One Version Of The Truth – Making Sense Of Project Accounting

I remember, when I was managing a portfolio of projects at my last employer, the most stressful moments came, not when I was eyeball to eyeball with the customer in a project meeting but when I was in management meetings with our Finance Director. Don't get me wrong, he was a nice enough chap and we got on famously, but it often seemed we were talking about different projects, such was the chasm between our respective views.

You see, as a project/program manager, my focus was on getting things done; problem solving, managing work, and planning. While my FD was more worried about tracking the money; recognising revenue, absorbing costs and forecasting the final impact on the company's bank account.

Nothing surprising about that of course, but the way we worked and the systems we used reflected our own goals and trying to reconcile them was virtually impossible. It did appear that we had two versions of the truth.

I'm sure my experiences weren't unique, as many organisations aren't designed to work in a project-centric way. So where are you likely to stumble across problems, as a result of these mismatched approaches? And what can you do to avoid them?

Setting off on the right foot

At the risk of upsetting line managers everywhere, I'd suggest that departmental budgeting isn't the most difficult exercise in the world. There is usually previous year's data to refer to, that will show up any trends and patterns, and future price and salary increases can be estimated reasonably accurately.

Project budgeting on the other hand, has a whole load of additional traps to fall into. Apart from the challenge of accurately identifying the activities needed and the associated time and resources to do them, you need to think about:

- If your project overlaps the end of the financial year, how will your budget be linked to the departmental or corporate budget for the next financial year?
- How will labour costs be calculated? At direct cost (i.e. payroll), loaded (i.e. including overheads), opportunity cost or full market cost (i.e. sales list price)?
- What expenses will be included in your project costs? Direct costs (i.e. travel) or indirect costs (i.e. training, procurement, admin)

By making sure that the basis for your project budget follows corporate standards for these issues, you can avoid unpleasant surprises later. Or if there are no standards for these, I suggest you agree them with your FD before you go any further with defining your project.

Billing and revenue ain't the same

In the world of tangible products, revenue equals billing equals shipping. Nice and straightforward then. But in the world of projects with the messy reality of stage payments, intangible deliverables and final acceptance, things aren't so straightforward. Following the accounting principle of fiscal prudence, your FD will rarely recognise delivered or billed outputs immediately. Instead, recognition will take place based on project progress or against contractual milestones.

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So why is this important? Well, the recent problems at iSoft, the NHS software and services vendor, where incorrect recognition of £174m revenue over the last three years meant a huge reversal in the current year and a resulting £382m loss, is a case in point. Even then, iSoft's auditors were unable to sign off the years accounts and a huge question mark was left over the company's real financial performance.[1]

Although there are guidelines and standards such as IFRS (International Financial Reporting Standards) they aren't adopted by all companies, especially SME's, so it's worth finding out on what basis your company recognise revenue. At the slightly reckless end of the scale, you may recognise revenue as soon as the work is done while at the super-prudent end, you may only recognise revenue when the client pays the invoice. In practice, you will probably use a rule somewhere in between the two but the point is that you have to agree this with your FD and in accordance with your contract with the client, if it is to be 'true and fair', as accountants like to describe these things.

Before you get to the revenue recognition process, you need to ensure your client is billed accurately and in line with the contract. Unless these are extremely straightforward, it's probably unrealistic to expect your finance team to remember specific detail of each one, so a joint approach is often most effective.

The first step is to ensure that you, as project manager, are part of the invoice generation and approval step and so, each month, review all work done and deliverables completed with the finance team and agree what you can bill, what you may defer until a future period and what, unfortunately, you may decide to write-off. Ensure accurate records are kept so that nothing slips through the net and so that there is an audit trail in case of a query by the client.

But these aren't my costs!

That's the revenue side dealt with but what issues can trip you up when managing project cost? Even when you've agreed what costs are going to be allocated to your project and how they will be calculated, there is still the problem of making sure you track them accurately, to be overcome.

The worst time to find out what costs you've been hit with is when you get your monthly accounting reports. Not only do they often lack the detail you need for traceability but you will get roundly abused by the finance team if you try to get them changed. And they aren't people you want to upset too often.

Far better to make sure you are part of the sign-off process for each category of cost in your project so you can spot any mistakes before they get posted to the accounts. For most ICT and business change type projects, labour is the largest element of cost but its quite astounding how few organisations have a time and expense reporting system in place. By which I mean, a standardised time sheet and expense claim form that identifies project work clearly and is approved by the project manager (and usually the line manager) before landing in finance's in-tray. Of course, time sheets are universally unpopular but which is more important, a few minutes of admin or out-of-control costs on your project?

Even if your organisation doesn't have this process in place, there's nothing to stop you establishing it as part of your project governance as long as you get the commitment of the various department managers to help enforce it. If there is a strong case for your project, it would be hard to argue against it.

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[1] Ref Accountancy Age 25th August 2006

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The mystery shopper

Procurement is another accident waiting to happen for many project managers. Whether you are buying services through a sub-contractor or materials from a vendor, the procurement processes already in place may not be suitable for our needs.

Firstly, any purchase and subsequent payment needs to be authorised by the project manager, if he/she is to be accountable for the costs. Sounds obvious? Well, it is but how many times have you seen purchase costs allocated to your project for unauthorised purchases? Believe me, it happens all the time.

And because of the need to track your budget carefully, it's important to know what cost you have committed to at the time of placing the purchase order, not just when the purchase invoice is received from the vendor. Few accounting systems allow you to accrue like this as a matter of course but with a potential gap of months between the work being done and the invoice being received, it's not only prudent but also avoids your FD having a cash-flow induced heart attack when a big bill lands in his lap. By tracking purchasing commitments and payments for your project and sharing this with your finance department, you can jointly decide what to accrue for and your financial reports will be more accurate as a result.

Battle of the financial statements

If you follow the guidelines above, hopefully you will be aware of what costs and revenue are being incurred and created by your project. But that still leaves the problem of making sure that the monthly financial reports reflect the reality of these costs and revenue. There's nothing more unedifying than a project manager and a FD waving different versions of the same report at each other; you really need to understand and agree that how the project is reported financially is accurate and meaningful.

The first concern is how your company's chart of accounts is structured. Often, these aren't designed to reflect project activity and so don't have the level of detail you would wish for. For example, can you differentiate between reimbursable and other direct costs? Do you have an account for unbilled revenue so you can track WIP? Do your direct expense accounts give you enough detail about what type of product/service they relate to? Changing a chart of accounts isn't something that should be done lightly, but if there is a lack of detail, you should agree how you will track and reconcile it on a regular basis.

But apart from what you report, the timing of the figures relative to the project baseline is important. Corporate financial reporting is done relative to the financial calendar i.e. by period and year and it is easy to transpose the project figures directly but this takes no account of whether the project is running early or late. For example, you may report that your project costs are only 80% of the project budget for the period and, on the face of it, you would be congratulated for effective cost control. But if you have only achieved 50% of the work planned for this period, then you are actually 60% over budget! In effect you are storing up an unpleasant surprise for later when the overrun becomes apparent.

So what can you do about it? The simple but time consuming process is to recast your project budget on a monthly rolling basis, so that your project variances are against the latest plan. Or alternatively, you can adopt an earned value reporting process that allows you to measure both schedule variance ("are we behind or ahead against plan") and cost variance ("are we spending too much or too little"). This is a technically elegant solution but the challenge is in educating your management team in how it works and how to interpret the results. Without

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common understanding you will be no further forward in reaching this elusive single version of the truth.
However you manage this timing issue, the single most important figure will be the forecast cost to completion. This will give you an overall variance against your project budget and also help your project sponsor (and FD) confirm the continued viability of your project against the business case.

Spreadsheets, spreadsheets, spreadsheets

Hopefully, you will be convinced by now that just adopting 'business-as-usual' commercial and financial processes won't really get the job done. So you've talked through the specific needs of your project and your FD has raised the practical objection; how is this extra work going to get done?
Assuming your accounting systems are reasonably current, it should be possible to create what is in effect a project ledger in a spreadsheet and then import individual transactions into the accounting application. This has the benefit of being relatively quick and low cost to implement but with the downside that it's reliant on one individual and has little validation or real-time capability. Which means that mistakes get made and data isn't always up to date.
By far the best solution is to implement a PSA (Professional Services Automation) application, either to interface with an existing accounting system or, better still, to replace it. This gives a single system for time & expense entry, procurement and billing, all related to a specific project, and ensures postings are made to the right account and to the right project. By tying together the project information and the accounting information at the point of recording the transaction, you can avoid incorrect or missing data. Most importantly, reconciliation between the project view and the accounting view is a given; the system ensures both are kept in line.
Which is the best solution for you? Well, if projects are genuinely an occasional requirement rather than a typical mode of business, then the overhead of running a manual project ledger and interfacing it with your accounting system would probably be acceptable. But if your business model is all about projects, the investment in selecting and implementing a PSA application could well be justified in more accurate, timely and efficient project accounting processes.

Think like a Finance Director

Probably the most fundamental change that will make your project accounting process run smoothly is for you, as Project Manager, to think and act as a business owner of your project. Which means that you know the business case inside out, that the budget is as important to you as if you were spending your own money , and you pursue the benefits of the project, whether its cash from an external client or a cross-charge from another department, with a vengeance. By adopting the persona of your Finance Director, it will help you question how the budgeting, billing, procurement and financial reporting processes are done. But more importantly, how to make sure they support your project in a way that is effective and meaningful. Without this impetus, it's easy to end up with two versions of the truth. And that's no way to manage a project.

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