Chapter 2: Business Finances

The course's own whiteboard summaries, key numbers and common traps for the sections written so far (16 of 16). Separate from the PrepPass book.

For your own study. Please do not share.

2.0 Chapter 2 map

The Chapter 2 map: its weight, its four CSLB subtopics and the order of its fifteen lessons. About 1 minute of narration.

BOARD 1 Chapter 2 map

About 15% of the CSLB content outline (approximate)

Cash management · Budget and planning · Taxes · Financial reporting

Lessons	What you learn
2.1a · 2.1b	Markup, margin, costs, break-even
2.2 · 2.3	Statements, liquidity, cash flow, retention
2.4 · 2.5	Payroll taxes, sales tax, franchise tax, records
2.6 · 2.7	Job profit, financing, PACE, bonding
2.8	Budget, overhead rate, cash forecast
2.9 · 2.10	Estimated tax, 1099-NEC, reporting rules, depreciation
2.11 – 2.14	Workshops and case labs

✗ Profit on paper, ~~no cash~~ in the bank

First: markup vs margin

Key numbers and formulas

- First: markup vs margin

Common traps

- Profit on paper, no cash in the bank

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2.1a Markup is not margin

Why a 20% markup is not a 20% margin, and how to price to a target margin. About 2 minutes of narration.

BOARD 1 The $10,000 job

Your cost: $10,000

You mark it up 20%

So your margin is...?

16.7% or 20% or 25%

Margin = 16.7%

✗ ~~20%~~ is the markup, not the margin

BOARD 2 Two bottom numbers

Same profit, different bottom number

Markup	Margin
profit ÷ cost	profit ÷ price
cost is smaller	price is bigger

- Smaller bottom number, bigger percent

BOARD 3 Work it

Cost $10,000

+ 20% × $10,000 = $2,000 profit

Price = $12,000

Margin = $2,000 ÷ $12,000

= 16.7%

Cost ▪▪▪▪▪▪▪▪▪▪

Price ▪▪▪▪▪▪▪▪▪▪▪▪ ~~not 20%~~

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BOARD 4 Work it backward

You want a 20% margin

Price = $10,000 ÷ 0.80

= $12,500

Markup = $2,500 ÷ $10,000

= 25% markup for a 20% margin

Check: $2,500 ÷ $12,500 = 20%

BOARD 5 The habit

- Markup is always the bigger number
- Margin bigger than markup? Stop and check.

$80,000 cost, want a 25% margin

✗ ~~× 1.25 = $100,000~~ (only a 20% margin)

✓ ÷ 0.75 = $106,667 (33.3% markup)

Gap: $6,667 left on the table

BOARD 6 Overhead, then profit

Direct cost $50,000

- Overhead first, then profit on the new total

+ 15% overhead: $50,000 × 1.15

= $57,500

+ 10% profit: $57,500 × 1.10

= $63,250

✗ ~~× 1.25 = $62,500~~ (profit taken on the wrong base)

Markup ÷ cost · margin ÷ price

Next: 2.1b Three kinds of cost and break-even

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Key numbers and formulas

- Margin = 16.7%
- + 20% × $10,000 = $2,000 profit
- Price = $12,000
- Margin = $2,000 ÷ $12,000
- = 16.7%
- Price = $10,000 ÷ 0.80
- = $12,500
- Markup = $2,500 ÷ $10,000
- = 25% markup for a 20% margin
- + 15% overhead: $50,000 × 1.15
- = $57,500
- + 10% profit: $57,500 × 1.10
- = $63,250
- Markup ÷ cost · margin ÷ price

Common traps

- 20% is the markup, not the margin
- × 1.25 = $100,000 (only a 20% margin)
- × 1.25 = $62,500 (profit taken on the wrong base)

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Why the tempting answers fail (from the section practice)

1. A job will cost $80,000 in direct costs. The contractor wants a 25% markup on cost. What should the bid price be?

   Right: $100,000. Markup is a percentage of cost, so 25% of $80,000 is $20,000. Add it to the cost and the price is $100,000.

   - $95,000: That adds only $15,000, which is less than 19% of the cost.
   - $106,667: That is the price for a 25% margin (cost divided by 0.75), a different question.
   - $120,000: That adds $40,000, which is 50% of the cost.

2. A job costs $48,000. The contractor wants a 20% margin on the selling price. What must the selling price be?

   Right: $60,000. For a target margin, divide the cost by one minus the margin: $48,000 divided by 0.80 is $60,000. The profit is $12,000, and $12,000 divided by $60,000 is 20%.

   - $54,000: The $6,000 profit is only about an 11% margin on this price.
   - $57,600: Adding 20% to the cost is a 20% markup. The $9,600 profit is a 16.7% margin on this price.
   - $58,500: The $10,500 profit is about an 18% margin on this price, still short of 20%.

3. A contractor marks a job up 25% on cost. What margin on the selling price does that equal?

   Right: 20%. Take a $100 cost. The price is $125 and the profit is $25. Margin divides by the price, so $25 divided by $125 is 20%. Margin is the smaller number because the price is the bigger bottom number.

   - 15%: Margin is lower than markup, but $25 divided by $125 is 20%, not 15%.
   - 25%: That repeats the markup. Margin divides by the price, not the cost.
   - 33%: That is the markup needed for a 25% margin, the reverse direction.

2.1b Three kinds of cost, depreciation and break-even

Direct, overhead and G and A costs, then the break-even revenue formula. About 5 minutes of narration.

BOARD 1 Three buckets

Bucket	Test	Example
Direct	traces to one job	job labor, materials, subs
Overhead	supports many jobs	shared foreman, shared equipment
G&A	runs the company	office rent, office staff

The test: can you point to the one job?

- Yes means direct

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BOARD 2 The truck trap

Owner's pickup: sales calls, estimates

Never assigned to one job

Its depreciation goes in...?

Direct or Overhead or G&A

✓ G&A: sales or office asset depreciation

✗ ~~Direct cost~~

- Bids look too high
- Job reports overstate cost

Recovered through markup on all work

BOARD 3 Depreciation

Straight-line: the same amount every year

(Cost – Salvage) ÷ Life

Truck $60,000 · salvage $10,000 · life 5 years

($60,000 – $10,000) ÷ 5

= $10,000 per year

- Noncash: no cash leaves that year
- The cash left when the truck was bought
- Tax depreciation can differ from this book number

BOARD 4 Fixed, variable, break-even

- Break-even: profit = $0
- Below = loss · Above = profit

Fixed	Variable
rent, office salaries, insurance	job labor, materials

$1 of revenue – variable cost = what is left

- What is left = contribution margin

Break-even = Fixed ÷ contribution margin

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BOARD 5 Work it

Fixed overhead $120,000 a year

Variable cost = 70% of revenue

Contribution margin = 100% − 70% = 30%

Break-even = $120,000 ÷ 0.30

= $400,000

Check: 70% × $400,000 = $280,000

$400,000 − $280,000 = $120,000

Profit = $0

✗ ~~÷ 0.70~~ is the variable share

✓ ÷ 0.30 is what is left

Break-even = fixed cost ÷ contribution margin

Next: book value and other methods

BOARD 6 Book value and accumulated depreciation

Book value = cost − accumulated depreciation

Compactor $45,000 · salvage $5,000

Life 8 years

($45,000 − $5,000) ÷ 8

= $5,000 a year

3 × $5,000 = $15,000 accumulated

Book value $45,000 − $15,000 = $30,000

- Year 8: book value = salvage $5,000

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BOARD 7 Other methods, same total

- Units of production: by use

Life 8,000 hours

$40,000 ÷ 8,000 hours = $5 an hour

1,200 hours × $5 = $6,000

- Declining balance: more early, less later

Same total · different timing

✗ ~~Cost ÷ life~~, salvage forgotten

Tax rules: lesson 2.10

Next: 2.2 Two statements, three liquidity numbers

Key numbers and formulas

- (Cost – Salvage) ÷ Life
- ($60,000 – $10,000) ÷ 5
- = $10,000 per year
- Break-even = Fixed ÷ contribution margin
- Break-even = $120,000 ÷ 0.30
- = $400,000
- $400,000 – $280,000 = $120,000
- Profit = $0
- Break-even = fixed cost ÷ contribution margin
- Book value = cost – accumulated depreciation
- ($45,000 – $5,000) ÷ 8
- = $5,000 a year
- 3 × $5,000 = $15,000 accumulated
- Book value $45,000 – $15,000 = $30,000
- $40,000 ÷ 8,000 hours = $5 an hour
- 1,200 hours × $5 = $6,000
- Same total · different timing

Common traps

- Direct cost
- ÷ 0.70 is the variable share
- Cost ÷ life, salvage forgotten

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Why the tempting answers fail (from the section practice)

1. Which of these is a fixed cost for a contracting business?

   Right: The monthly office rent. A fixed cost does not move with the amount of work. The office rent is the same whether one job runs or ten, so it is a G&A cost recovered across all of them.

   - Fuel burned by equipment on a job: Fuel rises and falls with the work and is charged to the job that used it.
   - Materials for one specific job: Materials are bought for a specific job and scale with it.
   - Subcontractor fees on a job: Subcontractor fees only exist when there is a job to sub out.

2. A job cost sheet shows materials $30,000, labor $20,000, subcontractors $15,000 and an overhead allocation of $10,000. What is the total direct job cost?

   Right: $65,000. Direct cost is what traces to this one job: $30,000 + $20,000 + $15,000 = $65,000. The $10,000 overhead is a share of office and company costs spread over every job.

   - $45,000: That leaves out the materials and counts the overhead allocation.
   - $50,000: That leaves out the subcontractors.
   - $75,000: That adds the overhead allocation, which gives the loaded cost, not the direct cost.

3. A contractor has fixed overhead of $10,000 a month and variable costs of 70% of revenue. What monthly revenue is needed to break even?

   Right: $33,333. Each dollar of revenue leaves 30 cents after variable cost. Break-even revenue is $10,000 divided by 0.30, which is $33,333.

   - $10,000: That only covers the fixed cost. Each dollar of revenue also carries 70 cents of variable cost.
   - $14,286: That divides by 0.70, the variable share, instead of the 0.30 that is left over.
   - $70,000: At $70,000 the costs would be $59,000, so the business would already be well past break-even.

4. A $50,000 piece of equipment has an estimated salvage value of $5,000 and a useful life of 9 years. What is the annual straight-line depreciation?

   Right: $5,000. Straight line = (cost - salvage) / life = ($50,000 - $5,000) / 9 = $5,000 a year.

   - $45,000: That is the whole depreciable amount, cost minus salvage. It still has to be spread over the 9 years.
   - $4,500: That divides $45,000 by 10 years. The useful life is 9 years.
   - $5,556: That divides the full $50,000 by 9 and forgets to subtract the $5,000 salvage value first.

5. A contractor's equipment cost $18,000. After 3 years of straight-line depreciation (6-year life, no salvage), what is its book value?

   Right: $9,000. Annual depreciation = $18,000 / 6 = $3,000. After 3 years, accumulated depreciation = $9,000, so book value = $18,000 - $9,000 = $9,000.

   - $12,000: That subtracts only two years of depreciation ($6,000). Three years have passed.
   - $3,000: That is one year's depreciation ($18,000 / 6), not the remaining book value.
   - $6,000: That subtracts four years of depreciation. Only three years have passed.

6. A pickup costs $72,000, has $12,000 of salvage value and a 6-year life, and is depreciated straight line. What is its book value after 4 years?

   Right: $32,000. Annual = ($72,000 - $12,000) / 6 = $10,000. Accumulated after 4 years = $40,000. Book value = $72,000 - $40,000 = $32,000.

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- $24,000: That ignores salvage: $72,000 / 6 = $12,000 a year, times 4 = $48,000, leaving $24,000. Salvage must be subtracted first.
- $40,000: That is the accumulated depreciation after 4 years, not the book value.
- $20,000: That is the depreciable amount still left to take ($60,000 - $40,000). Book value still includes the $12,000 salvage.

7. An excavator costs $150,000, has $30,000 of salvage value and is expected to run 12,000 hours. Using units of production, what is the depreciation for a year in which it runs 1,500 hours?
   Right: $15,000. Rate = ($150,000 - $30,000) / 12,000 = $10 an hour. 1,500 hours x $10 = $15,000.
   - $18,750: That divides the full $150,000 by 12,000 hours ($12.50 an hour) and forgets salvage.
   - $3,750: That spreads only the $30,000 salvage value over the hours. Salvage is what is left, not what is depreciated.
   - $10: That is the rate per hour. It still has to be multiplied by the 1,500 hours run.

2.2 Two statements and three liquidity numbers

Balance sheet, income statement, current ratio, quick ratio, working capital, cash versus accrual. About 6 minutes of narration.

BOARD 1 Two reports

Owns and owes today vs. earned this year

Balance sheet or Income statement

Balance sheet	Income statement
a snapshot: one date	a period: month, quarter, year
assets, liabilities, equity	revenue – expenses = net profit

- Income statement = the P&L

BOARD 2 Assets, liabilities, equity

Assets = Liabilities + Equity

Assets $500,000

Liabilities $300,000

Equity = $500,000 – $300,000

= $200,000

- Sureties and lenders read both
- Balance sheet: owns and owes today
- Income statement: earned over the year
- Equity + profit help unlock bonding

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BOARD 3 Three liquidity numbers

Current assets: cash within a year

Current liabilities: bills due within a year

Number	How	Answer is
Current ratio	assets ÷ liabilities	a ratio
Quick ratio	(assets – ~~inventory~~) ÷ liabilities	a ratio
Working capital	assets – liabilities	dollars

- Working capital = dollars, not a ratio

Quick ratio is stricter: inventory is slow cash

- Working capital = cushion while retention is uncollected
- Higher = stronger · lenders and sureties watch

BOARD 4 Work it

Current assets $200,000

of which inventory $40,000

Current liabilities $100,000

Current ratio = $200,000 ÷ $100,000

= 2.0

Quick = ($200,000 – $40,000) ÷ $100,000

= 1.6

Working capital = $200,000 – $100,000

= $100,000

What if inventory = $60,000?

- Current ratio still 2.0

Quick = ($200,000 – $60,000) ÷ $100,000

= 1.4

- More inventory, lower quick ratio

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BOARD 5 Cash versus accrual

Cash basis	Accrual basis
counts when money moves	counts when earned or incurred
Job done in December, paid in January	
revenue in January	revenue in December

- Different timing, different profit
- Accrual matches costs to jobs
- Sureties prefer accrual
- Job cost records: not optional

BOARD 6 Dollars or ratio?

Question asks: working capital

- The answer is in dollars

✗ ~~1.25~~ is the current ratio

Current assets $150,000 · liabilities $120,000

Working capital = $150,000 − $120,000

= $30,000

Current ratio = $150,000 ÷ $120,000

= 1.25

- Same numbers, two answers
- Read which one is asked

Snapshot vs period · ratios vs dollars

Next: equity and a full balance sheet

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BOARD 7 Equity and retained earnings

- Owners' investment
- + Retained earnings

Start + net profit − owner draws = end

- Draws · dividends · distributions · losses reduce it

Start $150,000

Net profit $60,000 · owners take $20,000

$150,000 + $60,000 − $20,000 = $190,000

✗ ~~Retained earnings = cash~~

BOARD 8 Work it: read a balance sheet

Assets	Liabilities and equity
Cash $40,000	
Receivables $110,000	
Equipment, net $150,000	
Total $300,000	
	Payables $70,000
	Long-term loan $80,000
	Liabilities $150,000
	Equity $150,000

$150,000 − $50,000 invested = $100,000 retained

Current assets $40,000 + $110,000 = $150,000

Current liabilities $70,000

Working capital $80,000 · current ratio 2.14

Next: 2.3 Why a profitable job can run out of cash

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Key numbers and formulas

- Assets = Liabilities + Equity
- Equity = $500,000 − $300,000
- = $200,000
- Current ratio = $200,000 ÷ $100,000
- = 2.0
- Quick = ($200,000 − $40,000) ÷ $100,000
- = 1.6
- Working capital = $200,000 − $100,000
- = $100,000
- Quick = ($200,000 − $60,000) ÷ $100,000
- = 1.4
- Working capital = $150,000 − $120,000
- = $30,000
- Current ratio = $150,000 ÷ $120,000
- = 1.25
- Snapshot vs period · ratios vs dollars
- Start + net profit − owner draws = end
- $150,000 + $60,000 − $20,000 = $190,000
- $150,000 − $50,000 invested = $100,000 retained
- Current assets $40,000 + $110,000 = $150,000
- Working capital $80,000 · current ratio 2.14

Common traps

- 1.25 is the current ratio
- Retained earnings = cash

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Why the tempting answers fail (from the section practice)

1. A contractor has current assets of $120,000 and current liabilities of $80,000. What is the current ratio?

   Right: 1.5. Current ratio is current assets divided by current liabilities: $120,000 divided by $80,000 is 1.5. The business has $1.50 of current assets for every $1.00 it owes soon.

   - 0.67: That flips the division and gives liabilities over assets.
   - 2.0: A ratio of 2.0 would need $160,000 of current assets.
   - 40: That is the $40,000 difference written without its zeros. The difference is working capital, not a ratio.

2. A contractor has current assets of $90,000 and current liabilities of $60,000. What is the working capital?

   Right: $30,000. Working capital is current assets minus current liabilities: $90,000 − $60,000 = $30,000. It is a dollar amount, not a ratio.

   - $1.50: That is the current ratio, a ratio rather than a dollar amount.
   - $60,000: That is the current liabilities on their own.
   - $150,000: That adds the two numbers instead of subtracting.

3. Which accounting method records revenue when it is earned and expenses when they are incurred, even if no cash has changed hands?

   Right: Accrual basis. Accrual accounting puts revenue and expenses in the period they are earned and incurred, which gives a truer picture of profit than counting cash alone.

   - Cash basis: Cash basis records money when it moves, not when it is earned.
   - Job cost basis: Job costing tracks cost by project. It is not a rule about timing.
   - Break-even basis: Break-even is a calculation, not an accounting method.

4. Which equation does every balance sheet follow?

   Right: Assets equal liabilities plus owners' equity. The balance sheet always balances: assets = liabilities + equity. Equity is what remains after liabilities.

   - Revenue minus expenses equals the profit: That is the income statement, which covers a period, not the balance sheet.
   - Assets plus liabilities are the equity: Liabilities are subtracted from assets to find equity, not added to them.
   - Assets minus equity equals revenue: Revenue belongs on the income statement. Assets minus equity equals liabilities.

5. On a balance sheet, which of the following is a current asset?

   Right: Accounts receivable from customers. Receivables are expected to turn into cash within a year, so they are a current asset.

   - The company's office building: A building is a long-term asset used for many years.
   - Goodwill from buying a firm: Goodwill is a long-term intangible asset, not something that turns into cash within a year.
   - A dump truck the firm owns: A truck is equipment, a long-term asset that is depreciated over its life.

6. A company's retained earnings were $220,000 at the start of the year. It had a net loss of $35,000 and paid $15,000 of distributions to its owners. What are ending retained earnings?

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Right: $170,000. $220,000 - $35,000 loss - $15,000 distributions = $170,000. A loss and distributions both reduce retained earnings.

- $200,000: That adds the distributions back instead of subtracting them.
- $240,000: That treats the loss as a profit.
- $185,000: That subtracts the loss but forgets the distributions.

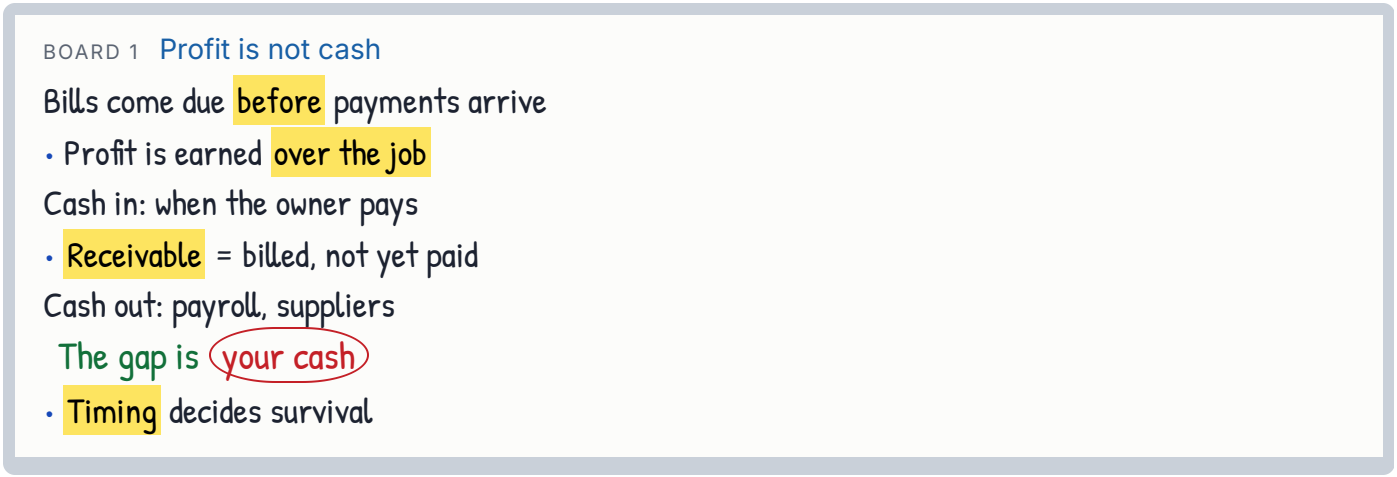
7. A balance sheet shows total assets of $520,000 and total liabilities of $310,000. The owners invested $60,000 in the company. What are its retained earnings?

   Right: $150,000. Equity = $520,000 - $310,000 = $210,000. Retained earnings = $210,000 - $60,000 invested = $150,000.

   - $210,000: That is total equity. Part of equity is the $60,000 the owners invested.
   - $270,000: That adds the investment to equity instead of subtracting it.
   - $250,000: That subtracts the investment from liabilities. Retained earnings come from equity, which is assets minus liabilities, $210,000.

2.3 Why a profitable job can run out of cash

Receivables, retention, over-billing and under-billing. About 4 minutes of narration.



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BOARD 2 Retention

Owner holds back about 5% of each payment

- Cap: 5% on private contracts from 2026 (Civ. Code §8811)
- Exceptions: residential, not mixed use, 4 stories or less · sub that fails to give a bond required in writing at bid time
- Earned, but not collectible yet
- You finance it until release

Progress bill $60,000 · retention 5%

Held back = 5% × $60,000 = $3,000

Cash now = $57,000

- $3,000 = retention receivable

BOARD 3 Profit locked in retention

Contract $800,000

Retention 5% · expected margin 4%

Retention = 5% × $800,000 = $40,000

Profit = 4% × $800,000 = $32,000

$40,000 held back > $32,000 profit

Collected $800,000 − $40,000 = $760,000

Cost about $768,000

Cash short $8,000 until release

- Profit locked in retention

BOARD 4 The release clocks

	Private work	Public work
Owner to contractor	45 days after completion	60 days after completion

- Clock starts at completion of the whole work
- Not when your own scope ends

Contractor to sub	10 days after receipt	7 days after receipt

- Private 10 · Public 7

Civ. Code §§8812, 8814 · Pub. Contract Code §7107 (cap: Civ. §8811, PCC §7201)

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BOARD 5 Over-billing and under-billing

Over-billing	Under-billing
billed more than work done	work done is more than billed
cash early, but a liability	you finance the owner

- Can hide a job falling behind

✗ Home jobs: after the down payment, payments above work performed or material delivered are ~~barred~~ (B&P §7159.5)

- Under-billing: your cash funds the owner

✓ Track billings vs. cost to date and % complete

BOARD 6 Work it

Contract $600,000 · est. cost $480,000

Cost to date $240,000

% complete = $240,000 ÷ $480,000

= 50%

Earned = 50% × $600,000

= $300,000

Billed $330,000

Over-billed by $30,000 (a liability)

If billed $270,000: under-billed $30,000

- Percent complete follows cost, not billings

Profit is not cash: watch retention and billing

Next: 2.4 Payroll taxes

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Key numbers and formulas

- The gap is your cash
- Held back = 5% × $60,000 = $3,000
- Cash now = $57,000
- Retention = 5% × $800,000 = $40,000
- Profit = 4% × $800,000 = $32,000
- $40,000 held back > $32,000 profit
- Cash short $8,000 until release
- % complete = $240,000 ÷ $480,000
- = 50%
- Earned = 50% × $600,000
- = $300,000
- Over-billed by $30,000 (a liability)
- Profit is not cash: watch retention and billing

Common traps

- Home jobs: after the down payment, payments above work performed or material delivered are barred (B&P §7159.5)

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Why the tempting answers fail (from the section practice)

1. A contractor has a $180,000 contract, and the owner holds 5% retention on each billing. So far $120,000 has been billed. How much retention is the owner holding?

   Right: $6,000. Five percent of the $120,000 billed so far is $6,000. Retention builds on what has been billed, not on the whole contract.

   - $9,000: That is five percent of the full $180,000 price, which the owner holds only after everything has been billed.
   - $12,000: That is ten percent of the amount billed, and this contract holds five percent.
   - $114,000: That is the cash the contractor has received after retention, not the amount being held.

2. Which statement best explains why retention strains a contractor's cash?

   Right: The earned money stays with the owner until the job is complete. The work is done and the money is earned, yet it cannot be collected until completion. The contractor must fund costs in the meantime.

   - It raises the overhead rate that every later bid must carry: Retention is held from payments already earned. It does not change how overhead is figured.
   - The owner adds it to the price as a penalty for late work: Retention is part of the contractor's own earned pay. The owner does not add it to the price as a penalty.
   - The contractor must pay it to the tax agency every quarter: Retention is held by the owner and has nothing to do with quarterly tax payments.

3. Under California home improvement contract law, what limits the progress payments a contractor collects?

   Right: After a down payment, they may not exceed work performed or material delivered. Billing ahead of the work is more than a cash tactic on a consumer job. After the down payment, the law bars payments above the value of the work performed or material delivered.

   - They must be collected in full before any work on the job begins: Taking the whole price before starting is the extreme case of billing ahead of the work, which the law restricts.
   - They must be one lump sum, paid on the day the contract is signed: A single lump sum at signing would also run ahead of the work, so it is not the rule.
   - They must be larger than the work done, to give the contractor a safety margin on the job: Collecting more than the work justifies is exactly what the rule prohibits, so a built-in cushion is not allowed.

4. Poor cash flow on a construction project is MOST often caused by:

   Right: Paying labor and materials before billings land. Wages and supplier bills come due weeks before the owner pays a progress billing, so cash drains even on a profitable job.

   - Paying suppliers early to take their discount: Taking an early-payment discount uses cash, but it earns a return and is a choice, not the usual cause.
   - Holding retention back from all the subcontractors: Holding retention from subs keeps cash in the contractor's account. It does not drain it.
   - Billing the owner monthly rather than weekly: Monthly billing can widen the gap, but the gap itself comes from paying before you are paid.

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2.4 Payroll taxes

Deposit schedules, FICA, FUTA, the four California payroll taxes, new-hire reports and filing due dates. About 7 minutes of narration.

BOARD 1 Whose money?

Federal unemployment tax (FUTA)

worker or employer or half and half

FUTA = employer only

✗ ~~Taken from the worker's check~~

- Every payroll tax is one of 3 kinds
- Matched
- Employer only
- Worker only

BOARD 2 Matched: Social Security and Medicare

Worker's share: withheld

Employer: matches it

Tax	Each side pays
Social Security	6.2%
Medicare	1.45%

- Social Security stops at a yearly wage limit
- 2026 limit: $184,500
- Medicare: no limit
- Over $200,000 wages: +0.9% Additional Medicare, withheld, no match

✗ ~~Medicare stops at the same limit~~

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BOARD 3 What the match costs

Wage: $5,000 a month

Below the wage limit

Social Security: $5,000 × 6.2%

= $310

Medicare: $5,000 × 1.45%

= $72.50

$310 + $72.50

Employer match = $382.50

- Before unemployment taxes
- Labor costs more than the wage: bid it

BOARD 4 Common trap: how often to deposit

✗ ~~Number of workers~~

Set by the lookback period

- Dollars of payroll tax reported

Lookback tax	You deposit
$50,000 or less	monthly
more than $50,000	semiweekly

- Dollars decide, not headcount
- $100,000 or more in a day: next business day

Federal rules for 2026.

BOARD 5 Four California taxes

Collected by the state EDD

- State taxes, on top of federal
- Employer pays: UI and ETT
- Worker's check pays: SDI and PIT

Employer sends it in, but it is the worker's money

Employer = UI + ETT

Worker's check = SDI + PIT

✗ ~~Employer pays SDI~~

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BOARD 6 Register, then report

More than $100 wages in a quarter

Register within 15 days

- State number is not the federal number: need both

Form 1099-NEC for subs

Line: $2,000 for 2026 payments

- Count the year's total, not each invoice

$1,800 → no form

$2,600 → file by Jan 31

- Corporations: generally exempt

Was $600 before 2026

BOARD 7 Report new hires, file on time

Form	What	Due
DE 34	new hire report (EDD)	20 days from start
941	federal payroll return, quarterly	Apr 30 · Jul 31 · Oct 31 · Jan 31
940	FUTA, yearly	Jan 31
W-2	to each worker and to SSA	Jan 31
DE 9 + DE 9C	California wages, quarterly	late after the next month ends

✗ ~~New hire report in 15 days~~: 15 days is registration

Who pays each tax · register first · file on time

Next: UI, ETT, SDI and FUTA numbers (2026)

BOARD 8 California rates for 2026

Tax	Rate	Wage base	Who pays
UI		$7,000	employer
UI range	1.5%–6.2%		
UI, new employer	3.4%		
ETT	0.1%	$7,000	employer
SDI	1.3%		worker
		no cap since 2024	

✗ ~~SDI on $7,000 only~~

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BOARD 9 Work it: federal unemployment and one worker

FUTA 6.0% × first $7,000

– credit up to 5.4%

Net 0.6% × $7,000 = $42

✗ California: credit reduction

2025 wages: –1.2%

1.8% × $7,000 = $126

Source: Schedule A (Form 940)

Wages $40,000 · new employer · 2026

UI 3.4% × $7,000 = $238

ETT $7 · SDI 1.3% × $40,000 = $520 withheld

Next: 2.5 Sales and use tax, franchise tax, records

Key numbers and formulas

- FUTA = employer only
- Social Security: $5,000 × 6.2%
- = $310
- Medicare: $5,000 × 1.45%
- = $72.50
- $310 + $72.50
- Employer match = $382.50
- Employer = UI + ETT
- Worker's check = SDI + PIT
- Register within 15 days
- $2,600 → file by Jan 31
- Who pays each tax · register first · file on time
- FUTA 6.0% × first $7,000
- – credit up to 5.4%
- Net 0.6% × $7,000 = $42
- 1.8% × $7,000 = $126
- UI 3.4% × $7,000 = $238
- ETT $7 · SDI 1.3% × $40,000 = $520 withheld

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Common traps

- Taken from the worker's check
- Medicare stops at the same limit
- Number of workers
- Employer pays SDI
- New hire report in 15 days: 15 days is registration
- SDI on $7,000 only
- California: credit reduction

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Why the tempting answers fail (from the section practice)

1. A contractor has employees. Which group lists payroll taxes the contractor itself owes as the employer, on top of what it withholds from its workers?

   Right: Its share of Social Security and Medicare, plus unemployment taxes. The employer matches the worker's Social Security and Medicare share and also pays the unemployment taxes. All of this sits on top of the amounts withheld from workers.

   - The owner's personal income tax on whatever profit the business makes: The owner's income tax is the owner's own bill. It is not a payroll tax owed because of the workers' wages.
   - The yearly premium that the contractor pays for the license bond: A license bond premium is a business cost paid to a surety. It is not a tax on wages.
   - Sales tax on the wages, which is added to each worker's paycheck: Wages carry no sales tax, so nothing like it is added to a paycheck.

2. Which payroll tax is withheld from the worker's pay, and not paid by the employer?

   Right: California State Disability Insurance. State disability insurance comes out of the worker's check. Unemployment insurance, the training tax and federal unemployment tax are all employer-paid.

   - California Unemployment Insurance: Unemployment insurance is an employer-paid tax. Nothing is taken from the worker's pay for it.
   - Employment Training Tax: The employment training tax is paid by the employer alone, not withheld from wages.
   - Federal Unemployment Tax: Federal unemployment tax is employer-only. It is never withheld from the worker's pay.

3. A general contractor pays an unincorporated sub $3,400 over 2026 for services. Which form must it issue to the sub?

   Right: Form 1099-NEC, since the year's total is at or over the $2,000 line. Service payments to an unincorporated payee are reported on Form 1099-NEC once the year's total reaches the line, which is $2,000 for 2026 payments. $3,400 is over it.

   - Form W-2, since the sub did the work on the contractor's jobs: A W-2 goes to employees. This payee is an unincorporated independent sub, paid for services.
   - No form, since a licensed sub is exempt from information reporting: A license does not remove the reporting duty. What matters is who is paid and how much over the year.
   - Form 1099-MISC, since a sole proprietor is not a corporation: Payments to a sole proprietor for services go on the nonemployee compensation form, not this one.

4. A California contractor paid three employees more than $7,000 each in 2025 and paid its state unemployment tax on time. With California's 1.2% credit reduction for 2025, what is its total 2025 FUTA tax?

   Right: $378. Net rate = 6.0% - 5.4% + 1.2% = 1.8%. Each worker: 1.8% x $7,000 = $126. Three workers: $378.

   - $126: That is the FUTA for one worker. There are three.
   - $1,260: That applies the full 6.0% to $21,000 and ignores the credit for paying state tax.
   - $252: That counts only the 1.2% credit reduction and leaves out the basic 0.6% net FUTA.

5. A project manager earns $210,000 in 2026. How much California SDI is withheld from his pay for the year?

Right: $2,730. The 2026 SDI rate is 1.3% with no wage cap: 0.013 x $210,000 = $2,730.

- $91: That applies the rate to only $7,000, the unemployment insurance base. SDI has no wage cap.
- $2,398.50: That stops at the $184,500 Social Security cap. SDI has no cap since 2024.
- $2,520: That uses the 2025 rate of 1.2%. The 2026 rate is 1.3%.

6. A contractor's 2026 rate notice shows a UI rate of 2.9%. A worker earns $25,000 in 2026. What do the employer-paid California UI and ETT total for this worker?

   Right: $210. UI: 2.9% x $7,000 = $203. ETT: 0.1% x $7,000 = $7. Total $210.

   - $203: That is UI alone. ETT of 0.1% on the same $7,000 adds $7.
   - $725: That applies 2.9% to all $25,000 wages. UI stops at the first $7,000.
   - $750: That applies UI and ETT to the full wage. Both stop at the first $7,000.

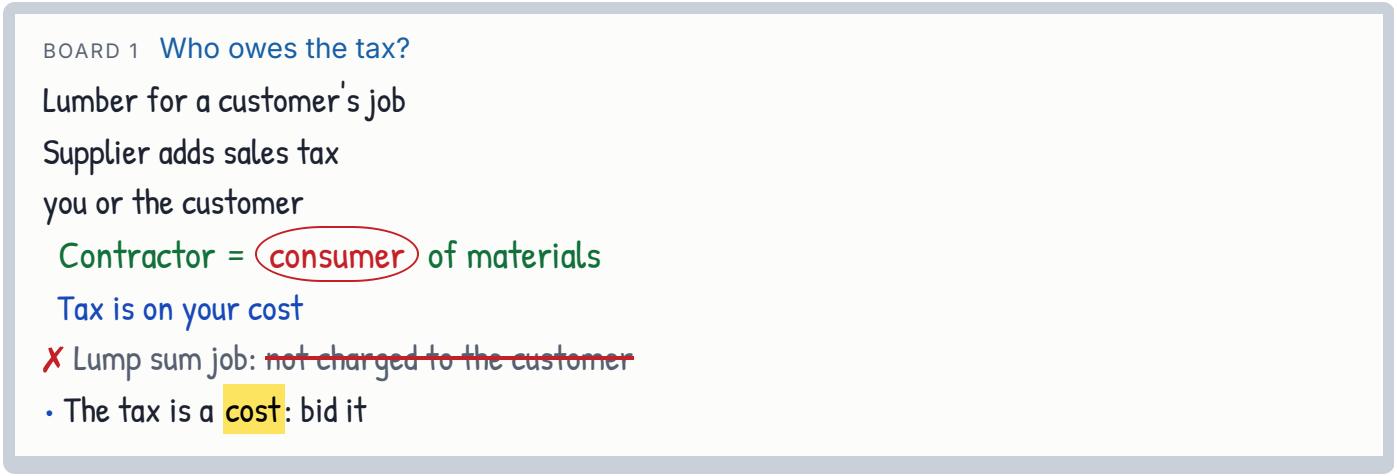
7. Which California payroll tax applies to every dollar of a worker's 2026 wages, with no wage cap?

   Right: State disability insurance. Since January 1, 2024, all wages are subject to SDI. For 2026 it is withheld at 1.3%.

   - Unemployment insurance: UI applies only to the first $7,000 of each worker's wages.
   - Employment training tax: ETT uses the same $7,000 base as UI.
   - Federal unemployment tax: FUTA is federal, not California, and applies only to the first $7,000.

2.5 Sales and use tax, the $800 minimum, records

Seller's permit, the 7.25% statewide rate, fixtures versus materials, franchise tax minimum, how long to keep records. About 4 minutes of narration.



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BOARD 2 Do the math, and use tax

Materials $30,000

Rate 10% (example only)

- Statewide base 7.25% + local district tax

$30,000 × 10% = $3,000

Real cost = $33,000

✗ ~~Left out of the bid~~: $3,000 of profit gone

Bought out of state, no CA tax?

You owe use tax

- Out of state does ~~not~~ avoid the tax

BOARD 3 Materials or fixtures?

Keeps its identity once installed?

- Not size. Not price. Identity.

Materials	Fixtures
paint, lumber, wiring	furnace, cabinets, A/C unit
you = consumer	you = retailer
tax on your cost	tax on selling price

- No price stated? Use cost price

Sell fixtures = seller's permit

Only furnish and install materials, lump sum: generally no permit

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BOARD 4 Common trap: more than $800

Sole owner: personal return

- Corporation: $800 minimum, even at no profit

New corporation: no $800 minimum in its first year

- LLC: $800 a year

LLC first-year break: ~~ended~~ (2021-2023 only)

Formed 2024 or later: owes it in year one

- Plus an income fee

At $250,000 or more total CA income

Total income = gross income + cost of goods sold

✗ ~~gross receipts net profit~~

✗ ~~LLC owes only $800~~

BOARD 5 How long to keep records

Record	Keep
Income tax	3 years
Over 25% of income left out	6 years
Bad-debt deduction	7 years
Never filed, or fraud	forever
Payroll (IRS and EDD)	4 years
California income tax	at least 4 years

- Four years also covers the 3-year wage record rule

✗ ~~3 years for payroll~~

- Two clocks? Keep to the longer one

Materials taxed · $800 minimum · payroll records 4 years

Next: 2.6 Revenue recognition and job cost

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Key numbers and formulas

- Contractor = consumer of materials
- Tax is on your cost
- $30,000 × 10% = $3,000
- Real cost = $33,000
- You owe use tax
- Sell fixtures = seller's permit
- At $250,000 or more total CA income
- Total income = gross income + cost of goods sold
- Materials taxed · $800 minimum · payroll records 4 years

Common traps

- Lump sum job: not charged to the customer
- Left out of the bid: $3,000 of profit gone
- gross receipts net profit
- LLC owes only $800
- 3 years for payroll

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Why the tempting answers fail (from the section practice)

1. A contractor's bid left out the sales tax on $20,000 of materials, at a nine percent rate. If it cannot pass the tax on, how much profit disappears?

   Right: $1,800. $20,000 × 9% = $1,800. On a lump sum job the contractor is the consumer of the materials, so this tax is its own cost. Leaving it out takes that amount straight from profit.

   - $180: That is nine percent of $2,000, only a tenth of the true base. The tax applies to the whole $20,000 of materials.
   - $900: That is nine percent of only half the materials. The tax applies to all of them.
   - $2,000: That is ten percent of the materials. The rate in the question is nine percent.

2. What yearly minimum franchise tax does California charge most corporations, even in a year with no profit?

   Right: $800. A corporation owes the $800 minimum franchise tax every year, whether or not it earned a profit. New corporations are generally exempt only in their first year.

   - $25: That is far below the minimum. The figure to remember is eight hundred dollars.
   - $1,000: That rounds the minimum up. The figure is eight hundred dollars, not one thousand.
   - $8,000: That is ten times the minimum. Mixing up the zeros is the usual slip.

3. For how long should a contractor keep records, and what changes for payroll records?

   Right: Three years for income tax, at least four for payroll. Ordinary income tax records are kept three years. Payroll records need at least four, because both the federal rule and the state payroll rule set a four year floor.

   - Six months after the last payment, for every kind of record: Six months is far too short. Returns can be looked at years later, and payroll records have a four year floor.
   - Thirty days after the permit is signed off, for any record: Closing out a permit has nothing to do with tax clocks. The permit date does not start or end any of them.
   - No time limit applies, so nothing needs to be kept: Records are required, and each agency sets a clock for them.

2.6 Revenue recognition and job cost

Percentage-of-completion versus completed-contract, gross profit per job. About 4 minutes of narration.

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BOARD 1 How far along?

Price $240,000

Estimated total cost $200,000

Spent so far $50,000

about 21% or 25% or 83%

25% complete

% complete = cost to date ÷ estimated total cost

$50,000 ÷ $200,000 = 25%

✗ ~~Not the price. Not billings.~~

BOARD 2 Revenue earned so far

Earned = % complete × price

25% × $240,000

= $60,000 earned

$60,000 − $50,000 cost

Gross profit so far = $10,000

Whole job: $240,000 − $200,000 = $40,000

- 25% of $40,000 = $10,000 ✔
- This is percentage of completion
- Cost recognized to date = cost to date = $50,000

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BOARD 3 Common trap: billed is not earned

Billed $90,000

Earned $60,000

Over-billed $30,000

✗ ~~Extra profit~~. It is a liability

- Percent complete follows costs

Method	Profit shows
Percentage of completion	as work goes
Completed contract	at the end

- Until then: nothing on the income statement

Job cost records: kept all along

- Not a free choice: tax and accounting rules limit it
- Sureties and lenders like percentage of completion

BOARD 4 Gross profit per job

Gross profit = price − direct job costs

Gross margin = gross profit ÷ price

Job A	Job B
price $100,000	price $60,000
cost $78,000	cost $51,000
profit $22,000	profit $9,000
margin 22%	margin 15%

Gross profit total = $31,000

− overhead and G&A $25,000

= $6,000 before tax

✗ ~~Gross profit = net profit~~

- Gross profit pays overhead first
- Margin ranks jobs, not volume

Cost drives % complete · gross profit pays overhead

Next: the WIP schedule

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BOARD 5 The WIP schedule

- Every open job · often monthly
- Price · estimated cost · cost to date · billed

% complete → earned revenue

Billed vs. earned, per job

- Over-billing = liability
- Under-billing = asset
- Sureties read it closely
- Schedule of values: bill the % done on each line

BOARD 6 Work it: two jobs on the schedule

	Job 1	Job 2
Price	$500,000	
Est. cost	$400,000	
Cost to date	$100,000	
% · earned	25% · $125,000	
Billed	$150,000	
Result	over $25,000	
Price · est. cost		$300,000 · $250,000
Cost to date		$150,000
% · earned		60% · $180,000
Billed		$160,000
Result		under $20,000

Liability $25,000 · asset $20,000

✗ ~~Net them: $5,000 over~~

Next: 2.7 Financing, lease or buy, PACE, bonding

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Key numbers and formulas

- 25% complete
- % complete = cost to date ÷ estimated total cost
- $50,000 ÷ $200,000 = 25%
- Earned = % complete × price
- 25% × $240,000
- = $60,000 earned
- $60,000 − $50,000 cost
- Gross profit so far = $10,000
- Over-billed $30,000
- Gross profit = price − direct job costs
- Gross margin = gross profit ÷ price
- Gross profit total = $31,000
- − overhead and G&A $25,000
- = $6,000 before tax
- Cost drives % complete · gross profit pays overhead
- % complete → earned revenue
- Billed vs. earned, per job
- Liability $25,000 · asset $20,000

Common traps

- Not the price. Not billings.
- Extra profit. It is a liability
- Gross profit = net profit
- Net them: $5,000 over

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Why the tempting answers fail (from the section practice)

1. A job is thirty percent complete. Total estimated job cost is $250,000 and the contract price is $320,000. Under percentage of completion, how much job cost is recognized to date?

   Right: $75,000. Cost recognized = total estimated cost × percent complete = $250,000 × 30% = $75,000.

   - $96,000: That is the revenue earned, thirty percent of the $320,000 price. The question asks for the cost.
   - $250,000: That is the whole estimated cost. Only thirty percent of it belongs to the work done so far.
   - $320,000: That is the full contract price. Neither price nor total cost is recognized all at once.

2. A fixed price job was bid at $50,000 with estimated direct costs of $40,000. Actual direct costs came to $46,000. What was the actual gross profit?

   Right: $4,000. Actual gross profit = price − actual cost = $50,000 − $46,000 = $4,000. The overrun ate most of the planned profit.

   - $6,000: That is the overrun itself, the gap between actual and estimated cost. It is not a profit.
   - $10,000: That is the planned profit, $50,000 − $40,000. The overrun destroyed part of it.
   - $14,000: That is not price minus actual cost. Only $50,000 − $46,000 gives the gross profit, and an overrun lowers profit.

3. A contractor's gross margin slips from thirty percent to twenty two percent over a year. What is the best first step to find the cause?

   Right: Review the job cost reports for overruns on each cost line. A falling gross margin means direct cost is taking a bigger share of the price. Only the job cost reports show whether labor, materials or subs caused it.

   - Raise the markup on every future bid before checking anything: Raising the markup treats the symptom before the cause is known, and it may only lose bids.
   - Compare this year's franchise tax with last year's: Franchise tax sits below the gross profit line, so it cannot move gross margin.
   - Increase the size of the contractor's license bond: The license bond is a licensing matter. It has no effect on job cost.

4. A job sells for $50,000 with a 20% gross margin. What are the direct job costs?

   Right: $40,000. Gross margin is profit over price: 20% x $50,000 = $10,000 of profit, so direct cost = $50,000 - $10,000 = $40,000.

   - $10,000: That is the gross profit, 20% of the $50,000 price, not the cost.
   - $41,667: That treats 20% as a markup on cost ($50,000 / 1.2). Margin is measured on the price.
   - $60,000: That adds 20% to the price. Cost must be lower than the price.

5. Under the schedule-of-values method of progress billing, each payment application is based on:

   Right: The percentage of each line item completed. The schedule of values splits the price into line items, and each application bills the percent of each line completed.

   - A flat monthly fee, whatever is done: A flat fee ignores the work done. A schedule of values bills by progress.
   - The contractor's yearly overhead rate: Overhead rate is used in pricing, not in measuring progress for a payment application.

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- The sales tax collected during the month: Sales tax has nothing to do with measuring progress on the work.

6. Accurate job-cost records are important mainly because they:

   Right: Show which jobs made money, and sharpen future bids. Job-cost records show actual cost against the estimate, job by job, which tells you what made money and corrects future bids.

   - Replace the license bond that the law requires: A license bond is a separate legal requirement. Records do not replace it.
   - Must be filed with each building permit: Building departments do not ask for a contractor's job-cost records with a permit.
   - Set the CSLB license classification the firm holds: Classification comes from experience and the exam, not from accounting records.

7. A job is priced at $800,000 with estimated total cost of $640,000. Cost to date is $320,000 and billings to date are $350,000. What does the WIP schedule show for this job?

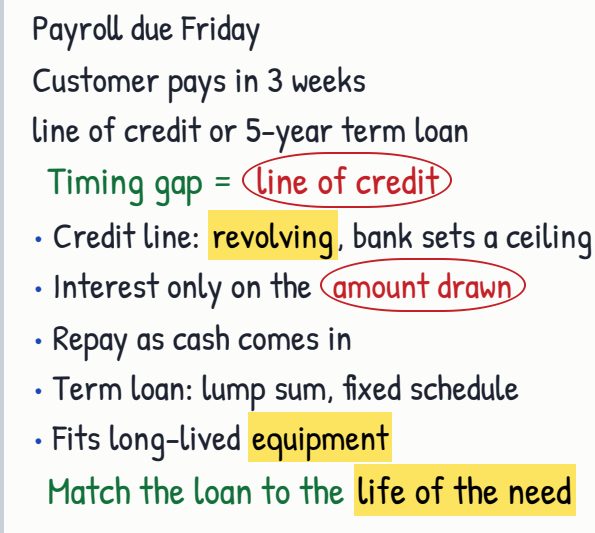
   Right: Under-billed by $50,000. Percent complete = $320,000 / $640,000 = 50%. Earned = 50% x $800,000 = $400,000. Billed $350,000 is $50,000 less than earned: under-billed.

   - Over-billed by $30,000: That compares billings with cost to date. Billings are compared with earned revenue.
   - Over-billed by $50,000: The gap is $50,000, but billings are below earned revenue, so the job is under-billed, not over-billed.
   - Under-billed by $30,000: That uses cost to date as the earned figure and also flips the sign.

2.7 Financing, lease or buy, PACE, bonding capacity

Credit lines, simple interest, lease versus buy, PACE assessments. About 5 minutes of narration.

BOARD 1 Match the loan to the need



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BOARD 2 Simple interest and the time trap

Interest = principal × annual rate × years

✗ Time: a yearly rate, so pro-rate it

$30,000 at 10% for 6 months

$30,000 × 10% = $3,000 a year

$3,000 × 0.5 = $1,500

✗ ~~Not $3,000~~

- Monthly rate: annualize it

2% a month = 24% a year

BOARD 3 Fees change the real cost

Borrow $50,000 for one year

Bank A: 10%, no fees

$5,000 = 10%

Bank B: 9% + $1,000 fee

$4,500 + $1,000 = $5,500

$5,500 ÷ $50,000 = 11%

✗ ~~Lower sticker rate~~, higher cost

- Simple one-year comparison, not a legal APR
- APR folds in fees, but Truth in Lending: business loans generally exempt
- No APR given? Run the comparison yourself

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BOARD 4 Lease or buy?

- Lease: keeps cash and borrowing power
- ...but you ~~own nothing~~
- Buy: more cash up front
- ...but you own it, take depreciation, keep resale value

Excavator, 5 years of steady work

Buy: $120,000 − $20,000 resale

Net cost of owning = $100,000

Lease: $2,500 × 60 months

= $150,000

Buying is about $50,000 cheaper

- Cash tight? May lease anyway

Only 6 months? Lease or rent.

✗ ~~Lessee takes depreciation~~

- Lessee deducts the lease payments

BOARD 5 PACE financing

Energy and water improvements

✗ ~~Just a bank loan~~

- Repaid by an assessment on the property tax bill
- May stay with the property...
- ...but transfer is ~~not assured~~
- Lender or buyer may want it paid at sale or refinance

Who	Duty
Administrator	ability to pay check
Contractor (solicitor)	enrollment + disclosure
Contractor	home-improvement contract rules

✗ ~~Contractor does the ability-to-pay check~~

- No pressure on seniors, no ~~false terms~~

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BOARD 6 Bonding capacity

✗ ~~A bond is not insurance for you~~

- Protects the party owed, the obligee
- Surety pays a claim? You repay the surety
- Surety underwrites you like a bank

Working capital = current assets − current liabilities

Equity = assets − liabilities

- Profit trend + accrual, % of completion statements

✗ Sureties look at ~~revenue~~ first? No

Contractor A	Contractor B
revenue $8M	revenue $4M
working capital $60,000	working capital $350,000
cash-basis books	% of completion books

Surety backs B

- Keep earnings, collect receivables, keep debt modest

Next: 2.8 Budget and planning

Key numbers and formulas

- Timing gap = line of credit
- Match the loan to the life of the need
- Interest = principal × annual rate × years
- $30,000 × 10% = $3,000 a year
- $3,000 × 0.5 = $1,500
- 2% a month = 24% a year
- $5,000 = 10%
- $4,500 + $1,000 = $5,500
- $5,500 ÷ $50,000 = 11%
- Buy: $120,000 − $20,000 resale
- Net cost of owning = $100,000
- Lease: $2,500 × 60 months
- = $150,000
- Buying is about $50,000 cheaper
- Working capital = current assets − current liabilities
- Equity = assets − liabilities
- Surety backs B

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Common traps

- Time: a yearly rate, so pro-rate it
- Not $3,000
- Lower sticker rate, higher cost
- Lessee takes depreciation
- Just a bank loan
- Contractor does the ability-to-pay check
- A bond is not insurance for you
- Sureties look at revenue first? No

Why the tempting answers fail (from the section practice)

1. A contractor borrows $50,000 at an eight percent annual rate. What is the simple interest owed for six months?

   Right: $2,000. Interest = principal × rate × time = $50,000 × 0.08 × 0.5 = $2,000. Six months is half a year, so the time factor is 0.5.

   - $400: That uses a time factor of one tenth of a year. Six months is half a year.
   - $4,000: That is the interest for a full year. The loan is only for six months, so it must be cut in half.
   - $8,000: That is two years of interest. The rate is yearly and the time here is half a year.

2. For which need is a revolving line of credit most useful to a contractor?

   Right: Covering payroll until the next progress payment arrives. A line of credit is revolving. The contractor draws what it needs, pays interest only on the draw, and repays as receivables come in. That is exactly the timing gap in construction.

   - Buying raw land that the company plans to hold for many years: Land is long-lived, so it belongs on a term loan. A credit line fits short timing gaps, not long-lived assets.
   - Deferring this year's income tax to a later tax year: A loan does not change when income tax is owed. This is not what a credit line is for.
   - Paying the contractor license renewal fee at each renewal: A renewal fee is a small recurring cost. It is not the kind of timing gap that a credit line bridges.

3. A contractor's license bond is a surety bond. What does that mean?

   Right: The surety pays valid claims, then the contractor repays it. A surety bond is closer to credit. The surety backs the contractor's promise, pays a valid claim, and then looks to the contractor for repayment.

   - Claims the surety pays are written off, never repaid by anyone: The contractor must indemnify the surety, so a paid claim is a debt to repay. It is not written off.
   - The premium is a deposit the licensee can draw on later: The premium buys the guarantee. It is not a deposit the licensee can draw on.
   - The bond replaces the need for liability insurance: A bond is not insurance for the contractor. It protects those who are owed, such as the owner or the public, so it cannot replace liability insurance.

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2.8 Budget and planning: the overhead rate and the cash forecast

The overhead budget, the overhead rate on a base, the company plan, a monthly cash-flow forecast with DSO, and budget versus actual. About 7 minutes of narration.

BOARD 1 A budget looks forward

Record of past spending or Plan for the year ahead

✗ A ~~rear-view record~~ of what was spent

✓ A forward-looking plan

- Revenue and expenses, estimated in advance
- Set prices · control spending · see cash gaps
- Then compare actual vs plan

Business practice, not a code section

BOARD 2 The overhead budget

Overhead and G and A: no single job

Line	Budget
Office rent	$24,000
Office and estimating salaries	$80,000
Insurance, licenses, fees	$18,000
Shop, yard, shared equipment	$28,000

Total = $150,000

- Mostly fixed: owed with or without work

BOARD 3 From budget to overhead rate

Rate = budgeted annual overhead ÷ base

- Base: direct cost, direct labor, or revenue

Overhead $150,000 · direct cost $1,000,000

$150,000 ÷ $1,000,000 = 15% of direct cost

Or: direct labor $375,000

$150,000 ÷ $375,000 = 40% of direct labor

- One base, used consistently

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BOARD 4 Work it: one bid

Direct cost $40,000

Overhead = 15% × $40,000 = $6,000

Loaded cost = $46,000

Profit = 10% × $46,000 = $4,600

Bid = $50,600

- Overhead first, then profit

BOARD 5 The rate that was too low

Actual overhead $180,000

Bids carried 15% × $1,000,000 = $150,000

Underpriced or Overpriced or No effect

Every job underpriced

$30,000 of overhead unrecovered

- It comes out of profit

True rate = $180,000 ÷ $1,000,000 = 18%

✗ "The ~~big job~~ carries the office"

✓ Every job carries its share

BOARD 6 The company plan

Line	Plan
Revenue forecast	$1,200,000
Direct cost	$1,000,000
Gross profit	$200,000
Overhead (12.5% of revenue)	$150,000
Profit before tax	$50,000

Break-even = $150,000 ÷ (1/6) = $900,000

- Break-even method: lesson 2.1b

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BOARD 7 The cash-flow forecast

Opening cash + receipts − payments = closing cash

- Month by month, carried forward

Receipts depend on collection speed

- Receivables = billed, not yet paid

DSO = receivables ÷ annual credit sales × 365

Receivables $120,000 · credit sales $1,200,000

0.1 × 365 ≈ 37 days

- On average, a bill is cash in about five weeks

BOARD 8 Spot the gap

	Month 1	Month 2
Opening cash	$40,000	$20,000
+ Receipts	$90,000	$80,000
− Payments	$110,000	$115,000
Closing cash	$20,000	?

+$15,000 or −$15,000 or $0

Month 2 closes at −$15,000

✓ Seen early: arrange credit in time

BOARD 9 Budget versus actual

$150,000 ÷ 12 = $12,500 a month

Six months: plan $75,000 · actual $84,000

$9,000 over plan (12%)

✓ Find the line, act now

- Cut the cost, or raise the rate in new bids

✗ ~~Wait for year-end~~

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BOARD 10 Recap

- Budget = forward plan, checked against actual

Overhead rate = annual overhead ÷ base

$150,000 ÷ $1,000,000 = 15%

✗ Rate too low: ~~every bid underpriced~~

- Cash-flow forecast: shortfalls seen early
- Budget vs actual: monthly

Business practice, not statute

BOARD 11 Chapter 2 summary

Topic	Key numbers
Markup · margin	profit ÷ cost · profit ÷ price
Price to a margin	cost ÷ (1 – margin)
Break-even	fixed cost ÷ contribution margin
Liquidity	current ratio · quick ratio · working capital ($)
Retention	5% cap · private contracts from 1/1/2026 (Civ. Code §8811)
FICA	6.2% + 1.45%, each side · Medicare has no wage limit

Chapter 2 summary (continued)

Topic	Key numbers
Worker pays	SDI · income tax withholding
Franchise tax	$800 minimum (corporation, LLC)
Records	3 years income tax · 4 years payroll
% complete	cost to date ÷ estimated total cost
Simple interest	principal × annual rate × years
Overhead rate	overhead budget ÷ base

Next: 2.9 · added lessons 2.9 to 2.14

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Key numbers and formulas

- Total = $150,000
- Rate = budgeted annual overhead ÷ base
- $150,000 ÷ $1,000,000 = 15% of direct cost
- $150,000 ÷ $375,000 = 40% of direct labor
- Overhead = 15% × $40,000 = $6,000
- Loaded cost = $46,000
- Profit = 10% × $46,000 = $4,600
- Bid = $50,600
- Every job underpriced
- $30,000 of overhead unrecovered
- True rate = $180,000 ÷ $1,000,000 = 18%
- Break-even = $150,000 ÷ (1/6) = $900,000
- Opening cash + receipts − payments = closing cash
- DSO = receivables ÷ annual credit sales × 365
- 0.1 × 365 ≈ 37 days
- Month 2 closes at −$15,000
- Six months: plan $75,000 · actual $84,000
- $9,000 over plan (12%)
- Overhead rate = annual overhead ÷ base
- $150,000 ÷ $1,000,000 = 15%

Common traps

- A rear-view record of what was spent
- "The big job carries the office"
- Wait for year end
- Rate too low: every bid underpriced

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Why the tempting answers fail (from the section practice)

1. A contractor budgets $96,000 of overhead for the year and projects $320,000 of direct labor. It allocates overhead on direct labor. What overhead rate should its bids carry?

   Right: 30% of direct labor. The rate is budgeted annual overhead divided by the base: $96,000 divided by $320,000 is 30% of each job's direct labor.

   - About 23% of direct labor: That divides overhead by labor plus overhead. The base is the direct labor alone, so the rate is $96,000 over $320,000.
   - About 333% of direct labor: That turns the fraction upside down, dividing labor by overhead. The overhead budget goes on top.
   - 2.5% of direct labor: That spreads one month of overhead, $8,000, over a full year of labor. Overhead and base must cover the same year.

2. If a contractor underestimates his overhead rate when bidding, the most likely result is:

   Right: Jobs are underpriced and the company loses money. A rate that is too low leaves part of the real overhead out of every price. Each job can look fine on its own sheet while the company loses money once the real overhead is paid.

   - Bids come in high and he wins fewer jobs: High bids come from the opposite error, an overhead rate set too high.
   - His income taxes fall along with the reported profit: Lower taxes would follow lower profit, but that is a symptom, not the harm the low rate causes.
   - Overhead is absorbed by his subcontractors: Subcontractors price their own overhead. Nothing moves the contractor's overhead onto them.

3. A cash flow projection primarily helps a contractor:

   Right: Foresee cash shortfalls in time to arrange credit. A projection lays expected receipts against expected payments month by month, so a shortfall shows up early enough to arrange credit or change billing.

   - Set the overhead rate each bid should carry: The overhead rate comes from the overhead budget and the chosen base, not from a cash schedule.
   - Value the work in progress for the year-end balance sheet: Work in progress is valued from job-cost records against contract amounts, not from a cash forecast.
   - Compute the depreciation on owned equipment: Depreciation follows the asset's cost and schedule, and it involves no cash timing at all.

4. A contractor forecasts $900,000 of revenue and budgets overhead at 14% of revenue. Six months into the year, actual overhead is $70,000. What does the budget check show?

   Right: $7,000 over plan for the first half of the year. The annual overhead budget is 14% of $900,000, or $126,000. Half a year is $63,000, so $70,000 actual is $7,000 over plan.

   - $56,000 under budget, so overhead is well controlled: That compares six months of actual cost with the whole year's budget of $126,000. Compare like periods.
   - $7,000 under plan for the first half of the year: The sign is reversed. Actual spending of $70,000 is above the half-year plan of $63,000.
   - Nothing yet, since a budget is only checked at year end: Waiting for year end defeats the purpose. Checking monthly lets you act while the year can still be saved.

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2.9 Quarterly estimated tax, self-employment tax, 1099-NEC and W-9

Who pays estimated tax, federal dates and the California 30/40/0/30 split, safe harbors, self-employment tax, 1099-NEC, W-9 and 24% backup withholding. About 7 minutes of narration.

BOARD 1 No boss, no withholding

Sole owner: no withholding

All in April · Four payments in the year · Only if the IRS asks

4 payments during the year

- Sole owners · partners · S corp shareholders

Federal: expect to owe $1,000 or more

California: $500 ($250 married filing separately)

✗ ~~Pay it all in April~~ → penalty

BOARD 2 Four due dates, two calendars

Due	Federal	California
Apr 15, 2026	25%	30%
Jun 15, 2026	25%	40%
Sep 15, 2026	25%	0%
Jan 15, 2027	25%	30%

- California: Form 540-ES

California: 70% paid by June 15

BOARD 3 The safe harbor

- 90% of this year's tax
- 100% of last year's tax

Last year's AGI over $150,000 → 110%

$75,000 if married filing separately

- California: same 90% · 100% · 110%, same $150,000

California AGI this year $1,000,000 or more

→ only 90% of this year's tax

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BOARD 4 Work it: Maria's safe harbor

Last year's tax $20,000

Last year's AGI $120,000

This year's tax (expected) $30,000

90% × $30,000 = $27,000

100% × $20,000 = $20,000

Safe harbor $20,000

4 × $5,000

If last year's AGI = $180,000

110% × $20,000 = $22,000

4 × $5,500

- Balance of $30,000 due at filing

BOARD 5 Work it: California's split

California tax estimate $8,000

Apr 15: 30% × $8,000 = $2,400

Jun 15: 40% × $8,000 = $3,200

Sep 15: $0

Jan 15: 30% × $8,000 = $2,400

✗ ~~4 × $2,000~~

✗ Short $400 in April · $1,600 behind by June

- Short installment → penalty

BOARD 6 Self-employment tax

- Covers both halves of Social Security and Medicare

Rate 15.3%

12.4% Social Security + 2.9% Medicare

- Owed once net earnings reach $400

Base = net profit × 92.35%

- 2026 Social Security cap $184,500
- Medicare: no cap
- Deduct half in figuring AGI

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BOARD 7 Work it: Maria's self-employment tax

Net profit $100,000

$100,000 × 92.35% = $92,350

- Under the 2026 cap → full rate

$92,350 × 15.3% = $14,129.55

✗ ~~15.3% × $100,000~~

✗ = $15,300, too high

✗ ~~Only 7.65%~~

Deductible half $7,064.78

BOARD 8 Paying subs: W-9 and 1099-NEC

- Get a signed Form W-9 before paying

It certifies the TIN

2026 payments: line $2,000

- Form 1099-NEC · not for corporations
- Year's total per sub · due January 31

✗ No correct TIN → backup withholding

Rate 24%

- Withheld money goes to the IRS

BOARD 9 Work it: two subs

March $1,500 · August $900

Each check under $2,000?

Total $2,400 → file 1099-NEC

Sub 2: no W-9

Payment due $5,000

24% × $5,000 = $1,200 to the IRS

Sub receives $3,800

Pay as you go · W-9 before the first check

Next: 2.10 Revenue, receivables, depreciation

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Key numbers and formulas

- 4 payments during the year
- Federal: expect to owe $1,000 or more
- California: $500 ($250 married filing separately)
- California: 70% paid by June 15
- Last year's AGI over $150,000 → 110%
- California AGI this year $1,000,000 or more
- → only 90% of this year's tax
- 90% × $30,000 = $27,000
- 100% × $20,000 = $20,000
- Safe harbor $20,000
- 4 × $5,000
- 110% × $20,000 = $22,000
- 4 × $5,500
- Apr 15: 30% × $8,000 = $2,400
- Jun 15: 40% × $8,000 = $3,200
- Sep 15: $0
- Jan 15: 30% × $8,000 = $2,400
- Rate 15.3%
- 12.4% Social Security + 2.9% Medicare
- Base = net profit × 92.35%
- $100,000 × 92.35% = $92,350
- $92,350 × 15.3% = $14,129.55
- Deductible half $7,064.78
- 2026 payments: line $2,000
- Rate 24%
- Total $2,400 → file 1099-NEC
- 24% × $5,000 = $1,200 to the IRS
- Sub receives $3,800
- Pay as you go · W-9 before the first check

Common traps

- Pay it all in April → penalty
- 4 × $2,000
- Short $400 in April · $1,600 behind by June
- 15.3% × $100,000
- = $15,300, too high
- Only 7.65%
- No correct TIN → backup withholding

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Why the tempting answers fail (from the section practice)

1. In 2026 Dan, a sole-owner framer, expects $40,000 of federal income and self-employment tax. His 2025 tax was $28,000 and his 2025 AGI was $140,000. What is the least he can pay through his 2026 estimated payments and still meet the federal safe harbor?

   Right: $28,000. The safe harbor is the smaller of 90% of this year's tax ($36,000) and 100% of last year's tax ($28,000). With 2025 AGI of $140,000, the 100% figure applies, so $28,000.

   - $30,800: That is 110% of last year's tax. The 110% rule applies only when last year's AGI was over $150,000, and Dan's was $140,000.
   - $36,000: That is 90% of this year's $40,000. The safe harbor is the smaller of that and 100% of last year's tax.
   - $40,000: That is the full expected tax. Dan may pay that, but the safe harbor lets him pay less during the year and settle the rest at filing.

2. Same facts, except Dan's 2025 AGI was $190,000. His 2025 tax was $28,000 and he expects $40,000 for 2026. If he pays his safe-harbor amount in four equal federal installments, how much is each one?

   Right: $7,700. Last year's AGI was over $150,000, so the prior-year safe harbor is 110% x $28,000 = $30,800. That is smaller than 90% of $40,000 ($36,000). Divided by 4, each installment is $7,700.

   - $7,000: That splits 100% of last year's tax. With last year's AGI over $150,000, the prior-year figure must be 110%.
   - $9,000: That splits 90% of this year's tax ($36,000). It works, but it is not the least he can pay, because $30,800 is smaller.
   - $10,000: That splits the whole expected tax of $40,000, more than the safe harbor requires.

3. A contractor expects to owe $12,000 of California income tax for 2026 and pays Form 540-ES installments on the California schedule. How much is due with the June 15, 2026 installment?

   Right: $4,800. California's split is 30%, 40%, 0% and 30%. The June 15 installment is 40% x $12,000 = $4,800.

   - $3,000: That is one quarter of $12,000. California does not use equal quarters.
   - $3,600: That is the 30% share, which belongs to the April 15 and January 15 installments.
   - $8,400: That is the 70% total due by June 15 (30% plus 40%). The June installment by itself is only the 40% share.

4. A sole-owner painter has $60,000 of net profit in 2026 and no wages from any job. What is the self-employment tax?

   Right: $8,477.73. $60,000 × 92.35% = $55,410. That is under the 2026 Social Security cap of $184,500, so the full 15.3% applies: $55,410 × 15.3% = $8,477.73.

   - $9,180.00: That applies 15.3% to the full $60,000 profit. The rate applies to 92.35% of net profit.
   - $4,590.00: That is 7.65% of the profit, the employee's half alone. A sole owner pays both halves.
   - $6,870.84: That is only the 12.4% Social Security part of $55,410. The 2.9% Medicare part is left out.

5. A sole-owner general contractor has $250,000 of net profit in 2026 and no wages. Using the 2026 Social Security cap of $184,500, what is the self-employment tax (before any Additional Medicare Tax)?

   Right: $29,573.38. Base: $250,000 × 92.35% = $230,875. Social Security: 12.4% x $184,500 = $22,878. Medicare has no cap: 2.9% x $230,875 = $6,695.38. Total $29,573.38.

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- $35,323.88: That applies the full 15.3% to all of $230,875. The 12.4% Social Security part stops at the $184,500 cap.
- $38,250.00: That applies 15.3% to the full $250,000. It skips both the 92.35% step and the cap.
- $28,228.50: That is 15.3% of the $184,500 cap. It caps the Medicare part too, but Medicare has no cap.

6. A sole-owner roofing sub has refused to give a contractor a taxpayer identification number. A $7,500 payment to him is reportable on Form 1099-NEC. How much must the contractor backup withhold?
   Right: $1,800. With no correct TIN, the payer withholds 24% of the reportable payment: 0.24 x $7,500 = $1,800, sent to the IRS.
   - $1,147.50: That is 15.3%, the self-employment tax rate. Backup withholding has its own rate.
   - $1,500: That uses 20%. The backup withholding rate is 24%.
   - $2,000: That is the 2026 reporting line, not an amount to withhold.
7. In 2026 a contractor pays an unincorporated electrician three times: $800, $700 and $600. What is the contractor's 1099-NEC duty for this sub?
   Right: File, because the $2,100 year total passes the $2,000 line. The year's payments add up: $800 + $700 + $600 = $2,100. For 2026 payments the line is $2,000, so a 1099-NEC is filed and furnished by January 31.
   - None, because no single payment reached $2,000: The line is tested on the year's total paid to the sub, not on each check.
   - None, because the 2026 line is $2,500 a sub: The 2026 line is $2,000, not $2,500.
   - File three forms, one for each payment of $600 or more: The $600 line applied before 2026, and the form reports the year's total on one form, not each payment.
8. Which dates are the four federal estimated tax due dates for the 2026 tax year?
   Right: Apr 15, Jun 15 and Sep 15, 2026, and Jan 15, 2027. Form 1040-ES lists April 15, June 15 and September 15, 2026, and January 15, 2027.
   - Mar 31, Jun 30, Sep 30 and Dec 31, 2026: These are calendar quarter ends. Estimated tax is not due at quarter end.
   - Apr 15, Jul 15, Oct 15, 2026, Jan 15, 2027: These are evenly spaced three-month dates. The real dates are uneven: the second one is June 15.
   - Jan 15, Apr 15, Jul 15 and Oct 15, 2026: This starts in January of the tax year. The last 2026 payment is due January 15 of the next year.
9. A contractor's 2026 California AGI will be about $1.2 million. Which California estimated tax safe harbor may she use?
   Right: Only 90% of her 2026 California tax, with no prior-year option. With current-year California AGI of $1,000,000 or more, the FTB requires estimates based on 90% of the current year's tax. The prior-year safe harbor is gone.
   - The smaller of 90% of her 2026 tax or 110% of her 2025 tax: That is the usual high-AGI rule. At $1,000,000 or more of current-year California AGI, the prior-year option is not available.
   - Only 100% of her 2025 California tax, the usual prior-year figure: The prior-year option is not available at this income level, at any percentage.
   - Only 110% of her 2025 California tax, since her AGI is over $150,000: The 110% prior-year figure applies above $150,000 of prior-year AGI, but not at $1,000,000 or more of current-year AGI.

2.10 Reporting rules: revenue recognition, receivables aging, depreciation

Percentage of completion versus completed contract, the IRC 460 small-contract exception, ASC 606 in concept, receivables aging, and MACRS, section 179 and bonus depreciation versus book. About 6 minutes of narration.

BOARD 1 Two ways to book one job

Price $1,000,000

Estimated cost $800,000

Cost to date, year 1: $300,000

$0 or $75,000 or $200,000

$300,000 ÷ $800,000 = 37.5%

37.5% × $1,000,000 = $375,000 earned

Year 1 profit: $375,000 − $300,000 = $75,000

- Completed contract: $0 in year 1

Year 2: all $200,000

BOARD 2 Same profit, different timing

Method	Year 1	Year 2
Percentage of completion	$75,000	$125,000
Completed contract	$0	$200,000

Total either way: $200,000

- POC: profit follows the work
- CC: profit and tax deferred

✗ ~~Free choice for everyone~~

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BOARD 3 The tax rule: section 460

- Default: percentage of completion

Exception: meet BOTH tests

- 1. Expected to finish within 2 years
- 2. Gross receipts test: $32,000,000 (2026)

Average of the 3 prior years

- Home and residential construction: separate exception

Exempt → completed contract allowed

BOARD 4 Work it: is the job exempt?

Receipts $28M · $30M · $35M

2026 office job, expected 14 months

$93M ÷ 3 = $31M

- $31M ≤ $32M · 14 months < 2 years

Exempt

✗ ~~Latest year only: $35M~~

✗ 30-month job → not exempt

BOARD 5 The GAAP layer

- Revenue standard: ASC 606
- Revenue as each promise is satisfied

Usually over time

✗ ~~Completed contract by choice~~

- Tax method ≠ statement method: allowed
- Your part: clean job cost records

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BOARD 6 Receivables aging

0–30	31–60	61–90	Over 90
Total A/R $150,000			
$75,000	$45,000		
		$20,000	$10,000

$20,000 + $10,000 = $30,000

$30,000 ÷ $150,000 = 20% past 60 days

BOARD 7 Collecting

- Bill promptly, per the contract
- Follow up on a fixed schedule
- Keep lien rights alive (Chapter 4)

✗ ~~Old A/R = cash~~

- Paper revenue ≠ payroll cash

BOARD 8 Tax depreciation: MACRS, 179, bonus

- Federal system: MACRS
- Construction equipment: 5-year property

Year 1 20% · Year 2 32%

- §179: expense it in year one

2026 limit $2,560,000

Reduced above $4,090,000 of purchases

Bonus 100%: acquired after Jan 19, 2025

✗ California: no bonus · §179 limit $25,000

Reduced above $200,000 of purchases

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BOARD 9 Work it: book versus tax

Excavator $120,000 (2026)

Book: 8-year life · $20,000 salvage

($120,000 − $20,000) ÷ 8 = $12,500

Federal, bonus: $120,000 in year 1

Elect out → MACRS 20% × $120,000 = $24,000

- Book = useful life · tax = the code

✗ ~~Book $12,500 = tax deduction~~

Timing · collections · depreciation: separate rules

Key numbers and formulas

- $300,000 ÷ $800,000 = 37.5%
- 37.5% × $1,000,000 = $375,000 earned
- Year 1 profit: $375,000 − $300,000 = $75,000
- Year 2: all $200,000
- Total either way: $200,000
- Average of the 3 prior years
- Exempt → completed contract allowed
- $93M ÷ 3 = $31M
- Exempt
- Usually over time
- $20,000 + $10,000 = $30,000
- $30,000 ÷ $150,000 = 20% past 60 days
- Year 1 20% · Year 2 32%
- 2026 limit $2,560,000
- Bonus 100%: acquired after Jan 19, 2025
- ($120,000 − $20,000) ÷ 8 = $12,500
- Federal, bonus: $120,000 in year 1
- Elect out → MACRS 20% × $120,000 = $24,000
- Timing · collections · depreciation: separate rules

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Common traps

- Free choice for everyone
- Latest year only: $35M
- 30-month job → not exempt
- Completed contract by choice
- Old A/R = cash
- California: no bonus · §179 limit $25,000
- Book $12,500 = tax deduction

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Why the tempting answers fail (from the section practice)

1. A contractor has a $900,000 fixed-price contract with estimated total cost of $720,000. By year end it has spent $270,000. Under percentage of completion, how much gross profit is recognized for the year?

   Right: $67,500. Percent complete = $270,000 / $720,000 = 37.5%. Revenue = 37.5% x $900,000 = $337,500. Gross profit = $337,500 - $270,000 = $67,500.

   - $0: That is the completed-contract answer. Percentage of completion recognizes profit as the work goes.
   - $54,000: That takes percent complete as cost over price ($270,000 / $900,000 = 30%) and applies it to the $180,000 total profit. Percent complete uses cost over estimated total cost.
   - $180,000: That is the whole job's expected profit. Only the share earned so far is recognized this year.

2. Same $900,000 job: $67,500 of gross profit was recognized in year one under percentage of completion. It finishes in year two at exactly the estimated $720,000 total cost. How much gross profit is recognized in year two?

   Right: $112,500. Total profit = $900,000 - $720,000 = $180,000. Year one took $67,500, so year two recognizes $180,000 - $67,500 = $112,500.

   - $180,000: That is the whole job's profit, which is what completed contract would put in year two. Year one already took $67,500.
   - $67,500: That repeats year one's figure. Year two takes whatever profit is left.
   - $0: Profit is not used up in year one. The rest of the job's profit lands in year two.

3. A contractor's gross receipts for the three years before 2026 were $28 million, $31 million and $36 million. In 2026 it signs a commercial job it expects to finish in 18 months. Is the job exempt from the federal percentage-of-completion rule?

   Right: Yes, the $31.67 million average is under $32 million and the job is under two years. Average = ($28M + $31M + $36M) / 3 = $31.67 million, under the $32 million line for tax years beginning in 2026, and 18 months is within two years. Both tests are met.

   - No, because the latest year of $36 million is over the $32 million line by itself: The gross receipts test uses the average of the three prior years, not the latest year alone.
   - No, because only home and residential builders can avoid percentage of completion: Home and residential construction have a separate exception, but small contractors can also qualify on other construction contracts.
   - Yes, because any job under two years is exempt, whatever its gross receipts: The time test is only half. The gross receipts test must also be met.

4. An aging report shows receivables of $84,000 at 0-30 days, $36,000 at 31-60, $18,000 at 61-90 and $12,000 over 90 days. What share of receivables is more than 60 days old?

   Right: 20%. Total = $150,000. More than 60 days = $18,000 + $12,000 = $30,000. $30,000 / $150,000 = 20%.

   - 8%: That counts only the over-90 bucket. More than 60 days includes the 61-90 bucket too.
   - 44%: That adds the 31-60 bucket, which is not more than 60 days old.
   - 25%: That divides $30,000 by $120,000, leaving the old receivables out of the total.

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5. A contractor places an $80,000 loader in service and elects out of bonus depreciation and does not use section 179. As 5-year MACRS property with the half-year convention, what is the year-two tax depreciation?

   Right: $25,600. The 5-year half-year table gives 32% for year two: 0.32 x $80,000 = $25,600.

   - $16,000: That is the 20% year-one rate. Year two uses 32%.
   - $15,360: That is the 19.2% year-three rate.
   - $32,000: That is a full 40% rate with no half-year convention. The table rate for year two is 32%.

6. In 2026 a contractor buys a $120,000 excavator. For its books it uses straight line with an 8-year life and $20,000 salvage. For federal tax it takes 100% bonus depreciation. How much larger is the year-one tax deduction than the year-one book depreciation?

   Right: $107,500. Book = ($120,000 - $20,000) / 8 = $12,500. Tax with 100% bonus = $120,000. Difference = $120,000 - $12,500 = $107,500.

   - $11,500: That uses the 20% MACRS year-one deduction ($24,000) instead of 100% bonus: $24,000 - $12,500 = $11,500.
   - $105,000: That figures book depreciation as $120,000 / 8 = $15,000, forgetting to subtract salvage.
   - $100,000: That subtracts the salvage value, not the year's book depreciation.

7. For tax years beginning in 2026, what are the federal section 179 expensing limit and the purchase level where it starts to shrink?

   Right: $2,560,000, reduced above $4,090,000. Rev. Proc. 2025-32 sets the 2026 limit at $2,560,000, reduced dollar for dollar once section 179 purchases exceed $4,090,000.

   - $2,500,000, reduced above $4,000,000: Those are the base amounts set for 2025. They are indexed, and the 2026 figures are higher.
   - $25,000, reduced above $200,000: Those are California's section 179 figures, not the federal ones.
   - $4,090,000, reduced above $2,560,000: That swaps the two figures. The limit is the smaller number, and the larger one is where the reduction starts.

8. A California contractor buys a $120,000 excavator in 2026. Which statement about its California tax depreciation is correct?

   Right: California does not allow bonus depreciation and caps section 179 at $25,000. Per the FTB, California does not conform to federal bonus depreciation, and its section 179 limit is $25,000, reduced once purchases pass $200,000.

   - California allows the federal 100% bonus depreciation in full: California does not conform to federal bonus depreciation.
   - California follows the federal $2,560,000 section 179 limit: California does not conform to the federal section 179 limits. Its limit is $25,000.
   - California requires completed-contract depreciation for equipment: Completed contract is a revenue method for contracts, not a depreciation method.

9. Under the GAAP revenue standard, ASC 606, how does a typical construction contractor recognize revenue on a job the owner controls as it is built?

   Right: Over time, as the work is performed for the owner. When the owner controls the work as it is built, the contractor satisfies its promise over time, so revenue is recognized over time, much like percentage of completion.

   - Only when the owner's final payment arrives at the end: That is cash timing. Revenue recognition does not wait for payment.

- Each time a progress invoice goes out to the owner: Billing is not earning. Over-billing and under-billing come from that gap.
- Only once the whole job is complete and accepted: That is completed-contract timing, which is not a free choice under GAAP.

2.11 Cash and liquidity workshop

Four worked examples on current and quick ratios, working capital, days sales outstanding, receivable aging and the bridge from profit to cash, then eleven calc problems and two concept checks. About 5 minutes of narration.

BOARD 1 Profit is not cash

Profit $90,000

Yes: profit and cash arrive at different times

- Profit: when earned
- Cash: when received
- Receivables · retention · equipment soak up cash

Four tools: ratios · DSO · aging · cash bridge

BOARD 2 Example 1: three liquidity numbers

Cash $60,000 · receivables $150,000

Retention receivable $30,000 · inventory $40,000

Current assets $280,000

Current liabilities $200,000

Current ratio = $280,000 ÷ $200,000 = 1.4

Quick ratio = ($280,000 − $40,000) ÷ $200,000

Quick ratio = 1.2

Working capital = $280,000 − $200,000 = $80,000

- Two ratios · one dollar amount
- $30,000 of it is retention, not spendable

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BOARD 3 Example 2: days sales outstanding

DSO = receivables ÷ annual credit sales × 365

Credit sales $1,095,000

$1,095,000 ÷ 365 = $3,000 a day

Receivables $150,000

$150,000 ÷ $3,000 = 50 days

- Terms net 30: about 20 days late
- Each day of DSO ≈ $3,000 tied up

50 → 35 days = 15 days

15 × $3,000 = $45,000 freed

- Late customers borrow from you, interest free
- Supplier terms 1/15, net 45: 1% off within 15 days

Otherwise full price by day 45

BOARD 4 Example 3: aging the receivables

What the 50-day average hides

Age of bill	Amount
0–30 days	$60,000
31–60 days	$45,000
61–90 days	$25,000
Over 90 days	$20,000

- Total $150,000 = balance sheet

Net 30: past due $90,000 = 60%

✓ Past 60 days: $45,000 = 30% · call first

- Aging names the customers behind DSO
- Retention: own line, due at release

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BOARD 5 Example 4: from profit to cash

Profit $90,000

- + Depreciation $10,000 (no cash)
- – Receivables up $85,000
- – Retention receivable up $30,000
- + Payables up $5,000

90 + 10 – 85 – 30 + 5 (thousands)

Cash change = –$10,000

- Receivables up = cash used · payables up = cash supplied

A short form of the cash flow statement

BOARD 6 Common trap: wrong base, wrong bucket

✗ DSO on ~~total sales~~

✓ DSO on credit sales

- Full year of sales · 365 days

✗ Retention receivable = ~~cash for payroll~~

- Current asset, but locked until release

✗ Good ratio = ~~cash on Friday~~

✓ Ratios = snapshot · forecast = timing

BOARD 7 Recap

- Ratios: current, quick · dollars: working capital
- DSO = receivables ÷ annual credit sales × 365
- Aging: which bills are getting old
- Bridge: profit ± depreciation, receivables, retention, payables

Profit ≠ cash

Next: 2.12 Pricing and job cost

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Key numbers and formulas

- Current ratio = $280,000 ÷ $200,000 = 1.4
- Quick ratio = ($280,000 − $40,000) ÷ $200,000
- Quick ratio = 1.2
- Working capital = $280,000 − $200,000 = $80,000
- DSO = receivables ÷ annual credit sales × 365
- $1,095,000 ÷ 365 = $3,000 a day
- $150,000 ÷ $3,000 = 50 days
- 50 → 35 days = 15 days
- 15 × $3,000 = $45,000 freed
- Net 30: past due $90,000 = 60%
- 90 + 10 − 85 − 30 + 5 (thousands)
- Cash change = −$10,000
- Profit ≠ cash

Common traps

- DSO on total sales
- Retention receivable = cash for payroll
- Good ratio = cash on Friday

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Why the tempting answers fail (from the section practice)

1. A contractor has current assets of $330,000, including $66,000 of inventory, and current liabilities of $220,000. What is its current ratio?

   Right: 1.5. Current ratio is current assets over current liabilities: $330,000 ÷ $220,000 = 1.5. Inventory stays in for this ratio.

   - 1.2: That is the quick ratio, ($330,000 − $66,000) ÷ $220,000 = 1.2. The current ratio keeps inventory in.
   - 0.67: That divides liabilities by assets, $220,000 ÷ $330,000. The ratio puts current assets on top.
   - $110,000: That is working capital, $330,000 − $220,000. It is a dollar amount, not a ratio.

2. A contractor has current assets of $250,000, including $50,000 of inventory. Current liabilities are $160,000. What is its quick ratio?

   Right: 1.25. Take inventory out of current assets first: $250,000 − $50,000 = $200,000. Then $200,000 ÷ $160,000 = 1.25.

   - 1.56: That is the current ratio, $250,000 ÷ $160,000, with the inventory still in.
   - 2.27: That subtracts the inventory from the liabilities instead: $250,000 ÷ $110,000. Inventory comes out of the assets.
   - $90,000: That is working capital, $250,000 − $160,000, a dollar amount rather than a ratio.

3. A contractor has current assets of $400,000 and current liabilities of $300,000. It draws $50,000 on its line of credit, due within the year, and keeps the cash. What is its working capital now?

   Right: $100,000. Cash rises $50,000 and current liabilities rise $50,000: $450,000 − $350,000 = $100,000. Borrowing short term does not change working capital.

   - $150,000: That adds the cash but forgets the new $50,000 debt due within the year.
   - $50,000: That counts the loan as a liability but forgets the cash it brought in.
   - 1.29: That is the new current ratio, $450,000 ÷ $350,000. Working capital is a dollar amount.

4. A contractor's receivables are $90,000. This year it had $900,000 of total sales, of which $730,000 were on credit. Its job costs were $584,000. What is its days sales outstanding?

   Right: 45 days. Credit sales per day = $730,000 ÷ 365 = $2,000. Then $90,000 ÷ $2,000 = 45 days.

   - 36.5 days: That uses total sales, $90,000 ÷ $900,000 × 365. Cash sales never become receivables, so they do not belong in the base.
   - 56.25 days: That uses job cost, $90,000 ÷ $584,000 × 365. Receivables are billed at price, so the base is credit sales.
   - 8.1 days: That is $730,000 ÷ $90,000, how many times receivables turn over in a year. It is not a number of days.

5. A contractor has $1,460,000 of annual credit sales. It cuts its days sales outstanding from 55 days to 40 days. It pays suppliers in 30 days. About how much cash does the faster collection free up?

   Right: $60,000. Daily credit sales are $1,460,000 ÷ 365 = $4,000. Fifteen fewer days × $4,000 = $60,000.

   - $160,000: That is the receivables still tied up at 40 days, 40 × $4,000, not the amount freed.
   - $220,000: That is the receivables tied up at the old 55 days, 55 × $4,000.
   - $100,000: That multiplies the old 25-day gap between collecting and paying suppliers. The supplier terms did not change.

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6. A contractor's terms are net 30. Its aging shows $96,000 current (0 to 30 days), $64,000 at 31 to 60 days, $24,000 at 61 to 90 days, and $16,000 over 90 days. What share of its receivables is past due?
   Right: 52%. Past due = everything past 30 days: $64,000 + $24,000 + $16,000 = $104,000. $104,000 ÷ $200,000 = 52%.
   - 8%: That counts only the bills over 90 days, $16,000 ÷ $200,000. With net 30 terms, every bill past 30 days is past due.
   - 20%: That counts only the bills past 60 days, $40,000 ÷ $200,000. The 31 to 60 day bills are past net 30 terms too.
   - 48%: That is the current share, $96,000 ÷ $200,000, the bills still within terms.
7. This year a contractor earned $120,000 of profit after $15,000 of depreciation. Receivables rose $70,000, retention receivable rose $25,000, and payables rose $10,000. Ignoring other items, how did its cash change?
   Right: Up $50,000. $120,000 + $15,000 depreciation − $70,000 − $25,000 + $10,000 = $50,000. Depreciation used no cash, and higher payables kept cash longer.
   - Up $120,000: That treats profit as cash. Growing receivables and retention hold back $95,000 of it.
   - Up $20,000: That subtracts depreciation instead of adding it back. Depreciation lowered profit but spent no cash.
   - Up $30,000: That subtracts the rise in payables. Owing suppliers more means you have not paid that cash out yet.
8. A contractor has billed $400,000 on a job with 5% retention, and the owner has paid every bill less retention. Costs paid so far are $360,000. How much cash has the job produced so far?
   Right: $20,000. Collected = $400,000 × 95% = $380,000. Cash produced = $380,000 − $360,000 = $20,000. Half the $40,000 profit sits in retention.
   - $40,000: That is the profit on paper, $400,000 − $360,000. The $20,000 of retention has not been collected.
   - $38,000: That takes 5% off the profit, not off the billings. Retention is held from each payment.
   - $22,000: That figures retention on cost, 5% × $360,000. Retention is held from what was billed.
9. A contractor has current assets of $300,000 and current liabilities of $200,000. It uses $50,000 of cash to pay suppliers. What is its new current ratio?
   Right: 1.67. Both sides fall by $50,000: $250,000 ÷ $150,000 = 1.67. Working capital stays $100,000, but the ratio rises.
   - 1.5: That is the ratio before the payment. Paying a bill with cash changes both totals.
   - 1.25: That lowers cash but leaves the paid bills in liabilities: $250,000 ÷ $200,000.
   - 2.0: That removes the bills but leaves the cash in assets: $300,000 ÷ $150,000.
10. A contractor buys $5,000 of materials with terms 1/15, net 45. If he pays on day 12, what does he pay?
    Right: $4,950. 1/15 means 1% off if paid within 15 days. Day 12 qualifies: $5,000 − $50 = $4,950.
    - $5,000: That is the full invoice. Paying within 15 days earns the 1% discount.
    - $4,850: That takes $150 off, three times the 1% the terms allow.
    - $4,250: That reads the 15 as a 15% discount. The 15 is the number of days.
11. Next month a contractor opens with $30,000 of cash. It expects $85,000 of receipts and $140,000 of payments. It wants at least $20,000 on hand at month end. How much should it plan to draw on its line of credit?

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Right: $45,000. $30,000 + $85,000 − $140,000 = −$25,000. To end at $20,000, draw $25,000 + $20,000 = $45,000.

- $25,000: That only covers the shortfall and ends the month at zero, below the $20,000 cushion.
- $55,000: That is payments minus receipts, $140,000 − $85,000. It forgets the $30,000 opening cash.
- $20,000: That is just the cushion. The month is also $25,000 short before any cushion.

12. A contractor's days sales outstanding rose from 38 to 52 days while its sales held steady. What does that most directly mean?

    Right: Customers are taking longer to pay, so more cash is tied up in receivables. DSO measures how long bills take to turn into cash. With sales steady, a higher DSO means slower collection and more cash waiting in receivables.

    - Each job's profit margin has fallen by about fourteen points: DSO counts days, not margin points. Margin can be unchanged while collections slow down.
    - The company is paying its own suppliers faster than before: DSO looks at what customers owe you, not at how fast you pay suppliers.
    - More materials are sitting in inventory in the yard: Inventory is not part of DSO. The measure uses receivables and credit sales.

13. A contractor's current assets include $40,000 of retention receivable on a private job that is still under way. Why can't it count on that money for this month's payroll?

    Right: It cannot be collected until the retention is released after completion. Retention is earned and counts as a current asset, but the owner holds it until release after completion. It is not spendable cash this month.

    - It is a liability, so it lowers working capital instead: Retention receivable is money owed to the contractor, an asset, not a liability.
    - It belongs to the subs, so it never counts as an asset: Only the subs' shares pass through to them when retention is paid. The contractor's own retention is its asset.
    - It must be taxed before it can be spent on wages: Tax timing is not what holds retention back. The owner keeps it until release.

2.12 Pricing and job-cost workshop

Five worked examples on markup and margin conversions, labor burden, the overhead rate and its recovery, a bid built from cost, overhead and margin, break-even and retention's effect on cash; thirteen calc problems and two concept checks. About 5 minutes of narration.

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BOARD 1 Markup or margin?

Markup 30% vs margin 30%

No: the margin price is higher

- Markup = profit ÷ cost · margin = profit ÷ price

  Cost $10,000: markup price $13,000

  Margin price ≈ $14,286

  Margin = markup ÷ (1 + markup)

  Markup = margin ÷ (1 − margin)

Watch the base

BOARD 2 Example 1: convert both ways

Markup 25%

25% ÷ 1.25 = 20%

25% markup = 20% margin

Target margin 30%

30% ÷ 70% ≈ 42.9%

30% margin ≈ 43% markup

- Margin < markup, always

BOARD 3 Example 2: labor burden

Wage $40.00 an hour

Employer FICA 7.65% × $40 = $3.06

Workers' comp (say 10%) = $4.00

Real rate: by trade and insurer

Benefits = $5.00

Burdened rate = $52.06 an hour

✓ Bid the burdened rate

- CA unemployment and training tax: first $7,000 of wages (2026)

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BOARD 4 Example 3: overhead rate and recovery

Overhead budget $180,000

Projected direct labor $450,000

Rate = $180,000 ÷ $450,000 = 40% of labor

Job labor $25,000 × 40% = $10,000

Actual labor $400,000

Recovered = 40% × $400,000 = $160,000

Under-recovered $20,000

✗ Rate built on volume you ~~never reach~~

BOARD 5 Example 4: the bid price

Materials $25,000 · tax rate 8%

Tax = $2,000, a cost on lump sum

Labor $23,000 · subs $14,000

Direct cost $64,000

Overhead 12.5% × $64,000 = $8,000

Loaded cost $72,000

Price = $72,000 ÷ 0.90

Bid $80,000 · profit $8,000 = 10%

✗ $72,000 × 1.10 = $79,200

• Only ≈ ~~9.1%~~ margin

BOARD 6 Example 5: break-even

Fixed overhead $240,000 a year

Left after direct cost: 20% of revenue

Break-even = $240,000 ÷ 0.20

= $1,200,000 a year

• Below it: a losing year

✗ Not ÷ ~~0.80~~

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BOARD 7 Retention eats the margin

Bid $80,000 · margin 10%

Retention 5% (private commercial)

5% × $80,000 = $4,000 held

Profit $8,000

Half the profit waits in retention

✓ Plan or finance the wait

BOARD 8 Common trap and recap

✓ Cost ÷ 0.70 = 30% margin

✗ Cost × 1.3 = 30% markup, ~~smaller price~~

✗ Labor at ~~pay rate~~

✗ Rate on volume you ~~never reach~~

Margin = markup ÷ (1 + markup)

Price = loaded cost ÷ (1 – margin)

Next: 2.13 Case lab: the cash crunch

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Key numbers and formulas

- Cost $10,000: markup price $13,000
- Margin price ≈ $14,286
- Margin = markup ÷ (1 + markup)
- Markup = margin ÷ (1 – margin)
- 25% ÷ 1.25 = 20%
- 25% markup = 20% margin
- 30% ÷ 70% ≈ 42.9%
- 30% margin ≈ 43% markup
- Employer FICA 7.65% × $40 = $3.06
- Workers' comp (say 10%) = $4.00
- Benefits = $5.00
- Burdened rate = $52.06 an hour
- Rate = $180,000 ÷ $450,000 = 40% of labor
- Job labor $25,000 × 40% = $10,000
- Recovered = 40% × $400,000 = $160,000
- Under-recovered $20,000
- Tax = $2,000, a cost on lump sum
- Direct cost $64,000
- Overhead 12.5% × $64,000 = $8,000
- Loaded cost $72,000
- Price = $72,000 ÷ 0.90
- Bid $80,000 · profit $8,000 = 10%
- Break-even = $240,000 ÷ 0.20
- = $1,200,000 a year
- 5% × $80,000 = $4,000 held
- Half the profit waits in retention
- Price = loaded cost ÷ (1 – margin)

Common traps

- Rate built on volume you never reach
- $72,000 × 1.10 = $79,200
- Not ÷ 0.80
- Cost × 1.3 = 30% markup, smaller price
- Labor at pay rate
- Rate on volume you never reach

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Why the tempting answers fail (from the section practice)

1. A job priced at $9,600 carried a 20% markup on cost. What was the direct cost?
   Right: $8,000. Price = cost × 1.20, so cost = $9,600 ÷ 1.20 = $8,000. Check: $8,000 + 20% = $9,600.
   - $12,000: That adds 25% to the price, $9,600 × 1.25. The markup was already inside the price.
   - $7,680: That takes 20% off the price, $9,600 × 0.80, as if 20% were a margin on price. The markup is on cost.
   - $1,920: That is 20% of the price, $9,600 × 0.20. It is neither the cost nor the actual markup dollars.
2. A remodeler adds a 40% markup to cost. What profit margin on the selling price does that give?
   Right: 28.6%. Margin = markup ÷ (1 + markup) = 40% ÷ 140% = 28.6%.
   - 40%: That is the markup itself. The margin is figured on the larger price, so it is smaller.
   - 66.7%: That divides 40% by 60%, the margin-to-markup formula run the wrong way.
   - 71.4%: That is 100% ÷ 140%, the share of the price that is cost, not profit.
3. A contractor wants a 15% margin on its selling price. What markup on cost does it need?
   Right: 17.6%. Markup = margin ÷ (1 – margin) = 15% ÷ 85% = 17.6%.
   - 15%: Using the same number assumes markup and margin are equal. The markup must be larger.
   - 13.0%: That is 15% ÷ 115%, the markup-to-margin formula used in the wrong direction.
   - 85%: That is 1 – 15%, the share of the price left for cost. It is not a markup.
4. A job's loaded cost is $63,000. The contractor wants a 30% margin on the selling price. What price must it bid?
   Right: $90,000. Price = cost ÷ (1 – margin) = $63,000 ÷ 0.70 = $90,000. Profit $27,000 is 30% of $90,000.
   - $81,900: That adds a 30% markup, $63,000 × 1.30. Profit of $18,900 is only about 23% of that price.
   - $27,000: That is the profit at the right price, not the price itself.
   - $210,000: That divides by the margin, $63,000 ÷ 0.30. Divide by one minus the margin.
5. A carpenter earns $36.00 an hour. The employer's Social Security and Medicare match is 7.65%, workers' comp costs 9% of wages, and benefits cost $4.50 an hour. What is the burdened hourly rate?
   Right: $46.49. $36.00 + $2.75 FICA (7.65%) + $3.24 comp (9%) + $4.50 benefits = $46.49.
   - $41.99: That leaves out the $4.50 of benefits.
   - $49.25: That uses 15.3% for Social Security and Medicare. The worker's half is withheld from pay, so the employer adds only 7.65%.
   - $38.75: That adds only the payroll tax match and forgets workers' comp and benefits.
6. A contractor's job took 220 labor hours at a burdened rate of $48 an hour. Materials were $9,400 and a sub billed $6,200. What was the total direct cost?
   Right: $26,160. Labor = 220 × $48 = $10,560. Direct cost = $10,560 + $9,400 + $6,200 = $26,160.
   - $10,560: That is the labor alone. Materials and the sub are direct costs of the job too.
   - $19,960: That is labor plus materials. The sub's bill traces to this job, so it is a direct cost.
   - $15,600: That is materials plus the sub. It leaves out the labor.
7. A company budgets $210,000 of overhead. It projects $1,400,000 of direct cost and $1,750,000 of revenue, and it allocates overhead on direct cost. A job has $60,000 of direct cost and a price of $80,000. How much overhead should the job carry?

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Right: $9,000. Rate = $210,000 ÷ $1,400,000 = 15% of direct cost. Job overhead = 15% × $60,000 = $9,000.

- $7,200: That uses the revenue rate, 12%, on the job's cost. The company chose direct cost as its base.
- $12,000: That applies the 15% rate to the job's price. The rate was built on direct cost, so apply it to cost.
- $9,600: That applies a revenue-based 12% to the price. It is a valid method, but not the one this company uses.

8. A contractor set its overhead rate at 40% of direct labor, from a $200,000 overhead budget and $500,000 of projected labor. Actual labor came in at $425,000, and actual overhead was $200,000, as budgeted. How much overhead went unrecovered?

   Right: $30,000. Bids recovered 40% × $425,000 = $170,000. $200,000 − $170,000 = $30,000 unrecovered.

   - $0: The budget was met, but the rate assumed more labor. Less volume means less overhead recovered.
   - $75,000: That is the labor shortfall, $500,000 − $425,000. Only 40% of it was meant to carry overhead.
   - $170,000: That is the overhead recovered, not the amount left unrecovered.

9. Direct cost on a job is $40,000. The contractor adds 20% overhead, then 10% profit on the overhead-loaded cost. What is the bid?

   Right: $52,800. $40,000 × 1.20 = $48,000 loaded cost. $48,000 × 1.10 = $52,800.

   - $52,000: That adds 30% to direct cost. The profit is figured on the loaded cost, not on direct cost.
   - $48,000: That stops after overhead and leaves out the profit.
   - $53,333: That divides $48,000 by 0.90, a 10% margin on price. The stem asks for 10% on cost.

10. A contractor's fixed overhead is $270,000 a year. On average, its jobs leave 18% of revenue after direct cost. What yearly revenue does it need to break even?

    Right: $1,500,000. Break-even = fixed cost ÷ share left after direct cost = $270,000 ÷ 0.18 = $1,500,000.

    - $329,268: That divides by 0.82, the share that direct cost uses up. Divide by what is left.
    - $318,600: That adds 18% to overhead. Break-even divides; it does not mark up.
    - $48,600: That is 18% of the overhead, which has no meaning here.

11. A private job bills $120,000 this month, and the owner holds 5% retention. The work billed cost $110,400, an 8% margin. The costs are paid when this bill is paid. How much of this bill's profit arrives in cash now?

    Right: $3,600. Cash received = $120,000 − $6,000 = $114,000. Less costs paid of $110,400 leaves $3,600 now.

    - $9,600: That is the full profit, $120,000 − $110,400. Of it, $6,000 is held in retention.
    - $6,000: That is the retention held, not the profit received.
    - $9,120: That takes 5% off the profit. Retention is held from the whole payment, so it takes a bigger bite.

12. On a lump-sum job, a contractor buys $40,000 of materials where the sales tax rate is 8.75%. What material cost should the bid carry?

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Right: $43,500. On a lump-sum job the contractor is the consumer and pays the tax: $40,000 × 1.0875 = $43,500.

- $40,000: That leaves out the $3,500 of tax, which then comes out of profit.
- $36,500: That subtracts the tax instead of adding it.
- $3,500: That is the tax alone. The materials themselves cost $40,000.

13. A job was bid at $50,000 with an estimated cost of $42,500. Actual cost came in $3,000 over the estimate. What margin did the job earn?

    Right: 9%. Actual cost = $45,500. Profit = $50,000 − $45,500 = $4,500. Margin = $4,500 ÷ $50,000 = 9%.

    - 9.9%: That divides profit by cost, $4,500 ÷ $45,500. That is the markup earned, not the margin.
    - 15%: That is the margin the bid planned, before the overrun.
    - 6%: That is the overrun as a share of price, $3,000 ÷ $50,000, not the margin left.

14. A contractor's overhead rate was built on the volume it expected. Why does a slow year leave the jobs underpriced?

    Right: Fewer jobs carry the rate, so less overhead is recovered than budgeted. Overhead is mostly fixed. With less work carrying the same rate, the bids recover less than the budget, and the gap comes out of profit.

    - Overhead costs rise on their own whenever sales and job counts fall: Fixed overhead stays about the same. The problem is less work to spread it over.
    - The overhead rate starts applying to the price instead of to the cost: The base does not change in a slow year. The volume behind it does.
    - A slow year moves overhead out of the rate and into direct job cost: Overhead stays overhead. It does not turn into direct cost.

15. An estimator prices labor at the workers' pay rate instead of the burdened rate. What is the main effect on the bid?

    Right: Every hour is underpriced by its payroll taxes, insurance and benefits. The burdened rate adds the employer's payroll taxes, workers' comp and benefits to the wage. Leaving them out underprices every labor hour.

    - The bid overstates labor and loses work to lower-priced rivals: The pay rate is lower than the burdened rate, so labor is understated, not overstated.
    - Overhead ends up counted twice, once in the labor rate and once in markup: Leaving out burden does not double count anything. It leaves real costs out.
    - The workers' withheld taxes go unpaid because the bid left them out: Withholding happens in payroll whatever the bid says. The issue is the employer's added cost.

2.13 Case lab: the cash crunch

Case lab: a profitable builder with slow customers, retention held and payroll due works through payday, trust fund taxes, sub payment, retention and prompt-payment clocks, and a line of credit draw. About 3 minutes of narration.

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BOARD 1 Meet the company

Profit this year $210,000

Receivables $380,000

DSO 58 days

Bank $35,000

- Growth: costs paid before bills are paid
- Profitable, but short of cash

BOARD 2 The squeeze

Payday Fri Oct 16: net pay $48,000

Payroll tax deposit $14,000 (incl. withheld)

Supplier $25,000

Retention 5% × $1,200,000 = $60,000

Warehouse complete Sept 1

Undisputed $80,000 bill · demand 50 days ago

- Still unpaid

Out within days: $48,000 + $14,000 + $25,000 = $87,000

BOARD 3 Money in

Progress payment $90,000

- $30,000 of it is for the electrical sub's work

Whose money is the $30,000?

Line of credit $150,000, unused

Keep at least $20,000 in the bank

$35,000 + $90,000 = $125,000

- Not all of it belongs to the builder

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BOARD 4 Three tempting ideas

✗ Pay the crew ~~late~~

✗ Hold the ~~withheld taxes~~

✗ Use the ~~sub's $30,000~~

✗ Crew, tax agency, sub are ~~not lenders~~

✓ Line of credit: built for short gaps

• Clocks running: retention · overdue bill

✓ Collect hard · pay on time · borrow the gap

BOARD 5 Next time

• Bill promptly · chase late invoices

• Watch DSO and aging monthly

• Monthly cash forecast

✓ Line of credit before you need it

• Price retention and slow pay into bids (lesson 2.12)

Key numbers and formulas

- Retention 5% × $1,200,000 = $60,000
- Out within days: $48,000 + $14,000 + $25,000 = $87,000
- $35,000 + $90,000 = $125,000

Common traps

- Pay the crew late
- Hold the withheld taxes
- Use the sub's $30,000
- Crew, tax agency, sub are not lenders

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Why the tempting answers fail (from the section practice)

1. Cash is short on Friday, October 16, a regular payday. The owner wants to pay the crew after the slow customers pay. What does California law require?

   Right: Pay the wages on the regular payday; a customer's late payment does not move it. Labor Code section 204 makes wages due on the regular paydays the employer sets in advance. A customer paying late is not an exception, so the gap must be financed.

   - Pay within 30 days of the payday, since the customer has not yet paid: No 30-day grace period applies to regular wages. They are due on the designated payday.
   - Pay late only the workers who worked on the slow-paying jobs: Every worker's wages are due on the payday, whichever job they worked on.
   - Pay the crew once the retention on the warehouse is released: Retention timing is between the builder and the owner. It does not change when wages are due.

2. To save cash, the owner suggests paying net wages Friday but holding the $14,000 tax deposit, including the amounts withheld from workers, for a few weeks. What is the main risk?

   Right: Withheld taxes are held in trust; a responsible person who willfully fails to pay them can owe them personally. Withheld income tax and the worker's share of FICA are trust fund taxes. The IRS can assess a penalty equal to the unpaid trust fund tax against a responsible person who willfully fails to pay. Paying other creditors first is a sign of willfulness.

   - A small late fee applies, so holding the deposit works like a cheap short-term loan: Holding trust fund money is not a loan. It can create personal liability for the full unpaid amount, on top of late deposit penalties.
   - There is no risk, because payroll taxes are settled only once a year: Deposits follow a schedule, monthly or semiweekly, not a once-a-year settlement.
   - The workers lose credit for the withheld amounts, but the company itself is protected: The employer collected the money from the workers, so the company and its responsible people carry the risk.

3. The $90,000 progress payment includes $30,000 for the electrical sub's work, and the subcontract does not change the timing. When must the builder pay the sub its share?

   Right: Within 7 days after receiving the progress payment. Business and Professions Code section 7108.5 requires payment to the sub within seven days after receipt of each progress payment, unless agreed otherwise in writing. Late payment brings a 2% per month penalty and discipline.

   - Within 10 days after receiving the progress payment: Ten days is the private retention clock for passing retention on to subs, not the progress payment clock.
   - Within 30 days after the sub sends a written demand: Thirty days after a demand is the owner's deadline to pay the direct contractor under Civil Code section 8800.
   - When the owner releases retention at the end: The sub's progress money cannot wait for retention. It is due seven days after the builder is paid.

4. The whole warehouse was completed on September 1, 2026, and there is no dispute over the retention. By what date must the owner pay the $60,000 retention to the builder?

   Right: October 16, 2026. Civil Code section 8812 gives a private owner 45 days after completion of the work of improvement. September 1 plus 45 days is October 16.

   - October 1, 2026: That counts 30 days, the progress payment clock after a demand, not the retention clock.

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- October 31, 2026: That counts 60 days, the public works retention rule. This is a private job.
- September 11, 2026: That counts 10 days, the time the builder has to pass retention on to subs after receiving it.

5. The other owner received a proper written demand for the undisputed $80,000 progress payment 50 days ago, and the contract does not change the statutory terms. What does Civil Code section 8800 give the builder?

   Right: A 2% per month penalty on the amount wrongfully withheld, in place of interest. Section 8800 requires an undisputed progress payment within 30 days after the demand, unless otherwise agreed in writing. An owner who violates it owes 2% per month on the amount wrongfully withheld, $1,600 a month here, in place of interest.

   - Interest at the legal rate, starting only when the job is complete: The statute replaces interest with a 2% per month penalty, and the clock runs from the demand, not completion.
   - The right to deduct the $80,000 from the retention it owes subs: Money owed to subs is theirs. An owner's late payment does not let the builder keep it.
   - Nothing more, because the contract alone controls the payment: The statute applies unless the owner and builder agreed otherwise in writing, and the stem says they did not.

6. Over the next few days the builder starts with $35,000 and receives the $90,000 payment. It must pay $48,000 of net payroll, the $14,000 tax deposit, the sub's $30,000, and the $25,000 supplier. It wants to keep $20,000 in the bank. How much should it draw on the line of credit?

   Right: $12,000. Cash in hand = $35,000 + $90,000 = $125,000. Payments = $117,000. That leaves $8,000, so draw $12,000 to keep $20,000. A line of credit fits this short gap.

   - $0: The bills can be paid, but only $8,000 would be left, below the $20,000 cushion.
   - $20,000: That draws the whole cushion and ignores the $8,000 left after the bills.
   - $102,000: That forgets the $90,000 payment received on Monday.

2.14 Case lab: from bid to year-end

Case lab: a lump-sum kitchen remodel from bid to year end, covering sales tax on materials, a change order, a work in progress report, use tax, payroll tax deposit timing and record keeping; ends with the Chapter 2 added-numbers review. About 4 minutes of narration.

BOARD 1 The bid

Lump-sum kitchen, 2026
Materials $30,000 · tax rate 9%
Labor $27,300 · subs $12,000
Overhead 12.5% of direct cost
Target margin 10%
Who pays the tax? What is the bid?

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BOARD 2 The change order

Upgrade +$6,500 price

+$5,200 cost · +1 week

✗ "Just go ahead"

BOARD 3 Work in progress

Price $96,500

Est. total cost $77,200

Cost to date $38,600

Billed $52,000

Over or under, by how much?

BOARD 4 Tile from out of state

Tile $3,000, no CA tax charged

- Installed in California

BOARD 5 Payroll tax deposits

Monthly depositor (lookback under $50,000)

October taxes $6,800

- Never $100,000 in a day

Nov 15, 2026 = Sunday

BOARD 6 Year-end records

Payroll records · income tax files

Keep or shred?

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BOARD 7 Chapter 2 review: the added numbers

- Current, quick = ratios · working capital = dollars
- DSO = receivables ÷ annual credit sales × 365
- Margin = markup ÷ (1 + markup)
- Price = loaded cost ÷ (1 − margin)
- Employer FICA match 7.65%
- CA unemployment and training tax: first $7,000 (2026)
- Wages on payday · subs within 7 days
- Private retention: 45 days, then 10 days to subs
- Undisputed progress payment: 30 days after demand
- Late: 2% a month

Chapter 2: the added numbers (taxes)

- Monthly deposit: 15th of next month (next business day)
- Payroll tax records: at least 4 years
- California estimated tax: 30% · 40% · 0% · 30%
- SE tax 15.3% × 92.35% of profit
- 1099-NEC line $2,000 (2026 payments)
- Backup withholding 24%
- §460 small-contractor test $32,000,000 (2026)

Next: Chapter 2 quiz

Common traps

- "Just go ahead"

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Why the tempting answers fail (from the section practice)

1. Materials are $30,000 plus 9% sales tax, labor is $27,300, and subs are $12,000. Overhead is 12.5% of direct cost, and the target margin is 10% of price. What is the right lump-sum bid?

   Right: $90,000, with the $2,700 of tax carried as a cost. On a lump-sum job the contractor is the consumer of the materials, so the $2,700 tax is a cost. Direct cost $72,000 × 1.125 = $81,000; $81,000 ÷ 0.90 = $90,000.

   - $86,625, plus $2,700 of sales tax shown to the homeowner: A lump-sum contractor does not charge sales tax on the finished work. The tax it pays the supplier belongs in its own cost.
   - $86,625, because the supplier's tax is the homeowner's to pay: The contractor pays the tax as the consumer. Leaving it out of the cost takes it out of profit.
   - $89,100, adding a 10% markup to the $81,000 loaded cost: The tax is handled right, but a 10% markup gives only about a 9.1% margin. Divide by 0.90 instead.

2. The homeowner asks for $6,500 of upgraded cabinets that add one week, and says to go ahead and settle up later. What should the contractor do first?

   Right: Put it in writing: scope, the $6,500, and the effect on payments or completion date. Under Business and Professions Code section 7159.6, a change order is not enforceable against the buyer unless it sets out the scope, the amount added or subtracted, and the effect on progress payments or the completion date.

   - Go ahead on the oral request, then add the $6,500 to the final bill at the end: An oral change order cannot be enforced against the homeowner as a change order, so the $6,500 is at risk.
   - Install the cabinets first, then email the new price and the new date afterward: A price sent after the work is done does not meet the change-order rule.
   - Write down only the $6,500 price; the one-week schedule change can stay oral: The statute requires the effect on progress payments or the completion date, not just the price.

3. The price is now $96,500, estimated total cost is $77,200, cost to date is $38,600, and billings are $52,000. What does the work in progress report show?

   Right: Over-billed by $3,750, which is a liability, not profit. Percent complete = $38,600 ÷ $77,200 = 50%. Earned = 50% × $96,500 = $48,250. Billed $52,000 − $48,250 = $3,750 over-billed, a liability. On a home improvement job, payments beyond the value of work performed or material delivered, apart from the down payment, are also barred.

   - Under-billed by $3,750, so the next bill can be larger: Billings exceed what has been earned, so the job is over-billed, not under-billed.
   - Over-billed by $13,400, billings less cost to date: That compares billings with cost. Compare billings with earned revenue instead.
   - Over-billed by $7,000, against half the original price: That uses half the original $90,000 price and forgets the change order.

4. The company buys $3,000 of tile from an out-of-state website that charges no California tax, and installs it in the California kitchen. What tax result follows?

   Right: The company owes California use tax on its $3,000 cost. On a lump-sum job the contractor is the consumer of materials. For materials bought without tax from an out-of-state vendor, use tax is owed when they enter California.

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- No tax is due, because the seller is outside California: Buying across the state line does not avoid the tax. Use tax replaces the sales tax that was not charged.
- The homeowner owes use tax, because the tile ends up in the home: The contractor, not the homeowner, is the consumer of materials on a lump-sum job.
- The company must add sales tax to its bill to the homeowner: A lump-sum contractor does not charge sales tax on the finished work. It owes the tax on its own cost.

5. The company is a monthly schedule depositor, owes $6,800 for October payroll, and never reached $100,000 in a day. November 15, 2026 is a Sunday. When is the federal deposit due?

   Right: By Monday, November 16, 2026. Monthly depositors deposit by the 15th of the following month. When that day is not a business day, a deposit made the next business day is on time.

   - By Friday, November 13, 2026: The rule moves a weekend due date forward to the next business day, not back.
   - By the next business day after each payday: The next-day rule applies only when $100,000 or more builds up on one day.
   - Only when the fourth quarter return is filed: Deposits follow the deposit schedule. They do not wait for the quarterly return.

6. At year end the office wants to shred files. Which plan meets the federal and California rules?

   Right: Keep payroll and income tax records at least four years, to cover California too. The IRS and the EDD both set at least four years for payroll records. Federal income tax records are generally kept three years, but California's assessment window is generally four years, so four covers both.

   - Keep every record for three years, the usual income tax rule: Three years is the general federal income tax rule. Payroll records need at least four, and California income tax records generally four.
   - Keep payroll records two years and income tax records one year: Both periods are shorter than either agency allows.
   - Keep only the filed returns; the records behind them can go: The records behind a return are what support it in an audit, so they must be kept too.

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