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Move Your Company Forward

2023 +
BEYOND

CONSTRUCTION **PROFITABILITY**

Sound accounting leads to a more profitable construction company.

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MANAGING
CASH FLOW

Managing cash flow is one of the biggest challenges for contractors in the construction industry. Whether you're a small or large construction firm, you need to have a solid understanding of your cash flow situation in order to make informed business decisions and stay financially stable.

That's where construction accounting comes in. Proper accounting practices can help you manage your cash flow and ensure that you have enough cash on hand to cover expenses and invest in growth opportunities.

Construction Accounting Tips
Here are some key ways you can manage cash flow:

Accurate Recordkeeping
One of the most important functions of construction accounting is to keep accurate records of all financial transactions. This includes tracking income, expenses, and assets, as well as monitoring accounts receivable and payable.

By maintaining accurate records, you can get a clear picture of your current cash flow situation and make informed decisions about spending and investments. You can also identify areas where you may be overspending or missing out on opportunities to generate revenue.

Budgeting and Forecasting
Another important aspect of construction accounting is budgeting and forecasting. By creating a budget and regularly reviewing it, you can identify areas where you can cut costs or invest more in order to improve your cash flow.

Forecasting, on the other hand, allows you to anticipate potential cash flow issues and plan for them accordingly. By predicting cash inflows and outflows, you can make strategic decisions about when to take on new projects or invest in new equipment.

Cash Flow Forecasting

Construction accounting can also help you forecast your cash flow over time. By using historical data and current trends, you can predict how much cash you will have on hand in the coming weeks or months.

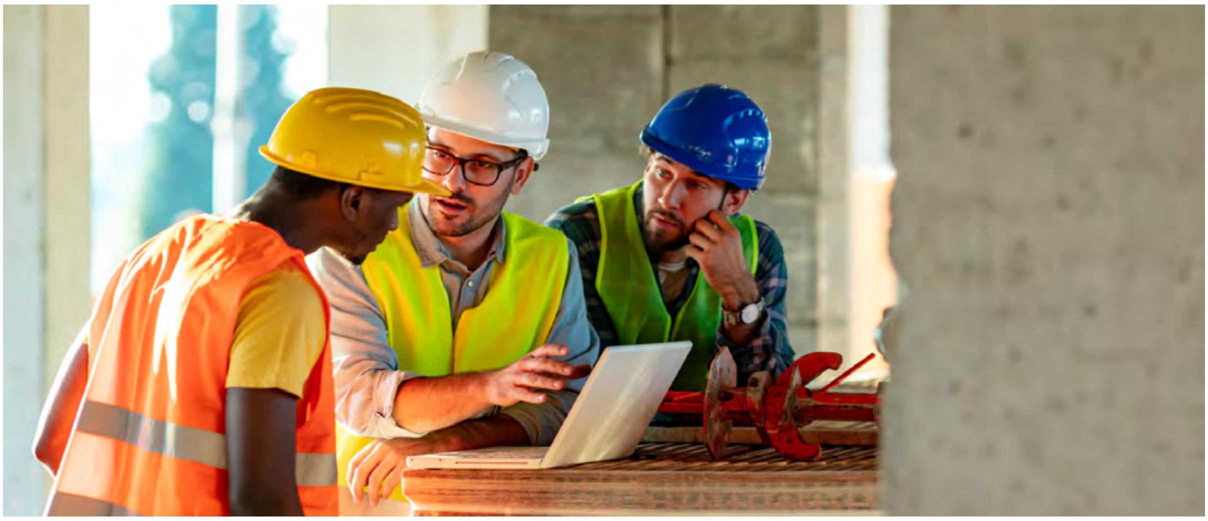
This allows you to plan ahead and make strategic decisions about spending and investments. For example, if you know that you will have a cash surplus in a few months, you may decide to invest in new equipment or take on a new project.

Are forecasts reliable?

Well, nobody can predict the future; no one can be certain about what will happen. And that's why financial forecasting is so challenging. But extrapolating from past trends lets you come up with a most likely scenario for the future. The future rarely imitates the past, especially when you consider evolving laws and regulations, the geopolitical order, and economic influences. You don't want to drive forward while looking in the rear view mirror.

However, you can create a precise forecast. Be thorough and carefully examine and model each input to make the most accurate predictions possible. If done correctly and with the right input from accounting, forecasting finances for your business can help you make projections applicable to your income statement, balance sheet, and cash flow.

Effective accounting is essential for managing cash flow in the construction industry. By keeping accurate records, creating budgets and forecasts, monitoring cash flow, managing accounts receivable, and forecasting future cash flow, you can ensure financial stability and make informed business decisions.

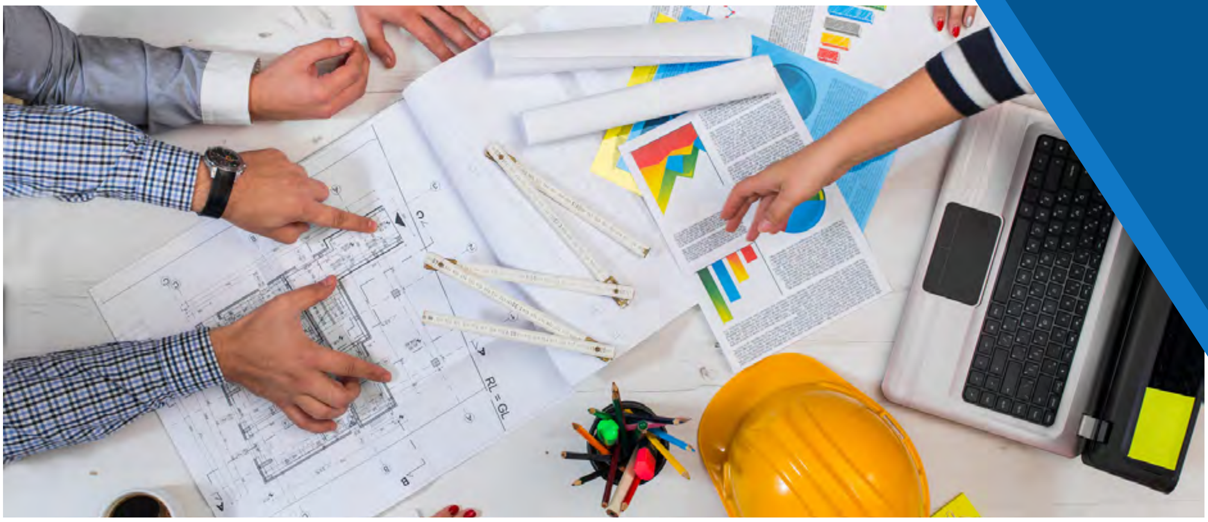


Most owners focus on operational activities, not seeing how decisions like financing purchases and selling assets make a difference. Projecting future cash flow isn't easy, but it's even more complicated in construction because no project is the same, and change orders can drive you crazy.

Cash flow management involves looking at current cash flow reports and making business decisions based on that information. Using cash management software can give you a general idea of income and expenses now and in the future.

Mistakes that drain cash flow:

- High payroll burden. If your company does labor-intensive work, the financial stress of paying your employees can make cash flow difficult. Employee paychecks are the biggest casualty of poor cash flow caused by late payments. Many subcontracts contain a paid-if-paid or paid-when-paid clause, meaning that payment is not due to you until the owner pays the general contractor. These clauses provide protection for the GC.
- Paying bills early. If you always pay your bills as soon as they come in, this can leave you cash-strapped. Waiting until the end of the payment terms gives you more money to work with. While it's good to pay your bills promptly, if you spend money you don't have, you'll end up with a negative cash flow.
- Failing to budget for retainage. Retainage is money withheld until the end of a project to ensure the project is completed to specifications and is typically 5%-10% of the total contract. This may result in cash flow issues: With average profit margins of only 5%, a 10% retention holdback means there's no room to pay overhead once payments come in.
- Processing change orders quickly — don't wait until the project is complete. The money needs to be received quickly to positively impact cash flow.
- Paying cash for assets. Creating positive cash flow is about managing working capital — the liquid cash to pay bills, wages, and expenses. If you're buying equipment with cash, you're essentially stealing money from yourself. Financing large purchases frees up your cash. You'll pay interest, but that interest buys time and builds up a good credit rating.
- Slow-paying customers. The longer you wait for payment, the longer you're without cash. This doesn't just affect your future cash flow — it costs you more as late fees and finance charges add up.
- Being slow to invoice customers. Customers won't pay you until you invoice them. If invoicing is slow or inconsistent, it costs you money.
- Using cash for other investments. Invest excess cash to earn more through interest and investment gains. If a sudden cash emergency comes up, you're often left with no quick way to recoup that money.



Ways to improve your cash flow:

- Establish good accounting and financial practices. Identify how each project affects your cash position overall. Accounts payable reports help you identify aging bills that accrue interest penalties. An accounts receivable report shows which customers delay payment so you can follow up or decide which jobs to lien. A mechanics lien, for example, can be a powerful tool to ensure you get paid. Send preliminary notices when you start work, send a notice of intent to lien when payment is late, and file a lien claim before the deadline. Since every state has its own laws and regulations, have someone in your firm keep tabs on the different rules.
- Negotiate better payment terms. Talk to several suppliers to get the best offer on materials. Buy larger quantities to get discounts, and don't be shy about letting current suppliers know when you find a better deal elsewhere. Your terms should ideally be equal to or longer than the terms you give your customers.
- Offer discounts for early payment. A 2% - 5% discount is the industry standard.

Managing cash flow is the key to survival. Make it easier for your customers to pay you. When a market is volatile, you'll be able to stay lean and prevent money waste. During a slump, you may need to cover unexpected costs. During a spike, you may need to purchase more materials than you thought you needed.

Address practices that drain your cash to prevent future problems. Companies with the most control over cash flow are the ones most likely to be in business 10 years from now.

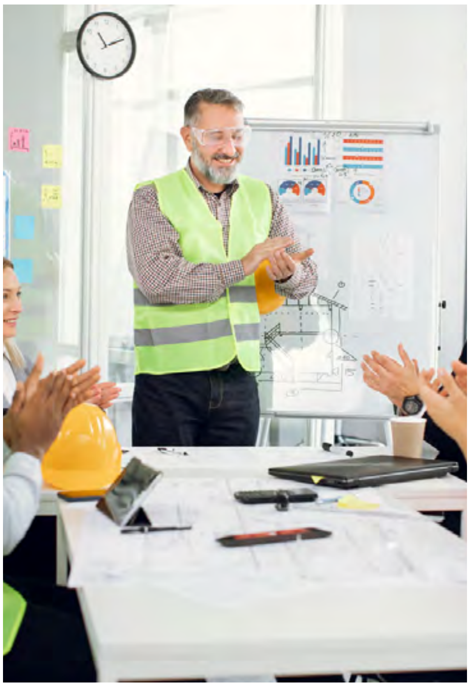
BUDGETING
SUCCESS

When a construction business doesn't have a clear idea of its annual budget, it runs the risk of spending more money than it earns that year. You may have been running smoothly for years, and then decide to expand or replace old machinery. There's money coming in, so it seems you're fine. But if you don't have a good handle on expenses versus income, you can quickly find yourself in the red.

Maybe you want to apply for a loan. If so, the bank is certainly going to want to see a formal budget as part of your business plan.

Basic Budgeting Techniques
Budgeting can be done in different ways with different processes, depending on the particular business and the people involved. However, there are several universal parameters within a typical budget plan that provide a foundation. For instance, most businesses make a rent or mortgage payment on their premises.

Next, there are basic overhead costs such as utility bills, payroll expenses, and raw material costs, as well as interest, insurance, and tax payments. As a construction expert, you may know that, but have you considered some of the "softer" expenses, such as website development, signage for your business, business cards, and advertisements?



These are safe initial elements when developing a budget plan, and then you can add any expenses that are specific to your business. As a construction business, there are several key expenses you need to account for, including:

- Business permits and licensing requirements.
- Salaries, wages, and benefits for you and your employees.
- Tools, supplies, and inventory.
- Loan and credit card payments.
- Services, such as accounting, maintenance, and marketing.
- Heavy machinery and vehicles or equipment payments, fuel, and insurance.

If you are just launching your business, you may need to do some research to come up with estimates of monthly expenses. If your business is already established, you can base your assumptions of future costs or revenues on your past 12 months of figures.

A typical 12-month budget can be updated with actual expenditures and revenues each month so you know whether you are on target for your goals. Many plans feature one column of estimated expenses, with one blank column next to it where businesses fill in their actual expenses each month to track and compare.

If you are missing your planned targets, you can then apply the plan to troubleshoot by figuring out how you can reduce expenses like labor or new machinery, increase your sales with more aggressive marketing, or lower your profit expectations.

By charting a comprehensive budget plan, you can enhance your chances of your business succeeding by anticipating future needs, spending, profits, and cash flow. A good budget provides a detailed road map so that you are not driving your business blindly. When done correctly, it will provide clear insight into how your business is performing to help you achieve growth and success.

12-Month Business Budget Template

SUMMARY	JAN	FEB	MAR	APR	MAY	JUN
Total Income						
Total Expenses						
NET Income	--	--	--	--	--	--

INCOME

Operating Income

Total:	*$0.00*	*$0.00*	*$0.00*	*$0.00*	*$0.00*	*$0.00*

Non-Operating Income

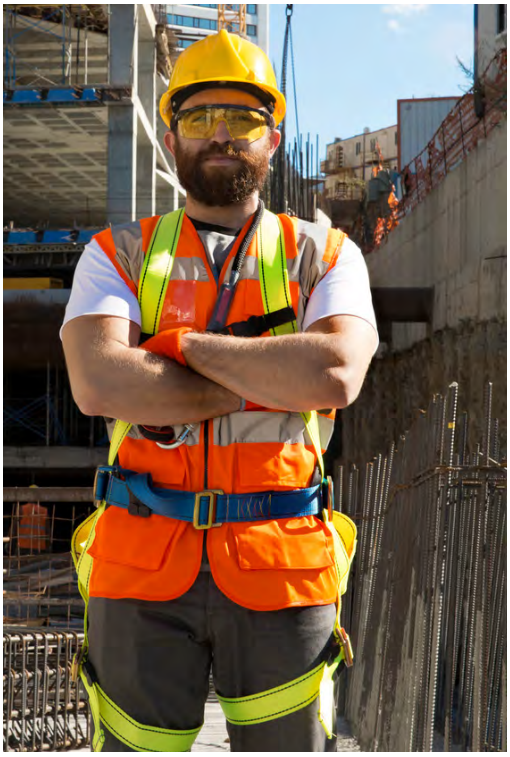
Total:	*$0.00*	*$0.00*	*$0.00*	*$0.00*	*$0.00*	*$0.00*

TAX
MISTAKES

Regardless of your trade in the construction industry, allowable tax deductions can lower your tax liability and possibly lead to getting a tax refund. You can deduct common expenses such as tools and materials, and even certain other items that come in handy in your business or on the job.

Key Takeaways

- If you're an employee of a construction company, you cannot deduct unreimbursed expenses unless they occurred prior to the tax year 2018. If you're an independent contractor, you can deduct work-related expenses that are ordinary and necessary.
- The cost of work-related travel—driving to and from work sites, client meetings, and picking up tools and materials—typically is one of your largest deductions.
- You can also deduct the cost of tools and equipment, work clothing and gear, advertising and marketing expenses, subcontractor or employee salaries, phone and internet costs, membership and license fees, subscriptions, and other expenses.
- Equipment that you use for multiple years usually must be depreciated over its useful lives, meaning that you claim a portion of them on your taxes over a period of years.



Who can take deductions?

If you're an employee for a construction company, rather than an independent contractor, and your employer doesn't reimburse you for expenses on the job, you can usually deduct them for tax years prior to 2018. Beginning in 2018, unreimbursed employee expenses are no longer deductible. Independent contractors generally have no limit on the ability to deduct work-related expenses as long as they are ordinary and necessary for your line of work.

Learn more about tax deductions you can take if you work in the construction industry, including:

- Mileage
- Tools of the trade
- Steel-toed boots
- Fees

UNDER-
CAPITALIZATION

Even without knowing its exact definition, you can just tell from the way the word sounds that undercapitalization is not good for your business. Undercapitalization occurs when a business holds insufficient funding — or capital — to support its operations. It is cause for serious concern about a potentially major financial crisis for any business, but among contractors, it is considered by many financial experts to be the leading cause of business failures.

Obviously, your company needs enough money to achieve your financial and business goals. More specifically, though, you should never underestimate how much capital is necessary to pursue the most profitable construction projects. Those contractors who aren't fully aware or conscious of the money required to get a business up and running, and then sustain it as they work to establish a commercial foundation, may find themselves undercapitalized. The challenge is that, for any business, undercapitalization can quickly turn into a perpetual downward spiral from which it is difficult to recover.

Construction businesses need to keep their focus on attaining and maintaining the cash necessary to fund projects in terms of employee wages, equipment, and supplier materials before the first installment of the project payment.

The Impacts of Bad Cash Flow

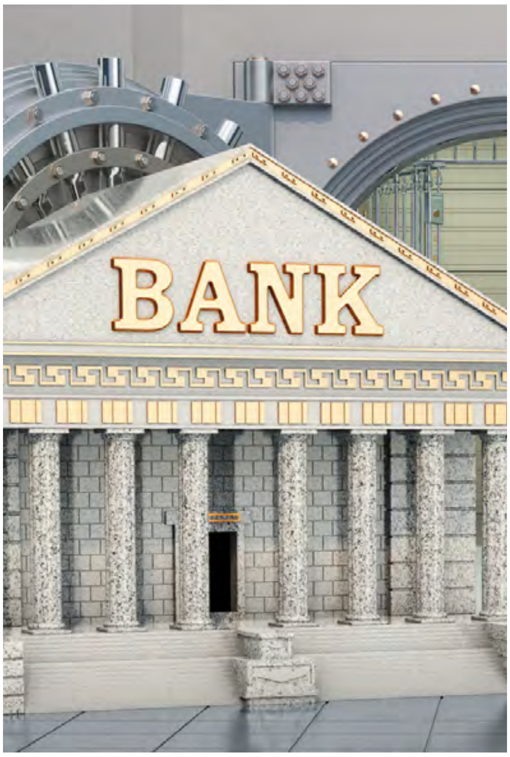
Often, bad decisions are made when a company's management is forced to wrestle with poor cash flow. Behind-schedule payments then have an increasingly detrimental effect on the company's cash flow and start that downward slide into undercapitalization.

One cash flow issue you should try to avoid is mistaking cash receipts or positive cash flow with excess cash. Once the money is spent, there's no way to get it back, right? So, one of the best tools you should employ to manage cash flow is your monthly budget and cash flow projections. Regular comparison of current and projected expenses, for example, will help keep you on track with spending.

While getting paid on time can be an ongoing struggle, there are steps you can take to address that issue as well. Understanding how each client handles accounts payable when you submit for draws will help you maintain a positive cash flow. Missing a draw or having poor-paying clients can lead to problems, so stay committed to your draw dates.

The Rewards of Planning

One of the most important skill sets to avoid undercapitalization is the ability to develop a comprehensive, accurate construction project plan. By determining your manpower, equipment, and cash items up front, you will enhance the chances of success for a project. Basically, you never want to overestimate your team's capabilities or underestimate your cash flow. If you have correctly accounted for what machinery, tools and skilled specialists will be needed and when they must be provided in the construction schedule, you can limit any periods of downtime or decreased productivity. Of course, you need to continually monitor and review a project plan to address any delays or other circumstances that may arise.



Always Strive for Sufficient Capitalization

In the end, undercapitalization can seriously restrict your business's daily operations, growth and success. Sufficient capitalization, on the other hand, enables a business to handle slow periods in the business cycle or address other challenges that occasionally happen in the life of a company. More important, it can give you a competitive edge that positions you to grow and move ahead as a company.

In fact, according to the Small Business Administration publication "Financing for the Small Business," one of the critical characteristics of successful entrepreneurship is having access to sufficient funds to run a business.

BUSINESS SUCCESSION

There is an unbelievable number of companies across a wide array of industries, which may lead you to believe that the creation of a succession plan must be a unique and one-off process. For instance, family businesses in particular carry distinctive cultures and reflect idiosyncratic histories in ways that might be challenging for outsiders to relate to, let alone understand.

But despite all the differences that set companies apart from one another, the process of compiling a business succession plan is remarkably uniform, no matter the specifics of your business. Although a good plan must be customized to each business and its needs, there are many standard principles that apply to all businesses across the board.

The value of having a business succession plan in place is universally recognized by all company owners. Plans such as these serve the purpose of facilitating leadership continuity and preparing a framework, especially since changes can occur rather quickly. Firms are advised to plan anywhere from three to five years ahead of any anticipated changes in ownership. It is equally important that they review their plans regularly.

The Plan

When putting together a business succession plan, there are certain general considerations that should be thought about before moving into the more specific aspects of the plan. For instance, successful business owners are attuned to fluid environments, and they understand that key people will eventually retire, meaning new strategies and directions will subsequently require various levels of competency.

It's important to think about all possibilities and be honest with yourself during this process. For instance:

- Should a family continue to own and manage the firm, or is it time to enlist the guidance of professionals outside the family tree?
- If family members are retiring soon, what are their objectives and cash flow requirements?
- What are the personal and career aspirations of the next generation of employees?

These are all inquiries that point to the foundation of the business, and once they have been addressed, it's time for the authors of the business succession plan to turn to the more difficult questions.

Plan Components

Some important plan components include the following:

- Build a succession timeline, including dates where feasible.
- Compile a list of succession candidates, noting strengths as well as weaknesses.
- Assemble all relevant documents, including procedures, handbooks and employee training manuals.
- Decide on the method for valuing the operation in addition to any and all funding options.
- Document dispute resolution procedures in writing.
- Review any tax implications, both for the owner and for the business itself, in the context of what may arise from the sale or transfer of the company.
- If partners are involved, draft a buy-and-sell agreement that will become an official part of the plan so that the process of directing how everyone's shares will be distributed is detailed and defined in the plan itself.
- Prepare funding mechanisms, such as life insurance or key person insurance.
- Craft ways to develop internal talent.
- Forecast the firm's future needs, focusing on market trends, compensation and retirement schedules.
- Set out individual development plans along with necessary training or coaching protocols.
- With your attorney's help, prepare or update all governing documents. These may include partnership or operating agreements, articles of incorporation, and written instructions regarding disputes, terminations for removal, resignations, and death or disability contingencies.
- Arrange a procedure for delegating authority to successors.
- Consider how to retain employees by way of equitable compensation programs.
- Bring in external advisers, like us, if warranted to promote objectivity.

Implementation

Once all the aforementioned measures have been taken and the processes are officially documented, the moment has come to roll out concrete action plans. Continue to monitor and calibrate the business succession plan along the way.

As the last stages fall into place, you may be ready to circulate the plan amongst fellow employees in an effort to collect critical feedback. The instrument should be dynamic, meaning it must be constructed to adapt and adjust with the times. Open communication between family members, stakeholders and employees will lead to a far more comprehensive blueprint.

If the timing of the transfer can take place during the owner's lifetime, it may benefit all parties to maintain ongoing consultations. It might also lessen any prospects for a discounted sale. Linking the succession plan to an overall strategic plan will provide your business with a clear map for continuity into the future.

Many moving parts play a collective role in the production of a consummate business succession plan. Tap into the expertise of your attorneys, us, and internal management team to achieve concerted results that set up your business for unwavering success moving forward.

LANG ALLAN & COMPANY

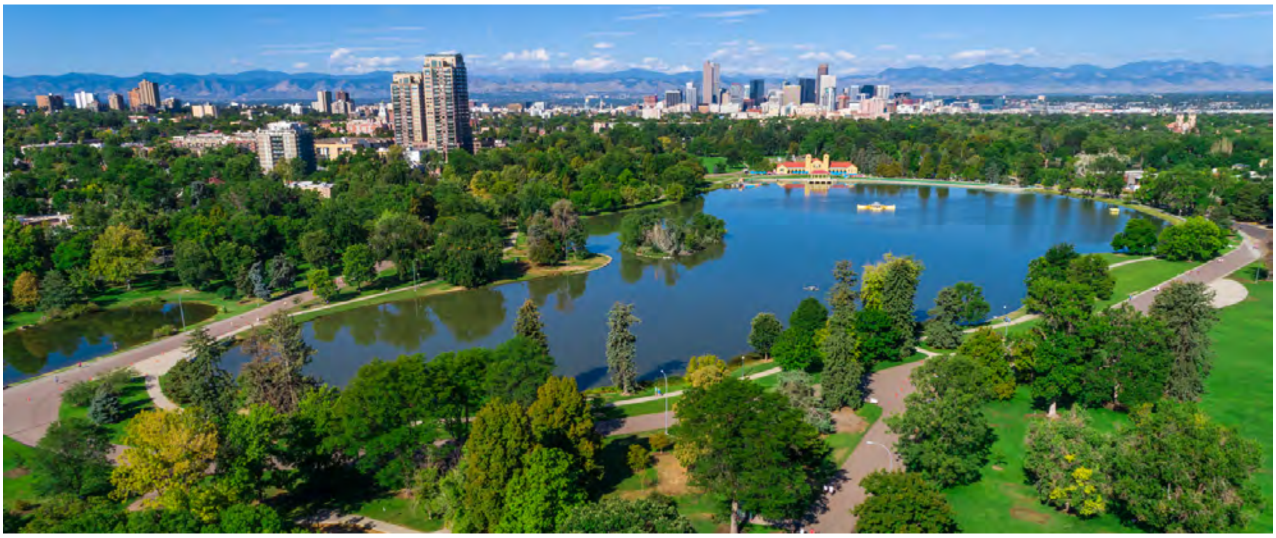
ABOUT US

Lang Allan & Company CPAs PC provides audit, review and compilation attest services, tax financial accounting and management and consulting services to construction companies to small and mid-size construction companies. Our goal is to serve your needs in a professional, prompt and courteous manner.

We believe it is important for you to know we care about you and your future. We will always provide personalized services to businesses and their owners.

We have an expertise in serving the construction industry throughout the United States. Through our experiences and understanding of the industry and communications with sureties and bankers, we gain a further understanding of the issues relevant to the construction industry. As a client, you will be able to leverage our relationships with other professionals and gain an increased credibility with financial institutions and bonding companies.

Our big firm experiences, combined with small firm service helps to **Move Your Company Forward**.



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LET'S WORK **TOGETHER**

303-792-9445
langallancpa.com
info@langallancpa.com
6130 Greenwood Plaza Blvd
Suite 130
Greenwood Village, Co 80111