

Construction

WINTER 2009

Industry Advisor



Mirror, mirror on the wall, do I look good to my surety at all?

Improve collections to boost your cash flow

6 things you should know about before you do work in another state

Protecting data on mobile communication devices

CONTRACTOR'S TOOLBOX

New law gets to the HEART of military service

MARTIN
HOOD
FRIESE
& ASSOCIATES, LLC

Contact our Industry Leaders:

Mark E. Czys, CPA
mark@mhfa.net

Denise V. Martin, CPA
denise@mhfa.net

Mitchell R. Schluter, CPA
mitch@mhfa.net

2507 South Neil Street
Champaign, Illinois 61820
217.351.2000
Fax: 217.351.7726
www.mhfa.net

A CPA FIRM DEDICATED TO EXCELLENCE
IN SERVING THE CONSTRUCTION INDUSTRY



Mirror, mirror on the wall, do I look good to my surety at all?

When the economy's robust, chances are you don't have much trouble getting a surety bond. When the economic forecast is bleak, however, sureties may not be as trusting and you may need to do more to improve your bonding capacity.

Prove your worth

One of the first things surety companies want to know is that you're able to ride out the economic storms. Anything you can do to remain profitable — from reducing your own indebtedness to improving your collections — will be particularly valuable in periods of economic uncertainty.

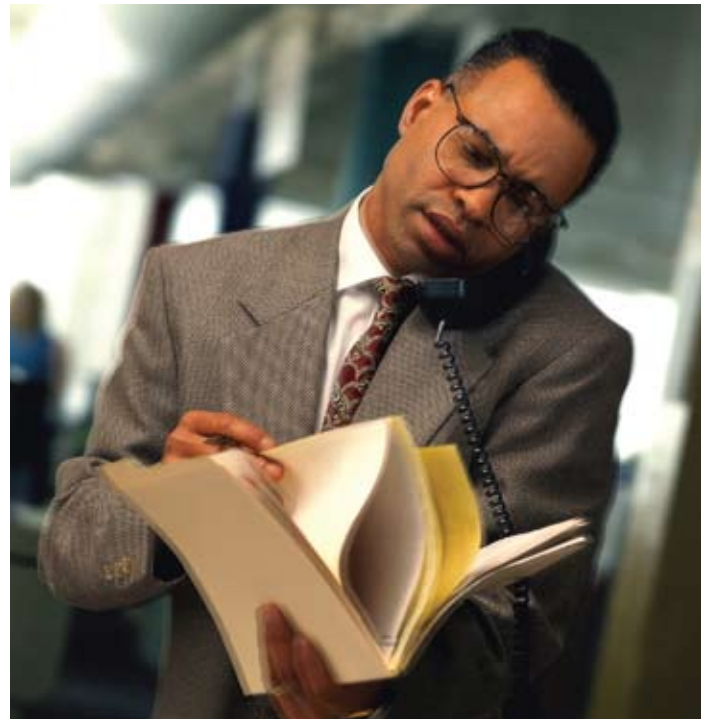
Your working capital and tangible net worth will likely sit near the top of any surety's list of critical attributes, as will receivables and debt. Obviously, you want to increase working capital and tangible net worth, while decreasing tardy receivables and debt.

To improve your standing, consider debt reduction strategies such as equipment sale and leaseback arrangements.

A little debt will go a long way in influencing your surety's view of you. You need to show a healthy relationship between liquidity and debt, as sureties aren't comfortable with a contractor who's so heavily leveraged that virtually all revenue is going to pay off debt. To improve your standing, consider debt reduction strategies such as equipment sale and leaseback arrangements.

Explain variances

Of course, sureties look for consistency as well as solvency. If you've had significant swings in monthly performance, try to eliminate them and be prepared to explain them. Your surety is likely to look at how



you fund delays and retainage, as well as how you handle change orders.

If you recognize major revenue immediately after a sizable change order, you're risking profit fade if an owner disputes the charge. Wait until the matter is settled and post revenue that will stay in place.

In addition, though a surety wants to know you can finish a job, it also wants to know you have assets it can seize if you don't. Excessive prepaid expenses, shareholder receivables and inventory all will count against you. Cash, current receivables and a reasonable amount of inventory will work in your favor. Sureties are less enamored of property and equipment that aren't liquid — particularly if you have too much capital tied up in them.

Show progress and stability

Another important consideration for bonding capacity is work in progress. Sureties aren't looking for expert builders; they're looking for expert *business* people. They want some assurance that you use accurate estimates

and consistent approaches, and that you can still complete what you're doing if you add more work to the schedule.

If you have multiple projects open, you may want to close a few to improve your bonding capacity. Also, review your charges. If you billed one owner \$150 per hour for a backhoe and another owner \$200 for the same piece of equipment, be prepared to explain why. If you're undercharging on some jobs, the surety may reason that you're undervaluing your work in progress.

Sureties look beyond the numbers, too. They want to see a history of successful projects and work experience,

an organizational leadership depth chart that demonstrates your ability to stay in business if a key leader leaves unexpectedly, a history of banking relationships and a business plan that indicates you know where you're going and what you're doing.

Don't hold back

As you prepare to impress your surety, remember that being open, honest and available may be the most important attributes. Your relationship with your surety will be the strongest indicator of your character — and that may be the strongest bridge to bonding success that you can build. ■

Improve collections to boost your cash flow

Collections may be a nasty part of doing business but, in a down economy, it's critical. Sure, you can file a mechanics' lien to demand payment, but the reality is that, if the bank takes over the property, a lien means you have to get in line to get paid. (See "Lien laws can be tricky" on page 4.)

A far better approach is to develop a good collection process that will keep the cash flowing in when you need it most.

Start with payment terms

If you don't have a collection policy that establishes specific actions triggered by specific conditions, work with your CPA to develop one. The basics should include determining when bills will be sent, what type of follow-ups will be used — phone calls a week later to be sure the bill arrived, for example — and how your billing and collection staff should respond to payment delays.

It doesn't make sense to demand payments on a schedule that your customer can't meet, and it's equally senseless to ambush a customer with unexpected demands for large amounts. To avoid misunderstandings — and give yourself some



muscle should a dispute arise — work with each client to develop a realistic payment plan and then include it in the job contract.

As you work to accommodate your client's situation, keep in mind that you'll be paying wages, overhead, and material and equipment costs throughout the life of the project. Your goal should be for the scheduled payments to cover those costs. Make sure that you know your customer's payment cycle so you can time your bills to arrive before a cycle closes.

When you send bills, pay attention to details and enclose appropriate documentation. If an invoice includes a change order, for example, send a copy of the approved order so the client understands what's being billed. In other words, don't give the customer any reason to delay payment pending clarification.

Perfect your pitch

A week or two later, follow up each bill with a phone call or e-mail by asking whether the bill arrived and whether there are any questions. Then, thank the client for the business and remind him or her of the contract payment terms.

Make sure everyone involved in a project, from the project manager to the accounting clerks, knows when payments are due and whether they've been made. Your accounts receivable staff may have primary responsibility for monitoring past-due accounts, but collections should be a companywide concern.

Sales and project managers also should be aware of clients that are habitually late payors so your staff can try to prevent further late payments from these customers *and* encourage them to pay more promptly.



When a payment is late, don't wait to act. Send another bill requesting immediate payment, and then call to ask when you can expect that payment. Remind the customer of the contract payment terms and, if feasible, offer to pick up a check. If you can't actually go get the check, ask that the client send it to you by overnight delivery.

Don't back down

Above all, don't feel you're being unreasonable in asking to be paid. Slow-paying customers are using

Lien laws can be tricky

When all else fails, contractors can file mechanics' liens to get what's coming to them. But that's not as easy as it sounds.

Lien laws vary from state to state, but most include very strict timelines. If you miss a deadline — some of which may be before a project even starts — you may have missed your chance. In some states, for example, contractors who don't notify owners that they're preserving lien rights will lose those rights. The timing of the notification varies, from as soon as a week after work begins to as much as 45 days.

Additionally, lien protections vary broadly among states, and a lien doesn't always guarantee you'll get paid. If you decide to navigate the hidden currents of lien laws, be sure to have your financial advisor and attorney on board.

your goodwill to give themselves interest-free loans — and the longer you let them slide, the harder it will be to collect.

If an account is more than 60 days past due, you may want to consider harsher measures. For example, notify the client that you will turn the account over to a collection agency if you don't receive payment within a specified time — say, a week.

It's possible that you're slow to get paid because your reputation has preceded you: If you're known to be forgiving when payments are late, your customers are more likely to let paying your bills slide to the bottom of their lists. Turning a couple of accounts over to collections will put everyone on notice that you're serious about getting paid — and move you to the top of the pile.

Then again, resorting to a collection agency could mean you may never work with that customer again. And in the construction business, where healthy working relationships are paramount, you could be burning a bridge you may need to cross again. So weigh the pros and cons of this harsh measure carefully before you act.

Increase your odds

Beefing up your collection process will help keep you in the black. You may not be able to guarantee 100% on-time payments, but your chances should improve. ■

6 things you should know about before you do work in another state

If this tight economy is pinching your wallet, you may be thinking that now is a good time to explore business opportunities in other states. Before you venture too far from home, however, know what you're getting into.

State requirements surrounding construction projects vary widely. These requirements may not be burdensome, but you'll need to satisfy them *before* you can lay the foundation. Here are the top six you should know about.

1. Taxes

Tax laws differ from state to state, but most states levy *sales* taxes on building materials purchased in the state and *use* taxes on materials brought in from outside the state. Some states, such as Mississippi, levy a flat tax on all commercial construction rather than charging sales and use taxes.

Other states, such as Iowa, require out-of-state contractors to obtain use tax permits if they do more than one project in the state. Before taking a job in another state, ask your CPA for help parsing the state and local tax laws.

2. Insurance

The first thing you should know about insurance is whether yours is valid in other states. Check with your carrier to see what limitations your general and workers' compensation coverage may have — and how much it will cost to change them, if necessary.

Check, too, to be sure you'll be paying workers' compensation premiums only once. In some cases, contractors must pay premiums in their home states as well as the states in which they do business. Neighboring states often have reciprocal agreements to prevent such double payments.

3. Licensing and registration

In most states, out-of-state contractors must be licensed or registered to do business in that state. Licensing requirements vary, with some states requiring examinations as well as proof of insurance and evidence of financial solvency. In states that don't require a license, contractors often must register with appropriate state offices.



In either case, state rules regarding the timing of licensure and registration also vary. Furthermore, in some states, only licensed contractors may bid on jobs; in others, unlicensed contractors can bid, but projects may be awarded only to licensed construction companies. Know the rules before you venture too far afield.

4. Bonding

Most states require out-of-state contractors to post bonds before they do business in the state. The type and amount of bonds required fluctuate vastly — in Arizona, for instance, bonds can range from \$1,000 to \$90,000, depending on the type of license sought and the amount of work anticipated.

In some states, all contractors must post bonds or cash; in others, only specific types of contractors or only those working on public projects must provide bonds.

5. Labor

You can save yourself a great deal of trouble by learning about the labor relations and union issues in the states you're thinking of expanding into. If you're considering

a public project, you'll probably be subject to prevailing wage laws, meaning you must pay whatever rate is common for similar work in other areas of the state.

And regardless of the type of jobs you're interested in, determine up front whether there's a strong union presence in the area. If so, be ready to deal with union issues whether you have a labor contract or not.

6. Contracts

If you're going to work in more than one state, a one-size-fits-all contract won't do you much good. State laws governing construction are even more complicated and more divergent than their licensing and bonding requirements. In California, for example, construction defects are prime legal hunting ground, while such suits are rare in other parts of the country.

Another common construction contract clause, pay-if-paid, has become a contentious issue for out-of-state contractors. In New York, for example, courts are divided on whether pay-if-paid clauses are enforceable when contracts are governed by the laws of another state. It's always best to avoid such clauses at any time but, if you have one, be sure it's applicable wherever you're working.

Above all, make sure you work with a contract law attorney so that your out-of-state contracts are airtight.

Go slowly, but don't stop

Expanding your business into other states is a great way to bring in additional revenue during a down building market. But before you pack your bags, know where you're going and what you'll find when you arrive. ■

Protecting data on mobile communication devices

Like those of most construction companies, your employees probably rely on mobile communication devices to keep them in touch and in control. And whether they're going across town or across the country, they're taking critical information with them.

If a worker leaves a laptop in a cab or a BlackBerry® at a restaurant, you may be losing more than a piece of equipment. In the wrong hands, such communication devices could be the equivalent to the keys to your company vault. They're worth protecting.

The best way to keep information safe is to keep it from being stolen in the first place. If you don't have a formal mobile communication device security policy, develop one. Although it may seem like a no-brainer, emphasize to employees that they must never leave mobile devices in unlocked cars or unattended in public places. And if a laptop isn't being used for long periods of time, the employee should lock it up in the hotel safe.

If the worst happens, however, and a device is lost or stolen, make sure whoever has it can't use it. Require employees to password-protect any sensitive files they create, and use logins and passwords to allow access to corporate files.

More important, require employees to back up everything they do. With jump drives and other small portable units readily available, there's no excuse for not having routine backups — including serial numbers and insurance data — secured away from the device at all times.

Also make sure all your corporate laptops and mobile communication devices are equipped with antitheft software that can track and locate them if they're lost or stolen. The systems use the devices' IP addresses to find them if someone logs on to the Internet without authorization.

Finally, look into remote "kill" programs that allow you to erase all the data from devices such as laptops, PDAs and smartphones. You can send the device a specific text message or use the tracking software to delete everything. Granted, you won't have the information any longer — but neither will a thief.



New law gets to the HEART of military service

Last summer, in an effort to give military veterans some financial relief, the Heroes Earnings Assistance and Relief Tax (HEART) Act of 2008 was signed into law. If your construction company employs workers active in the military, you may need to make some changes to your accounting procedures as well as your benefits programs for employees who perform qualified military service.

Survivors' benefits

For purposes of determining survivors' benefits under qualified retirement plans, HEART requires that you treat employees who perish during military service as if they had returned to work the day before they died. Military personnel's survivors are entitled to any and all benefits that survivors of nonmilitary employees would receive.

If, for example, your retirement plan offers accelerated vesting for survivors of employees who die while employed by your company, the survivors of someone killed in military duty are entitled to the same benefit.

In addition, if you pay active-duty employees the difference between their military pay and the amount they would have earned if they hadn't been called up, those are now "differential wage payments" that must be treated as compensation for tax and retirement plan purposes. In the past, such payments weren't considered wages, meaning employees paid taxes on all their differential pay, which was included on a Form 1099-MISC.

HEART also makes it more attractive for very small employers — those who average fewer than



50 employees — to pay differential wages by creating a new tax credit of 20% of the sum of all differential wage payments per year.

Early distributions

Under the HEART law, employees who are on active military duty for at least 180 days may take early distributions from their IRAs or 401(k) plans without penalty. This provision was set to expire Dec. 31, 2007, but the act makes it permanent. Although employers aren't required to amend their plans, they must administer the rule for anyone called to active duty after Dec. 31, 2007.

HEART also allows military employees to make IRA contributions for two years after the end of their active duty without being subject to the dollar limitations that typically apply. The total contributions may not, however, amount to more than the employees receive in "qualified reservist distributions." Qualified reservist distributions are those made from retirement plans or Flexible Spending Accounts (FSAs) to military reservists who are called to active duty.

Employers aren't involved in such contributions, but you should be aware of them in case questions arise.

Optional changes

In addition to the above-mentioned mandatory changes, HEART contains some *optional* changes that may or may not affect you. One relates to FSAs; another has to do with pension rights. To determine whether these and other provisions of the act will affect your employee benefits plan, consult your financial advisor. ■

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.

MARTIN
H O O D
F R I E S E
& ASSOCIATES, LLC

2507 South Neil St.
Champaign, Illinois 61820
phone 217.351.2000
fax 217.351.7726