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Key Financial Ratios and New York State Sales Tax for Contractors

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Key Financial Ratios for Contractors

... Analytical Ratios for Contractors

- Ratios play a pivotal role in analyzing financial statements of construction contractors.
- Understanding what the outside users of the financial statements are looking for is ultimately key for any construction financial statements.
- Look over various balance sheet examples to explore the nuances that slight changes in the makeup of the financial data that can cause a financial statement to be viewed favorably or unfavorably.

Example Contractor Balance Sheet

BALANCE SHEETS

	2021	2020
Assets		
Current Assets		
Cash and cash equivalents	\$ 139,000	\$ 63,000
Contracts and retainage receivable, net	3,473,736	1,481,430
Contract assets, including conditional retainage of \$718,000 and \$680,000 at December 31, 2021 and 2020, respectively	1,548,709	1,104,546
Due from Stockholder	2,956,000	2,956,000
Due from affiliates	946,000	1,041,000
Prepaid expenses and other assets	67,000	67,500
Total Current Assets	<u>9,130,445</u>	<u>6,713,476</u>
Property and Equipment		
Vehicles and construction equipment	1,354,000	1,354,000
Buildings	848,000	848,000
Furniture and fixtures	115,000	113,000
Office equipment	94,000	93,000
	2,411,000	2,408,000
Less accumulated depreciation and amortization	1,329,000	1,158,000
Total Property and Equipment, net	<u>1,082,000</u>	<u>1,250,000</u>
Total Assets	<u>\$ 10,212,445</u>	<u>\$ 7,963,476</u>

BALANCE SHEETS (Continued)

	2021	2020
Liabilities and Stockholder's Equity		
Current Liabilities		
Line of credit	\$ 1,727,500	\$ 1,239,000
Current maturities of long-term debt	135,000	122,000
Accounts payable and accrued expenses	4,483,000	1,760,000
Contract liabilities, net of conditional retainage of \$377,555 and \$223,024 at December 31, 2021 and 2020, respectively	163,445	1,144,976
Total Current Liabilities	<u>6,508,945</u>	<u>4,265,976</u>
Long-Term Liabilities		
Long-term debt - less current maturities	300,500	435,500
Loan payable to stockholder	1,225,000	1,100,000
Total Long-Term Liabilities	<u>1,525,500</u>	<u>1,535,500</u>
Total Liabilities	<u>8,034,445</u>	<u>5,801,476</u>
Stockholder's Equity		
Common stock	31,000	31,000
Retained earnings	2,147,000	2,131,000
Total Stockholder's Equity	<u>2,178,000</u>	<u>2,162,000</u>
Total Liabilities and Stockholder's Equity	<u>\$ 10,212,445</u>	<u>\$ 7,963,476</u>

Example of Statement of Income and Cash Flows

STATEMENTS OF INCOME AND RETAINED EARNINGS FOR THE YEARS ENDED DECEMBER 31, 2021 AND 2020

	2021	2020
Revenues Earned	\$ 18,990,000	\$ 9,970,000
Cost of Revenues Earned	<u>16,699,000</u>	<u>7,100,000</u>
Gross Profit	2,291,000	2,870,000
General and Administrative Expenses	<u>2,020,000</u>	<u>1,960,000</u>
Income From Operations	<u>271,000</u>	<u>910,000</u>
Other Expenses		
Interest expense	<u>(232,000)</u>	<u>(107,000)</u>
Total Other Expenses, net	<u>(232,000)</u>	<u>(107,000)</u>
Net Income	39,000	803,000
Retained Earning, Beginning	2,131,000	1,522,000
Distributions to stockholder	<u>(23,000)</u>	<u>(194,000)</u>
Retained Earning, Ending	<u>2,147,000</u>	<u>2,131,000</u>

Cash Flows from Operating Activities

	2021	2020
Net income	\$ 39,000	\$ 803,000
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation and amortization	170,700	175,000
Changes in assets and liabilities:		
Contracts and retainage receivable	(1,992,306)	(1,235,000)
Contract assets	(444,163)	(75,000)
Prepaid expenses	500	137,000
Accounts payable and accrued expenses	2,723,000	(752,000)
Contract liabilities	<u>(981,531)</u>	<u>452,000</u>
Net Cash Used in Operating Activities	<u>(484,800)</u>	<u>(495,000)</u>

Cash Flows from Investing Activities

Repayments from (advances to) affiliates	95,000	(676,000)
Purchase of property and equipment	<u>(2,700)</u>	<u>(112,000)</u>
Net Cash Provided by (Used in) Investing Activities	<u>92,300</u>	<u>(788,000)</u>

Cash Flows from Financing Activities

Proceeds from stockholder loan	125,000	1,100,000
Proceeds from line of credit, net	488,500	163,000
Distributions to stockholder	(23,000)	(194,000)
Principal payments on long-term debt	<u>(122,000)</u>	<u>147,000</u>
Net Cash Provided by Financing Activities	<u>468,500</u>	<u>1,216,000</u>
Net Change in Cash and Cash Equivalents	76,000	(67,000)
Cash and Cash Equivalents - Beginning	<u>63,000</u>	<u>130,000</u>
Cash and Cash Equivalents - Ending	<u>\$ 139,000</u>	<u>\$ 63,000</u>

Analytical Ratios for Contractors

Key Performance Indicators	
Profitability Ratios	Leverage Ratios
Return on Assets	Debt to Equity
Return on Equity	Asset Turnover
Times Interest Earned	Fixed Asset Ratio
Liquidity Ratios	Efficiency Ratios
Current Ratio	Backlog to Working Capital
Quick Ratio	Months in Backlog
Days of Cash	Days in AR / Inventory / AP
Working Capital Turnover	Operating Cycle

General Construction Industry Standards:

10% Rule -	10% Working Capital
	10% Equity of Total Costs to Complete
Working Capital -	10 – 15% of Annual Revenue
Backlog -	Equal to 1 years' worth of Revenue
Debt-to-Equity Ratio -	Below a 3:1 Ratio
Under billings -	Under 25% of working Capital
Profit Fade -	Less than 10% of the Original Estimate
Bonding -	10-20 times Working Capital
	10 times net worth

... Contractor Warning Signs

- Large number of underbillings (CIE).
 - Asset on the balance sheet - is it really a “good” asset?
 - Consider the concerns that are present if the contractor’s contracts are mostly underbilled. The situation can be an indication that:
 - Poor billing practices exist within the contractor;
 - Poor measurement of total job costs can be seen in the gross profit trend analysis;
 - Possibly poor practices exist in estimating and quoting values and quantities (lack of front-end loading); and/or
 - Certain industry billing restrictions (such as input versus output measurements) exist that cause the contractor to always be underbilled.
 - Is it better to have a \$1,000,000 CIE balance on a job, or improve billing practices and potentially bill that same amount at period end?
 - The actual billing has zero impact on net income, but greatly improves ratios.

Contractor Warning Signs

- Large number of overbillings (BIE).
 - Liability on the balance sheet - is it really a “good” liability?
 - Consider the concerns that are present if the contractor’s contracts are mostly overbilled. The situation can be an indication that:
 - Aggressive billing practices exist within the contractor;
 - Looking to fund a project with project money vs. bank/line of credit;
 - Where are billings in excess on the balance sheet (cash/accounts receivable)?
 - Subsequent approval of requisitions/overbillings (“pencil” vs. “approved” copy);
 - Contractor uses cash from overbillings to fund other ventures (outside of the company).

... Working Capital & Stockholder's Equity

- **Working capital** is the most important contractor ratio. It is a direct indicator of a contractor's short-term financial strength and is used to help evaluate a contractor's ability to fund construction projects.
 - Calculation – ***current assets minus current liabilities***
- **Stockholders' equity**, often referred to as book value or net worth, represents the accumulated earnings and invested capital since the inception of the company.
 - Calculation – ***total assets minus total liabilities***

What Are the Working Capital and Equity of the Following Company?

BALANCE SHEETS

	2021	2020
Assets		
Current Assets		
Cash and cash equivalents	\$ 139,000	\$ 63,000
Contracts and retainage receivable, net	3,473,736	1,481,430
Contract assets, including conditional retainage of \$718,000 and \$680,000 at December 31, 2021 and 2020, respectively	1,548,709	1,104,546
Due from Stockholder	2,956,000	2,956,000
Due from affiliates	946,000	1,041,000
Prepaid expenses and other assets	67,000	67,500
Total Current Assets	9,130,445	6,713,476
Property and Equipment		
Vehicles and construction equipment	1,354,000	1,354,000
Buildings	848,000	848,000
Furniture and fixtures	115,000	113,000
Office equipment	94,000	93,000
	2,411,000	2,408,000
Less accumulated depreciation and amortization	1,329,000	1,158,000
Total Property and Equipment, net	1,082,000	1,250,000
Total Assets	\$ 10,212,445	\$ 7,963,476

BALANCE SHEETS (Continued)

	2021	2020
Liabilities and Stockholder's Equity		
Current Liabilities		
Line of credit	\$ 1,727,500	\$ 1,239,000
Current maturities of long-term debt	135,000	122,000
Accounts payable and accrued expenses	4,483,000	1,760,000
Contract liabilities, net of conditional retainage of \$377,555 and \$223,024 at December 31, 2021 and 2020, respectively	163,445	1,144,976
Total Current Liabilities	6,508,945	4,265,976
Long-Term Liabilities		
Long-term debt - less current maturities	300,500	435,500
Loan payable to stockholder	1,225,000	1,100,000
Total Long-Term Liabilities	1,525,500	1,535,500
Total Liabilities	8,034,445	5,801,476
Stockholder's Equity		
Common stock	31,000	31,000
Retained earnings	2,147,000	2,131,000
Total Stockholder's Equity	2,178,000	2,162,000
Total Liabilities and Stockholder's Equity	\$ 10,212,445	\$ 7,963,476

Working Capital Comparison

BALANCE SHEETS

	2021	2020
Assets		
Current Assets		
Cash and cash equivalents	\$ 139,000	\$ 63,000
Contracts and retainage receivable, net	3,473,736	1,481,430
Contract assets, including conditional retainage of \$718,000 and \$680,000 at December 31, 2021 and 2020, respectively	1,548,709	1,104,546
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Furniture and fixtures	115,000	113,000
Office equipment	94,000	93,000
Less accumulated depreciation and amortization	2,411,000	2,408,000
	1,329,000	1,158,000
Total Property and Equipment, net	1,082,000	1,250,000
Total Assets	\$ 10,212,445	\$ 7,963,476

Working Capital
2021 =
\$2,621,500

Working Capital
2020 =
\$2,447,500

BALANCE SHEETS (Continued)

	2021	2020
Liabilities and Stockholder's Equity		
Current Liabilities		
Line of credit	\$ 1,727,500	\$ 1,239,000
Current maturities of long-term debt	135,000	122,000
Accounts payable and accrued expenses	4,483,000	1,760,000
Contract liabilities, net of conditional retainage of \$377,555 and \$223,024 at December 31, 2021 and 2020, respectively	163,445	1,144,976
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Total Liabilities	8,034,445	5,801,476
Stockholder's Equity		
Common stock	31,000	31,000
Retained earnings	2,147,000	2,131,000
Total Stockholder's Equity	2,178,000	2,162,000
Total Liabilities and Stockholder's Equity	\$ 10,212,445	\$ 7,963,476

Adjusting Working Capital

BALANCE SHEETS

	2021	2020
Assets		
Current Assets		
Cash and cash equivalents	\$ 139,000	\$ 63,000
Contracts and retainage receivable, net	3,473,736	1,481,430
Contract assets, including conditional retainage of \$718,000 and \$680,000 at December 31, 2021 and 2020, respectively	1,548,709	1,104,546
Due from Stockholder	2,956,000	2,956,000
Due from affiliates	946,000	1,041,000
Prepaid expenses and other assets	67,000	67,500
Total Current Assets	9,130,445	6,713,476
Property and Equipment		
Vehicles and construction equipment	1,354,000	1,354,000
Buildings	848,000	848,000
Furniture and fixtures	5,000	113,000
Office equipment	94,000	93,000
	2,411,000	2,408,000
Less accumulated depreciation and amortization	1,329,000	1,158,000
Total Property and Equipment, net	1,082,000	1,250,000
Total Assets	\$ 10,212,445	\$ 7,963,476

Adjusted
Working Capital
2021 =
(\$1,280,500)

Adjusted
Working Capital
2020 =
(\$1,549,500)

BALANCE SHEETS (Continued)

	2021	2020
Liabilities and Stockholder's Equity		
Current Liabilities		
Line of credit	\$ 1,727,500	\$ 1,239,000
Current maturities of long-term debt	135,000	122,000
Accounts payable and accrued expenses	4,483,000	1,760,000
Contract liabilities, net of conditional retainage of \$377,555 and \$223,024 at December 31, 2021 and 2020, respectively	163,445	1,144,976
Total Current Liabilities	6,508,945	4,265,976
Long-Term Liabilities		
Long-term debt - less current maturities	300,500	435,500
Loan payable to stockholder	1,225,000	1,100,000
Total Long-Term Liabilities	1,525,500	1,535,500
Total Liabilities	8,034,445	5,801,476
Stockholder's Equity		
Common stock	31,000	31,000
Retained earnings	2,147,000	2,131,000
Total Stockholder's Equity	2,178,000	2,162,000
Total Liabilities and Stockholder's Equity	\$ 10,212,445	\$ 7,963,476

Related Party to Equity

BALANCE SHEETS

	2021	2020
Assets		
Current Assets		
Cash and cash equivalents	\$ 139,000	\$ 63,000
Contracts and retainage receivable, net	3,473,736	1,481,430
Contract assets, including conditional retainage of \$718,000 and \$680,000 at December 31, 2021 and 2020, respectively	1,548,700	1,104,546
Due from Stockholder	2,956,000	2,956,000
Due from affiliates	946,000	1,041,000
Prepaid expenses and other assets	67,000	67,500
Total Current Assets	9,130,445	6,713,476
Property and Equipment		
Vehicles and construction equipment	1,354,000	1,354,000
Buildings	848,000	848,000
Furniture and fixtures	115,000	113,000
Office equipment	94,000	93,000
	2,411,000	2,408,000
Less accumulated depreciation	1,329,000	1,158,000
Total Property and Equipment	1,082,000	1,250,000
Total Assets	\$ 10,212,445	\$ 7,963,476

Adjusted
Stockholder's
Equity 2021 =
(\$499,000)

Adjusted
Stockholder's
Equity 2020 =
(\$735,000)

BALANCE SHEETS (Continued)

	2021	2020
Liabilities and Stockholder's Equity		
Current Liabilities		
Line of credit	\$ 1,727,500	\$ 1,239,000
Current maturities of long-term debt	135,000	122,000
Accounts payable and accrued expenses	4,483,000	1,760,000
Contract liabilities, net of conditional retainage of \$377,555 and \$223,024 at December 31, 2021 and 2020, respectively	163,445	1,144,976
Total Current Liabilities	6,508,945	4,265,976
Long-Term Liabilities		
Long-term debt, less current maturities	200,500	425,500
Loan payable to stockholder	1,225,000	1,100,000
Total Long-Term Liabilities	1,525,500	1,535,500
Total Liabilities	8,034,445	5,801,476
Stockholder's Equity		
Common stock	31,000	31,000
Retained earnings	2,147,000	2,124,000
Total Stockholder's Equity	2,178,000	2,162,000
Total Liabilities and Stockholder's Equity	\$ 10,212,445	\$ 7,963,476

Backlog Ratios

- **Total backlog** is the amount of work under contract not yet completed.
 - Calculated – *total contract value on open projects less earned revenue on open projects*
- **Backlog gross profit** represents the amount of future gross profit not yet earned on uncompleted contracts. Generally, backlog gross profit should exceed 50 % of general and administrative expenses.
 - Calculated – *estimated total G.P. on open projects less G.P. earned to date*

Work-in-Process Schedule

Contract	Total Contract		From Inception to December 31, 2021				At December 31, 2021		Year Ended December 31, 2021			At December 31, 2021		
	Contract Price	Estimated Gross Profit	Revenue Earned	Costs of Revenues Earned	Gross Profit	Billings To Date (Including Conditional Retainage)	Revenue in Excess of Billings and Conditional Retainage	Billings and Conditional Retainage in Excess of Revenues	Revenues Earned	Costs of Revenues	Gross Profit	Backlog	Estimated Costs to Complete	
Job 1	\$ 9,524,500	\$ 1,423,242	\$ 8,256,453	\$ 7,022,695	\$ 1,233,758	\$ 8,412,904	\$ --	\$ 156,451	\$ 8,248,684	\$ 7,016,095	\$ 1,232,589	\$ 1,268,047	\$ 1,078,563	87%
Job 2	7,355,500	2,111,972	204,216	145,580	58,636	--	204,216	--	204,216	145,580	58,636	7,151,284	5,097,948	3%
Job 3	3,068,132	797,324	2,689,782	1,990,781	699,001	2,726,981	--	37,199	2,516,931	1,847,218	669,713	378,350	280,027	88%
Job 4	2,954,024	287,751	2,049,455	1,849,818	199,637	2,133,855	--	84,400	2,049,455	1,849,818	199,637	904,569	816,455	69%
Job 5	2,564,000	430,802	883,822	735,323	148,499	258,038	625,784	--	883,822	735,323	148,499	1,680,178	1,397,875	34%
Job 6	2,193,000	380,898	148,039	122,326	25,713	243,505	--	95,466	148,039	122,326	25,713	2,044,961	1,689,776	7%
Job 7	1,263,170	219,826	907,163	749,292	157,871	982,006	--	74,843	677,139	535,515	141,624	356,007	294,052	72%
Job 8	798,759	127,578	113,572	95,432	18,140	125,942	--	12,370	113,572	95,432	18,140	685,187	575,749	14%
Job 9	640,000	160,825	436,927	327,132	109,795	517,198	--	80,271	436,927	327,132	109,795	203,073	152,043	68%
	<u>\$ 30,361,085</u>	<u>\$ 5,940,218</u>	<u>\$ 15,689,429</u>	<u>\$ 13,038,379</u>	<u>\$ 2,651,050</u>	<u>\$ 15,400,429</u>	<u>\$ 830,000</u>	<u>\$ 541,000</u>	<u>\$ 15,278,785</u>	<u>\$ 12,674,439</u>	<u>\$ 2,604,346</u>	<u>\$ 14,671,656</u>	<u>\$ 11,382,488</u>	

Calculation of Backlog

Total Contract			From Inception to December 31, 2021			At December 31, 2021			Year Ended December 31, 2021			At December 31, 2021	
	A	Estimated	B	Costs of		Billings	Revenue	Billings and					
Contract	Contract	Gross	Revenue	Revenues	Gross	Date	in Excess	Conditional	Retainage in	Revenues	Costs of	Gross	Estimated
	Price	Profit	Earned	Earned	Profit		of Billings and	Excess of	Revenues	Earned	Revenues	Profit	Costs to
							Conditional	Revenues					Complete
							Retainage						
Job 1	\$ 9,524,500	\$ 1,423,242	\$ 8,256,453	\$ 7,022,695	\$ 1,233,758		--	\$ 156,451	\$ 8,248,684	\$ 7,016,095	\$ 1,232,589	\$ 1,268,047	\$ 1,078,563
Job 2	7,355,500	2,111,972	204,216	145,580	68,636		--	--	204,216	145,580	58,636	7,151,284	5,097,948
Job 3	3,068,132	797,324	2,689,782	1,990,717	699,065		--	37,199	2,516,931	1,847,218	669,713	378,350	280,027
Job 4	2,954,024	287,751	2,049,455	1,849,818	199,637		--	84,400	2,049,455	1,849,818	199,637	904,569	816,455
Job 5	2,564,000	430,802	883,822	735,323	148,499	625,784	--	--	883,822	735,323	148,499	1,680,178	1,397,875
Job 6	2,193,000	380,898	148,039	122,326	25,713		--	95,466	148,039	122,326	25,713	2,044,961	1,689,776
Job 7	1,263,170	219,826	907,163	749,292	157,871		--	74,843	677,139	535,515	141,624	356,007	294,052
Job 8	798,759	127,578	113,572	95,432	18,140	42	--	12,370	113,572	95,432	18,140	685,187	575,749
Job 9	640,000	160,825	436,927	327,132	109,795	7,198	--	80,271	436,927	327,132	109,795	203,073	152,043
	\$ 30,361,085	\$ 5,940,218	\$ 15,689,429	\$ 13,038,379	\$ 2,651,050	\$ 15,400,429	\$ 830,000	\$ 541,000	\$ 15,278,785	\$ 12,674,439	\$ 2,604,346	\$ 14,671,656	\$ 11,382,488

Backlog
(Contract
Value –
Revenues
Earned)

\$14,671,656

A – B = 14,671,656

Calculation of Backlog Gross Profit

Total Contract		From Inception to December 31, 2021				At December 31, 2021		Year Ended December 31, 2021			At December 31, 2021		
Contract	Contract Price	A Estimated Gross Profit	Revenue Earned	Costs of Revenues Earned	B Gross Profit	Billings To Date (Including Conditional Retainage)	Revenue in Excess of Billings and Retainage	Revenues Earned	Costs of Revenues	Gross Profit	Backlog	Estimated Costs to Complete	
Job 1	\$ 9,524,500	\$ 1,423,242	\$ 8,256,453	\$ 7,022,695	\$ 1,233,758	\$ 1,451		\$ 8,248,684	\$ 7,016,095	\$ 1,232,589	\$ 1,268,047	\$ 1,078,563	87%
Job 2	7,355,500	2,111,972	204,216	145,580	58,636			204,216	145,580	58,636	7,151,284	5,097,948	3%
Job 3	3,068,132	797,324	2,689,782	1,990,781	699,001			2,516,931	1,847,218	669,713	378,350	280,027	88%
Job 4	2,954,024	287,751	2,049,455	1,849,818	199,637			2,049,455	1,849,818	199,637	904,569	816,455	69%
Job 5	2,564,000	430,802	883,822	735,323	148,499			883,822	735,323	148,499	1,680,178	1,397,875	34%
Job 6	2,193,000	380,898	148,039	122,326	25,713			148,039	122,326	25,713	2,044,961	1,689,776	7%
Job 7	1,263,170	219,826	907,163	749,292	157,871	98,271	74,843	677,139	535,515	141,624	356,007	294,052	72%
Job 8	798,759	127,578	113,572	95,432	18,140	125,942	12,370	113,572	95,432	18,140	685,187	575,749	14%
Job 9	640,000	160,825	436,927	327,132	109,795	517,198	80,271	436,927	327,132	109,795	203,073	152,043	68%
	<u>\$ 30,361,085</u>	<u>\$ 5,940,218</u>	<u>\$ 15,689,429</u>	<u>\$ 13,038,379</u>	<u>\$ 2,651,050</u>	<u>\$ 15,400,429</u>	<u>\$ 830,000</u>	<u>\$ 15,278,785</u>	<u>\$ 12,674,439</u>	<u>\$ 2,604,346</u>	<u>\$ 14,671,656</u>	<u>\$ 11,382,488</u>	

Backlog Gross Profit (Estimated G.P. – Gross Profit Earned)
\$3,289,168

A – B = 3,289,168

What Do the Backlog Figures Tell Us?

STATEMENTS OF INCOME AND RETAINED EARNINGS FOR THE YEARS ENDED DECEMBER 31, 2018 AND 2017

	2018	2017
Revenues Earned	\$ 18,990,000	\$ 9,970,000
Cost of Revenues Earned	<u>16,699,000</u>	<u>7,100,000</u>
Gross Profit	2,291,000	2,870,000
General and Administrative Expenses	<u>2,020,000</u>	<u>1,960,000</u>
Income from Operations	<u>271,000</u>	<u>910,000</u>
Other Expenses		
Interest expense	<u>(232,000)</u>	<u>(107,000)</u>
Total Other Expenses, net	<u>(232,000)</u>	<u>(107,000)</u>
Net Income	39,000	803,000
Retained Earnings, Beginning	2,131,000	1,522,000
Distributions to stockholder	<u>(23,000)</u>	<u>(194,000)</u>
Retained Earnings, Ending	<u>\$ 2,147,000</u>	<u>\$ 2,131,000</u>

- As determined on the previous slide the backlog for this Company is currently \$14,671,656 with a backlog gross profit of \$3,289,168.
- Based on the income statement herein, would you say we have sufficient backlog gross profit?

Percentage of Completion Adjustment

- **Total job borrow** indicates the net percentage of completion adjustment. A **positive** number represents a net overbilling. This indicates that the contractor has bid its work in which the contract owner assists the contractor in financing the job. A **negative** number represents a net underbilling, which is considered unusual by most sureties. Net underbillings may indicate poor billing or bidding practices or may also indicate overly aggressive profitability forecasts.
 - Calculated – ***total billings in excess of costs and estimated earnings minus total costs and estimated earnings in excess of billings.***

... Total Job Borrow – (New WIP Numbers)

Contract	Total Contract			From Inception to December 31, 2021				At December 31, 2021	
	Contract Price	Estimated Cost of Revenues	Estimated Gross Profit	Revenue Earned	Costs of Revenues Earned	Gross Profit	Billings To Date (Including Conditional Retainage)	Revenue in Excess of Billings and Conditional Retainage	Billings and Conditional Retainage in Excess of Revenues
Job 1	\$ 14,500,000	\$ 14,349,760	\$ 150,240	\$ 2,925,792	\$ 2,895,477	\$ 30,315	\$ 3,565,818	\$ --	\$ 640,026
Job 2	4,765,226	4,267,593	497,633	4,765,226	4,267,593	497,633	4,729,672	35,554	--
Job 3	4,323,649	4,006,344	317,305	4,323,649	4,006,344	317,305	4,321,266	2,383	--
Job 4	4,223,292	4,012,127	211,165	1,763,517	1,675,341	88,176	1,888,655	--	125,138
Job 5	3,085,716	2,892,345	193,371	3,085,716	2,892,345	193,371	2,923,213	162,503	--
Job 6	2,994,541	2,747,066	247,475	688,954	632,017	56,937	1,303,531	--	614,577
	<u>\$ 33,892,424</u>	<u>\$ 32,275,235</u>	<u>\$ 1,617,189</u>	<u>\$ 17,552,854</u>	<u>\$ 16,369,117</u>	<u>\$ 1,183,737</u>	<u>\$ 18,732,155</u>	\$ <u>200,440</u>	\$ <u>1,379,741</u>
								B	A
								A – B = 1,179,301	

... Underbilling and Overbilling Ratios

- **Ratio of underbillings to equity** is the percentage of the contractor's net worth which is represented by work which has been performed but not yet billed. A ratio in excess of 20% is considered unusual by most sureties.
 - Calculated – *cost and estimated earnings in excess of billing divided by stockholder's equity*
- **Underbillings to working capital** represents the portion of the contractor's working capital which is comprised of underbillings. A ratio in excess of 25% is considered unusual by most sureties.
 - Calculated – *cost and estimated earnings in excess of billing divided by working capital*
- **Ratio of cash to overbillings** represents the amount of cash in the bank as a ratio of billings in excess of costs and estimated earnings on uncompleted contracts. All overbilled amounts should be represented by cash in the bank. Therefore, an acceptable ratio of cash to overbillings is generally 1 or higher.
 - Calculated – *billings in excess of costs and estimated earnings divided by cash and cash equivalents*

Analyzing Underbillings to Equity

BALANCE SHEETS

	2021	2020
Assets		
Current Assets		
Cash and cash equivalents	\$ 139,000	\$ 63,000
Contracts and retainage receivable, net	3,473,736	1,481,430
Contract assets, including conditional retainage of \$718,000 and \$680,000 at December 31, 2021 and 2020, respectively	1,548,709	1,104,546
Due from Stockholder	2,956,000	2,956,000
Due from affiliates	946,000	1,041,000
Prepaid expenses and other	67,000	67,500
Total Current Assets	9,130,445	6,713,476
Property and Equipment		
Vehicles and computer equipment	1,354,000	1,354,000
Buildings	848,000	848,000
Furniture	115,000	113,000
Office equipment	94,000	93,000
Less accumulated depreciation	2,411,000	2,408,000
	1,329,000	1,158,000
Total Property and Equipment	1,082,000	1,250,000
Total Assets	\$ 10,212,445	\$ 7,963,476

Underbillings to
Equity 2021

$$1 - (1,548,709 - 718,000) = 830,000$$

$$2 - (830,000 / 2,147,000) = 38\%$$

BALANCE SHEETS (Continued)

	2021	2020
Liabilities and Stockholder's Equity		
Current Liabilities		
Line of credit	\$ 1,727,500	\$ 1,239,000
Current maturities of long-term debt	135,000	122,000
Accounts payable and accrued expenses	4,483,000	1,760,000
Contract liabilities, net of conditional retainage of \$377,555 and \$223,024 at December 31, 2021 and 2020, respectively	163,445	1,144,976
Total Current Liabilities	6,508,945	4,265,976
Long-Term Liabilities		
Long-term debt - less current maturities	300,500	435,500
Loan payable to stockholder	1,225,000	1,100,000
Total Long-Term Liabilities	1,525,500	1,535,500
Total Liabilities	8,034,445	5,801,476
Stockholder's Equity		
Common stock	31,000	31,000
Retained earnings	2,147,000	2,131,000
Total Stockholder's Equity	2,178,000	2,162,000
Total Liabilities and Stockholder's Equity	\$ 10,212,445	\$ 7,963,476

Analyzing Underbillings to Working Capital

Reminder:
Working
Capital 2021
= \$2,621,500

BALANCE SHEETS

	2021	2020
Assets		
Current Assets		
Cash and cash equivalents	\$ 139,000	\$ 63,000
Contracts and retainage receivable, net	3,473,736	1,481,430
Contract assets, including conditional retainage of \$718,000 and \$680,000 at December 31, 2021 and 2020, respectively	1,548,709	1,104,546
Due from Stockholder	2,956,000	2,956,000
Due from affiliates	946,000	1,041,000
Prepaid expenses and	67,000	67,500
Total Current Assets	9,130,445	6,713,476
Property and Equipment		
Vehicles	1,354,000	1,354,000
Buildings	848,000	848,000
Equipment	115,000	113,000
	94,000	93,000
	2,411,000	2,408,000
	1,329,000	1,158,000
Total	1,082,000	1,250,000
Total Assets	\$ 10,212,445	\$ 7,963,476

Underbillings to Equity
2021

$$1 - (1,548,709 - 718,000) = 830,000$$

$$2 - (830,000 / 2,621,500) = 38\%$$

BALANCE SHEETS (Continued)

	2021	2020
Liabilities and Stockholder's Equity		
Current Liabilities		
Line of credit	\$ 1,727,500	\$ 1,239,000
Current maturities of long-term debt	135,000	122,000
Accounts payable and accrued expenses	4,483,000	1,760,000
Contract liabilities, net of conditional retainage of \$377,555 and \$223,024 at December 31, 2021 and 2020, respectively	163,445	1,144,976
Total Current Liabilities	6,508,945	4,265,976
Long-Term Liabilities		
Long-term debt - less current maturities	300,500	435,500
Loan payable to stockholder	1,225,000	1,100,000
Total Long-Term Liabilities	1,525,500	1,535,500
Total Liabilities	8,034,445	5,801,476
Stockholder's Equity		
Common stock	31,000	31,000
Retained earnings	2,147,000	2,131,000
Total Stockholder's Equity	2,178,000	2,162,000
Total Liabilities and Stockholder's Equity	\$ 10,212,445	\$ 7,963,476

Contract Gain/Fade Analysis

- **Contract gain or fade** is the net change in estimated contract profitability from year to year and is used to calculate the overall impact on the bottom line of the contract.
 - A contract fade could indicate poor contract profit estimating or unforeseen jobsite conditions.
 - When a fade is identified, we need to establish if this is a result of recent events or a bad estimate. The validity of the entire FS is based on management's ability to estimate projects. A trend of missed/bad estimates would lead to a cause for concern in our reliance on management's estimates.
 - However, a contract fade could simply be the result of pending unapproved change orders that have been performed but are not yet reflected in the contract value due to official execution being pending. Therefore, the estimated costs have increased without a corresponding increase in the contract price. This is where understanding the client's practices for change order recognition is important.
 - It's important to evaluate if there is a material impact on the overall profit margin that may require a change in estimate disclosure on the FS.

... Contract Gain/Fade Analysis

- Trend analysis (job fade/gain analysis).
 - A trend toward overstating profits on uncompleted contracts should not be permitted to continue by the auditor. Historic company trends on estimates and changes to revenues and costs should be maintained and analyzed over a several-year period of time.
 - This is another example of why understanding the specific Company you're reviewing or auditing is an important layer of evaluating the trend analysis.

Contract Gain/Fade Analysis

Purpose: To review prior year estimates and address any significant fluctuations in gross margin during the current year as well as to assess management's estimates on their costs to complete. /jc

Source: Current year and prior year WIP schedules. /jc

Scope: We will investigate any changes in excess of \$200,000 (from contract materiality) or anything considered unusual. /jc

	<u>12/31/20X1</u>	<u>10/31/20X2</u>		<u>12/31/20X1</u>	<u>10/31/20X2</u>			
<u>Job #</u>	<u>Contract Total</u>	<u>Contract Total</u>	<u>Incr.(Decr.) Change</u>	<u>Total Estimated Cost</u>	<u>Total Estimated Cost</u>	<u>Incr.(Decr.) Change</u>	<u>Incr.(Decr.) to GP Net Change</u>	<u>% of 20X2 Contract</u>
125	\$ 14,700,000	\$ 14,690,000	\$ (10,000)	\$ 13,450,000	\$ 13,390,000	\$ (60,000)	\$ 50,000	0.34%
127	33,200,000	33,260,000	60,000	30,200,000	30,290,000	90,000	(30,000)	-0.09%
128	29,000,000	27,000,000	(2,000,000)	26,750,000	25,675,000	(1,075,000)	(925,000)	-3.43%
129	12,250,000	11,780,000	(470,000)	10,300,000	10,301,500	1,500	(471,500)	-4.00%
131	11,815,000	12,811,000	996,000	10,460,000	11,345,000	885,000	111,000	0.87%
132	44,300,000	47,000,000	2,700,000	41,125,000	44,200,000	3,075,000	(375,000)	-0.80%
133	4,750,000	4,400,000	(350,000)	4,400,000	4,490,000	90,000	(440,000)	-10.00%
134	15,889,000	16,900,000	1,011,000	15,200,000	16,200,000	1,000,000	11,000	0.07%
	<u>\$ 165,904,000</u>	<u>\$ 167,841,000</u>	<u>\$ 1,937,000</u>	<u>\$ 151,885,000</u>	<u>\$ 155,891,500</u>	<u>\$ 4,006,500</u>	<u>\$ (2,069,500)</u>	<u>-1.23%</u>

Conclusion: Per work performed, fluctuations in gross margin although material, are appropriate based on review of supporting documentation and discussions with CFO regarding differences from PY estimated contracts and estimated costs to complete to current year costs, other than those identified above, which were the result of circumstances occurring in 20X1 and 20X2 that were not anticipated. The Company has been conservative in their estimations for costs to complete reflected on the job schedule and we can rely on management's current year estimated costs to complete. Further, we will review contracts as part of our year end testing. /jc

A background image showing a group of people in business attire working at a table. One person is pointing at a document, while others look on. A laptop is visible in the foreground. A solid blue rectangular overlay covers the center of the image, providing a background for the text.

New York State Sales Tax for Contractors

Taxable vs. Nontaxable Services

... Taxable Services

- The following services performed are subject to sales tax collection:
 - Repair and maintenance; and
 - Installation.

... Repair and Maintenance Defined

- Taxable repair and maintenance is defined as a job where the purpose is to keep real property in good working order, readiness, or safety, or restoring it to that condition.
- Examples:
 - Fixing a broken railing;
 - Re-pointing a chimney;
 - Replacing a faucet; and
 - Replacing damaged roof shingles.

... Installation Defined

- Taxable installation services are defined as the service of installing items that do **not** become part of the real property.
 - Examples:
 - Installing freestanding appliances;
 - Installing above-ground swimming pools;
 - Installing canvas awnings; and
 - Installing weather stripping.

... Nontaxable Services

- Capital improvements are nontaxable services that sales tax does not need to be collected on.

... Capital Improvements Defined

- A capital improvement is an addition or alteration to real property that:
 - Substantially adds to the value of the real property, or appreciably prolongs the useful life of the real property;
 - Becomes part of the real property or is permanently affixed to the real property so that removal would cause material damage to the property or article itself; and
 - Is intended to become a permanent installation.
- You must receive Form ST-124, “*Certificate of Capital Improvement*”, from the customer.

... Leasehold Improvements

- As a general rule, additions or alterations to real property for or by a tenant with respect to leased premises are presumed to be temporary in nature.
- Due to the temporary nature, they do not qualify as capital improvements, thus making them subject to sales tax.
- However, they can qualify as a capital improvement if there is a demonstrated intention to make the improvements permanent:
 - Provision in the lease agreement stating upon installation, title of the improvement vests with the lessor and remains with the property upon lease termination; and
 - Written agreements between lessor and lessee.

... Determining Whether Services are Repairs or Capital Improvements

- NYS Publication 862 provides specific examples of services that are classified as repairs and maintenance, installation, or capital improvements. A few of the categories that are included in these examples are HVAC, bathrooms, brickwork, driveways/parking lots/walks, electrical, exterior, floors, kitchens, landscaping, masonry, painting, plumbing, and roofing.
 - Work must be looked at on a case-by-case basis as to the classification and taxability of the services provided.

Capital Improvement vs. Repair – HVAC

- Capital Improvement:
 - Original installation or complete replacement of “through-the-wall” mounted units.
 - Installation of central air conditioning systems.
 - Original installation of ductwork or required additional ductwork.
 - Replacement of complete central air conditioning units.
 - Installation or complete replacement of heating systems:
 - Boilers;
 - Furnaces;
 - Hot water systems; and
 - Solar systems.

Capital Improvement vs. Repair – HVAC

- Repair/Maintenance:
 - Repair or replacement of in-window, through-the-wall mounted units, central air conditioning, or heating system components:
 - Blowers;
 - Casings;
 - Compressors;
 - Fans/fan motors;
 - Filters;
 - Fuses;
 - Pressure controls;
 - Refrigerant
 - Storage tanks; and
 - Thermostats.
 - Maintenance contracts.
 - Cleaning of heating systems.
- Installation:
 - Installation or replacement of window air conditioners.

Capital Improvement vs. Repair – Bathrooms

- Capital Improvement:
 - Complete remodeling of bathrooms (toilet, tub and vanity).
 - Complete installation or replacement of:
 - Cabinets;
 - Exhaust fans;
 - Floor tiles (ceramic or quarry);
 - Sinks;
 - Tile (floor or wall);
 - Toilets;
 - Tubs;
 - Tub or shower enclosures;
 - Vanities; and
 - Wall tiles.

Capital Improvement vs. Repair – Bathrooms

- Repair/Maintenance:
 - Repair of:
 - Cabinets;
 - Exhaust fans;
 - Faucets;
 - Mirrors ;
 - Shower heads;
 - Sinks.
 - Tile;
 - Toilets;
 - Tubs;
 - Tub or shower enclosures;
 - Vanities; and
 - Replacement of faucets and shower heads.
- Installation:
 - Installation of free-standing cabinets.

Capital Improvement vs. Repair – Brickwork

- Capital Improvement:
 - Construction of new or complete replacement of brick:
 - Chimneys;
 - Exterior surfaces;
 - Fireplaces;
 - Stairs or Step;
 - Structures; and
 - Walls.
- Repair/Maintenance:
 - Fixing cracks;
 - Replacing damaged bricks;
 - Repointing; and
 - Sandblasting.

Capital Improvement vs. Repair – Driveways, Parking Lots, and Walks

- Capital Improvement:
 - Installation or complete repaving (resurfacing) of driveways, parking lots, and walks;
 - Original landscaping of parking lot islands;
 - Original installation of gravel or crushed stone driveway; and
 - Original stripping (line painting) on new parking lot.
- Repair/Maintenance:
 - Replacement of cobblestones, crushed stone, or crushed stone with oil;
 - Repairing and patching of holes and cracks;
 - Replacing sections of concrete or blacktop driveways, parking lots, and walks;
 - Restriping, sealing, and dressing;
 - Resurfacing of gravel or crushed stone driveways with new gravel or crushed stone; and
 - Maintaining or repairing parking lot islands, including ongoing landscaping.

Capital Improvement vs. Repair – Electrical

- Capital Improvement:
 - Complete wiring or rewiring of structures or the upgrading of a service;
 - Additions to wiring systems; for example, new circuits;
 - In-wall installations of electrical wiring and communications cables in connection with the installation of burglar alarms or security systems;
 - Original in-wall installations of telephone wiring, speaker wire, computer cable, or coaxial cable;
 - Original installation of circuit breakers, outlets, receptacles, or switches; and
 - Original installation or complete replacement of:
 - Add-on panels;
 - Breaker panels;
 - Ceiling fixtures;
 - Doorbells, buzzers, or chimes;
 - Floor outlets;
 - Fluorescent fixtures;
 - Main power boxes;
 - Metal raceways;
 - Multi-outlet strips;
 - Outdoor lamp posts;
 - Wall boxes;
 - Wall fixtures; and
 - Wiring.

Capital Improvement vs. Repair – Electrical

- Repair/Maintenance:
 - Repair of:
 - Floor outlets;
 - Fluorescent fixtures;
 - Lighting fixtures;
 - Main power boxes;
 - Metal raceways;
 - Multi-outlet strips;
 - Outdoor lamp post;
 - Wall boxes;
 - Wall fixtures; and
 - Wiring.
 - Replacement of:
 - Circuit breakers;
 - Fluorescent fixture parts (ballasts, starters, tubes);
 - Fuses;
 - Light bulbs;
 - Outlets;
 - Receptacles; and
 - Switches.
- Installation:
 - Installation of a dimmer switch to replace an existing switch.

Capital Improvement vs. Repair – Exterior

- Capital Improvement:
 - Additions to existing structures;
 - Application of siding to structures;
 - Complete replacement of porches;
 - Construction of:
 - Decks;
 - Dormers;
 - Footings;
 - Foundations;
 - Garages;
 - New homes;
 - New porches; and
 - Pole barns.
 - Deepening existing water wells;
 - Drilling or boring new water wells;
 - Excavation work if for a capital improvement;
 - Insulating structures;
 - Installation of new or complete replacement of existing awnings (other than canvas), gutter, and downspout systems, fences, louvers, shutters, or water well pumps;
 - Installation or complete replacement of permanent (non-floating) docks;
 - Complete re-siding of structures; and
 - Painting of new structures.

Capital Improvement vs. Repair – Exterior

- Repair/Maintenance:
 - Painting of existing awnings, brickwork, or concrete;
 - Repair of louvers and shutters;
 - Repair or maintenance of awnings, exterior surfaces, patios, roof decks, or water well pumps;
 - Repair, replacement, or maintenance of:
 - Canvas awnings;
 - Fence pickets, posts, rails, or sections;
 - Flashings;
 - Gates;
 - Shingles (partial); and
 - Siding (partial).
 - Excavation work – if for a repair or maintenance;
 - Snow removal; and
 - Repair or maintenance of any dock.
- Installation:
 - Installation of canvas awnings or patching cracks; and
 - Installation or replacement of floating docks.

Capital Improvement vs. Repair – Floors and Flooring

- Capital Improvement:
 - Installation or complete replacement of floorings such as wood floor, floating wood laminate floors, ceramic tile floor, terrazzo, marble, concrete, and other similar floors;
 - Cleaning, sanding, waterproofing, painting, staining, varnishing, and waxing **new** floors;
 - Raised flooring; and
 - Installation of carpet, carpet tile, carpet padding, linoleum, and vinyl roll floor covering, linoleum tile, vinyl tile and other similar floor covering as the initial finished floor covering:
 - In the new construction of a building or structure;
 - In a new addition to an existing building or structure; and
 - In the total reconstruction of an existing building or structure.

Capital Improvement vs. Repair – Floors and Flooring

- Repair/Maintenance:
 - Repair, maintenance, or partial replacement of floorings such as wood floor, ceramic tile floor, terrazzo, marble, concrete and other similar floors;
 - Cleaning, striping, sanding, waterproofing, painting, staining, varnishing, and waxing **existing** floors; and
 - Repair, maintenance, or replacement of any of the above floor coverings.
- Installation:
 - Installation of carpet, carpet tile, carpet padding, linoleum, and vinyl roll floor covering, linoleum tile, vinyl tile, and other similar floor covering in an existing building, or in a building more than 6 months after the building has otherwise been completed.

Capital Improvement vs. Repair – Kitchens

- Capital Improvement:
 - Installation or complete replacement of:
 - Built in dishwashers, freezers, ranges, refrigerators, or ovens;
 - Countertops;
 - Ducted Hoods;
 - Exhaust Fans;
 - Garbage Disposals;
 - Kitchen Cabinets;
 - Sinks; and
 - Water Softeners.
 - Painting, varnishing, or staining of new kitchen cabinets; and
 - Complete reconditioning of kitchen cabinets.

Capital Improvement vs. Repair – Kitchens

- Repair/Maintenance:
 - Painting, varnishing, or staining of existing kitchen cabinets
 - Repair or maintenance of:
 - Cabinets;
 - Countertops;
 - Dishwashers;
 - Ducted or ductless hoods;
 - Exhaust fans;
 - Faucets;
 - Freezers;
 - Garbage disposals;
 - Ovens;
 - Ranges;
 - Refrigerators; and
 - Sinks.
 - Replacement of:
 - Cabinet doors;
 - Faucets;
 - Portable dishwashers, freezers, ranges, or refrigerators;
 - Portions of countertops; and
 - Portions of cabinets.
- Installation:
 - Installation of ductless hoods; and
 - Installation of free-standing appliances.

Capital Improvement vs. Repair – Landscaping and Yard Care

- Capital Improvement:
 - Original installation or complete replacement of:
 - Fences (permanent);
 - Flagstone walks, patio blocks, or other types of walks;
 - Fountains (except freestanding);
 - Gates;
 - Lawns or complete sections of a lawn;
 - Ponds (permanent);
 - Retaining walls;
 - Rock gardens;
 - Underground lawn sprinkler system;

Capital Improvement vs. Repair – Landscaping and Yard Care

- Capital Improvement (cont.):
 - Planting or replacing perennials;
 - Planting or replacing of shrubs and trees;
 - Original installation of gravel or crushed stone paths;
 - Original installation or complete replacement of concrete and blacktop sidewalks; and
 - Resurfacing of blacktop sidewalks.

Capital Improvement vs. Repair – Landscaping and Yard Care

- Repair/Maintenance:
 - Application of fertilizers, herbicides, and pesticides;
 - Maintenance contracts;
 - Mowing of lawns;
 - Planting of annuals;
 - Pruning, water banking, fertilizing of trees and shrubs;
 - Removal of walks; adding stone, replacing damaged patio blocks or bricks, releveling walks, repairing cracks in concrete;
 - Repair of fences and gates;
 - Repair or replacement of portions of underground lawn sprinkler systems;
 - Repairing sections of retaining walls;
 - Replacement of fence fabric;
 - Reseeding or overseeding lawn;
 - Sodding bare spots; and
 - Straightening or repairing retaining walls.

Capital Improvement vs. Repair – Landscaping and Yard Care

- Installation:
 - Installation of free-standing fountains; and
 - Installation of temporary or moveable ponds.

Capital Improvement vs. Repair – Masonry

- Capital Improvement:
 - Installation or complete replacement of:
 - Block walls;
 - Brick walls;
 - Footings;
 - Foundations;
 - Walks; and
 - Poured concrete posts, slabs, sidewalks, stairways, or walls.
- Repair/Maintenance:
 - Repair or replacement of:
 - Block walls;
 - Brick walls;
 - Footings;
 - Foundations;
 - Walks; and
 - Poured concrete posts, slabs, sidewalks, stairways, or walls.

... Capital Improvement vs. Repair – Painting

- Capital Improvement:
 - Painting of **new** buildings, structures, or additions; and
 - Painting of any **new** additions or installations that constitute capital improvements.
- Repair/Maintenance:
 - Painting or repainting of **existing** buildings, structures, or parts thereof.

Capital Improvement vs. Repair – Plumbing

- Capital Improvement:
 - Installation or complete replacement of sinks, toilets, shower stalls, and tubs;
 - Additions to piping systems;
 - Excavation required for installation or complete replacement of piping systems;
 - Original insulation of new or replacement piping systems;
 - Installation or complete replacement of:
 - Garbage Disposals;
 - Piping systems;
 - Sprinkler systems;
 - Water softeners; and
 - Water pumps.

Capital Improvement vs. Repair – Plumbing

- Repair/Maintenance:
 - Repair of pipes and fittings;
 - Repair of sprinklers, water softeners and well pumps;
 - Thawing frozen pipes;
 - Unclogging of main drain and pipes;
 - Cleaning;
 - Repair of enclosures;
 - Repair or replacement of:
 - Aerators ;
 - Air chambers;
 - Couplings;
 - Faucets;
 - Handles;
 - Hose assemblies;
 - Inlet seals;
 - Plungers;
 - Seats;
 - Spouts;
 - Storage tanks;
 - Tank drains;
 - Toilet seats;
 - Traps;
 - Tubes;
 - Valve seats;
 - Washers; and
 - Shutoff valves.

Capital Improvement vs. Repair – Roofs and Roofing Materials

- Capital Improvement:
 - Complete replacement of a roof or roofing materials, or the complete side of a peaked roof, or the complete roof or roofing materials on a wing, turret, dormer, etc.;
 - Installation or replacement of complete gutter and downspout system; and
 - Original installation of all types of roof systems including accessories.
- Repair/Maintenance:
 - Application of roof coating to existing roofs;
 - Cleaning and repairing of all types of roof systems, gutters, downspouts, drains, etc.;
 - Repair or spot replacement of all types of roofs or roofing materials;
 - Repair or replacement of:

<ul style="list-style-type: none"> – Copings; – Cornices; – Drip Edges; – Electric heating tape; – Expansion Joints; – Flashings; – Gravel stops and fascia's; – Gutter and downspout systems (partial); – Heating cables; – Louvers and screens; 	<ul style="list-style-type: none"> – Metal or compression valleys; – Metal ornaments; – Metal stacks; – Rain and draft deflectors; – Shingles; – Skylights and scuttles; – Snow guards; – Snow slides; and – Ventilators.
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Purchasing and Billing

... Purchasing Supplies/Materials

- As a contractor or subcontractor, you will pay sales tax on all building materials and other tangible personal property you purchase.
- If the materials are later transferred to your customer when performing a taxable repair, maintenance, or installation service, you may be able to take a credit for the sales tax you previously paid.

... Billing

- All charges for materials and labor that you bill to your customers for any repair, maintenance, or installation project, including any expenses or other markups, are taxable.

Example

You do repairs for a customer and charge \$150 for material and \$300 for labor. Your invoice should look, as follows:

Materials:	\$150
Labor:	<u>300</u>
Subtotal:	\$450
Sales Tax (8%)	<u>36</u>
Total:	<u>\$486</u>

Any sales tax paid on the materials purchased may be eligible for a credit on your sales tax return.

... Showing Sales Tax on an Invoice

- If you sell a combination of taxable and nontaxable items or services (partial capital improvement and partial repair), you must identify which of the items are taxable and which are not.
- You must separately state the total amount of sales tax due on any receipt or invoice that you give your customer.

Combined Taxable and Nontaxable Items

- When taxable and nontaxable items or services are sold together as one package, you may collect sales tax on only the taxable items if all three of the following are met:
 - The taxable and nontaxable items may be purchased separately;
 - The charges for the items are separately stated on your bill or invoice; and
 - The charges are reasonable in relation to the total charge.
- If the items are packaged together for one price and cannot be broken out and purchased separately, you must collect sales tax on the total price.

... Discounts

- Any discount that results in a reduction in the selling price, such as a trade discount, volume discount, or cash-and-carry discount, are subtracted before calculating the amount of sales tax due on the sale.
- Early payment discounts do not lower the amount of sales tax due on the sale.
 - This is an optional discount that customers may take advantage of but does not represent a discount in the actual selling price of the product or service.

Recording of Sales Tax

Recording Upon Purchases of Goods

- When you purchase materials and supplies and pay sales tax on those items, the amount of sales tax paid should be included in the corresponding expense.

Example

You purchase building materials for \$1,000 and pay \$80 in sales tax.

The entry to record this would be:

Materials:	\$1,080
Cash:	\$1,080

Recording Upon Taxable Sales

- When you make a taxable sale and are required to collect sales tax, the sales tax collected should be credited to a sales tax payable account on the balance sheet rather than to a revenue account.

Example

You provide repair services to a customer for a price of \$1,000. On this \$1,000, you are required to collect \$80 of sales tax. The entry to record this is, as follows:

Cash:	\$1,080
Revenue:	\$1,000
Sales Tax Payable:	\$80

Tax-Exempt Customers

... Examples of Tax-Exempt Organizations

- Churches;
- Private Schools;
- Charitable Organizations; and
- Governmental entities.

... Treatment of Tax-Exempt Customers

- You are not required to charge/collect sales tax on the previously listed organizations as long as they provide you with a properly completed exemption certificate (Form ST-119, *Exempt Organization Certificate*).
- In certain cases, you may be able to purchase materials or other tangible personal property that will be transferred to the tax-exempt customer as part of the project without paying sales tax.
- In order to purchase materials tax free, you must complete and provide Form ST-120.1, *Contractor Exempt Purchase Certificate*, to the supplier.

Use of Subcontractors

... Hiring of Subcontractors

- If a general contractor hires a subcontractor to perform taxable work as part of a project, the general contractor can purchase the subcontractor's services for resale by using Form ST-120.1, *Contractor Exempt Purchase Certificate*.
- This will allow you to purchase the subcontractor's services free of sales tax.
- The general contractor will still collect sales tax on its total charges to the customer.
- The purchase of services for resale can occur between general contractors and subcontractors, or between two subcontractors .

Credits Available

... Qualifying to Take a Credit

- You are eligible to take a sales tax credit if you:
 - Paid sales tax on building materials to a supplier;
 - Transferred those materials to your customer in a taxable repair, maintenance, or installation service; and
 - Charged sales tax to your customer.

... Subcontractors

- If you work as a subcontractor performing taxable services, you must be registered for sales tax purposes.
- As a subcontractor you may accept Form ST-120.1, *Contractor Exempt Purchase Certificate*, from the prime contractor instead of charging sales tax.
- Even if you do not collect sales tax from the prime contractor, you are still eligible for a credit for the sales tax paid on materials as long as the job being worked on qualifies as a taxable repair, maintenance, or installation service.

... Materials Used in a Taxable Repair, Maintenance, or Installation Service

- Sales tax must be paid at the time of purchase of materials from a supplier that will be transferred to your customer as part of a taxable repair, maintenance, or installation.
- The tax you paid on these materials qualifies for a sales tax credit.
- Materials eligible for this credit include:
 - Plywood, drywall, shingles, and 2 x 4s;
 - Nails, screws, bolts, and staples;
 - Electrical materials;
 - Plumbing materials; and
 - Landscaping materials.

... Materials Used in a Taxable Repair, Maintenance, or Installation Service

- You cannot claim a credit for sales tax paid on materials, supplies, or other items that are not transferred to your customer as part of the job you perform.
- These items include:
 - Tools, such as hammers, paint brushes, etc.;
 - Consumable supplies, such as sandpaper and garbage bags;
 - Cell phones, pagers, and office supplies;
 - Drop cloths;
 - Uniforms, clothing, and work boots;
 - Equipment or tools you rent;
 - Gases used in plumbing, welding, etc.; and
 - Vehicle fuels used in vehicles.

... Materials Used in a Capital Improvement Project

- When buying building materials and supplies for use in capital improvement projects, you must pay sales tax to your supplier.
- If your customer provides you with a properly completed form ST-124, *Certificate of Capital Improvement*, you should not charge sales tax to the customer for either the material or labor for the project when you bill the customer.
- You are **not** eligible to take a credit for the sales tax that you paid on the purchase of materials for a capital improvement project.

Work Performed for Exempt Organizations

- If you perform work for exempt organizations, you will not collect sales tax from the entity, no matter what type of job is performed and completed.
- You can purchase materials exempt from sales tax by using Form ST-120.1, *Contractor Exempt Purchase Certificate*.
- If you did not purchase the materials tax exempt, you may take a credit for the sales tax paid on the purchase of materials used in the project.
- Materials eligible for this credit include:
 - Plywood, drywall, shingles, and 2 x 4s;
 - Nails, screws, bolts, and staples;
 - Electrical materials;
 - Plumbing materials; and
 - Landscaping materials.

... Lump Sum Contracts

- If you are entered into a unit-price construction contract or have a pre-existing lump sum contract with a customer, and during the period of the contract the sales tax rate is increased, you may be eligible for a credit for the additional sales tax paid on property purchased after the rate change that is incorporated in the project.

Example

You enter an irrevocable contract when sales tax is at 7%. During the contract, sales tax increases to 8%, which you will be obligated to pay on any future purchases of building materials for this contract, without having the ability to charge the customer for this increase in sales tax to recoup your expenses. In this circumstance, you will be able to claim a credit or refund for the additional 1% paid on the materials purchased after the rate increased and used solely on that contract.



Other Situations Where Credits May Apply

- If you purchase materials and pay sales tax in New York, but later use the materials in a job outside of New York, you are allowed a credit for the sales tax paid to New York.
- If you charge your customer sales tax in error and later give the customer a refund of the tax.
- You overpay the sales tax.
- You paid sales tax by mistake.

... Claiming Credits

- Credits will be claimed on the sales tax return that covers the period when the work was performed and the taxable sale was reported, not when the material was purchased.
- Documentation will be needed.
 - Purchase invoice showing the sales tax paid to the supplier.
 - Sales invoice to the customer showing the material used on the project.
 - Contract or invoice showing that the service was a repair, maintenance, or installation.
 - Any other documentation, including copies of exemption or certificates received from customers showing you are entitled to a credit for tax paid.

Questions





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