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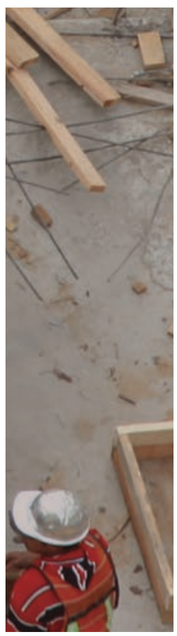

Year-end tax planning

Work Opportunity Tax Credit could solve two problems

A holistic approach to fraud prevention

5 change order pitfalls to avoid

Digitize your supply chain to better manage risk

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Year-end tax planning

WORK OPPORTUNITY TAX CREDIT COULD SOLVE TWO PROBLEMS

For contractors, the struggle to find skilled workers — and in some cases any workers at all — is real. It's a long-standing industry problem that's been exacerbated by the pandemic because many of those who lost jobs in 2020 haven't returned to work or have moved on to other vocations.

One way construction companies can widen their hiring pools while potentially qualifying for a valuable tax break is to complete the eligibility requirements for the Work Opportunity Tax Credit (WOTC).

Amounts and basic rules

The WOTC is designed to incentivize employers to hire employees from "targeted" groups made up of typically disadvantaged individuals. The tax break can be worth as much as $2,400 for each eligible employee hired and even more in other cases. For example, the WOTC can be worth $4,800, $5,600 or $9,600 for certain veterans, and $9,000 for long-term family assistance recipients. (We'll explain how below.)

> The maximum credit available for first-year wages is $2,400 for most eligible employees.

The credit is generally limited to eligible employees who begin work for the employer before January 1, 2026. An employer is typically eligible for the credit only for qualified wages paid to members of one or more of 10 targeted groups: 1) qualified members of families receiving assistance under the Temporary Assistance for Needy Families program, 2) qualified veterans, 3) qualified ex-felons, 4) designated community residents, 5) vocational rehabilitation referrals, 6) qualified summer youth employees, 7) qualified members of families in the Supplemental Nutrition Assistance Program, 8) qualified Supplemental Security Income recipients, 9) long-term family assistance recipients, and 10) qualified long-term unemployed individuals.

There's also a minimum requirement that each employee must have completed at least 120 hours of service for the employer. The credit is unavailable for certain employees who are related to the employer or work more than 50% of the time outside of the employer's trade or business. (One example of this is someone working as a maid in the employer's home). Additionally, the credit is generally unavailable for employees who have previously worked for the employer.

How to calculate

For employees other than summer youth workers, the credit amount is calculated under a basic set of rules. The employer can account for up to $6,000 of first-year wages per employee ($10,000 for "long-term family assistance recipients"; $12,000, $14,000 or $24,000 for certain veterans). "First year" refers to the year-long period beginning with the employee's

OTHER WAYS TO MITIGATE THE SKILLED LABOR SHORTAGE

The Work Opportunity Tax Credit offers construction companies a tax-saving incentive to expand their search for labor to often underserved groups. There are, of course, other ways to address this ongoing challenge.

The adage "money talks" still applies to some extent. Look into whether your compensation rates and benefits are as competitive as possible. Use benchmarking data to compare your offerings to those of similar businesses.

You may also be able to mitigate the skilled labor shortage through shrewd project management. See whether you can adjust job scheduling to distribute skilled labor more easily and evenly. Consider alternate project delivery methods as well. For example, integrated project delivery actively seeks to maximize efficiency — including labor usage.

first day of work; "second year" is the year that immediately follows.

If the employee completed at least 120 hours but less than 400 hours of service for the employer, the wages accounted for are multiplied by 25%. If the employee completed 400 or more hours, all accounted-for wages are multiplied by 40%.

Thus, the maximum credit available for first-year wages is, as previously noted, $2,400 ($6,000 × 40%) for most employees. However, a $4,000 credit ($10,000 × 40%) can be calculated for some long-term family assistance recipients. And an employer may be able to calculate credit amounts of $4,800, $5,600 or $9,600 ($12,000, $14,000 or $24,000 × 40%) for certain veterans.

In addition, for long-term family assistance recipients, a 50% credit may be available for up to $10,000 of second-year wages, resulting in a total maximum credit, over two years, of $9,000 ($10,000 × 40% plus $10,000 × 50%).

For summer youth employees, the rules in the preceding paragraph apply, except that the employer can account for only up to $3,000 of wages. These wages must be paid for services performed during any 90-day period between May 1 and September 15. So, for summer youth workers, the maximum credit available is $1,200 ($3,000 × 40%) per employee.

Certain limits apply

Three primary limits apply to claiming the WOTC:

1. No deduction is allowed for the portion of wages equal to the amount of the credit determined for the tax year,
2. Other employment-related credits are generally reduced with respect to an employee for whom a WOTC credit is allowed, and
3. The credit is subject to the overall limitations on the amount of business credits that can be taken in any tax year. (However, a one-year carryback and 20-year carryforward of unused business credits is allowed.)

Because of these three limits, there may be circumstances under which an employer might elect *not* to have the WOTC apply. Also, there are some additional rules that, in limited circumstances, prohibit the credit or require an allocation of the credit.

Explore the option

Construction companies need employees — preferably skilled, though you may be able to train or "upskill" a worker with the right programs in place. Contractors also need tax breaks to reduce their tax bills and keep the cash flowing. The WOTC represents an opportunity (no pun intended) to solve both problems. Contact your CPA for more information. ■

A HOLISTIC APPROACH TO FRAUD PREVENTION

Most experts would agree that the best way to minimize fraud at any company, including a construction business, is to take a holistic approach. As the owner, you must set the tone at the top regarding a zero-tolerance, fully vigilant approach to stopping fraud. Then you need to permeate the organizational culture with strong values, ethics and controls.

Identify risk

The first significant challenge is understanding where and how you're at risk for fraud. Be specific and realistic. Your vulnerabilities aren't necessarily the same as those of similar-sized businesses or even of your close competitors in construction. You may, for example, already segregate duties in your purchasing department, while your competition may have stopped with password protections.

Examine your risks objectively. The question isn't whether your long-time bookkeeper would embezzle funds; the question is whether he or she could. When assessing threats, consider both internal and external opportunities for malfeasance and how employees at any level of seniority could work alone or in concert to exploit them.

Once you've performed a thorough review of your construction company's existing practices, consider the overall costs of your primary risks — including the consequences and long-term impact of letting them go unaddressed. Recognize that risk management is more than buying insurance; it's working to ensure that you don't need insurance because you're taking steps to close gaps that fraudsters could exploit.

Build defenses

Next, turn your attention to preventive strategies. If you don't have a written code of ethics and business conduct, now's the time to develop both. As mentioned, fraud prevention begins at the top — with a clearly communicated commitment on the part of ownership and management. It isn't enough that you have a code of ethics; you must be seen following it.

Then look at your internal controls. Did you consider fraud prevention when you designed them? If not, re-evaluate the controls with an eye on closing possible loopholes. Policies to consider implementing or reviewing for efficacy include *segregating* financial and accounting duties *while* duplicating sensitive tasks such as double-signing checks over certain amounts. You should also regularly reconcile bank accounts and perform both internal and external audits that include fraud detection measures.

Of course, you shouldn't go it alone. Train trusted in-office supervisors or managers to spot fraud and do the same for on-site project managers. It's important, however, that you don't allow employees to create and manage fraud policies all by themselves. For instance, if your IT staff devises its own security measures, someone outside the department should determine whether the measures are appropriate and being followed adequately.

Allocate resources

Once you've determined your areas of risk and ways to address them, you may discover that you can't do everything at once. If so, set priorities so you can allocate resources optimally.

Understand that not all risk is created equal. Some risk has the potential to cause damage that would ripple throughout the company but, viewed objectively, is highly unlikely to occur. Fraudulent financial reporting, for example, can ruin a business. However, as long as your financial statements are properly generated and regularly audited by a third party, it's more difficult to perpetrate today than it was decades ago.

Other potential problems may do less damage, but there's a much better chance that they'll happen. An overworked bookkeeper with a heavy mortgage could easily, for example, exploit operational loopholes to embezzle money. In deciding how best to allocate your fraud prevention resources, assess the probability of different risks, rather than simply their size.

Finally, set up a continuous monitoring system that will allow you to track and adjust controls as changing circumstances require.

Remain vigilant

Fraud risk management can't be a one-time or even once-in-a-while activity. Construction business owners must constantly evaluate their existing controls, comparing them with legal, regulatory and best practice standards. Don't let your guard down! ■

5 CHANGE ORDER PITFALLS TO AVOID

Change orders can lengthen a project's schedule and increase labor and material costs. Of course, they can also mean a more profitable job if the change is approved and paid for. When the process doesn't go smoothly, however, you risk not getting paid on time — or at all — for the extra work. Here are five common pitfalls to avoid:

1. Poorly defined scope of work. Among the most common causes of disputes is uncertainty over what's considered within or beyond the job scope. In preconstruction meetings, review the contract (and building plans). Sometimes contractors assume a contract is "boilerplate," only to later learn that it includes language well outside the normal scope of a certain type of job. Don't hesitate to submit requests for information to clarify vague language.

2. Owner won't pay for changes because of inaccurate plans. Sometimes bid documents state that the contractor is responsible for all field measurements and building applications. In turn, project owners interpret this language to mean the contractor assumes responsibility for all costs when changes arise related to these elements. Unless you drew up the plans, think twice before taking on any job for which you're responsible for field measurements and building applications.

3. Contracts limiting markups on change orders. Many owners want to discourage contractors from submitting low bids and overcharging on change orders later. However, contracts that limit maximum overhead and profit markup percentages can prevent a construction company from generating the revenue needed to cover its costs — especially when changes substantially add to project specifications.

Ideally, you should never sign an agreement that restricts you from making changes on a job without your full markup. At the very least, try to avoid agreements that limit you to "cost" or "cost plus 10%."

4. Undocumented changes. It can be tempting to rely on verbal agreements and submit change orders later. However, you risk submitting a change too late in the project to obtain approval or forgetting to submit it altogether. Without documentation, project owners can reject the validity of the extra work and refuse to pay for it.

Be sure your project managers are following a formal change order process. This typically means first notifying the owner in writing that extra or different work is required. Then, before performing the work in question, submit the change order paperwork and accompanying documentation along with a request for written authorization from the owner. Follow this process even for changes requested *by* the owner.

5. Unaddressed/delayed change orders. Some owners keep a long, readymade list of reasons to reject a change order. Others will simply sit on a change order for weeks, hoping the contractor will forget about it, give up on it or settle for a lower payment just to get the job over with.

If you haven't done so lately, review the language of your proposals. They should include a clear invoice submittal process with a payment schedule. Consider verbiage stating that, if a change order isn't approved or denied within a certain period — say, three to five days — you'll assume it's been approved. (Ask your attorney to review the language before using it.) ■

DIGITIZE YOUR SUPPLY CHAIN TO BETTER MANAGE RISK

Supply chains in the construction industry are often complex and difficult to manage. The bigger the project, the more players involved and the longer and more intricate the supply chain.

The COVID-19 pandemic and subsequent materials shortages have strained supply chains over the past year or so. More recently, a growing number of high-profile cyberattacks have threatened to disrupt supply chains (at least temporarily) in nearly every industry — including construction.

These heightened risks and uncertainties require high-level, real-time visibility into a company's supply chain — from beginning to end. This is difficult to achieve with simple spreadsheets or certainly old-fashioned paper documentation. That's why more and more construction businesses are digitizing their supply chains to improve oversight, increase efficiency and manage risk.

Handling the chain

Generally, construction companies are automating three key business areas:

- Procurement,
- Accounts receivable, and
- Inventory management.

To do so, they're adopting the technological tools necessary to better communicate and coordinate with all parties along each project's distinctive supply chain, from the project owner to the designers to the contractor and subs to the actual suppliers.

One such tool is supply chain management (SCM) software. Also known as logistics software, SCM solutions help manage how and when equipment, materials and services are procured. Although more prevalent in other industries, SCM software is making its way into construction, doing the hard work of tracking the many parts of a project's supply chain and often providing a digital platform that all parties can use to view the same data.

Managing the risk

For more in-depth supply chain monitoring, another tool to consider is supply chain risk management (SCRM) software. You can use SCRM solutions to ensure you're working with vetted suppliers and subcontractors who have the proper insurance, training and qualifications. Typical features include:

Contractor/supplier assessments. Create standardized assessments and customize question weights and thresholds based on relevance.

Risk management. Monitor suppliers and sites, configure risk scores, get critical failure points, and track risk-mitigation progress.

Mapping. Visualize your supply chain using maps, assess potential vulnerabilities and prioritize supplier workflows.

Event monitoring. Track events across the supply chain and create "what if" scenario modeling. Users can load sites and points of interest, and monitor local impacts via news outlets, social media and regulatory agencies.

Adding people

On the human side of things, some construction companies are hiring supply chain managers with educational backgrounds and experience focused on the distinctive challenges of this area. Although investing in new employees and software is costly and should be done with great care, maintaining a strong supply chain is imperative in today's business environment. ■

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About Wouch, Maloney & Co., LLP

Wouch, Maloney & Co., LLP is a regional certified public accounting firm with offices in Horsham and Philadelphia, Pennsylvania and Bonita Springs, Florida. The firm has provided closely held business and individual clients with a wide array of accounting services for over 30 years. Wouch, Maloney & Co.'s domestic, multi-state and international clients reflect a broad range of industries from real estate and construction to manufacturing, wholesale and professional service. The firm offers a comprehensive group of services including tax, audit and accounting, business consulting, estate planning, business valuation, litigation support and forensic accounting.

Serving the Construction Industry

Wouch, Maloney & Co., LLP prides itself on its niche practice in the construction industry. The majority of our clients are involved in construction and we are adept at recognizing and solving problems common to that industry. For over thirty years, we have represented contractors along with commercial and home builders in Pennsylvania, New Jersey and Florida.

- We develop **relationships with lenders and bonding agents** and understand how to present your financial picture in their preferred format.
- We assist you in **keeping a close eye on debt, cash flow, profit margins** and other measures of financial health.
- We prepare **contracts in progress** schedules that management can understand which clearly illustrate gross profit, job costing and over/under billings per job.
- We have highly trained staff with **expertise in construction accounting** who are detail oriented, but who do not lose sight of the larger goal which is to provide our clients with quality services to meet their many financial needs.

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