

# On-Site

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THE CONTRACTOR'S CORNER

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## Construction accounting

# Learn the ABCs of activity-based costing

**Y**our latest project might be running on budget, but how can you determine whether your work in progress is really boosting profits or hurting the bottom line? Or, if a job is exceeding forecasted costs, how do you break it down to identify the problem?

Many construction companies have addressed such issues by measuring the cost and effectiveness of individual jobsite activities. This is done through an accounting process called activity-based costing (ABC).

### Challenge and solution

As you well know, construction sites contain many “parts” — people, machinery, materials. These parts work together to complete a great many tasks, or activities, over the course of the project.

Because of the varied resources used to complete each activity, it can be challenging to calculate and track costs, efficiency and sources and uses of cash. Yet, as a contractor, you need this information to ensure you’re not wasting time, money or resources — and to bid on future projects more effectively.

In a construction context, ABC assigns cost codes (think of them as price tags) to each activity completed onsite based on the resources consumed. These cost codes define the activity; the equipment, materials and labor used to complete it; and how long it takes to finish the task. (For an example of how a code might be determined, see “4 steps to calculating a cost code” on page 3.)

### Powerful benefits

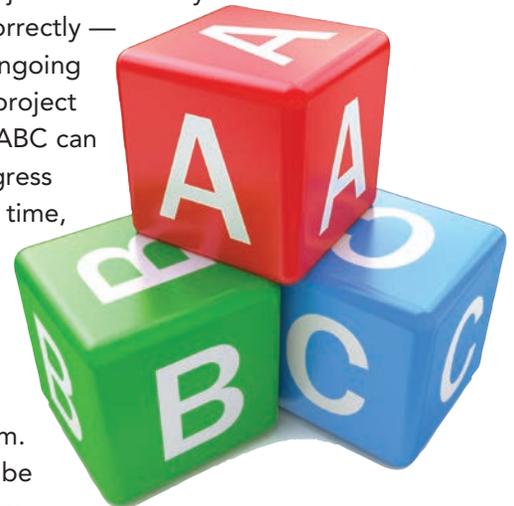
Construction companies can use ABC to more accurately estimate the cost of each activity and evaluate the process involved, as well as apply those cost estimates to future bids. The process could benefit your construction company in several powerful ways:

**Gain insight into what’s working and what can be improved.** If a job is costing more than it should, or is taking too long to complete, ABC prices out and quantifies for each task:

- ▶ The materials consumed,
- ▶ Which pieces of equipment were deployed, and
- ▶ How many labor hours were spent to complete.

You then examine that analysis to identify wastefulness and adjust as necessary.

When used correctly — that is, with ongoing reporting by project managers — ABC can track the progress of jobs in real time, so you can correct mistakes and inefficiencies before losing money to them. You also may be able to uncover



excessive spending trends, so you can better control purchasing.

**Identify what's profitable and what isn't.** The combination of direct costs (resources consumed, such as materials) and indirect costs (expenses not solely related to one project) can make it difficult to pinpoint which jobsite activities are effective and which either aren't adding value to a project or are causing wastage.

ABC provides the means to collect the necessary data on specific tasks, employees and equipment so you can determine what's helping the project and what isn't. Thus, for strategic planning purposes, the process can provide a clearer picture of what types of activities and jobs will likely boost the bottom line and enable you to grow your construction business.

**More accurate estimates.** Because ABC gives you a more detailed look at the elements driving the cost of each jobsite activity, you can naturally devise more precise estimates. With price tags attached to everything, estimators can "cut up" a prospective job into well-defined activities and then calculate estimates for each of those tasks, resulting in a more accurate overall project estimate.

If the scope changes, thereby increasing or decreasing the number of activities, it's much easier to recalculate the estimate. Activities essentially become line items that can be added or deleted.

### An intriguing challenge

Please note: We've provided here a basic overview of ABC, but don't construe this article as comprehensive or complete coverage of the topic. Also, bear in mind that implementing ABC is neither easy nor instantaneous. Software is available that can help shorten the learning curve, but you should still expect to face an arduous training process to get everyone onboard.

## 4 steps to calculating a cost code

Here are four basic steps used to create a cost code in activity-based costing:

- 1. Identify activities.** Create a list of tasks your company performs to complete a job. Define each activity in such a way that there's no overlap between them.
- 2. Allocate resources.** For each activity, list resources used. These include material, equipment, labor hours and subcontracting costs.
- 3. Calculate the per-unit cost of each resource.** Determine costs using purchase receipts. (You may have to calculate an average cost based on purchase receipts for a specific period.) Choose a standard, measurable unit of each resource and calculate the cost per unit.

For example, if a box of screw anchors holds 100 and costs \$30, the per-unit cost of screw anchors would be 30 cents if you consider one "unit" to be a single screw anchor. For labor hours, the measurable unit would be the wage paid per hour.

- 4. Determine how much of each resource is used for each activity.** Multiply the per-unit cost of each resource by the number of units consumed. Add indirect costs to determine the total cost; these may include rents, machinery payments, salaries and other expenses that don't directly contribute to completing an activity.

Discuss the idea with your CPA to get a better idea of precisely how ABC could be applied to your construction company's projects and whether it's right for you. ▀

# Project management solutions may lie in the cloud

**A** good project manager knows communication is key to delivering a job on time and within budget. When team members can't easily obtain project data, the result is often wasted time as they track down that information or, worse, duplicate efforts. Meanwhile, profit-eating costs mount and schedule overruns can occur.

Many top-level construction companies are equipping their project teams with the latest Web-based technology — specifically cloud-based solutions and mobile apps — to ensure all parties have ready access to the data needed to complete work.

## Common roadblocks

Here are some common communication roadblocks to successful project management:

**Team members don't have on-demand access to job data.** In-house software and document-management systems located on office servers



are often difficult to connect to and use by both external team members (such as project owners, architects and subcontractors) and internal team members working in the field.

Worse yet, construction businesses still relying on pencil-and-paper methods and printed documents run the risk of misplacing or losing hard copies — or not getting project updates relayed to applicable parties in a timely manner.

**Cross-functional team collaboration is difficult.** Sharing information across departments, disciplines or locations can be challenging. Face-to-face meetings aren't always possible, and spreadsheets and other static documents may not be updated until the end of the workday. Internal file-management systems, which are difficult to share with other entities, can turn into information silos. With the big picture lost, each entity has access to only one part of the project's story, and a multitude of redundancies or errors may occur.

**There are too many emails.** As you well know, every project brings with it an influx of documents — plans and drawings, requests for information, submittals, change orders and more. Email is a good communication method in some instances, but these items can easily clog inboxes and overwhelm recipients.

**Participants are using too many different tools to manage the project.** Disparate software and communication tools that may not interface well with one another can lead to lost information, wasted time and misunderstandings.

**There's inadequate transparency.** When one party doesn't know what the others are doing, things can go awry. This can lead to duplication of work, project delays and costly safety hazards.

### Accessible solutions

If your jobs are experiencing any of these problems, it may be time to consider moving to a cloud-based project management system. By eliminating the need for in-house document storage, one of these solutions can provide a broad set of users with one shared, online workspace with many points of access — so they can keep current on the most up-to-date project documentation and deliverables.

Team members equipped with mobile devices can access, update and immediately share project

information in real time, anytime, no matter where they're located. Online meetings can be held, and tasks and deadlines can be assigned to team members within the application. Everybody stays in the loop as to what's been completed, what's in progress, what's still needed and who's responsible for those tasks.

### The answer

Naturally, there's going to be an upfront cost to buy and implement the right system. You'll also probably face some adjustment issues as everyone buys in. But if inefficient project management is keeping your company from reaching its next level of success, the answer may lie in the cloud. ▲

## Take a keen interest in your company's insurance protection

**N**ot many people wake up in the morning wanting to talk about insurance. But it's important for contractors to take a keen and ongoing interest in their company's coverage. It needs to meet not only the bid requirements of every project you take on, but also the wider needs of your construction business as it grows and evolves. Let's look at some important aspects of insurance that warrant regular re-evaluation.

### Be prepared for adjustments

As you've probably noticed, many projects require endorsements to your policies — instances where an expansion of your coverage is needed, such

as adding a new project site or new drivers for your vehicles. These endorsements aren't unusual; they'll continue to come up during the normal course of business. So, be sure to maintain constant communication with your agent to ensure you're properly covered on every job.

Also review your policy's exclusions. You don't want to learn too late that something you'd thought was covered isn't. Should a claim arise, it will be better if you have paid the cost of covering items that are typically excluded. For example, your standard policies won't likely cover you in the event of a mishap involving hazardous materials. So, if you regularly deal with those substances, consider obtaining additional coverage before a problem occurs.

## Review your vehicles

This area deserves a special mention because of the vast differences from company to company. When setting up or reviewing vehicle coverage, consider how your employees use your vehicles and be sure your insurance covers all potential situations. Ask yourself some key questions.

For example, do your salespeople or estimators have cars that they drive home and keep overnight or on weekends? Have you moved on to larger projects that now require you to operate cranes or other large equipment on your jobsites? Jobsite security can affect insurance coverage and costs, too. Are your vehicles protected by sound, documented measures?

In addition to maintaining proper coverage, do you screen the driving records of employees who use your vehicles? Sometimes, you can save yourself from big headaches by keeping poor drivers from getting behind the wheels of your vehicles.

## Anticipate disasters

In recent years, clusters of hurricanes and widespread wildfires have served as cruel reminders of the importance of disaster recovery planning and the often-unavoidable necessity of policy riders.

For instance, many construction companies operating in Florida or near the Gulf Coast have seen marked increases in the wind coverage portion of their builder's risk insurance. This originally occurred because Hurricane Katrina wiped out many jobsites covered by these policies. Since then, many insurers exclude or severely limit wind damage from their basic plans, meaning that a specific rider is likely needed for such coverage.

Even if you don't work in a region typically afflicted by natural disasters, familiarizing

yourself with your builder's risk policy is essential. Generally, most construction businesses have this coverage for their projects.

But many contractors may forget to check the job documents to see who's responsible for the deductible. And considering the ever-present possibility that insurance costs have gone up, you absolutely need to know whether you're on the hook for that deductible so you don't get stuck with an unanticipated cost.

If your company has a significant amount of assets, or if an additional layer of protection would help you sleep at night, an additional coverage to consider is an umbrella policy. These protect your company against losses greater than your other coverage. Typically, umbrella policies are separate from your standard package and often provided by a different carrier.



## Protect yourself

Granted, there are more exciting developments going on in the construction industry today than insurance. But there's no getting around the general importance of risk management and the specific necessity of having the right safeguards in place with which to protect your company. And don't sell your insurer short — it may have some new products that spark your interest, after all. ▲

## Which accounting system upgrades should I look for?

*My construction company hasn't upgraded its accounting software in a while — and it shows. We've lost a few invoices, had a couple of payroll delays, and let's not even get into filing our taxes. I know we need to do better, but I don't want to overspend on system features we'll never use. Which upgrades should I focus on?*

Construction accounting is unique and complex. Each of your projects serves as an individual profit center with its own revenue, expenses and payroll. This means contractors shouldn't use an off-the-shelf system. When looking to upgrade, focus on industry-specific features such as:

**Job-cost tracking.** Contractors need to track expenses according to projects, cost codes, classes, and job phases. What separates construction-specific accounting systems from general-purpose ones is that they use job-costing modules to track costs and revenues by project. This measures actual vs. estimated costs to determine which jobs are generating positive cash flows and where costs need to be controlled. One function to upgrade is communication among the various modules to ensure everything is updating seamlessly across the board.

**Simplified payroll.** Prevailing wage rates, unions, multistate deductions and government compliance are just a few challenging aspects of construction payrolls. Your accounting software should support various forms of timecard entry and include features such as payroll reporting; certified payroll for federal, state and local agencies; Equal Employment Opportunity Act compliance; automated fringes; and multistate, multilocality and multijob processing. It's also important that your payroll data flow into the software's general ledger and job-costing modules.



**Standardized billing.**

Construction-specific billing methods include service, unit price, time and material, customized percentage of

completion, and American Institute of Architects billing. Users also should be able to use lump-sum, itemized and free-form invoices.

**Purchasing and subcontract controls.** This feature determines what's been invoiced and what committed costs remain outstanding. It also prevents overbilling on committed costs.

**Stress-free general ledger and job reports.** From income statements and cash-flow analysis (by job) to over/underbillings, production and estimated vs. actual costs, contractors should generate reports rather than spreadsheets. Your software shouldn't force you to manually create reports from spreadsheets or perform additional entry into a job journal once an invoice or timecard has been submitted.

**Strong vendor support.** Look for a vendor that provides not only initial training, but also continuing education along with the requisite patches and updates. Check references to find one with fast response times and priority support for work-stoppage issues.

**Compatibility with other systems.** Ensure the solution can integrate with other software, such as your equipment usage system. You want to be able to share information with ease — particularly with your CPA, who can help you select the ideal accounting software for your construction company's size and specialty. ▴



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