

Construction

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Industry Advisor



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IN SERVING THE CONSTRUCTION INDUSTRY



Ending on a high note

How to close out a project without regrets

It would stand to reason that the closeout of any construction project is an important, if not *the most* important, part of a job. Why, then, is it so easy to let the final stages of a project fall apart? Problems can stem from inadequate scheduling, poor communication or simply a rush to push through and finish quickly. But in today's economy, when a good reputation and client satisfaction are especially important, allowing an otherwise great project to fall apart at the end can strike a blow to both.

The key to closing out a project on a high note is to stay on top of all aspects of the project right down to the last detail.

Starting on the same page

Before any ground is broken, sit down with the owner and architect to make sure expectations for completion are addressed in the contract and any related building specifications. The specifications should include as-built drawings that show the location of building components that are in walls or underground. Make sure the specs



include operations and maintenance (O&M) manuals, which feature a list of all materials and equipment in the building. The specifications should also contain a detailed list of items that will be turned over when the project is completed, such as leftover materials.

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Moreover, they need to include training requirements that outline the job's moving parts, from the location of circuit breakers to instructions for using the site's electrical components.

As the project progresses, keep key people informed and involved. Ask the owner and architect to visit the job site often so they can address any concerns while there's time to make changes. And stay on-task by providing a specific time frame for dealing with project revisions.

Getting close to the end

When the project is nearing completion and everything seems to be running smoothly, you may think you're home free and you can relax. But that could be a huge mistake; there are still a number of key steps you need to accomplish *proactively*.

Roughly one month before substantial completion is reached — which is indicated by the building's readiness to be used for its intended purpose — you'll need to coordinate move-in routes with the mover, as well as the use of dumpsters and elevators.

When you reach a level of substantial completion, reserve at least one day for the punch list walk-through, and make sure all key people are present — the architect, engineers and site owner.

Wrapping up loose ends

When most or all construction tasks are finished, staff training on the use of the new building's systems, including heating, cooling and electrical, should be under way, whether it's being handled by your company, the owner or an independent consultant. Also do a second punch-list walk-through so that you can assess any corrections that resulted from the first walk-through.

This is when you should issue your final invoice for payment, making sure it has the approval of the lender and surety. Once you're paid, you'll need to provide the owner with a release guaranteeing that the project won't have mechanics' liens filed against it due to unpaid work. Turn over any spare parts and leftover equipment owed to the owner, as well as the as-built drawings and O&M manuals.

When all is said and done, take a moment to send thank-you letters to the owner, architect, engineer and other key persons. It will help solidify the rapport you've built and keep you top-of-mind for future jobs.

Closing out successfully

A successful project begins with proper planning and ends with a smooth, amicable closeout. The key is maintaining a forward-thinking attitude throughout. When you follow the proper steps along the way, you can view each ending as a victory — and a boon to your reputation. ■

Check these features sooner for a happier client later

It's easy to lose track of functional details when you're dealing with a major project, but lack of oversight can mean lost time *and* lost income. Keep your client's possible punch list in mind throughout the course of a job to stay on top of avoidable missteps. In addition:

- Check often-overlooked features such as sinks and toilets, hot and cold water, outlets, door hinges, drawers and other moving parts to make sure they're functioning properly,
- Replace filters on HVAC systems for heating and cooling,
- Clean and label all pipes and equipment for the inspection process,
- Make sure exterior railings are properly secured, locks are working correctly, and gas and electrical meters have been sealed, and
- Check the surrounding area for debris, and remove any pieces of wood from soil to avoid termites.

Of course, these are just a few of the many building features a client will examine for deficiencies during the walkthrough, but they illustrate the level of detail you need to look out for in order to stop problems before they start.

Sale-leaseback financing: The pros and cons of a quick fix

Sale-leaseback financing has long been a common way for contractors to gain some added income without having to sacrifice the use of their equipment. And as the economy forces contracting businesses to tighten those proverbial belts, it has become an even more appealing option for boosting capital. But along with the obvious benefits are some drawbacks.

The benefit of instant gratification

With a sale-leaseback agreement, your construction company sells an asset and then leases it back from the buyer. Selling the asset can provide you with up to 100% of its cash value. Moreover, you make no immediate sacrifice. You get the use of your equipment, and the added cash flow from the sale could help you buy

out a partner, pay off a lender, improve liquidity or upgrade remaining assets.

Beyond the seemingly effortless influx of income, which is recognized over the course of the leasing period, contractors choose sale-leaseback financing over retaining ownership (or choosing a loan or standard lease) for a variety of reasons. For instance, a sale-leaseback arrangement is less restrictive than other types of financing, as it can be structured as a taxable sale — a transaction that can be offset by net operating losses, helping to reduce future tax payments. Additionally, the rental payments you'll make on your sold equipment may be fully deductible if you're dealing with an operating lease (which means the purchaser transfers to the seller only the right to use the property without the risk of ownership).

A sale-leaseback arrangement is less restrictive than other types of financing, as it can be structured as a taxable sale.

And, if your lease is considered an operating lease, your ratio of current assets to current liabilities could improve. This sheds a positive light on your ability to pay back short-term debts, and it could boost your credit rating.

The downside of easy money

The biggest disadvantage of a sale-leaseback agreement is the loss of flexibility associated with ownership, including your freedom to make modifications to a piece of property. And typically, you won't reassume ownership at the end of the lease term unless you choose to include a repurchase option in the leaseback agreement. If you do that, you'll recoup your original investment, minus any interest paid over the course of the lease.

Be aware, however, that choosing to include a repurchase option will likely categorize your lease as a capital lease, in which the seller assumes some risk of ownership, as well as certain ownership benefits, such as the ability to claim depreciation.

A capital lease is recorded as an asset, and your obligation to make lease payments is considered as debt. Your lease is viewed as a capital lease if any of these four factors is present:

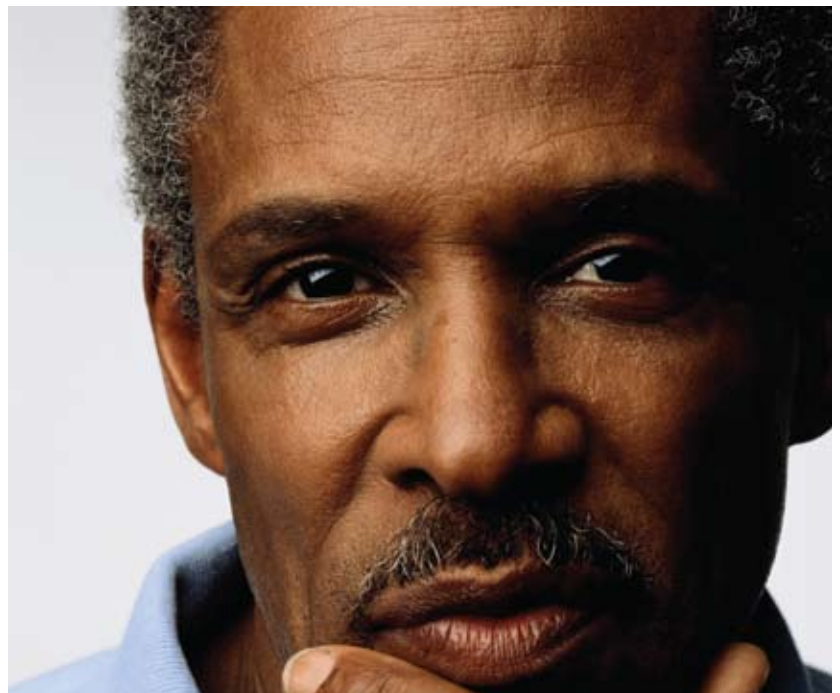
1. Its life exceeds 75% of the asset's life.
2. There's a transfer of ownership at the end of the lease.
3. There's an option to purchase the asset at a discounted price at the end of the term.
4. The present value of your minimum lease payments is greater than 90% of the equipment's fair market value.

If the terms of your transaction remain outside of these categories, you will retain more sale-leaseback benefits by entering into an operating lease.

Deciding what's right for you

It's important to review the usefulness of sale-leaseback financing on a case-by-case basis. You should know ahead of time how you'd use the influx of cash, and you should make sure that the life of the asset will exceed the lease term. It's also important to negotiate the terms of use for the equipment up front, so you don't encounter unexpected restrictions later on.

Your CPA can help you understand the many tax issues involved, as well as show you how your particular lease may affect your credit standing. When you know all the pros and cons, as well as your eligibility, sale-leaseback financing is a convenient option to have on the table. ■



Automate purchase orders to control costs, save time

As hard as you try to track every expense on every project you're managing, it's easy to lose control of costs if you're using an antiquated purchasing system. Moreover, if your current system is allowing billing and inventory discrepancies to fall through the cracks, you're likely experiencing a negative effect on your cash flow *and* your ability to take on more work.

Now more than ever, contractors are choosing to automate the purchasing process, resulting in increased tracking efficiency — and increased profits.



Understanding purchase orders

Purchase orders benefit the overall function of a construction company by creating a system for tracking purchases and subcontractor work, thus helping you manage inventory and expenses. Contractors that don't use them can end up paying for materials that weren't delivered and incomplete work.

Let's look at a practical example: Suppose only half a shipment of 30 windows is delivered to a jobsite, but you receive an invoice for the full shipment. There's no way you can reconcile this mistake if you don't use purchase orders. In the end, you're forking over money you don't owe.

Moreover, companies that use purchase orders, but don't use an automated purchase order system to support them, face the time-consuming process of manually comparing packing slips with the original purchase orders.

Upgrading your efficiency

By automating your purchase order system using accounting software that features a purchase order function, you can avoid such costly mistakes and save

time. If you fail to receive a complete supply order, for example, you can input the packing list into the program and automatically compare it to the purchase order. The system then produces a report showing the discrepancy and current inventory details. Most software can also be programmed to alert you if your supplier tries to bill you for the full amount.

More complex software options can also help you track subcontractor billing and retainage. Whereas in the past you might have miscalculated profits due to a subcontractor's outstanding bills, the system tracks what's been billed and what's still owed. Most software also features safeguards against overbilling and sends alerts regarding unfulfilled contracts, as well as expired insurance or certifications on the subcontractor's end.

Implementing purchase order software

Most purchase order applications can set up work orders, create schedules using purchase orders, and update and e-mail or fax weekly schedules. When a project is complete, the system can use the original work orders to create invoices and send payment to subcontractors and suppliers.

Software can cost anywhere from \$10,000 to \$60,000 and up, depending on its options. The cost usually includes tech support for implementation, which is helpful in terms of training employees and getting the system up and running. While this may seem like a lot of money, it can be a small price to pay for the time and money saved in the long run. Plus, under the American Recovery and Reinvestment Act of 2009, both higher Section 179 expensing limits and 50% bonus depreciation have been extended for 2009. So you may be able to take a current deduction for a large portion or even all of the cost.

Leaping over the final hurdle

Getting all employees and subcontractors on board can be daunting. The key is to introduce the idea of a

new system early and explain its benefits. Make it clear to subcontractors that they can enter their data from any computer, using any type of Internet connection, ultimately simplifying the payment process. As for your employees, most software companies will allow you to test their products in-house, which will allow your team to view all the options and try their hand at features that they are likely to use regularly. Keep in mind, too, that most systems can take two to six months before they're functioning smoothly.

Once you've got everyone's buy-in and the short learning curve out of the way, your new automated purchase order process will begin to pay for itself in fewer financial losses, fewer headaches, more income — and, hopefully, more time to pursue lucrative new jobs. ■

Grow your business in a slow economy? Yes!

By now, you've probably grown accustomed to the slow economy, adjusting cash flow projections and your expectations for the business as a whole. But beyond a focus on basic survival, are you proactively seeking new business?

The current slowdown actually provides opportunity for growth, especially with the spending provisions of the American Recovery and Reinvestment Act of 2009 (ARRA), signed into law in February. The new ARRA funding includes \$30 billion for highway and bridge construction projects and \$7.7 billion for federal buildings. If you want to come out on top when the economy regains momentum, now's the time to prepare for this substantial increase in infrastructure-related government jobs.

First, strengthen your team by removing weak performers and adding staff. Recent layoffs have resulted in an abundance of capable candidates from which to choose. It's time to reinforce your fleet, too.

Construction companies that were forced to cut back have unloaded a lot of quality used equipment, so peruse live and online auctions for deals. Those same companies may be unloading clients as well, so look for opportunities to pursue those clients. And don't forget to take advantage of your long-term relationships with vendors. Suppliers hungry for business now are more inclined to offer deals that could last well into the future.

This is also a good time to re-examine the bidding process for government jobs. To bid on government contracts, you're required to register with the Central Contractor Registration (CCR) database and complete the Online Representations and Certifications Application (ORCA), found at <https://orca.bpn.gov>. Look for upcoming projects on Federal agencies' individual Web sites. Of course, you're more likely to make a successful bid for a government project if your company is well established and has a strong track record. You should be able to obtain adequate bonding, because you'll need to put up 100% payment for government jobs worth more than \$100,000.

The ARRA funding reserved for infrastructure is already starting to turn into construction jobs across the country. By improving your offerings now, you'll be poised to step up and take on the influx of work, expanding your experience and boosting your bottom line.



Lawsuits may be on the rise

The right precautions can help you avoid them

Lawsuits are a common means of righting wrongs, fixing mistakes and recouping expenses. But now, as a tough economy forces many to look for cash wherever they can find it, litigation may be seen as a quick source of income. Any knee-jerk reaction by a client could mean a big financial loss for you. Although unnecessary lawsuits are time-consuming and costly, you may be able to avoid them if you take the right precautions.

A too-quick trip to court

Money may not be the root of all evil, but it *is* the root of most construction disputes. If there's enough of it to go around, disagreements tend to be resolved quickly and easily. It's when funds are tight that clients are more likely to file lawsuits quickly, without considering other options such as negotiation, mediation or arbitration.

A lot of construction litigation arises from owners who allege that their buildings are, in the process of aging, revealing deficiencies. These owners maintain their buildings have lost value because of improperly installed roofing and windows, poorly sealed wood surfaces and more.



Litigation due to construction delays is common, as is litigation that results from an unexpected increase in the cost of work, often brought about by last-minute scope changes.

Dot your "i's," cross your "t's," and be nice

Contractors are often sued because the end product is somehow different from what the client had foreseen. To avoid litigation, take advantage of the project planning stage to control expectations for a project's evolution and conclusion. Your explanation of how you *expect* the project to proceed should be in writing and approved by the client.

Also, have an attorney review all contracts before you or the client signs them. If possible, make sure your contract provides an opportunity for mediation, where you can try to settle any disagreements with help from an independent third party. Successful mediation can help you avoid the greater financial cost of a lawsuit.

Additionally, keep in mind that something as simple as common courtesy may help turn an angry client into a satisfied one. Make sure you respond to phone calls and e-mails promptly, *listen* to complaints and concerns — and handle any disputes quickly and in a constructive, professional manner.

In avoiding litigation, everyone wins

Avoiding a lawsuit through reasonable expectations, clear communication and common courtesy saves everyone the time, cost and hassle of heading to court. Nevertheless, should a dispute arise, consult your lawyer right away. He or she can help you prevent a disagreement from turning into a lawsuit, while also ensuring that, if a lawsuit becomes unavoidable, you're in the best position possible. ■

Helping Contractors Build Success

Succeeding in the construction industry takes smart bidding, quality work, savvy management — and the assistance of advisors who know the business and can help move your company ahead.

Martin Hood Friese & Associates, LLC excels in helping construction businesses build their success. We offer a full range of tax, audit, accounting, business consulting and financial planning services tailored to the unique needs of the construction industry.

Our experienced professionals are dedicated to delivering timely, accurate and personalized service that meets the highest standards of quality and integrity. As a result, we have built a strong reputation for helping construction businesses like yours increase their profitability and success.

We are ready to help you with a broad range of tax, accounting and business management issues, including:

- Accounting systems and controls
- Project bidding and estimating
- Change orders and closeouts
- Cost segregation studies
- Tax planning and filing
- Estate and succession planning
- Bonding and financing
- Job costing and project management

We would welcome any questions you may have on the topics discussed in this newsletter or on other issues affecting your business. Please contact our office at 217.351.2000 and let us know how we can be of assistance.

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