Construction Accounting and Financial Management

Chapter 1
Construction Financial Management

Why do Construction Companies Fail?

- Ineffective financial management systems
- Lines of credit constantly borrowed to the limits
- Poor estimating and/or job cost reporting
- Poor project management
- No comprehensive business plan
- Communication problems

Surety Information Office, *Why Do Contractors Fail?*, downloaded from http://www.sio.org/html/whyfail.html downloaded on April 3, 2003.

What is Financial Management?

- Financial management is the use of a company's financial resources
- Financial resources include:
  - Cash
  - Assets—such as equipment

Why Is Construction Financial Management Different?

- Project oriented:
  - Greater variety of projects (products)
  - Harder to determine the cost of projects
  - Cannot stockpile completed work for future use
  - Greater need for detailed job cost accounting

Why Is Construction Financial Management Different?

- Decentralized:
  - Must track equipment
- Payment terms:
  - Progress payments
  - Retention
- Heavy use of subcontractors

Who Is Responsible for Construction Management?

- Owners
- General Managers
- CFO (Chief Financial Officer)
- Estimators
- Project Managers
- Superintendents

What Does a Financial Manager Do?

- Accounting for financial resources
- Managing costs and profits
- Managing cash flows
- Choosing among financial alternatives

Accounting for Financial Resources

- Making sure costs are accurately tracked through the accounting system
- Ensuring that the construction accounting system is functioning properly
- Projecting the costs at completion for the individual projects, including unbilled committed costs
- Determining whether the individual projects are over- or underbilled

Accounting for Financial Resources

- Making sure that the needed financial statements have been prepared
- Reviewing the financial statements:
  - Inline with the rest of the industry
  - Identify potential financial problems before they become a crisis

Managing Costs and Profits

- Controlling project costs
- Monitoring project and company profitability
- Setting labor burden markups
- Developing and tracking general overhead budgets

Managing Costs and Profits

- Setting the minimum profit margin for use in bidding
- Analyzing the profitability of different parts of the company and making the necessary changes to improve profitability
- Monitoring the profitability of different customers and making the necessary marketing changes to improve profitability

Manage Cash Flows

- Matching the use of in-house labor and subcontractors to the cash available for use on a project
- Ensuring that the company has sufficient cash to take on an additional project
- Preparing an income tax projection for the company

Manage Cash Flows

- Preparing and updating annual cash flow projections for the company
- Arranging for financing to cover the needs of the construction company

Choosing among Financial Alternatives

- Selecting which equipment to purchase
- Deciding which area of the business to invest the company's limited resources