▶ Business

Job-Costing for Survival
by Paul Eldrenkamp

Accurate estimating is the foundation of your business. Until you have control over your estimates, anything else you want to do with your company is mostly a pipe dream. You'll find it hard to generate a reliable revenue stream, so you'll lose control of many facets of the business.

You'll be rushing to sign jobs to collect the down payment, rather than taking the time to set them up properly. There will be a constant push to start more jobs than you have the resources to finish, and you may come to rely on an aggressive payment schedule that masks the bleak financial picture of how a project is going. Eventually, you'll probably take a job you know you shouldn't — one that is doomed from the start — and it may sink your business completely.

Keep Good Records

The only way to generate consistently accurate estimates is to compare estimated costs with actual costs on a regular basis, for every job you do, and then apply any lessons learned to subsequent estimates. This is called job-cost accounting, and I know from hard personal experience that until you do it diligently, every price you give for any project will be a leap of faith. Such faith is sometimes rewarded, but more often it's punished; either way, it's an irresponsible way to operate.

I say this not as a business consultant who has no concept of what it's like to run a remodeling company, but as an owner who put a very low ceiling on what I could accomplish with my business for longer than I care to admit — all because I did not treat job-cost accounting as an essential part of the estimating process.

The first step in job-cost accounting

is to generate some sort of tangible trail of what went into the estimate to begin with: handwritten notes, spreadsheet entries, estimating-software calculations — anything that enables you to document and remember what your assumptions were going into the job.

Use whatever system you're comfortable with. If you want a recommendation, I suggest you start with a simple, homegrown spreadsheet. Eventually you may want to work up to a more sophisticated, off-the-shelf estimating package, but that's probably the wrong place for most of us to start.

Once you have a documented estimate for the job in place, the second step is to track your costs as they're incurred on the job. Just about any bookkeeping software has the ability to assign job codes to expenses as you enter them. It's pretty easy to assign job codes to invoices from suppliers and subcontractors, particularly if everything on the invoice is for just one job. It's a little more difficult if your invoice contains materials from more than one job, but if you find it's too complicated to split one invoice among multiple projects, then ask for separate receipts at the lumberyard. If the lumberyard balks at that, then buy the stuff for one project, take it out to your truck, and then go back in to buy the stuff for the other project. In other words: Do whatever it takes. There's no excuse for not developing this sort of job-cost accounting discipline.

Simple Is Better Than Not at All

Sooner or later, you'll want to use line-item job codes (to split a job among various phases, such as foundation, framing, electrical, roofing, and so on). But rather than getting bogged down and frustrated in the effort, and

giving up on doing any job-costing at all, you can back off from that level of detail when you're getting started. Instead, treat all expenses for the job as one category. If it's too hard, for example, to track "Smith kitchen framing" and "Smith kitchen electrical" and "Smith kitchen cabinets" as separate categories — or you find you're just not doing it — then track "Smith kitchen" as one category of expenses, putting all costs for that job into one category, whether they're cabinet or electrical or flooring costs.

This simpler strategy will still yield essential information. In setting up a new business system, it's tempting to aim too high and accomplish nothing at all as a result. But job-cost accounting is too crucial to let that happen.

However you break down job costs, payroll costs can be hard to assign to particular jobs, because not only do you have to get your crew to fill out timecards, but once again you'll have to split one transaction (that is, each paycheck) among several jobs. Additionally, there are payroll costs on top of wages, like FICA and workers' compensation, that need to be allocated. Some bookkeeping software comes with a payroll module that makes this easier to deal with. Work with your bookkeeper and accountant until you have a system in place that's easy enough to implement.

Don't Forget Your Own Time

Frequently, the hardest cost to track and to assign to projects is the cost of the owner's time. If you think it's hard to get your crew to fill out timecards, just imagine if they had to get you to fill one out. This is less of a problem if the owner doesn't really do anything, which is the model I try to follow

(although I do at least try to stay out of my crew's way, unlike many bosses who do nothing).

If you're in the field working in production, it's really important that you track your hours and bill them to the right jobs. Otherwise, your job costs will calculate as artificially low and you'll be lulled into thinking your estimates are better than they really are. Then, when you finally hire someone to replace yourself in the field and that person expects to be paid, you'll be in for a rude shock.

Here's the simple, unavoidable truth: If you're working on the job, your time needs to be billed to the job. It will take some trial and error to figure out the best way to do this. Whatever system you work out for your crew's time should work for you, too, provided you have the discipline to keep a time-card for yourself.

Compare Estimated to Actual

Once you're getting decent data *into* your bookkeeping program, you should be able to get some decent data back out. You'll be able to print profit-and-loss reports for your jobs that lay out all project-related expenses. The reports may not be easy to generate or to read at first, and you may find data-entry errors, but they're part of an essential process and will get easier over time.

Once you have printed out the profit-and-loss report showing actual expenses, the next step in job-cost accounting is to compare those actual expenses with the originally estimated expenses. Get out the original quote. No matter what format that quote was in, you should be able to pull the actual project costs off of the profit-and-loss report and line them up against the costs that went into the original quote. The discrepancies you find between the actual and the estimated costs represent opportunities to improve your estimating and increase

your control over what's going on in your business. Cherish those discrepancies. Don't ignore them or try to explain them away; confront them and deal with them.

Using the Information

By now, you've done the hard part, from a data-tracking and paperwork point of view. But next comes the really important work: figuring out how to use that actual-vs.-estimated variance information to make your next estimates (including those you're working on right now) more accurate.

If all you have been able to do is to track the job as a whole (treating all job-related expenses the same, rather than breaking them down into line items such as flooring and painting), you will be more limited in what sort of analysis you can do. But you can still make some crude improvements that might save your company from disaster. If you learn, for instance, that your actual costs for the project were 25 percent higher than you had estimated, you can still use the same method you used before to estimate the new job, but this time just add 25 percent to the estimated job costs. It may be crude, but it's an important step in the right direction: It may buy you the time you need to get more sophisticated.

Make Obvious Corrections First

As you develop your job-cost accounting beyond the most basic level, you'll find that some major components of an estimate are easy to tighten up and others aren't.

Subcontractor quotes are among the easy ones — or should be. Comparing your estimated costs with your actual costs for electrical, for instance, should be fairly straightforward. All you have to do is compare the electrician's original quote with what he or she actually billed you.

If there's a big discrepancy, you need

to find out why. Did the electrician quote from incomplete documents? If so, start to insist on more thorough plans and specs, or tighten up your change-order procedures. Were there omissions in the electrical quote that didn't make it into your specifications, so that you had to eat the costs the electrician didn't account for? In that case, have someone in your organization compare your contract exclusions with all the exclusions in your subs' quotes before contract signing.

What if you find you plugged into the estimate what you thought the electrical should cost, but didn't bother getting an actual quote from the electrician? Not much you can do about that. But next time, get the quote.

Look at the Big-Ticket Items

Another significant cost factor that should be a snap to get right is large special orders like cabinets, countertops, windows, and doors. Again, this should be a simple comparison of the originally quoted costs with the actual costs, and you should be able to track down the source of estimating errors in these categories pretty easily.

If you add up sub costs and special-order items — all of which are easy to estimate accurately — you may find they represent half to two-thirds of the project cost. That's a solid base to work from: With a little time and energy and a lot of self-discipline, more than half your job costs can be estimated with something very close to rock-solid reliability.

Fine-Tuning Labor

That leaves the biggest challenge — calculating realistic labor budgets. There are lots of ways to do this. One is by unit rate — so many hours per window installation, per door opening, per square of clapboard, and so on. Another is by day rate — the first floor will take so many days to frame, the roof that many more. A third —

which can happen only after you have several successfully job-costed projects — is through comparison with similar past projects.

I won't recommend a method; it needs to be *your* method. I will say, however, that whatever approach you take, the process of improving the accuracy of your labor estimates is one of accepting rather than glossing over the realities of the job site. As discrepancies between estimated and actual costs appear, look first to the estimate to pin down the problems.

If you're off by 100 percent in labor costs for the trim installation, it's more likely that the trim labor budget was way too low than that your crew was only half as productive as it should have been. Placing the blame on the field crew for a big disconnect between actual and estimated costs is pointless — your estimates need to reflect the facts in the field, not the dreams in the office.

Once they do start to better reflect those facts, and you start generating a more predictable revenue stream, you can move on to the next step, which is analyzing where and how to increase field efficiencies. (Keep in mind, though, that those field efficiencies are most effectively generated by properly setting up the job before the field crew ever appears on the site, not by exhorting your crew to work harder or smarter.)

Ultimate Goal

Once you lock in job costs up-front with hard quotes from subs and suppliers, and once you tighten up your labor budgets by using well-documented past experience, the accuracy of your estimates will improve dramatically. At my company, our goal is for actual costs to be within 2 percent of estimated costs (including change orders). We are hitting that target more and more reliably, so we

are increasingly able to closely predict and control how much we make on a project.

For example, we are now able to measure the accuracy of our estimates as the job progresses, using percent-completion accounting. This allows us to predict where a job is headed far enough in advance that we can correct any problems. More important, we're also able to apply these job-cost accounting principles to the entire company, fine-tuning our overhead budgets and getting a clearer picture of how the company as a whole — not just an individual project — is doing financially.

This sort of control should be your ultimate goal. And it is attainable, no matter how difficult and distant it may seem. But remember: It all starts with a good estimate. ◢

Paul Eldrenkamp is owner of Byggmeister Inc. in Newton, Mass.