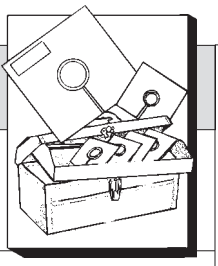
STATE-OF-THE-ART CONTRACTOR



Accrual Accounting Easier by Computer

by Morris D. Carey, Jr.

The California State Contractor's License Board tells me that contractors fail in business mostly due to poor business ability, not lack of trade knowledge. And those who fail as a result of bad business ability most often use the *cash method* rather than the *accrual method* of accounting. The upshot: A novice contractor using the cash method may be working against big odds.

Cash Method

The cash method of accounting records income and expenses in the profit-and-loss statement when money is actually received or paid out. Although this method may work for some, it can be a poor indicator of the real ins and outs of cash flow.

For example, if bills for a job aren't paid for a month after payment for the job is received, the books will reflect big income one month and big expenses the following month. On the other hand, if bills are paid as the job progresses, but payment for the work isn't received until the following month, then the opposite happens. The cash method of accounting can provide an extremely distorted picture of how well the business is actually doing.

Accrual Method

The accrual method of accounting provides a more realistic picture of business activity. With the accrual method, purchases (cash or credit) are recorded in the books at date-of-purchase. And client billings (paid or not) are recorded as income. Unpaid job bills are posted as accounts payable and expense, and unpaid client billings are posted as accounts receivable and income. At the end of each month (prior to closing the books), adjustments should be made to ensure that the income statement is an accurate reflection of what is happening in the field.

For example: if our sales income for the month is shown at $50,000, but actual work performed was $60,000, then we'd have to make a $10,000 journal entry to correct matters. In this example, a temporary entry would be made crediting (increasing) sales income and debiting (decreasing) a current asset account called *Work in Progress*. *Work in Progress* is the balance sheet account that is used when work has been completed but has not been billed.

With temporary entries, after the books have been closed for the month, we make a reversing entry to the next month's set of books to put things back to where they were. Then, the same process is repeated the following month. In our example, if actual work performed had been $42,000, then we would have to make an $8,000 adjusting journal entry in the opposite direction. In this case a temporary entry would be made debiting sales income and crediting a current liability account called *Customer Deposits*. *Customer Deposits* is the balance sheet account used when we have been paid more than we have earned. Actual work performed and billings rarely match.

Getting a Match

Before adjustments can be made to correct the financial statement (the balance sheet and income statement), you must first determine how much work was actually performed for the month. Since this task can involve doing math on hundreds of numbers, it is simplified when done by computer. We use a simple spreadsheet program to determine year-to-date percentage of completion and year-to-date dollars of completion (Table 1).

How this spreadsheet is formatted is extremely important. *Analysis of Work Performed*, the *Revised Contract Amount* and the *YTD Percent Complete* are manual entry columns. I input these numbers. The *YTD Dollars Complete* column is done by the computer, as are the three totals at the bottom. In order to determine the monthly percentage-of-completion, I either visit our jobs or have the job supervisor fill out a form that indicates estimated percentage of completion for each category of work for each job. The trick to getting the correct amount in the *Total YTD Percent Complete* cell is to make it equal to the value in the *Total Dollars Complete* cell divided by the *Total Revised Contract Amount* cell. (Caution: Using the standard averaging function that comes with a spreadsheet program in a column that contains zeros will render an improper percentage.)

Once I have completed an *Analysis of Work Performed* for each job in progress, the resulting information is transferred to another spreadsheet program that I call *Actual Production Income* (see Table 2, next page). The data in the columns titled *Job Name, Revised Contract Sum, YTD Percent Complete* and *Previous Month's Income* are entered manually. The *YTD Dollars Complete* column, the *Income This Month* column, and the *Total Income For the Month* are calculations performed by the spreadsheet program.

Before I do anything to this spreadsheet, I manually enter the amount shown in the *YTD Dollars Complete* column to the *Previous Month's Income* column. At this point both columns match. The value for new jobs (first month of activity) in the *Previous Month's Income* column is zero. The data entries for the *Revised Contract Sum* column and the *YTD Percent Complete* column are derived from the *Analysis of Work Performed* sheets. The values for each job in the *YTD Dollars Complete* column is equal to the value of the cell in the *Revised Contract Sum* times the value in the cell in the *YTD Percent Complete* column. Although I already have this data, and can enter it manually from the *Analysis of Work Performed* printout, I prefer to let the computer do it for me to avoid mistakes.

This is a very accurate way of monitoring monthly production — even when a credit is given to a customer at the last minute. In such a case, the revised contract sum is reduced, the previous month's income remains unchanged, and in the case of our example (the Yasukochi job), a negative income (loss) adjusts for the previous month's over-calculation. By using the computer to make these calculations each month, we are always able to track our actual work performed — regardless of how much we have billed. Once we know what actual dollar amount of work was performed, we can make the correct entry to *Sales Income* and either *Work-in-Progress* or *Customer Deposits*.

This sounds like a lot of work, and in the beginning it is. But once you get into the routine it

Table 1: Analysis of Work Performed

For Month of: Feb 91
Job Name: Jones

		Revised Contract Amount	YTD Percent Complete	YTD Dollars Complete
AA	Plans & Permits	4,306	100%	4,306
AB	Temporary Facilities	5,740	95%	5,453
AC	Demolition	12,904	100%	12,904
AD	Excavation	3,008	100%	3,008
AE	Concrete	7,135	70%	4,994
AF	Rough Carpentry	34,675	100%	34,675
AG	Finish Carpentry	11,133	80%	8,906
AH	Lumber & Rough Hardware	23,300	100%	23,300
AI	Roof Cover	6,723	100%	6,723
AJ	Windows/SGD/Skylight	10,167	100%	10,167
AK	Stucco	0	0%	0
AL	Masonry	3,567	0%	0
AM	Drywall	11,245	100%	11,245
AN	Metal Fireplace	1,721	100%	1,721
AO	Special Metal	1,132	100%	1,132
AP	Plumbing	12,590	70%	8,813
AS	HVAC	7,664	70%	5,364
AT	Electrical	13,210	70%	9,247
AV	Insulation	2,215	100%	2,215
AW	Doors & Millwork	9,352	100%	9,352
AX	Painting	12,100	80%	9,680
AY	Cabinets/Laminate Tops	2,382	100%	2,382
AZ	Cultured Products	10,546	100%	10,546
BA	Ceramic Tile	3,686	100%	3,686
BC	Finish Hardware	255	0%	0
BD	Finish Flooring	616	100%	616
BE	Mirror/Shower Door	2,459	0%	0
BG	Cleanup	5,214	65%	3,389
BH	Supervision	5,228	69%	3,607
BI	Contin O/H & Profit	58,683		
TOTALS		**$282,956**	**69.8%**	**$197,431**

Table 2. Actual Production Income

For: Feb 1991

Job Name	Revised Contract Sum	YTD Percent Complete	YTD Dollars Complete	Previous Month's Income	Income This Month
Jones	282,957	69.8%	197,504	175,866	21,638
Stokes	15,582	10%	1,558	0	1,558
Sherrill	52,476	85%	44,604	33,990	10,614
Yasukochi	17,163	100%	17,163	18,235	(1,072)
August	37,527	60%	22,516	17,392	5,124
Zugnoni	32,909	53.5%	17,606	10,415	7,191
Smith, D.	7,334	100%	7,334	4,980	2,354
Auble	14,959	80%	11,967	8,097	3,870
O'Keefe	28,779	10%	2,877	0	2,877
			Total Income For Month		**54,154**

really is easy. And it may help you stay profitable — or in business!

New Software For Remodelers

Step right up, folks, and check out a software product that could help you become a better remodeler. I recently received a program called Business Builders, from Northwest Construction Software in Beaverton, Ore. Business Builders is super. I have not seen a program that is any easier to install and operate. This menu-driven program contains several utilities, including a remodeler's checklist, a tool inventory program, a residential electrical service calculation module, a markup calculation program, a calender program, and a carpentry layout module. All for $195.

Remodeler's checklist. This module is used to create and print the checklist that is used when surveying a job for the first time. The program includes three thorough checklists. One for bathrooms, one for kitchens, and one for room additions. Each list can be altered to fit your specific needs. But the lists included are great. In the room-addition checklist, there are 37 sections, including customer information (Did you ever think to ask for a neighbor's name and phone number in case of an emergency?), a customer qualification section (Where will they get the money for the job?), a job location section (Are there parking or traffic problems at the job location?), a section on plans (existing or not?), and sections on crawl area, basement, attic, second floor, inspectors, and much more. This module alone is worth the price of the software since it can save you a lot of money and a lot of grief by reminding you about items to include in your bid, contract, and job planning.

Markup calculation. I can't decide whether I like this module the best or the remodelers' checklist. In this program you tell the system how much you expect to sell over the next year, what your overhead expenses are, and how much profit you want to make. The program calculates the information and tells you what your total cost-of-sale will be and how much markup you will have to charge. It also reflects how much dollar volume must be produced each week and each month to reach your goal and how much dollar volume must be produced each week and each month to break even.

Other useful modules. I found the tool inventory module and the electrical service module easy to use as well as useful — *if* your business is one that can make use of these functions. The calendar program is almost identical to the calendar in *Sidekick*, except it's not memory-resident. Finally, I haven't yet received the carpentry layout module, but I understand that it does basic stair and deck calculations, among other things. If you want more information on Business Builders, you can write to NCS at 11110 SW Partridge Loop, Beaverton, OR 97007, or call 503/644-6152. ■

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