His recent conversation with Bernadette regarding the prior year's percentage-of-completion schedule had him feeling sick. In addition to the increased stress level at work, his wife was expecting their second child, and he could not afford to create a question about his integrity or ability to handle his job.

Accounting Processes

Currently, when Blue Gilia signs a new long-term construction contract, Tom creates a job cost folder to file the contract and other documents related to the job. He makes sure that all invoices are timely paid. Direct materials are coded and posted to specific jobs; any materials not specifically identifiable are posted to "Job 1" to indicate indirect materials to be allocated as overhead costs. Employees complete timesheets to report time worked on specific jobs; if no job is identified, the time worked is posted to "Job 1" to indicate indirect labor to be allocated as overhead costs. Overhead costs are allocated based on direct labor time posted to each job. Tom is responsible for recording specific costs to the jobs, allocating overhead, preparing the percentage-of-completion schedule, reviewing the final schedule, and making any final adjustments

Georgia, the Construction Department Manager works closely with Tom to forward information about new contracts so that a job folder can be created. She oversees the construction projects and manages the job supervisors to sign timesheets and verify that job codes are properly assigned prior to submitting payroll records to Tom for payment. Georgia maintains her own scheduling software to order materials as needed for jobs and to submit requests for customer billing as construction phases are completed.

Similarly, job change orders are also handled by Georgia. She forwards the additional information to Tom for processing and he adds the change order to the existing job file.

The Meeting

"Tom, have you had a chance to look into the error of Job CHA-2209 on the percentage-of-completion schedule?" Bernadette asked. Tom explained that the error was a result of an oversight related to a job change order. The job included an approved change order for an upgrade in light fixtures and additional work to be performed to install stone flooring resulting in additional revenue of $12,250 and related estimated costs of $9,800. The job change order was signed just before year-end on December 31. On the percentage-of-completion schedule, the job's expected revenue had been updated to include the $12,250 related to the job change order, but the associated estimated cost of $9,800 was inadvertently omitted from the schedule. After the job's estimated cost is updated for this change order, the percentage-of-completion schedule will reflect the correct amount of 95% complete at year end.

"OK, that sounds reasonable" said Susan. "Tom, could you provide an updated schedule that includes the needed changes? From there, we can consider whether last year's financial information needs to be restated. Bernadette and I will work together to review the job cost procedures and make recommendations for improvements so that this type of error will not happen again. Mike, I know that Blue Gilia's revenues are generated primarily from long-term construction contracts, can you tell me more about the revenues from the maintenance contracts?" asked Susan.

"Sure" said Mike. "Most of the maintenance revenues come from short-term projects that are completed in two to three days or as long as a couple of weeks. We also have several long-term maintenance contracts which range from one to five years. Since we are on retainer, we record the monthly maintenance payments as income regardless of the work performed. Isn't that correct Bernadette?"

"Yes, Mike that is correct" said Bernadette.

Susan continued with her questions: "When a customer has a change order, do you ever consider creating a new job folder because the work is a separate performance obligation?" Tom shook his no. "Do you ever reconcile your accounting records with Georgia's production schedule?" Again, Tom shook his head and said, "no, we are usually pressed for time to get the reports out".

After Susan had left, Bernadette stayed behind to discuss the meeting with Mike. "I will work with our management team to make sure we have controls in place to avoid future problems with accurate revenue reporting. Once we have updated the financial reports and determined the impact of the changes caused by the error in reporting for last year, let's plan another meeting to review things. It will be good to keep Susan in the loop as we plan for our audited financial statements this year."

"That sounds like a plan to me. Thanks for all of your help, Bernadette," Mike noted.

Case Requirements

1. Should the change order in question have been considered a separate performance obligation or a modification of the original performance obligation? Provide two examples of change orders for each type (separate performance obligation or contract modification). Explain how the two types of change orders might affect the recognition of revenue.
2. Prepare a corrected percentage-of-completion schedule to show the effects of the updated cost estimates associated with Job CHA-2209.
3. Provide specific details (including accounts and amounts) of the impact to the Income Statement and the Balance Sheet resulting from properly reporting the change order for Job CHA-2209.
4. What internal control weaknesses do you find in the current accounting procedures of Blue Gilia that may have contributed to the misreporting of revenue? What procedures could the company put in place to increase the assurance that its financial reports reflect accurate financial information?
5. Prepare a memo to Mike Watson, President of Blue Gilia Construction, Inc., with your recommendations relative to implementing changes in the company's current accounting practices to reduce errors and strengthen internal controls.

Exhibit 1

Blue Gilia Construction, Inc.
Statement of Income and Retained Earnings
For the Year Ending December 31, 2020

Revenues		
Revenue From Construction Contracts		$ 4,386,223
Cost of Sales		
Materials and Items Charged to Jobs	$ 1,263,381	
Direct Labor	1,349,572	
Payroll Taxes	106,023	
Workmen's Comp Insurance	105,446	
Subcontractors	288,680	
Equipment Rental	27,176	
Other Cost of Sales	78,669	
Total Cost of Sales		3,218,947
Gross Margin		1,167,276
Operating Expenses		
Salaries and Wages	653,223	
Employee Benefits	50,125	
Safety and Training Expense	26,194	
Advertising	7,170	
Rent	67,960	
Equipment Rental	21,104	
Maintenance	16,686	
Depreciation	26,316	
Insurance	7,501	
Office Expense	42,882	
Telephone - Office and Mobile	22,466	
Utilities - Gas, Water, and Waste	9,613	
Professional Fees - Legal and Accounting	17,782	
Taxes	67,003	
Total Operating Expenses		1,036,025
Other Revenues and Expenses		
Interest Income	474	
Interest Expense	(11,531)	
Total Other Revenues and Expenses		(11,057)
Income Before Income Taxes		120,194
Income Taxes		43,166
Income After Income Taxes		77,028
Retained Earnings, Jan. 1, 2020		542,005
Retained Earnings, Dec. 31, 2020		$ 619,033

Exhibit 2

Blue Gilia Construction, Inc.
Balance Sheet
December 31, 2020

Assets		
Current Assets		
Cash - Checking	$ 83,414	
Cash - Money Market Accounts	18,043	
Contracts Receivable	1,133,053	
Costs & Profits in excess of Billings	34,582	
Total Current Assets		$ 1,269,092
Fixed Assets		
Equipment	1,190,718	
Accumulated Depreciation, Equipment	(1,180,643)	
Total Fixed Assets		10,075
Other Assets		
Prepaid Federal Income Tax	756	
Deposits	500	
Total Other Assets		1,256
Total Assets		$ 1,280,423
Liabilities and Stockholders' Equity		
Current Liabilities		
Accounts Payable	$ 112,590	
Accrued Wages and Payroll Taxes Payable	103,357	
Other Accrued Expenses	12,447	
Payable - Chase Bank Line of Credit	50,000	
Current Portion of Long-Term Debt	5,996	
Total Current Liabilities		$ 284,390
Long-Term Liabilities		
Notes Payable		367,000
Total Liabilities		651,390
Stockholders' Equity		
Common Stock, $1 par value, 500,000 shares authorized; 10,000 shares issued and outstanding	10,000	
Retained Earnings	619,033	
Total Stockholders' Equity		629,033
Total Liabilities and Stockholders' Equity		$ 1,280,423

Exhibit 3

Blue Gilia Construction, Inc.
Percentage-of-Completion Schedule
December 31, 2020

Job	% Complete (Based on Costs)	Expected Total Revenue	Estimated Total Costs	Actual To-Date Costs	Estimated Total Profits	Estimated To-Date Profits	Costs & Profits (C&P)	% Billed	Actual To-Date Billings	Billings in excess of C&P	C&P in excess of Billings
A	B	C	D	E	F	G	H	I	J	K	L
Formula	E/D				C-D	F*B	G+E	J/C		J-H	J-H
AEI-2101	25%	$ 72,300	$ 57,000	$ 14,448	$ 15,300	$ 3,878	$ 18,326	33%	$ 23,700	$ 5,374	
ANA-0119	63%	20,400	16,500	10,410	3,900	2,461	12,871	49%	10,000		$ 2,871
ARA-1801	46%	32,800	26,500	12,199	6,300	2,900	15,099	55%	18,000	2,901	
AZU-2501	68%	22,400	18,600	12,682	3,800	2,591	15,273	71%	16,000	727	
BRO-1601	77%	18,500	14,800	11,326	3,700	2,832	14,158	43%	8,000		6,158
CAP-2020	14%	10,350	8,500	1,192	1,850	259	1,451	24%	2,500	1,049	
CAP-2005	55%	46,000	38,000	20,873	8,000	4,394	25,267	52%	24,000		1,267
CHA-2209	116%	78,000	45,000	52,000	33,000	38,133	90,133	90%	70,000		20,133
CHR-2201	9%	92,000	74,000	6,875	18,000	1,672	8,547	10%	9,500	953	
CIT-0202	54%	10,000	8,900	4,792	1,100	592	5,384	40%	4,000		1,384
COC-2201	72%	11,300	9,350	6,700	1,950	1,397	8,097	44%	5,000		3,097
CRO-1801	23%	91,800	75,200	17,553	16,600	3,875	21,428	20%	18,000		3,428
ENE-1701	63%	11,250	9,350	5,902	1,900	1,199	7,101	64%	7,200	99	
ENE-3503	7%	46,500	38,200	2,660	8,300	578	3,238	8%	3,500	262	
FIT-0401	58%	8,000	6,800	3,966	1,200	700	4,666	38%	3,000		1,666
GEC-1801	75%	45,600	37,500	28,199	8,100	6,091	34,290	83%	38,000	3,710	
GLO-2501	12%	177,200	145,000	17,762	32,200	3,944	21,706	15%	26,000	4,294	
LOC-0116	78%	9,400	7,520	5,885	1,880	1,471	7,356	53%	5,000		2,356
MOR-0301	70%	18,500	15,500	10,849	3,000	2,100	12,949	86%	16,000	3,051	
NOR-1924	70%	9,100	7,100	4,997	2,000	1,408	6,405	43%	3,876		2,529
NOR-5627	45%	16,000	15,200	6,822	800	359	7,181	53%	8,500	1,319	
RET-2501	51%	95,500	76,500	39,056	19,000	9,700	48,756	42%	40,000		8,756
STI-0101	62%	15,800	12,700	7,816	3,100	1,908	9,724	50%	7,900		1,824
USO-3201	75%	42,300	33,850	25,316	8,450	6,320	31,636	78%	32,800	1,164	
VIS-3302	63%	56,000	45,000	28,531	11,000	6,974	35,505	65%	36,649	1,144	
WES-2401	49%	47,000	37,600	18,528	9,400	4,632	23,160	38%	18,000		5,160
	43%	$ 1,104,000	$ 880,170	$ 377,339	$ 223,830	$ 112,368	$ 489,707	41%	$ 455,125	$ 26,047	$ 60,629

C&P in excess of Billings $ 34,582

TEACHING NOTES

Case Overview

Blue Gilia Construction, Inc. was created as a family-owned construction business involved in both short-term building maintenance contracts and long-term construction contracts. The company President and Chief Executive Office, Mike Watson, plans to expand business operations in the near future and has put together a management team to help him develop procedures needed for healthy growth to take the business to the next level. The firm is now focused upon making sure accounting procedures are in place to accurately report revenue and prepare financial reports in anticipation of the upcoming audit and subsequent discussion with the bank to extend their credit line in order to expand their operations geographically. Recently, an error has been discovered in the prior year's financial report pertaining to the percentage-of-completion schedule which precipitates a series of meetings and review of procedures.

Learning Objectives

Upon the completion of the case study, students will be able to:

1. Apply concepts of the revenue recognition standard (ASU 2014-09) Revenue from Contracts with Customers (FASB Topic 606).
2. Identify performance obligations for revenue recognition in the context of change orders.
3. Understand a percentage-of-completion schedule for a construction company and describe how changes to the schedule impact the company's financial statements.
4. Apply the COSO framework to analyze internal control procedures and identify internal control weaknesses.
5. Demonstrate the ability to write a business memo to effectively communicate recommendations for changes to company accounting procedures.

Answers to Case Requirements

1. Should the change order in question be considered a separate performance obligation or a modification of the original performance obligation? Provide two examples of change orders for each type (separate performance obligation or contract modification). Explain how the two types of change orders might affect the recognition of revenue.

An upgrade in the quality of materials such as light fixtures does not result in a new performance obligation. The upgrade in flooring and additional labor to install the stone flooring is also a change in the existing specifications and not a new performance obligation. If the initial performance objective was the construction of a building and the change order was a different color of paint, different type of window or blinds, or upgrade in cabinets, the change order would be a modification of the initial performance objective. As a modification, the change order would alter the estimated total costs and expected revenues of the existing job. This would result in a recalculation of the percentage complete and change the amount of revenue recognized in the current period.

If the change order was to add a fence or a media center, or to remodel an existing structure for the customer or something distinctly different from the original contract, the change order would be a separate performance obligation and a new job should be established to account for the change order. As a separate performance obligation, the percentage complete would be based solely on the progress of the change order. The amounts and percentage of the original job would not be modified.

2. Prepare a corrected percentage-of-completion schedule to show the effects of the updated cost estimates associated with Job CHA-2209.

Appendix C provides a corrected Percentage-of-Completion Schedule for Blue Gilia.

3. Provide specific details (including accounts and amounts) of the impact to the Income Statement and the Balance Sheet resulting from properly reporting the change order for Job CHA-2209.

Failing to record the estimated costs of the change order caused the percentage complete for job CHA-2209 to be overstated and, therefore, revenue recognized on the income statement and current assets on the balance sheet are also overstated. The overstatement is $16,118 (original column H of $489,707 less corrected column H of $455,125). The journal entry to correct the error is provided below:

Revenue from Construction Contracts	16,118	
Costs & Profits in excess of Billings		16,118

4. What internal control weaknesses do you find in the current accounting procedures of Blue Gilia that may have contributed to the misreporting of revenue? What procedures could the company put in place to increase the assurance that its financial reports reflect accurate financial information?

Internal controls that may have failed or not been in place include the following possibilities:

a. Proper authorization for change orders;
b. Proper authorization for vendor invoices related to jobs;
c. Lack of regular comparison of contracted costs to actual costs and projected costs to complete each job;
d. Failure to compare purchases to original job cost approval.
e. Lack of segregation of duties.

The procedures in place should include appropriate written documentation, authorization, segregation of duties, and defined responsibilities. The company should have written procedures for each type of transaction. A checklist can be helpful to make sure that all steps are properly taken to complete a transaction. In the Blue Gilia case, the problem occurred because of an error in updating the estimated costs of a change order. There should be appropriate documentation for the change order and a subsequent verification of the estimated costs to complete the change order. Proper authorization for the change order is also necessary, which would include signatures of both the company's responsible party and the customer to the contract.

In the Blue Gilia situation, the expected revenue of the change order had been recorded in the accounting system, but the estimated costs were not recorded. Since this information is reported for job costing using percentage-of-completion, it requires communication between the accounting department and the construction job supervisor. Paperwork should have been used to record the expected revenue for the change order and additional paperwork to record the estimated costs of the change order. In addition, change orders should be evaluated to determine if the change gives rise to a new performance obligation. If so, the new performance obligation should be considered a separate job for reporting and revenue recognition purposes.

It is essential to have proper authorization before any expenses are incurred on jobs in progress. Therefore, an effective system of internal controls would include a system of checks and balances to ensure that all purchases, payroll, and disbursements are properly authorized for jobs. Segregation of duties would help to prevent fraud and error in the accounting functions.

The estimated costs to complete a job are not cash distributions or cash receipts until the work is done. Therefore, an internal control procedure such as a bank reconciliation would not have helped to catch this error. A job costing system must be updated with contract modifications and the estimated costs to complete jobs.

It would be beneficial to include a checklist with each job file to verify that all required steps are completed for each type of transaction. A review of each job at the end of each reporting period would be necessary to verify that all steps are completed prior to preparing the financial statements.

5. Prepare a memo to Mike Watson, President of Blue Gilia Construction, Inc., with your recommendations relative to implementing changes in the company's current accounting practices to reduce errors and strengthen internal controls.

Appendix C provides an example memo to Mike Watson.

Intended Audience

This case is designed for use in intermediate accounting, advanced financial accounting, auditing, and graduate level financial accounting courses. Generally, any course that covers revenue recognition and/or internal controls. Before presenting this case, it is important that the students already have knowledge of general revenue recognition concepts including contracts with customers, performance obligations, determining and allocating transaction price, and recognizing revenue and internal controls. The revenue recognition and internal control concepts could have been covered in the same course earlier in the semester or in a prior course. Nevertheless, a review of basic revenue recognition and internal control concepts are likely to be helpful to the students, especially if the basic knowledge was taught in a prior semester. Information for a review of these concepts is included in Appendix A.

Implementation Guidance

Our recommendation is to allocate one class period (approximately 75 minutes) for this case study and assign Case Requirements 1-3 as an in-class group activity and discussion. After the in-class activity and discussion, assign Case Requirements 4-5 which include a written communication assignment for completion outside the classroom (approximately one hour). To maximize class time, instructors should provide students with a copy of the case prior to class to allow sufficient time for students to carefully read the case before class and be prepared for the class discussion. Additionally, if your students need a refresher on revenue recognition concepts and the COSO framework, you may wish to provide students with Appendix A in addition to the case.

Splitting the class period into three segments of approximately equal time allotments works well. The first segment is used to introduce the percentage-of-completion schedule and change orders. We recommend using Appendix B as a handout for this introduction and to walk the students through Ellison's percentage-of-completion schedules column by column then discuss the impact on the income statement and balance sheet. The second segment is used to introduce the case study and groups of 2-4 students work on the case requirements 1 to 3. The last segment is used to bring the groups back together for a class-wide debriefing and assign the remaining case requirements, 4 and 5.

Based on our experience from implementing the case study and from the feedback of three other educators who extensively use case studies in the classroom, we have made several changes. We condensed the revenue recognition part of the case study so it can be accomplished in one class period. Additionally, we assign the case in groups rather than individually. We found the students responses are of higher quality when the students work in groups engaging in discussions and collective problem solving. We added examples of the percentage-of-completion schedule to use for classroom demonstration (i.e., Ellison Construction in Appendix B). The Ellison examples include one where costs & profits exceed billings (Panel A) and one where billings exceed costs & profits (Panel B). These examples allow the instructor to show the students how the percentage-of-completion schedule flows using an example company. The students can then apply this knowledge when analyzing Blue Gilia for the assignment.

Motivation and Classroom Validation

Accounting for revenue recognition using percentage-of-completion for long-term contracts can be challenging for students to grasp and remember. Textbooks often include percentage-of-completion as an appendix at the end of the chapter on revenue recognition. One of the authors had personal experience working with construction companies and recognized the importance of teaching students accounting for long-term contracts. In looking for resources to engage students in active learning and create an opportunity for improved comprehension of revenue recognition and internal controls, we found limited educational cases on the topic of revenue recognition focusing on long-term contracts. Therefore, we recognized a need for an engaging case study that could be used during class to teach the concepts and incorporate the use of Excel to demonstrate a real-world application of percentage-of-completion. This case study has been implemented at a liberal arts university in an undergraduate intermediate accounting course over a two-year period, 2018 and 2019. Thirty-five undergraduate accounting majors in their junior year completed the case study following implementation in Intermediate Accounting II. Using the rubric in Appendix D, the cases completed by students were assessed as exemplary (38%), good (47%), rudimentary (15%) and unacceptable (0%). The rudimentary assessments were due to incomplete responses and poorly written memos. In addition to utilizing this case in our own classrooms, we received feedback from three educators from other universities who extensively use case studies in their upper level accounting courses. As a result, this case study incorporates feedback from accounting educators based in the U.S. at both private and public universities with varied classroom sizes and diverse experiences including financial accounting, auditing, and information systems.

At the completion of the case study, the students were asked to voluntarily participate in a survey to gather feedback on the assignment. Some of the student comments are provided below:

- "The in-class exercise helped clarify the process of when and how to recognize revenue. It can be confusing if not laid out in detail. Thank you!"
- "It helped give a better understanding of revenue recognition. Seeing how to solve the problem and being able to discuss the how's and why's helps better retain that information."
- "It was a great tool/technique to visualize what is actually happening with revenue recognition …"
- "I believe it was beneficial using a real-life situation and explaining why we made changes to the accounts. It provides a real-life explanation as to what could occur in contracts and companies reporting revenue at inappropriate times."

Suggestions for Expanding this Case Study

The expansion opportunities for this case are plentiful. First, file management solutions are available to instructors through an Excel file including all case exhibits that is provided as part of the teaching notes. This Excel file offers instructors the opportunity to create different versions of the case study by changing amounts. Multiple versions can be beneficial if there is concern that the case study answers may be shared between the groups in the class and/or from students who previously completed the case.

Additionally, instructors may choose to ask their students to prepare the corrected percentage-of-completion schedule (Case Requirement 2) electronically. This is particularly relevant if the case is utilized in a course with an online or hybrid format. In the Excel file, instructors will find two versions of the percentage-of-completion schedule, with and without formulas. Either version can be copied into a separate Excel file and provided to students by posting in the learning management system for the course.

In addition to the revenue recognition problem, the case sets up two issues which students may explore – misstatements/errors and ethical issues. Because the error related to the change order was in a prior year, accounting for errors could be incorporated as part of the student research prior to class or during a class discussion. Restatement of financial statements and materiality are discussion topics which can also be included. The assignment could include a detailed written executive summary to resolve the misstatement. Additionally, the management team information for Georgia Cavanaugh can be used to discuss ethical issues.

Additional Learning Objectives

The learning objects for the case could be expanded depending on the additional expectations for the assignment. For example, the following additional learning objectives may be added:

Upon the completion of the additional requirements for the case, students will be able to:

- Evaluate the need for restatement of financial statements.
- Evaluate the ethical dilemma of considering colleague's actions differently depending on personal relationships. Is it appropriate to withhold information regarding a colleague's actions in an accounting situation?

Additional Case Requirements

1. What factors must Blue Gilia consider in evaluating the need to restate the prior year financial reports?
2. Does Georgia have an ethical issue regarding her hesitation to question Tom's job cost allocations?

Additional Answers to Case Requirements

1. What factors must Blue Gilia consider in evaluating the need to restate the prior year financial reports?

First, the error should be corrected to determine the difference to any account affected by the error in reporting. An analysis of differences is necessary to evaluate the need for a restatement of the financial reports. Errors or misstatements of financial statements are considered to be material if they could reasonably be expected to influence decisions of financial statement users. Critical analysis and professional judgement are needed to make a decision regarding materiality.

After determining the amount of the error, you should analyze the amount relative to the accounts in that category on the financial statements. For example, you would determine the percentage of the error in relation to the account and the total of that category of accounts. Next, you should look at the other financial ratios that might be affected by the error. For example, if the error is to a liability, you would determine the effect on the company's Debt-to-Assets or Debt-to-Equity ratios. Would the difference in the ratios before the correction and after the correction make a difference in the decisions of financial statement users, such as an investor or a creditor? If so, then the financial statements should be restated. If the error resulted in a very small difference which would not affect the financial decision making of the financial statement users, then a restatement is not necessary. For example, if a liability is understated by $41,000 it might seem like a large amount, but if total liabilities are $1,000,000, then the error would be around 4% of total liabilities, an immaterial amount. If the total liabilities were only $200,000, the error would be around 20% of total liabilities, clearly a material amount which would warrant a restatement of the financial statements. An error will affect two accounts, be sure to test for materiality with both accounts. In the example provided, materiality would be tested as it relates to both liabilities and revenues. Financial statement analysis comparing relevant ratios before and after the correction is also useful in applying professional judgement to determine materiality. In the Blue Gilia case, the correction would be made in the current period so that the next financial statements would be accurately reported. No restatement is necessary.

2. Does Georgia have an ethical issue regarding her hesitation to question Tom's job cost allocations?

Student answers will vary. This question provides the opportunity for students to discuss the implications of feelings that you might get a friend in trouble at work by disclosing information. In what situations should information be disclosed to supervisors or management and when is it appropriate to withhold information or ignore potential signs that something might not be as it should be?

Suggestions for Research Assignments for Graduate Level Courses

Graduate students could benefit by taking the concepts of the case to a higher level by researching authoritative source documents. The case could be assigned with an outside of class research assignment to be completed in preparation of the classroom discussion. A Financial Accounting Standards Board (FASB) codification research assignment would require students to identify revenue recognition standards relevant to accounting for construction contracts. A Commission of Sponsoring Organizations of the Treadway Commission (COSO) framework research assignment would require students to identify internal control weaknesses. For either research assignment, the instructor would begin class with a discussion of the topics to be researched and the importance of building the skills needed to find the authoritative guidance for accurate reporting and consulting with clients. If students do a research assignment, begin class with a discussion of internal controls or the challenges of identifying performance obligations and properly recognizing revenues with long-term contracts. If any students have experience working in construction, be sure to engage them with a discussion of their experiences in a real-world setting.

Research Assignments - Case Requirements

1. Research the Financial Accounting Standards Board (FASB) codification to find relevant guidance on revenue recognition for long-term contracts. The FASB codification login can be found at https://asc.fasb.org.
    a. Be prepared to discuss the relevant information from the case related to revenue recognition for long-term contracts and the related treatment as specified in the FASB codification.
    b. Using the information given in the case, analyze the impact of revenue recognition for long-term contracts on the financial statements.
2. Research the Commission of Sponsoring Organizations of the Treadway Commission (COSO) framework to find relevant guidance on internal controls. The Integrated Framework Executive Summary can be found at www.coso.org.

a. Summarize internal control weaknesses in the case and evaluate each according to the five components of the COSO framework.
b. Suggest control activities for Blue Gilia Construction, Inc.

References

Committee of Sponsoring Organizations of the Treadway Commission. Available at: https://www.coso.org

Financial Standards Accounting Board. Update No. 2014-09—Revenue from Contracts with Customers (Topic 606) Section A—Summary and Amendments That Create Revenue from Contracts with Customers (Topic 606) and Other Assets and Deferred Costs—Contracts with Customers (Subtopic 340-40) Available at: www.fasb.org/cs/ContentServer?c=Document_C&pagename=FASB%2FDocument_C%2FDocumentPage&cid=1176164076069

APPENDIX A – REVIEW OF KEY CONCEPTS (FOR STUDENTS)

Revenue Recognition Standard: Accounting Standards Update (ASU) 2014-09, Revenue from Contracts with Customers (Topic 606).

The goal of the revenue recognition standard is to provide consistency in reporting revenues and increase comparability among companies. For revenue recognition, the key guiding principle is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. To achieve that key principle, an entity should apply the following steps:

- Step 1: Identify the Contract with a Customer.
  A contract is an agreement between two or more parties that creates enforceable rights and obligations. A separate contract is created if an agreement has commercial substance, approval and commitment by both parties, defined rights to both parties under the agreement, and payment terms with consideration that is probable that the entity will collect in exchange for the goods or services.
- Step 2: Identify the Performance Obligations in the Contract.
  A performance obligation is a promise in a contract with a customer that can be completed separate and apart from other obligations or agreements with the customer. A good or service that is not distinct and independent from other performance obligations should be combined into one performance obligation.
- Step 3: Determine the Transaction Price.
  The transaction price is the amount to be paid in exchange for the goods or services provided. The price to be recorded as revenue is the expected value or the most likely amount that will be paid net of any discounts, credits, coupons, vouchers, or expected write-offs. Therefore, the revenue recognized includes only amounts that are not expected to be reversed. In other words, a reversal of the revenue amount is not probable. If there will be more than one year between the completion of the contract obligation and full payment by the customer, the time value of money should be considered, and a financing component should be recorded. If the payment for the contract includes any noncash consideration, a reasonable estimate of the fair value of the noncash portion should be recorded.
- Step 4: Allocate the Transaction Price to the Performance Obligations in the Contract.
  If a contract contains more than one performance obligation, the transaction price should be allocated to each performance obligation based on the price that is expected to be received on a standalone basis. If a standalone selling price is not observable, it should be estimated. Any subsequent change in the transaction price should be allocated on the same basis as at contract inception and recognized as revenue (or a reduction of revenue) in the period in which the transaction price changes.
- Step 5: Recognize Revenue When (or As) the Entity Satisfies a Performance Obligation.
  Revenue should be recognized when (or as) a performance obligation is completed by transferring a promised good or service to a customer. A transfer is complete when the customer obtains control of that good or service. Transfer of control happens when the customer has legal title to the asset, or takes physical possession of the asset, or when the seller has a right to payment for the asset just to name a few examples. If the transfer of the good or service does not happen at one point in time, but occurs over time, revenue is recognized over time by consistently applying a method of measuring progress toward complete satisfaction of that performance obligation. An appropriate method to recognize revenue for long-term construction contracts is the percentage-of-completion method. In these cases, actual costs and estimated profits are accumulated as Construction in Progress, also referred to as CIP, and actual to-date billings are accumulated as Billings on Construction in Progress, also referred to as Billings on CIP.

Committee of Sponsoring Organizations of the Treadway Commission (COSO) Framework.

The COSO framework for internal controls is based on five concepts: the control environment, risk assessment, control activities, information and communication, and monitoring activities. The firm should begin by documenting and evaluating the accounting processes. By mapping the activities and evaluating the internal controls, the firm could create a checklist for future review and monitoring. Then the firm should test the internal controls system through validation testing to identify deficiencies and weaknesses. Any identified weaknesses should be addressed, and processes implemented to ensure internal controls are effective and maintained for the integrity of the financial reporting system. Lastly, the internal controls review should be incorporated into the regular system processes for analysis and continuous improvements.

APPENDIX B – INTRODUCTION OF THE PERCENTAGE-OF-COMPLETION SCHEDULES, CHANGE ORDERS, AND ACCOUNTING ERRORS (FOR STUDENTS)

Percentage-of-Completion Schedule.

The percentage-of-completion schedule is prepared to calculate the amount a company should report on the balance sheet for contracts that are not yet completed. Each row in the schedule is a separate performance obligation and is referred to as a job. Once a job is complete, it is removed from the schedule, so the schedule reflects only jobs in progress.

Job costs are recorded to construction in progress when incurred. When customers are billed, the amount billed is recorded as revenue, and the costs associated with the job are moved from construction in progress to cost of goods sold. Because the amount billed to the customer may not reflect the amount that should be recognized as revenue for financial statement purposes, an adjusting entry is necessary to properly recognize revenue based on the job's percentage complete.

At the end of this appendix are two percentage-of-completion schedules for Ellison Construction. There are four inputs for each job – expected total revenue (column C), actual to-date billings (column J), estimated total costs (column D) and actual to-date costs (column E). The remaining columns are calculations and the respective formula is stated in the formula row of the schedule. Estimated to-date profits (column G) is a portion of the estimated total profit by job based on the percentage of costs that have been incurred to-date (column B) to total expected costs. For each job, Billings (i.e., actual to-date billings) are compared to Costs & Profits (i.e., actual to-date costs plus estimated to-date profits) and, depending on which amount is higher, the difference is shown in column K (Billings in excess of Costs & Profits) or L (Cost & Profits in excess of Billings). At the bottom on the schedule, a net balance for all uncompleted jobs for the company is calculated. An adjusting entry is necessary to properly recognize earned revenue and adjust the construction related current liability (Billings in excess of Costs and Profits) or current asset (Costs and Profits in excess of Billings) on the balance sheet.

When the net balance on the percentage-of-completion schedule is Costs & Profits in excess of Billings, revenue is understated. The adjusting entry is to credit revenue and the corresponding debit is to Costs & Profits in excess of Billings (a current asset similar to inventory). Using Ellison's Panel A, the balance sheet should reflect a current asset, Costs & Profits in excess of Billings, in the amount of $33,130.

When the percentage-of-completion schedule results in Billings in excess of Costs & Profits (e.g., Ellison's Panel B), revenue is overstated. The adjusting entry is to debit revenue and the corresponding credit is to Billings in excess of Costs & Profits (a current liability similar to unearned revenue).

Change Orders for Long-Term Contracts.

When a customer makes a change to an existing long-term contact, a change order is created. Additional revenue and costs are frequently associated with a change order. When accounting for change orders, you must determine if the change order is a modification of an existing performance obligation or a separate performance obligation. This determination is the same process that is used to identify performance obligations for the initial contract. For example, if the change order is to change the color of paint on the walls or to add a wall to a building in the initial contract, the change order is most likely a modification of a performance obligation because the color of wall paint or an additional wall is not distinct and independent from the initial building. On the other hand, the addition of a fence or parking lot would likely be a separate performance obligation because each of these are distinct and independent from the initial building. If the change order is a modification of an existing performance obligation, the existing job on the percentage-of-complete schedule must be updated to reflect any additional expected total revenue (column C) and/or estimated total costs (column D) related to the change order. If the change order is a separate performance obligation, a new job must be added to the percentage-of-completion schedule with the expected total revenue and estimated total costs.

Accounting Errors.

Using the percentage-of-completion schedule for Ellison Construction, Inc., notice that Job 5084 on Panel A results in 114% complete which means 114% of estimated total costs have been spent to-date. This example corresponds with the problem in the case study. If you are working on a job, how can the job be more than 100% complete? There must be an error.

The schedules for Ellison present two examples of accounting errors with change orders. First, on Panel A, assume that Job 5084 was modified for a change order with expected revenue of $36,000 which was properly recorded and estimated cost of $15,000 which was not recorded. Since the revenue was properly recorded, the expected total revenue of $120,000 (column C) includes the $36,000 for the change order. However, the estimated total costs of $70,000 (column D) does not include $15,000 for the change order. The percentage complete (column B) is determined by calculating actual to-date costs (column E) as a percent of estimated total costs (column D) resulting in 114% complete for Job 5084 ($80,000 / $70,000). The percentage complete is overstated resulting in an overstatement of revenue on the income statement and Costs & Profits in excess of Billing on the balance sheet.

On Panel B assume Job 5084 is correct on the percentage-of-completion schedule for Ellison. The estimated total costs (column D) are increased to $85,000 ($70,000 in Panel A plus $15,000 for the change order) and the percentage complete decreases to 94% ($80,000 / $85,000). The correction results in a decrease in revenue recognized of $24,100 ($57,000 in Panel A column G less $32,900 in Panel B column G) and a decrease in current assets. The journal entry to correct this error would be as follows:

Revenue from Construction Contracts	24,100	
Costs & Profits in excess of Billings		24,100

The opposite omission could occur in the accounting system. Assume the estimated cost associated with the change order is properly recorded, but the expected revenue is not recorded. Using Ellison's job 5085, assume the job included a change order that is considered a modification of the original contract with expected revenue of $10,000 and estimated costs of $8,000. On Panel B, assume estimated costs of $8,000 were properly recorded and expected revenue of $10,000 was not recorded. Since estimated costs were properly recorded, the estimated total costs of $78,000 (column D) includes the $8,000 for the change order. However, the expected revenue of $80,000 (column C) does not include the $10,000 for the change order.

On Panel A assume Job 5085 is correct on the percentage-of-completion schedule. The expected revenue (column C) is increased to $90,000 ($80,000 in Panel B plus $10,000 for the change order). Using cost as the basis to determine the percentage complete, the job continues to be 16% complete ($12,480 / $78,000), but the estimated to-date profits increases by $10,000. The correction results in an increase in revenue recognized of $1,600 ($1,920 in Panel A column G less $320 in Panel B column G) and a decrease in current liabilities. The journal entry to correct this error in reporting would be as follows:

Billings in excess of Costs & Profits	1,600
Revenue from Construction Contracts	1,600

APPENDIX B (continued) – EXAMPLE PERCENTAGE-OF-COMPLETION SCHEDULES (FOR STUDENTS)

Panel A

Ellison Construction, Inc.
Percentage-of-Completion Schedule
December 31, 2020

	Job	**% Complete (Based on Costs)**	**Expected Total Revenue**	**Estimated Total Costs**	**Actual To-Date Costs**	**Estimated Total Profits**	**Estimated To-Date Profits**	**Costs & Profits (C&P)**	**% Billed**	**Actual To-Date Billings**	**Billings in excess of C&P**	**C&P in excess of Billings**
	A	B	C	D	E	F	G	H	I	J	K	L
	Formula	E/D				C-D	F*B	G+E	J/C		J-H	J-H
	5076	67%	$ 65,000	$ 45,000	$ 30,000	$ 20,000	$ 13,400	$ 43,400	77%	$ 50,000	$ 6,600	
	5079	59%	210,000	170,000	100,400	40,000	23,600	124,000	55%	115,000		9,000
	5083	6%	159,000	123,500	6,900	35,500	2,130	9,030	10%	15,900	6,870	
*	**5084**	114%	120,000	**70,000**	80,000	50,000	57,000	137,000	90%	108,000		29,000
*	**5085**	16%	**90,000**	78,000	12,480	12,000	1,920	14,400	7%	6,000		8,400
	5086	4%	25,000	20,000	800	5,000	200	1,000	3%	800		200
		46%	$ 669,000	$ 506,500	$ 230,580	$ 162,500	$ 98,250	$ 328,830	44%	$ 295,700	$ 13,470	$ 46,600

C&P in excess of Billings $ 33,130

Panel B

Ellison Construction, Inc.
Percentage-of-Completion Schedule
December 31, 2020

	Job	**% Complete (Based on Costs)**	**Expected Total Revenue**	**Estimated Total Costs**	**Actual To-Date Costs**	**Estimated Total Profits**	**Estimated To-Date Profits**	**Costs & Profits (C&P)**	**% Billed**	**Actual To-Date Billings**	**Billings in excess of C&P**	**C&P in excess of Billings**
	A	B	C	D	E	F	G	H	I	J	K	L
	Formula	E/D				C-D	F*B	G+E	J/C		J-H	J-H
	5076	67%	$ 65,000	$ 45,000	$ 30,000	$ 20,000	$ 13,400	$ 43,400	77%	$ 50,000	$ 6,600	
	5079	59%	210,000	170,000	100,400	40,000	23,600	124,000	55%	115,000		9,000
	5083	6%	159,000	123,500	6,900	35,500	2,130	9,030	10%	15,900	6,870	
*	**5084**	94%	120,000	**85,000**	80,000	35,000	32,900	112,900	90%	108,000		4,900
*	**5085**	16%	**80,000**	78,000	12,480	2,000	320	12,800	8%	6,000		6,800
	5086	4%	25,000	20,000	800	5,000	200	1,000	3%	800		200
	5087	31%	100,000	80,000	25,000	20,000	6,000	31,000	50%	50,000	19,000	
		42%	$ 759,000	$ 601,500	$ 255,580	$ 157,500	$ 78,550	$ 334,130	46%	$ 345,700	$ 32,470	$ 20,900

Billings in excess of C&P $ 11,570

APPENDIX C – ANSWERS TO CASE REQUIREMENT #2 & #5 (FOR INSTRUCTORS)

Case Requirement #2 - Corrected Percentage-of-Completion Schedule for Blue Gilia

Blue Gilia Construction, Inc.
Percentage-of-Completion Schedule
December 31, 2020

Job	% Complete (Based on Costs)	Expected Total Revenue	Estimated Total Costs	Actual To-Date Costs	Estimated Total Profits	Estimated To-Date Profits	Costs & Profits (C&P)	% Billed	Actual To-Date Billings	Billings in excess of C&P	C&P in excess of Billings
A	B	C	D	E	F	G	H	I	J	K	L
Formula	E/D				C-D	F*B	G+E	J/C		J-H	J-H
AEI-2101	25%	$ 72,300	$ 57,000	$ 14,448	$ 15,300	$ 3,878	$ 18,326	33%	$ 23,700	$ 5,374	
ANA-0119	63%	20,400	16,500	10,410	3,900	2,461	12,871	49%	10,000		$ 2,871
ARA-1801	46%	32,800	26,500	12,199	6,300	2,900	15,099	55%	18,000	2,901	
AZU-2501	68%	22,400	18,600	12,682	3,800	2,591	15,273	71%	16,000	727	
BRO-1601	77%	18,500	14,800	11,326	3,700	2,832	14,158	43%	8,000		6,158
CAP-2020	14%	10,350	8,500	1,192	1,850	259	1,451	24%	2,500	1,049	
CAP-2005	55%	46,000	38,000	20,873	8,000	4,394	25,267	52%	24,000		1,267
CHA-2209*	95%	78,000	54,800	52,000	23,200	22,015	74,015	90%	70,000		4,015
CHR-2201	9%	92,000	74,000	6,875	18,000	1,672	8,547	10%	9,500	953	
CIT-0202	54%	10,000	8,900	4,792	1,100	592	5,384	40%	4,000		1,384
COC-2201	72%	11,300	9,350	6,700	1,950	1,397	8,097	44%	5,000		3,097
CRO-1801	23%	91,800	75,200	17,553	16,600	3,875	21,428	20%	18,000		3,428
ENE-1701	63%	11,250	9,350	5,902	1,900	1,199	7,101	64%	7,200	99	
ENE-3503	7%	46,500	38,200	2,660	8,300	578	3,238	8%	3,500	262	
FIT-0401	58%	8,000	6,800	3,966	1,200	700	4,666	38%	3,000		1,666
GEC-1801	75%	45,600	37,500	28,199	8,100	6,091	34,290	83%	38,000	3,710	
GLO-2501	12%	177,200	145,000	17,762	32,200	3,944	21,706	15%	26,000	4,294	
LOC-0116	78%	9,400	7,520	5,885	1,880	1,471	7,356	53%	5,000		2,356
MOR-0301	70%	18,500	15,500	10,849	3,000	2,100	12,949	86%	16,000	3,051	
NOR-1924	70%	9,100	7,100	4,997	2,000	1,408	6,405	43%	3,876		2,529
NOR-5627	45%	16,000	15,200	6,822	800	359	7,181	53%	8,500	1,319	
RET-2501	51%	95,500	76,500	39,056	19,000	9,700	48,756	42%	40,000		8,756
STI-0101	62%	15,800	12,700	7,816	3,100	1,908	9,724	50%	7,900		1,824
USO-3201	75%	42,300	33,850	25,316	8,450	6,320	31,636	78%	32,800	1,164	
VIS-3302	63%	56,000	45,000	28,531	11,000	6,974	35,505	65%	36,649	1,144	
WES-2401	49%	47,000	37,600	18,528	9,400	4,632	23,160	38%	18,000		5,160
	42%	$ 1,104,000	$ 889,970	$ 377,339	$ 214,030	$ 96,250	$ 473,589	41%	$ 455,125	$ 26,047	$ 44,511

C&P in excess of Billings $ 18,464

Case Requirement #5 - Memorandum to Mike Watson

To: Mike Watson

From: (Various names)

Subject: Internal Control Recommendations

Thank you for including me in the meeting with your team as you evaluate the company's current accounting practices and make changes to strengthen the company's internal controls. The following suggestions will improve internal control procedures and increase the reporting accuracy for Blue Gilia.

I would suggest that you have your accounting department document their existing procedures for recording jobs and change orders. They should give special thought to each step to determine the performance obligations and record the job's revenue and cost information from the initial contract to the final closing of each job. This will help you identify areas that may lack internal controls as you develop a better method to ensure that there are no errors in reporting. It is necessary to have proper written documentation, appropriate authorization for each step, and a separation of duties to verify the integrity of the process. Each expenditure on contracts, including change orders must have the customer signature for approval and proper authorization before disbursement of funds.

It would be useful to develop a checklist and require a supervisor to review and sign to ensure that the appropriate procedures and authorizations are in place and properly implemented. I would be happy to help you develop the checklist and review the system of internal controls if needed.

I look forward to working with you during this time of transition. Please let me know if you have questions or would like to schedule a meeting to discuss the issues in greater detail.

Thank you.

APPENDIX D – SUGGESTED GRADING RUBRIC FOR CASE REQUIREMENTS (FOR INSTRUCTORS)

Quality / Requirement	Unacceptable	Rudimentary	Good	Exemplary
Performance obligation	Fails to present a position, provide examples and/or discuss effects on revenue recognition	Presents a position but provides limited examples or examples that are inconsistent with position; discusses some effects on revenue recognition	Presents a position and provides examples consist with position; discusses impact on revenue recognition	Presents a position, provides comprehensive examples recognizing distinctions of impact on revenue recognition
Corrected percentage-of-completion schedule	Fails to make corrections to the percentage-of-completion schedule	Updated percentage-of-completion schedule includes limited corrections	Updated percentage-of-completion schedule includes most corrections	Updated percentage-of-completion schedule includes all corrections
Impact to financial statements	Fails to identify impacts to financial statements	Identifies limited impacts to financial statements; limited accounts and/or amounts are included	Identifies key impacts to financial statements; most accounts and amounts are included	Impact to financial statements is comprehensively explained; includes accounts and amounts
Internal control weaknesses and procedures	Fails to identify weaknesses and recommend procedures	Identifies limited weakness; provides limited recommended procedures or procedures that do not adequately address the related weakness	Identifies key weaknesses and recommends procedures that appropriately address the related weakness	Identification of weaknesses is comprehensive and recommendations on procedures abundantly address the related weakness
Memo	Main points are not presented and/or supported.	Not communicated reasonably well; logical flow is missing; some points are presented are not adequately supported	Communicated reasonably well; logical flow; some main points presented and supported.	Communicated logically and comprehensively; main points are presented and supported.