

Profit Recognition with Costs Charged Directly to Profit and Loss Account

By Richard Berry

WE1 Editor's Note: When Richard Berry first wrote about Profit Recognition, he gave us a detailed view from the "normal" setup, which included charging project costs to the Balance Sheet. But for some users—"normal" just wasn't going to cut it; they needed a way to charge directly to the Income Statement. So, Richard's back, this time to compare both methods, and the when and where you'll want to use the "alternative" method.

Introduction

In my article, "Job Cost Profit Recognition," April, 2005, in the JDEtips Document Library, I provided the full details of how to set up and run Profit Recognition. However, I have recently come across several users that wanted to account for project costs by charging them directly to the Income Statement. I've mentioned before in training classes that it could be done this way, but had never actually met a user that wanted to do it in a big way. This article is the result of an implementation experience at one such client.

The standard JD Edwards® way of accounting for Work-in-Progress is to create detailed cost and billings accounts in the Balance Sheet. When profit recognition is calculated, the WIP in the Balance Sheet is relieved and the actual costs are transferred, in summary, to the Income Statement. Depending on the recognition method used (percent of revenue or percent of cost), a provision is then made to adjust actual cost or billings to recognized cost and revenue. An "underbilling" or "overbilling" will result. If there is a projected

loss, the full amount of the loss will be accounted for immediately. These are the "normal" accounting entries created when profit recognition is computed. "Normal", that is, if we follow the standard setup in the demo junior and per the explanations in the training manuals.

But, what's not widely known is that JD Edwards can work the other way around. That is to say, direct costs and billings can be charged directly to Income Statement, and then adjusting entries can be computed to convert actual cost and billings to recognized cost and revenue. There is some value to following this method. Additionally, both methods can coexist on the same system, provided they are used by different companies. One company can use one method; another company can use the other method.

It makes sense to charge all costs directly to Income Statement for a variety of reasons.

For the purposes of this article, we will simply call these two methods:

Method 1: The standard JDE method of putting project costs into WIP in the Balance Sheet

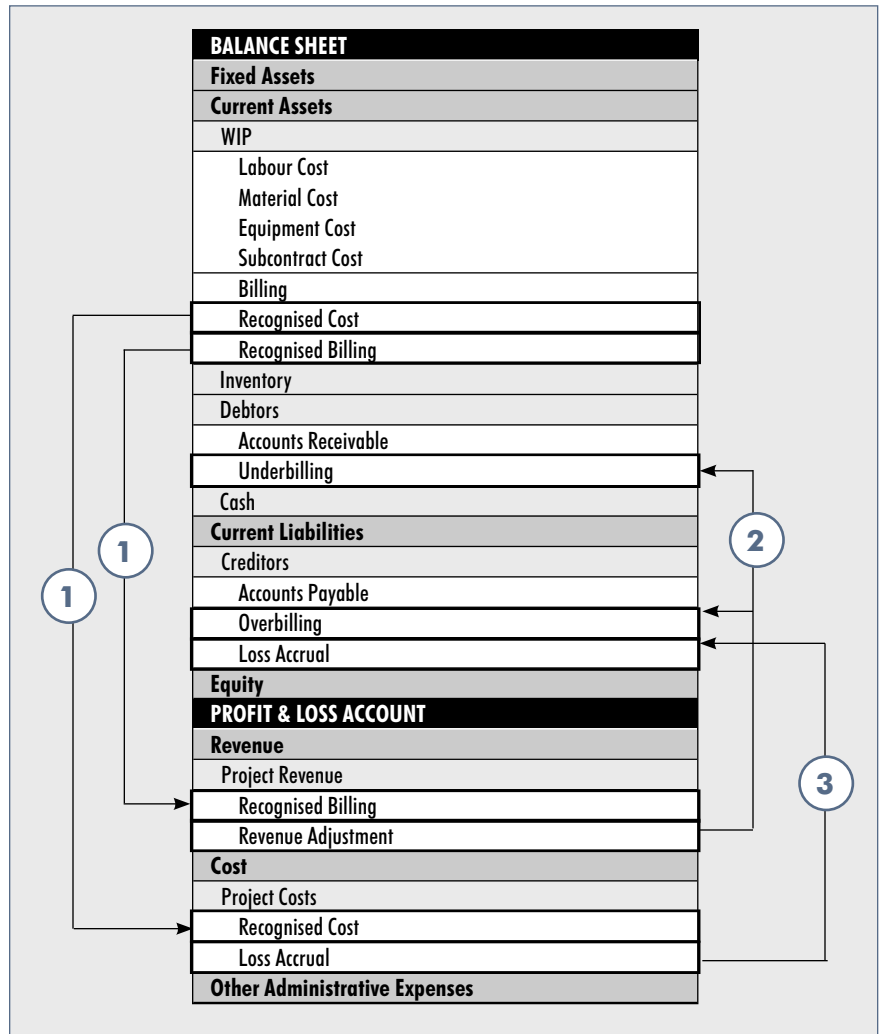
Method 2: The alternative method (still supported by JDE) of putting project costs directly into the Income Statement

Some reasons for selecting Method 2 are:

- Some companies use JDE Job Cost to monitor thousands of jobs. Some jobs can be short, some long. It makes sense to charge all costs directly to Income Statement for a variety of reasons. It is different for companies that handle a few large projects at a time. In such situations, where projects may span several years, it makes more sense to put actual costs into the Balance Sheet.
- Profit recognition accounting entries are simpler using Method 2. This is because actual costs and billings do not need to be transferred to Income Statement, because they are already there.
- For companies where there is a large element of intercompany charging, it would be necessary to carefully separate intercompany and third party costs, billings, and revenues. It would be easier to do this right from the beginning, rather than having to replicate the split during profit recognition. To put this another way, under Method 1, if we put intercompany costs and

third party costs into separate accounts in WIP, we must make very sure that we preserve this split when we recognize costs. The Income Statement must also show the split between intercompany and third party costs. This can be done, of course, if we set our AAIs correctly, but it would obviously be simpler if it were done only once.

The big disadvantage of Method 2 is that if project costs are put directly into P&L, they will not be carried forward to the next year. This is not a problem for the Job Status Inquiry, nor is it a problem for the Profit Recognition File Build Program (R51800). It does become a problem in the General Ledger where cumulative project cost reports may be required. For this reason, for large and long running projects that cross financial years, it is better to follow standard JDE practice (Method 1) and put project costs into the WIP section in the Balance Sheet.



Method 1

Under Method 2, costs and billings are put directly into the Income Statement.

As already mentioned, for short duration jobs, users may not feel that this is a disadvantage. Under Method 2, the balance sheet will contain a summarized provision for WIP costs.

Let's illustrate the principles of these two methods, using the percentage of cost recognition policy.

Method 1: Project expenses in the Balance Sheet

Under Method 1, the general principle is that WIP is completely "relieved" and transferred to the Income Statement. That is, after profit recognition, the total of the

WIP section should be zero. Any difference between actual cost/revenue and recognized cost/revenue would appear as underbilling or overbilling. The loss accrual, if relevant, is a separate calculation.

Method 2: Project expenses in the Income Statement

Under this method, costs and billings are put directly into the Income Statement. The only thing necessary is to calculate the revenue adjustment (if the percentage of cost policy is used) and the loss accrual, if relevant.

This Article Continues...

Subscribers, log in from our main search page to access the full article:

www.JDEtips.com/MyAccess.html

Not a Subscriber? Gain access to our full library of JDE topics:

www.JDEtips.com/JD-Edwards-Library

Visit www.JDEtips.com for information on the JDEtips University schedule, private training and consulting, and our Knowledge Express Document Library.

License Information: The use of JDE is granted to JDEtips, Inc. by permission from J.D. Edwards World Source Company. The information on this website and in our publications is the copyrighted work of JDEtips, Inc. and is owned by JDEtips, Inc.

NO WARRANTY: This documentation is delivered as is, and JDEtips, Inc. makes no warranty as to its accuracy or use. Any use of this documentation is at the risk of the user. Although we make every good faith effort to ensure accuracy, this document may include technical or other inaccuracies or typographical errors. JDEtips, Inc. reserves the right to make changes without prior notice.

Oracle and J.D. Edwards EnterpriseOne and World are trademarks or registered trademarks of Oracle Corporation. All other trademarks and product names are the property of their respective owners.

Copyright © by JDEtips, Inc.