

PERSPECTIVES ON THE CONSTRUCTION INDUSTRY



Webster Rogers LLP
CERTIFIED PUBLIC ACCOUNTANTS ♦ CONSULTANTS

www.websterrogers.com

Spring 2008

Sureties Want To See Strong Balance Sheets

Irrespective of how good or bad the construction market may be, you can be sure of one thing — your surety provider will want to take a close look at your numbers before it will issue bonding. What it finds on your balance sheet will influence whether you'll get competitively priced bonding or not.

Ideally, the facts presented in your financial statement will show that your firm is in good financial health. Here are some measures that are commonly used to assess the strength of the balance sheet.

Working Capital

The amount of available working capital determines your company's ability to finance current operations. Two key measures of the adequacy of working capital are the current ratio and the quick ratio (also known as the "acid test"). The current ratio is simply the amount of current assets divided by current liabilities. Ideally, your company should try to maintain a 1.2 to 1 or better ratio of current assets to current liabilities. The quick ratio is the amount of cash, cash equivalents, and short-term receivables divided by current liabilities. This ratio predicts your company's ability to pay its current obligations with cash. One way to increase working capital is to use long-term debt instead of cash or short-term financing for fixed asset purchases.

Getting Paid

Slow collections are a serious problem for many contractors. You should monitor the amount of your accounts receivable over 60 days and try to hold that figure to a minimum. You can calculate the average number of days accounts are outstanding by taking net accounts receivable, multiplying by 365, and dividing the result by annual revenue. You can improve the number by sending bills out for work and materials as you complete each stage

"Too little capital and high levels of debt can also make your balance sheet look extremely unattractive to a surety."

of the project. Be sure each bill clearly explains what stage of the work was completed. Send reminders when the customer doesn't pay you within an allotted time. That usually works, but if you still don't receive payment, you may have to threaten to stop work on the project until you're paid.

Capitalization and Debt

Too little capital and high levels of debt can also make your balance sheet look extremely unattractive to a surety. One common way to measure a company's level of capital is the debt to equity ratio.

It is calculated by taking total liabilities divided by net worth. The higher the ratio, the greater the risk creditors face.

You also have to watch underbillings. Significant underbillings could indicate that your company is facing some problems on one or more jobs. You should be prepared to explain why costs that have been incurred cannot be billed currently.

Profitability

Low profit margins on too many jobs will limit your company's future growth. You can measure profitability by using a return on assets ratio or a return on equity ratio. The first indicates your company's profits generated from its assets and is calculated by taking net earnings and dividing that amount by average total assets. Well-run construction firms typically derive a 10% or higher return on assets. Return on equity measures the return on money invested by the owners. You can find this number by dividing net earnings by total net worth. It's not unreasonable to expect to have a 15% or greater return on equity.

Analysis of your company's financial statements can provide valuable information you can use to effectively manage the firm. By paying close attention to the balance sheet items that sureties focus on most, you can put your company in a better position to obtain the bonding it needs. ✓

Managing Your Company's Cash Flow

It's no secret: Inadequate cash flow is a leading cause of financial failure. In a tough economic environment, it's more important than ever to focus on cash flow. Adopting some of the following "best practices" can help you manage — and enhance — your contracting firm's cash flow.

Prepare Cash Forecasts

Map out the way you will bill jobs before you begin work; then use that information when preparing cash flow projections. Err on the conservative side and be sure to forecast both regular expenses and those that come up infrequently, such as annual insurance premiums.

Control Spending

Keeping a lid on spending allows you to hold on to cash for those times when you really need it. Run the numbers and,

if they appear compelling, look into leasing equipment and heavy machinery rather than buying. To the extent possible, avoid job borrowing — using overbillings on one job to finance another. Setting aside the money collected on a project

your credit rating. If you don't already do so, use electronic funds transfer to make payments on the last day they are due. Review vendor discounts for early payment and take advantage of terms that are favorable to you.

"Keeping a lid on spending allows you to hold on to cash for those times when you really need it."

to pay that project's expenses avoids a cash squeeze down the road.

Manage Your Payables

Take advantage of creditor payment terms and time your payments to conserve cash. Don't get too carried away, however — you don't want to take any actions that might negatively impact

Tighten Receivables

Know the payment terms outlined in your contracts. Issue invoices promptly, supplying any required supporting documentation, and contact customers as soon as you detect any delays in payment. Of course, you can also encourage customers to pay their bills quickly by offering a discount. ✓

Federal Water Resources Development Act of 2007

The Water Resources Development Act of 2007 (WRDA), regarded as the largest civil works bill in the nation's history, was recently passed by Congress and signed into law by the President. The new law mandates federal budget authorizations

Numerous construction industry groups, including the Construction Management Association of America and the Associated General Contractors of America, urged passage of the measure. The economic benefits of this new law for

from an estimated \$1.9 billion allocated for the construction of enhanced navigation improvements for the Upper Mississippi River. In addition, \$1.7 billion will be spent on an ecosystem restoration project, also for the Upper Mississippi River.

"Utility contractors are likely to be among the winners since the WRDA authorizes \$2.4 billion for water and wastewater projects."

of \$23 billion in funding for more than 900 projects overseen by the U.S. Army Corps of Engineers.

The projects, which currently will impact 24 states, include flood control, coastal restoration, navigation, and recreational projects, as well as studies for future projects.

the construction industry are expected to be significant.

Who Gets What

Utility contractors are likely to be among the winners since the WRDA authorizes \$2.4 billion for water and wastewater projects. Other contractors will benefit

The Gulf Coast, which has seen significant construction activity since Hurricane Katrina, will benefit from money allocated for coastal restoration projects and water control infrastructure that are needed to mitigate hurricane damage. An estimated \$600 million will be spent on reducing hurricane and flood damage across 1,700 square miles of coastal Louisiana.

In all, the Congressional Budget Office estimates that nearly \$7 billion will be spent over the next 10 years on these Gulf Coast projects. ✓

Safety Self-inspections Make Sense for Contractors

Recent estimates place the business costs associated with occupational injuries at close to \$170 billion annually.* No contractor wants to see employees injured on a work site. Addressing safety and health issues in the workplace can save contractors money and add value to their businesses through:

- ✓ Lower workers' compensation insurance costs
- ✓ Reduced medical expenditures
- ✓ Fewer quality issues on projects
- ✓ Increased productivity
- ✓ Improved morale
- ✓ Better labor relations
- ✓ Reduced turnover

“By being proactive, contractors are also sending a clear message that employee safety is a priority.”

Many contractors are taking the initiative and conducting their own safety inspections at every work site where they are active, as well as at the storage, maintenance, and office facilities they operate. By being proactive, contractors are also sending a clear message that employee safety is a priority.

If you are interested in instituting a formalized safety program in your company, OSHA has checklists that can help. Here are some key areas that may deserve your attention.

Receiving, Shipping, and Storage

Examine equipment, layout, heights, floor loads, material handling and storage methods, and training for material handling equipment, such as loaders and forklifts.

* Occupational Safety and Health Administration, 2008.

Hand and Power Tools

Review inspection, storage, and repair of all power tools. Educate employees on the proper grounding, use, and handling of all tools used in your projects.

Electric Power

Review and formalize policies on working with, in, or near electric lines. Project managers and supervisors should use only certified electricians to set up switches, breakers, fuses, switch boxes, junctions, circuits, and extensions on your work sites.

Chemicals

Any chemicals used on work sites should be handled, transported, and stored according to state and federal

requirements. Employees working with these chemicals should be trained, closely supervised, and provided with protective clothing.

Personnel

Provide employees with appropriate training in identifying hazards and in checking machines before use. Training should also be provided on the safest methods for cleaning, oiling, and adjusting machinery.

Maintenance

Provide regular and preventive maintenance on all equipment used at different work sites and record all work performed on the machinery.

Building and Grounds Conditions

Examine all floors, walls, ceilings, exits, stairs, walkways, ramps, platforms, and

aisles to ensure that they do not present any safety hazards.

Safety Equipment

You should be aware that, by law, contractors are required to provide certain types of protective clothing and equipment to employees. According to the federal government, personal protective equipment (PPE) in this category includes the following:

- ✓ Nonprescription eye protection
- ✓ Prescription eyewear inserts/lenses for full-face respirators
- ✓ Goggles
- ✓ Face shields
- ✓ Laser safety goggles
- ✓ Hard hats
- ✓ Hearing protection
- ✓ Respiratory protection
- ✓ Fall protection
- ✓ Ladder safety device belts
- ✓ Reflective work vests
- ✓ Rubber insulating gloves
- ✓ Non-specialty gloves — payment is required if they are PPE, such as for protection from dermatitis or severe cuts and abrasions. Payment is not required if they are for keeping clean or for cold weather protection. ✓

The general information in this publication is not intended to be nor should it be treated as tax, legal, or accounting advice. Additional issues could exist that would affect the tax treatment of a specific transaction and, therefore, taxpayers should seek advice from an independent tax advisor based on their particular circumstances before acting on any information presented. This information is not intended to be nor can it be used by any taxpayer for the purpose of avoiding tax penalties.

1411 Second Loop Road / 29505
PO Box 6289 / 29502
Florence, SC
843-665-5900 (ph)
843-678-9523 (fx)

1759 North Fraser Street / 29440
PO Drawer 1628 / 29442
Georgetown, SC
843-546-2426 (ph)
843-546-0028 (fx)

Parkway Center, Suite 201
950 48th Avenue North
Myrtle Beach, SC 29577
843-448-1500 (ph)
843-497-2588 (fx)

380 West Wesmark Blvd.
Sumter, SC 29150
803-905-4000 (ph)
803-905-4001 (fx)

Carolina First Center, Suite 320
40 Calhoun St. / 29401
PO Box 20099 / 29413
Charleston, SC
843-577-5843 (ph)
843-723-3075 (fx)

Exchange Commons Building, Suite 2A
14361 Ocean Highway 17
PO Box 350 / 29585
Pawleys Island, SC / 29585
843-237-9004 (ph)
843-237-9160 (fx)

The Tower at 1301 Gervais
Suite 802
Columbia, SC 29201
803-312-0001 (ph)
803-255-8886 (fx)

Building For Your Future

*A Full Array
Of Services*

- ✓ Tax Planning & Consulting - Licensing, Multi-State Tax & Bonding
- ✓ Financial Statement Audits and Reviews for Licensing, Bonding, & Financing Purposes
- ✓ Monthly Financial Statements & Customized Management Reports
- ✓ Management Consulting (M&A Advisory and Business Consulting)
- ✓ Accounting Services Support (AP, Check Writing, & Management)
- ✓ Software Solutions & Support
- ✓ Employer Services Group (HR, Employee Benefits, Payroll)
- ✓ And More . . .

WR WebsterRogers LLP
CERTIFIED PUBLIC ACCOUNTANTS ♦ CONSULTANTS

Florence, Charleston, Myrtle Beach, Columbia, Georgetown, Sumter, Litchfield

Contact Us
wr@websterrogers.com

www.websterrogers.com

Developments in Tax and Business

The Regulatory Burden

The cost of complying with federal regulations falls most heavily on companies with fewer than 20 employees. These very small firms pay \$7,647 per employee per year to stay in compliance, substantially more than the \$5,282 per employee spent by much larger firms.

Building Information Modeling Gaining in Popularity

Over a third of construction project and program owners stated that they have used Building Information Modeling on one or more of their projects, according to a recently released survey conducted by the Construction Management Association of America and FMI. Building Information Modeling involves the creation of digital

information about a building project, which is used for design decision-making, the production of construction documents, cost estimating, construction planning, and, ultimately, managing and operating the facility.

Audit Chances

The IRS 2006 Data Book shows that the percentage of partnership returns that were audited by the IRS rose from 0.26% in 2004 to 0.36% in 2006, while the percentage of S corporations that were audited doubled over the same period, rising from 0.19% in 2004 to 0.38% in 2006. The audit rate for corporations under \$10 million in assets rose from 0.32% in 2004 to 0.80% in 2006, while the audit rate for corporations with \$10 million or more in assets jumped from 16.74% to 18.60%. ✓

Can We Serve You?

Our firm provides a broad range of accounting, auditing, tax, employee benefit, and management consulting services to contractors.