White Paper 2014-06

How to Use Reconciliation between Cost Control and Accounting to Improve Control on your Project

While Accounting and Cost Control functions and processes should be separated (as described in White Paper 2014-02), it is essential to reconcile very regularly the data from these two processes to ensure that your project is under control. In this White Paper we expose the principles of this reconciliation and the best practices that need to be followed to get the most out of this useful process.

A useful reality check

Reconciliation with accounting will give an indication of the quality of the cost tracking on the project (which forms the basis for the forecast).

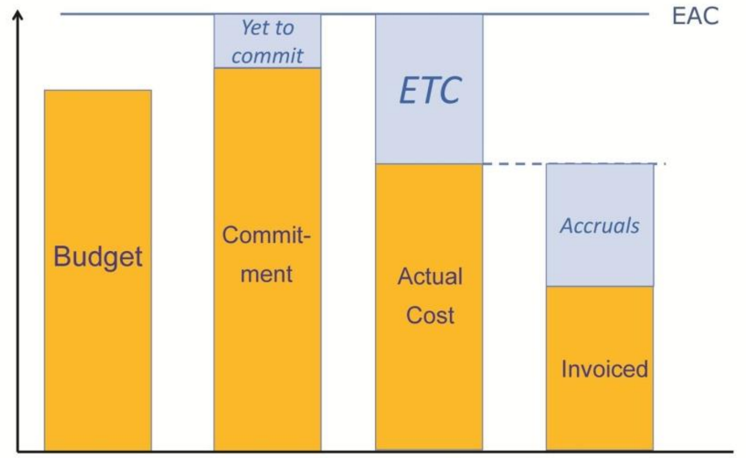
Reconciliation needs to be performed on a monthly basis at the Work Package level, the lowest level of the Cost Breakdown Structure. This is feasible through the consistent implementation of the Cost Breakdown Structure in both the Cost Control and Accounting systems. There shall normally be a positive difference between Cost Control's actual cost and the Accounting cost (also called Invoiced Cost), and this difference will form the period's accruals.

The figure on the next page shows how the reconciliation process works. Reconciliation needs to be done manually at the Work Package level to understand whether the difference between the Invoiced Amounts and the Actual Cost (including accruals) makes sense.

A proper reconciliation process between Cost Control and Accounting allows to benefit fully from these two independent control systems and increases assurance that the project is effectively under control

Principles of reconciliation checks

The following figure illustrates the principle, which can be applied to any breakdown level in the project, down to the work package.



Actual Cost = Invoiced + Accruals
For Internal Costs:
EAC = Actual Cost + ETC
For External Costs:
EAC = Commitment + Yet to commit
ETC = EAC – Actual Cost

Example:
Actual Cost = 30 = 20 + 10
EAC = 60 = 30 + 30
EAC = 60 = 50 + 10
ETC= 30 = 60 - 30

It is important to check that the Actual Costs be higher than the Invoiced Costs at any time (barring any advance payment which only affects cash flow). This difference should be fully explained by the invoicing delays compared to the actual performance of the work.

Commitments shall also always be higher than Actual Cost (otherwise there is an evident issue with the commitment process and tracking), and the Estimate at Completion (EAC) shall be higher than the Commitments at all times, except upon project completion and final close out when they all converge and equal each other. Finally, Actual Costs should normally only grow over time, unless a mistake has been made which would result in a credit note.

The difference between Actual Cost and Invoiced Cost values in accounting shall be examined to detect whether the Actual Cost basis is indeed a sound basis for forecasting. Any excessive difference needs to be explained (it could be, for example, unusual invoicing delays from a contractor, but could also be that the basis for Actual Cost derivation is not relevant).

Important note on invoicing recognition timing: *A best accounting practice is to book invoices at the time they are received and found to be formally acceptable (if there is a non-obvious mistake, a credit note can be requested before payment anyway). This allows the organization to get a clear view of its liabilities. However, many organizations do wait for the invoices to be approved before booking them. This practice has significant drawbacks because it lowers the apparent liability level and because it may create additional delays which will amplify the difference between Actual Cost and invoicing levels, and hence increase accruals. This will in turn make the reconciliation process more challenging. In addition, in situations of tight cash flow, this practice will be an impediment to proper cash flow management because of lack of visibility on actual invoices received.*

Organization of the reconciliation process

Reconciliation should be done on a monthly basis, at the time where the accruals need to be determined by the organization (following the accounting calendar). The reconciliation needs to be lead with either Cost Control or Accounting, with most organizations having Accounting drive it. Reports are produced both from the Cost Control systems and the Accounting systems, the results are compared during a meeting where differences need to be examined and where it needs to be decided if they make sense based on the past and current activities of the project.

Reconciliation needs to be performed on a monthly basis at the Work Package level

This process will lead possibly to changes in the Actual costs or Invoiced cost (e.g. if it is discovered that invoices have not been keyed in while they had indeed arrived).

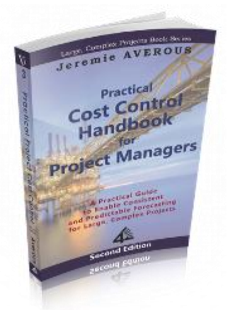
Monitoring the level of accruals

The level of accruals in a project need to be monitored, as a too low or a too high level can reflect issues with project controls:

- Too low accruals would tend to show that the Actual Cost determination by Cost Control is insufficient,
- Too high accruals would tend to show that some suppliers are too long in their invoicing, which might be a problem if the commitment system is not fully performing, as the people that committed the cost might have left the project when the invoices will arrive.

Conclusion

A proper reconciliation process between Cost Control and Accounting is essential. It allows to benefit fully from these two independent control systems to increase assurance that the project is effectively under control. It needs to be implemented regularly and its conclusions need to be traced. The Project Manager, without being involved in the details, must keep abreast of its results and of possible identification of issues related to project controls that might have been detected.



.