

# A Study on Need of Robust Financial Management and Accounting System with Reference to Construction Industry

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## Abstract

*In today's scenario, it's uncertain to set up a construction firm. Many construction enterprises quit their business operations every year. Due to the specific characteristics of the construction business, running a successful construction firm demands a professional set of financial management abilities and robust accounting system. The construction industry, in contrast to other sectors, faces a number of obstacles, such as: (1) an ongoing demand to create unique projects; (2) the need to construct projects at various sites; (3) the handling of retention and advance payments; and (4) a reliance on subcontractors for the successful completion of operations. This study attempts to know the significance of robust financial management and accounting systems in the construction industry.*

**Keywords:** Construction, Financial Management, Projects, Accounting, Professionals, Profits, Cash Flow.

## Introduction

Utilising a company's financial resources effectively and efficiently in any organisation is known as financial management. This encompasses how funds and other resources are used. The choice to bid on a significant project can have a significant influence on a company's financial situation. When an organisation wishes to bid for a project, it should analyse various matters for its effective operations such as funding, changes in financial structure, hiring of employees or subcontracting, purchase of equipment or hiring of equipment, project overheads, etc. Companies in the construction industry are distinct from the majority of other businesses and have to deal with a variety of issues that are specific to their industry. The financial management techniques used in other product oriented businesses must at times be changed before being used in the construction sector because of their distinctive qualities.

For many construction companies, each output is distinct but often the output is very different. Even when a construction business is working on related projects such as a real estate construction or building a number of convenience stores, the projects are frequently distinct owing to geographical factors and locations, which impact the accessibility of manpower and facilities. In the construction sector, projects are frequently designed specifically for a particular owner on a particular site.

It cannot retain residual production for future projects since the majority of its work is done on the site of each unique project.

For each project, a construction business is required to maintain accurate construction costs. This information is required to manage the expenses of the ongoing project and to be used in the project bidding process in the future.

It works in a variety of dispersed sites. Each employee's and the relevant equipment's location must be monitored in order to assure that the costs they incur are allocated to the appropriate project. Due to their bizarre cash flows, the construction industry needs to modify their accounting and other financial systems in order to manage deferral and the onset of their cash flows. The employment of subcontractors is largely relied upon by many construction organisations. The financial soundness of the construction company is significantly impacted by the usage of subcontractors.

### Objective of the Study

A study on the need for a robust financial management and accounting system with reference to the construction industry.

### Research Methodology

To perform a pilot research, 100 experts from the construction business were selected using the convenience sample approach.

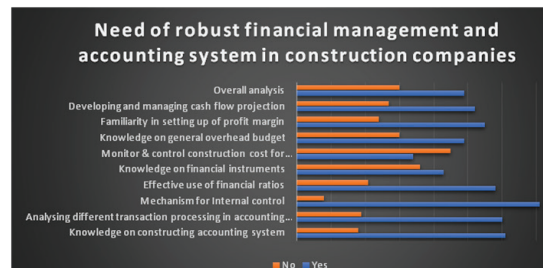
Open-ended questions were first posed to them in order to get detailed information. The data was gathered using polar questions (Yes or No). 79 experts from the construction industry answered the questionnaire. To examine the gathered data, Chi-Square, Anova single factor and the basic percentage technique were applied.

### Hypothesis Testing

- H0 (Null Hypothesis) – There is no impact on the requirement of knowledge and necessity for a robust financial management and accounting system in the construction industry.
- H1 (Alternate Hypothesis) - There are impact on requirement of knowledge and necessity for a robust financial management and accounting system in construction industry

### Analysis

79 professionals from construction sector shared their views as follows.



**Figure 1 Need of robust financial management and accounting system in construction companies (Source: Compiled by author)**

### Knowledge on Constructing Accounting System

The business must examine the distinctions between the accounting tools utilised for cost reporting and methods used for cost control, in addition to the various accounting techniques accessible to construction enterprises. There are some significant variations between the accounting and financial reporting systems for the construction sector and other industries as a result of the special characteristics of construction businesses.

### Analysing Different Transaction Processing in Accounting System

The organisation should gain insight into how various transactions in accounting are handled by the accounting system. Construction accounting involves a variety of special transactions that are unlikely to take place in other businesses. The construction industry's emphasis on job costing, monitoring of equipment, and accounting for long-term agreements is the cause of the majority of these transactions. To make sure that the accounting system is configured to fit the demands of the business, it is essential to understand construction accounting.

### Mechanism for Internal Control

To predict the projected cost and profit at completion of projects, the organisation must ensure that it is acquainted with the committed costs. By using computerised construction accounting systems, internal controls play a crucial role in safeguarding the company's financial resources.

### Effective Use of Financial Ratios

Using financial ratios to analyse the financial statements of an organisation effectively requires an understanding of how to do so, as well as the ability to compare the company's ratios to those of its industry. This will include customising frequently used ratios to the distinctive features of a construction business. The financial statement analysis will assist specialists in spotting issues before they develop into crises. These difficulties might endanger the company's existence or just be basic planning errors.

### Knowledge on Financial Instruments

Financial decisions such as choosing equipment to purchase and allocating limited resources are crucial for business decisions. An understanding of financial instruments helps to moderate borrowing costs and decide the finest approach to arrange for the finance to operate a construction company.

### Monitor & Control Construction Cost for Material, Labour, Overheads and Equivalent Cost

It is important to have the ability to track and supervise construction expenses for materials, labour, subcontractors, machinery, additional costs, and general overhead. This skill gauges the success of the project by measuring the profitability, using the schedule performance index, the cost performance index, and project closeouts.

### Knowledge on General Overhead Budget

The organisation has to ensure that a general overhead budget is created so that overhead expenses may be evaluated. A business might easily squander its earnings if general overhead expenditures are not kept under control. While neglecting general overhead expenses, construction professionals frequently expend an extensive amount of time and energy in budgeting, monitoring, and managing construction costs. Setting and adhering to a general overhead budget is vital for preparation of a company's yearly cash flow prediction.

### Familiarity in Setting up of Profit Margin

The organisation must be familiar with setting profit margins for application to bids and understand

how the profit varies as the volume of work increases. Profits are utilised to cover for general overhead costs. If the earnings are not adequate to pay regular operating expenses, the business will run out of cash and be unable to operate. The owner may opt for better investment if the returns are insufficient.

### Developing and Managing Cash Flow Projection

Many successful businesses collapse since they lack funds to cover their expenses. The usage of internal labour and subcontractors in relation to the amount of funding that can be utilised for a project must be taken into consideration by experts. Monitoring whether the business has enough funds on hand to embark on a new project, creating a prediction for the business's income taxes, creating and maintaining the company's yearly cash flow estimates, securing funds to meet the requirements of the construction company.

### Overall Analysis

Analysing the conversion of cash flows from a one-time period to an equivalent cash flow from a different period or into a consistent succession of cash flows from succeeding intervals of time is crucial. In order to comprehend debt finance and to gauge two or more financial solutions, it is necessary to have a basic understanding of the time value of money. In order to evaluate financial options and select the one that is most appropriate for the organisation, a variety of quantitative methodologies may be applied. Without a quantitative strategy, it is challenging for specialists to choose the optimal alternative.

#### Chi Square Test

Chitest			
Test Statistic	df	p	Critical Level
58.26	9	0.00	2.09

It can be observed from the above table that the p – value is less than 0.01, significant level. We reject the null hypothesis and it can be concluded that impact on requirement of knowledge and robust financial management and accounting system is necessary for success of construction industry

Anova: Single Factor		
F	P-value	F crit
35.21	0.00	8.29

It can be observed from the above table that the p-value is less than 0.01, significant level. Therefore, the formulated hypothesis, "There is no impact on requirement of knowledge and necessity for a robust financial management and accounting system in construction industry." is rejected. It indicates that there is a significant impact on requirement of knowledge and robust financial management and accounting system is necessary for potential earning of construction industry

### Conclusion

More risk exists in the construction industry than in any other typical industry. Inefficient financial management is the main cause of failure for a construction company. This includes using inappropriate accounting practices and systems, failing to control cash flow, failing to precisely monitor and handle job and capital costs, having too much overhead, failing to adequately prepare for and attain a sufficient profit margin, having too much debt, and failing to make sound business decisions on reliable financial information. Construction firms are doomed to collapse if they fail to practise solid financial management. Hence the company in the construction sector is in need of a robust financial management and accounting system to overcome a particular set of challenges in their quest to build the business that can maintain consistent profitability.

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