

# Financial Statement and Cash Flow Deep Dive


Dave O'Brien

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## Introduction

### Mosley Glick O'Brien, Inc.

Founded in 2008, Mosley Glick O'Brien, Inc. provides Accounting, Tax and Tax Planning, Business Valuation, Start Up Compliance, Succession Planning and Management Consulting to a wide variety of clients nationwide. Located in Maumee, Ohio, our staff of nearly 20 professionals allows us to provide focused, personalized, and comprehensive client services.


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• 571 Longbow Dr., Maumee, OH 43537

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## R. David O'Brien, CPA, CGMA

Partner & Director of Construction Services




Dave is a graduate of California State University at Chico, California. He worked for large firms in Reno, Nevada and Toledo, Ohio before becoming a partner at Mosley Glick O'Brien, Inc.

[dobrien@mgoinc.com](mailto:dobrien@mgoinc.com) Direct. 567.703.8836 Mobile. 419.350.5750

Dave has an extensive background in assurance and accounting with an emphasis in real estate, construction, manufacturing and distribution. His primary focus is in the construction industry. His clientele in the construction industry includes general contractors, mechanical contractors, and electrical contractors, flooring contractors, sheet metal contractors, fire protection contractors, landscape contractors, homebuilders, commercial developers, land development and numerous other contractors.

Dave is a member of the American Institute of Certified Public Accountants, the Society of Certified Public Accountants in Ohio, Nevada and Michigan. He is also affiliated with the Construction Industry CPA's/Consultants Association (CICPAC) and the Construction Financial Management Association (CFMA).

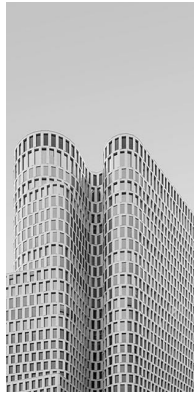
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## Construction Industry Advisors

We have created a team of construction industry specialists to serve you.

- Dave O'Brien, CPA, CGMA  
Member and Director of Construction Services
- Marcia Veres-Sutton, CPA, MBA  
Principal of Construction Services
- Eric Whipple, CPA, CVA  
Accounting Manager
- Lisa Tietje, CPA, MBA  
Accounting Manager



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Your Financial Tools for the Construction Industry



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## Financial Statements

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## INTRODUCTION

- Financial statements provide an overall picture of a company's financial health
- The ability to effectively understand and communicate financial information is key to the success of every business
- Adequate systems must be in place to gather the data used in preparing financial statements
  - "garbage in = garbage out"

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# INTRODUCTION

Financial statements are comprised primarily of:

- Balance Sheet
  - Counts your “stuff”
  - Snapshot of the company’s financial position on a given date
- Income Statement/Profit & Loss
  - Measures financial performance
  - Like a movie – covers a specific period of time

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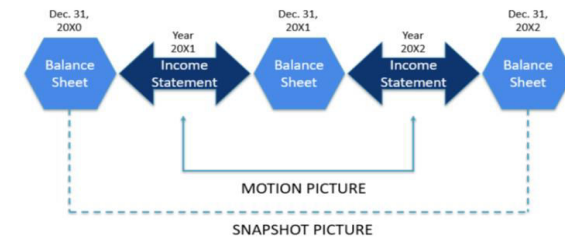
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# INTRODUCTION

The picture below shows the difference between the two statements and how they feed into each other:



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# BALANCE SHEET

- A “snapshot in time”
- Presents the financial picture or physical health of the Company as of a specific date
- The Balance Sheet is usually ignored and often misunderstood with most business owners focusing only on the Income Statement
- Your Balance Sheet provides a wealth of information
  - Learn how to read and understand it!

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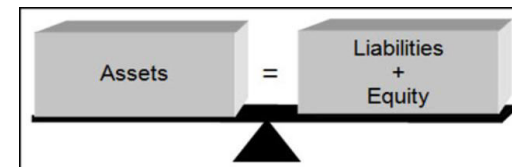
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# BALANCE SHEET

$$\text{Assets} = \text{Liabilities} + \text{Equity}$$

Or

What you own (assets) = what you owe (liabilities) + value to owners/net worth (equity)



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# ASSETS

- Assets are everything you own (cash, investments, property and equipment) or have a right to receive in the future (accounts and notes receivable)
- Assets are presented on the balance sheet in order of liquidity (how easily the asset can be converted to cash)

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## ANY CONSTRUCTION CONTRACTOR, INC. BALANCE SHEET December 31, 20XX

ASSETS		LIABILITIES AND SHAREHOLDERS' EQUITY	
<b>CURRENT ASSETS</b>		<b>CURRENT LIABILITIES</b>	
Cash	\$ 120,322	Line of Credit	\$ 120,000
Accounts Receivable		Current Portion of Long-Term Liabilities	7,335
Trade	325,015	Accounts Payable - Trade	127,312
Retainage	65,500	Accrued Wages	65,426
Unbilled	12,125	Contract Liabilities	50,200
Inventory - Materials and Supplies	21,000	Accrued Losses on Contracts in Process	1,800
Contract Assets	55,840	Other Current Liabilities	2,640
Prepaid Expenses	<u>5,245</u>	<b>Total Current Liabilities</b>	<u>374,713</u>
<b>Total Current Assets</b>	<u>579,047</u>		
<b>PROPERTY AND EQUIPMENT</b>		<b>LONG-TERM LIABILITIES</b>	
Construction Equipment	287,469	Notes Payable	45,691
Office Equipment	62,360	Deferred Income Taxes	5,500
Vehicles	<u>32,158</u>	<b>Net Long-Term Liabilities</b>	<u>51,191</u>
Subtotal	381,987	<b>Total Liabilities</b>	<u>425,904</u>
Less: Allowance for Depreciation and Amortization	( 105,195)		
<b>Net Property and Equipment</b>	<u>276,792</u>	<b>SHAREHOLDERS' EQUITY</b>	
		Common Stock, Without Par Value, Stated Value \$10	
<b>OTHER ASSETS</b>		Per Share, 1,000 Shares Authorized,	
Deposits	<u>1,000</u>	600 Shares Issued and Outstanding	6,000
<b>Total Other Assets</b>	<u>1,000</u>	Retained Earnings	<u>424,935</u>
		<b>Net Shareholders' Equity</b>	<u>430,935</u>
<b>TOTAL ASSETS</b>	<u>\$ 856,839</u>	<b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b>	<u>\$ 856,839</u>

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# CURRENT ASSETS

- Current assets are important because they can be used to fund day-to-day business operations and to pay for ongoing operating expenses
- Common current assets include:
  - Cash
  - Investments
  - Accounts Receivable
  - Contract Assets (Underbillings)
  - Prepaid Expenses
  - Due from Officers/Owners

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# CURRENT ASSETS

## CASH

- Cash on the Balance Sheet should include:
  - Operating accounts
  - Payroll accounts
  - Money market and savings accounts
  - Certificates of deposits with an initial maturity of 3 months or less
- ALL cash accounts should be reconciled monthly
- Any old uncleared transactions on bank reconciliations should be cleaned up periodically otherwise your cash balances will be incorrect

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# CURRENT ASSETS

## INVESTMENTS/MARKETABLE SECURITIES

- Report investments/marketable securities as current if they can easily be liquidated to meet current obligations
- Examples:
  - Stocks
  - Bonds
  - Mutual Funds
  - Exchange-traded funds (ETFs)
- Investments on the Balance Sheet should be reported at market value

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# CURRENT ASSETS

## ACCOUNTS RECEIVABLE

- Accounts receivable is money your customers owe you for goods or services they purchased from you
- Review accounts receivable aging monthly for accuracy
  - Follow up with customers who have not paid their invoices timely
  - Late payments from customers is one of the main causes of cash flow issues
  - Write off uncollectible receivables so assets are not overstated
    - Should exhaust all collection efforts before writing off

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# CURRENT ASSETS

## ACCOUNTS RECEIVABLE, cont.

- Check on any credit amounts appearing in the aging report
  - Often credits are not amounts due to customers but are actually errors
- Make sure billings are done timely, otherwise financial statements will not be accurate

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# CURRENT ASSETS

## ACCOUNTS RECEIVABLE, cont.

- Accounts Receivable – Retainage is money customers hold back from each payment to ensure certain conditions are met
  - These conditions may include project completion, inspection approvals or predetermined milestones
  - Acts as a safeguard against potential issues such as incomplete work
- Retainage is generally specified in the terms of the contract
- Retainage should be recorded in a separate account on your Balance Sheet
- Review Retainage balances at least monthly and make sure any retainage that can be billed is billed timely

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## CURRENT ASSETS

### CONTRACT ASSETS (UNDERBILLINGS)

- Contract assets represent revenue earned for goods or services provided that have not yet been billed to a customer
- Contract assets should match the amount shown on your WIP schedule
- If Contract Assets are significant, review your internal procedures to determine if customer billings can be done sooner

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## CURRENT ASSETS

### OTHER CURRENT ASSETS

- Prepaid Expenses – Includes items paid for in advance
  - Examples:
    - January rent paid in December
    - Three-year anti-virus plan purchased in current year
- Notes Receivable – Shareholders or Related Parties
  - Classify as current only if it is expected to be received within the next 12 months

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## PROPERTY AND EQUIPMENT

- Land
  - Not depreciated
- Building
- Vehicles
- Construction Equipment
- Office Furniture
- Leasehold Improvements

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## PROPERTY AND EQUIPMENT

- Fixed assets are recorded at cost and then depreciated in annual installments until the asset has little or no remaining recorded value.
- Due to depreciation, the asset's value on the balance sheet may not reflect its current or market value
- Have a capitalization policy and consistently apply it
  - Example: Only fixed asset purchases of \$2,500 or more are capitalized while purchases less than \$2,500 are expensed

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## PROPERTY AND EQUIPMENT

- Review fixed asset schedule at least annually for assets no longer owned
- Provide CPA with list of assets sold, disposed of, or no longer in service
- Ask CPA for monthly depreciation entry
- If fixed assets are purchased with a loan, make sure you enter both the total cost of the asset and the full amount of the loan on the Balance Sheet

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## LIABILITIES

- Liabilities are obligations of the Company to others such as money owed to vendors, lenders, or employees
- Liabilities are presented on the Balance Sheet in two primary categories
  - Current Liabilities
    - Obligations which are due within one year from the Balance Sheet date
  - Long-Term Liabilities
    - Obligations which are due more than one year from the Balance Sheet date

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## CURRENT LIABILITIES

- Common Current Liabilities include:
  - Accounts Payable
  - Line of Credit
  - Contract Liabilities (Overbillings)
  - Payroll Taxes Withheld and Accrued
  - Other Accrued Expenses
  - Union Benefits

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## CURRENT LIABILITIES

### ACCOUNTS PAYABLE

- Money owed to vendors or suppliers for goods or services purchased on credit
- Review Accounts Payable Aging monthly to verify all amounts listed are owed to vendors
- Confirm any credits listed are valid and due from the vendor or available to be applied to future invoices

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## CURRENT LIABILITIES

### ACCOUNTS PAYABLE – RETAINAGE

- Money held back from each payment to subcontractors to ensure the project is completed
- Usually hold the same percentage as Accounts Receivable Retainage
- Record in separate account on the Balance Sheet

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## CURRENT LIABILITIES

- Line of Credit
  - Included as a Current Liability on the Balance Sheet
  - Verify the balance agrees to the monthly statement each month

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## CURRENT LIABILITIES

### CONTRACT LIABILITIES (OVERBILLINGS)

- Arises when billings to customers exceed the amount of revenue allowed to be recognized based upon actual costs incurred to date
- Contract Liabilities should match the amount shown on your WIP Schedule

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## CURRENT LIABILITIES

### CONTRACT LIABILITIES (OVERBILLINGS), cont.

- Some overbilling is beneficial because customer payments in the construction industry are notoriously slow
  - Helps contractors stay ahead of the project cash flow
- Significant overbilling can lead to “job borrow”
  - Could lead to cash flow problems in the future
  - Understand overbillings on jobs and manage appropriately

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## CURRENT LIABILITIES

### OTHER CURRENT LIABILITIES

- Short-Term Loans Payable
  - Expected to be paid within the next 12 months
- Current portion of Notes Payable
  - Principal amounts due on long-term notes payable over the next 12 months are moved out of long-term liabilities and shown as current liabilities
  - Not moving to current will impact your perception of liquidity

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## CURRENT LIABILITIES

### OTHER CURRENT LIABILITIES

- Payroll Taxes Withheld and Accrued
- Accrued Wages
- Accrued Taxes
- Accrued Expenses
- Union Benefits

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## LONG-TERM LIABILITIES

- Notes Payable – Bank
  - Amounts due over the next 12 months should be shown as Current Liabilities
  - Confirm the balance agrees to the statement from the bank each month
- Notes Payable – Shareholder
  - Include in long-term if not expected to be paid in the next 12 months
- Notes Payable – Related Party
  - Include in long-term if not expected to be paid in the next 12 months

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## SHAREHOLDER'S OR MEMBER'S EQUITY

- Amount that remains after you deduct Total Liabilities (amount you owe) from Total Assets (what you own)
- Value of the Company to its owners

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## SHAREHOLDER'S OR MEMBER'S EQUITY

- Capital Stock or Member's Capital
  - Amount each owner has contributed
- Retained Earnings
  - The cumulative net earnings or profits of a company after deducting distributions
- Distributions
  - Company profits paid out to its shareholders
  - S Corp distributions must be proportionate to ownership
  - Generally, not taxable if there is tax basis
  - Should be closed out to Retained Earnings each year

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## BALANCE SHEET – SUMMARY

Items you do not want on your Balance Sheet include:

- Cash Overdraft
- Loans to Officers
- Loans to Employees
- Current Liabilities in excess of Current Assets
- Negative Equity

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### ANY CONSTRUCTION CONTRACTOR, INC. STATEMENT OF INCOME AND RETAINED EARNINGS Year Ended December 31, 20XX

		% of Sales
CONTRACT REVENUE	\$ 3,211,670	100.0 %
COST OF CONTRACT REVENUE	<u>2,562,913</u>	<u>79.8</u>
GROSS PROFIT	648,757	20.2
GENERAL AND ADMINISTRATIVE EXPENSE	<u>517,079</u>	<u>16.1</u>
OPERATING INCOME	131,678	4.1
OTHER INCOME (EXPENSE)		
Interest Expense	10,217	0.3
Loss on Disposal of Property and Equipment	( 1,750)	( 0.1)
Miscellaneous Income	3,575	0.1
Net Other Income (Expense)	<u>12,042</u>	<u>0.4</u>
NET INCOME BEFORE INCOME TAXES	143,720	4.5
PROVISION FOR INCOME TAXES		
Federal Current	45,165	1.4
Federal Deferred	3,700	0.1
Total Provision for Income Taxes	<u>48,865</u>	<u>1.5</u>
NET INCOME	94,855	<u>3.0 %</u>
RETAINED EARNINGS - BEGINNING OF YEAR	416,080	
Distributions	<u>( 86,000)</u>	
RETAINED EARNINGS - END OF YEAR	<u>\$ 424,935</u>	

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## INCOME STATEMENT/PROFIT & LOSS

- Provides information on the profitability of a Company over a specified period of time

Gross Profit = Contract Revenue – Cost of Contract Revenue  
Net Income = Gross Profit – Selling General and Administrative Expenses

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## INCOME STATEMENT/PROFIT & LOSS

- Contract Revenue
  - Should be reported under the Percentage of Completion Method
  - Should be adjusted monthly for Over and Under Billings on your WIP
- Cost of Contract Revenue
  - Include all costs directly related to the performance and completion of construction projects
- Gross Profit
  - A measure of how efficiently and effectively labor and supplies are used to produce goods or services

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## INCOME STATEMENT/PROFIT & LOSS

- Selling, General and Administrative Expenses
  - Costs to maintain daily operations and not directly attributable to the production of goods and services
  - These costs are incurred even if no revenue is generated
  - Referred to as "fixed costs"

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## INCOME STATEMENT/PROFIT & LOSS

### Common general and administrative costs

- Rent
- Utilities
- Dues and Subscriptions
- Administrative Salaries and Wages
- Legal and Accounting
- Computer Expenses

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## INCOME STATEMENT/PROFIT & LOSS

- Net Income
  - Often referred to as "*The Bottom Line*"
  - Net Income does not equal cash!

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## FINANCIAL STATEMENT RATIOS

- Calculating and monitoring certain ratios on a regular basis will assist you in understanding your financial picture and identifying problems

- **Current Ratio = Current Assets ÷ Current Liabilities**

- Measures the ability to pay short-term obligations
- Number should be greater than 1.25 to 1.0
- If less than one, may indicate cash flow issues
- For Current Ratio to be meaningful, Current Assets and Current Liabilities on Balance Sheet must be classified properly

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## FINANCIAL STATEMENT RATIOS

- **Working Capital = Current Assets – Current Liabilities**

- If negative, Current Liabilities exceed Current Assets and there are not enough resources in the short term to pay off Liabilities
- For Working Capital to be meaningful, Current Assets and Current Liabilities on Balance Sheet must be classified properly

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## FINANCIAL STATEMENT RATIOS

- **Debt to Equity Ratio = Total Liabilities ÷ Total Equity**

- Measures how much debt is carried compared to amounts invested by owners
- A lower ratio indicates the company has more borrowing capacity and greater long-term financial stability
- Large Notes Payable to Officer balances that are subordinated to other debt should be moved to equity in this calculation
- Lenders like this ratio to be less than 3.0

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## FINANCIAL STATEMENT RATIOS

- **Gross Profit % = Gross Profit ÷ Sales**

- Most basic measure of a company's profitability
- Measures how efficiently the company is producing and selling its products
- Goal is a stable or growing gross profit margin
- Most meaningful when compared to prior periods or benchmarked against competitors

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## FINANCIAL STATEMENT RATIOS

- **Overhead Percentage = Total G&A Costs ÷ Sales**
  - This ratio is most meaningful when compared to prior periods



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## FINANCIAL STATEMENT RATIOS

- **Months of Revenue in Backlog = Revenue in Backlog ÷ (Revenue on Income Statement ÷ number of months covered by Income Statement)**
  - Tells how much Revenue is left on work yet to be completed on signed contracts
  - If less than 6 months, need to find more work

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## FINANCIAL STATEMENT RATIOS

- **Months of Overhead covered by Gross Profit in Backlog = Gross Profit in Backlog ÷ (Overhead Expenses ÷ number of months of Overhead Expenses included in calculation)**
  - Tells how many months of G&A Expenses can be paid with the Gross Profit expected on work yet to be completed on signed contracts
  - If less than 6 months, need to find more work

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## Other Analysis Techniques

- Prepare common size financial statements
  - Displays each line item as a percentage of a base amount
  - Helps to spot trends that raw financial statements may not reveal
  - Most common base for common size Balance Sheets is Total Assets
  - Most common base for Income Statement is Revenue
  - Makes comparisons to other companies more meaningful, especially if revenue varies significantly
  - Can easily compare different periods which may have varying revenue amounts

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## Other Analysis Techniques

## Benchmarking

- A valuable function of trade associations is to publish performance data of successful companies
- Compare results with results of similar sized companies

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## SUPPLEMENTAL JOB SCHEDULES

## Schedules of Contracts in Process and Completed Contracts are a must for Banks and Bonding Companies

- **Schedule of Contracts in Process (WIP)**
  - Lists all jobs currently in process
  - Helps contractors determine profitability by job
  - Number of jobs is important
  - Size of jobs is important
  - Include Backlog on WIP

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## SUPPLEMENTAL JOB SCHEDULES

- Schedule of Completed Contracts
  - Provides information on the ability to estimate
    - Compare gross profit percentages on closed schedule with percentages on WIP
    - Compare gross profit percentages on jobs closed to the percentages on prior period schedules when the job was open
      - Profit fade/slippage
      - Profit pickup/grippage

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## SUPPLEMENTAL JOB SCHEDULES

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[illegible]

# SUPPLEMENTAL JOB SCHEDULES

## Reconciling to the Income Statement

- Current year income earned on the WIP and the Completed Contract Schedule must equal contract revenue on the Income Statement
- Current year costs on the WIP and the Completed Contract Schedule must equal cost of contract revenue on the Income Statement

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Sep 28 - Oct 1  
2024

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# SUPPLEMENTAL JOB SCHEDULES

## Reconciling to the Income Statement, cont.

**Reconciliation of Revenue and Costs to the Income Statement:**

Revenue Earned Year Ended December 31, 20XX on WIP	A	\$ 465,884
Revenue Earned Year Ended December 31, 20XX on CC	C	<u>2,745,786</u>
Contract Revenue on Income Statement		<u>\$ 3,211,670</u>
Costs Incurred Year Ended December 31, 20XX on WIP	B	\$ 393,221
Costs Incurred Year Ended December 31, 20XX on CC	D	<u>2,169,692</u>
Cost of Contract Revenue on Income Statement		<u>\$ 2,562,913</u>

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# Cash Flow

## Cash Flow Projection & Cash Management



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## Cash Flow Projection & Cash Management

### Cash Flow is not profitability

- Cash Flow measures Liquidity
- The Income Statement measures profitability

### Cash Flow management is essential

- Cash management can generate Cash Flow and Profit with proper investment of excess cash

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## Cash Flow Projection Form

### Budget Cash Flow – overall company and by project

- Should be prepared:
  - Weekly
  - Monthly
  - Quarterly
  - Annually
- Use a standard form and compare to actual results

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## Cash Flow Projection Form

	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034	2035	2036	2037	2038	2039	2040
<b>Operating Activities</b>																		
Net Income																		
Depreciation & Amortization																		
Change in Accounts Receivable																		
Change in Accounts Payable																		
<b>Investing Activities</b>																		
Capital Expenditures																		
Acquisition of Intangible Assets																		
Disposal of Intangible Assets																		
<b>Financing Activities</b>																		
Debt Issuance																		
Debt Repayment																		
Equity Issuance																		
Equity Repurchase																		
<b>Net Change in Cash</b>																		
<b>Free Cash Flow</b>																		
<b>Operating Cash Flow</b>																		
<b>Investing Cash Flow</b>																		
<b>Financing Cash Flow</b>																		

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## Cash Flow Projection Form

- You can be as detailed or summarized as you would like
- Forecast as frequently as you'd like
  - Weekly
  - Monthly
  - Quarterly



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## Cash Management

### Most effective methods to improve cash flow:

- Timely collections, cash receipts
- Can you stretch out cash disbursement terms?
- Profitability
- Bank loans, stockholder loans, capital



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## Cash Management

### Breakeven analysis – know your breakeven point

$$\text{Operating Expenses \$} \div \text{Gross Profit \%} = \text{Breakeven Contract Revenue}$$

- In order for this to be accurate you must know accurate:
  - Operating Expense
  - Gross Profit



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## Cash Management

What happens when you think your gross profit percent is 20% but it is really 17%?

	20% Gross Profit	17% Gross Profit
Operating expenses	500,000	500,000
Gross profit %	÷ 20%	÷ 17%
Break-even revenue	2,500,000	2,941,176

If you're making

operating costs

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## Analyze your WIP Schedule

- Job fade/gain
- Excess Over or Underbillings

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## Where is the money?

- In Cash
- Used for front-end items on the job you got the Overbilling on
- Fund cash flow on operations, other jobs, etc.?

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## Steady cash flow is crucial in the construction industry

- To fund new projects
- To keep current projects moving forward
- To pay for materials and labor



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## Cash Shortfall Causes

### Cash shortfalls can be caused by:

- Late or missed payments from customers
- Overstock of inventory (may be necessary due to increased lead times)
- Sudden increase in cost of materials
- Changes in labor costs not factored into job estimates
- Cost overruns on projects/estimating errors
- Unpredictable events (like a pandemic)

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## Maintaining Healthy Cash Flow

### Have enough cash on hand

- Estimate average monthly overhead expenses and have at least 6 months on hand
- Budget contributions to your cash reserve as a fixed expense and replenish if you dip into the reserve

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## Maintaining Healthy Cash Flow

### Finance Assets

- Finance the purchase of equipment and vehicles to keep working capital free
- Do not prepay insurance or other costs that allow installment payments, unless you receive a discount for paying in advance
- Stretch payments to vendors to 60 or more days, if possible

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## Maintaining Healthy Cash Flow

### Obtain a Line of Credit with a Bank

- Provides immediate access to money should you need it
- Only pay interest on what you use

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## Maintaining Healthy Cash Flow

### Shop around for the best price on materials

- Do not pay up front unless you receive a discount
- If you pay suppliers and vendors before you are paid, you run the risk of running out of cash

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## Maintaining Healthy Cash Flow

### Before signing a contract, review terms related to material cost escalations and delivery delays

- Understand your rights and negotiate more favorable terms, if possible
- Material escalation clause
  - Shifts risks from contractor to customer
  - Provides a clear means of addressing issues
- Every material escalation clause is different and must be evaluated
- Can build smaller contingencies into bids

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## Maintaining Healthy Cash Flow

### Make Invoicing and Collections a priority

- Contractors are paid an average of 90 days after invoicing
- The sooner you bill, the sooner you get paid
- Establish a consistent billing process
- Review retainage balances periodically and bill it timely

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## Maintaining Healthy Cash Flow

### Make Invoicing and Collections a priority, cont.

- Accept electronic payments – this speeds up receipt of payments
- Regularly call on accounts not paid timely
- Check credit reports of new customers

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# Maintaining Healthy Cash Flow

## Manage Cash at the project level

- Track the status of Over and Underbillings
  - Bill as close to costs as possible
- Request advance payment from customers to offset required purchases before the job begins

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# Maintaining Healthy Cash Flow

## Understand what Over and Underbillings are telling you

- **Large Underbillings**
  - Slow billing practices
  - Unapproved change orders
  - Inaccurate estimates

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# Maintaining Healthy Cash Flow

## Understand what Over and Underbillings are telling you, cont.

- **Large Overbillings**
  - Can lead to "job borrow"
  - Amount of cash needed to complete the project exceeds the amount that can still be billed
  - Must be offset with cash and receivables
  - Could be profit, but do not assume this without verifying estimates are correct

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# Maintaining Healthy Cash Flow

## Actively manage jobs

- Before committing to job, ensure profit margin is sufficient to weather potential material and labor price increases
- Monitor actual vs. estimated costs
- Monitor schedule to anticipate and manage delays
- Track progress to identify potential issues early and avoid job loss or stoppage

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## Maintaining Healthy Cash Flow

### Process Change Orders immediately

- The sooner you get approval, the sooner you can bill the additional costs
- Have a good process to handle change orders
- Make sure the person approving change orders for the customer has the authority to enter the contractual obligation

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## Maintaining Healthy Cash Flow

### Turn in project closeout documents promptly

- The sooner you turn in, the sooner you can receive final payment, including Retainage
- Have a good process for contract closeout
  - Punch list
  - Inspection certificates
  - Lien waivers

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## Maintaining Healthy Cash Flow

### Cut Expenses

- Eliminate all unnecessary expenses
- Focus spending on costs that keep you operational or generate revenue

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## Maintaining Healthy Cash Flow

### Prepare and maintain Cash Flow Projection

- Helps to prevent payroll and vendor payment problems
- Helps you know when draws on the line of credit may be necessary



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## Maintaining Healthy Cash Flow

### Prepare financial statements timely

- Review and understand them
- Ask your CPA for assistance, if needed



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## Maintaining Healthy Cash Flow

### Do not take on too much

- Committing to too many jobs in a volatile market with uncertain labor and material lead times can make it hard to fulfill obligations and lead to cash flow issues
- Bigger is not always better



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## Maintaining Healthy Cash Flow

### Proper Tax Planning

- Unexpected large tax payments can negatively affect cash flow
- Understand the timing and amount of tax estimates that will be due throughout the year
- Work with a qualified Tax Advisor who can suggest tax savings strategies

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## Maintaining Healthy Cash Flow

### Use Metrics

- Study Job Cost Reports to verify jobs are priced correctly and are profitable
- Perform Cash Flow Analysis
  - Where money is going
  - Where money is coming from
  - How much money is on hand

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## Maintaining Healthy Cash Flow

### Use Metrics, cont.

- Key metrics to track:
  - Working Capital
  - Current Ratio
  - Debt to Equity Ratio



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## Maintaining Healthy Cash Flow

### Use Metrics, cont.

- Gross Profit Percentages
  - On WIP
  - On Completed Contracts
  - On P & L
- Project Gain/Fade
- Number of months Overhead covered by Gross Profit in Backlog



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## Overhead Budget



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## Overhead Budget

### Consider all costs the company will incur

- **Fixed Costs** – do not vary with the revenue
- **Variable Costs** – vary with revenue



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## Overhead Budget

### Operating Expenses as a Percentage of Contract Revenue (Overhead Budget)

- Percentage of each contract revenue dollar earned used on operating expenses
- Be sure to include Overhead in your bid

$$= \text{Operating Expenses} \div \text{Contract Revenue}$$

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## Overhead Budget

### Start with prior year General Ledger

- Update known amounts
- Use prior year amounts for estimates
  - Analyze all expenses
  - Become leaner
  - Consider debt payments and needed equipment purchases
- Prepare a 'best case', 'worst case', 'mostly likely' scenario budget

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## Overhead Budget

	20xx Actual	Best Case 20xx	Worst Case 20xx	Most Likely 20xx	20xx Actual		20xx Actual	Best Case 20xx	Worst Case 20xx	Most Likely 20xx	20xx Actual
Contract revenue	-	-	-	-	-	Operating Expenses	-	-	-	-	-
Total revenue	-	-	-	-	-	Payroll, PR taxes, benefits (V)	-	-	-	-	-
Cost of contract revenue	-	-	-	-	-	Insurance expense, all (F)	-	-	-	-	-
Gross profit	-	-	-	-	-	Rent (F)	-	-	-	-	-
Operating Expenses	-	-	-	-	-	Utilities (V)	-	-	-	-	-
Operating income	-	-	-	-	-	Dues and memberships (V)	-	-	-	-	-
Interest expenses	-	-	-	-	-	Office expenses (V)	-	-	-	-	-
Net income	-	-	-	-	-	Repairs & maintenance (V)	-	-	-	-	-
						Equipment & vehicle expense (V)	-	-	-	-	-
						Lease expense (F)	-	-	-	-	-
						Travel, meals, entertainment (V)	-	-	-	-	-
						Professional fees (V)	-	-	-	-	-
						Advertising (V)	-	-	-	-	-
						Depreciation (V)	-	-	-	-	-
						Taxes, all (V)	-	-	-	-	-
						Miscellaneous, other (V)	-	-	-	-	-
						Total operating expenses	-	-	-	-	-

(V) =  
Variable  
(F) = Fixed

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## Components of WIP



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## Components of WIP

### Contract Price

- Based on your Bid/Estimate
  - Markup vs. Margin Method
  - Make sure that you compute your desired margin correctly when estimating projects
- Should be adjusted for approved Change Orders
- Must be updated for an accurate picture of earned revenue

$$\% \text{ Complete} \times \text{Contract Price} = \text{Earned Revenue}$$

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## Components of WIP

### Estimated Costs

- Most important item on WIP Schedule
- Significant factor in determining Earned Revenue and Percent Complete
- Should be adjusted for approved Change Orders
- Should be adjusted for known Cost Overruns
- Provided by the Project Manager who has in-depth job knowledge
- If this amount is incorrect, integrity of financials is affected
- Review and update monthly

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## Components of WIP

### Estimated Costs, cont.

- % Complete Formula (cost to cost)

$$\text{Actual Costs-to-Date} \div \text{Estimated Costs} = \% \text{ Complete}$$

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## Components of WIP

### Estimated Costs, cont.

If Percentage Complete calculates above 100%

- Verify all Change Orders have been included in Cost Estimates
- Verify Cost Overruns have been included in Cost Estimates
- Not correcting will result in computed Revenue in excess of Contract Price and incorrect Financial Statements

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## Components of WIP

### Estimated Costs, cont.

- Should include:
  - Direct Costs
    - Direct labor and related Payroll Taxes and Benefits
    - Direct materials
    - Subcontractors
  - Indirect Costs – costs **allocated** to contracts
    - Indirect labor
    - Small Tools
    - Insurance
    - Equipment
    - Repairs and Maintenance



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## Components of WIP

### Contract Assets – formerly Underbillings

- Current Asset on the Balance Sheet
- Revenue recognized in excess of billed amounts
- Function of ability to accurately and timely invoice customers
- Can lead to cash flow issues
- Should be less than 25% of Working Capital



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## Components of WIP

### Contract Liabilities – formerly Overbillings

- An obligation for work to be performed (billed more than Earned Revenue)
- Generally, it's good to be slightly overbilled...BUT
  - Too much can be like "robbing Peter to pay Paul"
- Offset should be in Accounts Receivable (AR), or Cash if collected
  - Is there sufficient Cash to cover Overbillings?
  - May result in inability to complete work already paid for by customer

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## Components of WIP

**Backlog** — *total dollar amount of projects under contract but not completed*

- Can be an indicator of financial health or distress
- Only includes signed contracts
  - Including contracts not yet signed in backlog may give a false sense of security
- Needs to be well balanced (a large Backlog with low Profit Margins is not desirable and a small Backlog could be a sign of trouble)

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## WIP Schedule

Company Name: \_\_\_\_\_  
 Main Office Phone: \_\_\_\_\_  
 Date: \_\_\_\_\_

		CONTRACTS										CONTRACTS										CONTRACTS										CONTRACTS									
		ORIGINAL		REVISED		CHANGE		TOTAL		ORIGINAL		REVISED		CHANGE		TOTAL		ORIGINAL		REVISED		CHANGE		TOTAL		ORIGINAL		REVISED		CHANGE		TOTAL									
1																																									

NOTES:  
 Shaded areas are formula driven. No data input necessary.

1. Percentage of Completion Calculation  
 $D / B \times E$   
 Costs Incurred to Date / Total Estimated Costs = % Complete

2. Revenue Earned to Date Calculation  
 $E \times A \times C$   
 % Complete X Total Contract Price = Revenue Earned to Date

3. Other Under Billing Calculation  
 $C - F + G \div H$   
 Revenue Earned to Date - Billings/Charges to Date + (Other Billings or Under Billings)

4. Revenue Earned Prior Year + I  
 Basic Revenue Earned to Date from your Prior Year Work in Process Schedule, if applicable

5. Costs Incurred Prior Year + J  
 Basic Costs Incurred to Date from your Prior Year Work in Process Schedule, if applicable

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## Completed Contracts Schedule

Company Name: \_\_\_\_\_  
 Main Office Phone: \_\_\_\_\_  
 Date: \_\_\_\_\_

		CONTRACTS										CONTRACTS										CONTRACTS										CONTRACTS									
		ORIGINAL		REVISED		CHANGE		TOTAL		ORIGINAL		REVISED		CHANGE		TOTAL		ORIGINAL		REVISED		CHANGE		TOTAL		ORIGINAL		REVISED		CHANGE		TOTAL									
1																																									

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1. Percentage of Completion Calculation  
 $D / B \times E$   
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 $C - F + G \div H$   
 Revenue Earned to Date - Billings/Charges to Date + (Other Billings or Under Billings)

4. Revenue Earned Prior Year + I  
 Basic Revenue Earned to Date from your Prior Year Work in Process Schedule, if applicable

5. Costs Incurred Prior Year + J  
 Basic Costs Incurred to Date from your Prior Year Work in Process Schedule, if applicable

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## Components of WIP

### Weekly or Bi-Weekly Job Meetings

- Attendees should include members of Leadership Team, Project Managers, and Accounting Staff
- Critical to keep communication open and all staff up-to-date on job status
- Agenda items should include:
  - Project status
  - Change Orders
  - Project delays
  - Overdue Accounts Receivables
  - Differences between Project Manager and Accounting % Complete Estimates on WIP

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## Components of WIP

### Benefits

- Catch issues on a job early
  - Schedule may say a higher Percent Complete than what the Project Manager sees is happening on the job
    - May alert the Contractor that Change Orders need to be approved
    - May alert the Contractor that labor needs to be managed and run differently
    - May alert the Contractor that a Subcontractor is billing for work before it is completed and Percent Complete is inflated due to inflated Current Costs

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## Components of WIP

### Benefits, cont.

- More accurate picture of Earned Revenue
  - Reduce risk of overstating income – pay less income tax in the current year
  - Ability to effectively tax plan
    - Purchase equipment at year-end
    - Pay out bonuses
    - Maximize retirement contributions
    - Reduce risk of paying penalties and interest
- Catch Job Fade early and fix inefficiencies



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## THANK YOU

Any questions?

Please contact Dave O'Brien with additional questions and for copies of any presentation materials.

dobrien@mgoinc.com • 419-350-5750



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CONVENTION EDUCATION

