PERSPECTIVES ON THE CONSTRUCTION INDUSTRY

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Know the Rules on Independent Contractors

Outsourcing work to independent contractors is probably more common in construction than in many other industries. After all, bringing in qualified independent contractors to handle various aspects of a project with tight deadlines makes perfect sense. It also makes financial sense.

Know the Ground Rules

However, don't let the financial advantages of hiring independent contractors blind you to the need to consistently treat them as independent contractors. You must familiarize yourself with the factors that the IRS uses to help differentiate an independent contractor from an employee.

If you misclassify an employee as an independent contractor, the IRS will seek unpaid payroll taxes, and possibly penalties and interest on that amount, from your firm. And you could be forced to provide the worker with the same benefits you provide for your employees.

What the IRS Looks At

The IRS reviews a wide range of common law factors in determining whether a worker is an employee or an independent contractor. Depending on the circumstances, these factors include:

Behavioral control. Independent contractors are not under the direct supervision and control of company personnel and do not receive detailed instructions about how work is to be performed. All of the following are examples of such instructions:

- ✔ When and where to do the work
- ✔ What tools or equipment to use (Independent contractors furnish their own tools and equipment.)
- ✔ What workers to hire to assist with the work
- ✔ Where to purchase supplies and services
- ✔ What work must be performed by a specified individual
- ✔ What order or sequence to follow

Even if no instructions are given, behavioral control may exist if the business has the right to control how the work is performed. In addition, the issue of training is weighed by the IRS. Independent contractors do not receive company-provided training about procedures to be followed and methods to be used in performing a task.

Financial control. The facts that determine whether a business has the right to control the business aspects of a worker's job include:

- ✔ The extent to which the worker has unreimbursed business expenses (Independent contractors typically pay their own business and travel expenses.)
- ✔ The extent of the worker's investment
- ✔ The extent to which the worker makes services available to others
- ✔ How the business pays the worker (Independent contractors are usually paid separately by project.)
- ✔ The extent to which the worker has the opportunity to realize a profit or loss (Independent contractors may realize a profit or suffer a loss while performing contracted services.)

Relationship of the parties. A review of certain factors can illustrate the nature of the relationship:

- ✔ Written contracts that describe the relationship the parties intend to create
- ✔ Whether the business provides the worker with employee-type benefits, such as insurance, a pension plan, vacation or sick pay
- ✔ The permanency of the relationship (The independent contractor's services are typically for separate and distinct projects; however, employees also may be hired on a seasonal or project basis.)
- ✔ The extent to which services performed by the worker is a key aspect of the company's regular business

If a worker is hired with the expectation that the relationship is for more than a specific period or project, then the IRS will consider this factor as evidence of an employer-employee relationship.

If you need help in ensuring that your firm correctly classifies independent contractors, please contact us. ✔

Before Accepting "Takeover" Work

Takeover work can be a good opportunity, but there are several issues that contractors should examine before agreeing to step in and complete a project. If a takeover project has been offered to your firm, here are some things you'll want to investigate.

Background of the Dispute

Find out why the owner and the original contractor parted ways. Was it for cause? If so, can you avoid the same issue? Did the owner have difficulties paying the contractor on time? If this was the case, can you say for sure that it will be different for you if you take on the project? Obviously, you don't want to commit your resources to a takeover project only to end up waiting a long time to get paid. One possible way to avoid late payment issues is to insist on a retainer up front or regular payments for completed work, on a weekly basis, for example.

> "Find out why the owner and the original contractor parted ways."

Current Status of the Work in Progress

A careful inspection of the worksite conditions, the worksite's access and egress, and the quality of the work performed so far can help you estimate expenses and how much profit you are likely to make on the work.

Adequacy of Current Insurance Policies

Contact your insurance agent for confirmation that your current policies include coverage for takeover work. Walk away from the project if you don't have or can't obtain coverage since the financial risks would be too high.

Willingness of Subcontractors To Stay on the Job

Clarify before accepting a takeover job whether some, all, or none of the subcontractors will be staying on the job. Some subcontractors might be reluctant to continue working if the original contractor failed to pay them for the work they'd already performed. If that's the case, it might be necessary for the owner to step in and pay the subcontractors what they are owed. If the subs have been paid on time, inspect their work to be sure that it meets your standards. Then, you can ask them to stay on if you wish.

Takeover work can be profitable. However, be sure to seek input from your professional advisors regarding due diligence before you agree to take over an existing project. We'd be happy to help you in any way we can. ✔

Verifying the Legal Status of Employees

A Presidential Executive Order issued last year requires contractors who perform work for the federal government to verify their employees' eligibility to legally work in the United States using the U.S. Citizenship and Immigration Services' E-Verify system. The new rule was originally scheduled to take effect on January 15, 2009. However, implementation of the rule has been delayed until May 21, 2009.

> ". . . the new rule virtually eliminates Social Security mismatch letters . . . ."

E-Verify

E-Verify is a free Internet-based system operated by the Department of Homeland Security in partnership with the Social Security Administration that allows participating employers to electronically verify the employment eligibility of their existing employees and new hires. The federal government says that the new rule virtually eliminates Social Security mismatch letters, improves the accuracy of wage and tax reporting, protects jobs for authorized U.S. workers, and helps employers maintain a legal workforce.

Under the new rule, contractors awarded a prime federal contract must use E-Verify on projects with a period of performance longer than 120 days and a value above $100,000. The requirement to use E-Verify also applies to subcontracts in situations where the prime contract contains the E-Verify requirement and the subcontract for services or construction has a value greater than $3,000. Any company awarded an applicable federal government contract will be required to enroll in E-Verify within 30 days of the contract award date and begin using the system to ensure their employees' legal status.

During fiscal year 2008, employers participating voluntarily in E-Verify made more than 6.6 million employment verification inquiries. Less than 4% of the individuals whose information was submitted to E-Verify were found to be ineligible to work legally in the U.S. Individuals who are not immediately cleared by E-Verify have the opportunity to correct their government records in order to confirm their work eligibility.

The use of the E-Verify system is under review by the current administration. At press time, no changes have been announced. ✔

Key Construction Contractor Financial Ratios

Sureties, banks, and other creditors measure your business's financial strength by reviewing financial trends and numerical relationships using the information presented on your financial statements. To do this, they typically calculate a variety of financial ratios. Comparing ratios from current periods to ratios from prior periods and to industry standards provides insight into your company's financial health and the potential risk of extending or guaranteeing credit.

Reviewing your firm's financial ratios with us on a regular basis can help you better manage your company's finances. Some of the ratios that can be important include:

- ✔ ***Profitability ratios,*** such as *gross profit margin, return on assets,* and *return on equity*. These ratios show how effectively your company is using its resources and curtailing costs to produce profits.
- ✔ ***Liquidity ratios,*** such as the *current ratio.* Liquidity ratios measure your firm's ability to pay off short-term obligations as they become due.
- ✔ ***Underbilling ratios,*** such as the *underbillings to equity ratio.* This ratio measures the percentage of your company's net worth represented by work performed but not yet billed. A ratio greater than 20% is considered unusual and would be a cause for concern. The *underbillings to working capital ratio* reveals the percentage of your working capital that is composed of underbillings.
- ✔ ***Backlog ratios*** indicate how long it will take to complete work under contract (*number of months in backlog*) and the remaining gross profit not yet earned on contracts that haven't been completed (*backlog gross profit*).
- ✔ ***Asset utilization ratios*** measure the efficiency of your company's use of its assets. For example, your *fixed asset ratio* will show to what extent fixed assets make up your company's equity. If the percentage seems too high, creditors and sureties may regard your company's investment in fixed assets as excessive.
- ✔ ***Debt utilization ratios*** allow you to measure your company's liabilities in relation to its asset base and earnings ability. For example, if your company has a high *debt-to-equity ratio*, it means that your company is financing its assets using a large amount of borrowed funds.

Financial Ratios

The Ratio	*How It's Calculated*	*What It Means*
Current Ratio	Current Assets ÷ Current Liabilities	Will current assets be enough to meet current liabilities?
Return on Equity	Net Earnings (before income taxes) ÷ Total Net Worth	Are your assets effectively generating profits?
Equity to Overhead	Total Net Worth ÷ General & Administrative Expenses	Are your overhead expenses appropriate for the size of your company?
Gross Profit Margin	(Net Sales – Cost of Goods Sold) ÷ Sales	What's the difference between revenues and cost of sales? Is it enough to meet selling and administrative expenses?
Debt-to-Equity	Total Liabilities ÷ Stockholders' Equity (or Net Worth)	How heavily is your company leveraged?
Fixed Asset Ratio	Net Fixed Assets ÷ Total Net Worth	Does your business have enough liquid funds for current operations?
Return on Assets	Net Earnings (before income taxes) ÷ Average Total Assets	Are your assets being used effectively to generate profits?
Backlog to Working Capital	Average Backlog in Dollars ÷ (Current Assets – Current Liabilities)	How much accumulated committed work do you have in relation to working capital?

Talk to Us

Financial ratios can give you a snapshot of your company's fiscal health. They can also help you identify potential problems that may require you to take corrective measures. Please contact us for assistance in analyzing your company's financial statements and tracking key ratios. ✔

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Developments in Tax and Business

New Draft Crane and Derrick Rules

The U.S. Department of Labor's Occupational Safety and Health Administration (OSHA) recently issued proposed regulations for cranes and derricks. The proposed rules focus on key crane safety issues — ground conditions, the assembly and disassembly of cranes, the operation of cranes near power lines, the inspection procedures for cranes, the use of safety devices and signals, and the training and certification of crane operators.

Electronic Filing Required

Contractors with 25 or more trucks, tractors, or other heavy vehicles used on highways must now file their excise tax, Form 2290 (Heavy Highway Vehicle Use Tax Return), electronically with the IRS. Contractors can choose to file Forms 720 (Quarterly Federal Excise Tax Return) and 8849 (Claim for Refund of Excise Taxes) electronically also.

Increases Expected in Federal Highway Spending

Industry observers are speculating that state and local governments facing serious fiscal problems in 2009 may defer transportation investments to meet budgets. However, federal spending may blunt the impact of any such cutbacks. Congress increased federal highway funds in 2008 by 5.5% over 2007's number by allocating $41.2 billion in spending. In addition, the recently enacted American Recovery & Reinvestment Tax Act of 2009 makes infrastructure spending one of its priorities. ✔

Can We Serve You?

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

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