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## The Importance of Understanding Over- and Under- Billings and Work In Process

Among the most important accounting concepts for contractors and construction companies to understand are the concepts of over- and under-billings and work in process (or WIP). Not accounting for over- and under-billings and WIP accurately can lead to a host of financial problems for contractors, including cash flow shortfalls and “profit fade,” or the recognition of profit too early (or late) during the job cycle. In addition to potentially wreaking havoc on your finances, these problems can also be a major red flag for sureties and lenders.

### What Are Over- and Under-Billings and WIP?

Some construction projects are long-term in nature, with invoicing and costs spread out over a long period of time. The challenge is to match up accounting for invoicing and costs as closely as possible to the actual construction progress that’s occurring on the project. For example, let’s say you have completed 25 percent of a construction project. Ideally, you will have billed out about 25 percent of the contracted amount at this point. For a variety of different reasons, though, it can be difficult to match up billings with the amount of work that has been completed (or work in progress).

If you have invoiced 50 percent of the contract amount at the 25 percent project completion stage, you would be 25 percent over-billed. Conversely, if you have completed 50 percent of the project but have only invoiced 25 percent of the contract amount, you would be 25 percent under-billed. The problem with either scenario is that it results in an inaccurate monthly income (or profit-and-loss) statement. If you are over-billed, your P&L will reflect too much profit; if you’re under-billed, it will reflect too little profit.

Changes in projected costs, meanwhile, can result in profit fade. For example, suppose you are working on a one-year, \$1 million project with projected expenses of \$800,000. During the first six months, you bill half of the project total (or \$500,000) and incur half of the expenses (or \$400,000), realizing half of your projected profit (or \$100,000). Expenses during the next six months, however, hit \$500,000, bringing total costs up to \$900,000 and dropping total profit to \$100,000. But this profit was already realized during the first six months, which is now over-billed, resulting in profit fade during the next six months of \$50,000.

You can use the following formula to calculate your over- and under-billings:

Job#	Costs	/	Budget	=	%	X	Contract	=	Earned -	Billed =	Over	Under
186-Smith	372,263.17		468,432.00		79.47		553,499.00		439,865.66	540,551.80	- 100,686.14	
215-Jones	142,068.50		379,535.62		37.43		663,868.00		248,485.79	140,073.23		108,412.56

## Making a WIP Adjustment

Once you know the amounts that you are over- or under-billed, the next step is to post a WIP adjustment. This will enable you to utilize the matching principal — or in other words, to match your income and expenses to the same period of time — and produce an accurate monthly P&L.

Following are the steps for posting over- and under-billings using *Sage 100 (Master Builder)*®:

1. Make sure the contract amount and the job status are correct (*menu 3-5*).
2. Make sure a budget has been entered (*menu 6-2*).
3. Make sure all change orders have been posted and have the correct status (*menu 6-4-1*).
4. Run the Over/Under Billings report for projects with current status with the correct posting period selected (*menu 6-1-7*).
5. Post the over/under billing adjustment using the correct date and posting period (*menu 1-3*). **Note: Check the “reverse in next period” box.**

Account	Debit Amount	Credit Amount
1190 Under billings (current assets)	108,412.56	
2100 Over billings (current liabilities)		100,686.14
4300 Over/Under billings (income)		7,726.42
Totals	108,412.56	108,412.56

## To Learn More

There are many subtle nuances involved in contractor accounting, including the concepts of over- and under-billings and work in progress. If you have more questions about these concepts or need help implementing them into your accounting practices, please contact On Track Business Management at (530) 478-9234 or send an email to [accounting@on-trackinc.com](mailto:accounting@on-trackinc.com).

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