Winter 2025

CONSTRUCTION INDUSTRY ADVISOR

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Get more from your chart of accounts

Managing the financial performance of any business can be complicated. But it's especially complex for construction companies, which routinely juggle multiple projects at different stages of completion — all while estimating and bidding on other jobs.

That's why proper financial reporting is so important for contractors. Relevant data can easily become fragmented or corrupted, leading to costly financial statement errors, operational inefficiencies and lack of information for strategic planning.

Like many small to midsize construction companies, yours likely keeps a chart of accounts as part of its bookkeeping function. Let's review why this chart is such an important tool for contractors and how you might get more out of it.

The basics

A chart of accounts is a structured list of general ledger accounts used to record and organize financial transactions. Essentially, the chart mirrors a business's financial statements, including major balance sheet and income statement accounts. Here are five commonly used general ledger accounts, including common subcategories for construction companies:

1. Assets: cash on hand, undeposited funds, accounts receivable, equipment, machinery, vehicles, real estate and inventory,
2. Liabilities: accounts payable, taxes payable, outstanding loans, accrued expenses and credit card balances,
3. Equity: retained earnings and capital,
4. Revenue: contract revenue, change order revenue, reimbursements and retainage, and
5. Expenses: direct costs (for instance, materials, labor, equipment and subcontractors) and operating costs (for example, payroll and benefits, facilities, utilities, equipment leasing, accounting, marketing, insurance, depreciation, and other indirect and administrative costs).

Each account is assigned a unique identification number. Customarily, the range of account numbers is 1000 to 1999 for the different types of assets, 2000 to 2999 for the different liabilities

How a chart of accounts can help with cash flow management

A chart of accounts (see main article) organizes the information that's reported on your construction business's financial statements, including its balance sheet, income statement and statement of cash flows. That last one is especially important because it shows your company's sources and uses of cash, and the net change each period. More specifically, it focuses on:

- Daily operations,
- Investments (which, for contractors, is typically the purchase or sale of equipment), and
- Financing that provides or requires cash.

The statement of cash flows generally gives you a more accurate assessment of your construction business's current financial performance than the other two major parts of financial statements. For example, your income statement can show a profit even though you're experiencing negative cash flow. And, unlike the balance sheet, the statement of cash flows can help you better understand changes in working capital accounts (such as accounts receivable, accounts payable and inventory).

and so forth. Each number is accompanied by an account name (for instance, "cash on hand" under assets) and a short description (for example, "operating cash on hand").

Considerable benefits

A well-thought-out chart of accounts is critical for construction companies. Without one — or with a chart that lumps transactions into overly broad, undefined "buckets" of data — you're operating in the dark.

An organized chart of accounts simplifies the preparation of tax returns and financial statements that comply with formal accounting standards, such as U.S. Generally Accepted Accounting Principles. Each account that appears on your balance sheet (assets, liabilities and equity) and income statement (revenue and expenses) is clearly broken out and totaled. So, whether your financial statements are generated internally or externally, the task becomes easier and less error prone.

Additionally, a detailed chart provides insight into project and asset management, allowing you to catch problems such as cost overruns and missing equipment before they spiral out of control. It can also help you better monitor key performance indicators, such as net profit margin and working capital.

Armed with this information, you should be able to identify financial and operational areas in need of improvement and make better strategic decisions. These insights can also help you communicate more effectively with stakeholders such as lenders and potential investors.

Customized approach

There's no one-size-fits-all format for a chart of accounts. The appropriate structure will depend on the number, nature and complexity of your construction company's financial transactions.

Although most businesses use the five main general ledger accounts described above, you'll need to identify the optimal subcategories to track. You

could, for example, have subaccounts for different specialties (such as concrete, roofing and asphalt) or types of work (commercial vs. residential).

Like most construction companies, yours probably manages multiple projects simultaneously. If so, assign project codes to individual jobs. This extra layer of coding in the chart helps allocate direct costs and overhead to get a clearer picture of which jobs are profitable.

For more granular tracking, some contractors even create subcodes for activities within each phase of a project, such as excavation, framing, plumbing and so on. Task-specific codes can help management evaluate job progress and apply the percentage-of-completion or completed-contract accounting methods. Construction-specific accounting software is usually helpful for automating code assignment and ensuring a consistent chart structure.

Don't feel obligated to go overboard, though. Start-ups and small businesses may be able to use a simplified chart of accounts, adding more layers of detail as they grow. Focus on areas that will shed the most light on your construction company's financial performance.

Best it can be

Consistency in a chart of accounts is important for comparing financial results from one reporting period to the next. But don't hesitate to continuously improve yours to capture the most relevant information. Ask your CPA for help making it the best it can be. ■

Why busy contractors should consider benchmarking

If you're like most busy construction business owners, you have plenty on your plate. Adding anything more to it is likely a tall order unless that item is going to make a real difference in your company's success. Well, here's something to snack on: benchmarking.

There are many ways to go about benchmarking. It's essentially a research-based process for comparing your construction business's current results (in whatever measures you choose) to either your past results or those of similar companies.

Know where you stand

The purpose of benchmarking is to help business owners and their leadership teams more effectively manage their companies and engage in better strategic planning for the future. It provides a context for how your construction business is performing and shows you where you might improve.

Internal benchmarking — comparing current performance to historical results — highlights what you've done well but also points out potential risks. For example, a benchmarking study might indicate that your long-term debt-to-equity ratio is rising. This means your ability to pay long-term debt may be weakening. Knowing this can prompt an investigation as to why it's happening and enable you to bring that ratio back into proper alignment.

External benchmarking helps you understand how other construction companies like yours have performed over a given period. For instance, how does your average time-to-completion metric compare with those of similar businesses over the last three years? Is your profit margin in line with comparable competitors?

Choose your benchmarks

The specific benchmarks you choose should be those that have the biggest financial impact on your company. A plumbing contractor, for instance, is unlikely to be as concerned with capital equipment costs as an excavator.

In deciding which benchmarks would be best for your construction company, consult your leadership team and professional advisors. Reach a consensus on which data points to benchmark.

For example, you might compare your estimates to historical averages over a three- to five-year period. Or you could look at how gross profit in backlog, or profit recognized to date, compares to historical averages. Other points to consider include:

- Labor costs, including overtime,
- Overhead and indirect costs,
- Materials and equipment costs,
- Cycle time, and
- Change orders.

In addition, you might want to consider benchmarking bonding-related information. How does your bonding capacity today compare to three years ago? Or how does it compare to your competitors' average capacity? If you do decide to benchmark any such points, be sure to let your surety know. Demonstrating that you're working to improve your bonding status should be a major point in your favor.

Gather the data

Once you've chosen your benchmarks, you'll need to gather the data to measure and compare them. If you're engaging in internal benchmarking, you should be able to rely on regularly generated business documentation such as your financial statements, tax returns, accounts receivable and payable records, and bank statements.

For external benchmarking, look to reputable sources such as industry reports from construction trade associations and government agencies; publicly available data from competitors' websites, annual reports and press releases; and online benchmarking tools and databases. Just make sure you're working with accurate information that's relevant to what you're measuring. Construction industry organizations can indeed be reliable sources, but they tend to have a national or regional focus. You may need to drill down further to get local data.

The hardest part is getting started. Once benchmarking is a regular part of your financial operations, it should become easier as you establish trustworthy data sources and sound processes.

Explore the concept

There's no doubt that benchmarking takes time and resources, which may not be easy for busy contractors to give up. But, done properly, it's a practice that can take growing construction companies to the next level. If you're interested in exploring the concept further, contact your CPA. ■

Considering the cost savings of mobile field fueling

Keeping construction vehicles and equipment fueled up has always been a challenge. Customarily, contractors transport vehicles and equipment to off-site fueling stations when needed. But this often interrupts work and consumes even more fuel in the process. One intriguing recent development is the rise of mobile field fueling.

On-site vs. mobile

Under the mobile field fueling model, fuel and other service fluids are delivered directly to jobsites. In one version, the construction business itself buys bulk diesel trucks or service vehicles to transport fuel.

The ownership cost for such vehicles, however, can be considerable. It includes the initial investment, wages for drivers with the proper licenses, maintenance and repairs, and insurance. Recently, less expensive trailer-mounted setups and medium-duty truck upfits have entered the market. The smaller trucks and tanks often don't require additional driver certifications.

Another approach is to engage mobile fuel providers who use specialized trucks equipped with advanced delivery systems, such as pumps and metering devices, to deliver fuel to jobsites. Contractors can coordinate deliveries based on project timelines and expected fuel consumption.

But wait a minute, you might say, why bother with those approaches if we can just set up our own fuel tanks on remote or hard-to-reach jobsites? That remains an option. But on-site storage poses safety concerns. Your construction company must comply with stringent regulations to prevent fires, property damage, injuries and even fatalities.

Careful coordination is necessary to ensure fuel deliveries align with job schedules and don't disrupt operations.

Security is another issue. Fuel theft can happen when tanks are accessible and left unattended. Plus, the tanks themselves can be expensive to buy and maintain, not to mention difficult to move.

Potential benefits

When the service is well-coordinated and ably provided, mobile field fueling helps maintain operational continuity, enhancing overall efficiency. By planning deliveries around project needs and machine usage patterns, equipment stays running without unnecessary idle time waiting or traveling to refuel.

Another major benefit of mobile field fueling is long-term cost savings. Fuel deliveries are based on specific needs, which helps avoid overbuying and reduce waste. Security also is enhanced. When fuel is dispensed directly into equipment, there's little opportunity for theft.

Mobile field fueling reduces carbon emissions, too. Eliminating trips to off-site fueling stations lowers a project's carbon footprint, aiding compliance with green initiatives and environmental regulations.

Risks to manage

Naturally, mobile field fueling has its risks. Safety is a significant concern. When choosing a provider, ensure the company follows stringent protocols to comply with regulations and local guidelines. Vendors should be able to clearly describe their fuel delivery processes, including safety measures, as well as provide references.

Also, careful coordination is necessary to ensure fuel deliveries align with job schedules and don't disrupt operations. Look for providers capable of drawing up responsive delivery plans that are adaptable to project changes and unexpected developments.

Finally, there's the question of cost. A best practice is to conduct thorough cost-benefit analyses of using the traditional off-site fueling approach vs. acquiring your own equipment vs. mobile field fueling. With this necessary financial information in hand, you can make the best choice for your company.

Logistical convenience

It seems we live in a world where, in many places, virtually anything can be delivered. For construction businesses, this includes fuel — a logistical convenience well worth considering. ■

Is CRM software for construction companies, too?

In technological parlance, "digital transformation" refers to many businesses' ongoing efforts to digitalize *all* their processes. One area of your construction business you may have yet to digitally transform is how you manage contact information related to customers and other parties. For many years, companies in other industries have used customer relationship management (CRM) software for this purpose. But can contractors? You bet!

Centralizing data

The purpose of CRM software is to enable users to put all customer- and prospect-related data in one central repository. That way, the most current version of this information is accessible to everyone authorized to see it. The software eliminates having redundant or outdated bits and bytes of customer and prospect data scattered across multiple systems or hidden in employees' email or phone contacts.

Construction companies, however, tend to have far more contacts than just customers and prospects. Your business may also interact with government agencies, real estate developers and agents, architects, engineers, subcontractors, suppliers and vendors, lenders, investors, professional advisors, inspectors, and consultants. (Did we miss anyone?)

By centralizing all that data, CRM software eliminates the information silos that often happen when, for instance, estimators work with some contacts and project managers work with others. Everyone has access to the same comprehensive, regularly updated data set.

Contact information can include more than the basics of name, address, phone number and email. You also might add project history, email exchanges and notes about conversations. Individual contacts can be grouped however you choose — including by project, company and subcontractor specialty.

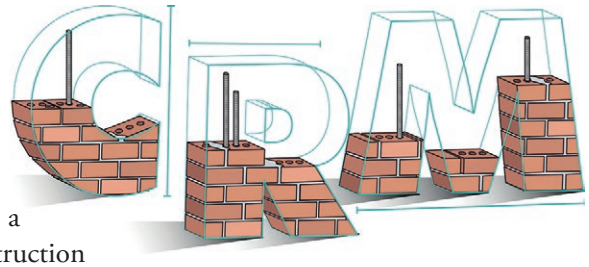
Plus, most CRM solutions are now cloud-based, allowing users to remotely access information via a mobile device anywhere, any time. This can automate processes and speed up all phases of construction, from estimating to bidding to completing the work itself.

Finding your sweet spots

CRM software is more than just a digital storage depot. It can serve as a library of past bids and projects that estimators can reference when writing up proposals. You may be able to use it to form project teams more quickly and easily. And all the while, you and your leadership team can run various reports to identify key strategic points such as:

- The most fruitful lead sources, and
- The most winning and profitable project types.

Some construction businesses even retain their employees' contact information to track and leverage those relationships if staff members change employers.



Shopping smart

There's no doubt CRM software *could* do a lot for your construction company. But that doesn't mean it's a must-buy item. If interested, shop smart by researching various products, evaluating the total cost (including training, maintenance and cybersecurity), and ensuring compatibility with existing systems. ■

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