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PRODUCT COST CONTROL

THE ULTIMATE GUIDE

Cost Tracking for Modern Construction SMBs

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CHAPTER 1

5 Steps for a Successful Construction Project Budget

A construction budget is a statement of the amount of money that is available to spend over a period of time, or on a specific item, such as a building.

Generally they are derived from a Quantity Surveyors Bill of Quantities as a starting point. It may include an outline plan for how that money will be spent, and a breakdown of the items it will be spent on.

The modern construction industry typically deals with large numbers in terms of the estimated amounts but relatively small numbers with available margins.

These tighter margins demand a far greater focus on operating within budget to avoid completed projects delivering little profit or, in the worst cases, considerable losses.

So where should a company focus its efforts to stay on budget?

Let's take a look at the key areas in a successful budget.

1. Creating A Realistic Budget

One of the primary reasons contractors fail to hit their profit goals is because they are overly optimistic about their margins.

When creating / reviewing a construction project budget or estimate, you need to challenge all assumptions that have been made. Can your company perform better than they have in the past?

Unless there is established proof that you are more efficient than before, have introduced more efficient equipment, cheaper materials are available or that operations on site will be able reduce downtime, do not assume your costs will outperform the costs from the past.

Your project, however unique it might be will have other similar projects to compare to. Checking out costs of past projects with the same goals and objectives can give you great insights for your new project budget.

2. Know your Overheads

Overheads are a deep topic here at Livecosts. It is a extremely complex equation when you try to apply expected overheads to a project as they all vary so much in value, length and strain on resources. The most effective method we have seen is to at least establish what your overhead allowance should be on a project budget, this is done by calculating your overhead percentage and ensuring this is covered in your project budget. The math here is relatively straightforward:

Total overhead costs last year
% Total sales last year

= **Overhead Rate**

To get a percentage instead of a decimal after you first divide, multiply the result by 100. This will give you a percentage number that you can easily work with for a greater understanding of your overheads.

For example, if you have a 10% overhead rate, this means that your company invests 10 cents in overhead for every dollar that you make. The appropriate overhead rate is industry-specific, so you should take some time to research what the standard is for businesses in your region and that your rate is in the same ballpark.

3. Use Project Accounting Practices

Unlike traditional accounting, project accounting measures the financial performance of specific projects and phases. It requires collecting key data throughout a project, such as time and expense information.

Project accounting provides real-time data, giving firms the financial insights they need to thrive. In many cases, small decisions at key times can have a big impact on staying within a project budget.

Using an effective project management software will allow you to set up construction project budgets and allocate the various incoming costs against those initial budgets.

4. Avoid Scope Creep

In construction, it's imperative for the scope to be comprehensive, agreed upon, and understood by all parties involved.

The client, the contractors, and even the sub-contractors all need to be in agreement regarding who is doing what, who is responsible for what, when it needs to be done, and for how much. This agreement is generally formalised in a contract.

By and large, your clients don't care about the nuts and bolts of how your company produces the final result.

They may ask you, entirely out of ignorance or innocence to change direction mid-construction, erasing all chances for staying within scope.

This is where having a clearly outlined, written estimate is so important. It's less important that your client signs the document, the signature is mostly used for legal purposes, than it is for them to understand what's in the contract and how changes to the contract will be addressed.

5. Manage Variations

Variations to the initial scope of a project (also commonly known as change-orders) are not unusual for those who undertake job-based work.

Managing those changes efficiently and effectively can be tricky – but it is essential that they are managed correctly if you are to recover, and profit from, the extra work you will do outside the original scope.

Ensure that any variations are notified, costed and passed onto the client as soon as possible, in full and with a margin on top.

This may sound like common sense, but many companies manage variations badly, failing to pass on updated expenses to the client and effectively losing money on each variation.

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CHAPTER 2

Construction Overheads & 5 Methods To Allocate Them

What are Construction Overheads?

Construction Overheads refers to costs that cannot be directly attributed to one project, but instead are costs related to running the company and therefore apply to all projects the company completes. These costs can also be known as indirect costs.

Poorly tracked indirect / overhead costs can give you a false sense of job performance, so how can we calculate and distribute them?

Let's take a look at what these costs are and how to allocate them.

1. Direct Costs

First of all it is important to know what are not Overheads. Construction costs that are specifically allocable to a construction project are typically referred to as direct costs.

Common direct costs are often made up of materials, direct labour and subcontractor costs. They are typically easy to assign to a specific construction project.

2. Indirect Project Costs

Indirect costs are expenses that relate to your project activity. Unlike a direct cost, though, an indirect cost is tied to multiple projects or difficult to tie to one project. Let's look at an example, a construction contractor buys ten tons of hardcore for Project A, if it wasn't for that one project, the cost wouldn't exist, right? So that's pretty clear it's a direct cost to that project.

If the contractor uses company machines to spread and compact the material of course it wouldn't be fair for Project A to shoulder all the expenses for that piece of equipment like a direct cost. Instead, every project that uses the machinery has some responsibility for it needing oil, service work, depreciation etc. Therefore, these are indirect costs they might consider as overheads.

In short, when several projects are responsible for the expense, several projects benefit from it, but not all jobs necessarily relate to it equally.

3. General & Admin Costs

A general & administrative cost might be one that applies to the general running of the business. All projects probably benefit from it more or less equally. Examples include office rent and utilities, administrative salaries, advertising, general liability insurance, and many more.

Generally G&A costs are relatively stable despite fluctuation in the number and progress of your active projects. They support your ability to quote, take on and bill projects. If you'd still have the expense even if you had no active jobs (rent, for example), that's likely G&A cost.

In general, showing a connection between one job and its effect on a G&A expense is quite difficult. Can you see how difficult it might be to allocate more printer ink to one project!

4. Allocation of Construction Overheads

There are several methods to allocate indirect and G&A costs to projects. Companies should use the method that most closely matches their business type and that most accurately distributes costs to the projects.

Let's take a look at some methods:

Activity Based Allocation

Labour Hours
Contractors who mainly provide labour may want to allocate their indirect & G&A costs based on the number of labour hours in a period.

To do this, find the total indirect costs and the total labour hours for the period, then divide the hours into the costs to determine the cost per hour.

You can then allocate this cost for every hour of work performed on each project.

Labour Costs
Another method for contractors who mainly provide labour to allocate their indirect labor costs.

To calculate the distribution, divide total labour costs into total indirect costs to get the percentage of indirect costs.

Then, take the percentage and multiply it by the labor costs for each project. This is the additional amount that should be allocated to each project.

Material Costs
For contractors who mainly provide materials, basing the allocation on material costs may be more accurate.

The math is similar to that used for labour costs – just substitute material costs.

Equipment Hours
If your company allocates costs by equipment, then this could be the calculation that you want to use.

It's similar to the labour hours calculation – just substitute equipment hours for the labour hours.

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CHAPTER 3

6 Tips For Keeping Your Construction Budget On Track

In a recent survey by KPMG, they found that just 31% of projects came within 10% of budget and just 25% within 10% of original deadlines in the past three years.

Pretty shocking figure really.

How can we keep it on track when the project is active?

Let's take a look at some of the key areas to monitor.

1. Use Project Accounting Methods

Unlike traditional accounting, project accounting measures the financial performance of specific projects. It requires collecting key data throughout a project, such as time and expense information.

Project accounting provides real-time data, giving firms the financial insights they need to thrive. In many cases, small decisions at key times can have a big impact on staying within a project budget.

2. Establish Phase Budgets

Measure your financial performance regularly by breaking your projects total construction budget into shorter intervals or bodies of work (phases).

By tracking all incoming project expenses against these phase budgets, over runs can be caught earlier, giving you an opportunity to try and recoup as the project progresses.

3. Manage Scope Creep

With the initial phase budgets set now it's time to manage it. Changes on a project are unavoidable but scope creep refers to uncontrolled growth or changes in the scope of a project.

Establish a known company communication process and ensure your team are very skilled in this area. This is essential for adjusting budgets and a clear communication channel can keep the project moving forward.

4. Track Staff Time

In most construction companies, your team is your most valuable asset. It is difficult to know how profitable projects are without knowing where their time is allocated.

Again, allocating time to smaller phase budgets will give you great data when a similar task shows up again on another project.

With the right software, time tracking is nearly effortless. After implementing practices for tracking time, many companies discover that seemingly profitable phases are not. Tracking staff time is often a missing ingredient in creating realistic project budgets.

5. Monitor Spend

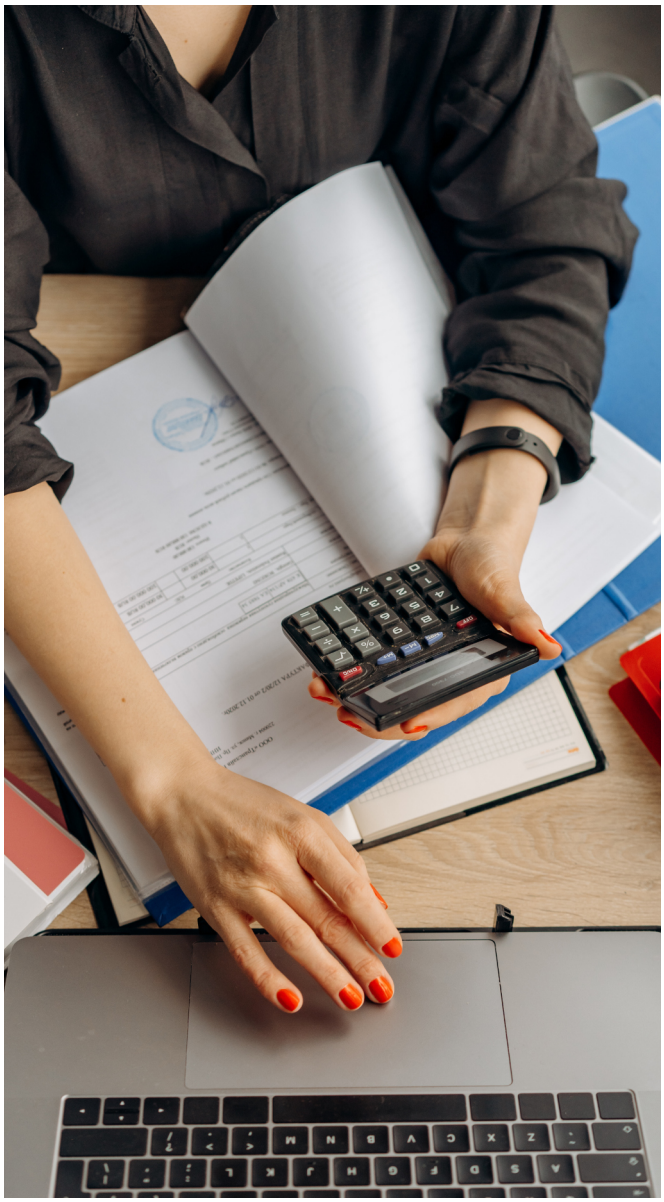
Clearly define a Purchasing Process and ensure all staff are educated. Material price fluctuation is a huge issue at the moment, do all materials orders over a certain value require an RFQ?

A well defined purchase order system will track all spends and apply the costs to the phase budgets in real time.

6. Have a Project Post Mortem

A good idea for any company is analysing what worked and what didn't after the fact. This process will give you insight not only for this project but for future ones too.

This knowledge will be especially helpful if you intend to do additional work with the same team, client, and project manager. Again, breaking this action into phases or milestones can be especially useful.



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CHAPTER 4

8 Methods to Track Construction Project Costs and Increase Profitability

What Is Construction Cost Control?

Cost control is the process of collecting actual costs and collating them in a format to allow comparison with project budgets.

1. Start With An Accurate Budget

Fail to plan, plan to fail. How many projects go ahead with an over optimistic estimate. How much scrutiny is the estimate put under before it is tendered?

Is there any evidence based on previous projects that it can be achieved with profitability?

Understanding your own prices is the key to a successful estimate. Just releasing an estimate based on industry standards does not make profitability a guarantee.

Time spent at this point is well worth upfront efforts. It is made easier and even more accurate if you can leverage information from historical projects to feed estimates.

Not all projects are made equal and there are details in each that need to be considered, tweaked and accounted for, but overall knowing that you completed a similar phase previously will give you clues to the estimates accuracy.

2. Break the Project Into Parts

Given an estimate is generally broken into phases or bodies of work, it makes sense to track in this fashion.

This gives us the ability to build up performance data for these bodies of work. This data can then assist in validating the next estimates accuracy. It also helps to locate weak points in your service. Maybe groundworks are an area of a build where you constantly lose.

That's ok as long as it is realised and fixed. It can be useful to break the phases into cost types Labour / Material etc etc.. to further track the issue. If you constantly overspend on labour on groundworks maybe you could contract out next time or raise the estimation.

3. Manage, Track & Document Project Changes

Changes happen on projects. It's inevitable. How you manage and document project changes will have a key impact on your profitability.

Here's one reason why: you can easily be held responsible to pick up extra project costs if you can't produce the necessary documentation that proves out a change request.

Don't let that happen. It's essential to have a formal way to track, measure and report on change – in addition to documenting its impact on scope and cost.

Getting into any sort of dispute with a subcontractor or an owner is not a good place to be; and disputes are almost always a direct result of either side not being able to produce an appropriate amount of documentation or audit trail.

So track and document everything!

4. Track Staff Time

In most companies, your team is your most valuable asset. It is hard to know how profitable certain clients and projects are without knowing how time is allocated. With the right software, time tracking is nearly effortless.

You probably use software now without realising, be it email, text or whats-app etc. After implementing practices for tracking time, many companies discover that seemingly profitable clients or project types are not.

Tracking staff time is often a missing ingredient in creating realistic project budgets.

5. Understand What Things Cost

Construction project managers need to have a solid understanding of what labour and materials costs are, so they can make informed decisions about whom to employ on a job & what types of materials to use.

Understanding the value of various project components can also help inform decisions about where one can acquire cost savings, spur use of alternative materials or methods, and find creative ways to increase productivity.

6. Be a Negotiator

That means being able to negotiate with the client, with subcontractors, and with suppliers.

Being able to work with others to ramp up productivity, obtain better pricing, or adjust project plans for efficiency or cost savings will go a long way toward keeping your project on schedule and on budget.

7. Committed Costs

A big challenge for many project based companies is that they often understand what the budgeted costs are and what the actual costs are, however there is no clear visibility on what the committed costs look like or the purchase orders that have been raised.

If this is done manually and through different systems and processes it is often hard to see what the committed costs look like and can quite often be a leading cause in projects running significantly over budget and reducing profitability.

Remember that invoice that comes in 2 months after the project is complete?

8. Use Project Accounting Practices

Unlike traditional accounting, project accounting measures the financial performance of specific projects and phases. It requires collecting key data throughout a project, such as time and expense information.

Project accounting provides real-time data, giving firms the financial insights they need to thrive. In many cases, small decisions at key times can have a big impact on staying within a project budget.

Using an effective project management software for construction industry will significantly help construction companies to track their costs and increase profitability.

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CHAPTER 5

Accounts Payable Role In Cost Tracking

In this chapter we discuss 6 methods the role of Accounts Payable can contribute to cost tracking on a construction project.

1. Accounting Versus Project Accounting

Understanding the difference between accounting and project accounting can be very useful for cost tracking. Generally businesses will have a good structure for financial accounting as it is legally required and vital to any businesses day to day function.

Financial accounting is reportable in periods throughout the financial year (monthly, bi-monthly, quarterly and yearly).

Generally costs are allocated to departments or nominal codes or cost-centers which makes comparison easy from period to period.

Project accounting is inherently different as a project has a specific start and end date and means the accounting work ends when the project is completed. Costs are allotted to particular contracts as well as the accounting nominal codes.

Most construction businesses may have a method of allocation whether in excel or categories in an accounting software package but it can be quite simplistic as just allocating costs to a project. Project accounting should be working against an initial project budget and be tracked against the same to understand overruns.

Commonly with projects that are large, the overruns only become apparent when the project is complete and too late to make alternative plans to avoid problems. This is where the budgets may be broken down into smaller elements and be tracked against the same as the project progresses.

2. Understanding of Project Structure & Budget

An estimate for a construction project will generally have a clear structure. This may be as simple as Labour, Material, Sub Contract, Plant & Machinery etc or as complicated as 100 elements or phases of a project. Either way, the estimate provides a key to the trackable budgets of each project element.

Breaking a project's expected costs into

smaller elements / budgets allows us to see how each element is performing as the project progresses rather than discovering an overrun at the end.

Discovering a particular element has overran its budget earlier can help project managers to take actions that could impact the budget positively later in the project can make a huge difference to the bottom line.

Discovering particular elements of a project are always overrunning i.e. foundations for example could lead to understanding that they are being underestimated or not efficient on-site. Either way there should be specific learnings from overruns.

3. Overhead Distribution

It is critical to understand how overheads contribute to a project's cost given that we are trying to track costs against an initial estimate.

The best method for allocating overhead in construction is a way that's fair. After all, the idea is to allocate costs that each project shares responsibility for, meaning the job either caused or benefited from the cost.

But, the costs should also be proportional to that responsibility. Figuring out how to strike that balance is the art of overhead allocation.

There are many methods to apply overhead costs to a project and there is no one size fits all. The key is to understand what method is best suited and to apply it.

4. Allocation of Project Costs

As we mentioned, the project budget structure holds the key to cost allocation. Accounts payable need a very good understanding of what each cost is and where it is to be allocated. This is challenging especially when a project has numerous elements / phases or sections that will be individually tracked.

Purchase orders can be a big help in this context as the allocation is set by the owner of the Purchase Order. Accounts Payable can match the incoming invoices back to the PO to allocate. At LiveCosts we certainly see this on a daily basis.

Companies can manage without up to a certain level but at some stage the process becomes very difficult and Purchase Orders become a must.

5. Budget Monitoring / Reporting

All of the effort to carry out the above is of no use if there is no outcome. A good idea for any company is analysing what worked and what didn't after the fact.

This may be called a "post mortem meeting" and be held at the end of a project or better still a phase. This process will give you insight not only for this project but for future ones too.

This knowledge will be especially helpful if you intend to do additional work with the same team, client, and project manager.

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CHAPTER 6

6 Reasons You Need More Than Accounting Software For A Construction Business

Introduction

Running a successful business usually means that you are focused on looking after your customers, growing sales, and improving profitability.

It also means that you are on top of your finances with accurate information so that you can make well-informed decisions, improve profits, and manage your cash flow.

In the last 10 years, financial processes have been swiftly moving from the desktop to cloud softwares with great benefits.

Although there is no doubt of the benefits of the cloud accounting software, they can only do parts of the construction cost tracking process.

Sure, it can do the basics for a small company but once a company has multiple projects, many users, and many complicated parts to a project, regular cloud accounting software becomes strained – and strains the company.

It generally doesn't work for a medium or large-size construction company that can have multiple quantity surveyors, project managers, and that works with tens or hundreds of subcontractors.

Construction processes are too specific for a general accounting software to be able to do all of it. Below we discuss six reasons you need more than accounting software for a construction business.

1. Control User Access

One fundamental issue in using an accounting software for job cost tracking is user access control. You probably want your quantity surveyors, project managers, and possibly also your site team to be able to attach project and job information to costs that they have incurred.

One challenge with this is that you possibly do not want to give non-accountant users too much access to sensitive company information. You want the users to just access their projects and the jobs where they are doing something. With accounting software, there isn't always a way to give access to just some parts of the financials. There are some options to allow time tracking or looking at reports, but that isn't enough.

2. Mobile Capabilities

Along with general access, in construction we are not all sitting in front of a computer at all times and may not have Internet on occasions!

Having the ability to complete tasks while on the move or on-site is important. Mobile apps for site personnel to track time, create purchase requisitions / orders, confirm deliveries is vital.

3. Construction Accounting VS General Ledger Accounting

Construction accounting is different from General Ledger accounting in the way that the financial tracking is at the project level.

In addition to the accounting ledger, ideally the project and cost types should be stored. This can get more complex with larger projects of course when trying to track against individual budget lines within a project. This granularity of data is very valuable in estimating future projects since the previous data is easily accessible.

In short, in addition to just tracking a company's general financial performance, the performance of each job and project is also tracked.

Oftentimes, the term job costing is used to describe the process of construction accounting.

Job costing can be used in the context of both estimating a new project and also adding up the incurred costs on an ongoing project.

4. Procurement Workflows in Construction Accounting Software

Accounting softwares will handle the accounts payable function of your business very well and keep you organized. In construction, workflows will be required long before an invoice is seen.

If you consider materials or services that may be procured first, then initiated with a Purchase Order and confirmed with a delivery note, this process is running long before an invoice is received.

This can leave these tasks being carried out outside the software and unconnected to your accounts.

5. Construction Project Profitability Projections

For many construction companies, it is critical that the project profitability is known throughout the whole lifecycle of the project.

This is not the case when a contract structure like cost-plus is used. This means that knowing the profitability of the project or a job is a matter of surviving.

For example, let's say you find out at the end of a project that your quoted cost of €100k is instead €120k. You might run into cash flow issues assuming you don't have enough money in the bank.

Unfortunately, accounting softwares don't really provide a good way of projecting the future profitability. It rather provides you different tools to look at your past costs and incomes.

This means that there is no way to continuously see the profitability of the project when the project is still running.

You might need to do this analysis in a different tool or try to solve this with a custom Excel spreadsheet.

6. Project Progress and WIP Reporting

Slightly connected to the project profitability is also the tracking current progress and remainder of the project.

This task involves seeing how much of the project is finished when compared to the initial estimate and budget.

An up to date project cost value is critical to keep track of so that you can compare it to the currently paid out expense amounts.

Since most accounting softwares are not specific to construction, it doesn't really know too much about your estimations and budget.

It also does not know anything about your initial estimate vs the current up to date costs of the project.

It also means that compiling an accurate enough project progress report is not really possible.

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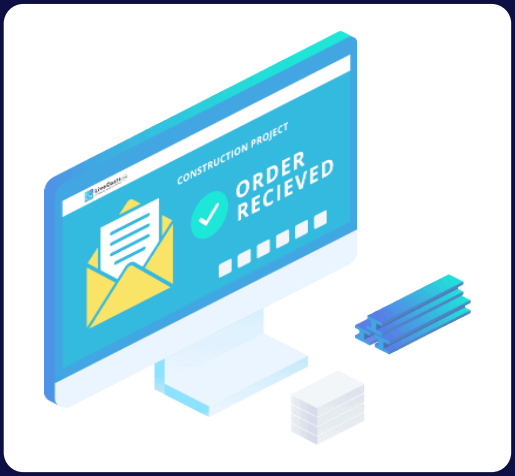
What Can LiveCosts Do For Your Business?



LiveCosts is a construction technology company founded and run by construction people. We know the pains and frustrations involved in getting projects over the line on time & on budget. LiveCosts was founded out of with the lack of simple software options available for builders, subcontractors and other small to medium sized businesses operating in the construction sector worldwide.

- Gain control of project costs
- Automate managing your labour, material, and subcontractors
- Have full visibility on your project costs

LiveCosts will show you exactly where you are losing money on your projects.

What We Do

- Project Dashboard
- PO
- E-Invoice
- Delivery
- Labour
- Pricing Catalogue
- Accounting Integration
- Connected Suppliers

Who We Serve

Roles

- Business Owners
- Accounts Payable
- Quantity Surveyors
- Suppliers
- Procurement

Trades

- Electrical
- Builder
- Mechanical
- Plumbing
- Landscaping

LiveCosts can help you gain control of your project costs

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