Winter 2017

CONSTRUCTION INDUSTRY ADVISOR

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6 common accounting mistakes to avoid

Third-party funding helps contractors pursue claims

Help yourself and the environment with recycled materials

Looking for skilled workers in all the right places

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Soggy numbers

6 common accounting mistakes to avoid

You're probably familiar with the term "crunch the numbers." Well, in a tumultuous industry like construction, it's all too easy to let crisp, timely financials go soggy with outdated data and flat-out mistakes. Here are six common accounting errors to avoid.

1. Inaccurate allocation of overhead

To develop a realistic picture of your job costs — and, therefore, the profitability of your projects — you need reliable methods for allocating overhead among jobs. Overhead generally refers to costs that benefit all jobs. Examples include rent, office equipment and supplies, salaries for executives and clerical staff, insurance, taxes, advertising and marketing expenses, and accounting and legal fees.

Construction companies often allocate overhead among jobs based on direct labor costs or direct labor hours. But, in some cases, this approach causes over- or underallocation of overhead, which creates a distorted picture of job profitability.

For example, if your projects tend to be equipment or material intensive, rather than labor intensive, it may make sense to allocate overhead based on one of those costs or perhaps some blend of direct job costs. The key is to develop a method for allocating overhead costs to the jobs that drive them.

2. Improper cutoff of job costs

Many construction businesses use the accrual basis of accounting, which means they record revenues when earned and expenses when incurred. Cutoff errors occur when expenses are omitted from a period covered by a financial statement — typically, because invoices aren't received until after the period is closed.

Are you susceptible to this problem? If so, consider implementing a voucher system or some other mechanism to ensure costs are recorded as liabilities or accrued costs in the period in which they're incurred.

3. Erroneous change orders

Change orders represent both great opportunities and potential pitfalls for contractors. What's more, the accounting rules for dealing with them are complex and can lead to errors.

For instance, if you're overly optimistic that a change order will lead to additional revenue, you may overestimate profits — resulting in profit fade as the job progresses. This may happen if you begin out-of-scope work before the change order is approved, or if you and the owner agree on scope but leave discussions of price for another day.

Third-party funding helps contractors pursue claims

Like it or not, disputes are an inevitable part of the construction process. Unfortunately, to avoid the high cost of litigation, many contractors fail to pursue even strong claims or settle for far less than they deserve. An increasingly popular option that may help with this dilemma is third-party funding of construction disputes.

How does it work?

Third-party funding involves engaging an outside party (that is, one without a current interest in the dispute) to finance some or all of a claimant's legal costs in exchange for a portion of any recovery. Essentially, it's a nonrecourse loan secured by the claimant's rights to any judgment, arbitration award or settlement. "Nonrecourse" means that, if the claimant is unsuccessful, the third party receives nothing.

Such arrangements are also available for defendants, who pay a premium to the funder in the event their defense is successful. With these arrangements, it's critical for the parties to agree upfront on what constitutes a successful result. For example, it might mean dismissal of the claim or settlement below a specified amount.

Not all claims are suitable for third-party funding. Typically, they're limited to commercial, rather than individual, disputes. And litigation funding firms generally won't get involved with claims that have a low probability of success or are expected to drag on for extended periods of time, increasing their expense and risk.

Funders will also evaluate other factors. They'll assess the quality of the law firm representing the claimant, and examine the defendant's financial strength to gauge the likelihood that any judgment or settlement will be collectible.

What are the benefits and risks?

The most obvious benefit of third-party funding is that it enables parties to bring claims that they would otherwise lack the resources to pursue. But the benefits may go further than that.

Because the financing is nonrecourse, third-party funding shifts some or all of the risks associated with litigation or arbitration from the contractor or other party to the funding firm, which is better equipped to bear that risk. Another benefit of nonrecourse financing is that it may allow a claimant to keep litigation expenses off his or her financial statements, making it easier to continue operating while a dispute is pending. Contractors who finance claims themselves may find that significant litigation expenses hurt their ability to secure loans or surety bonds.

Third-party funding may also be available for claims that have been settled but not yet paid. For instance, they may allow a contractor to convert pending settlement funds into cash they can use to finance ongoing business operations.

As you can see, third-party funding offers a variety of benefits. But they come at a hefty price. Third-party funders assume a great deal of risk, and they expect to enjoy returns that are commensurate with that risk when claims are successful. It's not unusual, for example, for a funder to receive 40% of the proceeds. Add in contingent attorneys' fees and the percentage left for the claimant is relatively modest.

Is it right for you?

If you're contemplating third-party funding, be sure that you understand the payment terms and weigh the costs against the potential benefits. Your CPA can help you calculate a cost vs. benefit analysis. ■

Help yourself and the environment with recycled materials

Using recycled and reclaimed materials for construction projects can help curb greenhouse gas emissions and other pollutants. Doing so can also reduce the amount of waste sent to landfills.

But, while doing good is its own reward, construction companies that use or produce these materials can also enjoy a variety of financial benefits. These include spending less on materials, reducing disposal costs, and even bringing in revenue from the resale of reclaimed building materials or components.

C&D sites

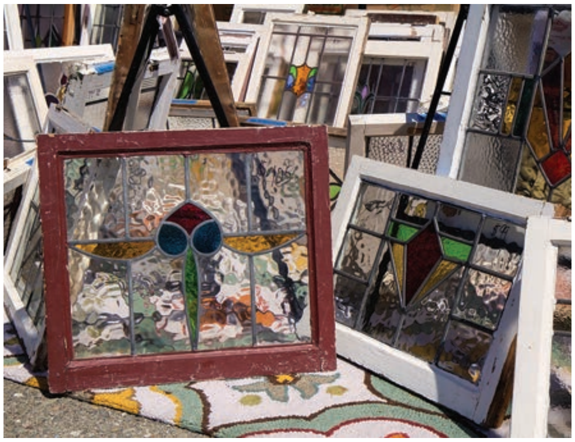
Construction and demolition (C&D) sites are great sources of recycled building materials. These locations are typically run by architectural salvage dealers, demolition contractors, C&D haulers, recycling companies and other entities.

Items found at C&D sites are generally cheaper than "virgin" material, and they may have "vintage" qualities that appeal to certain customers. Examples include:

- Doors and windows,
- Lighting and bathroom fixtures,
- Pipes and fittings,
- Appliances, and
- Vintage items such as hand-carved fireplaces or antique doorknobs.

In addition, it may be possible to recycle beams and other structural components, crush masonry for use in sidewalks or road bases or melt down scrap metal for reuse.

C&D sites can also be places to *leave* materials and walk away with a little extra revenue. For example, instead of simply demolishing a building, you might develop a "deconstruction" plan designed to preserve materials for reuse or resale. Following such a plan can reduce your hauling and disposal costs, too.



$2,400 per adult employee. But the credit can be as high as $9,600 per qualified veteran.

As you might expect, a variety of rules and restrictions apply. Work with your CPA to determine whether and how to qualify for the credit.

Hire more widely

Also consider looking into additional labor networks you may not have previously fully tapped. For example, as recently as 2014, women made up only about 9% of U.S. construction workers, according to the Bureau of Labor Statistics. But there remains a strong push within the industry to get more women involved. If you do hire from this group, you may want to add or enhance the sexual harassment prevention components of your employee orientation and training program.

Another potential source of skilled labor is your competition. Keep an eye on what other local construction companies might be changing specialties or closing up shop. Obviously, hiring away employees could rub these industry colleagues the wrong way. So be sure to execute this strategy carefully and ethically.

Work smarter

There are a variety of project-management strategies for dealing with a skilled labor shortage. Look into spreading out jobs over longer periods to more easily and evenly distribute skilled labor. Many contractors are also taking a keen interest in integrated project delivery, which is a more collaborative approach that actively seeks to maximize project efficiency — including labor usage.

In addition, if you're losing skilled laborers or having a hard time hiring, review whether your compensation rates and benefit plans are as competitive as possible. You can use benchmarking data to compare your offerings to those of similar companies.

Fix the future

Looking at the long term, construction company owners should consider themselves ambassadors for the industry. This means:

- Emphasizing customer service,
- Running clean, minimally disruptive job sites, and
- Minimizing your carbon footprint.

Positive publicity is also important. Getting involved in social media not only can promote your company's services, but also can attract quality employees. Publicizing notable projects with your local print, radio and television media can let the best and brightest skilled laborers in the area know what you do, too. Put (or keep) industry events such as trade shows on your agenda, as well.

In the long term, contractors interested in nurturing tomorrow's workforce need to get involved in educational outreach. This means starting high school kids in classes and internships that spark their interest in the construction trades. From there, mentorship programs can set them on track for fulfilling careers.

Exercise optimism

It's easy to get down about the skilled labor shortage. But just because this problem has been persistent doesn't mean it's unsolvable. As you continue to build your construction company's success, you've also got to invest in the success of the industry itself. ■