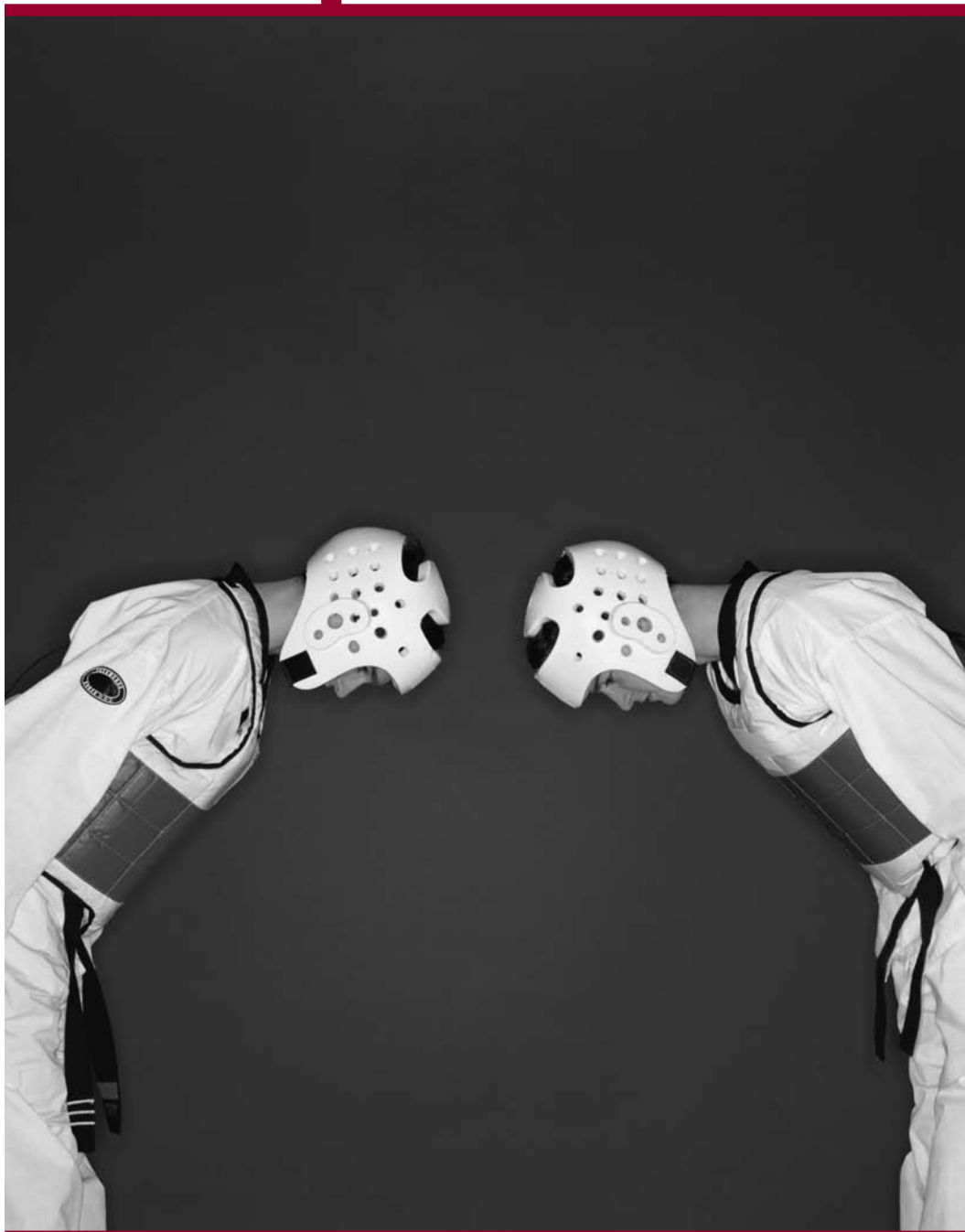


# Contractors' Perspective

SPRING 2010



**Preparing for battle**  
Strategic risk management  
for contractors

**Discover the secret**  
to your success  
with bid-hit ratios

**Care to trade?**  
Trying your hand at a  
Sec. 1031 exchange

## **PLUS!**

**Construction Success Story**  
Contractor rolls  
out new technology  
the right way

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# Preparing for battle

## Strategic risk management for contractors

In a perfect world, accidents never happen. Unfortunately, hazards abound on construction sites and, therefore, someone is bound to get hurt ... eventually. And the risks don't end there. Bumps in the supply chain can stall deliveries, weather can wreak havoc on project schedules and owners can go bankrupt, among many other potential snags.

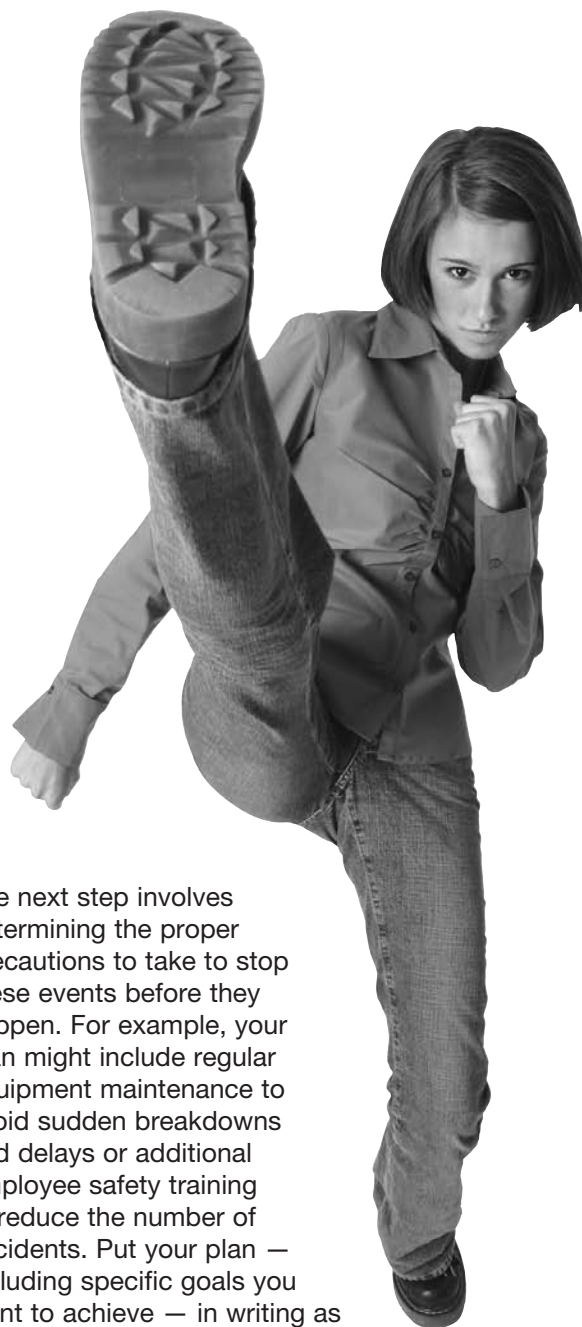
These realities, compounded by recent natural disasters, heavier pressure to finish projects faster and more efficiently, and a steep rise in global competition, have prompted contractors to turn to strategic risk management (SRM). Think of it as preparing for battle, as your management team evaluates potential risks and devises a plan of action to curtail them.

### Your plan of attack

Developing and implementing an SRM plan begins by gathering insight into potential risks (both obvious and not so obvious) associated with your construction business. In addition to those discussed earlier, these risks might include an unexpected rise in materials costs or an unforeseen IT failure that leads to loss of vital records or project delays.

By putting safeguards in place, you'll reduce the chances of unexpected risks destabilizing your construction business.

Also look at your company's history related to these items, your project records, accident logs, equipment records and insurance claims. Most data analysis and risk identification can now be automated, which can ease the process considerably.



The next step involves determining the proper precautions to take to stop these events before they happen. For example, your plan might include regular equipment maintenance to avoid sudden breakdowns and delays or additional employee safety training to reduce the number of accidents. Put your plan — including specific goals you want to achieve — in writing as part of an official SRM initiative, and commit to seeing it through.

### 2 powerful moves

To get started on these steps, hold a meeting with your project managers, human resource reps and any other key people involved in your construction business. In the meeting, discuss potential gaps or overlaps in responsibility that could lead to safety, legal, technological or

## Insurance and monitoring critical to SRM success

When considering strategic risk management (SRM), it's important to remember that not all risks are foreseeable or preventable. And even with a plan in place, unexpected events could still hurt your construction company's bottom line. So, don't be fooled into thinking that even the most well-thought-out, comprehensive SRM initiative can replace the need for adequate insurance.

In fact, one could say that SRM begins and ends with insurance. Your plan should include a comprehensive analysis of your current coverage to determine whether any areas of coverage may be lacking. An annual insurance review with your financial and insurance advisors is also a must.

Also bear in mind that implementing and maintaining an SRM plan requires employee time, adequate funding and a collective desire to make the plan work. Many contractors see their SRM plans fail over time as interest wanes and updates drop off. You must monitor the progress of your plan and the impact of the precautions you've implemented, as well as the money spent on the plan vs. the money saved through risk prevention. Appointing a manager to oversee the plan may help ensure its continuity.

financial risks and then work to eliminate these issues. Two powerful moves you may want to consider are:

**1. A methodical approach to dealing with your equipment.** Letting obsolete equipment sit unused — or leaving it in service too long — could end up hurting your productivity. Equipment disposal, however, is fraught with its own rules and risks. When selling or donating old equipment, fully disclose any potential problems or hazards as well as the equipment's inspection history (or lack thereof). Consult your legal counsel to help avoid any future liability.

**2. A renewed focus on safety.** To reduce costly injury claims, you might establish a safety incentive program and foster a safety-focused company culture. This may include providing employee rewards and celebrating accident-free months. And, should an accident or injury still occur, your plan should include postinjury management training in which managers are taught proper protocol to help avoid unnecessary liability.

### The benefits of foresight

Developing an SRM plan for your construction company provides a number of important benefits. First and foremost, by putting safeguards in place, you'll reduce the chances of unexpected risks destabilizing your business.

You'll also gain a better perspective on what risks could actually be beneficial to your construction business. For example, you might initially view fully automating your delivery process as a risk — and you wouldn't be wrong, given that just about any significant technological undertaking is at least a little risky. But it's also a move that could help your company grow if the right safeguards, such as plenty of IT support, are in place.

Ultimately, you can use SRM to decrease your chances for future earnings volatility and, over time, cut unnecessary expenses, allowing you to channel income into future opportunities. And by stabilizing your operations and reducing your chances of sudden loss, you'll help protect your reputation in the marketplace as well as with insurers and sureties.

### Winning the battle

Contractors are faced with distinct risks — risks that are often unforeseen in the chaos of tight deadlines, new project bids and the pressure imposed by a strained economy. By taking the time to develop an SRM plan now, you'll end up with a clearer view of your potential risks and in a better position to win the battle against any prospective problems, whether minor foibles or full-blown catastrophes, that may be lying in wait for you down the road. ■

# Discover the secret to your success with bid-hit ratios

**A**s a contractor, you may equate success with the number of bids you win or perhaps simply with the number of jobs on which you're bidding at any given time. But a more accurate and useful gauge lies in your bid-hit ratio — the rate at which you successfully bid on projects.

In fact, your construction company's bid-hit ratio may be the key to discovering the secrets to your success. It also can help you identify project types where you consistently fall short.

Remember that the higher your bid-hit ratio, the more you're spending on estimating without a return on investment.

## Strengths and weaknesses

Let's say, over the past month, you've bid on four projects and won one. Well then, your bid-hit ratio for the month would be 4:1. By tracking and analyzing this ratio monthly, quarterly and yearly — and breaking it down into job types and sizes — you can gain insight into the types of projects you should pursue and those that may not be worth the effort or cost of estimating.

For example, if you have a bid-hit ratio of 9:1 on private construction projects and 3:1 on public



jobs, you may want to consider channeling your time and effort into pursuing public projects, where you've been three times as successful. These ratios may also be a cue, however, to examine why your new-construction bids have fallen short. Such analysis can help you determine whether you can make improvements to increase your success in the private sector or if it truly makes more sense to simply focus on public jobs.

## The lower, the better

What is a good bid-hit ratio? Ratios can vary depending on project type, but a lower ratio is always more desirable — as close to 1:1 as possible.

It's important to remember that the higher your bid-hit ratio, the more you're spending on estimating without a return on investment. After calculating your bid-hit ratios, work with your management team and professional advisors to target ideal ratios for your construction company.

Also keep in mind, however, that your ratios won't give you insight into how much you're actually making on the projects you win. You should also track the profitability from each job, because even a 1:1 bid ratio doesn't guarantee that you're actually making money.

### Informative trends

Bid-hit ratios are most useful when tracked over time, because you'll begin to see informative trends emerge. Ultimately (and ideally), being familiar with these valuable indicators can help you tailor your bids to the projects that suit your construction company best while forgoing those you aren't likely to win. ■



## Care to trade?

### Trying your hand at a Sec. 1031 exchange

In the course of dealing with real estate developers or property owners, you may have heard the term "Section 1031 exchange" or "like-kind exchange." Both refer to the swapping of two properties, potentially resulting in a significant tax advantage — deferring gain until the replacement property is sold. What you may not know is that, under Sec. 1031 of the Internal Revenue Code (IRC), you may swap more than just real estate.

#### IRS ground rules

To qualify for the tax deferral of a Sec. 1031 exchange, you'll naturally need to follow some IRS ground rules. For starters, the swapped properties must be of a like kind — in other words, real estate must be exchanged for real estate and equipment must be exchanged for equipment.

Also, there must be an actual exchange, rather than a sale (though cash can change hands), and the properties must be used in business or held for investment. They can't, however, be stock held for investment or inventory. Last, the

exchange must be completed within specified timeframes (more on this below).

Business-related swaps can involve more than two parties, and it's permissible to include both real and personal property. The property doesn't even have to exist at the time of the exchange.

#### On the clock

As mentioned, to succeed from a tax perspective, the timeframe in which the Sec. 1031 exchange occurs is critical. You aren't required to exchange property simultaneously, but there are strict time limits for trade completion.

First, you must identify the property you'll receive within 45 days after you close on the property you're trading. So if you're trading an inventory storage facility for a newer one closer to the area of most of your projects, you have 45 days to designate in writing where the new facility will be. In the case of equipment, you'll need to provide specific identification of the asset in question.

Another timing rule relates to receipt of the chosen replacement property. Said property must be in your possession either within 180 days after you transfer your original property or by the date the relinquishing party's tax return is due for the taxable year — whichever is earlier.

To succeed from a tax perspective, the timeframe in which the Sec. 1031 exchange occurs is critical.

Thus, for instance, if you receive the property 120 days after the transfer date but three days after the relinquishing party's taxes were due, you can't consider the transaction a Sec. 1031 exchange. If it's impossible to complete the exchange before the tax due date, the relinquishing party can request an automatic extension. But you still can't exceed the 180-day limit.

#### **All about the boot**

Some exchanges may call for the inclusion of non-like-kind property. For example, you might wish to obtain a new bulldozer. In this case, you can pay the dealer some cash for the new one without losing the tax benefits of the Sec. 1031 exchange.

How would that work? Instead of trading your bulldozer in on a new model, you'd have to sell it to the dealer for its trade-in value and then buy your new bulldozer from the same dealer. Because the sale and purchase are reciprocal and mutually dependent, you may be able to treat the transaction as a Sec. 1031 exchange.

Bear in mind, however, that any cash involved is called "boot," and the recipient must recognize it as gain to the extent there is gain. (From an accounting perspective, that gain would be of the same "character" as the underlying property.) But if there is depreciation recapture on the property, it would be recognized first.

Similarly, if any property you receive has assets (such as fixtures and equipment) that the property you trade doesn't have, you may have to recognize gain to the extent of those assets as well.

#### **Tricky business**

The IRC rules for Sec. 1031 exchanges are complex and, as always, the IRS stands ready to challenge your transaction. Additionally, because capital gains rates may increase after 2010, you also need to consider how that may ultimately affect the tax consequences of a Sec. 1031 exchange. For these reasons, professional guidance is a must. ■



## Construction Success Story

### Contractor rolls out new technology the right way

In the midst of a flush of stimulus-related public projects, a small subcontractor was finding his old accounting system too slow and cumbersome. So, with little time to spare, he headed to the software market and chose a new system.

Upon introducing the technology to his managers, however, the contractor was met with an unexpected response. Everyone had a gripe. His project manager saw a lot of bells and whistles but few useful on-site features, while his office manager was worried about the software's compatibility with the company's other applications. Frustrated, the contractor mentioned the dilemma to his financial advisor.

#### **Taking it to the team**

The advisor explained that the contractor's problems began when he chose the software completely on his own. Because new technology affects the entire team, the entire team (or at least key members thereof) should have input on the choice. And while it may be impossible to please everyone, it's possible to come close.



Fortunately, the software came with a money-back guarantee and had yet to be fully implemented. So the advisor suggested the contractor gather feedback from his team, including thoughts on which features are “must haves” and which ones are “just wants,” and start again. Then he could work with his IT specialist on the tech side and the financial advisor on the accounting side to get everything just right.

#### **Coping with resistance**

The advisor warned that, once key team members have agreed on a system, the process isn't over. While giving lower-level employees a say in the software selection process would likely create more problems than it solves, they'll be using it, too. So the groundwork for a smooth implementation must be laid.

Therefore, the next step in the process should include working with employees to overcome any fear or confusion about the prospective software. The advisor suggested announcing the plans to upgrade the accounting system immediately, giving a rundown of the company's objectives for doing so and keeping staff updated on the effort's progress. This approach can make the staff feel like they're part of the initiative and help foster more rapid buy-in.

#### **Training is key**

This contractor needed to, shall we say, reboot his software implementation efforts to find success. But, once he did get it right — and provided the critical training needed to get the most from the system — his choice paid off. For just as teamwork on a job can lead the way to that project's success, implementing new software also calls for a team effort.

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