



Surviving The Market

NECA

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CICPAC is a national association of CPA firms recognized in their respective markets for providing high-quality financial and consulting services to the construction industry.

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- **James F. Weber, CPA**


- **Developing comprehensive business and personal financial strategies for small business owners.**

- **R. David O'Brien, CPA**

- **Specializing in the construction industry and leads the Contractor Industry Practice Group.**



FIRM BACKGROUND AND STRUCTURE

 Founded in 1986, Weber • O'Brien Ltd. provides Auditing, Accounting, Tax, and Management Consulting to a wide variety of clients nationwide. Located in Toledo, Ohio, our staff of nearly 40 professionals allows us to provide focused, personalized, yet comprehensive client services. We have over 20 years of experience servicing middle-market companies in a variety of industries. Weber • O'Brien is a member of BDO Seidman, and CICPAC

- Life, business, and the natural laws that govern the universe all have one thing in common...that is cycles. We are in a cycle now. We cannot predict its depth and duration, but we can say with great certainty that some of us will survive this cycle better than others, and some of us who are not prepared or who do not react until it is too late will not survive at all.
- What it takes to survive a business cycle such as the one we are currently experiencing.



- Financial Statements
- Cash Management
- General Matters
- Banking
- Personal Planning
- Fraud/Internal Controls
- Management/Leadership
- Legal
- Key Employees
- Taxes



FINANCIAL STATEMENTS

FINANCIAL DEPARTMENT

- ❶ Financial statements must be prepared monthly, by the 10th of the following month
- ❶ All accounts must be reconciled to the detailed account information monthly
- ❶ Financial statements should include month-to-date and year-to-date information as well as budgeted data
- ❶ The Controller should review the financial statements before its release to the President
- ❶ The Controller should prepare an “executive summary” that provides a one-page overview of all positive and negative variances and trends with recommendations and solutions

FINANCIAL STATEMENTS

FINANCIAL DEPARTMENT

- ❶ You, the President of the Company, must understand the financial statements. Your knowledge of the actual financial condition of the Company will serve you well in analyzing the operational needs of the Company in difficult times.
- ❶ The Controller and Chief Financial Officer must provide financial leadership.
- ❶ Job profitability, cost management, vendor and subcontractor cost, construction draws, and general and administrative costs must be a principal focus.
- ❶ They must meet regularly with the management team and provide proactive solutions
- ❶ The strongest companies have the strongest financial staff.

- Use an Impress Petty Cash System
- Maintain a positive cash balance
- Do you have sufficient cash to fund operations for the next 30, 60 and 90 days (Note the longer the better)
- Do you have a cash budget prepared using a standardized form
- Is the cash budget prepared regularly
- Are cash disbursements limited to the 10th and 20th of the month
- Other

ACCOUNTS RECEIVABLE/DRAWS

- **Schedule Monthly**
- **Are all receivables collectable and what steps are taken to make sure they are collected on a regular basis**
- **Are draw requests properly completed and submitted in a timely manner**
- **Establish formal policies for collection**

RELATED PARTY TRANSACTIONS

- **Make sure these are collectible between the companies**
- **Are they formally documented**
- **Are they secured by UCC filings**
- **Can the related Company pay the balance due the operating Company**



RELATED PARTY TRANSACTIONS

- Are monthly payments made
- Are management fees considered
- Are all transactions at fair market value
- Consider tax effects between companies



- Is real property held outside of the construction company
- Depreciation methods – Book vs. Tax
 - Book
 - Straight-line depreciation
 - Tax
 - Accelerated Depreciation
 - Section 179
 - Bonus



- Compute the carrying cost
- What is fair market value



- Establish proper cutoff each month
- Take advantage of discounts
- Accrue all appropriate expenses at month end



- ❑ Review terms of loan documents
- ❑ Evaluate subordination of personal loans to the Company
- ❑ Limit personal guarantees
- ❑ Evaluate carve outs or collateral limitations (personal residence stays with spouse)
- ❑ Make sure collateralized assets at a reasonable fair market value is more than bank debt
 - ❑ Avoid excess collateral positions with the bank
 - ❑ Avoid cross collateralization



- **Maintain a positive balance**
- **Make sure distributions do not violate bank covenants**
- **Pro rata distributions for S corporations**



■ Liquidity Ratios

■ Number of Days Cash

■ Cash times 360 divided by annual revenue.

■ Account Receivable Turnover

■ Accounts receivable times 360 divided by revenue

■ Accounts Payable Turnover

■ Accounts payable times 360 divided by cost of contract revenue



- **Current Ratio**
 - **Current assets divided by current liabilities**
- **Working Capital**
 - **Current assets minus current liabilities**
- **Adjusted Working Capital**
 - **Working capital adjusted for the following:**
 - **Items added back**
 - **Cash surrender value of life insurance**



- ❑ **Items deducted from working capital**

- ❑ **Any related party receivable**

- ❑ **Inventory at 50%**

- ❑ **Prepaid Items**

- ❑ **Leverage Ratios**

- ❑ **Debt to Equity Ratio**

- ❑ **Total liabilities divided by equity**

- ❑ **Long-Term Debt to Equity**

- ❑ **Long-term debt divided by equity.**



- ❶ Profitability Ratios

- ❶ **Gross Profit to Sales**

- ❶ **Gross profit divided by annual revenue**

- ❶ **NPBT**

- ❶ **Net profit before taxes divided by annual revenue.**



- **Return on Assets**
 - **Net income before taxes divided by total assets**
- **Return on Equity**
 - **Net income before taxes divided by prior year equity**



- Are sales at projected levels
 - What are sales trends (5 year)
- Review gross margin trends (5 year)
- Understand difference between direct costs and general and administrative expenses
- Prepare a breakeven analysis
- Review all expenses monthly to the budget. Identify variances from budget, understand all variances and make necessary adjustments



GENERAL ADMINISTRATIVE EXPENSES

- **Fixed vs. Variable Costs**
- **Interest expense**
- **Depreciation**
 - **Book vs. Tax**



- Match the payment of your payables with the collection of cash receipts
- Establish a standard payment cycle
- Pay only on the 10th (discount) or 20th of the month
 - Take advantage of all discounts

PURCHASE ORDERS

- **Require purchase orders**
- **Require approval**
- **Install a purchase order system with your business software**
- **Note: We have seen a three percent (3%) reduction in cost once a purchase order system is installed**



PAYMENT CYCLE

- Expand the payment period for non-discounted vendors to no less than 45-60 days
- Do not pay vendors weekly or on request

- Establish billing and collection policies in writing
- Establish follow up protocol and hold regular meetings with staff to make sure all collection policies are followed

CHANGE ORDERS

- Establish a standard procedure to capture all change orders
- Require customer to approve change order before performing additional work

- Bid all subcontractors regularly
- Seek highly cost effective bids from quality subcontractors
- Allow no opportunity for subcontractors to increase pricing once a contract is signed



- ❶ Pay all taxes when due
- ❶ Be aware of all taxes
- ❶ Save for tax estimates
- ❶ Payroll taxes must be paid timely
 - ❶ Expensive form of borrowing
 - ❶ Penalties
 - ❶ Interest
 - ❶ If not paid timely and company has cash flow problems
 - ❶ Consider an offer of compromise

OVERBILLING

- ❑ Can lead to cash flow problems
- ❑ Can create a false sense of cash flow



- Hire competent advisors
- Hire competent staff
- S Corporation
 - Salary vs. distribution
- Related party transactions
 - Arms length
 - Documented

- **Related party rents/leases**
 - **Fair market value**
 - **Beware of potential sales tax liability**



- Evaluate banking relationship
- Receive accurate and timely data monthly
- Receive accurate and timely management data
- Job cost meetings
 - Review all jobs weekly
 - Document all change orders
 - Make adjustment to gross profit immediately



- **Business projection**
 - **Optimistic**
 - **Realistic**
 - **Pessimistic**
- **Prepare a cash flow projection**



- **Communication with employees**
 - **Goals**
 - **Results**
 - **Rewards**
- **Develop management information, key indicators**
- **Use project management software**



- **Take a class on understanding financial statements or meet with your CPA to learn how to read your financials.**
- **Take two hours a month to read the prior month's financials (income statement and balance sheet). Review with your Controller.**
- **Clearly define Controller/Bookkeeper duties.**



- **Term Debt**
 - **Can payment terms be extended**
 - **Covenants**
 - **Restrictive**
 - **Negative**
- **Line of Credit**
 - **Amount**
 - **Collateral**
 - **Renewal**

- **Meet with your banker, tell them your story**
- **Prepare projection and business plan**
- **Make sure he/she is connected to you beyond a loan document**
- **Make sure he/she believes in you**

LOAN DOCUMENTS

- Know today if you are not going to meet the covenants, find out alternative ways to do so or obtain waivers
- Review all terms and become familiar with them
- Evaluate your personal guarantee and spousal guarantees.
- Have attorney review all documents

- **LIBOR - (London Interbank Offered Rate)**
- **Prime**
- **Fees/Rate**
 - **Renewal fees**
 - **Termination fee**
 - **Minimal rate (floor)**



- **SBA**
- **More than one bank**
- **Avoid cross collateralization of Company's assets**
- **Avoid excess collateral position, update personal financial statement (be reasonable)**
- **Finance fixed asset purchases**
- **Lease (Capital versus Operating)**



- Hire excellent advisors
- If challenged, meet with a reorganization specialist (lawyer)
- Hire excellent internal financial staff
- Do not borrow from the government. Make sure all trustee taxes are paid. Penalties and interest are high and trust fund liability, if you are a responsible party, goes past bankruptcy
- Split assets between spouses
- Do not have spouse be an officer or owner of operating Company

- Remember that retirement plan assets are not subject to creditor claims. This may also apply to annuities and cash surrender value of life insurance (children accounts, trusts)
- If possible, eliminate or minimize spousal guarantee. Consider carve out provisions

- Do you have a worse case personal budget prepared, is your spouse on board
- Do you know how long you can last financially if you did not sell
- What is your liquid net worth
- Know your “Burn” rate

- **When the economy is difficult on businesses, it often becomes difficult on employees who work for you**
- **During times like this, it is more important than ever to be aware of employee fraud and to note that it exists with all Companies 20% to 40% of the time**
- **You can take steps to minimize fraud:**
 - **Bond all employees who have access to cash**
 - **Segregate duties**
 - **Open the bank statements and review all bank activity**



- The following is a brief but not complete list:
 - Review the checks
 - Look for unusual activity
 - Do not use a signature stamp
 - Audit sample disbursements on a regular basis
 - Examine receiving reports
 - Invoice packets
 - Review payroll regularly
 - Control credit cards, PayPal accounts

INTERNAL CONTROLS

- **Have strong internal controls**
- **Review and understand your system:**
 - **Cash receipts and disbursements**
 - **Billing**
 - **Purchases**
 - **Payroll**
 - **Journal entries**
 - **Software**

INTERNAL CONTROLS

- Review the bank statements and credit card statement activities before giving them to the controller
- Review internal controls system with your CPA to find weaknesses and try to correct them

SMALL BUSINESS INTERNAL CONTROLS

- Segregation of duties
- Reconcile and examine bank statements every month:
 - Receive the unopened bank statement directly and open it personally
 - Scan the front and back of all canceled checks
 - Question the purpose of all transfers

SMALL BUSINESS INTERNAL CONTROLS

- Reconcile and examine bank statements every month:
 - Compare payroll checks with employee records and ask questions
 - Have the banks statement reconciled by someone other than the bookkeeper/ controller if possible

SMALL BUSINESS INTERNAL CONTROLS

- **Signing checks:**
 - **Never sign a check without inspecting original supporting documentation including the invoice, shipping documents and the purchase order**
 - **Cancel all supporting documentation after signing a check**
 - **Never sign a check that is not completely filled in**
 - **Do not pay from vendor statements**
 - **Verify the names of your vendors**

SMALL BUSINESS INTERNAL CONTROLS

- **Protection of valuables:**
 - **Keep blank checks and the signature stamp secure**
 - **Deposit all cash and checks daily**
 - **Backup all computer files on a regular basis and store the backup at a secure, remote location**
 - **Periodically change computer system passwords**



SMALL BUSINESS INTERNAL CONTROLS

- Prepare and use budgets
- Employees
 - Always verify employee references before hiring
 - Require all employees to take vacations
- Don't abuse your company
- Caveat: There is no assurance that all fraud will be discovered or totally eliminated



■ You are the leader of your Company. There is a big difference between management of your Company and leadership. Managers do things right and leaders do the right things. Focus your efforts on a few things that are critical to the organization. Make sure that you have appropriate managers in place:

- Project management
- Sales
- Administration



- **A less than appropriate person in these jobs could destroy you, your Company, and the jobs of all the people in your Company. Recruit and train your people. Make sure you share common vision and business values. Hiring, training and retention of highly qualified people remains the heart of business success. Avoid “political correctness” and actively seek out and select only the best people to accomplish your goals.**

- **Share your goals with your people. Prepare the following:**
 - **Business Plans**
 - **Projections**
 - **Marketing Plans**
- **Measure results often, share the results, good or bad, with your people. Share your success and failures with them.**
- **Meet regularly with your people, share summary results with them, and seek ideas from them.**



- ❑ Do your people have job descriptions. Are they evaluated regularly. Do you bonus people based on objective performance measures (project manager, gross profit cycle time, and customer satisfaction) or do you give subjective bonuses
- ❑ Do you perform random cost cuts
- ❑ Terminate employees as necessary, but do not do it every week as your best people will leave for job security

- Hire competent counsel
 - Make sure all attorneys are specialists in their respective areas (litigation, divorce, business, estate)
- Review all bank documents
- Review personal asset position, ownership, succession planning matters, and estate planning
- Meet regularly and discuss options

☐ Are all matters of corporate governance complete:

- ☐ Related party
- ☐ Notes from/to stockholders
- ☐ Contracts
- ☐ Key employees
 - ☐ Non-compete, Non-disclosure, Non-solicitation
 - ☐ Liquidated damages
- ☐ Board Minutes

- ❶ Identify, recruit, and develop a second level of management
- ❶ Create business plans with key people
- ❶ Reward key people who deliver results.
- ❶ Share financial data with key people (how much open book limited, i.e. except for payroll)
- ❶ Consider deferred compensation plan

- Consider extended benefits:
 - Life insurance
 - Disability insurance
 - Auto
 - Travel

- Create detailed job descriptions with goals, responsibility, and accountability (cycle time, gross profit, customer satisfaction).

- ❶ Family – Are they really the “right” choice or are they the only choice
- ❶ Is “key” employee based on performance or subjective factors (“length of time” with the company)
- ❶ Conduct annual retreat
- ❶ Do not wait to start this process
- ❶ Be a business moderator to review:
 - ❶ Performance – past and future
 - ❶ Lead the annual retreat.
 - ❶ Do **NOT** wait to start the process

- C Corporation vs. S Corporation
- Section 179 (\$250,000 in 2009)
- Section 199
- Net operating loss (carry-back/carry-forward)
- Basis
- Cost segregation
- Capitalization policy
- S corporation
 - Salary versus distribution
- C corporation accumulated earnings
- Estimated tax payments versus a bonus

- ❶ C corporation dividends
- ❶ Children Compensation
- ❶ Spousal compensation
- ❶ Related parties rules
- ❶ Self-Employment tax
- ❶ Retirement Plans



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CERTIFIED PUBLIC ACCOUNTANTS
STRATEGIC BUSINESS ADVISORS

THANK YOU!
Questions?

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