10 TIPS TO JOB COSTING

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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?

10 JOB COSTING TIPS

A checklist of important secrets to remember

- ☐ Practice your vocabulary
- ☐ Define your goals / what you want to accomplish
- ☐ Usability is priority number one
- ☐ Put technology to work for you
- ☐ Doing what you know
- ☐ Everything plus the kitchen sink
- ☐ Not just job cost – job profit
- ☐ Collect the arrows that missed the target
- ☐ A foolish consistency
- ☐ A not-so-vicious circle

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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's actually knowing 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:

1. **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 effects of the data. In other words, what business decisions will the information help you make? What view of your company will they help illuminate?

2. **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.

3. **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?

Secrets of the Veterans
You are not the first person to implement a job costing system, so why re-invent the wheel? Capitalize on the experience of other contractors who have already traveled down this road. Follow the ten tried-and-true secrets below to see the best results from your new system.

Secret One:

Practice Your Vocabulary
When designing a job costing system, it's very tempting to simply use the same system you use for estimating – and in some cases, it may make perfect sense. But keep in mind that your estimates and your budgets are not the same thing and do not have to be structured the exact same way. After all, each can serve a different purpose and may, therefore, have different needs.

 An estimate is a detailed breakdown of the estimated costs for a particular project, and if you've been doing formal estimating for very long, chances are your estimates are very specific, tracking specific materials down to the last nail. You've probably learned that the only way to build in a profit is to anticipate every possible cost and to take into consideration scheduling, availability of labor and materials, and such uncontrollable factors as the weather. This makes for a very detailed breakdown of costs.

A budget for your job, on the other hand, will often summarize or group many of the details on your estimates. It's typically used by your accounting staff to track purchases and payable invoices against

the anticipated costs, and it can be much less detailed than an estimate. While an estimate might list the specific lighting fixtures selected by a client with different costs for the fixtures in each office, for example, the budget may simply track the total costs for all lighting fixtures involved in the project.

When Rocko designed his cost structure, the simplest approach seemed to be using the same structure as his estimates. In talking with his employees, however, he soon realized that field workers and office staff would never be able to track costs and activities to that level of detail. It made much more sense to create a more generalized cost structure that categorized costs according to tasks on the job.

Secret Two:

What are You Trying to Accomplish Here?
It may be cliché, but it's worth repeating. If you don't define your goals at the outset, how will you know what you need to do – or whether your job costing system has succeeded or failed. The only way to avoid this is to write down your initial thoughts for the job costing system, and then whittle them into specific goals that can be measured and tested.

Thoughtful planning of goals early in the process will narrow your task list and help make clear exactly how your system should be structured. Each time you run across an idea, report or example that you think is interesting, you can run the litmus test of comparing it to your goals. If it helps to accomplish a goal, it's worth considering. If not, it's out.

Finally, when you reach the third stage of implementation – probing the success of your job costing system – you can easily determine what you've accomplished simply by comparing the results to your goals.

Defining your goals can be as simple as carefully considering the following kinds of questions, among others that are unique to your business situation:

- What business decisions might be made or processes changed based on insight from job costing?
- Are there areas of your business that you've considered adding or dropping? Are there areas where you feel efficiency or frugality can be improved?
- What is your current per-job profitability and by what amount would you like to improve that?
- How much information about job costing do you currently have? What specific information have you been lacking?
- Who will be interested in job costing reports? How will they use the information? Are reports needed for outside entities such as banks or bonding/surety agencies?
- How much time can be devoted to categorizing costs? To analyzing reports?

- Will you estimate or budget all jobs? How will this affect the use of job cost information?
- How much production reporting do you currently do? Do you track the quantity per man-hour (e.g., cubic yards completed in a man hour), man-hour per quantity (e.g., man hours for a single cubic yard) or use some other means of determining production? How accurate are your estimates based on this information?

Secret Three:

Usability is Priority Number One

You may spend a tremendous amount of time defining your job costing goals. You may ensure that they are precise, measurable and attainable. You can talk to every employee on your staff. You can do all of this and more, but if you define a job costing system that isn't user-friendly, it simply will not work.

There's an old adage that rings especially true here: garbage in, garbage out. If you don't put accurate information into your job costing system, you won't get very good reports. In fact, you may get severely skewed and misleading reports. Therefore, it's essential that you plan carefully for the usability of your job costing system.

There are two important considerations here:

1. How will information come from the field?

   Labor information is the obvious factor here. Your foremen, supervisors or field employees must be trained and required to submit timecards that include information relevant to your job costing structure. You may have them include the actual cost categories, or you may ask them to note the tasks on which they worked each day.

   A second factor is purchasing done from the field. If project managers or other staff can purchase materials, the POs must include cost categories, and, ideally, they should require approval from someone that has access to budget and actual-cost-to-date information to prevent overspending.

   If job costing is new to your staff, this will require a period of training and adjustment, and you must ensure that supervisors and managers completely buy into the concepts so that the correct behavior is modeled and enforced. You may want to consider printing job aids reminding employees of their new responsibilities and laminated index cards listing the possible job cost categories.

2. How will information be categorized in the office?

Most contractors say that getting information from the field is the most challenging part of a new job costing system, but being able to categorize costs in the office is not far behind. You must remember that every single cost incurred ust be carefully categorized in order to avoid the "garbage in, garbage out" syndrome. Therefore, your office staff may spend a lot of time – especially during the initial training period – looking at paperwork and learning how costs should be categorized. Every single purchase order, invoice, inventory receipt, timecard, etc. must include job cost detail.

Keep in mind, as Rocko did, that one of the goals of your job costing system may be to avoid keeping your hands in the details. While it may seem tempting to go through the paperwork and categorize costs for your accounting staff, it will be much more efficient in the long run if you teach them to do it themselves. Rocko found that, as his office staff became much more proficient at this, the time he spent dealing with paperwork was reduced by a third.

Secret Four:

Put Technology to Work for You
While it is certainly possible to create and maintain a manual job costing system, it is not easy. The best method involves using an accounting system specifically designed to accommodate construction job costing. Such a system should have the following characteristics:

- Flexibility in job cost structure .The system should allow you to design your job cost categories in the best manner for your goals. It should allow alphanumeric codes for the categories and at least three levels of costs – job, task, and classification such as labor, materials, equipment, etc. Ideally, it should allow even more levels, since your job cost structure might include a grouping of different tasks or sub-projects within a job (units within a shopping plaza, for instance).
- Integration of accounting and job costing. If you have to enter separate transactions or employ spreadsheets for normal accounting functions and the recording of job costs, the technology is not making you more efficient. Instead, everything should be fully integrated. For example, when you enter timecards, you should be able to code the time the employee worked by cost category, and that information should automatically and instantly update job costing. Ideally, the detail allowed in the breakdown should be very flexible. In timecards, for instance, you should be able to code increments of minutes or hours.
- Division of labor and burden. "Burden" is the employer's indirect payroll costs beyond normal wages. It generally includes such things as taxes and benefits. A good construction-specific payroll system will allow you to track the costs of labor and payroll burden either together or separately. In either case, burden definitions should be flexible enough to allow you to define your own types and amounts, but should be tracked automatically with payroll and require no extra transactions.

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- Suitable reports. While it's tempting to just look for the system that offers the most reports, it's much smarter to look for the system that offers the best reports for your needs. Ideally, your accounting software should offer reports that show cost breakdowns on many levels, from total costs for the entire company, to labor costs per task, to costs per cost category on a job. Some cutting-edge accounting packages now offer "drilldown" capability, which allows you to look at a report with higher-level totals, then click one of those totals to see the detail that makes it up. Additionally, report writers that allow you to easily create custom reports can be extremely helpful. In any case, make sure it's quick and easy to generate the reports and that you understand what they are showing you.

Secret Five:

Doing What You Know

If your employees are not fully aware of the nuances of your job cost system, they will not provide you the information you need. After all, they can't do what they don't know! As mentioned earlier, if you input incorrect or incomplete information, your reports are virtually useless. Training employees properly is the absolute key to a successful job costing system.

As you begin implementing your job costing setup, plan to spend quite a bit of time with your employees. Plan meetings or training sessions for all employees in all departments and at all levels. While you have their attention, don't just give them a 10-minute lecture on job costing or hand them a memo detailing what they should do. Instead, follow the all-important law of teaching and reach all their senses. Talk to them about what they should do. Let them see examples of how it should be done. Then, give them exercises to practice it. Ask them questions to test their understanding. Be sure they know all of the items that need to be costed as well as how to determine the categorization for each cost. Share your motivation for implementing the system and indicate how it will benefit them.

Keep in mind that training doesn't end after your initial meeting with your employees. You will have to give them reminders and coach them on categorizing costs correctly. And you will need to plan how you handle employees who work in multiple areas of the company as well as new hires.

Secret Six:

Everything Plus the Kitchen Sink

As your job costing system becomes more mature and stable, it should be applied across all projects and jobs on which you work. This seems obvious. However, a less obvious factor in job costing is overhead. While overhead costs such as telephone bills, fuel, marketing, etc. are not directly job related, they are costs that you have incurred, and you cannot really understand job profitability without factoring in overhead expenses. As your system matures, you should have the goal of categorizing every single expense that hits your books.

Ideally, the accounting software you use should allow you the option of job costing overhead expenses and/or performing overhead allocation. Doing both ensures that you can look at overhead costs from two angles:

- If you cost overhead expenses to an "overhead job" and categorize the expenses using cost codes just like you would actual job expenses, you can use job costing reports to prepare future budgets and to analyze where you're spending too much money on running your business.
- If you perform overhead allocation, you can examine job expenses with and without overhead, allowing you to get a feel for the impact these types of expenses have on your overall profitability as a company.

Secret Seven:

Not Just Job Cost – Job Profit
One of the obvious goals of job costing is to analyze where you may be spending the most money on a job, especially in comparison to estimated costs. As you implement your job costing system, however, don't forget that information you're gathering can be used on the flip side – to determine and analyze billings.

There are several ways in which job cost information can be helpful in billings:

- When cash is tight, it's important that you plan and schedule your jobs carefully to ensure that you will not overextend yourself. Ideally, you should consider this factor as you prepare estimates, and they should serve as the "law of the land" during a project. In the real world, however, estimates are an inexact science and things change rapidly as the project progresses. Since job costing reflects actual and up-to-the-minute costs, it can provide much more relevant information about your cash flow. This is even more true if you use a purchasing system that allows you to track and categorize committed costs. This information can and should be used to determine how often and how much to bill your customers. The ability to understand and predict cash flow was one of the biggest factors in Rocko Excavating's long-term success, as it is with most contractors.
- Progress billing such as percent-complete, AIA, or unit price billing offers you the chance to bill your customers more frequently and accurately, ensuring that expenses never get ahead of income for a project. A sound job costing structure can make progress billing much easier because information gathered through other sources and categorized by job cost category offers hints and verifications of the level of completion for each task on the job.
- Depending on the nature of your work and how you bill, you may wish to categorize income using the same categories you use for costs. This provides a very straightforward one-to-one

comparison of income vs. expense. Of course, not all companies can breakdown income on this level, and it's not always necessary. If you chose to categorize income, however, be sure your accounting/billing system supports it with full integration.

Secret Eight:

Collect the Arrows that Missed the Target
With all the work of implementing a job costing structure, it's very easy to lose sight of the real motivation for the system. That's why, in the planning phase of the implementation process, you should write down your goals for the system with specific, measurable targets. After the system has been in place for a while, dig out that notebook of ideas and goals, and determine how far you've come.

The idea is to determine if the job costing system has improved your business – as well as verify that you've accomplished your goals with the job costing system. But even more important than the "if" is the "why." If you're not meeting your goals, spend some time using the numbers to determine why that is.

Ask yourself the following questions:

- Where are my highest costs? Where are my largest profit margins? Are there positive or negative correlations between these two areas?
- Does this information indicate that any business processes need to be changed? Can I make something we do more efficient or less expensive?
- Is my estimating and scheduling accurate? Does my production reporting show consistency between estimated time/cost to complete a unit and the actual results?
- Are my billings optimizing my cash flow? Can job costing information be used to improve the process?
- Should I add or drop a line of business? Should I bring in tasks that I've been subcontracting or vice-versa, subbing-out tasks I ordinarily do with in-house labor?
- Are particular pieces of equipment, specific materials, individual employees and/or labor-trades making or costing me money?
- Are the reports I'm producing giving me all the information I need? Do they fit the requirements of any outside agencies to whom I'm submitting them?
- How much time is being spent on categorizing and recording costs? Is the investment of time worth the return on information?

Secret Nine:

A Foolish Consistency
Given the information you determine from comparing the results to your goals, you should have a

general indication if your job costing system is working. The answer will always be, "Not perfectly." But the good news is, you're not locked into the system. If you designed it properly and your accounting system offers enough flexibility, you can run tests on your current system, trying different things here and there, wherever appropriate.

You may think that consistency is essential, but as Ralph Waldo Emerson said in his essay, Self-Reliance, "A foolish consistency is the hobgoblin of little minds." In other words, inconsistent and sometimes correct is much better than consistently incorrect! So don't be afraid to try new methods or procedures, perhaps using different cost categories on different jobs, having different people responsible for cost categorization, or implementing new rules for how things are costed.

This constant testing and tweaking leads us to the last and most important secret …

Secret Ten:

A Not-So-Vicious Circle
You're not done! The three-phase process of implementing a job costing structure is a never- ending circle. The probing and analysis stage inevitably leads to the planning and questioning stage. Just as your business will grow from your use of job costing, your job costing system will change from the growth of your business. Don't rest on your laurels – or on your current job costing system. Use the information that you gather from job costing reports to improve not only your business, but your way of doing business.

YOUR SUCCESS STORY

The process of planning and implementing a brand-new job costing system was not always easy for Rocko Excavating. In fact, as employees turned in timecards without cost information and the accounting staff struggled to learn more about the industry, Rocko sometimes felt as if they would never get there. But the fact remained that the information provided by the new system illuminated his business and made Rocko understand more about running a successful company than he ever had.

The story is true of so many contractors. A simple change in the way they handle back-office procedures makes all the difference in profitability. Isn't it time you looked into growing your company into much more than it is today?

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He started the company in 1985 after spending several years developing customized software systems for the construction market. He has managed the growth and development of the company from start-up to leading supplier of construction accounting software.

Foundation Software is the developer of FOUNDATION® – America's #1 Construction Accounting Software. Since 1985, we've been dedicated to giving contractors the back office tools they need to manage their job cost accounting, project management, and scheduling.
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