ENHANCED ACCOUNTING METHODS ADD VALUE

How to apply Lean Six Sigma principles to improve financial strength

BY MICHAEL J. SIBLEY AND KATIE V. DAVIS

During the economic downturn, demand for construction plummeted, forcing contractors to face a new normal. Contractors were expected to maintain a high level of service at break-even or loss margins. New competitors created downward pressure on bid pricing, which radically reduced opportunities to replace backlog at reasonable margins for new projects.

One large commercial general contractor felt the pressure to face this new normal. The challenges of the recession made it more important than ever for the company's principals and management team to monitor their financial performance, both on a job-by-job basis as well as company-wide. A closer evaluation of their financial records in 2011 as compared to 2010 revealed a 21 percent decline in contract revenues, a 50 percent decline in gross profit and a rapidly shrinking net income.

At the time, the accounting department was working tirelessly, putting in significant amounts of overtime to compile quarterly financials which were typically ready for review 60 to 90 days after quarter end. The principals began investigating options to address these challenges, and decided to work with an outside consultant certified in Lean Six Sigma to improve its accounting processes.

WHAT IS LEAN SIX SIGMA?

Lean Six Sigma (lean) is the combination of two process improvement methodologies focused on increasing efficiency and quality in a process, by identifying non-value-added activities and eliminating them. Simply put, it's a way to do things better. For decades, manufacturers have been using lean to improve production output, quality and customer value. Over the past two decades, other industries have realized the significant benefits from using lean concepts to improve their processes as well. Although most corporate leaders have heard of lean manufacturing, they don't realize how applying lean can have a profound effect on their companies by improving productivity, customer value, employee morale and profitability.

THE PROJECT

The company's initial goal was to reduce its financial closing and reporting process from 60 to 90 days on a quarterly basis to 15 days on a monthly basis to allow the principals and management to make more informed decisions using real-time financial reports. However, after addressing the details associated with this project, the focus turned to the company's cash disbursement process because of its significant role in timing of the closing and reporting process.

A 12-employee team was formed to tackle this project. Formation of the team was strategic, in order to encompass a cross function of different departments and levels within the company. The team included two principals, the entire accounting department, a vice president, a director and a project manager. Each member represented various operational divisions. The items they introduced were evaluated and prioritized by the two facilitators certified in Lean Six Sigma.

GOALS AND SOLUTIONS

The team met for several days during a two-month period to analyze and review current processes, identify critical areas for improvement and develop solutions associated with each process based on lean techniques and procedures. The following goals and solutions, unique to the culture of the company, were developed by the team.

Goal 1: *Improve relationships and communication with customers, subcontractors and suppliers for timely receipt of documents required to make payment.*

Solution: Initiate deliberate conversations between project managers and subcontractors regarding the importance of timely receipt of pay applications, insurance waivers and lien releases. Establish consequences for untimely payment if the appropriate documents are not received.

Solution: Implement a paperless system for subcontractors to provide documents that do not require original signatures.

Goal 2: *Better communication between operations and accounting departments to improve the documentation provided by project managers to accounting.*

Solution: Develop and implement training programs for all personnel involved in the cash disbursement process, including reference guides for project managers to use when coding accounting documents.

Solution: Implement a paperless system for document sharing between project management and accounting personnel.

Goal 3: *More timely and meaningful internal financial reporting to decision-makers.*

Solution: Deliberate conversations between the principals, management team and accounting department to determine which financial reports are meaningful for timely decision-making.

Solution: Work with internal and external IT support to automate reports within the company's accounting system.

The team recognized the complexity of their situation and responded by creating a detailed timeline over one year for the rollout of these solutions. They also retained the facilitators to meet with them every other month to review the progress of implementation, add accountability for meeting progress goals and provide outside perspective and lean expertise when solutions needed to be adjusted.

While some solutions can be implemented within a short time frame, others may take months. The efficiencies will also not occur overnight. Rollout of a new process requires strategy, training and accountability. The creation of a timeline and the retention of experts on a part-time basis will help companies meet their end goals.

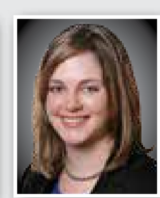
THE RESULTS

After project completion, the company lost three high-level accounting personnel, who have yet to be replaced. Even with a reduced head-count in the accounting department, they still generate monthly financial reports for principals and management within one to two weeks of month-end, while working more reasonable hours with improved employee morale.

The company also leveraged their gained capacity to focus on their client's needs and to seek out additional business development opportunities. They experienced improved financial and operational strength. Their backlog continues to grow as pent-up demand in their market materializes into good projects, and they have the financial resources and management experience to weather the poorer contracts that are approaching completion.

The recession is now labeled a recovery and jobs are becoming more prevalent within the construction industry. Contractors now face labor shortages and struggle to staff available jobs in today's recovering economy. By developing a culture that seeks continuous improvement and conducting periodic and purposeful reassessment of processes, contractors can maintain their edge in challenging environments and stay ahead of the competition.

Learn more at the Construction Financial Management Association (CFMA) Annual Conference & Exhibition in Chicago, June 27-July 1. Register at cfma.org/conference and follow CFMA on Twitter, Facebook and Instagram with #CFMACONF15.



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