

Mastering Construction Bookkeeping

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Construction bookkeeping is the backbone of financial management in the project-centric construction industry. In this comprehensive guide, we'll delve into the core principles, software solutions, and best practices that can empower construction professionals to master the art of bookkeeping and make sound financial decisions.

WHAT IS CONSTRUCTION BOOKKEEPING?

Construction bookkeeping involves the systematic recording and management of financial transactions within the construction industry. From tracking and forecasting business expenses to managing project budgets, it plays a pivotal role in ensuring financial health and project success.

THE BASICS OF CONSTRUCTION BOOKKEEPING

In this section, we embark on a journey, unraveling key principles and common financial terms for constructing a robust financial framework. Let's explore how these fundamental concepts lay the groundwork for informed decision-making, streamlined operations, and ultimately, success in construction.

KEY PRINCIPLES OF CONSTRUCTION ACCOUNTING

Job Costing

Job costing is a fundamental principle in construction accounting, as it involves allocating all costs associated with a specific construction project. Job costs include direct costs (material costs, labor costs, equipment costs, trade partner costs) and indirect costs (overhead expenses) to provide



a detailed breakdown of expenses related to a particular construction job.

Work-in-Progress (WIP) Reporting

Construction projects often extend over several accounting periods. WIP reporting involves tracking the costs and revenues associated with incomplete projects. This helps construction firms monitor the financial health of ongoing projects, make necessary adjustments, and properly recognize revenue.

Consistency in Revenue Recognition

Consistent application of revenue recognition policies is essential in construction accounting. Construction companies should follow a method that accurately reflects the stage of completion and revenue earned, ensuring uniformity in financial reporting.

Overhead Allocation

Construction companies typically have indirect costs, such as office rent, utilities, and administrative salaries, which are not directly tied to a specific project. Overhead allocation involves distributing these indirect costs proportionally across various construction projects, ensuring that each project bears its fair share of indirect expenses.

Percentage-of-Completion Accounting

This principle is particularly relevant in long-term construction projects. Revenue and expenses are recognized based on the percentage of the project that is completed. It provides a more accurate reflection of a project's financial status compared to recognizing revenue only upon project completion.

Retainage

Construction contracts often involve retainage, where a portion of payments is withheld until the completion of the project. Construction accountants must track retainage and ensure that it is properly accounted for in financial statements.

Financial Reporting Compliance

Construction companies need to adhere to specific accounting standards and regulations, such as the generally accepted accounting principles (GAAP) or International Financial Reporting Standards (IFRS), to ensure accurate and transparent reporting.

Contingency Planning

Construction projects are susceptible to uncertainties and unforeseen events. Construction accountants must incorporate contingency plans and allowances in financial forecasts to account for potential cost overruns or delays.

COMMON BOOKKEEPING TERMS

In construction bookkeeping, various financial terms are commonly used to track, analyze, and report the financial health of a construction business. Here are some common financial terms:

- » **Revenue:** The total income generated by a construction business.
- » **Expenses:** The costs incurred by a construction company in the process of completing projects.

- » **Profit margin:** The percentage of revenue that represents the profit earned on a project. It is calculated by dividing the net profit by the total revenue and multiplying by 100.
- » **Cost of goods sold (COGS):** The direct costs associated with the production of goods or services. In construction, COGS includes expenses directly tied to project completion, such as materials, labor, and trade partner costs.
- » **Gross profit:** The difference between total revenue and the cost of goods sold. It represents the profit before deducting operating expenses.
- » **Net profit:** The final profit amount after subtracting all expenses, including both COGS and operating expenses, from total revenue.
- » **Accounts receivable:** It represents the outstanding invoices or bills that have been issued to customers, but the payment has not been received yet.
- » **Accounts payable:** The amount of money that a construction company owes to its suppliers, trade partners, and other creditors for goods and services received but not yet paid.
- » **Working capital:** The difference between a construction company's current assets (such as cash, accounts receivable, and inventory) and its current liabilities (such as accounts payable and short-term debt). It measures the company's short-term health.
- » **Cash flow:** The movement of cash in and out of a construction business. Positive cash flow indicates that the company is receiving more cash than it is spending, while negative cash flow implies the opposite.
- » **Cash flow statement:** A financial statement that details the inflow and outflow of cash during a specific period. It provides insights into a construction company's liquidity and ability to meet financial obligations.
- » **Retainage:** The portion of a contractor's payment that is withheld until the completion of a project. It is a common practice in construction contracts to ensure that work is completed satisfactorily.
- » **Change order:** A modification to the original contract, often initiated by the client or due to unforeseen circumstances. Change orders can impact project costs and timelines.
- » **Depreciation:** The gradual decrease in the value of an asset over time. Construction companies may depreciate assets

such as equipment and vehicles for accounting and tax purposes.

- » **Overhead:** Indirect costs not directly tied to a specific project, such as administrative salaries, rent, and utilities. Overhead costs are allocated to projects based on a predetermined method.
- » **Committed costs:** Committed costs occur when a company agrees to buy something via a purchase order or contract. For example: If a general contractor has agreed to hire an electrician for a project, and they've signed the contract stating the amount of work and dollars to be billed, this is a committed cost. Other examples include unposted payroll, purchase orders in which you are waiting for delivery or the bill for the materials has not been paid yet, and open contract or trade partner agreements.

BENEFITS OF USING CONSTRUCTION BOOKKEEPING SOFTWARE

Construction accounting software offers construction bookkeepers specialized tools and features that address the unique challenges and intricacies of the construction industry. Benefits include:

- » **Project-centric financial management:** Construction bookkeeping software is designed with a project-centric approach, allowing businesses to manage finances on a project-by-project basis. This ensures accurate allocation of costs, tracking of project-specific expenses, and comprehensive reporting for each construction project.
- » **Accurate job costing:** The software enables precise job costing by tracking and allocating all direct and indirect costs associated with a particular project. This facilitates better budgeting, forecasting, and evaluation of project profitability.
- » **Real-time financial insights:** Construction bookkeeping software provides real-time access to financial data, allowing businesses to monitor cash flow, project expenses, and overall financial health instantly. This timely information empowers decision-makers to respond proactively to financial challenges.
- » **Efficient invoicing and payment processing:** Streamlined invoicing features in construction bookkeeping software simplify the billing process. The software allows businesses to generate customized invoices based on project

milestones, track payments, and manage complex billing structures, reducing the risk of errors and delays.

- » **Compliance with industry standards:** Construction bookkeeping software is designed to comply with industry-specific accounting standards and regulations. This ensures that businesses adhere to accounting practices relevant to the construction industry, promoting transparency and compliance.
- » **Integration with construction management tools:** Many construction bookkeeping software solutions seamlessly integrate with construction management tools. This enhances collaboration between financial and project management teams, ensuring a cohesive flow of information and reducing the likelihood of errors.
- » **Automated financial processes:** Software automates routine financial processes, such as data entry, invoicing, and payroll. This not only saves time but also minimizes the risk of human error, improving overall accuracy in financial transactions.
- » **Enhanced trade partner management:** The software typically includes features for efficient trade partner management. This includes tracking contracts, managing payments, and ensuring compliance with trade partner agreements. The streamlined process enhances relationships with trade partners and reduces administrative burden.
- » **Customized reporting:** Construction bookkeeping software provides customizable reporting features, allowing businesses to generate financial reports tailored to their specific needs. This flexibility enables stakeholders to analyze financial data in ways that are most relevant to their decision-making processes.
- » **Enhanced security and data integrity:** Construction bookkeeping software often comes with robust security features, ensuring the confidentiality and integrity of financial data. This is crucial in protecting sensitive financial information in the construction industry. 🛡️



About the Author

John Meibers is the vice president and general manager of [Deltek ComputerEase](#), a leading provider of accounting, project management, and jobsite-to-office software for the construction industry. Prior to joining ComputerEase more than 25 years ago, Meibers spent a decade working for a large mechanical contractor.

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