Covering the Industry's News
Texas Style
San Antonio - Austin
Dallas/Fort Worth - Houston

Fort Worth Water Gardens

Dallas/Fort Worth
CONSTRUCTION NEWS™
The Industry's Newspaper

www.constructionnews.net H (210) 308-5800 H Volume 14 H Number 5 H Q2 2017

ACCOUNTING

The real cost savings you should look for in a fixed price environment

Scott Allen, CPA, Tax and Consulting Partner
Cornwell Jackson
Plano, TX

Construction companies experience unique accounting structures due to expenses driving revenue as projects move through various stages of completion. By managing a variety of costs, maintaining safety for employees and hiring the right people, owners and project managers can improve cash flow and bid smarter on fixed price contracts.

In my role as the fractional CFO/controller for a rapidly growing construction company earlier in my career, I experienced the tough reality of out-of-control costs in a fixed contract price environment. Costs were out of control partially because the company's rapid growth was surreptitiously changing the company's underlying cost structure and partially because economic conditions had changed. The net result was a squeeze on profit margins and cash flows that placed the company in danger of marching down the primrose path.

The squeeze resulted in a snowball effect on cash management. The accelerated growth had outpaced the company's ability to increase the bank line of credit capacity, which meant that any increased demand for cash had to be satisfied through cash flow generated by the jobs. We had to navigate complicated lien rules in order to collect receivables.

We had to re-evaluate billing policies and increase the company's overbilled positions. When bidding new work, we had to be disciplined in the size of projects the company chased or risk the company's bonding capacity. Meanwhile, we saw general liability and worker's compensation insurance rate increases due to changes in the market. We could only hope that materials costs would not follow suit.

Once it became clear that we were dealing with something more systemic than a bad job or two, the owner and I went to work understanding what had happened and trying to correct the underlying issues. Within two years, the company accomplished a true turnaround. Starting with a company that was losing $400,000 a year, we ended up with a company that produced a gross profit margin of more than 15 percent annually.

Just one of the interesting lessons learned through this experience was that *few construction companies, if any, spend the necessary time each year to comb through their budgets and question the true costs of each line item.*

Whether it's the company cell phone plan or fuel and maintenance costs for fleet vehicles, no budget item is too small to scrutinize for long-term savings to the bottom line.

If your company exists in a fixed-price contract environment — as most construction companies do — expenses drive revenue. Especially with a Post-Recession mindset, profitable construction companies must have the discipline to look at their work–in-process reports every month and identify any expenses that are trending above budget.

There are, of course, other factors that can impact cash flow and profits in any given year. Let's look at the key drivers for real cost savings in the life of a construction company — both short-term and long-term.

Cornwell Jackson's tax team can provide guidance on reigning in costs by reviewing your profit and loss statements, work in process and general accounting ledgers. Contact our team with your questions.

Look for "Defining True Job Costs for Construction Bids" in the May Construction News publication to learn more on this topic.

Scott Allen, CPA, joined Cornwell Jackson as a tax partner in 2016, bringing his expertise in the construction and oil and gas industries and 25 years of experience in the accounting field. As the partner in charge of the tax practice at Cornwell Jackson, Scott provides proactive tax planning and tax compliance to all Cornwell Jackson tax clients. Contact him at Scott.Allen@cornwelljackson.com or 972-202-8032.

ACCOUNTING

Defining true job costs for construction bids

Scott Allen, CPA, Tax and Consulting Partner
Cornwell Jackson
Plano, TX

At the heart of a profitable construction company is an accurate bidding process. An accurate bid involves much more than expected materials or your subcontractor and labor costs. Other variables to consider are the weather, the subs (or GC), customer expectations and how you expect your competitors will bid. The more you factor in these variables across all bids, the closer you can get to a competitive that matches true costs.

Construction companies can get very efficient at estimating the expected costs per job; however, they don't always factor in "hidden" job-related costs in developing the bid:

- Labor-related benefits
- Fleet vehicles (owned or rented) and maintenance
- Fuel
- Small tools and other job consumables
- General liability insurance
- Safety program

If these costs are not considered, the company is at risk for missing the expected job profit, particularly in longer-lived jobs.

Reducing job costs and increasing margins

Identify the areas that have historically experienced cost overruns and develop incentive plans for the project management or field supervisory team to minimize costs. If bonuses are tied to the following key performance indicators, it can help to improve per job realization:

- Cost-effective materials sourcing
- Efficient and timely use of labor
- Waste reduction
- Safety management
- Early troubleshooting on budget or timeline concerns
- Timely work in process updates
- Quality standards (minor punch lists)

If you have never instituted a specific accountability program for these KPIs, develop standards for two or three and incorporate them into the next round of new work. If there is already some level of accountability in place, audit the results and look for additional areas for improvement.

When designing the incentive plan, it is important to keep parameters in place so that cost savings achieved do not come at higher costs in another category. For example, a labor savings incentive program may inadvertently incentivize the foreman to bypass safety protocols. An accident on the job will potentially result in long-term increased costs in worker's compensation insurance (not to mention legal claims) that far outweigh the labor savings. Design the program so that any bonuses are not paid until the warranty period has run in order to assure cost savings do not come at the cost of quality.

Realization meetings can identify jobs that provided a healthy margin as well as jobs that lost money. By reviewing past performance, you can get a better sense of where bidding and costs were not aligned, the drivers for cost overruns and even whether a project type is still worth pursuing. For these meetings to be effective, you have to have accurate cost reporting. When looking at past jobs in which a company made or lost money, it's a good exercise to understand exactly what drove the costs. Even though every company at some point has experienced a freak of nature, an accident or a materials shortage, there are usually more cost drivers that the company and its management can actually control.

One of the other areas that a company can review — and this ties to a longer-term shift in the business strategy — is the type of job bid.

Conditions change, and the jobs that used to be lucrative for a company can slowly whittle away margins due to higher competition, compliance issues or threadbare budgets. At the company I served, it was determined that K-12 school construction projects had experienced tightened margins, shortened project timelines and increased competition. Shifting the segment focus to junior college improvement projects, a market segment with less competition, helped the company to improve profit margins.

Cornwell Jackson's tax team can provide guidance on reigning in costs by reviewing your profit and loss statements, work in process and general accounting ledgers. Contact our team with your questions.

Look for "Balancing Overhead, Budgeting and Risk to Increase Project Profits" in June's Construction News.

Scott Allen, CPA, joined Cornwell Jackson as a tax partner in 2016, bringing his expertise in the construction and oil and gas industries and 25 years of experience in the accounting field. As the partner in charge of the tax practice at Cornwell Jackson, Scott provides proactive tax planning and tax compliance to all Cornwell Jackson tax clients. Contact him at Scott.Allen@cornwelljackson.com or 972-202-8032.

ACCOUNTING

Balancing overhead, budgeting and risk to increase project profits

Scott Allen, CPA, Tax and Consulting Partner
Cornwell Jackson
Plano, TX

Construction companies experience unique accounting structures due to expenses driving revenue as projects move through various stages of completion. By managing a variety of costs, such as overhead, budgeting, and talent, owners and project managers can improve cash flow and bid smarter on fixed price contracts.

Overhead and Budgeting

While profits (or lack thereof) are directly driven by job costs, don't forget to factor in overhead:

- Office payroll and benefits
- Building rent or mortgage
- Utilities
- Internet
- Insurance
- Marketing
- Equipment and supplies
- Professional services
- Professional dues
- Meals and lodging
- Shipping and postage
- Cell plans

Every dollar of overhead reduces your ability to compete and bleeds money from profit margins. Make the time and effort to examine every overhead line item on the profit and loss statement. Look for opportunities to reduce overhead. If it has been 2-3 years since you last shopped the item, whether it is property and casualty insurance, a cell phone plan or your electrical provider, do so. You may be surprised at the amount of cost you can drive out of your overhead.

Finally, make the time and effort to develop a comprehensive budget incorporating your understanding of your job cost drivers, your targeted sales numbers and your refined overhead. Develop the discipline to compare your actual performance to the budget on a monthly basis, if for no other reason than to refine your understanding as to the cost drivers within your business.

Talent and risk

This brings me to your pool of talent. FMI Quarterly noted in a 2016 survey of construction firm owners that lack of experienced field supervision and project schedules posed some of the top risks to their bottom line. This points to the critical role that the right talent plays in a company's success. And, as we know, skilled talent is very hard to come by in this field.

Traditionally, many construction companies have had a busy season and a slow season in which workers are furloughed and start collecting unemployment. Post-Recession, companies have downsized their primary workforce and brought on temporary labor through staffing agencies as needed. Others have changed their business model to eliminate the slow season and keep employees busy year-round.

Whichever hiring and retention option you choose, the main idea is to right size your workforce and make sure you are hiring the right people in the first place. A temp-to-hire option through a staffing agency can reduce the risk of hiring the wrong person who costs money in training and time but ends up quitting a few weeks or months later. The more you can stabilize and train a strong pool of talent, the less likely you are to outlay unemployment, worker's compensation or other employee costs.

Stay disciplined

Over the past decade, the construction industry has seen even the biggest and longest-running construction companies fail. A regular study of contractors by risk management consultancy FMI concluded that getting too much work, too fast, with inadequate resources led to inadequate capitalization. Often, the hubris within leadership led to the company's downfall, assuming they were too big to fail. Imagine the risks, then, to a small operation.

A dedicated CPA can perform an analysis of past jobs and predict the likelihood of profitability on future jobs. If your company is regularly averaging a negative margin, for example, it won't be long before your company risks its bonding capacity — or worse — is headed toward bankruptcy. Before taking that risk, get to the bottom of your true costs so your company can thrive in a competitive fixed-price environment.

Cornwell Jackson's Tax team can provide guidance on reigning in costs by reviewing your profit and loss statements, work in process and general accounting ledgers. Contact our team with your questions.

Scott Allen, CPA, joined Cornwell Jackson as a tax partner in 2016, bringing his expertise in the construction and oil and gas industries and 25 years of experience in the accounting field. As the partner in charge of the tax practice at Cornwell Jackson, Scott provides proactive tax planning and tax compliance to all Cornwell Jackson tax clients. Contact him at Scott.Allen@cornwelljackson.com or 972-202-8032. Download the Whitepaper: The Real Cost Savings to Look For in a Fixed Price Environment on CornwellJackson.com