




Lessons Learned: Paying Too Much in Taxes

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Introductions



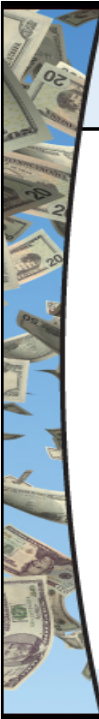
Leslie Shiner

- Owner of The ShinerGroup
 - Financial & management consultant for over 25 years
 - MBA in Accounting and Finance from U.C. Berkeley
- Certifications
 - QuickBooks Advanced ProAdvisor
 - Sage Certified Consultant
- Author:
 - A Simple Guide to Turning a Profit as a Contractor




Annie Kendrick

- Owner of Kendrick Business Services
 - Over 20 years experience in construction accounting
 - B.S. University of Utah
- Certifications & Software
 - QuickBooks Advanced ProAdvisor
 - Developer Method CRM for Solar
- Business Development Programs
 - Port of Portland Mentor Protégé Program contracted trainer since 2012 for Estimating and Construction Accounting



From the Blog: Lessons Learned: Paying Too Much in Taxes



Energy Trust Blog

- Endless Power Solar
 - Joe’s company signed over 60 contracts in December, 2018
 - He billed the customers 50% for the jobs in 2018
 - He was very profitable in 2018 and had to pay a lot in taxes
 - He did most of the work on these jobs in 2019
 - He made significant estimated taxes for 2019
 - He started running low of cash in 2019
 - And he was owed a significant tax refund, but wouldn’t receive until 2020

Read the blog at:

<https://insider.energytrust.org/programs/solar/business-development/#lessons-learned>

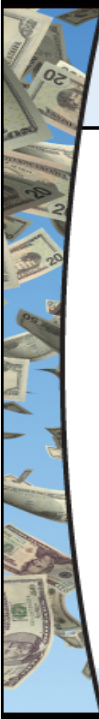
What Did Luke Do Wrong?

Why do my taxes fluctuate so much each year?



Time Frame Issues

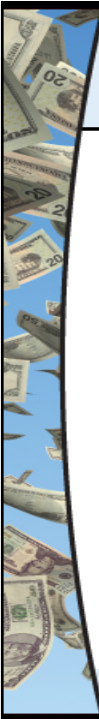
- Financial Statements (and tax returns) are based on an arbitrary cutoff
 - *Many jobs cross years, starting in one and finishing in another*
- Accounting process is date sensitive
 - *Time frame of the P&L does not match time frame of jobs*
- So the question is: when did you actually earn the revenue?
 - *When you invoiced the client?*
 - *When you received the money?*
 - *When you did the work?*



Two Months Into a Three Month Job

	November	December	Year-End Total
Income	18,000	16,000	34,000
COGS	<u>(5,000)</u>	<u>(10,000)</u>	<u>(15,000)</u>
Gross Profit	13,000	6,000	19,000
Gross Margin	72%	38%	56%

This job looks great!



But Profit Based on Invoicing...

Can be very misleading!

	November	December	Year-End Total		January	Job Total
Income	18,000	16,000	34,000		6,000	40,000
COGS	<u>(5,000)</u>	<u>(10,000)</u>	<u>(15,000)</u>		<u>(9,000)</u>	<u>(24,000)</u>
Gross Profit	13,000	6,000	19,000		-3,000	16,000
Gross Margin	72%	38%	56%		-50%	40%

How can you manage your business with these numbers?



Solution – Utilize the Matching Principle

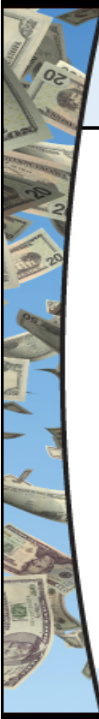
- Matching Principle
 - *The amount of income you show is related to the costs that you’ve actually incurred*
- The key to usable financial statements
 - *Income and expenses for same activity during same period*
 - *Smooths out fluctuations from trended financial statements*
 - *Recognizes true profit during course of project*
- Income statement should reflect **earnings** not **billings**



Measure True Profit

- Timing is everything!
 - *Measure gross margin and gross profit as the job progresses, not just at the end of the job*
- Make sure your numbers “match”
 - *Follow the Matching Principal*
 - *Measure gross margin using revenue and costs based on the same percentage of completion*

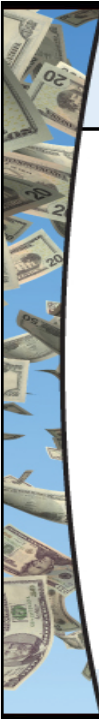
Let’s WIP your company into shape



Formula for Percentage Completion

- Step 1: determine percent complete
 - *Costs divided by budget = % complete*
- Step 2: determine earnings
 - *% complete times contract = earnings*
- Step 3: determine overbillings or underbillings
 - *Earnings minus billings equal under/(over) billings*
 - *Positive number = underbillings (increase income)*
 - *Negative number = overbillings (decrease income)*

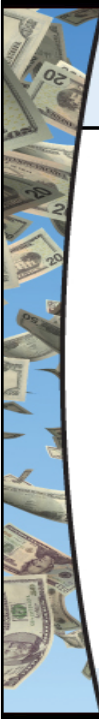
$$\frac{\text{Cost to Date}}{\text{Budgeted Costs}} = \% \text{ Complete} \times \text{Contract} = \text{Earnings} - \text{Billings} = \frac{\text{Under/(Over)}}{\text{Billings}}$$



Breakdown of Work in Progress Formula

Step 1 – Determine % complete

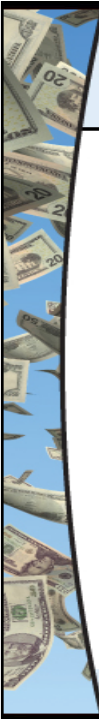
ACTUAL PROJECT COSTS TO DATE	÷	TOTAL CURRENT ESTIMATED COSTS AT COMPLETION	=	% Complete
Costs your company has incurred as of the date of the WIP (Paid & Unpaid)		The total costs you expect to incur by the end of the job		Percentage complete based on costs incurred to date



Breakdown of Work in Progress Formula

Step 2 – Determine true earnings

CURRENT REVISED CONTRACT VALUE	X	% Complete	=	EARNED REVENUE
Original Contract Value Plus Approved Change Orders		Percentage complete based on costs incurred to date		The dollar amount of income you will report on your Profit & Loss after adjustment



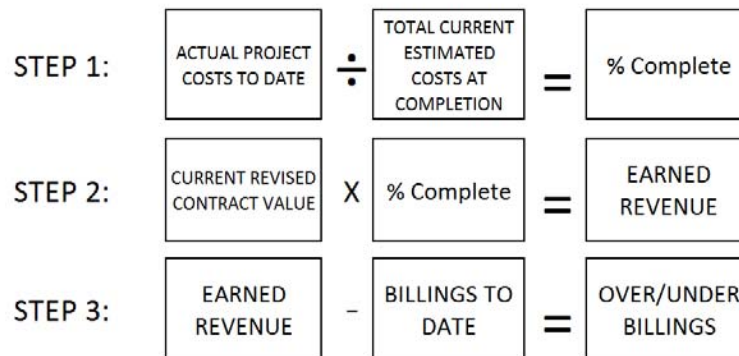
Breakdown of Work in Progress Formula

Step 3 – Determine over/under billings

EARNED REVENUE	-	BILLINGS TO DATE	=	OVER/UNDER BILLINGS
The dollar amount of income you will report on your Profit & Loss after adjustment		Total Invoices we have submitted to our customer to date (Paid & Unpaid)		The dollar amount over or under the invoices submitted that we have earned (adjustment)

Breakdown of Work in Progress Formula

Basic WIP Formula Explained



Exercise





Mathematical Example

- Budget = \$140,000
- Contract = \$200,000
- Cost to date = \$49,000
- Billings to date = \$90,000

$$\frac{\text{Cost to Date}}{\text{Budgeted Costs}} = \% \text{ Complete} \times \text{Contract} = \text{Earnings} - \text{Billings} = \begin{matrix} \text{Under/(Over)} \\ \text{Billings} \end{matrix}$$



Determine Adjustment – Overbilled

- Costs / budget = % complete
 - $\$49,000 / \$140,000 = 35\% \text{ complete}$
- % complete x contract = earnings
 - $35\% \times \$200,000 = \$70,000$
- Earnings – billings = under/(over) billings
 - $\$70,000 - \$90,000 = (\$20,000) \text{ overbilled}$
- Job is overbilled, therefore it is a liability
 - *Reduce income by \$20,000*



What if...

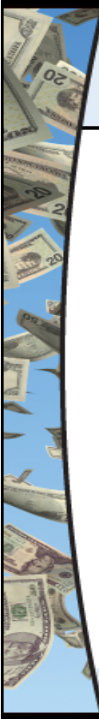
- Same numbers:
 - *Budget* = \$140,000
 - *Contract* = \$200,000
 - *Cost to date* = \$49,000
- Except: Billings to date = \$55,000

$$\frac{\text{Cost to Date}}{\text{Budgeted Costs}} = \% \text{ Complete} \times \text{Contract} = \text{Earnings} - \text{Billings} = \begin{matrix} \text{Under/(Over)} \\ \text{Billings} \end{matrix}$$



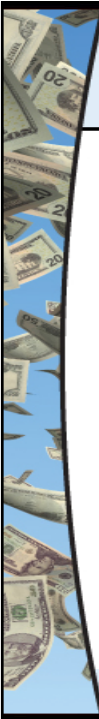
Determine Adjustment – Underbilled

- Costs / budget = % complete
 - $\$49,000 / \$140,000 = 35\% \text{ complete}$
- % complete x contract = earnings
 - $35\% \times \$200,000 = \$70,000$
- Earnings – billings = under/(over) billings
 - $\$70,000 - \$55,000 = \$15,000 \text{ underbilled}$
- Job is underbilled, therefore it is an asset
 - *Increase income by \$15,000*



Adjustment

- Last step – make adjusting journal entry
- Balance Sheet:
 - Increase/decrease Underbillings – Asset
 - Increase/decrease Overbillings – Liability
- Income Statement (P&L):
 - Net difference as adjustment to Income account (Increase/decrease Income)
- Suggestion: reverse in next month



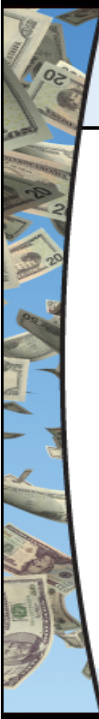
Results of WIP Formula

Overbilled Job

$\frac{\text{Cost to Date}}{\text{Estimated Costs}} = \% \text{ Complete} \times \text{Contract Price} = \text{Earnings} - \text{Billings} = \frac{(\text{Over})/\text{Under}}{\text{Billings}}$
$\frac{\$49,000}{\$140,000} = 35\% \times \$200,000 = \$70,000 - \$90,000 = (\$20,000)$

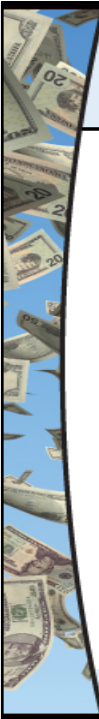
Underbilled Job

$\frac{\text{Cost to Date}}{\text{Estimated Costs}} = \% \text{ Complete} \times \text{Contract Price} = \text{Earnings} - \text{Billings} = \frac{(\text{Over})/\text{Under}}{\text{Billings}}$
$\frac{\$49,000}{\$140,000} = 35\% \times \$200,000 = \$70,000 - \$55,000 = \$15,000$



Without the WIP Adjustment

	Overbilled	Underbilled
Invoiced	\$90,000	\$55,000
COGS	<u>-\$49,000</u>	<u>-\$49,000</u>
Unadjusted Gross Profit	\$41,000	\$6,000
Unadjusted Gross Margin	46%	11%



After the Adjustment – Same Gross Profit

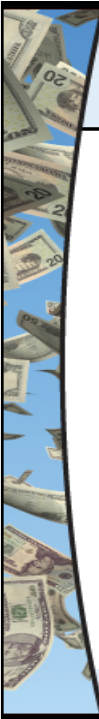
	Overbillings	Underbillings
Invoiced	\$90,000	\$55,000
COGS	<u>-\$49,000</u>	<u>-\$49,000</u>
Unadjusted Gross Profit	\$41,000	\$6,000
Unadjusted Gross Margin	46%	11%
WIP Adjustment	<u>-\$20,000</u>	<u>\$15,000</u>
Correct Gross Profit	\$21,000	\$21,000
Gross Margin	30%	30%

Consistent Gross Margin Across Time!



Another P&L Example – Prior to WIP Adjustment

	November	December	This Year	January	Total
Income	\$45,000	\$65,000	\$110,000	\$15,000	\$125,000
COGS	<u>-\$30,000</u>	<u>-\$20,000</u>	<u>-\$50,000</u>	<u>-\$25,000</u>	<u>-\$75,000</u>
Gross Profit	\$15,000	\$45,000	\$60,000	-\$10,000	\$50,000
Gross Margin	33%	69%	55%	-67%	40%



Another P&L Example – After WIP Adjustment

	November	December	This Year	January	Total
Income	\$45,000	\$65,000	\$110,000	\$15,000	\$125,000
WIP Adjustment	\$5,000	-\$31,500	-\$26,500	\$26,500	\$0
Total Income	\$50,000	\$33,500	\$83,500	\$41,500	\$125,000
COGS	<u>-\$30,000</u>	<u>-\$20,000</u>	<u>-\$50,000</u>	<u>-\$25,000</u>	<u>-\$75,000</u>
Gross Profit	\$20,000	\$13,500	\$33,500	\$16,500	\$50,000
Gross Margin	40%	40%	40%	40%	40%

Understanding WIP Adjustments

- Remember:
 - Balance Sheet reconciles to WIP report
 - Profit and Loss shows net difference

Sample WIP Report (Excel)

Overbilling/Underbillings (WIP) Report

Job #	Job Name	Costs	Budget	%	Contract	Earnings	Billings	Underbilled	Overbilled
101	Smith	12,570	12,570	100%	15,210	15,210	15,210	0	0
105	Jones	26,636	45,000	59%	54,450	32,229	54,450	0	22,221
109	Simpson	8,339	15,000	56%	18,750	10,424	7,500	2,924	0
110	Cosby	37,513	150,000	25%	181,500	45,391	50,000	0	4,609
111	Crane	16,190	25,000	65%	30,250	19,590	25,000	0	5,410
115	South Fork Ranch	831	18,500	4%	23,125	1,039	1,850	0	811
116	Kirk	8,854	75,500	12%	91,355	10,713	7,500	3,213	0
120	Central Perk	1,580	47,000	3%	58,750	1,975	4,700	0	2,725
125	Richard Kimble	77,193	125,000	62%	156,250	96,491	100,000	0	3,509
126	MacGyver	222,705	450,000	49%	544,500	269,473	250,000	19,473	0
127	The Bunkers	0	122,000	0%	152,500	0	15,250	0	15,250

Billings do not equal Earnings

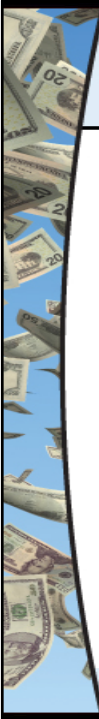
25,610 54,535
↑ ↑
Asset Liability

Cost / Budget = Percent Complete

Percent Complete * Contract = Earnings

If Earnings > Billings = **Underbilled** - recognize *asset* and **more income**

If Billings > Earnings = **Overbilled** - recognize *liability* and **less income**

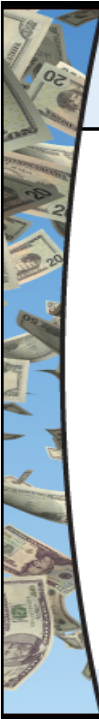


Sample WIP Report (QuickBooks Desktop)

- Start with Estimate to Actual report
 - Report available in QuickBooks Enterprise

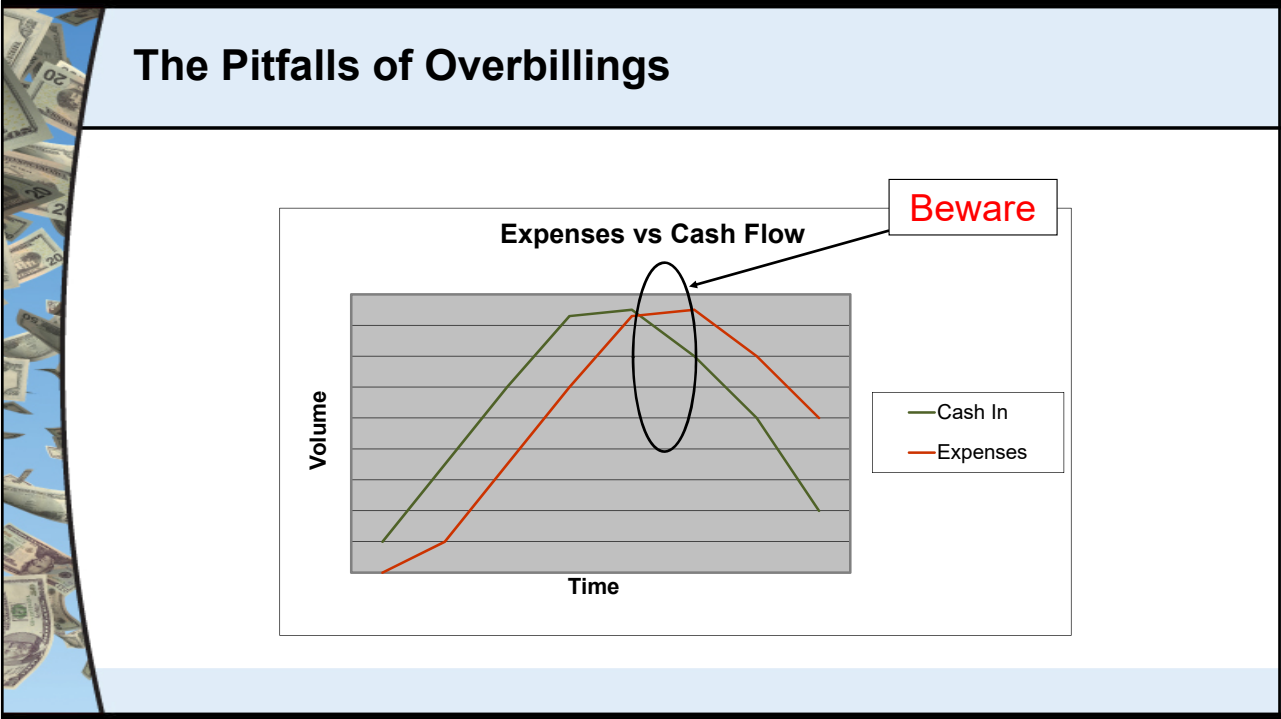
Only column that needs a formula

	Est. Cost	Act. Cost	Est. Revenue	Act. Revenue	(Over)/Under
Campbell, Heather	243,700	141,800	355,300	265,000	(58,264)
Cruz, Albert	217,000	191,500	295,000	275,000	(14,666)
Molotsi, Hugh	25,600	14,600	40,000	40,000	(17,188)
Wiessinger, Gary	78,500	68,000	125,000	78,500	29,780
Wilson, Brandon	282,600	81,550	443,550	103,000	24,996
TOTAL	847,400	497,451	1,258,850	761,500	(35,341)



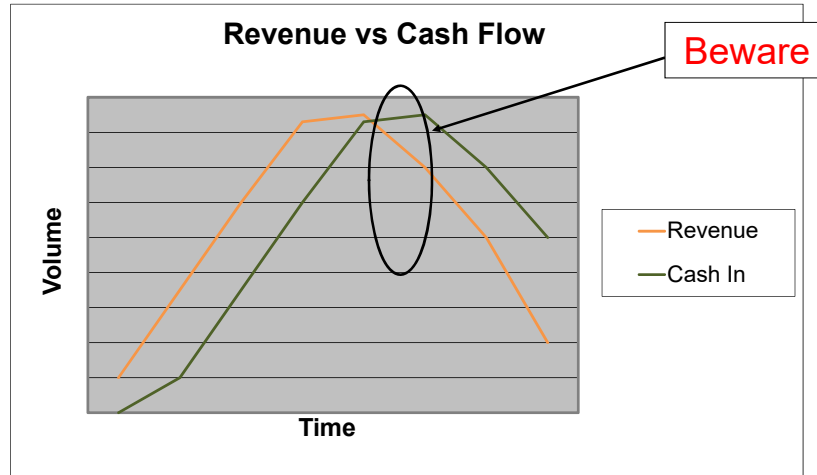
Customer Deposits Can Be Dangerous

- Customer deposits will help cash flow
 - But ...
- Over**billings will **over**state profit
- Don't run out of cash at the end of the job
- What happens when you:
 - Invoice the client for 100% of the job
 - Still have expenses on the job?
- Where is the cash to finish the job?
- It is very dangerous when you need to use tomorrow's jobs to finish today's jobs



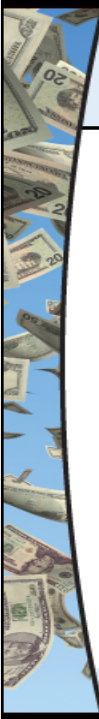
- ### Underbillings Hurt Cash Flow
- Underbillings mean that you did the work and haven't created the invoice yet
 - Are you financing the job?
 - Are you paying for all your own overhead costs?
 - Growing pains
 - Growth can cause cash flow problems
 - As volume increases, accounts receivable will also increase and cash flow may be tight
 - If accounts receivable increases more than accounts payable, cash flow will be tight

Cash Flow Can Fool You



Down and Dirty WIP

- Back into the WIP number
- You only know costs and billings but don't have an accurate budget
- Guesstimate the revenue number
 - $\text{Revenue} = \text{costs} + \text{"budgeted" markup}$
- Now you can guesstimate the WIP

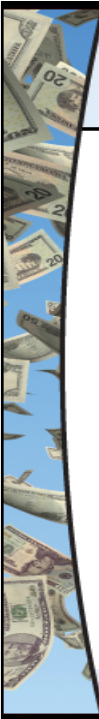


Quick Approximation

WIP - Quick Approximation

Typical Markup: 45%

Job #	Job Name	Actual Cost	Cost with Markup	Total Invoiced	(Over)/Under Billings
101	Smith	5,000	7,250	5,000	2,250
105	Jones	26,000	37,700	30,000	7,700
109	Simpson	7,500	10,875	18,000	(7,125)
110	Cosby	37,000	53,650	65,000	(11,350)
111	Crane	18,000	26,100	30,000	(3,900)
115	South Fork Ranch	43,000	62,350	75,000	(12,650)
				Total	(\$25,075)



Benefits of a Monthly WIP

- P&L shows true profit on a monthly basis
 - Can be used to make good financial decisions
- Include all team members to complete a monthly WIP
 - Accounting, Project Engineer, Estimator, Project Manager
- Billings no longer make false profits
- Project Managers can use the monthly WIP as a tool to manage slippage
- Know how much money is in the bank that you need to save for future work

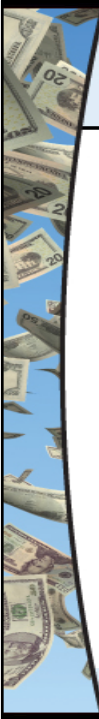
Fully Functional Spreadsheet

- Kendrick Business Services has developed a comprehensive WIP schedule
 - *To get a free copy, send an email to Annie@AnnieKendrick.com*
 - *Includes steps, summary pages and instructions*

[illegible]

New Revenue Recognition Rules (GAAP)

- Effective date for public companies was 2018
 - *Effective date for private companies was one year later*
- Related to contract milestones for revenue earned as opposed to percentage of completion
- You may be required to switch if your company needs audited financial statements (GAAP compliant)
 - *Check with your own CPA on this issue*



Summary

- Need to measure true profit – during the project
- Need accurate Profit and Loss Statements
- Long-term jobs pose revenue recognition issues
- Create monthly WIP adjustments for better analysis



Thank You



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Business Development Program



- Blog Posts and Webinars
- QuickBooks Assessment or Re-assessment
- Ongoing help with QuickBooks Desktop and business questions
- Remote CFO Meetings




Lessons Learned – Blog and Webinar Program




- Paying Too Much in Taxes webinar and blog post
 - *This was the fifth webinar in the series of six*
- 6th webinar and blog post: Project Scope and Change Order Management
- Watch for the Energy Trust newsletter for more information
 - *Or check the website*

Learn more about other Lessons Learned at:

<https://insider.energytrust.org/programs/solar/business-development/#lessons-learned>




QuickBooks Assessment




- Analyze current business processes and compare to best practices for the solar industry:
 - *Chart of Accounts setup and reporting*
 - *Project set up for tracking profitability – estimate vs actual*
 - *Project set up for managing projects and change orders*
 - *Use of cost codes for the solar industry*
 - *Entering of transactions associated with production and overhead*
 - *Best use of time tracking*
 - *Handling of inventory stock for job costing*
 - *Use of the matching principle*
 - *Accuracy of posting procedures*
 - *Many more review items summarized in 35-40 page report*
 - *Suggested improvements checklist*
 - *Follow up with meeting to discuss findings with key team members and outline for assistance*

\$500 after ETO match

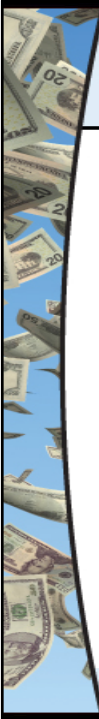


Ongoing Help with Your Business




- Assistance with...
 - *Payroll for good job costing set up*
 - *Forecasting and budgets*
 - *Labor burden calculations*
 - *Asset and Loan setup*
 - *3rd party program integration and implementation*
 - *Work in Progress Reports*
 - *Tracking key performance indicators*
 - *Much more, just ask*

\$100 per hour after ETO match



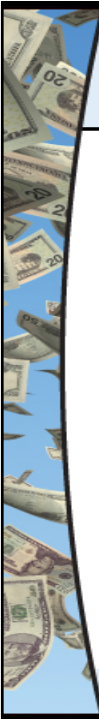
Remote CFO Meetings




Pre-requisite: file assessment and clean up

- Potential topics:
 - *Analyze trended Profit and Loss Statement*
 - *Evaluate profitability, gross, net*
 - *Evaluation overhead and markup*
 - *Review fully burdened labor costs*
 - *Review process for job costing*
 - *Analyze business plan, mission statement and vision statement*
 - *Perform ratio analysis*
 - *Create Key Performance Indicators (KPI) metrics for your company*
 - *Review internal controls*
 - *Create and manage a cash flow projection*
 - *Investigate productivity reports and charge-out rates*
 - *Reconcile your books to the latest tax return*

\$300 per meeting after ETO match



How to Get Started



- Complete the participation agreement and send to Jeni Hall at Energy Trust of Oregon. Jeni.Hall@energytrust.org
 - *Once approved you will be directed to Survey Monkey to answer a few questions about your business and then you will be contacted to set up your first meeting*
 - *You can also contact Annie Kendrick at Annie@AnnieKendrick.com or 541-926-6438 and she will help you navigate the start up process*



Thank You



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