

A Guide to Managing Budgets and Expenses

Written by: Builder Blog by RedTeam

Accounting is an essential and often complicated process for every business, especially when it comes to construction. Overhead costs are more complex than with your average business, and creating an accurate budget is a challenge since the cost of construction projects can change in response to a variety of factors.

All of this is to say construction accounting can be difficult, but it doesn't have to be. The right construction software can help you manage budgets and expenses with ease to keep your next project on track.

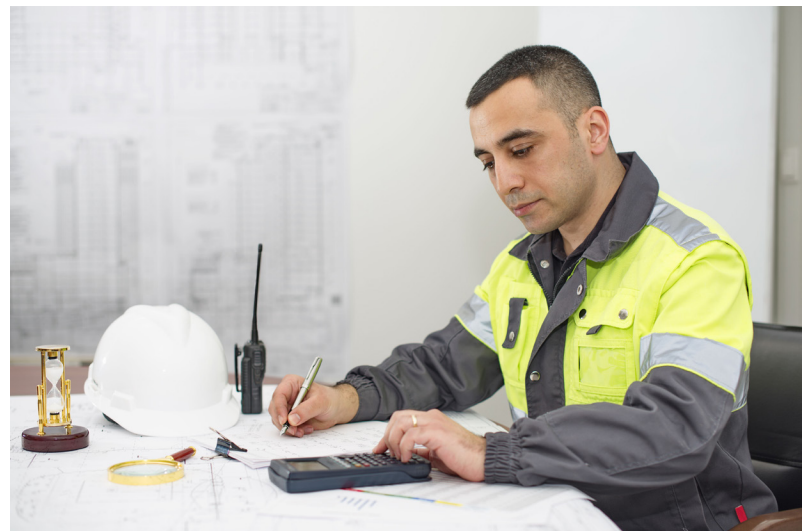
Read on to learn more about construction project accounting and how to choose the best software for your needs.

The Importance of Construction Accounting

Construction accounting is quite different from other industries due to the special considerations it requires. The complexity, long-term nature, and multi-stakeholder involvement of construction projects makes them unique and explains their distinct characteristics. Construction accounting has some specific features, such as:

1. BEING PROJECT-BASED

Accounting for construction companies focuses on individual projects rather than the entire business operation. Job



costing and project profitability are essential for successful financial management. It requires rigorous cost management for the financial viability of a project. Cost management in construction accounting will include planning, monitoring, controlling, and reporting costs.

2. HAVING A DECENTRALIZED PRODUCTION

Construction projects don't involve one onsite location. Logistics often needs to cater to moving materials and supplies from one place to the next. Production can occur on different jobsites, and requirements for equipment and personnel on each jobsite will vary. This complex setup means you must have a system that keeps track of everything.

3. HAVING LONG-TERM CONTRACTS

Construction projects often run for long periods of time. Many construction projects take years to complete, and payments are made continuously over that period. These payments can easily be delayed by retainage and contract terms with extended payment periods.

These special terms make it even more difficult to keep track of expenses and recognize revenue. A solid cash flow management strategy and reporting mechanism to ease the burden of sorting through years of invoices and bills is needed.

Construction Accounting Best Practices

If you want to have a successful construction project, construction accounting should be built on solid principles. These construction accounting best practices and accounting methods can help you save time and money:

1. CREATE SOUND JOB-COSTING PRACTICES

A job costing system can be implemented to allocate direct and indirect costs to individual projects accurately. Direct costs include labor, materials, and equipment. Indirect costs include overhead, insurance, and permits.

Reviewing and revising cost allocations regularly is essential to ensure accuracy and relevancy. Monitoring costs compared to the budget and assessing variances is vital to discover potential opportunities for improvement with real-time tracking and updated information.

2. CASH-BASIS ACCOUNTING

Smaller construction companies may favor the cash-basis method because of its flexibility. The IRS will however, require another method if your company generates revenue over a specific threshold. The cash method allows you to simply record revenue when payments are made.

3. ACCRUAL-BASIS ACCOUNTING

Accrual-based accounting is more suited for larger companies, but it's more complex. This is because it recognizes revenue when work is completed and expenses when they are incurred. It provides a more accurate representation of your construction accounting, but it could lead to cash flow issues.

4. PERCENTAGE-OF-COMPLETION METHOD

The percentage-of-completion method for construction accounting is widely used and allows you to recognize revenue and what's earned over a period. Contractors will bill you in stages as a construction project progresses for the work they do along with the expenses and earned revenue at each stage.

5. COMPLETED-CONTRACT METHOD

The completed-contract method is a revenue recognition approach used in the construction industry, particularly for short-term projects. Here, you'll recognize revenue and expenses associated with a construction project when the project is fully completed. Rather than being recognized incrementally over the project's life cycle.

Challenges of Construction Accounting

Construction accounting certainly has its challenges because of all the various moving parts. The accounting process in the construction industry is hardly straightforward. Therefore, you need to be organized or you could end up losing money.

Some common challenges in construction accounting include:

- » **Cash flow issues:** Working on long-term construction projects can cause cash flow issues and create challenges in accurately recognizing revenue and allocating costs correctly.
- » **Poor revenue recognition:** Construction accounting requires careful implementation of either the percentage-of-completion method or the completed-contract method to recognize revenue properly. Both ways are complex and require accurate definitions of costs and project progress.
- » **Inability to manage job-costing:** Job-costing is essential to determine if your project will be profitable. However, it can become complex quickly due to factors like change orders, additional costs, and variations in material and labor costs.
- » **Poor cost allocation:** Accurately attributing direct and indirect costs to various projects is a tricky task for construction firms. Primarily because of their shared resources, changing material prices, and differing labor rates.
- » **Change order issues:** Variations in project targets, technical details, or timelines can affect both expenditures and

income. Therefore, making financial record-keeping and predicting job results quite tricky.

- » **Delayed payments:** Retainage is a part of the contract price withheld until you complete certain milestones of a project. This practice can complicate accounting and cash flow management when milestones change or if delays occur due to disputes.

How to Use Accounting Software for Construction

Accounting software for construction can make your construction project more efficient. Picking the best construction accounting software, ideally one with the integrations you need, is only the first step. You need to know how to make the most of your construction software to manage your financials.


- » **Create detailed budgets and project financial estimates during the planning phase.** Thereby, stakeholders can see what financial constraints they are working with. Investigate any discrepancies and take corrective measures to control costs when needed.
- » **Track your expenses in real time with your construction software.** Daily expenses should be recorded with onsite activity to avoid delays and inaccuracies during reporting. Job-costing features allow you to accurately monitor the expenses associated with each project, including labor costs, materials, equipment, and overhead fees.
- » **When construction software supports or integrates with your accounting system, you can track your team's hours worked, calculate accurate pay rates and generate compliant tax documents for reliable payroll processing.** This allows you to manage your work against contractual agreements, easily track commitments and changes, and trigger invoices to vendors and subcontractors directly to avoid payment disputes.
- » **Use document management features to keep track of change orders.** Cloud-based document management improves the workflow for changes in project scope, specifications, budget, or schedules.

- » **Leveraging automated billing and invoicing features will allow you to produce accurate and timely pay applications.** Construction software that supports progress billing, time and materials billing, and retainage tracking helps manage cash flow.

Benefits of Using Construction Accounting Software

Construction software that supports accounting needs can bring numerous benefits to your business, some of which include:

- » **Improve job-costing accuracy** in cost allocation, revenue recognition and other financial processes, expense reports, income reports, and more.
- » **Save time** by automating various accounting processes. Those can include invoicing, payroll, and job-costing.
- » **Manage the finances** by simplifying the process of budgeting, cost monitoring, and profitability tracking.
- » **Integrate with other tools** for project or document management, creating a streamlined workflow.
- » **Scale your business** with effective and consistent financial management strategies.
- » **Access your financial data securely** anywhere at any time with a cloud-based solution.
- » **Integrated information** helps you and your stakeholders to make informed financial decisions. Resulting in more effectively managed projects.

Investing in construction software with accounting functionality is a smart move for any construction business looking to improve their financial management and overall performance. It can help you with job costing, revenue recognition, change order management, and financial reporting. 



About the Article

The [Builder Blog by RedTeam](#) was launched in 2023. It serves as a resource for construction professionals with industry insights, in-depth articles about solutions, and helpful customer stories. From best practices to workflow guides, the blog builds on RedTeam's expertise and knowledge of the industry to help create a better tomorrow for everyone in construction.

You can learn more about RedTeam at redteam.com.

Any views and opinions expressed in this article may or may not reflect the views and opinions of the Construction Management Association of America (CMAA). By publishing this piece, CMAA is not expressing endorsement of the individual, the article, or their association, organization, or company.