Hello, everybody. Dennis Engelbrecht with The Family Business Institute, with our pod series, Digging Deeper, where we try to explore in-depth some various construction company topics that'll hopefully be valuable to you in your company.

So, an interesting thing happened in the last couple of weeks. A fellow who wrote a book about construction, was a top industry professor, came up with a list of sort of self-analysis, maybe 15-20 questions in each area of your business to do a self-analysis about how you're doing. Today, I want to talk about one area of that business, which is really your accounting area, or keeping score, we call it in construction a lot. How well does your company keep score, and how effective is your controller, accounting department, et cetera? What does that look like?

So, I found when I was reading this list of issues for the self-analysis, my thought was, well, how does a contractor use this? Because I don't think they know what they don't know. So, if you don't know what a good construction accounting department looks like, how do you know whether you have a good one or a bad one? Right?

Unfortunately, many people who run construction companies came from the project management end or possibly the field, but they're more engineers. They're construction people. They're not accounting people, for the most part. That's, often times, not their comfort area. So, they rely on the professionals there, and frankly, they get what they get. So, getting what they get, let me try to paint the picture of what's good and what's bad, and what a great construction accounting department looks like.

Well, first of all, to be a top construction company and a top construction professional, what you need from your accounting department is you need timely, accurate information so you can make good business decisions. So, think about it, timely, accurate information so you can make good business decisions.

All right, so timeliness, let's cover that first of all. I have companies out there that get their monthly financial statements 45 days after the end of the month. Well, if I get a financial statement 45 days after the end of the month, well, first of all, I can't do anything about the past, anyway, right? The past has already occurred, but 45 days after, I may be looking at a specific account, and I can't connect what happened to the numbers because it's too far in the past.

I also have companies... I'm on the board of one company where I get my monthly report delivered, usually by electronic email. I usually get it on the fourth or fifth day of the following month. So, think about that. They closed their month four or five days after the end of the following month, and it's accurate. All right?

So, 5 days, 45 days? Where are you, first of all? If you're not closing your month at, maximum, 15 to 20 days after the close of a month, you're missing the boat somewhere. All right. So, that's one thing to see if you have a good accounting department.

Now, is the information accurate? All right, so when I say the information is accurate, probably the key thing in construction accounting is managing your WIP, your work in process. All right? If your work in process is updated and accurate, you won't have financial statements that look like this, where one month you make $800,000, the next month, you lose $200,000, then you make $300,000 then you lose $400,000, then you make $900,000.

Why? Why shouldn't it look like that? Well, the only variable, I mean, the set of jobs you're working on during this period doesn't change dramatically month-to-month. You might add on another job or one might drop off as you finish it. Each

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of these jobs, hopefully, you forecasted the profit of these jobs accurately so that it doesn't look like this. So then, the only variable is really, how much work did you put in place that month?

Now your overhead should be relatively steady through the course of the year, as well. The use of accruals, such as... and you may not understand accruals, but I'll give you one quick example. If you get your insurance bill and it's annually and you put... Let's just say it's $80,000 and you put that when you receive it in February, well, your February overhead is going to look like it went up by 80,000 and then it's going to go down by 80,000 the next month. Well, in accounting, that's actually not accurate. That's an item that should be accrued across the 12 months, so that each month would reflect approximately $6,333 per month for your insurance costs, and so that therefore, again, your overhead should be relatively stable across the whole year.

Those one-time items should be items that largely are accrued. So, if your overhead is stable and the jobs you're running are stable, then it's strictly volume. And so, if you run $5 million more than you did last month, yes, you'll produce more gross profit than you did last month, and that will affect your bottom line, but that should be where your large variations come from.

Now, the other way to check your accuracy is look at the end of the year when you do your review or your audit. That review in that audit should look very much like your internal financial statement and not just in the data that's on it, but also in the form that's on it. If your financial statement looks like hieroglyphics, you got 386 different accounts and they're not summarized so that you can say, "I'm spending this much money in marketing," for example. Let's say it's in 13 different accounts.

You can't manage all that gibberish. All right? Your accounting statement needs to be organized so that you can see the big picture. All right, so it should look like the accounting statement that your people put out at the end, and there should be very little changes. Again, if you haven't done your accruals and things like that, those are going to show up as changes between your internal books and your external books. There are plenty of companies finish the year and they think, "Oh, we made $300,000," go through their review in their audit and they go, "Oh, we lost $600,000." that should never happen to you.

So, if you're wondering, does my system work well, those are the first two things, and now the last thing I'm going to give you is a little tidbit. It should be paperless. We're in the world today where the accounting system are all available to be able to scan, distribute invoices, for example, to approval.

This way, your superintendent's getting their approval, for example, on subcontractor progress. Immediately, that can go to your project as soon as it's scanned in. It can go to your project manager, go to your superintendent as workflow on their computer. They can hopefully tag that and approve it or make their notes, make their questions, and accounting gets done a lot faster, more efficiently, what's gone.

So, to get the full picture of this story, again, thinking back to my consulting history, when things go bad at a construction company, I remember it. I always go in there and somewhere in the desk of the problem project manager, who quit mid-job or whatever, was a folder of invoices that were supposed to flow from accounting for approval to get back, things like that, but they get buried. When those guys get in trouble, they tend to bury those things, and you only know when they

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leave you and you start digging in later. So, accounting should be paperless, should have the proper approvals all taking place online, and you'll find you're more efficient, and that's what a modern accounting department looks like.

So, thanks for tuning in, again, Dennis Engelbrecht, Digging Deeper.

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