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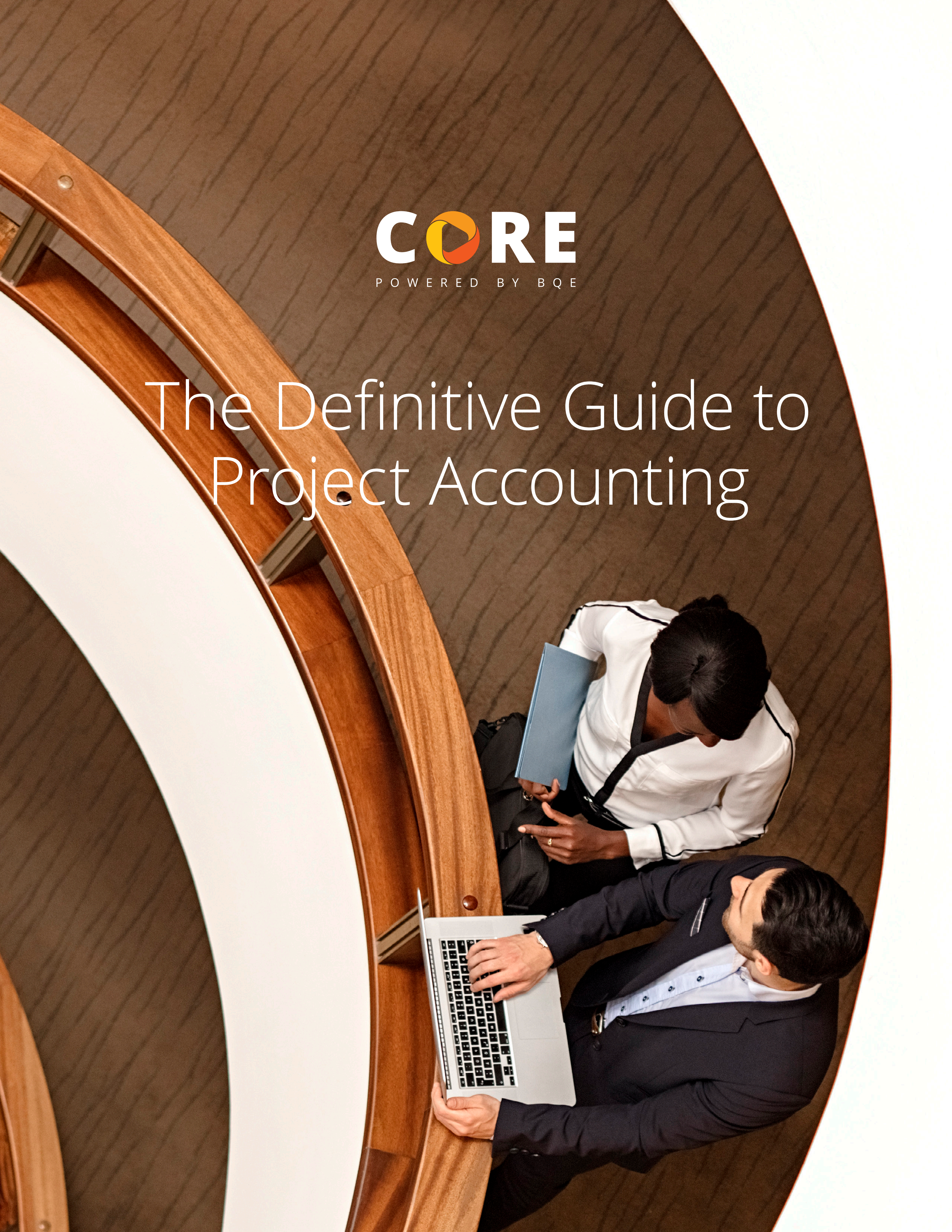
The Definitive Guide to Project Accounting



The Definitive Guide to Project Accounting

When you embark on a major road trip, it's important to have a functional gas gauge, speedometer, and thermostat. Although you don't actually need these instruments to drive your car, unforeseen failures can plague your trip, causing delays, breakdowns, and speeding tickets.

The same logic applies to architecture, engineering, and construction (AEC) businesses. Without the proper tools, you may be able to cruise along for a while, knowing that your firm is profitable without having any insight into the specifics. But eventually something will go wrong, and you won't know where to look for information that will help. If you want to make any improvements before things take a turn for the worse, you'll be out of luck if you're only relying on guesswork. But where can you find the insights to help you?

Examining your business on a project basis offers a new paradigm to identify threats, strengths, and opportunities. Can you pinpoint which projects have the largest margins? Which team members are making the greatest contribution to the bottom line? Are certain expenses eroding profits? Project accounting, also known as project-based accounting, provides the detailed data necessary to answer questions like these so you can dramatically increase your profitability and prepare for whatever lies ahead.

IN THIS WHITE PAPER, YOU'LL DISCOVER:

- The principles of project accounting
- How this method offers actionable insights that increase profits
- How practicing project accounting engages employees
- The essential metrics and terms for comprehensive analysis of your business's health

What is project accounting?

Project accounting tracks the financial performance of specific projects. Unlike traditional accounting, it provides the real-time data that businesses need to thrive. With project accounting, small decisions made at the right time can have a big impact.

If owners and managers want a clear snapshot of a project, they need to gather timely data on a project level. Many firms that use traditional accounting do not track their time, expenses, project metrics, and financials closely enough to gain insightful information. While regular accounting demonstrates whether a company is profitable within a given timeframe, it doesn't organize the information in the way necessary to drive the success of individual projects, phases, and even tasks.

Traditional accounting methods typically present financial information monthly, quarterly, and annually, but this information isn't connected to specific projects. At many firms, projects are completed within weeks or months, and the schedule doesn't correlate with accounting time periods. Business leaders often rely on intuition, trends, and guesswork to connect the dots. Project accounting, in contrast, provides the information businesses need at a granular level, allowing firms to gain clarity and meet larger financial goals.

With regular accounting, many firms only track billable hours and expenses, and information is entered in spurts. Without current comprehensive data, assumptions and hunches replace key performance indicators. Intelligently designed project accounting platforms make this information easy to capture on an ongoing basis, thus streamlining the entire process.

The Many Benefits of Project Accounting

Firms that perform project accounting experience a wide array of positive changes. They gain the data necessary to pinpoint successes and failures in real-time. Consequently, they can make adjustments while projects are still under way and better plan for the future.

Project accounting gives crystal clear insight into where projected and actual costs and profits do and don't match up. Managers can review past

BENEFITS AT A GLANCE:

- Protect and increase project profits
- Assist in long-term planning
- Invest in marketing, strategic hires, and other initiatives
- Engage employees
- Enhance collaboration

projects to assist in accurately pricing new ones, find ways to cut expenditures, or even pass up unprofitable work.

For example, at many firms, a big client's fees may cover a mere fraction of the staff hours used and the costs incurred on their behalf. If expenses, time, utilization, and other metrics aren't tracked on a project basis, this client could look far more profitable than they actually are. In addition, because the client consumes so much time, it becomes difficult to focus attention on attracting new clients or work.

This valuable information can shape business development goals and long-term planning by identifying the most lucrative clients, project types, markets, and employees, and effectively prioritizing resource use and acquisition.

As it stands currently, less than half of companies report having a high alignment between their projects and their strategic goals[1]. Meanwhile, 80% of project management executives don't know how their projects are relevant to their company's overall business strategy[2]. With project accounting, all stakeholders can see patterns more clearly and work towards the same goals.

This is true for both leadership and lower-level employees. When staff can more easily understand their roles in relation to the success of their projects, morale increases and collaboration is enhanced.

Furthermore, because teams must manage their own project KPIs, they become more accountable for the success of their projects. Indeed, with the increased emphasis on project metrics, many firms choose to tie compensation to project outcomes. This empowers employees to contribute more to profitability and makes the best use of business resources.

The Growing Importance of Project Accounting

Traditional accounting doesn't provide the type of financial information that many AEC firms need to thrive. Creating a company culture of innovation and collaboration is essential to be competitive. It isn't enough for firms to just be effective at their core competencies. Business skills and insights are needed to take firms to the next level. Project accounting provides the financial insights to help drive results.

Software solutions are expanding what is possible for businesses of all sizes, and many firms now

[1] THE PROJECT MANAGEMENT INSTITUTE'S PULSE OF THE PROFESSION 2016. ACCESSED MARCH 9, 2018. HTTPS://WWW.PMI.ORG/-/MEDIA/PMI/DOCUMENTS/PUBLIC/PDF/LEARNING/THOUGHT-LEADERSHIP/PULSE/PULSE-OF-THE-PROFESSION-2016.PDF.

[2] "20 SURPRISING PROJECT MANAGEMENT STATISTICS." CAPTERRA. ACCESSED MARCH 09, 2018. HTTPS://BLOG.CAPTERRA.COM/SURPRISING-PROJECT-MANAGEMENT-STATISTICS/.

have the capability to use these tools in-house. Innovative platforms can make data entry and analysis easy. Instead of consuming hours a week, tasks like time cards only take a minute. Meanwhile mobile apps, for example, let teams access vital KPIs from anywhere. These solutions are available and affordable for small and large firms alike.

Essential Project Accounting Metrics

The metrics you learn from project accounting make all the difference. While you don't necessarily need to track all of the indicators listed below, together they'll form a complete picture of your business.

BILLABILITY ANALYSIS: This metric provides a dissection of services and expenses as billed, billable, and non-billable. If you compare billable versus billed, you can determine what a project has earned and what revenue you can expect.

BUDGET ANALYSIS: This provides a breakdown of services and expenses in relation to what's already been used and what the project limits are. This highlights if a firm is over budget or approaching its budget limits.

EARNED VALUE: Earned value takes into account the project plan, actual work, and the value of completed work in order to help determine whether or not a project is on track. It offers a reliable projection of the future success of a project in terms of time and budget.

EFFECTIVE BILL RATE: Unfortunately, most firms cannot bill for every hour of their time, and the effective bill rate—also known as employee realization rate—takes this into account. It measures the billable value of all hours worked. Let's say an employee worked 40 hours last week, but only 30 were billable at a rate of $100 an hour. The effective bill rate would be 40 divided by 30, multiplied by $100, equaling $75 per hour.

MINIMUM BILL RATE: This measures what a firm should be charging for an employee's time given its target profits. It's calculated as follows: Minimum Bill Rate = (Pay Rate X Overhead Multiplier X Target Profit) / Utilization

PROFITABILITY: This is a very important metric to monitor throughout a project. Although the words "profit" and "revenue" are sometimes used interchangeably, they mean very different things. Profitability involves calculating costs and comparing them with what's been billed to the client. Revenue is simply all the money being earned.

REALIZATION: As noted above, the employee realization rate can be synonymous with effective bill rate. More generally, though, realization refers to the amount of billable hours that were actually paid by the client. Instead of measuring it as a monetary rate, it's a percentage.

UTILIZATION RATE: Utilization illustrates the efficiency and overall performance of an employee. It's a comparison between the billable and non-billable value of their time entries, and is based on their target billable hours. For example, if their target utilization is 30 hours a week and the employee logs 30 hours per week as billable, then utilization is 100%.

WORK IN PROGRESS: This refers to billable hours and expenses that a firm hasn't billed yet. It is important to track this as an asset on the balance sheet and as revenue on the income statement. It helps managers understand how far along work is and acts as a booster when applying for loans.

Finding the Perfect Project Accounting Software

Many firms find it daunting to adopt the new business practices necessary to implement project accounting. Some project management tools are unwieldy and difficult to implement. Other firms try to use spreadsheets but end up spending hours entering, formatting, correcting, and analyzing data.

You need the right tools to get buy-in from your team. With effective software solutions, capturing and analyzing vital business data is simple and can take merely a minute or two.

ANYTIME, ANYWHERE ACCESS: Is your team dispersed or frequently on the go? If so, it is important to use project accounting tools that are available from anywhere. This makes it easier for your team to embrace a new system and capture key data outside of the office. Make it effortless for your team by using cloud-based software with robust mobile apps.

THE IDEAL PROJECT ACCOUNTING SOFTWARE WILL:

- Save users hundreds of hours of data entry
- Eliminate manual data analysis
- Offer practical insights to increase efficiency and profits

CENTRALIZED PROGRAM: The ideal project accounting software combines many functions that help your business succeed. Software solutions that contain billing, time and expenses, accounting, and project management capabilities allow you to use one platform for numerous functions.

A comprehensive system is easier and more intuitive for everyone on your team to use: everything from project estimates to invoices is accessed in one place. This streamlines the process while saving time and money.

Perhaps most importantly, a unified project accounting platform allows for superior insights. Natively incorporating billing, time and expense, accounting, and project management data results in more in-depth analysis that simply isn't possible with point solutions, even if they're integrated.

For example, 62% of businesses say that capturing time and costs against projects—and consequently determining profitability—is a major challenge for them.[3] A unified project accounting program allows you to outstrip the competition and solve this problem in seconds.

[3] "20 SURPRISING PROJECT MANAGEMENT STATISTICS." CAPTERRA. ACCESSED MARCH 09, 2018. HTTPS://BLOG.CAPTERRA.COM/SURPRISING-PROJECT-MANAGEMENT-STATISTICS/.

AUTOMATION: Given that project accounting is a data-intensive practice, it's ideal to have software that makes both data entry and analysis easier. Automations can make a significant difference, saving you time and allowing you to devote more attention to profit-generating activities. Look for a project accounting platform that takes care of some of the work for you. Features like automatic billing, automated time tracking, report scheduling, and bank feeds for account reconciliation are all incredibly helpful.

ANALYTICS AND REPORTING: The most helpful project accounting platforms will offer ways for you to check KPIs at a moment's notice as well as formal reports. You should be able to instantly access dashboards with the metrics that matter to your work. Your software should have a sizeable library of reports, and it should be straightforward and fast to generate and share them. It's even better if you can also schedule reports to be automatically created and delivered to stakeholders. These features all make it simple to get the information you need to improve your projects and your firm. After all, that's at the heart of project accounting.

Important Project Accounting Terms

In addition to the metrics listed earlier, there are certain terms that are very useful when practicing project accounting. Here are some of the most essential ones.

COST OVERRUN: This occurs when actual costs are higher than budgeted ones due to underestimation or unforeseen circumstances.

KEY PERFORMANCE INDICATORS: Key performance indicators (KPIs) are a way to measure the effectiveness of various processes and functions within an organization. Examples include realization rates, new revenue, expenses for obtaining a new client, estimation accuracy, and schedule variance.

OVERHEAD MULTIPLIER: This is a helpful number to help a firm determine the revenue required for each hour spent on a project. The overhead multiplier is a ratio of total expenses compared to the direct project labor and project expenses.

SCOPE CREEP: This refers to changes or growth of a project's scope after a project has begun that can lead to cost overruns.

STAFF ALLOCATION: In many firms, payroll is the largest expense. It is important to strategically utilize employees and to avoid over- or under-allocation. Staff allocation is intended to help staff balance different tasks and to optimize workflow.

Conclusion

Without methods like project accounting to measure your projects' successes, your business's health is in jeopardy. In fact, the Project Management Institute reports that the main cause of project failure is "a lack of clearly defined objectives and milestones to measure progress." [4]

All too many organizations examine a project for lessons learned only once it is complete, but some agile businesses are reexamining this approach. Project accounting gives firms the tools to continuously evaluate their work throughout various phases by using key performance data.

Just as we can determine that we need to fill a car's gas tank without running out of gas, metrics such as utilization rates, budget analysis, and profitability indicators highlight project performance, allowing owners to make adjustments before major problems arise.

Given project accounting's role in both improving short-term profits and long-term planning, it's crucial to implement this method now in order to stay ahead of the competition.

[4] THE PROJECT MANAGEMENT INSTITUTE'S PULSE OF THE PROFESSION 2017. ACCESSED MARCH 9, 2018. HTTPS://WWW.PMI.ORG/-/MEDIA/PMI/DOCUMENTS/PUBLIC/PDF/LEARNING/THOUGHT-LEADERSHIP/PULSE/PULSE-OF-THE-PROFESSION-2017.PDF .

FOLLOW US

World Headquarters

NORTH & SOUTH AMERICA

3825 Del Amo Boulevard, Torrance, CA 90503
United States of America

Tel: (866) 945-1595 (toll-free)
+1 (310) 602-4010

Email: sales@bqe.com
support@bqe.com

Regional Offices

AUSTRALIA, NEW ZEALAND & ASIA

Level 40 North Point Towers, 100 Miller Street, North Sydney NSW 2060
Australia

Tel: 1300 245 566 (toll-free)
+61 (02) 9657 1355

Email: aus-sales@bqe.com
aus-support@bqe.com

EUROPE, MIDDLE EAST & AFRICA

Tel: +44 20 3318 8111

Email: uk-sales@bqe.com
uk-support@bqe.com