



**Wisconsin Contractors Institute**

# **ACCOUNTING BASICS FOR DWELLING CONTRACTORS**

**Course Number 961611  
3 CE Hours**

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## WHY IS ACCOUNTING IMPORTANT FOR CONTRACTORS?

Accounting is essential for general contractors to manage their finances effectively, comply with tax and legal requirements, track job costs, and make informed business decisions. Accurate accounting records are essential for achieving these goals and ensuring the long-term success of a contractor's business.

The most important areas of consideration are financial management, tax compliance, job costing, budgeting, and forecasting, financial reporting, and legal compliance.

At the end of this course, construction professionals will be able to:

1. Review debits and credits associated with general contractors and demonstrate the ability to document both.
2. Understand cash flow and financial statements associated with general contractors and discuss the benefits associated with different financial statements.
3. Define interest rate and interest carry as it relates to general contractors and examine its effects and consequences for general contractors.
4. Identify three common accounting methods and discuss the benefits associated with the use of each method for general contractors.



### Financial Management

Accounting allows general contractors to manage their finances more effectively. By keeping accurate records of income and expenses, contractors can understand their cash flow, identify areas where they can cut costs, and make informed business decisions.

Financial management also enables contractors to secure financing for their projects. In order to secure financing from banks, investors, or other sources, contractors must demonstrate that they have a solid financial foundation and can manage their finances effectively. By doing so, contractors can demonstrate to lenders and investors that they are financially stable and capable of repaying loans or generating returns on investments.

Proper financial management also enables contractors to manage their working capital effectively, which is essential for the success of any business. Working capital refers to the funds that a business has available to pay for day-to-day expenses, such as materials and labor costs. Without adequate working capital, contractors may be unable to complete projects or meet their financial obligations.

By managing their finances effectively, contractors can improve their chances of securing financing, manage their working capital more effectively, and ensure the long-term success of their businesses. This is why financial management is an essential component of accounting for general contractors.

### Tax Compliance

Contractors are subject to various taxes, including income tax, payroll tax, and sales tax. Proper accounting ensures that contractors are complying with tax laws and regulations, reducing the risk of penalties and fines.

**Late Payment Penalty:** Contractors who do not pay their taxes on time may face a late payment penalty, which is typically a percentage of the unpaid tax amount.

**Underpayment Penalty:** Contractors who underestimate their tax liability may face an underpayment penalty. This penalty is typically a percentage of the amount of tax owed that was not paid on time.

**Failure to Pay Sales and Use Tax:** Contractors in North Carolina are required to pay sales and use tax on certain purchases, such as building materials and supplies. If contractors fail to pay these taxes, they may face penalties, interest, and even criminal charges.

### Job Costing

Accounting is essential for job costing, which is the process of tracking the costs associated with a specific construction project.

**Understanding Project Profitability:** Job costing allows general contractors to track the costs associated with a particular construction project, such as materials, labor, and equipment costs. By understanding these costs, contractors can determine the profitability of a project and make informed decisions about resource allocation and pricing strategies.

**Accurate Estimating:** Job costing helps contractors develop more accurate estimates for future projects. By understanding the costs associated with similar projects, contractors can create more accurate bids and avoid cost overruns.

By tracking costs accurately, contractors can improve project profitability, develop more accurate estimates and budgets, manage resources more effectively, and comply with regulatory requirements.

### Budgeting and Forecasting

**Risk Management:** Budgeting and forecasting can help contractors manage risk by identifying potential financial challenges early. By forecasting future revenue and expenses, contractors can identify potential cash shortfalls or cost overruns before they occur. This information allows contractors to take action to address these issues before they become a problem, provides the information necessary for contractors to develop accurate budgets and forecasts for their business.

By creating a detailed budget for a project, contractors can determine the resources needed to complete the project, such as labor, equipment, and materials. Forecasting future resource needs can also help contractors plan for future projects and ensure they have the necessary resources to complete them.

**Improved Decision-Making:** Budgeting and forecasting provide contractors with the data needed to make informed business decisions. By analyzing financial data, contractors can identify areas where costs can be reduced or where investments should be made. This information can help contractors make better decisions that lead to increased profitability and long-term success.

**Managing Cash Flow:** Budgeting and forecasting are critical to managing cash flow. By creating a detailed budget for a project, contractors can estimate cash inflows and outflows, allowing them to plan for future cash needs. Forecasting cash flow can also help

contractors identify potential cash shortfalls and take action to address them.

## Financial Reporting

Financial reporting refers to the process of preparing and presenting financial information to internal and external stakeholders, such as investors, lenders, and regulators. Financial reports typically include financial statements, such as the balance sheet, income statement, and cash flow statement, as well as other reports that provide additional financial information about a company's operations, financial position, and cash flows.

The purpose of financial reporting is to provide stakeholders with accurate and timely information about a company's financial performance and to support decision-making. Financial reporting is an important component of financial management, as it provides the information necessary to make informed financial decisions. However, financial management involves a broader set of activities that go beyond financial reporting, such as budgeting, forecasting, and risk management.

## Legal Compliance

**Certified Payroll Reporting:** General contractors are often required to submit certified payroll reports for all public works projects. These reports must show the wages paid to each worker, including fringe benefits and deductions. Accurate accounting records are essential for preparing these reports and demonstrating compliance with this regulatory requirement. Proper accounting ensures that contractors are complying with these requirements and reducing the risk of legal issues.

**Sales Tax Compliance:** General contractors are often required to collect and remit sales tax on certain purchases, such as building materials and supplies. Accurate accounting records are essential for demonstrating compliance with this legal requirement and avoiding potential penalties and fines.

**Workers' Compensation Insurance:** General contractors are often required to carry workers' compensation insurance to protect their employees in case of injury or illness. Accurate accounting records are essential for demonstrating compliance with this legal requirement and ensuring that the appropriate premiums are paid.

## FINAL EXAM QUESTIONS:

- What is an important area in accounting for general contractors?**
  - Tax Compliance
  - Building Codes
  - Inspector Relationship
  - Site Evaluation
- Which term enables contractors to manage their working capital effectively, which is essential for any business?**
  - Tax Compliance
  - Legal Implications
  - Financial Management
  - Fiscal Literacy
- What allows general contractors to track the costs associated with a particular construction project, such as materials, labor, and equipment costs?**
  - Tax Compliance
  - Job Costing
  - Fiscal Literacy
  - Legal Implications
- Which of the following can help contractors manage risk by identifying potential financial challenges early?**
  - Budgeting and forecasting
  - Building codes
  - Legal implications
  - Tax Compliance
- Which of the following refers to the process of preparing and presenting financial information to internal and external stakeholders, such as investors, lenders, and regulators?**
  - Financial Management
  - Financial Literacy
  - Financial Estimating
  - Financial Reporting
- What is the key practice that helps contractors ensure they have enough funds to cover day-to-day operating expenses and manage their working capital effectively?**
  - Tax Compliance
  - Contract Negotiations
  - Financial Management
  - Safety Regulations

## TYPES OF CONTRACTS IN THE CONSTRUCTION INDUSTRY

There are several types of contracts that general contractors may use and accounting each one correctly is important. Each type of contract has its own advantages and disadvantages, and contractors may use different types of contracts depending on the specific needs and requirements of the project. Effective accounting and financial management practices are essential for managing costs and ensuring that the project remains profitable, regardless of the type of contract used. Types of contracts include fixed price contracts, cost-plus contracts, and time and materials contract.



## Fixed Price Contract

A fixed price contract is a type of contract where the contractor agrees to complete a project for a set price that is agreed upon BEFORE work begins. Under a fixed price contract, the contractor is responsible for completing the work within the agreed-upon scope, schedule, and budget, unless there is an agreed-upon change procedure. This condition should be defined in detail in the contract. Fixed price contracts are common in the construction industry, particularly for smaller projects such as residential remodeling or renovations. They are typically used when the scope of work is well-defined, and the project requirements are unlikely to change significantly during the project. However, fixed price contracts can also be risky for contractors, particularly if the scope of work is poorly defined or if unexpected costs arise during the project. From an accounting perspective, a fixed price contract provides contractors with a high degree of certainty in terms of project revenue and costs. The contractor is able to accurately estimate the expected revenue and expenses for the project before work begins, allowing for effective budgeting and forecasting. This also allows the contractor to manage their cash flow more effectively, as they know exactly how much revenue they will receive for the project. However, a fixed price contract also carries some risks for the contractor. If unexpected costs arise during the project, such as changes to the scope of work, materials cost increases, or delays caused by weather or other factors, the contractor may be responsible for covering these costs out of their own pocket. This can impact the profitability of the project and make it more difficult to manage cash flow effectively. To manage a fixed price contract effectively from an accounting perspective, it is essential for contractors to carefully estimate the costs and timeline of the project before work begins. This may involve conducting a thorough analysis of the project requirements, estimating the costs of labor and materials, and accounting for any potential risks or contingencies that may arise during the project. Effective project management practices, including regular progress reports and cost tracking, are also essential for managing costs and ensuring that the project remains profitable.

## Cost Plus Contract

A cost-plus contract is a type of construction contract where the contractor is paid for the actual costs incurred during the project, plus a markup or fee to cover their overhead and profit. Under a cost-plus contract, the owner agrees to reimburse the contractor for all actual costs incurred, such as materials, labor, and equipment, as well as any other allowable costs specified in the contract, such as insurance or permits. A cost-plus contract can be useful in situations where the scope of work is uncertain, or where the project requirements are likely to change during the project. Unlike a fixed price contract, where the contractor assumes the risk of unexpected costs, a cost-plus contract allows the owner to pay for the actual costs of the project, as well as any changes or modifications that may arise. A cost-plus contract may be relevant when working with clients who have specific or changing requirements, such as in custom home construction or high-end renovations.

## Time and Materials Contract

*Time and Materials Contracts:* A type of construction contract where the contractor is paid for the actual time spent working on a project, as well as the cost of materials and equipment used. The contractor is reimbursed for their actual labor costs. The contractor is also reimbursed for the actual cost of materials, equipment, and other direct costs associated with the project.

## FINAL EXAM QUESTIONS:

7. A \_\_\_\_\_ is a type of construction contract where the contractor is paid for the actual costs incurred during the project, plus a markup or fee to cover their overhead and profit.
  - A. Fixed Price Contract
  - B. Cost-Plus Contract
  - C. Time and Materials Contract
  - D. None of the above
8. Under a cost-plus contract, the owner agrees to reimburse the contractor for all actual costs incurred, such as:
  - A. Materials
  - B. Labor
  - C. Equipment
  - D. All of the above
9. A type of construction contract where the contractor agrees to complete a project for a set price that is agreed upon BEFORE work begins is a:
  - A. Fixed Price Contract
  - B. Cost-Plus Contract
  - C. Time and Materials Contract
  - D. None of the above
10. Under a fixed price contract, the contractor is responsible for completing the work within the agreed-upon:
  - A. Scope
  - B. Schedule
  - C. Budget
  - D. All of the above
11. True or false: From an accounting perspective, a fixed price contract provides contractors with a high degree of certainty in terms of project revenue and costs.
  - A. True
  - B. False
12. What type of construction contract where the contractor is paid for the actual time spent working on a project, as well as the cost of materials and equipment used?
  - A. Cost-Plus Contract
  - B. Time and Materials Contract
  - C. Fixed Price Contract
  - D. Lump Sum Contract

13. Which scenario best aligns with the utility of a cost-plus contract for residential general contractors?
- Projects with explicitly defined scopes of work and stable requirements.
  - Construction ventures characterized by fixed pricing structures and no variations in project specifications.
  - Custom home construction or high-end renovations where the scope of work might evolve or have unique, changeable demands.
  - Large-scale infrastructure development with clearly outlined and unchanging project objectives.
14. Which of the following characterizes a Time and Materials Contract in the construction industry?
- Payment based solely on the contractor's estimated time for project completion.
  - Reimbursement for the contractor's actual labor expenses and the actual cost of materials and equipment utilized.
  - Payment based on a fixed total project cost.
  - Reimbursement for the contractor's projected labor costs and standard material expenses.

## REVENUE RECOGNITION, PART 1

### Percentage of Completion Method

**Percentage of Completion Method:** The percentage of completion method is an accounting method that is commonly used in the construction industry to recognize revenue and expenses over the life of a long-term contract. Under the percentage of completion method, revenue and expenses are recognized as the project progresses, based on the percentage of the work that has been completed. To calculate the percentage of completion, the total estimated cost of the project is divided by the actual costs incurred to date. Revenue is recognized based on the percentage of the project that has been completed, while expenses are recognized based on the actual costs incurred to date. The percentage of completion method may be relevant when accounting for long-term contracts, such as custom home construction or major renovations. However, the percentage of completion method can be complex to implement and requires careful record-keeping and documentation to ensure accuracy.

### Completed Contract Method

**Completed Contract Method:** The completed contract method is an accounting method that is commonly used in the construction industry to recognize revenue and expenses at the completion of a long-term contract. Under the completed contract method, revenue and expenses are not recognized until the project is complete, and the final contract amount can be determined. This can be useful for managing cash flow, as the contractor does not need to pay taxes on the revenue until the project is complete and payment is received. The completed contract method allows the contractor to defer revenue and expenses until the project is complete, providing a more accurate picture of the financial performance of the project at the end of the contract.

### Choosing a Method

Which method a contractor chooses to use depends on the nature of the project and the contractor's accounting policies. In general, the percentage of completion method is preferred for long-term projects where revenue is recognized as work is completed, providing a more accurate picture of project profitability over time. However, the completed contract method may be preferred for short-term projects where revenue recognition at completion provides a more accurate picture of the project's profitability. It is important to note that both methods require accurate tracking and reporting of project costs, as well as regular analysis and adjustments to ensure that revenue is recognized accurately and in accordance with accounting standards. Effective accounting practices and strong project management are essential for successful revenue recognition in the construction industry.

This type of contract is useful in situations where the scope of work is uncertain or when the project is expected to take a significant amount of time to complete.

### What Are Debits and Credits?

In accounting, a debit is an entry made on the left side of a general ledger account to record an increase in assets, expenses, or withdrawals, or a decrease in liabilities or revenue. In accounting, a credit is an entry made on the right side of a general ledger account to record an increase in liabilities, equity, or revenue, or a decrease in assets or expenses. By accurately tracking debits and credits, general contractors can ensure that their accounting records are accurate and up-to-date, and that they are able to make informed business decisions based on their financial performance. Debits and credits are two fundamental terms used in accounting to record and track financial transactions. In accounting for general contractors, debits and credits are used to record expenses, revenues, assets, and liabilities associated with construction projects.

### How are Debits Applied?

To keep track of debits and credits, accountants use a system called double-entry accounting. This system requires that every financial transaction be recorded in at least two accounts, with one account debited and one account credited. The total value of debits must always equal the total value of credits, ensuring that the accounting equation ( $\text{Assets} = \text{Liabilities} + \text{Equity}$ ) remains in balance. Effective accounting for general contractors requires a thorough understanding of debits and credits, as well as strong bookkeeping and record-keeping practices to accurately track and report financial transactions. By maintaining accurate and up-to-date accounting records, contractors can effectively manage their finances and ensure the profitability of their construction projects.

**Purchases of Materials or Equipment:** When a general contractor purchases materials or equipment for a project, they would typically record a debit to the appropriate asset account (such as "Materials Inventory" or "Equipment") to reflect the increase in assets.

**Payments to Subcontractors or Suppliers:** When a general contractor pays a subcontractor or supplier for work or materials provided, they would typically record a debit to the appropriate expense account (such as "Labor Expense" or "Materials Expense") to reflect the increase in expenses.

**Withdrawals of Funds from the Business:** When a general contractor withdraws funds from the business for personal use, they would typically record a debit to the appropriate account (such as "Owner's Drawings" or "Withdrawals") to reflect the decrease in assets.

**Reductions in Liabilities:** When a general contractor makes a payment on a loan or other liability, they would typically record a debit to the appropriate liability account (such as “Notes Payable” or “Accounts Payable”) to reflect the decrease in liabilities.

In accounting, debits are used to record increases in assets and expenses and decreases in liabilities and equity. Here are some examples of how debits are applied in accounting:

- **Assets:** When a business acquires an asset, such as equipment or inventory, the value of the asset is debited to the appropriate asset account. For example, when a general contractor purchases a new truck for their business, the cost of the truck would be debited to the “Equipment” account.
- **Expenses:** When a business incurs an expense, such as salaries or rent, the value of the expense is debited to the appropriate expense account. For example, when a general contractor pays their employees for work completed on a construction project, the value of the salaries would be debited to the “Salaries Expense” account.
- **Liabilities:** When a business incurs a liability, such as a loan or accounts payable, the value of the liability is credited to the appropriate liability account. For example, when a general contractor takes out a loan to finance a construction project, the value of the loan would be debited to the “Loan Payable” account.
- **Equity:** When a business issues shares of stock or retains earnings, the value of the equity is debited to the appropriate equity account. For example, when a general contractor retains earnings from a completed construction project, the value of the earnings would be debited to the “Retained Earnings” account.

It is important to note that every debit must have a corresponding credit in double-entry accounting. This ensures that the accounting equation ( $\text{Assets} = \text{Liabilities} + \text{Equity}$ ) remains in balance. By accurately applying debits in accounting, general contractors can effectively track and manage their finances, ensuring the profitability and success of their construction projects.

## How are Credits Applied?

**Sales of completed projects:** When a general contractor completes a project and invoices the customer, they would typically record a credit to the appropriate revenue account (such as “Project Revenue” or “Sales”) to reflect the increase in revenue.

**Receipts of funds from customers:** When a general contractor receives payment from a customer for work completed, they would typically record a credit to the appropriate asset account (such as “Accounts Receivable” or “Cash”) to reflect the increase in assets.

When a general contractor makes a distribution to owners or shareholders, they would typically record a credit to the appropriate equity account (such as “Owner’s Equity” or “Retained Earnings”) to reflect the decrease in equity.

**Reductions in expenses:** When a general contractor receives a refund or credit for an expense previously incurred, they would typically record a credit to the appropriate expense account (such as “Materials Expense” or “Equipment Rental Expense”) to reflect the decrease in expenses.

## Types of Sales

In accounting, there are two types of sales: cash sales and credit sales. Cash sales refer to transactions where the customer pays for the product or service in cash at the time of purchase. Cash sales are often used in retail settings or for small transactions where immediate payment is expected.

From an accounting perspective, cash sales and charge sales are treated differently. Charge sales refer to transactions where the customer purchases a product or service but does not provide immediate payment

Instead, the customer is invoiced or charged for the product or service and is expected to pay at a later date. Charge sales are common in business-to-business transactions or for larger purchases where the customer may need time to obtain funds or arrange financing.

It is important for general contractors to carefully track and manage both types of sales to effectively manage their finances and ensure the profitability of their business. Effective sales tracking and management practices, including accurate record-keeping and proactive invoicing and collections, are essential for maintaining a healthy cash flow and ensuring the success of construction projects.

**Revenue Recognition:** As mentioned earlier, revenue from cash sales is recognized immediately when the sale is made, while revenue from charge sales is not recognized until the customer pays the invoice or fulfills the terms of the credit agreement. This means that for charge sales, the contractor must track outstanding invoices and monitor the collection process to ensure that revenue is recognized in the appropriate period.

**Cash Flow:** Cash sales provide immediate cash flow to the contractor, while charge sales may result in delayed cash flow. This can have implications for managing cash flow and working capital, as contractors must be prepared to manage periods of delayed payments from customers.

**Sales Tax:** Depending on the state and local tax laws, cash sales and charge sales may be subject to different sales tax rules. For example, in some states, sales tax is due at the time of the cash sale, while in other states, sales tax is due when the charge sale is invoiced.

**Accounting Systems:** Contractors may need to use different accounting systems or processes to properly account for cash sales and charge sales. For example, for cash sales, contractors may need to use a cash register or point-of-sale system to track transactions, while for charge sales, contractors may need to use an accounts receivable system to track invoices and payments.

## Receivables

In accounting, a receivable is an amount owed to a company or individual for goods or services provided but not yet paid for. For general contractors, accounts receivable typically refers to the amount of money owed to the contractor by customers for work that has been completed but not yet paid for. This may include progress billings, change orders, and other charge sales. When a contractor completes work for a customer and issues an invoice, the amount owed by the customer becomes an accounts receivable for the contractor. Accounts receivable are important for contractors to track and manage as they represent potential future cash inflows. Contractors must monitor their accounts receivable closely to ensure that invoices are paid on time and that cash flow is managed effectively.

Late payments or unpaid invoices can impact a contractor’s ability to pay suppliers and employees, and can have implications for the financial health of the business. In accounting, accounts receivable are typically recorded as an asset on the company’s balance sheet, and are recognized as revenue when payment is received from the customer. Receivables, also known as accounts receivable, are a type of asset in accounting that represent amounts owed to a business by its customers or clients. For general contractors, receivables represent amounts owed by clients for work completed on construction projects.

When a general contractor completes work on a construction project, they typically invoice the client for payment. The amount invoiced becomes a receivable until the client pays the invoice. The receivable represents the contractor's right to collect payment from the client for the work completed.

From an accounting perspective, receivables are recorded as an asset on the balance sheet. As payments are received from clients, the receivables account is reduced and the cash account is increased. If a receivable remains outstanding for an extended period of time, the contractor may choose to take additional steps to collect the payment, such as sending reminder notices or working with a collection agency.

Managing receivables effectively is critical for the financial health of general contractors. Slow or uncollected payments can negatively impact cash flow and profitability, making it difficult to fund ongoing projects or invest in future growth. To manage receivables effectively, contractors should develop strong invoicing and collection practices, including clear payment terms and timely follow-up on outstanding invoices. Effective communication with clients and proactive risk management can also help to minimize the risk of uncollectible receivables and ensure the long-term success of the business.

### Uncollectible Accounts

Uncollectible accounts, also known as bad debts, refer to accounts receivable that a contractor is unable to collect from a customer or client. This may occur if the customer goes out of business, declares bankruptcy, or simply refuses to pay their outstanding balance. Uncollectible accounts can have a significant impact on general contractors, as they represent a loss of potential revenue and cash flow. When a contractor is unable to collect on an account receivable, they must write off the amount as a bad debt, which reduces the company's income and may result in a tax deduction. If a contractor is unable to collect payment from a customer, it may damage the relationship and impact future business opportunities.

Mitigating bad debt in accounting refers to the process of minimizing the risk of non-payment or uncollectible receivables. This is an important consideration for general contractors, as slow or uncollected payments can negatively impact cash flow and profitability.

**Credit Checks:** Contractors may perform credit checks on potential customers before extending credit terms to minimize the risk of bad debts.

**Payment Terms:** Contractors may implement strict payment terms and enforce them consistently to encourage prompt payment.

**Collections:** Contractors may use a dedicated collections process to track and follow up on outstanding invoices and negotiate payment arrangements with customers who are experiencing financial difficulties.



Here are some strategies that contractors can use to mitigate bad debt:

**Conduct Credit Checks:** Before taking on a new client or project, it is important to conduct a credit check to assess the client's ability to pay. This can help to identify potential risks and avoid taking on projects with clients who may not be able to pay.

**Establish Payment Terms:** Contractors should establish clear payment terms at the outset of a project, including due dates, payment methods, and penalties for late payment. This can help to ensure that clients understand their payment obligations and are more likely to make timely payments.

**Invoice Promptly and Accurately:** Invoicing promptly and accurately can help to ensure that clients are aware of their payment obligations and are more likely to pay on time. Contractors should ensure that invoices are detailed, accurate, and provide clear instructions for payment.

**Follow Up on Outstanding Invoices:** Contractors should have a system in place for following up on outstanding invoices and communicating with clients who are late on payments. This can help to encourage timely payment and avoid the need for collection efforts.

**Use Collection Agencies or Legal Remedies:** If a receivable remains outstanding for an extended period of time, contractors may need to take additional steps to collect the payment. This can include working with a collection agency or pursuing legal remedies, such as a lien or lawsuit.

Effective management of bad debt is essential for the financial health and success of general contractors. By implementing strong invoicing and collection practices, conducting credit checks, and using collection agencies or legal remedies as necessary, contractors can minimize the risk of uncollectible receivables and ensure the profitability of their construction projects.

### Double-Entry Accounting System

Business transactions for general contractors are typically journaled using the double-entry accounting system. This system requires every transaction to be recorded with two entries — a debit and a credit — to ensure that the accounting equation (assets = liabilities + equity) remains balanced.

The journal entry for a business transaction typically includes the following information:

- Date of the transaction
- Accounts affected by the transaction
- Amount of the transaction
- Debit or credit to each account
- Description of the transaction

### Business Transaction Journal Example

| DATE   | ACCOUNT             | DEBIT   | CREDIT  | DESCRIPTION                     |
|--------|---------------------|---------|---------|---------------------------------|
| Jan. 1 | Materials Inventory | \$1,000 |         | Purchased materials for project |
| Jan. 1 | Accounts Payable    |         | \$1,000 | Purchased materials on credit   |

In this example, the transaction involves two accounts - Materials Inventory and Accounts Payable - and the journal entry reflects the increase in the Materials Inventory asset account (recorded as

a debit) and the increase in the Accounts Payable liability account (recorded as a credit).

Once the journal entries have been recorded, they are typically posted to the appropriate accounts in the general ledger. From there, the information can be used to generate financial statements, track project profitability, and make informed business decisions based on the company's financial performance.

## FINAL EXAM QUESTIONS:

15. **What is the completed contract method?**
  - A. Revenue and expenses are recognized as the project progresses, based on the percentage of the work that has been completed.
  - B. The contractor is paid for the actual time spent working on a project, along with the cost of materials and equipment.
  - C. In addition to labor costs, the contractor is also reimbursed for the actual cost of materials, equipment, and other direct costs associated with the project.
16. **What is a debit?**
  - A. An entry made on the right side of a general ledger account to record an increase in liabilities, equity, or revenue or a decrease in assets or expenses.
  - B. An entry made on the top side of a general ledger account to record a decrease in liabilities, equity, or revenue or a decrease in assets or expenses.
  - C. An entry made on the left side of a general ledger account to record an increase in assets, expenses, or withdrawals or a decrease in liabilities or revenue.
  - D. An entry made on the top side of a general ledger account to record an increase in assets, expenses, or withdrawals or a decrease in liabilities or revenue.
17. **What is the amount owed to a company or individual for products, goods, or services that have been provided but have yet to receive payment?**
  - A. Expenditures
  - B. Receivables
  - C. Bad Debt
  - D. Payments
18. **A transaction where the customer is invoiced for the product or service but does not provide immediate payment is a \_\_\_\_\_?**
  - A. Revenue
  - B. Cash sale
  - C. Tax
  - D. Charge sale
19. **The percentage of \_\_\_\_\_ method is an accounting method that is commonly used in the construction industry to recognize revenue and expenses over the life of a long-term contract.**
  - A. Contract
  - B. Completion
  - C. Revenue
  - D. Tax
20. **The method a contractor chooses to use depends on:**
  - A. The nature of the project and the contractor's accounting policies
  - B. Personal preferences
  - C. The needs of subcontractors
  - D. The location of the project
21. **How is the percentage of completion calculated?**
  - A. Half of the estimated cost is divided by the actual costs incurred to date.
  - B. Half the estimated cost is divided by the estimated costs incurred.
  - C. Total estimated cost divided by the actual costs incurred to date.
  - D. Total estimated cost divided by the estimated costs incurred to date.
22. **When a contractor purchases sheetrock for a project they would typically record a \_\_\_\_\_ to the appropriate asset account (i.e., materials).**
  - A. Debit
  - B. Credit
  - C. Charge sale
  - D. Cash sale
23. **To keep track of debits and credits, accountants use a system called \_\_\_\_\_ entry accounting.**
  - A. Single
  - B. Triple
  - C. Zero
  - D. Double
24. **What is a credit?**
  - A. An entry made on the right side of a general ledger account to record an increase in liabilities, equity, or revenue, or a decrease in assets or expenses.
  - B. An entry made on the top side of a general ledger account to record an increase in liabilities, equity, or revenue, or a decrease in assets or expenses.
  - C. An entry made on the left side of a general ledger account to record an increase in assets, expenses, or withdrawals, or a decrease in liabilities or revenue.
  - D. An entry made on the top side of a general ledger account to record an increase in assets, expenses, or withdrawals, or a decrease in liabilities or revenue.



25. Which of the following is the definition of a cash sale?

- A. Refers to transactions where the customer pays for the product or service in cash at the time of purchase.
- B. Refers to transactions where the customer pays for the product or service with debit card at the time of purchase.
- C. Refers to transactions where the customer pays for the product or service with credit card at the time of purchase.
- D. Refers to transactions where the customer pays for the product or service with a signed form at the time of purchase.

26. \_\_\_\_\_ sales refer to transactions where the customer purchases a product or service but does not provide immediate payment and is instead expected to pay at a later date.

- A. Cash
- B. Accounting
- C. Charge
- D. Revenue

27. What is a receivable?

- A. A promise to pay for good or services.
- B. An amount owed to a company or individual for goods or services provided but not yet paid for.
- C. It refers to transactions where the customer pays for the product or service in cash at the time of purchase.
- D. An entry made on the right side of a general ledger account to record an increase in liabilities, equity, or revenue or a decrease in assets or expenses.

28. Which of the following is the definition of a bad debt?

- A. An amount owed to a company or individual for goods or services provided but not yet paid for.
- B. It refers to transactions where the customer pays for the product or service in cash at the time of purchase.
- C. Accounts receivable that a contractor is unable to collect from a customer or client.
- D. Revenue and expenses are recognized as the project progresses, based on the percentage of the work that has been completed.

29. What system requires every transaction to be recorded with two entries - a debit and a credit?

- A. Single-entry accounting system
- B. Double-entry accounting system
- C. Triple-entry accounting system
- D. Quadruple-entry accounting system

30. What characterizes uncollectible accounts, commonly known as bad debts, in the context of a contractor's accounts receivable?

- A. Accounts receivable written off due to a customer's early payment of outstanding balances.
- B. Unpaid accounts resulting from a contractor's failure to provide an invoice to the customer.
- C. Outstanding balances that the contractor is unable to collect due to various reasons, causing potential revenue loss.
- D. Accounts receivable reflecting payments made by the customer in installments over an extended period.

31. In accounting for long-term contracts in the construction industry, which method recognizes revenue and expenses based on the project's progression and percentage completed?

- A. Lump-Sum Accounting Method
- B. Accrual Accounting Method
- C. Completed Contract Method
- D. Percentage of Completion Method

## REVENUE RECOGNITION, PART 2

### Uncollectible Debt Recording

Uncollectible debt, also known as bad debt, is recorded and written off in accounting using the allowance method. The allowance method is a method of accounting for uncollectible accounts that involves estimating the amount of bad debts that are likely to occur during a given period. This approach allows contractors to account for potential bad debts and reduce the impact on their financial statements.

For general contractors, bad debt may arise when a client is unable or unwilling to pay for work completed on a construction project. This can occur for a variety of reasons, including financial hardship, disputes over work quality or completion, or other factors that make it difficult to collect payment.

From an accounting perspective, bad debt is recorded as an expense on the income statement, reducing the contractor's net income for the period. The corresponding amount owed by the client is typically written off as a loss or allowance against accounts receivable.

To mitigate the risk of bad debt, general contractors should take steps to manage their receivables effectively, including conducting credit checks, establishing clear payment terms, and following up on outstanding invoices in a timely manner. By implementing strong invoicing and collection practices, contractors can minimize the risk of bad debt and ensure the profitability of their construction projects.

### Steps to Write Off Bad Debt

**Estimate Bad Debt:** At the end of each accounting period, the contractor must estimate the amount of accounts receivable that are unlikely to be collected. This is typically done using historical data or other factors, such as the age of the accounts receivable or the creditworthiness of the customer.

**Create a Bad Debt Allowance:** Based on the estimated amount of bad debt, the contractor must create a bad debt allowance account.

This account is a contra-asset account that is subtracted from the accounts receivable account on the balance sheet.

**Record the Bad Debt Expense:** The estimated amount of bad debt is recorded as a bad debt expense on the income statement, which reduces the net income for the period.

**Write Off Uncollectible Accounts:** If a customer's account becomes uncollectible, the contractor must write off the amount as bad debt. This is done by removing the amount from the accounts receivable account and the bad debt allowance account.

## Profit

Overall, accounting procedures for profits in a general contracting business involve careful tracking of revenue and expenses, job costing to allocate costs to specific projects, and regular review of financial statements to track profitability and identify opportunities for improvement. In general, accounting procedures for profits in a general contracting business involve tracking revenue and expenses related to the company's operations, and calculating the profit or loss for each project or period.

## Tracking Revenue

**Tracking Revenue:** General contractors must track revenue from each project they undertake, including fixed-price sales, cost-plus sales, time and materials sales, progress billings, and change orders. Revenue should be recognized in the accounting period in which it is earned, which may require tracking project milestones or completion dates.

**Tracking Expenses:** General contractors must track all expenses related to each project, including labor costs, materials costs, subcontractor costs, equipment rental costs, and overhead expenses. Expenses should be recorded in the accounting period in which they are incurred.

**Job Costing:** Job costing is a method of assigning costs to specific projects or jobs, allowing contractors to track profitability for each project. Job costing involves tracking direct costs (such as labor and materials) as well as indirect costs (such as overhead expenses) for each project, and allocating those costs to the project based on a predetermined method (such as labor hours or square footage).

Managing profits is an important aspect of accounting for general contractors.

Here are some key steps that can help contractors to maximize profits and ensure the financial success of their business:

**Accurate Job Costing:** Accurate job costing is essential for managing profits in construction. This involves tracking all costs associated with a project, including materials, labor, and overhead expenses, and comparing them to the revenue generated by the project. By accurately tracking costs and revenue, contractors can identify areas where they can improve efficiency and maximize profitability.

**Effective Budgeting and Forecasting:** Effective budgeting and forecasting are critical for managing profits in construction. Contractors should create realistic budgets for each project, including estimates of all costs and revenues. They should also regularly update their forecasts based on actual performance and adjust their budgets as necessary to ensure profitability.

**Monitoring Cash Flow:** Monitoring cash flow is essential for managing profits in construction. Contractors should have a system in place for tracking cash inflows and outflows, including monitoring accounts receivable and payable, and ensuring that they have sufficient cash reserves to fund ongoing projects.

**Managing Overhead Expenses:** Overhead expenses, such as rent, utilities, and insurance, can significantly impact profitability in construction. Contractors should carefully manage their overhead expenses, looking for opportunities to reduce costs where possible and avoid unnecessary expenses.

**Effective Invoicing and Collections:** Effective invoicing and collections are critical for managing profits in construction. Contractors should have a system in place for invoicing clients promptly and accurately, and following up on outstanding invoices in a timely manner. They should also have a plan for dealing with clients who are late on payments, including working with collection agencies or pursuing legal remedies if necessary.

**Calculating Gross Profit:** Gross profit is the difference between revenue and direct costs (such as labor and materials) for each project. Gross profit represents the amount of money that the contractor has earned before accounting for indirect costs and overhead expenses.

**Calculating Net Profit:** Net profit is the difference between gross profit and all indirect costs and overhead expenses for each project. Net profit represents the amount of money that the contractor has earned after accounting for all costs and expenses.

**Reviewing Financial Statements:** General contractors should review their financial statements regularly to track profitability and identify areas for improvement. Financial statements such as the income statement, balance sheet, and cash flow statement can provide valuable insights into the company's financial performance and help contractors make informed business decisions.

## Identifying Costs

Identifying costs for accounting purposes is a critical process for general contractors. It involves tracking and allocating costs related to specific projects, so that the contractor can accurately calculate their profit margins and ensure that they are operating within their budget. The importance of being accurate and correct when identifying costs cannot be overstated. By accurately tracking costs and allocating them to specific projects, general contractors can ensure that they are operating efficiently and effectively, and that they are able to plan for the future with confidence.

## Inaccurate Cost Tracking Consequences

**Reduced Profit Margins:** If costs are not accurately tracked and allocated, general contractors may end up underestimating the true costs of a project, which can result in reduced profit margins or even losses.

**Difficulty Managing Cash Flow:** If costs are not accurately tracked, it can be difficult for contractors to manage cash flow and ensure that they have sufficient funds to pay for materials, labor, and other expenses related to a project.

**Difficulty Planning for the Future:** Accurate cost tracking is essential for planning future projects and making informed business decisions. If costs are not accurately tracked, contractors may have difficulty predicting future costs and planning their resources accordingly.

**Potential Legal Consequences:** If costs are not accurately tracked, general contractors may be at risk of violating accounting standards or regulations, which can result in legal consequences or fines.

**Damaged Reputation:** Inaccurate cost tracking can damage a contractor's reputation and lead to reduced business opportunities in the future.

To avoid these consequences, it is important for general contractors to implement effective cost tracking systems and

processes, including accurate job costing, effective budgeting and forecasting, and regular monitoring and analysis of costs and revenues. Contractors should also maintain accurate records and documentation to support their cost tracking and be transparent with clients and stakeholders about their cost tracking practices. By effectively managing costs and tracking expenses, contractors can ensure the profitability and success of their construction projects.



### Purchase Orders

A purchase order is a document used to formally request and authorize the purchase of goods or services from a supplier. Once a purchase order is created, it is typically sent to the supplier as a formal request to provide the goods or services specified. The supplier may then provide an invoice or bill for the items supplied, which the general contractor can then use to record the transaction in their accounting records.

Purchase orders provide a clear and documented record of the goods or services requested and agreed upon, which can help to prevent misunderstandings or disputes between the general contractor and supplier. They also help to ensure that purchases are made in accordance with the company's policies and procedures, and that appropriate approvals are obtained before the purchase is made. Purchase orders can help to facilitate accurate accounting and financial reporting, as they provide a clear record of the expenses incurred for each project or period.

#### Information on a Purchase Order:

- Billing and delivery Address
- A number associated with the invoice for documentation
- Shipping instructions
- Description of the goods or services to be purchased
- Quantity and unit price of the items being purchased
- Delivery date, location, and instructions
- Payment terms and conditions
- Supplier name and contact information
- Purchase order number and date
- Signature and approval lines

### Average Inventory Ratio

**Raw Materials:** Ratio = Cost of raw materials used divided by the average inventories of raw materials

**Supplies:** Ratio = Cost of supplies used divided average of inventories of supplies

**Work in process:** Ratio= Cost of goods completed divided average inventories of work in process

**Finished Good:** Ratio= Cost of goods sold divided by the average inventories of finished goods

A low ratio can indicate the average inventory is excessive or high.

A high ratio can indicate that the inventory is too low and can impact sales negatively.

The average inventory ratio is a financial metric used in accounting to evaluate a company's efficiency in managing inventory. For general contractors, inventory typically includes materials, equipment, and supplies used in construction projects. The average inventory ratio is calculated by dividing the cost of goods sold by the average inventory value during a specific period of time. This ratio provides insight into how efficiently a contractor is managing their inventory and how effectively they are balancing inventory levels with customer demand.

A high average inventory ratio may indicate that a contractor is holding too much inventory and not efficiently managing their stock. This can result in increased carrying costs and decreased profitability. On the other hand, a low average inventory ratio may indicate that a contractor is not holding enough inventory, which can lead to stockouts and lost revenue opportunities.

To effectively manage inventory and improve their average inventory ratio, general contractors can implement strategies such as improving forecasting accuracy, implementing just-in-time inventory management practices, and negotiating better pricing and payment terms with suppliers. By effectively managing their inventory and improving their average inventory ratio, general contractors can improve profitability, reduce carrying costs, and ensure the success of their construction projects.

### FINAL EXAM QUESTIONS:

32. Which method in accounting estimates the number of bad debts that are likely to occur during a defined period of time?
  - A. Double Entry
  - B. Single Entry
  - C. Cost
  - D. Allowance
  
33. Which of the following is NOT a step to writing off bad debt?
  - A. Estimate bad debt
  - B. Avoid credit checks and payment terms
  - C. Create bad debt allowance
  - D. Record bad debt expense
  
34. What are the key components of accounting procedures for profits in a general contracting business?
  - A. Disregarding job costing and financial statement reviews
  - B. Allocating costs randomly to various projects
  - C. Careful tracking of revenue and expenses, job costing, and regular financial statement reviews
  - D. Avoiding tracking revenue and expenses related to operations

35. **How should general contractors handle the tracking of revenue for their projects?**
- Recognize revenue only at project completion.
  - Avoid tracking progress billings and change orders.
  - Track revenue from each project, recognizing the accounting period it is earned.
  - Only consider fixed-price sales for revenue recognition.
36. **Which of the following is NOT an aspect of job costing?**
- Costs are assigned to specific projects or jobs
  - Allows contractors to track profitability for each project
  - Based on a predetermined method
  - Indirect costs are unnecessary for consideration
37. **What term refers to the method used to monitor and allocate expenses related to a particular construction project?**
- Project Analysis
  - Job Costing
  - Economic Forecasting
  - Inventory Management
38. **Fill in the blank: \_\_\_\_\_ profit is the difference between gross profit and all indirect costs and overhead expenses for each project.**
- Net
  - Gross
  - Negative
  - Overhead
39. **What is the best method to provide accurate, documented, and recorded information on the products or services requested and agreed upon between the customer and the vendor?**
- Phone Call
  - Email
  - Purchase Order
  - YouTube Video
40. **Which of the following is a consequence of inaccurate cost tracking?**
- Reduced profit margins
  - Easily managing cash flow
  - Easy planning for the future
  - Perfect legal compliance
41. **What is a piece of information on a purchase order?**
- Reviews of the product
  - Questions about the product
  - Warranty or guarantee information
  - Notarized seal
42. **What is the average inventory ratio?**
- It is calculated by dividing the cost of goods sold by the total inventory value during a specific time.
  - It is calculated by dividing the estimate of goods sold by the average inventory value during a specific time.
  - It is calculated by dividing the cost of goods sold by the on hand inventory value during a specific time.
  - It is calculated by dividing the cost of goods sold by the average inventory value during a specific time.
43. **How do general contractors account for uncollectible debts, commonly known as bad debts, using the allowance method in their financial statements?**
- By recording bad debts as revenue, positively impacting net income.
  - By estimating and accounting for potential bad debts to minimize their impact on financial statements.
  - By ignoring the existence of uncollectible debts to maintain a favorable financial standing.
  - By immediately deducting the estimated bad debts from their cash reserves.
44. **Why is accurately identifying costs crucial for general contractors?**
- It has no impact on profit margin calculations.
  - To operate inefficiently and ineffectively.
  - To calculate profit margins and stay within budget.
  - To avoid planning for the future with confidence.
45. **What are the potential outcomes of inaccurate cost tracking for general contractors?**
- Improved profit margins and enhanced cash flow management.
  - Enhanced ability to predict future costs and improved project planning.
  - Reduced profit margins, challenges in managing cash flow, and difficulty planning for future projects.
  - Compliance with legal standards and increased business opportunities.

46. **What actions should general contractors take to avoid consequences related to cost tracking?**
- Implement inaccurate job costing and avoid budgeting.
  - Regularly monitor revenues but neglect cost analysis.
  - Maintain inaccurate records and lack transparency with clients.
  - Implement effective cost tracking systems, accurate job costing, budgeting, and regular monitoring and analysis of costs and revenues.
47. **What is the primary purpose of a purchase order in the procurement process for general contractors?**
- To finalize the transaction between the contractor and the supplier.
  - To formally request and authorize the purchase of goods or services from a supplier.
  - To record the transaction in the accounting records of the general contractor.
  - To make payment to the supplier for the items provided.
48. **What does a high average inventory ratio signify for general contractors in the construction industry?**
- Efficient management of stock and reduced carrying costs.
  - Overstocking and potential decreased profitability.
  - Precise forecasting accuracy and improved profitability.
  - Optimal inventory levels balancing customer demand.

## PAYROLL ACCOUNTING

### Payroll Introduction

Payroll accounting refers to the process of recording, tracking, and managing the financial aspects of employee compensation and benefits within an organization. In payroll accounting, a business records and tracks the salaries, wages, bonuses, and benefits paid to employees, as well as taxes and other withholdings related to employee income. The biggest and most fluctuating cost in building is labor.

Payroll accounting for general contractors involves the process of recording and reporting the financial transactions related to employee compensation and benefits. This includes tracking employee time worked, calculating and withholding taxes and other deductions, and processing payroll payments. Payroll accounting for general contractors can be complex and time-consuming, but it is a critical aspect of managing a business with employees.

Accurate and timely payroll processing is essential for maintaining employee morale and complying with various tax and labor laws. When it comes to employees, general contractors must withhold payroll taxes from their wages and pay their portion of Social Security and Medicare taxes. They are also responsible for paying state and federal unemployment taxes, as well as providing benefits such as workers' compensation insurance and health insurance. This is dependent upon the number of employees. Subcontractors and independent contractors, on the other hand, are responsible for

paying their own taxes and are not subject to payroll taxes. However, general contractors may need to issue them 1099 forms at the end of the year if they paid them more than \$600 during the year. A contractor may use payroll software to automate this process and ensure compliance with state and federal tax laws.

Payroll accounting involves a number of tasks, including calculating employee compensation, tracking and recording time worked, calculating taxes and other withholdings, and preparing and distributing employee paychecks or direct deposits. Payroll accountants also prepare and file various tax forms and reports related to employee income, such as W-2s and 1099s.

### Key Components of Payroll Accounting

**Employee Time Tracking:** To accurately calculate payroll, general contractors need to track employee hours worked, including regular and overtime hours.

**Tax Withholding:** General contractors are required to withhold federal, state, and local income taxes, as well as Social Security and Medicare taxes from employee paychecks. These amounts are typically calculated based on employee earnings and information provided on Form W-4.

**Benefits and Deductions:** General contractors may offer employee benefits such as health insurance, retirement plans, and paid time off. They may also deduct amounts for items such as 401(k) contributions, child support, and wage garnishments.

**Payroll Processing:** Once all the necessary data has been collected, general contractors must calculate and process payroll payments, including printing checks or initiating direct deposits.

**Recordkeeping and Reporting:** General contractors must maintain accurate payroll records for each employee, including earnings, deductions, and taxes withheld. They must also file various tax forms and reports, such as Form 941 and Form W-2.

Effective payroll accounting is important for ensuring that employees are paid accurately and on time, and for complying with relevant tax laws and regulations. By implementing effective payroll accounting practices, businesses can improve their financial management, reduce the risk of errors or compliance issues, and ensure the long-term success of their organization.

### FINAL EXAM QUESTIONS:

49. **Which of the following statements about payroll accounting for general contractors is accurate?**
- Subcontractors and independent contractors are exempt from paying their own taxes.
  - General contractors are not responsible for withholding payroll taxes from their employees.
  - Payroll accounting involves tasks such as calculating employee compensation, tracking time worked, and preparing tax forms.
  - Payroll software is primarily used by subcontractors to automate the payroll process.

- 50. What is a responsibility specific to general contractors regarding payroll processing?**
- A. Providing benefits such as workers' compensation insurance
  - B. Withholding taxes for subcontractors and independent contractors
  - C. Non-compliance with various tax and labor laws
  - D. Issuing W-2 forms to subcontractors at the end of the year
- 51. True or false: Recordkeeping and reporting are not key components of payroll accounting.**
- A. True
  - B. False
- 52. Why is effective payroll accounting crucial for businesses?**
- A. To increase the risk of errors in financial management
  - B. To complicate compliance with tax laws and regulations
  - C. To ensure accurate and timely employee payments
  - D. To hinder the long-term success of the organization

## OVERHEAD EXPENSES

### Introduction

Overhead expenses for general contractors refer to the indirect costs of running their business that are not directly related to a specific project or job. These costs are typically incurred regardless of whether or not the general contractor is actively working on a project, and must be carefully managed to ensure profitability and financial sustainability.

### Variable Overhead

Variable overhead expenses refer to indirect costs that fluctuate based on the level of production or activity of a business. These costs are not fixed and can vary depending on the volume of production, sales, or other business activities. Variable overhead expenses can include costs associated with manufacturing a product, such as raw materials, packaging, and direct labor costs. In a service business, variable overhead expenses can include costs associated with delivering the service, such as labor costs, transportation costs, and supplies.

Variable overhead is a type of indirect cost that varies with changes in production or activity levels. In accounting for general contractors, variable overhead costs typically include expenses related to materials and labor, such as supplies, tools, and equipment, that are used in construction projects.

Variable overhead costs are indirect costs because they are not directly attributable to a specific project or product. Instead, these costs are spread across multiple projects based on the level of activity or production for each project. For example, if a general contractor has a higher level of activity on one project than another, the variable overhead costs associated with that project will be higher. This can include costs for additional equipment, supplies, or labor needed to complete the project. To effectively manage

variable overhead costs, general contractors should have a system in place for tracking and allocating these costs across their various projects. This may involve using cost accounting methods such as job costing or activity-based costing to identify and track variable overhead costs related to specific projects.

By effectively managing variable overhead costs, general contractors can improve their financial performance and ensure the profitability of their construction projects. By carefully tracking and managing these costs, contractors can ensure that they are allocating resources effectively and maximizing profitability for their business.

### Fixed Overhead

Fixed overhead refers to indirect costs of a business that do not change regardless of the level of production or sales. These expenses are typically ongoing and must be paid on a regular basis, regardless of whether or not the business is generating revenue. Fixed overhead expenses are important for businesses to consider when budgeting and forecasting their financials. Since these expenses do not change with the level of production or sales, it is important to accurately estimate and plan for them to ensure that the business remains financially stable and profitable.

Businesses can manage fixed overhead expenses by identifying areas where they can reduce costs, such as negotiating better lease agreements or finding ways to reduce utility bills. It is important to balance cost-cutting measures with maintaining the quality of the business's operations and services.

In accounting for general contractors, fixed overhead costs typically include expenses such as rent, utilities, insurance, and other overhead costs that are incurred regardless of the level of construction activity.

Fixed overhead costs are called "fixed" because they remain constant regardless of the level of activity or production for each project. For example, a general contractor will still have to pay rent and utilities even if there are no active construction projects. To effectively manage fixed overhead costs, general contractors should have a system in place for allocating these costs across their various projects. This may involve using cost accounting methods such as absorption costing to allocate fixed overhead costs to individual projects based on predetermined allocation rates.

By effectively managing fixed overhead costs, general contractors can improve their financial performance and ensure the profitability of their construction projects. By carefully tracking and managing these costs, contractors can ensure that they are allocating resources effectively and maximizing profitability for their business.

### Variable and Fixed Overhead Comparison

| Variable Overhead          | Fixed Overhead       |
|----------------------------|----------------------|
| ⇒ Taxes (Payroll)          | ⇒ Salaries           |
| ⇒ Permits                  | ⇒ Professional Fees  |
| ⇒ Travel and Lodging       | ⇒ Insurance          |
| ⇒ Safety Equipment         | ⇒ Interest           |
| ⇒ Advertising or Marketing | ⇒ Software Licensing |
| ⇒ Rental Equipment         | ⇒ Property Taxes     |
| ⇒ Fuel Costs               | ⇒ Office Supplies    |
| ⇒ Repair and Maintenance   | ⇒ Rent               |

## FINAL EXAM QUESTIONS:

53. What is an example of a fixed overhead cost?
- A. Utilities
  - B. Lumber Prices
  - C. Appliance Prices
  - D. Gas Prices
54. What distinguishes variable overhead costs for general contractors?
- A. They are fixed and do not change with activity levels.
  - B. They are directly attributable to specific projects.
  - C. They only include labor-related expenses.
  - D. They vary with changes in production or activity levels.
55. What do overhead expenses for general contractors primarily encompass?
- A. Direct project costs
  - B. Indirect costs unrelated to specific projects
  - C. Employee salaries for project work
  - D. Materials for a specific project
56. What characterizes variable overhead expenses in accounting?
- A. They are fixed costs that remain constant regardless of production levels.
  - B. They are direct costs specifically associated with a particular project or product.
  - C. They vary with changes in production or activity levels.
  - D. They include only labor costs and exclude material costs in a manufacturing setting.
57. What characterizes fixed overhead expenses for a business?
- A. They vary based on production or sales levels.
  - B. They are directly related to specific projects.
  - C. They must be paid irregularly.
  - D. They do not change regardless of the level of production or sales.
58. How can businesses effectively manage fixed overhead expenses?
- A. Increasing production levels
  - B. Balancing cost-cutting measures with maintaining quality operations
  - C. Ignoring negotiations on lease agreements
  - D. Relying solely on revenue generation

59. Which of the following is an example of variable overhead?
- A. Rent
  - B. Travel and Lodging
  - C. Interest
  - D. Property Taxes
60. Which of the following is an example of fixed overhead?
- A. Insurance
  - B. Fuel Costs
  - C. Marketing
  - D. Maintenance

## FINANCIAL STATEMENTS

### Introduction

Financial statements are formal records of a general contractor's financial activities, including its income, expenses, assets, liabilities, and equity, over a specific period of time. A good financial statement will provide a summary or snapshot of the business operations activity for a given time period. The time frame that is normally portrayed is usually a month, quarter, or year. These statements are prepared by the general contractor or their accounting department and are used by internal and external stakeholders to evaluate the contractor's financial performance.

By analyzing their financial statements, general contractors can make informed decisions about pricing, resource allocation, and other business activities to optimize their profitability and financial stability.

Financial statements are reports that provide a summary of a company's financial performance and position. In accounting for general contractors, financial statements are important for tracking and managing the financial aspects of construction projects and ensuring the profitability of the business.



There are three types of financial statements:

**Income Statement:** Also known as the profit and loss statement, this financial statement shows a general contractor's revenue and expenses over a specific period of time, typically a month or a year. The income statement shows whether the contractor made a profit or a loss during the period.

**Balance Sheet:** This financial statement provides an overview of a general contractor's financial position at a specific point in time. The balance sheet shows the contractor's assets, liabilities, and equity, and can be used to calculate key financial ratios, such as the debt-to-equity ratio.

**Cash Flow Statement:** This financial statement shows a general contractor's cash inflows and outflows over a specific period of time, typically a month or a year. The cash flow statement shows how much cash the contractor generated from its operations, how much it invested in its business, and how much it borrowed or repaid during the period.

## Income Statements

Advantages of an income statement in accounting for general contractors include:

**Provides a snapshot of a general contractor's financial performance:** An income statement provides a summary of a general contractor's revenues, expenses, and net income over a specific period of time. This helps stakeholders quickly understand the contractor's financial performance and profitability.

**Helps identify areas for improvement:** An income statement allows general contractors to analyze their revenue and expenses in detail. By identifying areas where expenses can be reduced or where revenues can be increased, general contractors can make strategic decisions to optimize their profitability.

**Helps with financial planning:** General contractors can use an income statement to create budgets and forecasts for future periods. By analyzing past trends in revenues and expenses, they can make informed decisions about staffing, pricing, and resource allocation for future projects.

Disadvantages of an income statement in accounting for general contractors include:

**Limited view of a general contractor's financial performance:** An income statement provides only a snapshot of a general contractor's financial performance over a specific period of time. It does not provide information on the contractor's financial position or cash flow, which are important factors in evaluating a contractor's financial stability.

**Limited Comparability:** Income statements can be difficult to compare across different companies or industries, as accounting methods and revenue recognition policies can vary widely.

**Limited Reliability:** The accuracy of an income statement depends on the accuracy of the data used to prepare it. Errors in recording revenues or expenses can lead to inaccurate financial statements, which can have negative consequences for a general contractor's financial stability and reputation.

Overall, an income statement is an important tool for general contractors to evaluate their financial performance and make informed decisions about their business activities. However, it is important to consider its limitations and to use it in conjunction with other financial statements and metrics to gain a comprehensive understanding of a contractor's financial health.

## Balance Sheets

Advantages of a balance sheet in accounting for general contractors include:

**Provides a snapshot of a general contractor's financial position:** A balance sheet provides a summary of a general contractor's assets, liabilities, and equity at a specific point in time. This helps stakeholders understand the contractor's financial position and liquidity.

**Helps with financial planning:** General contractors can use a balance sheet to create budgets and forecasts for future periods. By analyzing past trends in assets and liabilities, they can make informed decisions about financing, capital expenditures, and other business activities.

**Helps identify areas for improvement:** A balance sheet allows general contractors to identify areas where they can improve their financial position. For example, by reducing liabilities or increasing assets, contractors can improve their working capital and financial stability.

Disadvantages of a balance sheet in accounting for general contractors include:

**Limited view of a general contractor's financial performance:** A balance sheet provides only a snapshot of a general contractor's financial position at a specific point in time. It does not provide information on the contractor's revenue, expenses, or profitability, which are important factors in evaluating a contractor's financial health.

**Limited comparability:** Balance sheets can be difficult to compare across different companies or industries, as accounting methods and valuation techniques can vary widely.

**Limited reliability:** The accuracy of a balance sheet depends on the accuracy of the data used to prepare it. Errors in recording assets or liabilities can lead to inaccurate financial statements, which can have negative consequences for a general contractor's financial stability and reputation.

Overall, a balance sheet is an important tool for general contractors to evaluate their financial position and make informed decisions about their business activities. However, it is important to consider its limitations and to use it in conjunction with other financial statements and metrics to gain a comprehensive understanding of a contractor's financial health.

## Cash Flow Statements

Advantages of a cash flow statement in accounting for general contractors include:

**Provides a comprehensive view of a general contractor's cash flows:** A cash flow statement provides a summary of a general contractor's cash inflows and outflows over a specific period of time. This helps stakeholders understand the contractor's liquidity and ability to generate cash from its operations.

**Helps with financial planning:** General contractors can use a cash flow statement to create budgets and forecasts for future periods. By analyzing past trends in cash flows, they can make informed decisions about financing, capital expenditures, and other business activities.

**Helps identify areas for improvement:** A cash flow statement allows general contractors to identify areas where they can improve their cash flows. For example, by reducing operating expenses or increasing revenues, contractors can improve their cash flow from operations.

Disadvantages of a cash flow statement in accounting for general contractors include:

**Limited view of a general contractor's financial performance:** A cash flow statement provides information on a general contractor's cash flows, but it does not provide information on the contractor's revenue, expenses, or profitability, which are important factors in evaluating a contractor's financial health.

**Limited comparability:** Cash flow statements can be difficult to compare across different companies or industries, as accounting methods and cash flow items can vary widely.

**Limited reliability:** The accuracy of a cash flow statement depends on the accuracy of the data used to prepare it. Errors in recording cash inflows or outflows can lead to inaccurate financial statements, which can have negative consequences for a general contractor's financial stability and reputation.



Overall, a cash flow statement is an important tool for general contractors to evaluate their cash flows and make informed decisions about their business activities. However, it is important to consider its limitations and to use it in conjunction with other financial statements and metrics to gain a comprehensive understanding of a contractor's financial health.

### Statement Overview

The balance sheet, income statement, and cash flow statement are three primary financial statements used in accounting to provide different information about a company's financial performance. Here are the distinct differences between these three statements:

**Balance Sheet:** A balance sheet is a snapshot of a company's financial position at a specific point in time. It provides information about a company's assets, liabilities, and equity. Assets are the resources a company owns, such as cash, investments, and property. Liabilities are the debts a company owes, such as loans and accounts payable. Equity is the difference between a company's assets and liabilities, representing the net worth of the company. The balance sheet shows how a company's assets are financed, either through debt or equity.

**Income Statement:** An income statement is a summary of a company's revenue, expenses, and net income over a specific period of time, such as a month or a year. It shows how much revenue a company generated from its operations, and how much it spent on costs and expenses to produce that revenue. The difference between revenue and expenses is the company's net income, which represents its profitability over the period.

**Cash Flow Statement:** A cash flow statement shows how much cash a company generated from its operations, how much it invested in its business, and how much it borrowed or repaid over a specific period of time. It provides information about a company's liquidity and cash position. The cash flow statement breaks down a company's cash flows into three categories: operating activities, investing activities, and financing activities.

Overall, the balance sheet provides information about a company's financial position, the income statement provides information about its profitability, and the cash flow statement provides information about its cash position and liquidity. Together, these three financial statements provide a comprehensive view of a company's financial performance and health.

### FINAL EXAM QUESTIONS:

61. **What is the typical time frame portrayed in financial statements for a general contractor?**
  - A. Hourly
  - B. Daily
  - C. Monthly, quarterly, or yearly
  - D. Bi-annually
62. **Which of the following is a key purpose of financial statements for a general contractor?**
  - A. Monitoring employee attendance
  - B. Evaluating marketing effectiveness
  - C. Showcasing customer testimonials
  - D. Assessing financial performance over a specific period
63. **Which of the following is NOT a type of financial statement?**
  - A. Market Analysis
  - B. Income Statement
  - C. Balance Sheet
  - D. Cash Flow Statement
64. **What is an advantage of an income statement?**
  - A. Limited view of financial performance.
  - B. Limited comparability.
  - C. Provides a comprehensive review of a general contractor's financial performance.
  - D. Limited reliability.
65. **What is a disadvantage of an income statement?**
  - A. Limited reliability
  - B. Helps identify areas for improvement.
  - C. Helps with financial planning.
  - D. Provides a comprehensive view of a general contractor's cash flow.
66. **Which financial statement is primarily used to assess the company's profitability and financial performance?**
  - A. Balance Sheet
  - B. Income Statement
  - C. Cash Flow Statement
  - D. Statement of Retained Earnings
67. **What is one advantage of a balance sheet for general contractors?**
  - A. It provides a detailed record of daily financial transactions.
  - B. It offers a snapshot of assets, liabilities, and equity at a specific point in time.
  - C. It provides information on revenue and profitability.
  - D. It helps with comparing financial performance across industries.
68. **What is one disadvantage of a balance sheet for general contractors?**
  - A. It offers a comprehensive view of a contractor's financial performance.
  - B. It is highly reliable and free from errors.
  - C. It provides limited information on revenue and expenses.
  - D. It allows easy comparability across different companies or industries.

69. **What does a cash flow statement provide for a general contractor?**
- Detailed information on revenue and expenses
  - Summary of cash inflows and outflows
  - Comparison of industry profitability
  - Assessment of debt levels
70. **Which of the following is NOT an advantage of cash flow statement for general contractors?**
- Offers a limited view of financial performance
  - Analyzes past trends and cash flows
  - Helps with financial planning
  - Identifies areas for improvement

## ACCOUNTING RATIOS

### Introduction

Financial ratios in accounting for general contractors are quantitative metrics used to evaluate a company's financial performance, health, and stability. These ratios are calculated by dividing one financial statement item by another, such as dividing revenue by total assets or dividing net income by equity.

Financial ratios are important tools for general contractors to analyze and compare their financial performance against industry benchmarks, identify areas for improvement, and make informed decisions about their business activities. They can also be used by stakeholders such as investors, lenders, and regulators to evaluate a general contractor's creditworthiness, risk profile, and potential for growth.

Financial ratios provide a quick and easy way to evaluate a general contractor's financial performance and identify areas for improvement. However, it is important to use financial ratios in conjunction with other financial statements and metrics to gain a comprehensive understanding of a contractor's financial health.

### Current Ratio

The current ratio is a liquidity ratio that measures a company's ability to meet its short-term financial obligations. Specifically, it measures whether a company has enough current assets to cover its current liabilities. Current assets are those that can be easily converted to cash within one year, such as cash, accounts receivable, and inventory. Current liabilities are debts that are due within one year, such as accounts payable, short-term loans, and accrued expenses.

The current ratio is calculated by dividing a company's current assets by its current liabilities. For example, if a general contractor has current assets of \$500,000 and current liabilities of \$250,000, its current ratio would be 2:1. This means that the contractor has \$2 of current assets for every \$1 of current liabilities, indicating that it is in a relatively strong financial position to meet its short-term obligations.

A higher current ratio is generally considered more favorable, as it indicates that a company has more current assets available to cover its current liabilities. However, a very high current ratio may also indicate that a company is not using its assets efficiently or may be holding too much inventory, which can reduce profitability.

The current ratio is an important metric for general contractors as it can help them assess their ability to meet short-term obligations

such as payroll, material costs, and supplier payments. It can also be used by lenders and investors to evaluate a company's short-term liquidity and financial health.

### Quick Assets Ratio

The quick assets ratio, also known as the acid-test ratio, is a liquidity ratio that measures a company's ability to pay off its current liabilities with its most liquid assets, excluding inventory. It is a more conservative measure of liquidity than the current ratio, as it excludes inventory which may not be easily converted to cash in the short term.

The quick assets ratio is calculated by dividing a company's quick assets by its current liabilities. Quick assets include cash, marketable securities, and accounts receivable, as they are the most easily convertible to cash. Prepaid expenses may also be included as quick assets if they can be converted to cash within a short period of time. Inventory is excluded from quick assets because it may take time to sell or may need to be discounted to be sold quickly.

For example, if a general contractor has quick assets of \$300,000 and current liabilities of \$200,000, its quick assets ratio would be 1.5:1. This means that the contractor has \$1.50 of quick assets for every \$1 of current liabilities, indicating that it has enough liquid assets to pay off its short-term obligations.

A higher quick assets ratio is generally considered more favorable, as it indicates that a company has more liquid assets available to cover its short-term liabilities. However, a very high quick assets ratio may also indicate that a company is not using its assets efficiently or may be holding too much cash, which can reduce profitability.

The quick assets ratio is an important metric for general contractors as it can help them assess their short-term liquidity and ability to meet immediate financial obligations. It can also be used by lenders and investors to evaluate a company's liquidity and financial health.

### Debt to Equity Ratio

The debt-to-equity ratio is a financial ratio that measures a company's leverage, or the proportion of debt financing relative to equity financing. It compares the amount of a company's total debt to the amount of shareholder equity, which represents the residual value of assets after liabilities have been paid off.

The debt-to-equity ratio is calculated by dividing a company's total debt by its total equity. Total debt includes all short-term and long-term debt obligations, such as loans, bonds, and other liabilities. Total equity includes common stock, preferred stock, retained earnings, and other equity accounts.

For example, if a general contractor has total debt of \$500,000 and total equity of \$1,000,000, its debt-to-equity ratio would be 0.5:1. This means that the contractor has \$0.50 of debt financing for every \$1 of equity financing.

A higher debt-to-equity ratio indicates that a company has more debt relative to equity, which can increase the financial risk of the company. This is because debt financing requires regular interest payments and eventual repayment, whereas equity financing does not require repayment and only pays dividends if the company chooses to do so. A lower debt-to-equity ratio generally indicates a more financially stable company with a stronger equity base.

However, the appropriate level of debt-to-equity ratio varies depending on the industry and the company's financial goals. Some industries, such as utilities and telecom, tend to have higher debt-to-equity ratios due to the nature of their business. Additionally, some companies may choose to take on more debt to finance

growth opportunities, while others may prioritize maintaining a strong equity base.

The debt-to-equity ratio is an important metric for general contractors as it can help them assess their level of leverage and financial risk. It can also be used by lenders and investors to evaluate a company's creditworthiness and potential for growth.

### Percentage of Gross Profit

The percentage of gross profit income account ratio is a profitability ratio that measures a company's gross profit margin as a percentage of its total revenue. It shows the percentage of each dollar of revenue that is left after accounting for the cost of goods sold, which is the cost of producing and delivering the goods or services sold by the company.

The percentage of gross profit income account ratio is calculated by dividing a company's gross profit by its total revenue, and then multiplying the result by 100 to express the ratio as a percentage. Gross profit is calculated by subtracting the cost of goods sold from total revenue.

For example, if a general contractor has gross profit of \$500,000 and total revenue of \$1,000,000, its percentage of gross profit income account ratio would be 50%. This means that the contractor earns a gross profit of \$0.50 for every \$1 of revenue.

A higher percentage of gross profit income account ratio generally indicates a more profitable company, as it shows that the company is earning a higher percentage of revenue as gross profit. However, it is important to compare the ratio to industry benchmarks and trends over time, as the appropriate level of gross profit margin varies depending on the industry and the company's business model.

The percentage of gross profit income account ratio is an important metric for general contractors as it can help them assess their profitability and pricing strategy. It can also be used by lenders and investors to evaluate a company's financial health and potential for growth.

### Return on Equity Ratio

The return on equity (ROE) ratio is a financial ratio that measures a company's profitability by calculating the amount of net income earned as a percentage of shareholder equity. It shows how much profit a company is generating for each dollar of equity invested by shareholders.

The return on equity ratio is calculated by dividing a company's net income by its total shareholder equity. Net income is the total profit earned by the company after all expenses have been deducted from revenue. Shareholder equity is the residual value of assets after liabilities have been paid off.

For example, if a general contractor has net income of \$200,000 and total shareholder equity of \$1,000,000, its return on equity ratio would be 20%. This means that for every dollar of shareholder equity, the contractor generates 20 cents of net income.

A higher return on equity ratio generally indicates a more profitable company, as it shows that the company is generating a higher percentage of net income relative to shareholder equity. However, it is important to compare the ratio to industry benchmarks and trends over time, as the appropriate level of return on equity varies depending on the industry and the company's business model.

The return on equity ratio is an important metric for general contractors as it can help them assess their profitability and efficiency in using shareholder equity to generate profit. It can also

be used by lenders and investors to evaluate a company's financial health and potential for growth.

### Asset Turnover Ratio

The asset turnover ratio is a financial ratio that measures how efficiently a company is using its assets to generate revenue. It shows the amount of revenue generated by each dollar of assets invested in the company.

The asset turnover ratio is calculated by dividing a company's total revenue by its total assets. Total revenue is the amount of money generated by the company's operations, while total assets include all of the company's tangible and intangible assets.

For example, if a general contractor has total revenue of \$1,000,000 and total assets of \$500,000, its asset turnover ratio would be 2:1. This means that for every dollar of assets invested in the company, it generates \$2 of revenue.

A higher asset turnover ratio generally indicates a more efficient company, as it shows that the company is generating more revenue for each dollar of assets invested. However, it is important to compare the ratio to industry benchmarks and trends over time, as the appropriate level of asset turnover varies depending on the industry and the company's business model.

The asset turnover ratio is an important metric for general contractors as it can help them assess their efficiency in using assets to generate revenue. It can also be used by lenders and investors to evaluate a company's financial health and potential for growth.

### Comparative Income Statements

A comparative income statement in accounting for general contractors is a financial statement that presents a side-by-side comparison of a company's income statements from two or more periods, typically two consecutive periods. This allows for the analysis of changes in a company's financial performance over time and provides insights into its revenue growth, profitability, and efficiency.

The comparative income statement presents the same information as a regular income statement, including a company's revenue, cost of goods sold, gross profit, operating expenses, net income, and earnings per share. However, it also includes additional columns that show the amounts and changes in these accounts between the different periods being compared.

For example, a comparative income statement for a general contractor might compare its income statements from the current year and the previous year. The income statements would be presented side by side, with the dollar amounts and changes in each account listed in separate columns. This would allow the contractor to see how its revenue, costs, and profitability have changed over the year and identify areas of growth or potential financial risk.

Comparative income statements are useful for general contractors as they provide a historical perspective on a company's financial performance. They can help identify trends and patterns over time, such as changes in revenue sources, shifts in cost structure, or changes in operating efficiency. This information can be used to inform strategic decisions and financial planning for the future. Comparative income statements can also be used by investors, lenders, and other stakeholders to evaluate a company's financial health and potential for growth.

## FINAL EXAM QUESTIONS:

71. **What is the primary purpose of financial ratios in accounting for general contractors?**
- A. They serve as legal documents for external stakeholders.
  - B. They provide a detailed record of daily financial transactions.
  - C. They offer a quick and easy way to evaluate financial performance and identify areas for improvement.
  - D. They replace the need for other financial statements and metrics in financial analysis.
72. **How is the current ratio calculated?**
- A. Dividing current liabilities by total assets
  - B. Multiplying current assets by current liabilities
  - C. Dividing current assets by current liabilities
  - D. Adding current assets to current liabilities
73. **What does a higher current ratio generally indicate for a company?**
- A. Inefficient use of assets
  - B. Strong ability to meet short-term obligations
  - C. Financial instability
  - D. Lack of liquidity
74. **What is excluded from the quick assets ratio calculation?**
- A. Marketable securities
  - B. Inventory
  - C. Prepaid expenses
  - D. Accounts receivable
75. **How is the quick assets ratio calculated?**
- A. Dividing current assets by current liabilities
  - B. Adding inventory to current assets
  - C. Dividing quick assets by current liabilities
  - D. Multiplying marketable securities by accounts receivable
76. **What does a higher debt-to-equity ratio typically indicate for a company?**
- A. Increased financial stability
  - B. Stronger equity base
  - C. Lower financial risk
  - D. More debt relative to equity
77. **What is the primary purpose of the percentage of gross profit income account ratio for general contractors?**
- A. Eliminating liquidity
  - B. Assessing profitability and pricing strategy
  - C. Measuring debt-to-equity ratio
  - D. Calculating current assets
78. **What does the return on equity (ROE) ratio measure for a company?**
- A. Profitability
  - B. Liquidity
  - C. Debt level
  - D. Operating efficiency
79. **What does a higher asset turnover ratio typically indicate for a company?**
- A. Decreased efficiency
  - B. Lower revenue generation
  - C. Greater efficiency
  - D. Higher debt levels
80. **Why are comparative income statements useful for general contractors?**
- A. Assessing short-term liquidity
  - B. Calculating debt-to-equity ratio
  - C. Providing a historical perspective on financial performance
  - D. Measuring asset turnover ratio

## ACCOUNTING SOFTWARE

### Introduction

There are several types of software that are specifically designed for accounting for general contractors. These include:

Construction-specific accounting software, such as Foundation Software, Jonas Premier, and Sage 300 Construction and Real Estate, which offer features such as job costing, project management, and estimating.

General accounting software, such as QuickBooks and Xero, which are not specific to the construction industry but can be used for general accounting tasks such as bookkeeping, invoicing, and financial reporting.

Enterprise resource planning (ERP) software, such as SAP and Oracle, which integrate accounting with other business functions such as supply chain management, human resources, and customer relationship management.

Project management software, such as Procore, PlanGrid, and CoConstruct, which include accounting features and are designed to help contractors manage construction projects from start to finish.

Cloud-based accounting software, such as FreshBooks and Wave, which offer online accounting tools that can be accessed from anywhere with an internet connection.



When choosing accounting software for general contractors, it is important to consider the specific needs and budget of the business, as well as the features and support provided by the software.

## Foundation Software

Foundation Software is construction-specific accounting software designed for general contractors. It offers a wide range of features to help contractors manage their finances, including job costing, project management, payroll, and financial reporting.

**Here are some advantages and disadvantages of Foundation Software:**

**Job Costing:** Foundation Software allows contractors to track the cost of each job individually, including labor, materials, and overhead costs. This helps contractors to estimate and bid on future jobs more accurately.

**Project Management:** Foundation Software includes features for managing construction projects, such as change orders, scheduling, and subcontracts. This helps contractors to stay organized and on track throughout the construction process.

**Payroll:** Foundation Software includes payroll features that allow contractors to manage employee hours, taxes, and benefits. This helps to streamline the payroll process and ensure compliance with labor laws.

**Financial Reporting:** Foundation Software includes a range of financial reporting tools that allow contractors to track their cash flow, profitability, and other key financial metrics. This helps contractors to make informed financial decisions and plan for the future.

**User-Friendly:** Foundation Software is known for being user-friendly, with a straightforward interface and helpful customer support.

**Disadvantages:**

**Cost:** Foundation Software can be expensive, with pricing based on the number of users and features needed. This may make it difficult for smaller contractors with limited budgets to afford.

**Customization:** While Foundation Software offers a wide range of features, some contractors may find that they need to customize the software to meet their specific needs. This may require additional time and expense.

**Learning Curve:** While the software is user-friendly, there may still be a learning curve for contractors who are not familiar with accounting software or construction-specific features.

**Limited Integration:** Foundation Software may not integrate with other software systems that contractors are using, which may require additional data entry and manual processes.

Overall, Foundation Software is a powerful tool for general contractors who need construction-specific accounting and project management features. While it may be expensive and require some customization, it can help contractors to manage their finances and projects more effectively.

## Jonas Premier

Jonas Premier is a cloud-based construction-specific accounting software designed for general contractors. It offers a wide range of features to help contractors manage their finances, including job costing, project management, payroll, and financial reporting.

**Advantages:**

**Job Costing:** Jonas Premier allows contractors to track the cost of each job individually, including labor, materials, and overhead costs. This helps contractors to estimate and bid on future jobs more accurately.

**Project Management:** Jonas Premier includes features for managing construction projects, such as change orders, scheduling, and subcontracts. This helps contractors to stay organized and on track throughout the construction process.

**Payroll:** Jonas Premier includes payroll features that allow contractors to manage employee hours, taxes, and benefits. This helps to streamline the payroll process and ensure compliance with labor laws.

**Financial Reporting:** Jonas Premier includes a range of financial reporting tools that allow contractors to track their cash flow, profitability, and other key financial metrics. This helps contractors to make informed financial decisions and plan for the future.

**Cloud-Based:** Jonas Premier is a cloud-based software, which means that contractors can access their financial data and project information from anywhere with an internet connection. This allows for greater flexibility and collaboration among team members.

**Disadvantages:**

**Cost:** Jonas Premier can be expensive, with pricing based on the number of users and features needed. This may make it difficult for smaller contractors with limited budgets to afford.

**Customization:** While Jonas Premier offers a wide range of features, some contractors may find that they need to customize the software to meet their specific needs. This may require additional time and expense.

**Learning Curve:** While the software is user-friendly, there may still be a learning curve for contractors who are not familiar with accounting software or construction-specific features.

**Limited Integration:** Jonas Premier may not integrate with other software systems that contractors are using, which may require additional data entry and manual processes.

Overall, Jonas Premier is a powerful tool for general contractors who need construction-specific accounting and project management features. While it may be expensive and require some customization, it can help contractors to manage their finances and projects more effectively, while offering greater flexibility and collaboration through its cloud-based platform.

## Quickbooks

QuickBooks is a popular general accounting software that can be used by general contractors to manage their finances. It offers a range of features for bookkeeping, invoicing, financial reporting, and project management.

### Advantages:

**Cost:** QuickBooks is an affordable option for general contractors, with pricing based on the number of users and features needed. There are also several pricing plans to choose from to suit different business sizes and budgets.

**User-Friendly:** QuickBooks is known for being user-friendly, with a straightforward interface and helpful customer support. It also offers a wide range of tutorials and resources to help users get started.

**Integration:** QuickBooks can integrate with a wide range of other software systems that contractors may be using, such as payroll, inventory management, and project management software.

**Financial Reporting:** QuickBooks offers a range of financial reporting tools that allow contractors to track their cash flow, profitability, and other key financial metrics. This helps contractors to make informed financial decisions and plan for the future.

**Mobile Access:** QuickBooks offers mobile apps that allow contractors to manage their finances and projects on the go, from anywhere with an internet connection.

### Disadvantages:

**Construction-Specific Features:** While QuickBooks can be used by general contractors, it does not offer specific features for construction, such as job costing or project management. This may require contractors to use additional software systems to manage these tasks.

**Limited Customization:** QuickBooks may not offer the level of customization that some contractors need to meet their specific accounting needs. This may require additional time and expense to integrate other software systems or create manual workarounds.

**Learning Curve:** While QuickBooks is user-friendly, there may still be a learning curve for contractors who are not familiar with accounting software or the features offered by QuickBooks.

**Data Security:** As QuickBooks is cloud-based, some contractors may have concerns about data security and privacy. It is important to ensure that appropriate security measures are in place to protect sensitive financial data.

Overall, QuickBooks is a versatile and affordable option for general contractors who need general accounting features. While it may not offer construction-specific features, it can be used in conjunction with other software systems to manage construction projects and job costing. QuickBooks offers a user-friendly interface, integration with other software systems, and mobile access, making it a popular choice among general contractors.

## Procore

Procore is a cloud-based construction management software designed specifically for general contractors. It offers a range of features to help contractors manage their projects, including project management, document management, financial management, and quality and safety management.

### Advantages:

**Project Management:** Procore offers a range of project management features, including scheduling, task tracking, and change orders. This helps contractors to stay organized and on track throughout the construction process.

**Document Management:** Procore allows contractors to store and share project documents, such as plans, contracts, and permits, in a central location. This helps to reduce duplication and improve collaboration among team members.

**Financial Management:** Procore includes financial management features, such as job costing, budget tracking, and invoice management. This helps contractors to manage their finances more effectively and make informed financial decisions.

**Quality and Safety Management:** Procore includes features for managing quality and safety on construction sites, such as inspections and punch lists. This helps to improve safety and quality control on construction projects.

**Integration:** Procore can integrate with a wide range of other software systems that contractors may be using, such as accounting software and project scheduling software.

### Disadvantages:

**Cost:** Procore can be expensive, with pricing based on the number of users and features needed. This may make it difficult for smaller contractors with limited budgets to afford.

**Customization:** While Procore offers a wide range of features, some contractors may find that they need to customize the software to meet their specific needs. This may require additional time and expense.

**Learning Curve:** While the software is user-friendly, there may still be a learning curve for contractors who are not familiar with construction-specific features or cloud-based software.

**Data Security:** As Procore is cloud-based, some contractors may have concerns about data security and privacy. It is important to ensure that appropriate security measures are in place to protect sensitive project data.

Overall, Procore is a powerful tool for general contractors who need construction-specific project management and financial management features. While it may be expensive and require some customization, it can help contractors to manage their projects and finances more effectively, while improving collaboration and safety on construction sites. Procore offers a user-friendly interface, integration with other software systems, and mobile access, making it a popular choice among general contractors.

## FINAL EXAM QUESTIONS:

81. **What of the following is an advantage of Quickbooks?**
  - A. Learning curve
  - B. Data security
  - C. User-friendly
  - D. Limited customization
  
82. **Which of the following software tools can be used for contractor accounting needs?**
  - A. Foundation Software
  - B. Jonas Premier
  - C. Procore
  - D. All of the above
  
83. **Which of the following is a disadvantage of using Foundation Software?**
  - A. Financial reporting capability
  - B. Job costing options
  - C. Project management
  - D. Learning curve

**84. True or false: Jonas Premier is a cloud-based software.**

- A. True
- B. False

## CONSTRUCTION LOAN INTEREST

### Introduction

Construction loan interest is the interest that is charged on a loan that is used to finance the construction of a property, such as a residential home or commercial building. Essentially interest is the price the contractor pays to borrow the money needed for the project. Construction loans are typically short-term loans that are used to finance the construction phase of a project, with the expectation that the loan will be paid off or refinanced once the construction is complete.

Construction loan interest rates are typically higher than traditional mortgage interest rates, as construction loans are considered to be higher-risk loans. The interest rate on a construction loan may be fixed or variable, depending on the terms of the loan agreement. The interest is usually calculated on the outstanding balance of the loan, and the borrower is typically required to make monthly interest payments during the construction phase.

Once the construction is complete, the borrower may refinance the construction loan into a traditional mortgage or pay off the loan entirely. In some cases, the construction loan may include a provision for converting the loan into a permanent mortgage at the end of the construction phase.

Overall, construction loan interest is an important factor to consider when financing the construction of a property. Borrowers should carefully evaluate the terms of the loan agreement, including the interest rate, repayment terms, and any associated fees, to ensure that the loan is affordable and meets their financing needs.

### Interest Carry

Interest carry is a term used in the construction industry to refer to the interest costs that are incurred by a residential general contractor on a construction loan during the construction phase of a project. When a contractor secures a construction loan to finance a project, they will typically be required to make monthly interest payments on the outstanding balance of the loan during the construction phase. These interest payments are known as interest carry.

Interest carry can be a significant cost for contractors, particularly on larger projects with longer construction timelines. In some cases, interest carry can exceed the contractor's expected profit margin, making it essential to carefully manage costs and ensure that the project is completed on schedule and within budget.

To manage interest carry, contractors must carefully plan the construction timeline, ensuring that the project is completed as efficiently and quickly as possible. This may involve managing subcontractors and suppliers, securing necessary permits and approvals, and implementing effective project management practices.

In addition to managing the construction timeline, contractors can also manage interest carry by negotiating favorable loan terms with their lenders. This may include negotiating a lower interest rate, a longer loan term, or other favorable terms that reduce the overall cost of the loan.

Overall, interest carry is an important factor for residential general contractors to consider when financing a construction project. By carefully managing the construction timeline and negotiating

favorable loan terms, contractors can minimize interest carry and ensure that the project is completed on schedule and within budget.

## FINAL EXAM QUESTIONS:

- 85. Why are construction loan interest rates typically higher than traditional mortgage interest rates?**
- A. Construction loans have lower risk.
  - B. Construction projects are considered less complex.
  - C. Construction loans are considered to be higher-risk loans.
  - D. Construction loans are backed by the government.
- 86. How is the interest on a construction loan usually calculated?**
- A. It is a fixed percentage of the property's appraised value.
  - B. It is based on the borrower's credit score.
  - C. It is calculated on the outstanding balance of the loan.
  - D. It is determined by the property's square footage.
- 87. What options does a borrower have once the construction is complete?**
- A. They must continue making monthly interest payments indefinitely.
  - B. They are required to pay off the loan entirely within a year.
  - C. They can only refinance the construction loan into another construction loan.
  - D. They may refinance the construction loan into a traditional mortgage or pay off the loan entirely.
- 88. What does the term "interest carry" refer to in the construction industry?**
- A. The interest paid by homeowners on their mortgages.
  - B. The interest costs incurred by a general contractor on a construction loan during the construction phase.
  - C. The interest rate charged by lenders for construction loans.
  - D. The interest earned by subcontractors during a construction project.
- 89. Why is interest carry considered a significant cost for contractors in larger projects with longer construction timelines?**
- A. It is incurred during the construction phase and can exceed the expected profit margin.
  - B. It is typically lower than the contractor's expected profit margin.
  - C. It is tax-deductible, reducing overall project costs.
  - D. It is not a factor in larger construction projects.

**90. How can contractors manage interest carry during a construction project?**

- A. By increasing costs associated with the project.
- B. By minimizing subcontractor involvement in the project.
- C. By carefully planning the construction timeline and negotiating favorable loan terms with lenders.
- D. By extending the construction timeline indefinitely.

In conclusion, inadequate accounting practices can have serious consequences for general contractors in the residential building industry. By prioritizing proper accounting practices, contractors can avoid cash flow problems, accurately estimate job costs, stay on top of tax payments, and make informed business decisions. With the right accounting tools and strategies in place, contractors can thrive and achieve long-term success in a competitive industry.

## CONCLUSION

Accounting is a critical aspect of residential general contracting, as it helps contractors to manage their finances and make informed business decisions. By tracking job costs, managing projects, and monitoring cash flow, contractors can ensure profitability and long-term success.

Effective accounting practices can help residential general contractors to stay organized and on track throughout the construction process. By creating and sending professional invoices, tracking payments, and managing payroll, contractors can streamline their operations and improve efficiency.

In addition to financial management, accounting also plays a crucial role in tax planning and compliance. By staying up-to-date with tax laws and regulations, contractors can minimize their tax liabilities and avoid costly penalties.

Accounting software can be a powerful tool for residential general contractors, providing a range of features for bookkeeping, invoicing, financial reporting, and project management. By investing in accounting software, contractors can save time and improve accuracy in their financial management.

Ultimately, strong accounting practices are essential for the success of residential general contractors. By prioritizing job costing, project management, financial reporting, and tax planning, contractors can improve their operations and achieve long-term financial success. With the right tools and strategies in place, contractors can thrive in a competitive and challenging industry.

Inadequate accounting practices can have serious consequences for general contractors in the residential building industry. Here are some of the potential dangers of inadequate accounting:

**Cash Flow Problems:** Inadequate accounting practices can lead to cash flow problems, as contractors may not have an accurate picture of their income and expenses. This can lead to late payments, missed opportunities, and difficulty in managing expenses.

**Overbudgeting and Underbudgeting:** Without proper accounting practices, general contractors may struggle to accurately estimate job costs and bid on projects. This can lead to overbudgeting or underbudgeting, both of which can result in financial losses.

**Missed Tax Payments:** Failure to pay taxes on time or accurately can result in costly penalties and fines, which can be detrimental to a contractor's finances.

**Legal Issues:** Inadequate accounting practices can lead to legal issues, such as failure to pay subcontractors or suppliers on time, or failure to comply with labor laws. This can result in costly lawsuits and damage to the contractor's reputation.

**Inaccurate Financial Reports:** Without accurate financial reports, contractors may struggle to make informed business decisions or secure financing. This can hinder growth and limit opportunities for success.