Surviving The Market
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INTRODUCTION

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

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Specializing in the construction industry and leads the Contractor Industry Practice Group.
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.
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- Financial Statements
- Cash Management
- General Matters
- Banking
- Personal Planning
- Fraud/Internal Controls
- Management/Leadership
- Legal
- Key Employees
- Taxes
Financial statements must be prepared monthly, by the 10th of the following month.

All accounts must be reconciled to the detailed account information monthly.

Financial statements should include month-to-date and year-to-date information as well as budgeted data.

The Controller should review the financial statements before its release to the President.

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.
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.

The Controller and Chief Financial Officer must provide financial leadership.

Job profitability, cost management, vendor and subcontractor cost, construction draws, and general and administrative costs must be a principal focus.

They must meet regularly with the management team and provide proactive solutions.

The strongest companies have the strongest financial staff.
FINANCIAL STATEMENTS

CASH

- 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
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
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
FINANCIAL STATEMENTS

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
FINANCIAL STATEMENTS

RATIOS

- 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
FINANCIAL STATEMENTS

RATIOS

- 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 Dept to Equity
    - Long-term debt divided by equity.
**Profitability Ratios**

- **Gross Profit to Sales**
  - Gross profit divided by annual revenue

- **NPBT**
  - Net profit before taxes divided by annual revenue.
FINANCIAL STATEMENTS

RATIOS

- **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 break-even analysis

Review all expenses monthly to the budget. Identify variances from budget, understand all variances and make necessary adjustments
Financial Statements

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
- 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
CASH MANAGEMENT
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
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
CASH MANAGEMENT

TAXES

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

OVERBILLING

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

- 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
GENERAL MATTERS

- 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
GENERAL MATTERS

- 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
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)
PERSONAL PLANNING

- Do not have spouse be an officer or owner of operating Company.
- Split assets between spouses.
- 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.
- Hire excellent internal financial staff.
- If challenged, meet with a reorganization specialist (lawyer).
- Hire excellent advisors.
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.
PERSONAL PLANNING

- 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
FRAUD / INTERNAL CONTROLS

INTERNAL CONTROLS

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

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.
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
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
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
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
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<thead>
<tr>
<th>Topic</th>
<th>Details</th>
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<tr>
<td>Prepare and use budgets</td>
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<td>Employees</td>
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<td>Always verify employee references before hiring</td>
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<td>Require all employees to take vacations</td>
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<td>Don’t abuse your company</td>
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<td>Caveat: There is no assurance that all fraud will be discovered or totally eliminated</td>
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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
 KEY EMPLOYEES

- Identify, recruit, and develop a second level of management
- Create business plans with key people
- Reward key people who deliver results.
- Share financial data with key people (how much open book limited, i.e. except for payroll)
- 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).
Family – Are they really the “right” choice or are they the only choice

Is “key” employee based on performance or subjective factors (“length of time” with the company)

Conduct annual retreat

Do not wait to start this process

Be a business moderator to review:
  - Performance – past and future
  - Lead the annual retreat.
  - 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
C corporation dividends
Children Compensation
Spousal compensation
Related parties rules
Self-Employment tax
Retirement Plans
THANK YOU!

Questions?

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