

WHITEPAPER

# THE ESSENTIALS OF COST VALUE RECONCILIATION IN CONSTRUCTION



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## INTRODUCTION

### Unlocking CVR Clarity for Construction Success

In the construction world, projects are like intricate puzzles of resources, deadlines, and money. Making each project succeed depends on finding the right balance among these pieces. But it's not always easy to do.

#### NAVIGATING THE COST VALUE RECONCILIATION MAZE

Construction experts are always trying to manage projects efficiently and make as much money as possible. That's where Cost Value Reconciliation (CVR) comes in. It's a way of saying that you closely examine how much you invest in a project to ensure it's a wise decision. You also want to see if the project is moving in the right direction and making a profit.

The tricky part is that this important information is scattered everywhere, like pieces of a jigsaw puzzle. To keep projects on track, find areas where you can improve, and ensure you're making money, you need to see the bigger picture of CVR.

And it's not just about today; it's also about keeping things going for the long haul. Your data is super valuable if you know how to use it. So, how can you make the most of CVR data? That's what this whitepaper explains.

If you have any questions after reading it, don't hesitate to get in touch. We're here to help you understand how to succeed in construction and make smart financial decisions.

## WHAT IS COST VALUE RECONCILIATION?

The aim of a Cost Value Reconciliation (CVR) is to assess how far through the project you currently are commercial - taking into consideration the expected final position of the project. It is good practice to keep the project on a realistic trajectory of cost and revenue.

Revenues and costs in construction rarely flow linearly over the project duration - the current margin, if left to its own devices, will fluctuate rapidly with whatever is happening on the project.

### **The complexity comes from the nature of the projects:**

- They are high-value items that take time to complete - payments need to be made during the project's life, and an agreement must be made between the client and the main contractor as to what these payments should be.
- Procurement is not steady through a project; high-value items may be purchased earlier on in the project, for example, and frequently may be made without visible progress to the project (especially if things need manufacturing off-site, for example).
- The client may over or underpay at any point in the project.

## WHY IS COST VALUE RECONCILIATION Important in The Construction Industry?

Cost value reconciliation is essential to the construction industry as it helps to ensure that a construction project is controlled and managed within expected profit margins.

Leaving margins to fluctuate does not give the business any certainty over a project's final position. If a client overpays, for example, and current margins look high, it might be good for short-term cash flow, although that may overstate how well the project is doing. Eventually, the overpayment catches up, and the margin for the project may suddenly fall off a cliff.

One aim of the CVR is to try and balance the project to show a more accurate position resembling where the project is heading.

### **Factors involved in this process include:**

- Project Progress - How far physically are you through the project?
- Costs - particularly considering progress - i.e. You may have spent more on materials than has been used in the project.
- Revenue - again considering progress. - i.e., the QS needs to identify why actual revenue is above or below where it 'should' be in the project. You may have over-claimed to your client, and they may have agreed, but that doesn't mean you've done it all.
- How much profit/margin can be 'taken' at a point in time?



Here are some key factors that are common to the CVR process:

### **UNDERSTANDING THE CURRENT POSITION**

The surveyor needs to understand exactly where they are in terms of the financials of the job. This understanding also needs to consider if these financials accurately reflect the genuine position of the job.

### **FORECASTING THE FINAL POSITION**

The business needs a solid financial plan and a realistic understanding of its financial position. The surveyor will periodically calculate the forecasted costs and revenues.

### **REALLOCATING INCORRECTLY ASSIGNED COST**

In reviewing the project costs, the surveyor may find that they have costs allocated to the wrong part of the project, or in the worst-case scenario, they have costs on their job that should not be there at all. The surveyor may have to reallocate costs to the appropriate Project, Work Breakdown Structure or Cost Code, which can have a knock-on effect in the subsequent period, or they may have to go through a lengthy process to negotiate and gain authorisation to move costs to another project to bring project costs back in line with the forecast.

### **ADDING ACCRUALS FOR MISSING SUBCONTRACT COSTS**

The surveyor knows that a subcontractor has worked diligently on their job all month but is a bit behind on their paperwork; they don't want the job to look too profitable in the current period but then lose all that gain in the subsequent period. A typical process for the surveyor is to account for that work using an accrual.



### **ADDING ACCRUALS FOR OTHER MISSING COSTS**

There could be many reasons why costs are missing from a job; a few examples might be...

- Materials have been received that haven't been invoiced yet.
- Labour timesheets have not been posted yet.
- Plant hire hasn't been invoiced yet.

### **ALLOCATING THE REASONS FOR WORK IN PROGRESS (WIP)**

WIP to be Analysed – The client may have certified less than the forecast expects based on the project's progress. The surveyor is then accountable for justifying the reasons why.

### **PROJECT CASH FLOW**

Not only do people want to know the cost and revenue to complete the project, but when that cost and revenue is going to happen.

# THE PROCESS OF Cost Value Reconciliation

The Cost Value Reconciliation process involves several key steps:

## 1. BUDGET

A budget is not a pre-requisite of a CVR – but it can help. At the pre-contract stage, a detailed estimation may be prepared based on the scope of work (materials, labour, equipment, and other associated costs).

Budgets can be high-level, very detailed or somewhere in between. As well as being used for project control, the budget can assist the surveyor with the cost to complete forecasting.

A budget helps the CVR by kick-starting the forecasting process – a surveyor may take a budget less committed/accrued/actuals and use the remainder as an initial forecast. Subsequent forecasts are then based on that initial forecast.

If the budget is incomplete, overly summarised or held in a separate place (spreadsheet or third-party system), then this will inhibit the efficiency of calculating the initial forecast, meaning that the surveyor must work that out from scratch.

## 2. MONITORING COSTS

Project managers track and record all costs, including labour, materials, subcontractor fees, equipment rentals, and indirect costs. A common issue is timing – maybe the finance team must painfully extract the data from a legacy system. When the surveyor gets this data, it's outdated and possibly inaccurate, especially if manual intervention is required.

Variations are frequently held outside of the legacy systems and complicate this further. Accessing up-to-date, accurate cost and revenue data provides certainty to the surveyor about what is and what isn't included – and saves time by eradicating the need for checking, double checking, and manually updating their records.

## 3. MONITORING REVENUE

Revenue is challenging to track if most of the data that makes it up is held outside the system; an example may be spreadsheet applications. If the surveyor needs to look at different sources for this information, this can be a bottleneck in the process and lead to human error.

## 4. UPDATING THE CVR

Typically, the CVR will be held in a spreadsheet and eventually updated with all the costs and revenues identified above. The surveyor will adjust in an isolated spreadsheet and be mindful of the date the data is held up to. These adjustments are taking place in isolation from the rest of the business in the surveyors' island of information.

Sharing the results of that CVR becomes manual – perhaps emailing versions of the spreadsheet around, for example. This is also the case for approving the CVR by management



## 5. COMPILING THE CVR

The business will receive back a series of spreadsheets from the surveyors, which are typically manually compiled into a summary position for the company. In addition, it is common for the finance team to post a long series of transactions to reflect the adjustments the surveyors have made.

## 6. WIP AND PROFIT CALCULATION

The business will use various CVR information to work out the project accounting position they want, considering profit and WIP. Surprisingly, this is another thing commonly held outside the core accounting system.



## WHAT ARE THE ADVANTAGES of Embedded Cost Value Reconciliation?

### CONTROLS ONGOING COSTS

Keeping control of ongoing costs has never been more important to construction companies in the current climate. CVR ensures ongoing costs can be tracked and monitored closely to ensure the construction project stays on course.

### CONTROLS REVENUE

CVR reports are traditionally produced monthly throughout a construction project. This regularity means that costs are frequently reviewed, and any required adjustments/actions are implemented to ensure that cost is aligned with revenue at the end of projects.

### MINIMISES HUMAN ERROR

Many construction companies build their CVR reports in Microsoft Excel, which relies on manual data entry, increasing the risk of human error. These errors can lead to miscalculations and incorrect costings later down the line with final reports. Construction companies use software to reduce the heavy lifting and automate their CVR reports to mitigate this risk.

### HELPS CONSTRUCTION FIRMS PRICE FUTURE PROJECTS ACCURATELY

Because CVR is a documented/recorded process, construction companies can use previously produced CVR reports as guidance on how to cost future construction projects correctly. CVRs are great for understanding previous mistakes and improving cost evaluations for the future.

## DEDICATED CONSTRUCTION SOFTWARE

An issue with conducting CVRs is that most construction companies rely on multiple team members collaborating. As such, they might keep the relevant data in various spreadsheets on different people's devices to compile and track CVRs. This presents problems such as a risk of duplications & errors leading to inaccurate data.

Alongside this potential issue, it can become difficult for multiple people to access CVR reports or collaborate on work without the correct means if you rely on generic solutions such as Excel.

A lack of industry-specific features severely limits the effectiveness of carrying out accurate CVRs and can sometimes lead to more problems!

The best way for construction companies to manage CVRs is through dedicated construction software. This means that CVR reports can be stored and attributed to specific contracts within the system rather than trying to match up the file name of a separate spreadsheet with the contract name/code.

The easier you make it for your team to carry out Cost Value Reconciliations, the more likely they will be completed on time. 4PS Construct has a specific CVR solution to help your team produce accurate CVR reports quickly and easily.

## CONCLUSION

Construction cost value reconciliation is a crucial process for successfully managing construction projects. It empowers project stakeholders to stay on top of budgets, make informed decisions, and mitigate financial risks. By closely monitoring costs and comparing them against initial estimates, construction professionals can ensure the project's financial success and deliver projects that meet the expectations of all parties involved.

The lessons learned from the reconciliation process can also improve future project estimates, enhance cost management strategies, and improve the CVR process.

So, contact 4PS today to learn more about our CVR solution.



## About the author



Paul Broderick | Paul has developed a keen eye for seeing specific customer requirements and recommending solutions to deliver business benefits and returns-on-investment. In the last three years Paul has focused this experience and knowledge specifically on the Construction industry, where digitisation is now the hot topic in IT, which has evolved and matured to become most relevant in today's construction industry.

[paulb@4ps.co.uk](mailto:paulb@4ps.co.uk) | 07581 502186



**4PS UK**  
Birmingham, United Kingdom  
[www.4ps.co.uk](http://www.4ps.co.uk)  
[hello@4ps.co.uk](mailto:hello@4ps.co.uk)  
+44 01675 432 400