



Construction Accounting Terms

**Plain-language definitions for the terms every contractor
should know**

Construction-focused accounting, tax, and advisory services
North Royalton, Ohio

COMPILED BY MC4 CPA, LLC

01 Working Capital

WHAT IT IS

The difference between your current assets and current liabilities, representing the liquid resources available to run the business day to day.

WHAT IT MEANS FOR CONTRACTORS

Working capital is one of the first things a surety or lender looks at when evaluating a contractor. It tells them whether you have enough liquidity to support the work already in backlog without running out of cash. Growth puts pressure on working capital before it shows up anywhere else on your financials.

HOW SURETIES AND LENDERS VIEW IT

A common benchmark is \$1 of working capital for every \$10 of bonded work. Falling below that threshold can limit bonding capacity or trigger additional scrutiny from underwriters.

02 Job Costing

WHAT IT IS

The process of tracking revenue, costs, and profitability at the individual project level rather than just across the business as a whole.

WHAT IT MEANS FOR CONTRACTORS

Without accurate job costing you cannot know which projects are making money, where costs are running over budget, or how the business is actually performing. A company can show overall profitability while losing money on individual jobs and never realize it without proper job cost tracking.

HOW SURETIES AND LENDERS VIEW IT

Sureties look for contractors with reliable job cost systems because it signals financial discipline. A contractor who can speak to project level profitability is far more credible than one who only knows their overall bottom line.

03 WIP / Work in Progress

WHAT IT IS

A schedule that shows the current status of all active contracts including total contract value, costs incurred to date, estimated costs to complete, and how much has been billed relative to the work performed.

WHAT IT MEANS FOR CONTRACTORS

The WIP report is one of the most important financial documents a contractor produces. It captures whether jobs are running on budget, whether billing is keeping pace with work performed, and where the business stands across all active projects at any given point in time.

HOW SURETIES AND LENDERS VIEW IT

Sureties consider the WIP schedule essential. A well prepared WIP report that shows conservative estimates and consistent methodology carries significant weight in the underwriting process. A missing or poorly prepared WIP schedule is one of the most common reasons contractors struggle to increase bonding capacity.

04 Overbilling and Underbilling

WHAT IT IS

Overbilling occurs when a contractor has billed more than the percentage of work actually completed on a project. Underbilling is the opposite — work has been completed but not yet billed.

WHAT IT MEANS FOR CONTRACTORS

Overbilling can mask cash flow problems by pulling future revenue into the present. Underbilling means the contractor has performed work they have not yet been paid for, which creates a receivable and puts pressure on cash flow. Both affect how the balance sheet looks and how financial performance is interpreted.

HOW SURETIES AND LENDERS VIEW IT

Significant overbillings on the balance sheet are a red flag for sureties because they represent work that still needs to be completed without additional billing available to fund it. Consistent underbillings may indicate billing inefficiency or collection problems.

05 Percentage of Completion

WHAT IT IS

An accounting method where revenue and expenses are recognized proportionally as a project progresses rather than all at once when the project is finished.

WHAT IT MEANS FOR CONTRACTORS

Percentage of completion provides a more accurate picture of financial performance on long term projects by matching revenue to the work actually done in a given period. It prevents large swings in reported income that would occur if revenue was only recognized at project completion.

HOW SURETIES AND LENDERS VIEW IT

Most sureties and lenders prefer or require percentage of completion accounting for contractors above certain revenue thresholds because it produces financial statements that more accurately reflect the true state of the business.

06 Completed Contract Method

WHAT IT IS

An accounting method where all revenue and expenses for a project are recognized only when the project is substantially complete rather than as work progresses.

WHAT IT MEANS FOR CONTRACTORS

The completed contract method can defer taxable income to future periods, which may provide cash flow benefits in certain situations. However it also means financial statements may not reflect the true state of the business during the life of active projects.

HOW SURETIES AND LENDERS VIEW IT

Smaller contractors may use the completed contract method, but sureties generally prefer percentage of completion for larger programs because it gives a more current view of profitability and financial position.

07 Retainage

WHAT IT IS

A portion of each payment withheld by the project owner or general contractor until the project is substantially complete. Retainage typically ranges from 5 to 10 percent of each pay application.

WHAT IT MEANS FOR CONTRACTORS

Retainage represents money earned but not yet collected, which can create significant cash flow pressure especially on larger or longer projects. Managing retainage receivables is an important part of keeping cash flow healthy.

HOW SURETIES AND LENDERS VIEW IT

Retainage receivables appear on the balance sheet and are considered less liquid than standard receivables. Sureties and lenders pay attention to the age and collectability of retainage, particularly on completed projects where retainage has not yet been released.

08 Backlog

WHAT IT IS

The total value of work that has been contracted but not yet completed. Backlog represents future revenue that is under contract.

WHAT IT MEANS FOR CONTRACTORS

Backlog is one of the key indicators of near term financial health and capacity utilization. A strong backlog means the business has work lined up. A declining backlog can signal future revenue pressure even if current financials look strong.

HOW SURETIES AND LENDERS VIEW IT

Sureties look at backlog relative to working capital and bonding capacity to assess whether a contractor has the financial resources to support the work already under contract. Too much backlog relative to working capital can be just as concerning as too little.

09 Debt Service Coverage Ratio

WHAT IT IS

A measure of how much cash flow a business generates relative to its debt obligations. It is calculated by dividing net operating income by total debt service including principal and interest payments.

WHAT IT MEANS FOR CONTRACTORS

A debt service coverage ratio above 1.0 means the business generates enough cash flow to cover its debt payments. A ratio below 1.0 means it does not. Lenders use this ratio to evaluate whether a contractor can safely take on additional debt.

HOW SURETIES AND LENDERS VIEW IT

Most lenders require a minimum debt service coverage ratio of 1.25 or higher for loan approval. A ratio that is trending downward over time raises concerns even if it is still above the minimum threshold.

10 Overhead Rate

WHAT IT IS

The percentage of a contractor's indirect costs relative to direct costs or revenue. Overhead includes expenses like office staff, rent, insurance, equipment, and other costs not directly tied to a specific project.

WHAT IT MEANS FOR CONTRACTORS

Understanding your overhead rate is essential for accurate estimating and bidding. If your overhead rate is higher than assumed in your bids you will consistently underprice work and erode margins even on jobs that appear profitable at the project level.

HOW SURETIES AND LENDERS VIEW IT

A high or growing overhead rate relative to revenue can signal operational inefficiency. Sureties and lenders may flag it as a risk factor particularly for contractors pursuing larger bonding programs or significant financing.

About This Guide

This guide was compiled by MC4 CPA, LLC as a practical resource for construction contractors. The definitions and commentary are intended to provide general context and are not a substitute for professional accounting or financial advice.

Terms and their application may vary based on company size, contract type, jurisdiction, and the specific requirements of your surety or lender. We recommend working with a qualified CPA familiar with construction accounting when making financial decisions.

QUESTIONS?

Reach out to us at info@mc4cpa.com or visit mc4cpa.com.



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