

ONSITE

CONSTRUCTION INDUSTRY PERSPECTIVES

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THE VALUE OF BENCHMARKING

It may seem easy to figure out how well your company is doing — you just look at whether or not you made a profit this month or this quarter. But you need to dig deeper if your profits are erratic or not at the level you'd like or expect them to be. You need a way to measure your business's performance in key areas and to identify areas that can be improved.

For starters, you can compare current and past performance to identify trends. Another approach: Compare key metrics with those of successful construction firms of a similar size. The data and insights gained from this type of performance benchmarking exercise can be invaluable.

OBTAINING DATA

Use credible data from similarly sized companies within your geographic region for your analysis. Choose an industry group source — generally based on North American Industry Classification System (NAICS) code — that best represents your business. And look into joining national industry and trade associations so you can access the financial and surety data they collect from their members every year.

FINANCIAL BENCHMARKING

This is a critical area for measurement since access to bonding and credit will depend on your business's financial health. Important metrics include:

- ▶ Profitability ratios, such as gross profit margin, return on assets, and return on equity
- ▶ Liquidity ratios, such as the current ratio, which measures your firm's ability to pay off short-term obligations as they become due
- ▶ Underbilling ratios, such as the underbillings-to-equity ratio, which

measures the percentage of your business's net worth represented by work performed but not yet billed

- ▶ Backlog ratio, which lets you know how quickly the firm is working through its back orders
- ▶ Asset utilization ratios, such as the fixed-asset turnover ratio, which measures how efficiently your company is using its assets
- ▶ Debt utilization ratios, which help your business measure its liabilities in relation to its earnings ability and asset base

OPERATIONAL BENCHMARKS

This generally includes everything from staffing and productivity to office flow and analysis of procedures performed. Potential areas for analysis and comparison include:

- ▶ Job site accidents
- ▶ Number of change orders
- ▶ Productivity levels per employee

There are other areas in which comparing your company's performance with those of competitors can be helpful. For example, look into sales and marketing issues and your firm's fuel and energy use.

If you would like advice and input on the most effective way to benchmark your company's performance, please call us. We can help you set up systems that will capture the data critical to your growth.

FACTORING IN FLOOD RISK ON PROJECTS

When coastal storms, snowmelt, or torrential rains cause water levels in rivers, lakes, and streams to rise and flood communities, the damages can be extensive and extremely costly. To protect themselves from potentially large financial losses, construction companies and developers need to proactively identify the flooding risk on any sites they plan to build on.

REVIEW THE DATA

The local officials responsible for overseeing a community's construction activity can provide information regarding the community's building codes and flood plain management requirements. State and local land use regulations should also be examined.

The Federal Emergency Management Agency (FEMA) Flood Map Service Center (<https://msc.fema.gov>) is the official public source for flood hazard information produced in support of the National Flood Insurance Program (NFIP). Most communities have altered their building codes to ensure they comply with NFIP standards so that they can qualify for federal disaster assistance and homeowners, renters, and business owners in the community can purchase flood insurance.

Designed to help communities understand their risk, FEMA's Flood Insurance Rate Maps can be used to identify those areas that FEMA categorizes as high risk or moderate to low risk for flooding. According to FEMA, in high-risk areas, there is at least a one in four chance of flooding over a 30-year mortgage period. Although the risk of flooding is less in moderate- or low-risk areas, such areas submit more than 20% of NFIP claims and receive one third of federal disaster assistance for flooding.

Once contractors review the data for sites they plan to build on, they are in a better position to determine whether the project is worth pursuing.

Note: The federal government recently updated its flood plain maps. As a result, thousands of previously unaffected properties have now been placed inside flood zones.

Construction companies with plans to build in communities that the federal government has identified as being

prone to flooding need to assess the flood risk and take action to avoid or mitigate the threat.

"The local officials responsible for overseeing a community's construction activity can provide information regarding the community's building codes and flood plain management requirements."

SMART MARKETING STRATEGIES FOR CONTRACTORS

Marketing is not rocket science. It is simply "the science" of generating business. Most contracting firms can use a variety of inexpensive marketing strategies to generate a steady stream of work. Here are some easy-to-implement basic marketing ideas.

EMPHASIZE YOUR STRENGTHS

How are you different from other construction companies? Is it workmanship? Do you guarantee work quality? Do you have a sterling record for completing projects on time and on budget? Once you identify the traits that make your business unique, you can emphasize these traits in print, online, and in radio ads.

FOCUS ON KEY PROSPECTS

Review prior jobs to identify those prospects that offer the greatest likelihood of generating work and focus on them. It's not just owners you should be marketing to. Architects, engineering firms, surveyors, and realtors are all likely sources of work or referrals. Use direct mail or emails to let them know of any equipment updates, additional capabilities, or major projects you've been involved in recently.

ASK FOR REFERRALS

Ask the owners of current and past projects you've worked on for referrals. Referrals are the least expensive and most effective way of marketing your business, but too few contractors make the effort to ask for them.

BUILD UP YOUR COMMUNITY PROFILE

Participating in charitable activities that add a positive association to your business's name can be an effective way to market your company. Volunteer materials and time to help build a playground or a baseball diamond at a local school or park. Follow up by contacting media outlets in your community to update them on your community involvement. And mention your charitable work in any business profiles or brochures you create.

CREATING AN INCENTIVE COMPENSATION PLAN

High-performing, highly productive employees help drive a business toward growth and financial success. A compensation package that includes something more than base pay can help keep valuable employees on board and performing at peak levels. But an incentive compensation plan can do more than retain and motivate skilled employees — it can align employee goals with overall business objectives. Developing an incentive compensation plan should be a priority for every construction firm. However, contractors have to determine what type of incentive compensation structure will work best for their employees and meet their company's unique needs.

VARIATIONS ON A THEME

A compensation plan ties pay to performance and the achievement of certain goals. It can be in the form of:

- ▶ Merit pay
- ▶ Bonuses
- ▶ Profit sharing
- ▶ Corporate stock ownership

Bonuses and merit pay tend to be the most common forms of incentive compensation in the construction industry. However, some larger, privately held firms offer top performers the opportunity to share in the ownership of the company, often in the form of restricted stock units. This arrangement grants employees an equity interest in the company that fully vests (by the elimination of restrictions) over a predetermined schedule.

Stock appreciation rights and "phantom" stock are other forms of incentive compensation plans that allow contractors to reward top performers without giving up any equity interest in their companies. Under these approaches, employees share in any increase in the value of the company stock while not actually owning any shares in the company. Phantom shares merely track the value of the underlying, real shares.

An incentive compensation plan can be purely discretionary. It can also be

targeted specifically to individual employees, work crews, a craft group, or a combination of these groups. In addition, it can be paid currently to employees or deferred to a future date, very often retirement.

CLARIFYING THE STANDARDS

An incentive compensation plan will generally be effective only if the participants fully understand what's required of them to qualify for the payment. That's why it's critical that contractors clearly define performance standards or benchmarks that will be used to determine who gets rewarded. Sometimes, pure performance-based plans may not work for certain employees whose contributions to the company may be difficult to measure. Discretionary plans may work best in this circumstance.

"An incentive compensation plan can be purely discretionary."

PERFORMANCE-BASED PLANS

Performance-based plans typically give key employees a fixed percentage of profits per contract or division. To

receive the added compensation, employees must meet clearly defined goals. Some contractors require managers and supervisors to bring in a certain percentage of projects on time, on budget, or under budget in order to receive the added compensation. Other performance goals relate to reducing or eliminating on-site accidents. Still other contractors reward managers for recording and billing owners for all change orders.

DISCRETIONARY PLANS

A discretionary plan is typically used in situations where it's not possible to assess an employee's contributions solely through an objective set of criteria. For example, an employee may be assigned to oversee the most complex projects because of his or her unique skills. Under a discretionary plan, a contractor can reward certain employees based on the contractor's subjective determination of how much value the employee brought to the company.

WE CAN HELP

Certain incentive compensation plans are treated differently from base pay for tax purposes. Our firm can help you explore what type of plan may make the most sense for your company and help ensure it complies with all relevant tax laws.



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DEVELOPMENTS IN TAX AND BUSINESS

TOP CONCERNS AMONG CONSTRUCTION COMPANIES

What are the issues that keep owners and executives of construction companies awake at night? Fifty-six percent of construction businesses said they worry most about medical cost inflation and legal liability, according to the *2016 Travelers Risk Index* report. Rising employee benefit costs were cited by 53% as a top worry while 50% identified broad economic uncertainty as their major concern. Attracting and retaining talent (48%), employee safety and workplace violence (46%), legal and

regulatory compliance (44%), and cyber risk/data breaches (41%) were the other construction business concerns identified in the survey.

EMPLOYEE ELIGIBILITY TO WORK

Beginning January 22, 2017, employers must use the 11/14/2016 N version of Form I-9, *Employment Eligibility Verification*, to verify the identity and work eligibility of every new employee hired after November 6, 1986. The new form must also be used for the reverification of expiring employment authorization of current employees (if

applicable). Employers who fail to use the new form on or after January 22, 2017, may be subject to penalties.

CAN WE SERVE YOU?

Our firm provides a broad range of accounting, auditing, tax, employee benefit, and management consulting services to contractors.

The general information provided in this publication is not intended to be nor should it be treated as tax, legal, investment, accounting, or other professional advice. Before making any decision or taking any action, you should consult a qualified professional advisor who has been provided with all pertinent facts relevant to your particular situation.