



Percentage-of-Completion Accounting Method – Entries and Construction Contracts

Most business management experts agree that you can only improve what you can measure, and that the process of (accurate) measurement in and of itself almost always brings about change and improvement.

Why? Because the process of measurement requires focused attention, knowledge, and creativity; Few problems can stand up against these critical factors for business success!

Custom Home Builders, Remodelers and Contractors,and the "in-process contract" problem

Many builders, remodelers, and contractors (B/R/C's) enter into contracts with clients where the jobs extend over relatively long periods of time - from several months to a year or more. For these types of contracts, it is also typical that you, as a business owner or bookkeeper will invoice and/or collect funds in advance of related expenses, or after various expenses are shown on your accounting records.

Typical accounting will show the income you have received or invoiced for, and the costs you have paid or incurred, as shown in the following illustration:

Reference Information:					
Illustration of accrual-based accounting on contract jobs BEFORE "Pct of Completion" entries:					
	Cash	Accts Rec by customer	Accts Payable by Vendor	Income by job	Cost by job
Revenue					
Invoice to customer		+		+	
Customer payment received	+	-			
Costs					
Bill entered			+		-
Bill paid	-		-		
Results-by account	+	0	0	+	-
				= Gross income	

Illustration of accrual-based accounting on contract jobs BEFORE "Pct of Completion" entries:

That's where the problem arises with a regular accounting system, because with all of the bills and checks and payroll and invoices and cash coming and going, it becomes extremely difficult to know how much you are truly EARNING on a day-to-day, week-to-week, and month-to-month basis for these types of jobs. And if you keep a multitude of projects running at the same time, it can become nearly impossible to nail down your financial scores for any given time frame!

Of course, if you have a good job-costing accounting system, you will ultimately know your return on any given job after it's completed, but that's far too late to take corrective action. And what about those other jobs currently claiming your attention?

This is where "Percentage of Completion" comes to the rescue! This accounting technique provides you with a stable, reliable way of matching each job's life-to-date revenue against its life-to-date expenses so that you can know how this month's or quarter's profit "lines up" against last month's, last quarter's or last year's numbers.

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Percentage of Completion entries act much like the bubble in a common level. The entries provide a way to "level" your financial results across accounting periods (i.e., entries temporarily adjust revenue for individual jobs to match costs incurred).

Additionally, as you undertake the discipline of assembling your numbers for the Percentage of Completion calculations, **you will become much closer to your critical numbers** (e.g., estimated income and costs, change orders, allowances, and over/under-runs). You will gain a much deeper understanding of exactly how individual jobs are shaping up from a financial standpoint as they progress.

And from there you will be able to quickly take corrective action to complete each job that much closer to **"on time"** and **"under budget"**.

Percentage of completion calculations & adjustments are therefore:

- Suggested for good management information.
- Required by the IRS for businesses above a certain gross revenue level. (The IRS also wants and needs to see that you are taking accurate measurements!)

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When builders and remodelers have access to accurate measurements, they automatically begin to take steps to improve their results!

The Process

Here is a primer for preparing a spreadsheet to help calculate your Percentage of Completion entries at the end of an accounting period (we suggest monthly entries):

Determine and Document the Period-ending Date:

- Enter the ending date for the applicable accounting period into the top of your worksheet..

Open Jobs:

- Determine which jobs will be (or were) open as of the end of the accounting period you are working on.

NOTE: "Open" means that you have sold or "landed" the job, **and** that you have invoiced or received money that is recorded in your accounting records as income, **and/or** that you show job costs, **and** the job is not yet considered to be financially "finished".

- Enter **ONLY** those jobs in column A.

Establish and enter anticipated contract income:

- Column B: Enter the amount of the original anticipated (contracted) income.
- Column C: Enter the amount you plan to charge the client for any known change orders.
- Column D: Add known amounts for client allowance "overages" and subtract amounts for "less than allowance".
- Column E: Enter a formula to show the "adjusted" or "forecasted" income after the preceding changes.

Totals	694,000.00	82,150.00	(800.00)	775,350.00
A	B	C	D	E
	CONTRACTED INCOME & MODIFICATIONS			
	Orig Contract	+ / (-) Chg orders	+ / (-) chgs to allowances	New forecast: Income
Job Name	Enter	Enter	Enter	B+C+D
Richards-Kitchen	50,000.00	5,500.00	(500.00)	55,000.00
Fellowes-Porch	9,500.00	700.00	0.00	10,200.00
Smith-Addition	100,000.00	0.00	0.00	100,000.00
Roberts-Bath	37,500.00	2,750.00	1,575.00	41,825.00
Nelson-Deck	18,500.00	0.00	0.00	18,500.00
Brown-Cust Home	475,000.00	73,200.00	(1,875.00)	546,325.00
Patterson-Design	3,500.00	0.00	0.00	3,500.00

Establish and enter anticipated estimated costs:

- Column F: Enter the original estimated costs for the job.
- Column G: Enter the additional costs (or reduced costs as a negative) related to client change orders.
- Column H: Add or subtract the estimated costs related to allowances "over" and "under".
- Column I: Enter known changes to original estimated costs. The best way to do this is for the estimator to carefully review estimated vs. actual job cost reports through the end of the accounting period and compute known "overs" minus "unders". (Remember to consider bills incurred but not yet received.)
- Column J: Enter a formula to show the "adjusted" or "forecasted" costs for the job at this point in time.

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Totals	453,308.75	42,300.00	(562.50)	11,790.00	506,836.25
				*Actual or anticipated over/(under)	
A	F	G	H	I	J
	ESTIMATED COST & MODIFICATIONS				
	Orig Cost Estimate	+/(-) Chg orders	+/(-) chgs to allowances	+/(-) chgs to estimate*	New forecast: Est'd cost
Job Name	Enter	Enter	Enter	Enter	F+G+H+I
Richards-Kitchen	35,000.00	3,000.00	(300.00)	750.00	38,450.00
Fellowes-Porch	4,500.00	350.00	0.00	0.00	4,850.00
Smith-Addition	66,576.00	0.00	0.00	0.00	66,576.00
Roberts-Bath	22,532.75	1,450.00	787.50	7,257.00	32,027.25
Nelson-Deck	12,500.00	0.00	0.00	0.00	12,500.00
Brown-Cust Home	310,000.00	37,500.00	(1,050.00)	3,783.00	350,233.00
Patterson-Design	2,200.00	0.00	0.00	0.00	2,200.00

Compute Gross Profit %'s:

- Column K: Enter a formula to compute your **original** estimated gross profit percentage for this job. (Column B – Column F then divide by Column B)
- Column L: Enter a formula to compute your latest **"adjusted"** (forecasted) gross profit percentage for this job. (Column E – Column J then divide by Column E)

Totals	34.7%	34.6%
	*) on labor/subs/materials	
A	K	L
	GROSS PROFIT %'s	
	Original Estimated	New Forecast
Job Name	(B-F)/B	(E-J)/E
Richards-Kitchen	30.0%	30.1%
Fellowes-Porch	52.6%	52.5%
Smith-Addition	33.4%	33.4%
Roberts-Bath	39.9%	23.4%
Nelson-Deck	32.4%	32.4%
Brown-Cust Home	34.7%	35.9%
Patterson-Design	37.1%	37.1%

(These screen shots were taken directly from the [Qlean\\$Start Worksheet™: Percentage of Completion Calculator](#))

Important Information to complete before proceeding

The final segments of information needed for your Percentage of Completion calculations will be extracted from your actual accounting records, so before you enter Life-to-Date Income and Costs from your accounting records to the Worksheet please keep the following information in mind.

1. Percentage of Completion entries are considered to be "adjusting" entries. Adjusting entries are normally made after "the books have been closed" (i.e., after all of the normal accounting processes have been completed).
2. It is therefore **absolutely necessary** that you "complete and finalize" your normal accounting and job-costing process BEFORE you extract information to use in your Percentage of Completion calculations.

For example, BEFORE you obtain information for this Worksheet from your accounting records, be sure that you have entered:

- All costs incurred for each job through the end of the accounting period (e.g., all known bills, bill credits, interest, credit card charges, and checks).
- All income that applies to that accounting period (e.g., invoices).
- A **closing date** in your QuickBooks® file for that accounting period so that additional job costs or income are **not** inadvertently applied to that job AFTER you have made your entries.

NOTE: If additional income and/or cost entries are made AFTER your adjusting entries, your entries and results become invalid! This is because you have changed the underlying data that "drives" the adjusting calculations,....

TIP: If you receive bills relating to the prior period after you have closed the books for the month, date them the first day of the following period. (You can place a note in the memo field regarding the actual date of the bill).

[Click here to review an easy to use POC Calculator](#)

Obtaining information from your accounting records to use in the Worksheet

The reference illustration (review the initial Illustration) shows how accrual-based accounting information should have initially been entered to your accounts for each job.

- To obtain the information that you need for your Worksheet, create a Profit and Loss by Job report. Because we want to use **LIFE-TO-DATE income and cost** for these jobs, set report date ranges as follows:
 - ✓ **Opening date:** Several months BEFORE the earliest start date of any of those jobs (e.g., If the "oldest" job started 18 months ago, set the opening date to 20 or 24 months ago).
 - ✓ **Ending date:** Use the end of the accounting period that you are adjusting (e.g., March 31, or September 30).
- Filter the report to show **only those jobs that were open** at the end of the accounting period

You will use the numbers from this report for your Worksheet and calculations.

NOTE: Memorize this report, or keep it "open" in your accounting program, because after you have posted your entries, you will check your results by matching the results shown in the modified report back against the Worksheet.

Enter Life-to-Date Income and Cost entries to the Worksheet and view results

Column M: Enter the Life-to-Date Cost shown on the Profit & Loss report for each open job.

Column N: Enter a formula to compute the percentage of life-to-date cost incurred in relationship to the total anticipated cost (column M divided by column J).

If you have **too much income** on the books for a given job, a sample entry might look like the following:

Debit - **Plus/(Less) Pct of Completion Adj** \$ 3,525 (decreases income)

Credit - **Billings in Excess of Cost** \$3,525 (decreases income) – Job 529

NOTE: Of course you can make entries for a number of jobs in a single journal entry if you wish,....

- Refresh your accounting report, and check the gross profit results and percentages against your Worksheet.
 - ✓ If the numbers don't match, go back and check your life-to-date cost and income amounts.
 - ✓ If the gross profits amounts and percentages match, you are ready to proceed to the next step.

The following illustration is an overview of the impact of your entries (note the Pct of Completion line):

New Reference Information:
Illustration of accrual-based accounting on contract jobs AFTER "Pct of Completion" entries:

Revenue	Cash	Accts Rec by customer	Accts Payable by Vendor	Income by job	Cost by job
Invoice to customer		+		+	
Customer payment received	+	-			
*Plus/(Less) Pct of Compl Adjustment				+ or (-)	
Costs					
Bill entered			+		-
Bill paid	-		-		
Results-by account	+	0	0	+	-
				= Adjusted gross income	

**The "offset" to these entries ends up in your Balance Sheet*

Illustration of accrual-based accounting on contract jobs AFTER "Pct of Completion" entries:

Now you have a **TRUE** picture of the correct proportion of income and expense for your company for the current accounting period.

The final step - Make a "reversing journal entry"

Because the Percentage of Completion entry is a temporary "timing of income" adjustment, it will need to be reversed (backed out) as of the first day of the following period. This allows the accumulation of income (via invoices) and costs (via checks, credit cards, and bills) to continue in the usual fashion.

The Percentage of Completion calculations, entries, and reversals will be repeated again at the end of the following accounting period for any jobs that are open at that time.

Note: All of these processes and calculations (plus "bonus" profitability projection information and actual journal entries and reversals!) have been carefully designed and built for you in our **QleanStart™ Worksheet: Percentage of Completion Calculator (Excel)**. Click [here](#) to learn more,...