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Subcontractor financial reporting:

3 must-review items on your financial statement and how QuickBooks can help

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Introduction

Financial statements show not only the current health of a business but also provide indicators of future trends. Running a successful subcontractor business requires regular review of financial reports, such as the balance sheet; P&L (profit and loss); and income, cash flow and work-in-progress statements. By doing so, it puts the contractor in a better position to identify potential red flags, accurately forecast budgets and maintain good financial health over the long term. QuickBooks can help you achieve this.

Deeper insight into the numbers provides subcontractors with a clear, real-time snapshot of the business's financial position at any given time. For example, reviewing receivables, payables and gross profits provide a solid foundation to predict profitability. This helps to better plan future projects, price appropriately, and ensure overall business liquidity. Maintaining current and accurate financial reports also helps banks, creditors and other lenders assess a contractor's creditworthiness when determining loan terms, interest rate and lines of credit.

While most subcontractors didn't launch their business because they are experts with generally accepted accounting principles (GAAP) or love handling complex accounting work, it is a necessary part of the job. It's imperative to consistently review financial reports in order to make informed and profit-driving business decisions. This guide was developed to outline key financial statement data points that every subcontractor should review.

This eBook was created to provide you with an informative guide on the top KPIs (key performance indicators) for subcontractors. We offer several tips throughout to help you maximize the power of QuickBooks to better manage your financials and grow a highly successful practice.

Key financial data points made simple

Accounting expert to the construction industry's subcontractor vertical, Tonya Schulte, principal at The Profit Constructors, deeply understands the necessity of financial reporting for her clients and the requisite data points subcontractors should be reviewing regularly.

As a QuickBooks ProAdvisor, Schulte provides added insight into core system features that can save you valuable time. From creating custom fields to pulling information-rich reports, you'll learn how to dig deeper into the numbers to support informed business decisions and fuel business growth.

Item 1: Project profitability

In relation to financial reporting, subcontractors operate like the majority of small businesses. They need to track the basics: overall profitability, cash flow and liquidity. Unlike some other businesses, however, subcontractors are subject to the "extreme seasonality effect," creating major highs and lows during the year in terms of quantity of work. Additionally, every job is different with a unique set of factors that drive timeline, labor costs, administrative expenses and other direct and indirect costs.

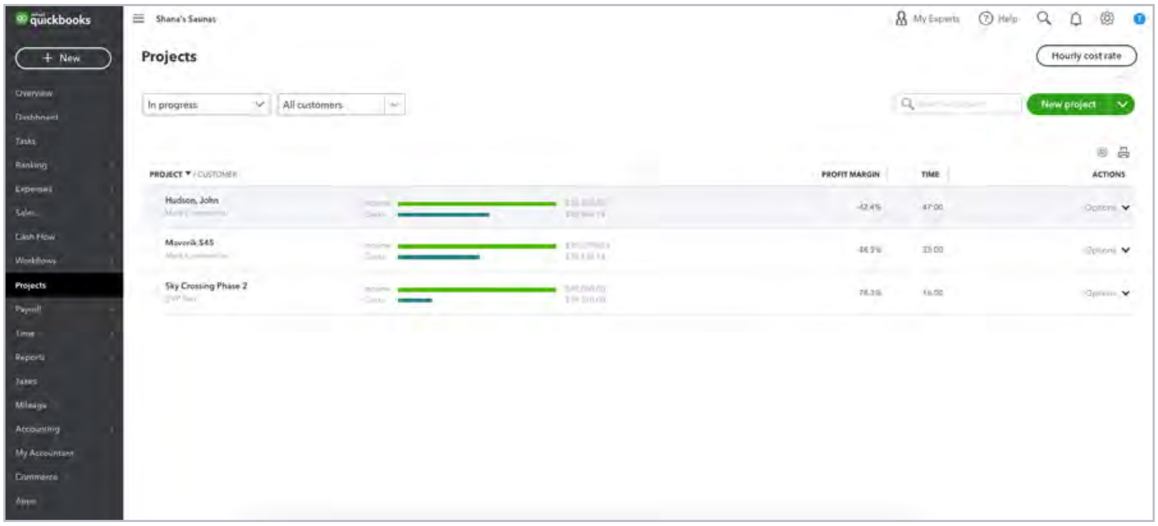
Schulte explained that subcontractors have to dig deeper into the numbers to better plan and forecast profitability by reviewing data regularly on each individual project. "This takes profitability to a different level and ensures that it's being measured on a per-project basis."

Being profitable on every job is the end goal. But for many contractors, this can be an overwhelmingly complex task. Tracking every expense against cash inflow when you are managing multiple jobs simultaneously requires dedicated, organized focus.

Project profitability tracking is made much easier by using the right technology according to Schulte: "The Project module in QuickBooks shows you exactly what your revenue and project expenses are in graphic form. And right next to that in big bold letters is your profit margin percentage for a given project."

QuickBooks Tips:

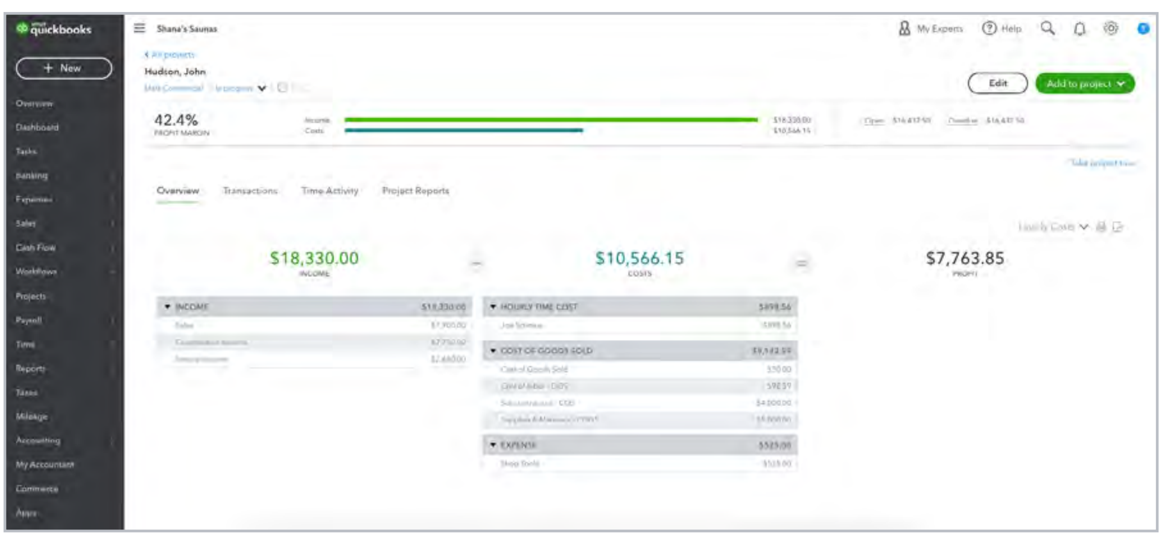
The Projects module provides you with an easy and convenient way to assess profitability on a project-by-project basis—offering a real-time view into income, costs, profit margin and a running total of time spent on a given job. Within the module, income and costs are presented in graph format for an at-a-glance comparison. All of this makes easy work of monitoring and managing project profitability to ensure positive profit margins along the way and flag issues early on.



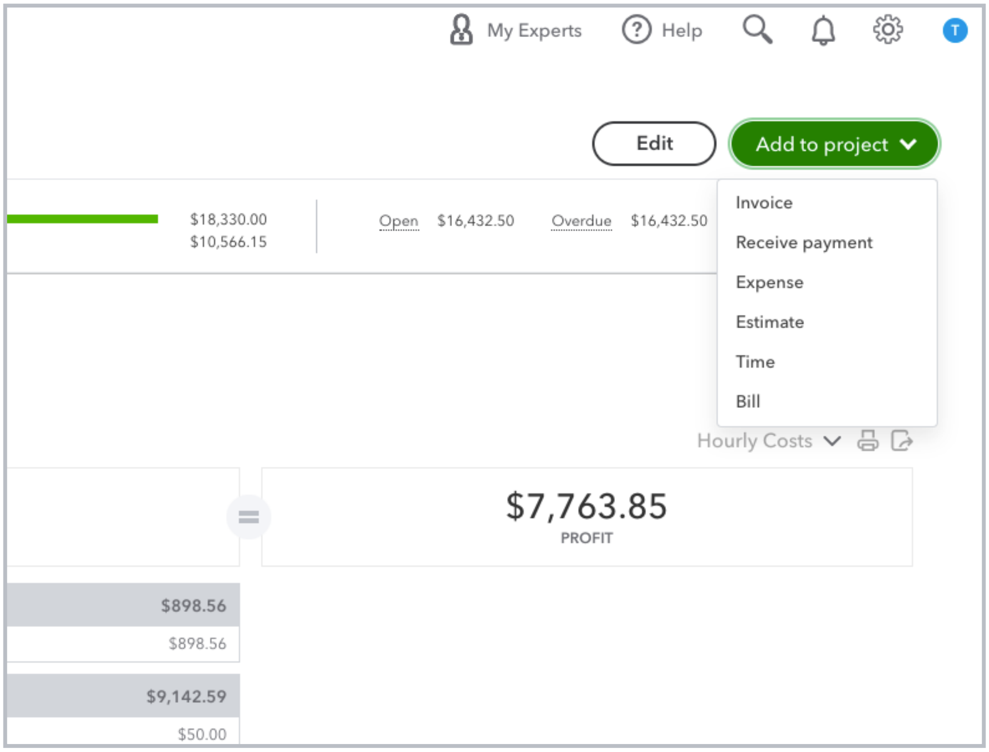
The Projects dashboard offers a single, organized space to view all projects in progress.

From the dashboard, you can click on any project to view the data in more detail. Within the individual project screen, you are presented with the profit margin percentage immediately at the top. Below the profit margin callout, QuickBooks does the math for you–breaking down the profit margin percentage to show income minus costs and the current profit in dollar amount.

“We work with each client to establish what their standard metric is for project profitability. The Project module offers a real-time snapshot of profit margin by project that we can review with the client to ensure they stay on track to hit their goals,” said Schulte.



Review profit margin percentages per project with ease while also getting a look at details, such as an itemized list of costs.



Quickly add an invoice or payment to a specific project without having to leave the project screen.

It's also worth highlighting the "Add to project" drop down within the Projects module. This feature allows you to add required items to a specific project directly within the individual project screen. For example, creating an invoice for a customer or receiving a payment.

According to Schulte, this is an exceptionally convenient feature. "It seems like a small thing, but it's another one of those thoughtful features that saves time."

Schulte added that business owners can also access other reports that provide more detail. "Within the Projects module they [subcontractors] can pull up a detailed profit and loss report to ensure that for a particular project, everything is being entered correctly... all of the revenue and all of the expenses are being accurately entered to the cost of goods sold accounts."

Reviewing profit and loss statements per project is key to ensuring that every job stays within budget and that, ultimately, each project positively adds to the bottom line. Frequent review can uncover such issues as labor or material costs that have increased since the initial bid and allow the contractor to make needed adjustments early on.

Item 2: Over and under billing

This core key performance indicator is important because it helps track the progress of each job in relation to billing. Over and under billing is determined as follows:

- **Over billing:** The total over-billing figure is determined by summing over-billing amounts for all jobs where progress billings-to-date exceed the associated costs.

- **Under billing:** The under-billing amount is calculated by totaling the under-billing amounts for all jobs where costs-to-date exceed the associated billings.

Schulte further explained: "The main goal of tracking the over and under billing is to employ the matching principle [which requires expense to be reported in the same period as the related revenues earned]. This allows us to recognize revenue in the proper period. Essentially, this boils down to keeping track of what we actually invoiced against the job versus what percentage of progress we've made on the job...and making sure, on an accrual basis, that we are really where we should be on the project in relation to revenue."

For example, if a business shows it's billed 70% on the job but is only at 60% completion (over billed), there is a need to adjust revenue, assets and liabilities accordingly. The same adjustments would need to be made if the subcontractor has underbilled during a given period.

"We like our clients to think in terms of over and under billing to help them better manage their businesses overall. It drives them to ask smart questions. Are they billing correctly? Are estimators providing accounting with good data? Is there good communication between those in the field and those working on admin items? All of this is important to track and understand," said Schulte.

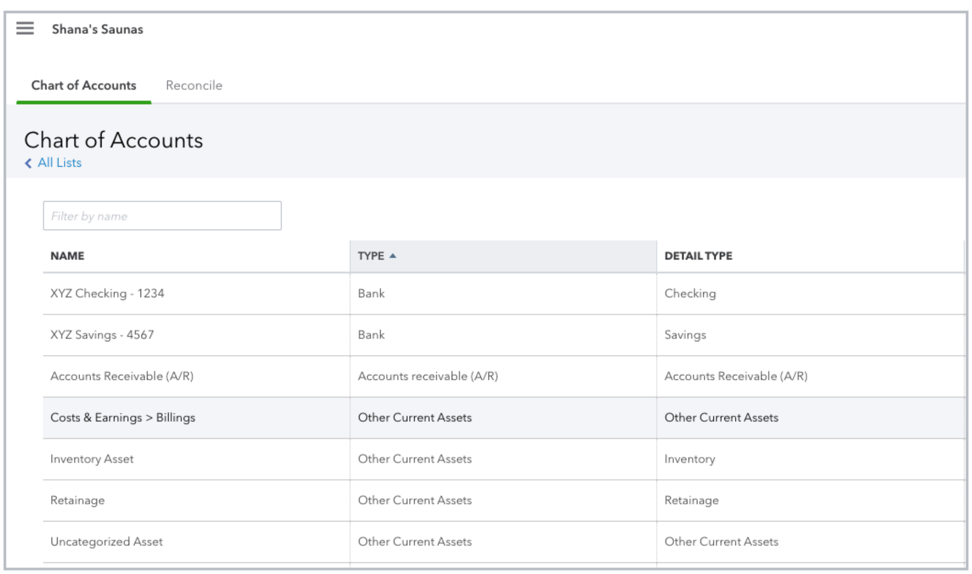
QuickBooks Tips:

To ensure proper management of over and under billing, Schulte suggests setting up three unique accounts within the chart of accounts for easy review of over/under billings each month. These include:

1. **Costs & Earnings>Billings:** This indicates instances of under billing (i.e., costs incurred are greater than what you've actually billed out). This is considered an asset account because, technically, anything under billed represents an asset to be collected. This data is a good indicator of how well a project is being managed. For example, is the estimator properly costing jobs? Is the project manager purchasing materials too far in advance for a job?

2. **Billing>Cost & Estimated Earnings:** This indicates instances of over billing (i.e., the amount billed is greater than the actual work completed on the project). This is considered a liability account as the amount cannot be added to equity because it has not yet been earned—equating to money owed to the customer.

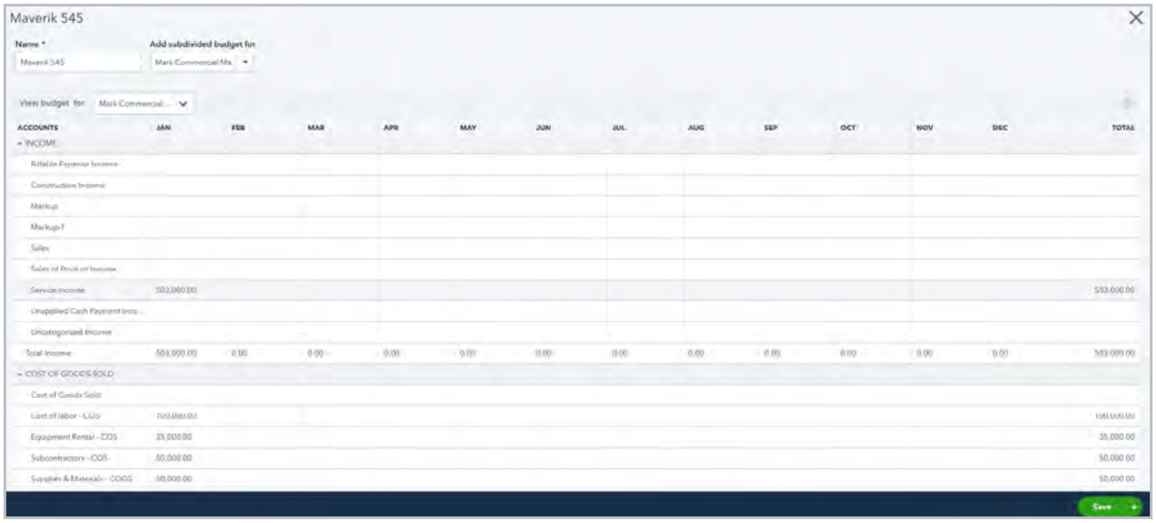
3. **Current year % completion revenue:** This is the income adjustment account that indicates the net effect of the asset and liability amounts. This tells you whether you are in an under or over billed situation and directs you to make the appropriate adjustments for the period.



NAME	TYPE ▲	DETAIL TYPE
XYZ Checking - 1234	Bank	Checking
XYZ Savings - 4567	Bank	Savings
Accounts Receivable (A/R)	Accounts receivable (A/R)	Accounts Receivable (A/R)
Costs & Earnings > Billings	Other Current Assets	Other Current Assets
Inventory Asset	Other Current Assets	Inventory
Retainage	Other Current Assets	Retainage
Uncategorized Asset	Other Current Assets	Other Current Assets

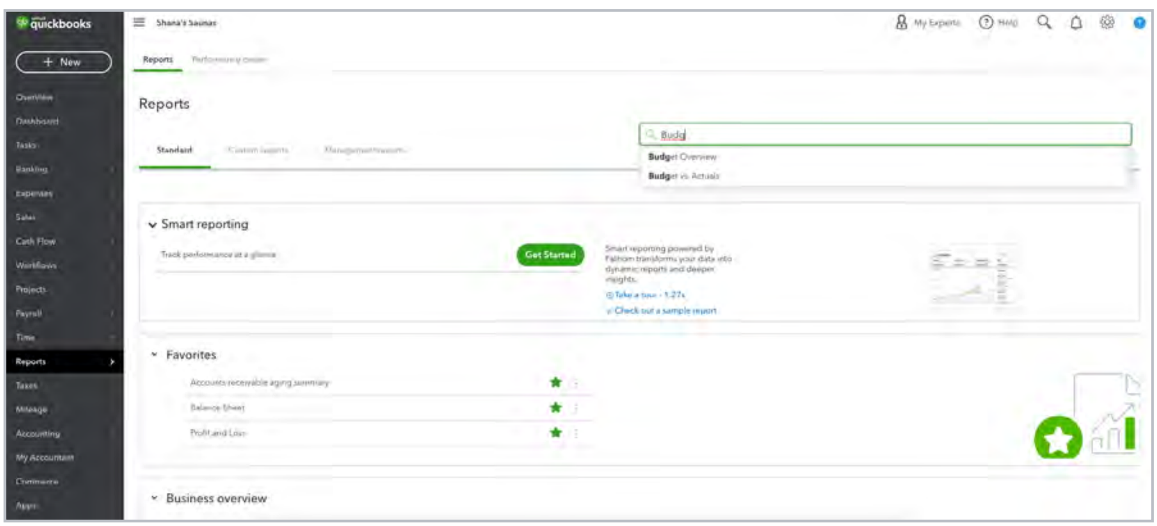
Set up custom accounts within the Chart of Accounts to help you efficiently manage over and under billing per period.

The ability to create a budget for each individual project up front is another great feature in QuickBooks. This offers a sound alternative to track budget to actual at a given point on any project. Once the budget is created, you can [set up a custom report]() and pull in the data that fuels the over/under billing information on a work-in-progress schedule.



Set up custom accounts within the Chart of Accounts to help you efficiently manage over and under billing per period.

To access that budget data against actual revenue and cost data, use the Budgets vs Actuals report and customize it by project.



The ability to quickly pull a custom report offers added insight on budget by project.

Item 3: Labor costs

For most subcontractors, labor is one of the biggest expenses. Tracking labor and keeping labor costs in line with budget directly affects overall profitability—making this one of the top must-have financial reporting items to review.

"If we don't understand our labor costs clearly, tracking project profitability is useless because improperly costing labor can be huge. Labor often equates to around 40% of the job cost, if not more, so you have to get it right," explained Schulte.

Contractors should be taking into account every single hour of labor on each job in order to uncover the full labor burden rate. The burden rate includes not just the wage a contractor is paying an individual but also adds in benefits, taxes and worker's compensation. Further, it can include other labor-related costs such as employer-provided equipment (e.g., cell phones or personal protective equipment), safety training and even holiday parties.

Schulte recommends using the hourly cost calculator in QuickBooks to get a clear picture of the burden rate. "This is a great tool to use because it uncovers labor-related costs that often contractors don't think about…costs that add up quickly and work against profitability."

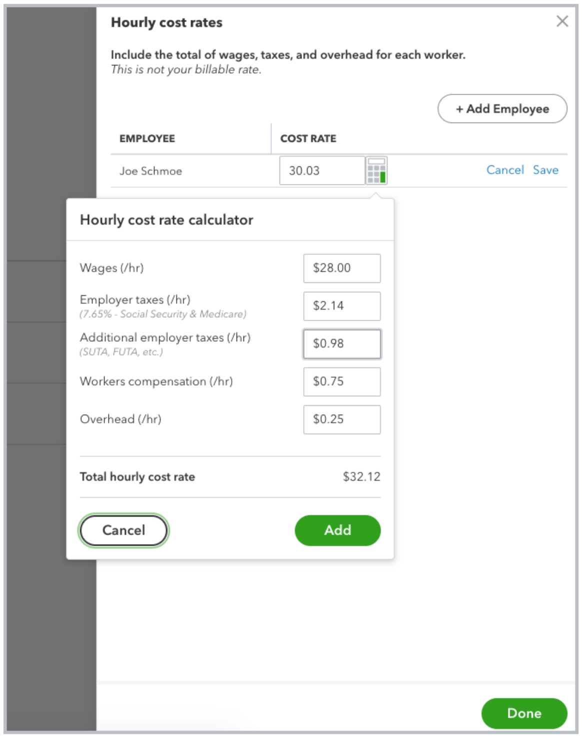
QuickBooks Tips:

The hourly cost rate calculator enables you to better forecast labor costs by calculating the actual rate of what an individual will cost you per hour on the job.

As you add employees, QuickBooks allows you to directly enter the cost (burden) rate for an employee if it's a recurring position where you already know exactly what the burden rate is. The system also makes it easy to perform a more detailed calculation by entering added data such as taxes, workers compensation and overhead.

Additionally, the hourly cost rate calculator automatically populates the "Employer taxes (/hr)" field once the wage per hour amount is entered. "This is another example of a time-saving feature," added Schulte.

Computing detailed labor costs versus simply tracking base hourly pay provides a far more accurate picture of a company's financial standing in relation to budget to actual.



QuickBooks jumpstarts your hourly cost rate figure by automatically calculating employer taxes per hour.

Final thoughts...

While not an exhaustive list, the tips offered in this eBook provide subcontractors with sound advice on what to look for in their financial statements. By reviewing the key data points each month and leveraging the powerful features in QuickBooks, business owners can stay in the know in relation to cash flow, net and gross assets, profit margins, and the overall financial health and sustainability of their business.

Learn more about how QuickBooks can provide you with better data and insights to grow your subcontractor business: QuickBooks Online Advanced for reporting & insights.