AJ-11
Revenue Recognition, Consultant Accruals and the importance of the Matching Principal

Merrigan Smith, Deltek
Amanda de Jong, Deltek
Morrigan Smith,
Functional Delivery Lead

Former CFO
• 15 years in AEC industry

At Deltek
• Ajera Delivery Lead – developing Deltek’s staff to better serve our clients
• Principal Consultant - implemented 200+ successful Ajera implementations
• Ajera Workshops – development and training to improve financial and project reporting management
Amanda de Jong, Solution Architect

» Results oriented professional with over 12 years experience in the A/E industry. (8+ years at Deltek)

» Specializes in business consulting, financial reconciliation, solution/custom workflow development, and software implementation.

» Offers a variety of skills in financial analysis, project management, budget preparation and management, productivity and utilization metrics analysis, process improvement, change management, and cash flow management.

» Bachelors of Administration, Finance & Accounting, University of Toledo, Toledo, OH.
Many A/E firms are filing their taxes on a cash basis and don’t always focus on the benefits of accrual accounting. In this session we take a deep dive into this core accounting principal (The Matching Principal) and how we can apply this in our day to day use of Ajera for Clarity in our reporting.

BONUS: Two reports / widgets covered during this course will be available to download at Insight (Insight exclusive!).
Accrual Accounting

Accrual accounting provides more accurate picture for making business decisions

✔ You recognize income when you have a right to that income (you bill a client)

✔ You recognize expense when you incur a debt (you receive a vendor invoice)

✔ You do not wait until funds are actually exchanged before you recognize the transaction
Accrual Accounting: Key Elements

Revenue Recognition
Matching Principle
Time Period Assumption
Revenue Recognition

✓ The revenue recognition principle is a cornerstone of accrual accounting together with the matching principle. They both determine the accounting period in which revenues and expenses are recognized.

✓ According to the principle, revenues are recognized when they are realized or realizable, and are earned (usually when goods are transferred or services rendered), no matter when cash is received.
Benefits of Revenue Recognition

» More reliable financial analysis and decision making tool with valid comparisons to prior periods and benchmarks
» Complies with GAAP accounting standard requirements
» Financial reports have more credibility with financial institutions and investors
» Positions the organization for future growth
» Allows for feedback on how things are going from the range of people involved in the organization
» Provides a more accurate and fair representation of the financial position and performance of the firm
» Provides the ability to recognize what is going well and what is not allowing you to take action
Matching Principal  “the best underlying guideline in accounting”

<table>
<thead>
<tr>
<th></th>
<th>The matching principle directs a company to report an expense on its income statement in the period in which the related revenues are earned. Further, it results in a liability to appear on the balance sheet for the end of the accounting period. The matching principle is associated with the accrual basis of accounting and adjusting entries.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>If an expense is not directly tied to revenues, the expense should be reported on the income statement in the accounting period in which it expires or is used up. If the future benefit of a cost cannot be determined, it should be charged to expense immediately.</td>
</tr>
</tbody>
</table>
Time Period Assumption

The accounting guideline that allows the accountant to divide up the complex, ongoing activities of a business into periods of a year, quarter, month, week, etc. The precise time period covered is included in the heading of the income statement, statement of cash flows, and the statement of stockholders' equity.
Accounting Date & Closing Periods

Accounting Date
» The accounting date is the date that determines the period in which an entry appears on a financial statement

Don’t Allow Entries Prior To
» Prevents accounting entries to post to the general ledger dated before this date. This is how accounting periods are closed in Ajera.
How Ajera assigns accounting dates

**NEW ENTRIES**
Accounting date is based on the date of the transaction.

**Changing EXISTING ENTRY**
Ajera uses the original accounting date to record the reversing entries and the new entries.

**Enter ACCOUNTING DATES**
Feature that allows you enter the accounting date of your choice when modifying an existing entry.
Let’s Check Ajera!

» Make sure the ‘Enter accounting dates’ checkbox is selected in your database.

» Update the ‘Don’t allow entries prior to’ to close your prior periods to ensure financial reporting consistency and integrity.
Revenue Recognition &
The Matching Principal
Revenue Recognition in Ajera

Methods
- Billed + WIP (Standard)
- None
- Percent of Contract
- Formula
- Billed
- Formula Plus WIP

Additional Options
- Cap WIP at Contract using Adjustments
- Cap WIP at Contract using Write-offs

*Defined in Company Preferences*
Billed Plus WIP is the default revenue recognition method in Ajera.

Work-In-Progress (WIP) is the billable time and expenses that have not yet been included on a final client invoice. It is an AEC companies ‘inventory’.
The Matching Principle
Revenue Recognition: Billed Plus WIP

» **Time & Expense Billing Type**, applies the Matching Principle automatically (see diagram on next slide)

» It is important to remember if WIP is crossing between periods to review the Work-In-Progress Aging Report in Ajera. This should be run prior to the close of the current period and after billing is completed to ensure the WIP accrued is valid and accurate.

» Valid and accurate WIP is defined as the ability to bill for this in the next period at the value that is accrued / shown in the WIP detail. If you have concerned that the full balance will not be able to be invoiced in the following period(s), then ‘Write-off’ or change the status to ‘Nonbillable’. *See Appendix for Deltek’s recommendation on when to use ‘Write-off’ and ‘Nonbillable’ in Ajera.*
The Matching Principle
Revenue Recognition: Billed Plus WIP

January
Matching Principal - Expense and Revenue in the same period

- Timesheet Recorded
  - Expense Recognized
  - Increase WIP Revenue

February
*Ideally a net zero effect on Revenue

- Consultant / Expense Recorded
  - Expense Recognized
  - Increase WIP Revenue

- Decrease WIP Revenue
- Income Billed Revenue
The Matching Principle
Revenue Recognition: Billed Plus WIP

» Fee Based Billing Types: Fixed Fee, Percent Complete, Unit Price, and Percent Construction the Matching Principle could need to be applied manually

» Labor Activity Type Billing

» If Labor is Billed in the same period the WIP was accrued no further action is typically required.

  » Unless a portion of the Labor should be deferred and billed in a future period, then defer and see second bullet.

» If Labor is Deferred or not billed until a future period, then validate the WIP accrual (like the recommendation for Time & Expense billing type) to confirm it does not exceed the projected/forecasted billable value in a future period.

» If you are billing the client in advance for services (not a prepayment / retainer), then consider changing the Revenue Recognition method to Percent of Contract to apply the Matching Principle.
The Matching Principle
Revenue Recognition: Billed Plus WIP

» Fee Based Billing Types continued

» Consultant Activity Type Billing

» Match the consultant WIP accrued with the actual amount billed in the period. If carrying over consultant WIP between periods, refer to the Labor recommendations and validate WIP accrual.

» In this scenario Labor billed percent could be out of alignment with the consultant percent billed. For instance 20% completion of Labor Billed and billing 10% of Consultant fee to align with the actual consultant WIP accrued to date.

» In lieu of finalizing a client invoice in lock-step with consultant expense:

» Option 1: Apply the Percent of Contract Revenue Recognition Method (optimal option)

» Option 2: Enter a manual journal entry at month end and reverse the following month utilizing the Commitment Management report for the Over / Under recognition of consultant cost to revenue recognition using contract accounts
The Matching Principle
Revenue Recognition: Billed Plus WIP

» Fee Based Billing Types continued

» Expense Activity Type Billing

» Frequently this is excluded from the fee and treated like Time & Expense billing (reimbursable expense), in cases where it is built into the fee:

» IF material in value then follow the Consultant Activity Type recommendation

» IF not material in value, then follow the Labor Activity Type recommendation
The Matching Principle
Revenue Recognition: Billed Plus WIP

» **Fee Based Billing Types** continued

» When setting up your Contract Amount in the Project Command Center, it is important to breakout the Activity Types: Labor, Expense & Consultant.
The Matching Principle
Revenue Recognition: Billed Plus WIP

» **Fee Based Billing Types** continued

» Below is an example of when the Project is setup with the Activity Type breakdown as shown in the prior slide, the Billing Amount can be allocated to this level when creating the Client Invoice in Ajera allowing greater transparency to apply the Matching Principle.
Percent of Contract

*Percent of Contract* is used if you are progress billing, where the amount you bill may not correspond with the actual percent of work completed.

- Ajera creates revenue entries when you print final invoices and then adjusts the entries by multiplying your revenue percent completed with the contract amount.
Percent of Contract

» When using percent complete as the revenue recognition method, you are able to adjust revenue up/down to match the spent/earned value

» This will create under billed/over billed entries on your balance sheet to account for the difference between the billed amount and the amount recognized in revenue
Consultant Accruals
## Consultant Accruals

| » A **consultant accrual** is a journal entry that is used to record a company's expenses to the general ledger in the period that the expense was incurred or consumed, regardless of when the cash is paid or the invoice is billed. |
| » Since expense accruals also represent a company's obligation to make future cash payments, they are shown on a company's balance sheet as a liability. |
Commitment Management

» *Commitment management* is a feature in Ajera for tracking amounts budgeted and paid to a consultant for a project. You can review the status of consultant budget items as you enter the associated vendor and client invoices.

» Your budget consultant and expense costs and fees are tracked directly to the project and phases. Tracking consultant and expense contracts from the beginning of the project gives you an accurate picture of your commitments at each phase. You can even track multiple consultant and expense contracts for one project and phase.

» Ajera automatically verifies invoices to the consultant and expense cost budget and generates warning notices to ensure that you are not overbilled and that projects stay within budget.
Commitment Management

» Use this report to compare consultant and expense budgets to the amount that has been invoiced and paid. You can drill down in the report to see vendor and client invoices, payments, and receipts for a given budget item.
Connect with Ajera at Xpo Booth

» Discuss options for connecting with experts across all Deltek software
» One provider of all things Deltek
» Certified team of consultants
» Deeper level of project governance
» Get information on how to get more out of your Deltek investment
Thank you!

Morrigan Smith – MorriganSmith@Deltek.com
Amanda De Jong - AmandaDeJong@deltek.com
Next Steps

1. Complete the session survey in the mobile app.
2. Utilize the Post-Event Toolkit to share what you’ve learned.
3. You can download Continuing Education credit information from your certificate hub link. The link is in the mobile app and will be emailed to you after the conference.

Downloading Presentations?

- Available presentation PDFs are in the Insight Attendee Portal (Schedule Builder) and in the mobile app.
- Online and mobile app access to this year’s presentations expires on March 1, 2020.
Appendix: Revenue Recognition – Recognizing WIP

**Balance Sheet Accounts**
- Work-In-Progress Labor
- Work-In-Progress Expense
- Work-In-Progress Consultant

**Income Statement Accounts**
- Unbilled Professional Services
- Unbilled Expenses
- Unbilled Consultant
- Professional Fees Write-off
- Expense Write-off
- Consultant Write-off
Appendix: What happens when WIP is Billed?

Example

The 10 hours, $2,000 WIP is billed and finalized on an invoice as **Time and Expense**

Reverse to clear the WIP that is billed
- **Debit:** Unbilled Professional Fees revenue account for $2,000.00
- **Credit:** Work-In-Progress Labor asset account for $2,000.00

Record the revenue generated by the billing
- **Debit:** Accounts Receivable asset account for $2,000.00
- **Credit:** Billed Professional Fees revenue account for $2,000.00
Appendix: What happens when WIP is Billed?

Example

The 10 hours, $2,000 WIP is billed and finalized on an Fixed Fee invoice for $1,000

Reverse to clear the WIP that is billed

- **Debit:** Unbilled Professional Fees revenue account for $2,000.00
- **Credit:** Work-In-Progress Labor asset account for $2,000.00

Record the revenue generated by the billing

- **Debit:** Accounts Receivable asset account for $1,000.00
- **Credit:** Billed Professional Fees revenue account for $1,000.00
Appendix: What happens when WIP is Nonbillable?

Example

The 10 hours, $2,000 WIP is changed to Nonbillable

Reverse to clear the WIP that is Nonbillable

- **Debit:** Unbilled Professional Fees revenue account for $2,000.00
- **Credit:** Work-In-Progress Labor asset account for $2,000.00

Reallocate the salary expense from Billable to Nonbillable

- **Debit:** Nonbillable Salaries at cost
- **Credit:** Billable Salaries at cost
Appendix: What happens when WIP is Write-off?

Example

The 10 hours, $2,000 WIP is changed to Write-off

Reverse to clear the WIP that is a Write-off
- **Debit**: Professional Fees Write-off revenue account for $2,000.00
- **Credit**: Work-In-Progress Labor asset account for $2,000.00

The cost of the salary remains Billable Salaries, there is no reallocation of cost.
Appendix: What’s the Difference?

Write-off v. Nonbillable

**Write-off** *(more common)*

» The Spent amount & Cost amount remains, but the Billed amount is zero, thus showing as a write-off on reports

» Typically, you write off amounts that cannot be billed for reasons beyond the company’s control, but you still want to track the potential earnings on the project.

**Nonbillable** *(less common > never)*

» The Cost amount remains, but the Billed and Spent amount is zero

» Typically, you use Nonbillable for non-replicable mistakes. It can also be used for capturing costs for administration or marketing to your project that your contract does not allow.

Proper usage of **Write-off** & **Nonbillable** is important regardless of revenue recognition method.
Appendix: Negative (Unbilled Income) = Bad?

Why negative Unbilled Income is actually Good

<table>
<thead>
<tr>
<th>January</th>
<th>February</th>
<th>March</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Unbilled Professional Fees</strong>&lt;br&gt;Accrue $100,000</td>
<td><strong>Unbilled Professional Fees</strong>&lt;br&gt;Accrue $100,000</td>
<td><strong>Unbilled Professional Fees</strong>&lt;br&gt;Accrue $100,000</td>
</tr>
<tr>
<td>Billed Professional Fees $80,000&lt;br&gt;Unbilled Professional Fees $20,000</td>
<td>Billed Professional Fees $90,000&lt;br&gt;Unbilled Professional Fees $10,000</td>
<td>Billed Professional Fees $130,000&lt;br&gt;Unbilled Professional Fees $-30,000</td>
</tr>
<tr>
<td><strong>Total Revenue $100,000</strong></td>
<td><strong>Total Revenue $100,000</strong></td>
<td><strong>Total Revenue $100,000</strong></td>
</tr>
</tbody>
</table>
Appendix: Revenue Recognition – Percent of Contract

» Setup by Project
  » Turned-on in +Company > Preferences on the Project tab by checking the Percent of Contract checkbox under ‘Additional Revenue Methods’
  » This is then assigned individually in the Project Command Center on the Revenue tab by Project > Phase.
To use commitment management, you perform these tasks:

- Turn on consultant budgets and/or Turn on expense budgets.
- Set up a consultant or an expense budget.
- Track consultant insurance, if needed.
- Verify invoice distributions to cost budgets.

Produce the Commitment Management report and the Resource inquiry to view the status of your consultant and expense budgets. You can compare your consultant and expense budgets with what’s been invoiced and paid.
Accounting Period Lifecycle

1: Record daily operational financial transactions
2: Reconcile accounting system modules and subsidiary ledgers
3: Record monthly journal entries
4: Reconcile balance sheet accounts
5: Review revenue and expense accounts
6: Prepare financial statements
7: Mgmt. review (of financial statements)
8: Close accounting system for the month
Ajera 8-Step Reconciliation Process

Step 1: Reconcile Trial Balance
Verify the Report Totals to Zero

Step 2: Reconcile Cash Accounts
- Reconcile Bank Statement
- Verify Bank Reconciliation ties to Accrual and Cash Trial Balance

Step 3: Reconcile Accounts Receivable
- Run Client Invoice Aging by Accounting Date
- Compare this to the Accounts Receivable balance Accrual Trial Balance

Step 4: Reconcile Prepayments
- Run the Client Invoice Aging report by Accounting Date and review the last column ‘prepayments’
- Compare this balance to the Trial Balance for Prepayments
Ajera 8-Step Reconciliation Process

**Step 5  Reconcile Work-in-Progress**
- Run the Work In Progress Aging Report & Sort by Activity Type
- Compare the balances to the Work In Progress balances on the Accrual Trial Balance

**Step 6  Reconcile Accounts Payable**
- Run the Vendor Invoice Aging report by Accounting Date
- Compare the balance to the Accounts Payable balance on the Accrual Trial Balance

**Step 7  Reconcile Salaries Payable**
- Run the Salaries Payable Balance report
- Compare the balance to the Salaries Payable balance on the Accrual Trial Balance
Ajera 8-Step Reconciliation Process

Step 8 (optional step)
Reconcile Gross Wages

- Used to verify your gross wages on the financials match what has actually been paid

Optional Step
*Reconcile Revenue

- Run the Client Invoice Register report by Accounting Date
- Compare the activity to the Accrual Profit and Loss Income Accounts
  - Labor, Expense & Consultant