

EFFECTIVE TIPS TO JOB COSTING IMPLEMENTATION

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INTRODUCTION

According to the United States Census Bureau, there are over two-and-a-half million firms involved in the construction industry in the U.S. That's a lot of competition. The good news is, just like you, they started their business and grew it from the ground up. They made mistakes, learned from them, and gradually improved not only the work they do but also how they do it. The even-better news is that, by expressing an interest in implementing a job costing system, you've made an important step for improving your business. In a recent survey by Construction Research Corporation, 75% of contractors indicated that job costing was among their top concerns for their business. That's not surprising, considering that successful job costing can mean the difference between a profitable business and one that struggles to stay alive.

Take Rocko Excavating, for example, a fictitious company that represents the typical construction firm started by a former operator who saw the potential of working for himself. When Rocko first started his business, he knew a great deal about construction and excavating, but very little about financial statements, labor laws and job costing. The *business* of his business was something Rocko had to learn through trial and error. In the early days of Rocko Excavating, Rocko did all the estimating himself and ran an off-the shelf accounting software that a friend recommended. Instead of formal estimating, he "guesstimated" based on his experience as a laborer and bid as many jobs as he could possibly handle. Sometimes he made money; sometimes he didn't. While Rocko's instincts told him that he was more profitable on those jobs that ran smoothly and didn't have a lot of change orders, he had no solid proof of that. The market was good and Rocko did great work. As he gained a solid reputation, his jobs picked up, and Rocko soon found himself frantically busy. It wasn't long before he was overwhelmed – but even then, Rocko really hadn't become much more profitable. The margins just weren't growing, and cash was tight. What's more, there was just too much work for him to be able to do all the estimating, project management and accounting himself. Rocko Excavating had reached a crucial make-or-break point. Either Rocko figured out a way to make the company grow beyond the mom-and-pop shop where he was involved in every element of the business ... or it would stagnate and die. Rocko contacted a construction-specific CPA, and, on his advice, began shopping for a construction-specific accounting package. Eventually, he settled on one that offered a strong job costing element with powerful, customizable reports. He hired an estimator who was familiar with production reporting and could work with his bookkeeper to leverage the power of the job costing system. Slowly, they implemented production reporting that could prove just how accurate Rocko's off-the-cuff estimating was. They carefully analyzed job costing reports for completed jobs and jobs in progress. They put into action a billing system that was tied carefully to actual and committed costs to keep the cash flow stable. With time and effort, Rocko Excavating flourished into a company that was profitable on almost every job. Rocko became much more hands-off, freeing up his time to run the business from a much more visionary position, further increasing its potential for growth. It's a happy story, isn't it? And while you may think it sounds like a fairy tale, the fact of the matter is that it is all-too-true. Those companies who don't look carefully at the hard facts – especially carefully tracked job profitability – simply cannot grow. The first rule of success is to know where and why you have failed. If you haven't implemented a job costing system yet, what would doing so tell you about your business? What are your bread-and-butter jobs? What margins are you sacrificing because you don't have production reports telling you exactly what your estimates should be?

THE PURPOSE OF JOB COSTING

There's no written record of it, but one can guess that the earliest job costing probably occurred when the pyramids were built. After all, the Egyptians were centuries ahead in their advanced building techniques. Wouldn't it follow that they were just as advanced in their methods of measuring productivity? One can presume they were very interested in the efficiency of the project, and job costing is one of the best ways to track such information. On a simple level, job costing as it applies to builders in the modern world, can be defined as a management control process of tracking and categorizing every cost incurred in business. The costs are usually associated with a particular job or construction project and then further categorized by the costs' relation to labor, burden, materials, subcontracts, equipment, etc. In most job costing systems, the costs are also associated with *tasks* on the job or *types of work* completed. The goal, of course, is to pinpoint very detailed information about how and why costs are incurred. Knowing this information can help a contractor with the following:

Tracking the progress of jobs as they are worked, as opposed to after they are finished. For Rocko Excavating, this meant Rocko could adjust the schedule and time based on an accurate account of progress. It also meant more accurate billing and, therefore, a more improved cash flow.

Improving the estimating and scheduling process by discovering where estimated costs frequently vary from actual costs. Rocko quickly found that his off-the-cuff estimating system was not very accurate, especially as his business grew and he had more laborers and less in-the-field control. It became essential that he bid based not on how he thought things should go, but on how they actually went on similar jobs.

Controlling purchasing and use of materials and labor by uncovering trends in spending. Without a formal tracking system, Rocko didn't know which vendors were offering the best prices, and the lack of organization frequently caused materials to be purchased twice – or not at all. The job costing system helped Rocko get a handle on purchasing, and it also helped him see which of his crews were most productive, leading to more efficient scheduling of staff and better hiring decisions.

Determining which areas of the business are most or least profitable. While Rocko thought that his best jobs were the easiest jobs – those that didn't require a lot of change orders or rescheduling, he soon found out that this simply wasn't true. Because his estimating wasn't very accurate, he wasn't making much at all on those types of jobs. The money was in the change orders. This helped Rocko improve the margins from the outset – and plan for profitability through changes. Obviously, job costing can benefit contractors of every trade and size. The ability to pinpoint the specific areas where money is made or lost is the key to success for any business. If you're not currently doing this, you're losing money.

IMPLEMENTING JOB COSTING

Convinced that tracking production is a good idea? Of course. Most contractors know that job costing is a good idea. It actually knows where and how to start that can seem overwhelming. But don't let this paralyze you into inaction. It's just like a building project. If you only look at the whole project and realize the infinite number of details that must be attended to, it's easy to throw up your hands and give up. As an experienced contractor, however, you know that even the largest project can be broken down into phases, and that those phases taken individually are much more manageable. Implementing a job costing system can be broken down into three manageable phases. If you focus on the tasks involved in each of these phases individually, the project loses much of its vastness and becomes much more controllable.

THE THREE PHASES OF IMPLEMENTING A NEW JOB COSTING SYSTEM OR TWEAKING AN EXISTING ONE ARE:

Planning – Planning a new system can seem very daunting. The key is to just dive in. Start by asking questions of your staff. What job costing is currently accomplished – even at the most rudimentary level? Do your accounting staff, project managers or field laborers track or categorize anything related to cost? Are completed quantities recorded? What reports would they like to see? How important are things like production reports? Will they be able to provide you with the information you need to produce them? Research the job costing reports that your current and other software systems can provide. These can serve as examples in discussion with your staff, and they can give you a good idea of the possibilities of job costing. For each report, consider the possible affects of the data. In other words, what business decisions will the information help you make? What view of your company will they help illuminate?

Practicing after the planning phase, it's time to put the system to use. However, now may not be the time to dive-in head-first. When it comes to implementing a new job costing system, the toe-at-a-time approach is often wiser. You may want to start small by costing just one job or one type of job. For example, you may want to forgo costing any jobs already in progress, and you may want to worry only about those jobs for which you've already created a budget. As you get used to the processes involved and you begin new jobs, deploy the costing system across the board.

Probing putting your new system into practice may take some time. As a result, it's tempting to skip the final phase – analyzing the results and how well the system works. The last step in the three-phase process is to probe the results of the job costing system, and this entails much more than printing out and glancing at some job costing reports. If your new system works well, you should have a useable cost structure that works for all your jobs. You should be costing overhead, have a finely tuned billing procedure and be receiving an abundance of information from all those job costing reports. However, be sure to ask yourself some additional questions. Are you getting all the information you need? Are all costs categorized – and is the categorization correct? Are the reports adequate for analyzing the information in many ways?

CONCLUSION

Next issue, we can look at how job costing can be easily implemented and maintained in your company. Job costing isn't difficult at all if you take a little time out of your work week to do it and you utilize some readily available, inexpensive software to automate the process. Between now and then, if you think of easy ways that have helped you to implement job costing, drop me an e-mail. Hopefully, your job costing idea can be published and-who knows?-may help another contractor or two learn to how to do job costing in a better way.