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PERSPECTIVES ON THE CONSTRUCTION INDUSTRY

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Key Internal Controls for Contractors

The construction industry is a risky one. While contractors can't do much about economic ups and downs, they can make sure their companies have strong internal controls to help guard against business risks.

In an uncertain environment, well-run companies that have strong controls in place are more likely to gain the confidence of sureties, lenders, and customers/owners. There are several important construction-specific areas you should focus on.

Estimating and Bidding Controls

Without reliable estimates, it is difficult to bid properly or decide whether a job is worth doing. You should have an established process in place for estimating and bidding. Assign a manager to review the estimates based on each project's specifications and plans.

There should be adequate documentation supporting the estimated costs for materials and labor, such as vendor price quotes and payroll data. Additionally, labor burden percentages should be checked to ensure they are adequate.

Designate a senior person to verify the clerical accuracy of final contract estimates. All bids should be approved by management before they are submitted.

Project Monitoring Controls

Hitting profit targets on each project is generally dependent on the efficient management of the actual construction process. Efficient management requires that you have controls in place to monitor results on an ongoing basis. To do this, you will need job progress reports that outline the actual costs incurred on a job and the projected costs to complete it.

Changes in Work Scope and Conditions

Changes are part and parcel of the contracting business. How well you monitor and manage them can determine whether a project makes or loses money.

There are steps you can take to identify and control changes that may occur during the course of a job. For starters, make sure your on-site supervisors are aware of what is and is not included in the contract. Whenever customers want changes made after the job has started, your supervisors should follow preestablished procedures to first get the changes approved and then to make sure the changes will be billed. Have written, signed change orders before any additional work is begun.

Fraud and Theft Controls

Without adequate internal controls, you have an increased chance of falling victim to theft and fraud. To limit the potential for losses, have estimators obtain more than a single quote and require management authorization of job site material purchases. In addition, set limits on the amounts site managers can spend without an additional, higher level of management authorization.

Require employees to check delivery receipts to ensure that all ordered items have been received, have procedures for managing purchased materials on the job site, and periodically verify materials inventories. You will also want to keep a log of small tools and equipment used on site and the individuals responsible for them. Emphasize proper job site security and hold employees accountable for following established security procedures. ✔

Protect Your Business with Corporate Minutes

It's not always necessary to document the routine business decisions you make every day as a contractor. However, as the owner of a corporation, it's important to understand state requirements regarding shareholders' and directors' meetings and maintaining corporate minutes.

Corporate minutes not only provide a written history of the decision-making process concerning important business strategies, they can also be important in protecting your limited liability status should your company become involved in legal proceedings or a dispute with the IRS.

What's Included

Corporate minutes describe how board members arrived at decisions. Essentially, the minutes record:

- ✔ The name of your company
- ✔ The date, time, and location of the meeting
- ✔ The name of the person who called the meeting to order
- ✔ The names and corporate titles of attendees
- ✔ Actions or motions
- ✔ Descriptions of decisions made, votes taken, and any abstentions from voting
- ✔ The time the meeting ended

Certain major business decisions should typically be documented in the corporate minutes. These include:

Stock: Note the issuance of shares to new or existing shareholders.

Salaries and Bonuses: The board's reasoning and approval of salaries and bonuses paid out to key employees can be helpful if the IRS ever challenges the reasonableness of the compensation.

Purchases and Leases: Significant equipment or real estate purchases and leases should have the board's approval.

Financing: Corporate minutes should document decisions made in relation to loans the company gives or receives. Corporate loans to owners should be approved by the board and be supported by promissory notes.

Observing the Formalities

In the face of a legal challenge, if you're not following proper protocol, a court may decide your business isn't being operated as a separate entity from the owner(s) — despite the existence of a corporation. That could lead to a legal decision to "pierce the corporate veil," a term that means the personal assets of the owner(s) can be used to satisfy business debts and liabilities. Meeting state requirements regarding director and shareholder meetings is one way of keeping a corporation separate from its owner(s).

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Corporate minutes can also help map out a plan for action items and help drive activities by executives and employees. You also can use them to review and measure your progress toward achieving certain goals. ✔

New Revenue Recognition Standard's Impact on Contractors

The Financial Accounting Standards Board (FASB) issued a new revenue recognition standard earlier this year. The release, *Revenue from Contracts with Customers*, is part of an effort to create a single worldwide revenue recognition standard. Over 700 pages in length, the new standard is complex and will have an impact on the financial statements of companies in many industries, including construction.

Why the Change?

Financial statement users look at revenue figures when assessing a company's financial performance. However, transactions that are economically similar may receive different accounting treatment under existing International Financial Reporting Standards (IFRS) and U.S. Generally Accepted Accounting Principles (GAAP). According to the FASB, the new converged standard will enhance the quality and consistency of how revenue is reported and improve comparability in the financial statements of companies reporting using these two main accounting standards.

New Requirements

A major change made by the new standard is that it involves recognizing revenue upon completion of a "performance obligation." The rules determining what is and is not a performance obligation are detailed. The new standard also increases the information that must be disclosed in the financial statement footnotes.

Private companies in the U.S. will apply the new standard for annual reporting

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New Revenue Recognition Standard's Impact on Contractors Continued from page 2

periods beginning after December 15, 2017. Public companies using U.S. GAAP are required to apply the standard for annual reporting periods beginning after December 15, 2016. The changes will affect different industries to different degrees. It's not too soon to begin an analysis of the best way to adapt to the new standard. We would be happy to help your company prepare for potential changes in how it reports revenues. Please contact us. ✔

What's Your Exit Strategy?

How long do you plan to work? If your plan is to retire one day with enough money to keep you and your loved ones comfortable for life, then you probably need to start planning for your exit now. Here are some important issues you should consider.

Define Your Goals

Your exit strategy largely depends on your goals. Do you want a child, grandchild, or business partner to take over the business? Or are you planning to sell to a competitor and trying to extract the maximum sale price? Clearly defined goals can help you evaluate the options for meeting your short- and long-term objectives.

Buy-sell Agreements

Part of your planning may involve executing a buy-sell agreement. A buy-sell agreement is a legal contract between the owners of a business, under which each owner agrees that, typically, on death, disability, or retirement, his or her business interest will be sold to the other owners (or to the business itself) at a price that's determined under the agreement.

The buy-sell agreement also can be triggered under other circumstances defined in its terms, such as an owner's bankruptcy or divorce.

A buy-sell agreement helps ensure the orderly transition and management of your construction firm and that surviving family members will be fairly compensated should you or a co-owner die. Buy-sell agreements are often funded with life insurance.

Lifetime Gifts to Family Members

There are several smart estate planning strategies that can help you transfer ownership in your firm to younger generation family members. For example, to remove potential appreciation in the business from your estate, you might consider a plan that transfers interests in the business to your children through a series of lifetime gifts over time. Use of the gift-tax annual exclusion and valuation discounts, where appropriate, can boost the effectiveness of a lifetime gifting strategy.

> **"A buy-sell agreement helps ensure the orderly transition and management of your construction firm and that surviving family members will be fairly compensated should you or a co-owner die."**

Ease the Transition

As the time of your departure draws closer, start thinking about implementing the following steps to ease the new owners' transition:

- ✔ Having up-to-date financial statements
- ✔ Documenting job descriptions
- ✔ Updating the organizational chart
- ✔ Preparing an accurate customer list
- ✔ Identifying prospects
- ✔ Training second-generation managers
- ✔ Updating business plans and financial forecasts
- ✔ Providing a list of vendors

Boost the Value of Your Business

Maximize the value of your business before a sale by:

- ✔ Implementing operational changes to improve the company's systems and procedures
- ✔ Cleaning up financial records and identifying areas of concern that can be corrected
- ✔ Resolving ongoing legal/litigation claims
- ✔ Resolving any tax disputes at the state or federal level

Work with Us

Planning for your eventual exit from your business is an ongoing process. We can assist you through every stage and help ensure you maximize the value of your ownership stake. Talk to us. We would be happy to help. ✔

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500 2nd Street South, Suite 200 La Crosse, WI 54602-4029

Green Bay, WI
920.336.9850

La Crosse, WI
608.784.7737

Manitowoc, WI
920.684.7128

Marshfield, WI
715.387.1131

Medford, WI
715.748.2856

Rochester, MN
507.424.1233

St. Charles, MN
507.932.3010

Winona, MN
507.452.8313

www.HawkinsAshCPAs.com

1.800.658.9077

Developments in Tax and Business

Storm Water Permitting Waivers

Contractors can qualify for a waiver from storm water permitting requirements in areas where the Environmental Protection Agency (EPA) is the permitting agency. Contractors can access the Rainfall Erosivity Factor Calculator on the EPA's website to determine the value of the rainfall erosivity factor (R-factor) on any construction project that disturbs less than five acres. Contractors should check with state permitting authorities to determine if they accept low erosivity waivers.

Good News for 2015

The American Institute of Architects (AIA) reported that its Architecture Billings Index for May 2014 was 52.6, a steep rise from its prior month reading of 49.6. That's good news for contractors since the Billings Index is regarded as a leading economic indicator of construction activity and reflects an approximate nine to twelve month lead time between architecture billings and construction spending.

Expected Surge in Demand for Senior Housing

Industry experts are predicting that the demand for senior housing will grow alongside the massive growth in the population of Americans who are over 65 years old. Data from the Center for Housing Policy estimates that the country's over-65 population will total 88 million by 2050 — a 120% increase from the 40 million Americans who are currently 65 years or older. ✔

Can We Serve You?

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