

Contractors' Perspective

FALL 2010



Cash: A contractor's best friend

Cash flow forecasting can keep the relationship going strong

Price adjustment clauses can help curtail unforeseen costs

Technology upgrades
Could automated purchase orders speed your processes?

PLUS!

Construction Success Story

Contractor heeds warning signs of questionable owner

Baltimore
SUITE 1300
100 SOUTH CHARLES STREET
BALTIMORE, MD 21201-2714
410-727-5735 / F: 410-727-1405

Washington
SUITE 250
655 FIFTEENTH STREET, NW
WASHINGTON, DC 20005-5701
202-638-0902 / F: 202-638-4311

Frederick
SUITE 105
30 WEST PATRICK STREET
FREDERICK, MD 21701-5589
301-696-1926 / F: 301-696-1933

Belcamp
SUITE 302
4692 MILLENNIUM DRIVE
BELCAMP, MD 21017-1535
410-272-1680 / F: 410-272-4290

Cash: A contractor's best friend

Cash flow forecasting can keep the relationship going strong

Strong cash flow is important for every business. But with projects scarce and stimulus dollars still slow to arrive in many areas, having enough money on hand to operate competitively could mean the difference between success and bankruptcy for a construction company. Indeed, one could say that cash is a contractor's best friend.

Like many construction business owners, however, you may see cash flow forecasting as either a distraction from your day-to-day activities or as a daunting, implausible undertaking. But the truth is that getting a clearer picture of where your company's dollars are going isn't as difficult as you might think — and doing so can help keep your relationship with your “best friend” going strong.



Estimating earnings

The first step to realistic forecasting is to approximate earnings. Start with projected earnings for planned, in-progress or completed jobs for which you haven't billed or collected fully. This task relies heavily on billing schedules.

At the beginning of each project, develop a well-thought-out, front-loaded billing schedule. Doing so will optimize cash flow by helping you anticipate timelines of costly expenditures related to the project, and allow you to schedule a billing cycle directly after each expense.

For example, if you know that you'll be buying or renting an expensive piece of equipment six weeks into a project, send an invoice directly after the expense to recoup cash as quickly as possible. Better yet, if possible, prebill the owner for the cost of the item to get a head start on recouping that cash.

Without this kind of careful planning, you may have to wait months to recover large cash expenses. Such billing schedules can also keep you on track with forecasting because they factor in expenditures related to the project and billing cycle dates.

Creating schedules

The next step is creating estimated billing schedules. Here you must determine approximately how many projects you'll bid on this year, and then break these projects into categories.

Breaking the bids into categories is necessary for more accurate forecasting because you might, for example, bid on more jobs for school construction projects, yet have a better success rate when bidding on health care construction jobs. Each category may have a different billing pattern as well. You may also want to determine the breakdown of your negotiated contracts vs. hard bids.

Once you've determined the number of bids and the success rate for each category, look to past projects to determine average billing cycles and create your cash flow projections. For example, to create a predicted billing and cash forecasting schedule for an office building project secured through a hard bid process, you should review typical items for a job such as this, including:

- Average earnings,
- Expected expenditures,
- Typical billing schedules,
- General financial effects of these types of projects, and
- Potential cost-escalating events.

Doing so will not only help you predict future earnings and cash flow, but also allow you to identify patterns and areas where you may be able to improve your cash flow management.

Putting it all to work

With your estimated earnings and billing schedules in hand — along with an overview of projected general operating expenses such as payroll, fleet costs, mortgage or rent — you're finally ready to forecast your cash flow in the near future.

So how do you do it? Well, your construction company should have the internal financial capabilities to start producing information for cash flow forecasting. But getting your financial advisor involved as early in the process as possible will get you to the finish line more quickly. Carefully organizing the data into easy-to-read categories and "bottom line" results is also key.

In addition, many financial management software applications come preloaded with cash forecasting functionalities. Work with your IT staff or advisor to determine whether

5 preventable cash flow killers

In the construction business, there's no shortage of things that can suddenly go wrong — accidents, bad weather, insolvent owners. But there are also a number of preventable situations that may be killing your cash flow. Here are five to consider:

1. Slow invoicing, slow payment. Offer easy and convenient ways for clients to pay (such as online bill pay) and do a thorough check of customers' financials and credit history to avoid drains on cash flow.

2. A lag between expenditures and payment. Try to at least partially prebill for materials, and time subcontractor payments for greater cash flow efficacy without risking legal repercussions. For large equipment purchases (such as HVAC chillers), negotiate vendor terms to give you enough time to receive owner payments before paying the vendor.

3. Inequitable retainage. Negotiate with owners to compromise on a reasonable retainage percentage that won't leave you cash poor. Your attorney may be able to help you here.

4. Poor fleet and resources management. Bloated equipment fleets, misguided investments and oversized offices are just a few examples of poorly managed expenses and overhead that can negatively affect cash flow.

5. Lawsuits. Granted, some unfavorable legal situations are unavoidable. But by following best practices in safety, insurance and general business operations — and keeping a watchful eye out for risks — you may be able to avoid costly litigation.

you have this capability. And, if you don't, consider an upgrade.

Discovering the benefits

With a little diligence, you'll likely discover just how beneficial and accurate cash flow forecasting can be. In addition to keeping your construction business on track, you may be able to leverage the data you gather to instill confidence in lenders, sureties, prospects and investors. Many contractors who once saw cash flow forecasts as a time- and resource-consuming luxury wind up wondering how they ever did without it. ■

Price adjustment clauses can help curtail unforeseen costs

From 2004 until late 2008, construction materials prices took contractors on a wild roller coaster ride, with many months and years bringing double-digit price percentage increases for steel and asphalt. Although prices for many materials have dropped or held steady in the last couple of years, some are climbing again.

The moral of the story? Construction materials prices are erratic and largely unpredictable — particularly in a shaky economy — and you can never be too careful when it comes to protecting yourself.

Rock, meet hard place

As construction materials prices skyrocketed, many contractors padded their bids to include room for increased materials costs over the life of their projects. The recent recession, however, has made it difficult for these cushioned bids to win jobs, so you may feel pressured to submit unrealistically low-priced bids.

Price conflicts can lead to costly litigation, contract losses, defaults, project delays, and damaged reputations and relationships.

To compound the financial stress of this situation, in many areas tensions are rising between owners and contractors: Owners feel taken advantage of when prices fall, and contractors feel forced to eat additional costs if bids leave no wiggle room for price increases. This conflict can lead to costly litigation, contract losses, defaults, project delays, and damaged reputations and relationships.



A good clause

One way to prevent, or at least mitigate, such sticky situations is to add a price adjustment clause to the contract. These clauses identify specific materials at risk for price increases and set an effective date from which to measure price changes that trigger an adjustment to the contract amount for materials. This date might be the date a contract is signed or the date a supplier provides initial quotes.

The clause must also identify the indexes used to gauge price fluctuations — for example, invoices from suppliers. Owners may insist, however, that a regularly published and credible index, such as the Producer Price Index, be used to support suppliers' price increases. More than one index may be used if materials or currencies differ greatly. You can also include

stipulations that specify the exact percentage a price must fluctuate to activate the clause.

Last, the contract must stipulate when and how often price adjustments will be considered and the process through which an owner will be notified of a price change. For instance, a clause might stipulate that adjustments be considered each time a materials shipment or purchase is made.

A win-win . . . generally

Price adjustment clauses can be helpful to contractors, but they go both ways. Clauses also protect owners in the event that prices drop from the original agreed-on numbers. Regardless of which way prices go, solidly drafted price adjustment clauses are generally a win-win — saving both parties time, money and risk. ■



Technology upgrades

Could automated purchase orders speed your processes?

Constant materials purchases on construction projects can cause a lot of confusion. Perhaps you've lost valuable hours during a busy workday tracking down invoices, double-checking figures, and making phone calls to managers and subcontractors. Don't you have better things to do?

Well, as is the case with so many aspects of the construction business, technology is here to help. Automated purchase order software can speed your buying processes and take much of the guesswork out of who's buying what, when.

The lowdown on POs

Purchase orders benefit the overall function of a construction company by creating a system for

tracking purchases and subcontractor work, thus helping you manage inventory and expenses. Contractors that don't use them can end up paying for materials that weren't delivered and incomplete work.

Let's look at a practical example: Suppose only half a shipment of 30 windows is delivered to a jobsite, but you receive an invoice for the full shipment. You might fail to reconcile this mistake if you don't use purchase orders and could end up paying for something you don't owe.

Moreover, companies that use purchase orders, but don't use an automated purchase order system to support them, face the time-consuming process of manually comparing packing slips with the original purchase orders.

Mistakes cost money

By automating your purchase order system using accounting software that features a purchase order function, you can avoid such costly mistakes and save time.



For example, if you fail to receive a complete supply order, you can input the packing list into the program and automatically compare it to the purchase order. The system then produces a report showing the discrepancy and current inventory details. Most software can also be modified to alert you if your supplier tries to bill you for the full amount.

More complex software options can also help you track subcontractor billing and retainage. Whereas in the past you might have miscalculated profits due to a subcontractor's outstanding bills, the system tracks what's been billed and what's still owed. Most software offerings also feature safeguards against overbilling and send alerts regarding unfulfilled contracts, as well as expired insurance or certifications on the subcontractor's end.

Buy-in and setup

Most purchase order applications can use purchase orders to set up work orders, create schedules, and update and e-mail or fax weekly schedules. When a project is complete, the system can use the original work orders to create

invoices and send payment to subcontractors and suppliers.

Getting buy-in from all employees and subcontractors can be daunting. The key is to introduce the idea of a new system early and explain its benefits. Make it clear to subcontractors that they can enter their data from any computer, using any type of Internet connection, ultimately simplifying the payment process.

As for your employees, most software companies will allow you to test their products in-house, which will allow your team to view all the options and try their hand at those features they are likely to use regularly. Keep in mind, too, that most systems can take two to six months to set up before they're functioning smoothly.

The costs of purchase order software vary from very rudimentary "freeware" to more advanced packages that can cost in the tens of thousands of dollars, depending on their options. For the better applications, your investment usually includes tech support for implementation, which is helpful in terms of training employees and getting the system up and running.

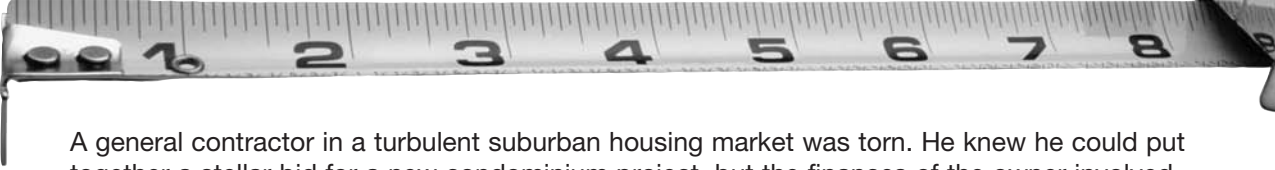
Purchase orders benefit the overall function of a construction company by creating a system for tracking purchases and subcontractor work, thus helping you manage inventory and expenses.

A good time

With competition still stiff in many construction sectors, running a tight ship has never been more important. That's what makes now a good time to consider an automated purchase order system. Although there's an upfront investment, which obviously shouldn't be taken lightly, the time and dollars you save could streamline your operations enough to give you a valuable competitive advantage. ■

Construction Success Story

Contractor heeds warning signs of questionable owner



A general contractor in a turbulent suburban housing market was torn. He knew he could put together a stellar bid for a new condominium project, but the finances of the owner involved were highly questionable. This local property developer had been involved in some unflattering legal proceedings of late and its financial standing was uncertain to say the least. The contractor paid a visit to his financial advisor to discuss the matter.

Stay on high alert

The advisor agreed that information such as this should keep the contractor on high alert should he decide to go through with the bid and, if successful, the project. In fact, some detailed research into the developer's financial history/standing and lending situation were undoubtedly in order.

Another step to take if the project does go through, the advisor noted, was to immediately open the lines of communication with any lenders involved. Should a lender's presence on the project suddenly increase while the owner's involvement (and communication) abruptly decrease, it could mean the job is headed south.

If owner bankruptcy becomes likely, the advisor warned, the contractor will need to be prepared to *properly* file a mechanics' lien as soon as possible as well as enter negotiations with the owner and his or her (or its) creditors.

Communicate and document

The advisor then turned to more nuts-and-bolts financial matters. When owners request out-of-scope work, fail to fulfill commitments and are unresponsive to contractor inquiries, project budgets can skyrocket.

The advisor cautioned that, if the contractor starts noticing the aforementioned behavior, he should be especially diligent about documenting work, notifying owners on paper before cost overruns occur and detailing exactly why a change order is necessary. Of course, the advisor observed, some wrong turns on the project may be the direct responsibility of his workers. So he should have a comprehensive system in place to alert him when productivity and resource allocation are suffering.



For example, software programs can help chart variables such as labor costs, materials costs, percent of job completed and equipment rental scheduling, and then compare the actual numbers to the planned schedule and budget. When the actual costs and times start to creep further from the original budget and timeline, the advisor counseled, it's time to take corrective action.

Get a boost

The contractor in this case followed his advisor's suggestions and carefully vetted the dubious developer. The increased diligence was time-consuming and challenging but, ultimately, he *boosted* his profit margin on the job thanks to several well-documented change orders. How's that for a happy ending?

Ellin & Tucker, Chartered

CERTIFIED PUBLIC ACCOUNTANTS AND BUSINESS CONSULTANTS

BALTIMORE WASHINGTON FREDERICK BELCAMP

SUITE 1300
100 SOUTH CHARLES STREET
BALTIMORE, MD 21201-2714

www.etnet.com



PRESORTED
STANDARD
U.S. POSTAGE
PAID
PERMIT #2996
BALTIMORE, MD

RETURN SERVICE REQUESTED

Build Your Foundation on Us.

At Ellin & Tucker, we understand that it takes more than just dedication and hard work to make your business a success. It requires the assistance of specialists who understand the industry and the challenges contractors face, and who have the knowledge, expertise, and commitment it takes to help them achieve their goals.

Our Construction Industry Services Group consists of experienced professionals focused on making your company a success. We are ready to assist you with a broad range of services tailored specifically to your needs, including:

Business Consulting

- > Bank Negotiations
- > Bonding Company Negotiations
- > Claims Consulting
- > Contract Profitability Analysis
- > Cost-to-Complete Analysis
- > Credit and Collection Consulting
- > Feasibility Studies
- > Financing Assistance
- > Financial Analysis
- > Operating Budgets and Plans
- > Profit Improvement Consulting
- > Strategic and Business Planning
- > Succession Planning
- > Turn Around Management Consulting

Accounting and Auditing

- > Accounting System Implementation and Reorganization
- > Audit, Review, and Compilation Reporting
- > Internal Control Reviews

Business Valuations

- > Valuation of Business and Entity Interests
- > Valuation of Stock Options and Related Compensation Plans

Tax and Financial Services

- > Financial, Retirement, and Estate Planning
- > Tax Compliance
- > Tax Planning and Minimization

For additional information regarding the services listed above, or the ideas presented in this newsletter, please contact Streett Baldwin, Ed Brager, Frank Brodnax, Todd Feuerman, Kristin King, or Mike Strauss. We would welcome the opportunity to help you build your success.

OUR MISSION

We, as a firm, are committed to maintaining and growing our successful accounting, tax and consulting practice, while adhering to our core values.

We strive to be recognized as leaders and as the standard of excellence with our clients, employees, community and profession.