on TRACK Business Management, Inc.
accounting and consulting for the construction industry

Sage 100 Contractor Certified Consultant 2019

10375 Laurentian Way, Nevada City, CA 95959
(530) 478-9234 www.on-trackinc.com
WE ARE A CERTIFIED WBE

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 underbillings and WIP accurately can lead to a host of financial problems for contactors, 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**