Dannible & McKee, LLP

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Key Accounting and Tax Considerations For Contractors

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Introduction

Purpose of the Presentation

- Provide a clear overview of accounting practices specific to contractors
- Equip teams with tools for accurate job costing and revenue recognition
- Strengthen communication between accounting and project management

Why Accurate Accounting Matters

- Construction projects are complex and long-term, requiring detailed tracking
- Accurate financials support cash flow, compliance, and profitability
- Prevents misstatements in revenue, costs, and job performance

Agenda

1. Tax Accounting Methods for Contractors
2. Tax Depreciation Changes for 2025
3. Notable Impacts of the One Big Beautiful Bill Act on the Construction Industry
4. Industry-Specific Accounting Principles
5. Contract Types
6. Job Costing Fundamentals
7. Understanding and Analyzing WIP Schedules
8. Internal Controls and Best Practices
9. Audit Automation

Tax Accounting Methods for Contractors

Internal Revenue Code Section 460

Targeting the construction industry, Internal Revenue Code §460 requires contractors to utilize the percentage-of-completion method of accounting for long-term contracts, for Federal income tax purposes.

Two exceptions:

- Home Construction Contract *
- Small Contractor Exception

**Changes under One Big Beautiful Bill Act*

Home Construction Contract

- By definition, a home construction contract is any contract where 80% or more of the estimated total contract costs are reasonably attributable to the building, construction, reconstruction, or rehabilitation of dwelling units contained in buildings with four or fewer dwelling units, with an anticipated completion date of two years or less.

- Any contractor meeting this criteria is exempt from utilizing the percentage-of-completion method of accounting for contracts.

** One Big Beautiful Bill Act (OBBB) has expanded these rules in 2025.*

Home Construction Contract - OBBB

- For residential construction contract entered in tax years beginning after July 4, 2025, a taxpayer is exempt from the percentage-of-completion method.

- A residential construction contract covers any number of dwelling units, with an anticipated project completion date of three years.

- The expanded percentage-of-completion method now applies to:

Apartment buildings	Condominiums
Townhouses	Student Housing
Mixed-use Developments	Senior Living Facilities

Small Contractor Exception

Defined as a business that meets the gross receipts test for the applicable tax year.

Gross Receipts Test

- Met when the average annual taxable gross receipts for the prior three tax periods does not exceed $31,000,000 (2025).
  - Threshold is subject to inflation on an annual basis.

Any contractor meeting this criteria is exempt from utilizing the percentage of completion method of accounting for contracts.

Definitions

Long-Term Contract

- For Federal income tax purposes, a long-term contract is defined as a contract that spans more than one tax year.

Small Contractor

- Defined as a business that meets the gross receipts test for the applicable tax year, also known as the small business exception under Internal Revenue Code §460.

Large Contractor

- Defined as a business that does not meet the small business exception under Internal Revenue Code §460.

Accounting Methods for Long-Term Contracts

- Percentage of Completion
- Completed Contract
- Accrual Less Retainage
- Additional tax deferral items available to contractors

Percentage of Completion Method

- Revenue and expenses are recognized based on the percentage of completion ratio determined by dividing total construction costs to date by the total estimated contract costs.

- Required method for long-term contracts for Federal tax purposes, for large contractors under Internal Revenue Code §460.

- Required method of long-term contracts for Alternative Minimum Tax purposes.

Percentage of Completion Example

- Contract Revenue: $1,200,000
- Cost-to-Completion: $800,000
- Cost-to-date: $200,000

- Percentage of Completion: 25%

- Current year revenue under percentage of completion: $300,000
- Current year costs under percentage of completion: $200,000
- Current year gross profit under percentage of completion: $100,000

Completed Contract Method

- Revenue and expenses are recognized when a contract is complete.
- A contract is considered complete once 95% of contract costs have been incurred and the customer has use of the property.
- The completed contract method allows taxpayers to defer revenue recognition until the contract is complete.
- Method available to small contractors.

Completed Contract Example

- Contract Revenue: $1,200,000
- Cost-to-Completion: $800,000
- Cost-to-date: $200,000

- Percentage of Completion: 25%

- Current year gross profit under percentage of completion: $100,000
- Current year gross profit under completed contract method: $0

Accrual Less Retainage Method

- A retainage is defined as a percentage of billings for services performed that are withheld by the customer until completion.
- A contractor can establish a method of accounting to exclude retainage receivables and payables from accrual basis income until the cash is received and/or paid.
- Large contractors who do not meet the gross receipts test under Internal Revenue Code §460, can utilize this method for short-term contracts.

Accrual Less Retainage Example

At year-end, the Taxpayer has the following jobs in process:

- Contract #101 uncollected retainage $5,000 (Long-Term)
- Contract #102 uncollected retainage $3,000 (Short-Term)
- Contract #103 uncollected retainage $7,000 (Short-Term)
- Contract #104 uncollected retainage $6,000 (Short-Term)
    - Total uncollected retainages at year-end $21,000

- Under accrual less retainage method, Taxpayer could exclude $21,000
- Large contractor could exclude retainages on short-term contracts of $16,000

Additional Tax Deferral Items Relating to Contractors

10% Elective Deferral

- Contractors may defer recognition of gross profit until a contract has reached 10% completion.

Non-Long-Term Contract Deferral

- Contractors may defer the over/under billings relating to short-term contracts.

Short-Term Contracts

- Short term contracts are contracts that do not span more than one tax year.
- These contracts are exempt from the required usage of percentage of completion method for large contractors.
- Available methods of accounting include:
  - Cash Basis
  - Accrual Basis
  - Accrual less Retentions

Methods of Accounting for Short-Term Contracts

Cash Basis Method

- Revenue and expenses are recognized as the cash is collected and/or paid.

Accrual Basis Method

- Revenue and expenses are recognized as progress billings are made and job costs are incurred.
  - Taxable income will increase due to overbillings.
  - Taxable income will decrease due to underbillings.

Depreciation Changes for 2025

Depreciation Changes for 2025

- Section 179 allows businesses to immediately expense the cost of qualified property, placed in service after December 31, 2024.

- Prior to One Big Beautiful Bill Act:

  - Expensing limit: $1,250,000 ($1,220,000 in 2024)
  - Phase out-threshold: $3,130,000 ($3,050,000 in 2024)

- Post One Big Beautiful Bill Act:

  - Expensing limit: $2,500,000 ($1,220,000 in 2024)
  - Phase-out threshold: $4,000,000 ($3,050,000 in 2024)

Depreciation Changes for 2025

- Bonus depreciation allows businesses to expense a fixed percentage of qualified property's cost.
- Prior to One Big Beautiful Bill Act:

- Bonus Depreciation: 40% (60% in 2024)

- Post One Big Beautiful Bill Act:

- Bonus Depreciation: 100% (60% in 2024)
  - *100% bonus depreciation for qualified property PIS after January 19, 2025.*

Depreciation Changes for 2025

- One Big Beautiful Bill Act introduces Internal Revenue Code Section 168(n).
- IRC Section 168(n) provides certain qualified nonresidential real estate used in the manufacturing or production process full expensing.
- Construction must begin after January 19, 2025, and before January 1, 2029, and placed in service by December 31, 2030.

Depreciation Changes for 2025

- Section 168(n) property must be:
  - Subject to depreciation under IRC Section 168.
  - Used by the taxpayer as an integral part of qualified production activity.
  - Placed in service in the United States or any US possession.
  - Original use commences with the Taxpayer.
- The property is subject to a 10-year recapture period.

Depreciation Changes for 2025

Depreciation Methods Comparison (2025)

Feature	Section 179 (2025)	Bonus Depreciation (2025+)	Traditional Depreciation
Annual limit	$1,250,000 (phase-out at $3,130,000)	100% if acquired ≥Jan 20, 2025; 40% otherwise	Spread over useful life
Dollar cap	Yes	No	No
Income limit	Yes (cannot create a loss)	No (can create a loss)	N/A
Heavy SUVs	$31,300 cap	No SUV dollar cap	N/A
Election	Asset-by-asset	Automatic unless opted out	Automatic schedules
Best for	Targeted, controllable expensing	Large purchases, loss planning	Steady write-offs over time

Other Notable Impacts of the One Big Beautiful Bill Act on the Construction Industry

Repeal of Section 179D
Energy Efficient Commercial Buildings Deduction

- Section 179D provides a tax deduction for energy efficient commercial building property located in the United States.
- Section 179D is subject to a deduction limitation, computed based on an energy savings per square foot calculation.
- The Section 179D deduction is allowed in the year in which the property is placed in service.
- Under the One Big Beautiful Bill Act, the deduction will expire for construction beginning after June 30, 2026.

Repeal of Section 45L
New Energy Efficient Home Credit

- Also referred to as the Internal Revenue Code §45L Credit.
- Amended by the Inflation Reduction Act of 2022, §45L provides a credit of up to $5,000 per dwelling unit, for homes located in the United States that meet specified energy savings requirements.
- The credit is available to eligible contractors meeting all requirements under Internal Revenue Code §45L.
- Under the One Big Beautiful Bill Act, the credit is terminated for homes acquired after June 30, 2026.

Changes to Section 163(j)
Limitation on Business Interest Expense

- Internal Revenue Code Section 163(j) was first introduced by the Tax Cuts and Jobs Act (TCJA), enacted in 2017.

- Section 163(j) limits deductible business interest expense to 30% of adjusted taxable income (ATI) for businesses that do not meet the small business exception (gross receipts test).

Changes to Section 163(j)
Limitation on Business Interest Expense

- The One Big Beautiful Bill Act restores and makes permanent the computation of adjusted taxable income (ATI).
- The basis for computing ATI has been reinstated to reflect earnings before interest, taxes, depreciation, and amortization (EBITDA).
- Previously, for tax years beginning after December 31, 2021, ATI did not allow for the addback of depreciation and amortization.
- The change allows businesses to deduct a larger portion of business interest expense.

Changes to Section 163(j)
Limitation on Business Interest Expense

- For tax years beginning after December 31, 2025, the limitations under 163(j) are extended to interest that is required to be capitalized.

- Under prior rules, some taxpayers could capitalize business interest expense under IRC Section 263(a) and avoid IRC Section 163(j) entirely.

- The One Big Beautiful Bill Act mandates that any business interest expense, including capitalized interest expense, will remain subject to the IRC Section 163(j) limitation for large taxpayers.

IRC Section 199A
Qualified Business Income Deduction made Permanent

- Internal Revenue Code Section 199A was first introduced by the Tax Cuts and Jobs Act (TCJA), enacted in 2017, scheduled to sunset after December 31, 2025.

- The provision allows for a deduction of up to 20% of qualified business income from partnerships, S corporations, or sole proprietorships.

- The One Big Beautiful Bill Act makes the Section 199A deduction permanent.

IRC Section 461(l)
Excess Business Loss Limitations made Permanent

- Internal Revenue Code Section 461(l) was first introduced by the Tax Cuts and Jobs Act (TCJA), enacted in 2017, scheduled to sunset after December 31, 2025.

- The Inflation Protection Act of 2022 extended the excess business loss limitation through December 31, 2028.

- The provision of the TCJA amended Section 461 to disallow excess business losses of noncorporate taxpayers if the amount of the loss exceeded an inflation-adjusted annual threshold.

IRC Section 461(l)
Excess Business Loss Limitations made Permanent

- For 2025, the thresholds are:
  - $313,000 for single filers
  - $626,000 for married couples, filing jointly
- Business losses more than the annual limit, are characterized as a net operating loss, carried forward for future use.

State and Local Tax (SALT) Cap Deductions

- The Tax Cuts and Jobs Act (TCJA), enacted in 2017, imposed a $10,000 cap on the state and local tax deduction, scheduled to sunset after December 31, 2025.
  - SALT deduction cap has increased to $40,000 for tax years 2025-2029
    - Subject to annual inflation adjustments
    - Phase out for high-income taxpayers (AGI more than $500,000)
- In response, several states implemented pass-through entity tax elections.
- The pass-through entity tax programs were not impacted by the One Big Beautiful Bill Act.

Basic Things You Need to Know About

Second Highest Failure Rate

- Restaurants continue to hold the top spot

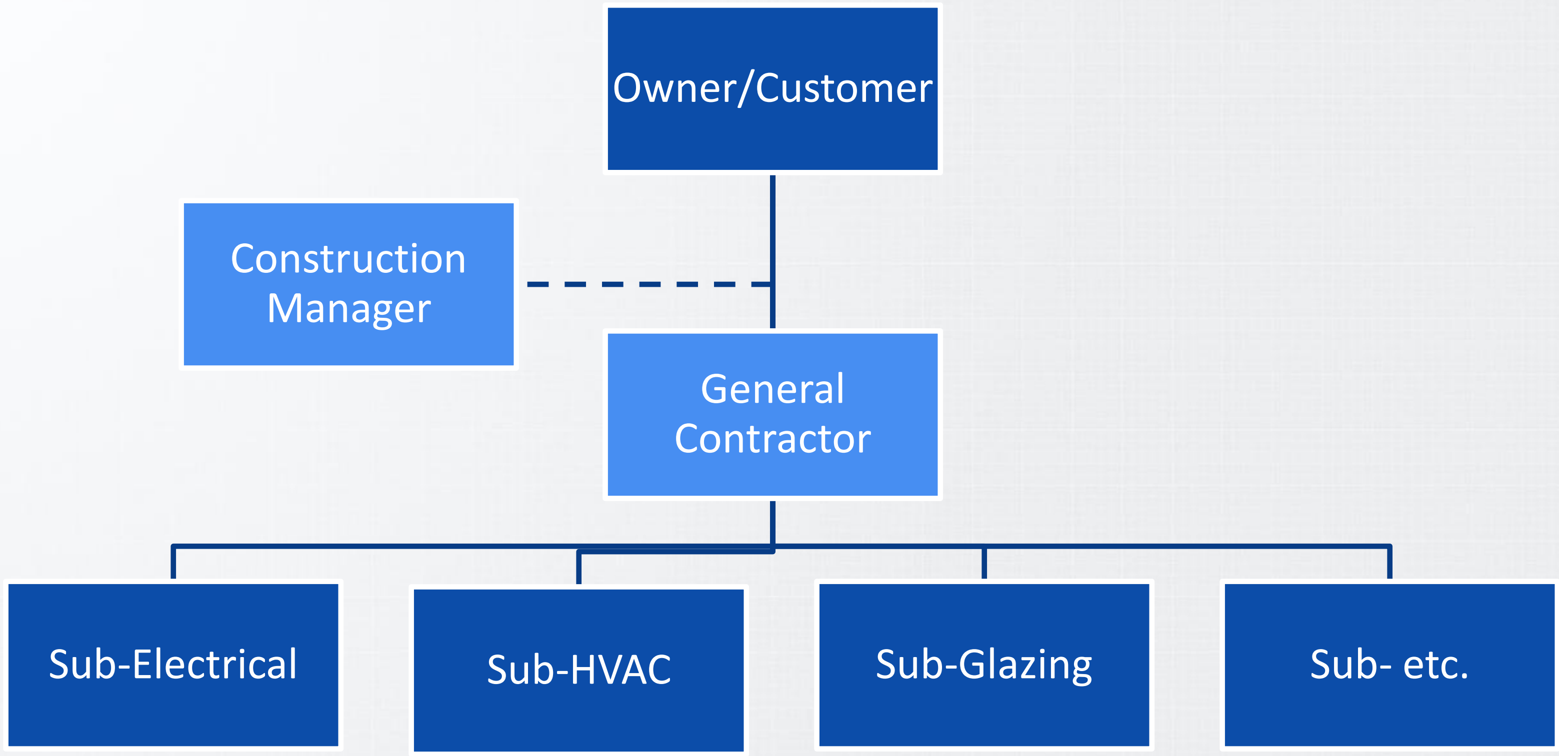
High Risk Industry

- Higher risk should equal higher rewards (if not business should be questioned)

It's All in the Estimate

- Estimates drive all recognition

Hierarchy of Construction



Industry-Specific Accounting Principles

Revenue Recognition (ASC 606)

- **Core Principle**
  - An entity shall recognize revenue to depict the transfer of goods or services to the customer in an amount that reflects the consideration the entity receives, or expects to receive, in exchange for those goods or services provided.
- All companies that have contracts with customers should now have fully adopted this standard
- Affects the revenue timing, contract assets/liabilities & disclosures
- Common mistakes include:
  - Disaggregation of revenue
  - Timing of revenue recognition
  - Contract assets and liabilities

Revenue Recognition

Five steps to apply the core principle:

1. **Identify the contract(s) with a customer**
2. **Identify the performance obligations in the contract**
3. **Determine the transaction price**
4. **Allocate the transaction price to the performance obligations in the contract**
5. **Recognize revenue when (or as) the entity satisfied a performance obligation**

Revenue Recognition

Five steps to apply the core principle:

1.
   - **Identify the contract(s) with a customer**
     - Ex. A signed $5M design-build agreement
2.
   - **Identify the performance obligations in the contract**
     - Multiple obligations (e.g., design and build) or a single combined project?
3.
   - **Determine the transaction price**
     - Fixed-cost, cost-plus, or time and materials
4.
   - **Allocate the transaction price to the performance obligations in the contract**
     - If multiple obligations, allocate accordingly
5.
   - **Recognize revenue when (or as) the entity satisfied a performance obligation**
     - Over time if criteria is met

Recognizing Revenue

- Revenue is recognized as performance obligations are satisfied, which can occur over time or at a point in time
- One of the following criteria must be met to use over-time recognition:
  - The customer receives and consumes the benefits as the work is performed
  - The customer controls the asset as it is created
  - The asset has no alternative use, and the contractor has an enforceable right to payment for work completed to date
- % Complete = Costs incurred to date ÷ Total estimated costs
- Revenue Recognized = % Complete x Transaction Price (POC Method)

Accounting for Future Losses

- ASC 606 requires recognition of estimated job losses as soon as they are known
- Accounting treatment:
  - Record a loss provision when total estimated costs exceed the total contract value
- Monitored through
  - Monthly WIP updates
  - Job cost-to-complete reviews
  - Regular gross profit trend analysis

Contract Types

Fixed-Price, Cost- Plus and Time & Materials Contracts

Fixed-Price Contract

- Contractor agrees to deliver the project for a set price
- Revenue is recognized using Percentage-of-Completion Method (now referred to as recognition over time under ASC 606)

Cost-Plus Contracts

- Customer reimburses actual costs plus a fee (fixed or % based)
- Revenue recognized over time, typically using an input method, such as cost-to-cost, which compares costs incurred to total expected costs

Time & Materials Contracts

- Contractor bills for labor hours and materials used
- Revenue is recognized as control is transferred

Job Costing Fundamentals

Job Costing Methods

Direct Costs

- Costs directly traceable to a specific job
- Includes labor, materials, subcontractors and equipment rentals

Indirect Costs

- Costs that aren't tied to one specific job, but support all projects
- Includes supervisors, equipment maintenance, jobsite trailers or tools used on multiple jobs
- These costs are shared across jobs and usually spread out using a method such as labor hours or project size

Cost Codes and Overhead Allocation

Cost Codes and Tracking

- Cost codes break down project expenses by category and phase
- Overhead allocated to jobs to capture full cost burden
- Supports detailed budget tracking and financial analysis

Overhead Allocation

- Represents general business expenses that are not directly tied to a single job (e.g., office rent, administrative salaries, insurance)
- These costs are allocated across all jobs to reflect the full cost of operations

Understanding and Analyzing WIP Schedules

Work-In-Process (WIP) Overview

- **Work-in-Progress (WIP) schedule** is a report that tracks the financial status of ongoing jobs and compares what's been earned versus what has been billed on each project
- It highlights whether a job is overbilled (billed more than earned) or underbilled (earned more than billed)
- Helps assess cash flow, billing accuracy and project health
- Ensures that revenue and profit are recognized based on project progress, providing the insight needed for accurate forecasting, job management, and financial planning

Components of a WIP Schedule

- Any work that has started, but is not yet completed by the end of an accounting period is required to be presented under GAAP
- While there is no universally accepted format to present a WIP schedule, it should include at minimum, the following information:
  - Contract value
  - Estimated costs to complete
  - Estimated gross profit
  - Current period revenue
  - Current period costs
  - Current period gross profit
  - Revenue and costs recognized to date
  - Gross profit to date
  - Percentage of work completed
  - Revenue billed to date

Components of a WIP Schedule

	Total Contract			From Inception to December 31, 2021				At December 31, 2021		Year ended December 31, 2021			At December 31, 2021		
Contract	Revenues	Estimated Cost of Revenues	Estimated Gross Profit	Revenues Earned	Total Cost	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 (Loss)	Backlog	Accrued Loss	Estimated Costs to Complete
CIP #1	$ 6,507,077	$ 6,156,931	$ 350,146	$ 4,882,418	$ 4,619,695	$ 262,723	$ 5,125,143	$ --	$ 242,725	$ 4,153,475	$ 3,938,133	$ 215,342	$ 1,624,659	$ --	$ 1,537,236
CIP #2	3,091,000	2,990,085	100,915	196,392	189,980	6,412	59,400	136,992	--	196,392	189,980	6,412	2,894,608	--	2,800,105
CIP #3	1,656,865	1,452,006	204,859	1,198,594	1,050,397	148,197	1,496,195	--	297,601	757,467	633,737	123,730	458,271	--	401,609
Miscellaneous < $1,500,000	57,489,888	53,912,250	3,577,638	36,089,195	33,953,387	2,135,808	43,014,868	904,622	7,830,295	28,630,039	27,393,811	1,236,228	21,400,693	(509)	19,958,863
	$ 68,744,830	$ 64,511,272	$ 4,233,558	$ 42,366,599	$ 39,813,459	$ 2,553,140	$ 49,695,606	$ 1,041,614	$ 8,370,621	$ 33,737,373	$ 32,155,661	$ 1,581,712	$ 26,378,231	$ (509)	$ 24,697,813

Contract Price

	Total Contract		
Contract	Revenues	Estimated Cost of Revenues	Estimated Gross Profit
CIP #1	$ 6,507,077	$ 6,156,931	$ 350,146
CIP #2	3,091,000	2,990,085	100,915
CIP #3	1,656,865	1,452,006	204,859
Miscellaneous < $1,500,000	57,489,888	53,912,250	3,577,638
	$ 68,744,830	$ 64,511,272	$ 4,233,558

Contract Price Consists of:

- Original Contract Price
- Change Orders
- Construction Claims
- Liquidating Damages
- Early Completion Bonus
- Back Charges

Estimated Cost of Revenues

	Total Contract		
Contract	Revenues	Estimated Cost of Revenues	Estimated Gross Profit
CIP #1	$ 6,507,077	$ 6,156,931	$ 350,146
CIP #2	3,091,000	2,990,085	100,915
CIP #3	1,656,865	1,452,006	204,859
Miscellaneous < $1,500,000	57,489,888	53,912,250	3,577,638
	$ 68,744,830	$ 64,511,272	$ 4,233,558

Estimated Cost of Revenues:

Direct Contract Costs

- Direct Labor, Subcontracts, Materials, Equipment, Small Tools

Overhead Estimates

- Equipment costs, Depreciation, Union, Insurance

Change Orders/ Claims

- Costs incurred and estimated future costs to complete change order requests and claims

Estimated Gross Profit

Contract	Total Contract Revenues	Total Contract Estimated Cost of Revenues	Total Contract Estimated Gross Profit
CIP #1	$ 6,507,077	$ 6,156,931	$ 350,146
CIP #2	3,091,000	2,990,085	100,915
CIP #3	1,656,865	1,452,006	204,859
Miscellaneous < $1,500,000	57,489,888	53,912,250	3,577,638
	$ 68,744,830	$ 64,511,272	$ 4,233,558

Estimated Gross Profit:

Calculation

- Contract price – estimated cost at completion

Loss Contracts

- Full loss must be recognized as soon as it is identified

Trend Analysis

- Historical gross profit trends reveal accuracy of cost estimates

Job Totals to Date

Contract	Revenues Earned	Total Cost	Gross Profit	Billings To Date (Including Conditional Retainage)
	From Inception to December 31, 2021			
CIP #1	$ 4,882,418	$ 4,619,695	$ 262,723	$ 5,125,143
CIP #2	196,392	189,980	6,412	59,400
CIP #3	1,198,594	1,050,397	148,197	1,496,195
Miscellaneous < $1,500,000	36,089,195	33,953,387	2,135,808	43,014,868
	$ 42,366,599	$ 39,813,459	$ 2,553,140	$ 49,695,606

Job Totals to Date:

Revenues Earned

- Revenue recognized to date (driven by costs/estimated costs)

Total Cost

- Actual expenses incurred to date

Billings to Date

- What has been billed to the client

Cost in Excess of Billings

Contract	At December 31, 2021 Revenue in Excess of Billings and Conditional Retainage	Billings and Conditional Retainage in Excess of Revenues
CIP #1	$ --	$ 242,725
CIP #2	136,992	--
CIP #3	--	297,601
Miscellaneous < $1,500,000	904,622	7,830,295
	$ 1,041,614	$ 8,370,621

Contract	From Inception to December 31, 2021 Revenues Earned	Total Cost	Gross Profit	Billings To Date (Including Conditional Retainage)
CIP #1	$ 4,882,418	$ 4,619,695	$ 262,723	$ 5,125,143
CIP #2	196,392	189,980	6,412	59,400
CIP #3	1,198,594	1,050,397	148,197	1,496,195
Miscellaneous < $1,500,000	36,089,195	33,953,387	2,135,808	43,014,868
	$ 42,366,599	$ 39,813,459	$ 2,553,140	$ 49,695,606

Cost in Excess of Billings:

- Referred to as “underbilling”
- Reported as a current asset on the balance sheet, typically labeled as a contract asset
- Represents revenue earned in excess of amounts billed to date on a project

Billings in Excess

Contract	At December 31, 2021 Revenue in Excess of Billings and Conditional Retainage	Billings and Conditional Retainage in Excess of Revenues
CIP #1	$ --	$ 242,725
CIP #2	136,992	--
CIP #3	--	297,601
Miscellaneous < $1,500,000	904,622	7,830,295
	$ 1,041,614	$ 8,370,621

Contract	From Inception to December 31, 2021 Revenues Earned	Total Cost	Gross Profit	Billings To Date (Including Conditional Retainage)
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Miscellaneous < $1,500,000	36,089,195	33,953,387	2,135,808	43,014,868
	$ 42,366,599	$ 39,813,459	$ 2,553,140	$ 49,695,606

Billings in Excess:

- Referred to as “overbilling”
- Reported as a current liability on the balance sheet, typically labeled as a contract liability
- Represents amounts billed in excess of revenue earned (deferred revenue)

Job Totals Year-to-Date

Contract	Year ended December 31, 2021		
	Revenues Earned	Costs of Revenues	Gross Profit (Loss)
CIP #1	$ 4,153,475	$ 3,938,133	$ 215,342
CIP #2	196,392	189,980	6,412
CIP #3	757,467	633,737	123,730
Miscellaneous < $1,500,000	28,630,039	27,393,811	1,236,228
	$ 33,737,373	$ 32,155,661	$ 1,581,712

Job Totals Year-to-Date:

- **Revenues Earned**
  - Revenue recognized for the period
- **Costs of Revenues**
  - Actual expenses incurred for the period
- **Gross Profit/ Loss**
  - Gross profit/ loss for the period

Other Components

Contract	At December 31, 2021 Backlog	Accrued Loss	Estimated Costs to Complete
CIP #1	$ 1,624,659	$ --	$ 1,537,236
CIP #2	2,894,608	--	2,800,105
CIP #3	458,271	--	401,609
Miscellaneous < $1,500,000	21,400,693	(509)	19,958,863
	$ 26,378,231	$ (509)	$ 24,697,813

Contract	Total Contract			From Inception to December 31, 2021			
	Revenues	Estimated Cost of Revenues	Estimated Gross Profit	Revenues Earned	Total Cost	Gross Profit	Billings To Date (Including Conditional Retainage)
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	$ 68,744,830	$ 64,511,272	$ 4,233,558	$ 42,366,599	$ 39,813,459	$ 2,553,140	$ 49,695,606

Backlog GP = $1,680,418

Other Components:

Backlog

- Contract value less revenue recognized to date

Accrued Loss

- Recognized loss on a contract when estimated costs exceed total contract revenue

Estimated Costs to Complete

- Remaining projected costs
- Total estimated costs less costs incurred to date

Components of a WIP Schedule

	Total Contract		From Inception to December 31, 2021				At December 31, 2021		Year Ended December 31, 2021			At December 31, 2021	
Contract	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
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
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
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
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
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
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
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
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
	$ 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

Components of a WIP Schedule

	Total Contract		From Inception to December 31, 2021				At December 31, 2021		Year Ended December 31, 2021			At December 31, 2021	
Contract	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
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
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
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
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
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
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
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
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
	$ 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 = $14,671,656

WIP High Risk Areas

- Estimated costs to complete
- Allocating Company overhead to jobs
- Exaggerated profit margins
- Failure to monitor field progress accurately
- Accruing for losses in the period the loss becomes evident
- Warranties/Contingencies in the contract
- Billings classification – Overbillings vs. Underbilling
- Change order tracking

WIP Financial Statement Red Flags

- **Balance Sheet**
  - Accounts Receivable
    - High balances may raise concerns about cash flow or collection issues
  - Unbilled Revenue
    - High unbilled revenue may indicate:
      - Underbilling due to poor billing practices
      - Delays in customer approvals
      - Cost overruns or disputed amounts
      - Potential collection risk
  - Overbillings
    - High overbillings may indicate possible future margin erosion if jobs are behind schedule or overbudget

WIP Financial Statement Red Flags

- **Income Statement**
  - Revenue Recognition
  - Gross Profit
    - Unexpected swings can signal:
      - Job performance issues
      - Poor cost estimating
      - Change orders not properly accounted for

Financial Statement Red Flags

- Red flags that concern lenders, auditors, and sureties:
  - Large/unexplained swings in WIP gross profit
  - Jobs with consistent profit fade (GP % drops over time)
  - Negative WIP adjustments late in the project life cycle
  - High unbilled revenue without timely billing follow-up
  - Backlog that grows while WIP gross profit declines
    - A disciplined reconciliation between the WIP schedule and backlog ensures consistency in reported financials and supports strategic forecasting

Internal Controls and Best Practices

Internal Controls and Key Components

Internal controls are the policies and procedures designed to provide reasonable assurance that a contractor's objectives are achieved in areas such as:

- Reliable Financial Reporting
- Efficient Operations
- Safeguarding Assets
- Legal & Regulatory Compliance

Key Components

- Control Environment
- Risk Assessment
- Control Activities
- Information & Communication
- Monitoring

Critical Controls in the Construction Environment

Estimating & Bidding:

- Standardized bid format and review process
- Multiple subcontractor quotes
- Approval required for budget revisions

Project Cost Management

- Match deliveries to invoices; secure materials
- Accurate time tracking; payroll segregation
- Subcontractor vetting, standardized contracts, and progress reviews
- Track equipment usage, repairs, and secure storage

Disbursement Controls:

- Segregation of Duties
- Pre-approval of vendors and payments
- Variance reviews of Budgets vs. Actuals

Fraud Risks and Ways to Combat

Common Fraud Schemes

- Shell companies
- Personal purchases
- Ghost employees
- Kickbacks

Ways to Combat

- Require dual approval for vendor setup & payments
- Match receipts to job site deliveries or use video confirmation
- Review payroll for duplicate bank info or suspicious entries
- Rotate purchasing responsibilities and enforce bid transparency
- Use anti-fraud/anti-corruption declarations

Audit Automation

Audit Automation

Audit Automation

- Use of electronic tools and systems to streamline audit processes and reduce manual work without replacing auditor judgement

Why Audit Firms are Automating

- Increases efficiency in audits
- Improve accuracy and consistency
- Enhance client experience
- Gain competitive advantage

Audit Automation in Audits

WIP Schedule testing

- Automated recalculation of costs, billings, and profit margins
- Easier identification of red flags

Document collection and retention

- Real-time status tracking of requested, secure documents

Trial balance and financial data import

- Automation of TB imports and journal entries

Data analytics

- Helps auditors detect anomalies, trends, or inconsistencies

Workflow and engagement tracking

- Dashboard to monitor audit progress, deadlines, and filing status

Questions

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