

# Are You Sure You Don't Need a Job Cost System?

By Wayne Clark, CPA

Basic job cost systems track revenues, costs and profits by contract or by tasks within a contract. Many government contractors intentionally avoid contracts that require this level of detail. Have these contractors avoided extra work, or are they unknowingly operating in a risky business environment? This article will discuss why having an effective job cost system is a necessity for government contractors.

Example: XYZ Company won its first government services contract, a five-year fixed-price contract, consisting of five separate CLIN's (Contract Line Item Number). XYZ keeps the accounting simple by charging costs of all five CLIN's to one account number. XYZ invoices the government 1/12 of the value of each CLIN on a monthly basis. Simple – right ?

Suppose six months into the contract it is operating at a loss. Management is unable to determine why. If XYZ had an accounting system that accumulated actual costs by CLIN, they could be compared to cost proposal worksheets to identify the cause of the losses. At this point one can only speculate. Was the bid flawed? Is there an operational problem? Is it something else?

Contractors increase the risk of a flawed bid by not having a job cost system. Job cost systems are a source of historical data for similar efforts that can be used as the basis for both cost and level of effort estimates when bidding new work. The process of comparing costs and hours bid to actual costs and hours incurred improves the internal bid process and reduces the risk to contractor when bidding new work.

The loss could be also be an operational problem. A job cost system is a management tool where project managers can be held accountable for the profitability of each of the five CLIN's. Project managers are generally held accountable only for controllable costs (direct labor, materials, travel). The project manager simply compares costs and hours from the cost proposal detail to the actual costs and hours incurred. All of this information can be available in a job cost report. An Excel-based approach is also effective, even though it is more labor intensive if the accounting system does not have such capabilities. The project manager is then held accountable for managing the controllable contract costs and working with senior management to address any potential contract cost over-runs.

Non-controllable costs such as fringe benefits, overhead and general & administrative (G&A) costs are usually the responsibility of senior management. Unfortunately for the project manager, senior management always has the right to request reductions in direct costs to offset unexpected and uncontrollable increases in indirect costs.

XYZ management finally realizes services in excess of CLIN 3 contract requirements were provided to the government. XYZ may seek additional compensation (request for equitable adjustment) for the additional costs incurred. Unfortunately, XYZ has the burden of proof that must consist of accounting records, timesheets, and employee expense reports that clearly indicate that these costs were incurred under CLIN 3 and are a direct result of the level of effort in excess of contract requirements. Without a job cost system XYZ has put itself in a very difficult position.

**Lessons Learned:** These are hypothetical examples of what can go wrong under a fixed price contract. Even though a company has fixed priced contracts, it is likely that a company will require job cost reports by contract or by separately priced items within a contract. A job cost system is an important tool for managing contracts, preparing cost

proposals for similar efforts, providing support for equitable adjustments and as basis for preparing a settlement proposal under a termination for convenience.

A job cost system is not just accounting or project software. It is process that impacts corporate culture at the senior executive, project manager, proposal manager and financial manager levels. Simply put, it is a system of checks and balances that ensures company profitability objectives are met both at the proposal stage and at the operational stage.

A job cost system is a long term investment in the company's future. The largest investment is usually the time required to set up a job cost system. The longer a company waits, the greater the level of effort and cost.

Many companies begin with inexpensive job cost software such as QuickBooks, which can generate job cost reports at the gross profit level, revenue less direct costs. Whether it is QuickBooks, Deltek or another software product is not important. Once established, a job cost structure can be migrated to another accounting system or enhanced as the contractor grows in both size and complexity.

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