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BUILD UP YOUR DEFENSES

9 cash-flow strategies to combat inflation

Rising inflation is on every business owner's radar — and contractors are no exception. Although you obviously can't control where the national economy goes, much less what happens globally, you can build up your defenses to rising costs by maintaining a strong cash flow.

Tools to deploy

Construction business owners have a wide variety of tools they can deploy to stabilize or improve cash flow in both the short and long term. Here are nine strategies to consider:

1. Formalize your approach to billing. Setting and adhering to a formal billing schedule that helps ensure prompt billing can reduce lags in the receipt of payments. Where feasible and appropriate, look at your billing *method* as well.

For example, if you haven't already, consider progressive invoicing. This is where you bill as phases of work are completed, rather than waiting until project completion. Just bear in mind that progressive invoicing will call for strong communication between project managers and the billing department.

2. Establish a payment schedule. Stick to a regular schedule for paying your own bills, too. Paying early may be virtuous, but you could create a negative cash-flow situation if prices have risen and you don't have revenue coming in to cover early payments.

Of course, you don't want to pay late and suffer penalties, interest or damaged vendor relationships either. So, pay on time generally and pay early only if it's feasible and perhaps qualifies you for a discount.

3. Require some upfront payment. Construction businesses often incur costs before work gets underway. For some projects, you might want to start requesting an advance payment from project owners. Otherwise, you could end up in the hole when your bills come due because of rising prices. Alternatively, under some contracts, you may be able to have the vendor bill the owner directly for certain materials and supplies.

4. Work retainage into your budget. As you're no doubt aware, retainage remains a relatively common practice in the construction industry. Yet some contractors fail to account for it in their budgeting. This can lead to cash shortfalls when overhead, indirect costs or other expenses come due. Be sure to accurately allocate retainage amounts in your job budgets.

5. Think twice before stockpiling inventory. With ongoing shortages in critical supplies and materials, many contractors are buying in bulk when they can. After all, no one wants to delay bidding

ENVISION THE FUTURE WITH CASH-FLOW FORECASTS

You probably already prepare a statement of cash flows as part of your construction company's financial statements. Although valuable, this statement provides only a historical snapshot of your cash position at the time.

To get advance warning of cash shortages, as well as to perhaps enjoy the pleasant surprise of an unexpected surplus, regularly perform cash-flow forecasts. Armed with this knowledge, you can preempt problems meeting your payment obligations or, on a brighter note, explore how a potential investment of extra dollars might work out.

Say you've had your eye on a new vehicle or piece of equipment. Accurate forecasting can give you a clear idea of how much more revenue you'll need to bring in to cover the payments without compromising your overall cash position.

Be forewarned, however, that cash-flow forecasting for construction companies tends to be more complicated than it is for other types of businesses because of the variable nature of projects both current and future. Your CPA can help.

on or starting a project simply because supplies or materials are unavailable.

However, stockpiling can take a serious bite out of your cash flow — especially when it comes with carrying costs. This doesn't mean you should reject the idea, but plan purchases carefully and assess the risks.

6. Encourage early payments. General contractors have two basic motivational tactics to prompt timely or even early payments from owners: late penalties and early bird discounts. The latter are more customer-friendly, but will mean less revenue coming in. The former could increase the odds of payment disputes. Either way, ensure your contracts and invoices state payment terms clearly.

7. Develop a formal change order management system. Properly handled change orders can mean a more profitable job if you can contain the costs. Don't manage change orders on an ad hoc basis. Establish a formal system to expedite the process of creating, processing and receiving the added payment for a change. The system should dictate the timing and steps to collect necessary documentation and obtain owner approval.

8. Finance purchases. From a cash-flow perspective, you're generally better off financing equipment, materials and even insurance. You'll have more cash on hand and could be able to deduct interest payments at tax time. Naturally, you still must keep an eye on your debt load.

9. Don't put off tax planning. While juggling multiple projects throughout the year, taxes probably aren't top of mind. A lackadaisical approach to tax planning, however, can hurt you. A hefty tax bill could seriously inhibit cash flow when you least expect it. Work closely with your CPA to incorporate tax planning into your strategies for managing cash flow.

Always vital

As the construction sector continues to adjust to changes wrought by the pandemic and events overseas, one thing remains clear: A strong cash flow is and always will be vital to running a successful business. Implementing some or all of the measures described above, as well as others specific to your operations, should help protect your construction company from the economic storms ahead. ■

MANAGING YOUR EXPOSURE TO SALES AND USE TAXES

Like many business owners, contractors tend to focus most of their tax-related attention on federal, state and local income tax liability. However, if your construction business operates in other states, there's something else you should keep an eye on: sales and use taxes.

Landmark decision

More than four years ago, the U.S. Supreme Court issued a landmark decision in *South Dakota v. Wayfair*. The Court ruled that a state may require out-of-state sellers to collect and remit sales tax if they have an "economic nexus" with the state. Previously, states were limited to imposing sales tax collection obligations on sellers with a physical presence in the state.

Economic nexus laws impose sales tax collection obligations on businesses that exceed certain sales thresholds in a state, regardless of physical presence. The South Dakota law upheld in *Wayfair* applied to businesses with more than $100,000 in annual sales or more than 200 separate annual transactions in the state.

Today, nearly every state with a sales tax has followed suit, though the annual sales and number-of-transaction thresholds for establishing economic nexus vary dramatically from state to state. For example, some states require sales as high as $500,000; others base nexus only on sales, regardless of the number of transactions. Still others require businesses to meet both sales and number-of-transaction thresholds.

What contractors should know

For construction businesses, managing sales and use taxes can be challenging. Generally, you're treated as the consumer of materials that you use on your jobs. Thus, you either pay sales tax to your vendors or, for out-of-state vendors that don't collect sales tax, you self-assess use tax and remit it to the state. You probably don't typically collect sales tax from the owners you contract with.

As with most general rules, however, there are exceptions. For instance, some states treat contractors as retailers of certain materials. In such cases, you buy the materials tax-free under a resale exemption and collect sales tax from the owner. Examples can include appliances, window treatments, window air conditioning units and carpeting. Some business fixtures treated as personal rather than real property might qualify for this treatment as well.

A few states impose sales tax on specified construction services, requiring contractors to pay sales tax on their materials and collect sales tax from customers. And in others, the sales tax treatment depends on the type of contract. With a lump-sum contract, for example, the state treats the construction company as the consumer of materials incorporated into the real estate.

However, with time and materials contracts, in which material charges are itemized separately from labor and other charges, the state views the construction business as a retailer. This allows the builder to buy materials tax-free for resale but requires it to collect sales tax from the owner.

In many states, certain types of entities — such as schools, hospitals and nonprofits — are exempt from sales tax. In some of these states, the exemption "flows through" to the construction business. That means the contractor can buy materials tax-free under an exemption certificate for use on a project involving an eligible entity. However, in other states, the exemption is available only if the entity itself buys the materials.

How to protect yourself

Because of *Wayfair*, contractors need to understand the sales and use tax rules in states where they operate. Be prepared to issue resale or exemption certificates to your vendors — or have exempt owners buy materials directly, if necessary — to take advantage of the sales tax exemptions available.

In addition, look closely into how the contract types that your business usually operates under affect your sales and use tax obligations. Consider those obligations when developing bids. Finally, if your construction business buys building materials, supplies, equipment and other items in several states, consider conducting a reverse sales-and-use tax audit.

Keep on truckin'

If out-of-state projects beckon, don't let sales and use taxes alone stop you from pursuing these opportunities. Your CPA can help you understand and manage your exposure. ■

OCCUPATIONAL FRAUD CONTINUES TO HIT CONSTRUCTION HARD

Construction ranks among the top five industries with the highest median losses from fraud, says the Association of Certified Fraud Examiners (ACFE). The organization's "Occupational Fraud 2022: A Report to the Nations," reviewed 2,110 of the largest occupational fraud cases investigated in 2020 and 2021 across 133 countries and 23 industries.

Occupational fraud generally refers to the type of fraud committed by employees. It's arguably the most common and most costly financial crime affecting companies around the world. Below are a few key takeaways for construction company owners from the report.

Fraud in the industry

Among the most common fraud cases found in construction, more than half were the result of corruption (56%). This is when an executive or employee influences a business transaction to gain direct or indirect benefits. Such schemes can include bribery and conflicts of interest.

Billing, payroll and "noncash" schemes each accounted for approximately one-quarter of construction fraud cases (24%). Billing schemes can include invoices for fictitious goods or services not rendered, invoices with inflated prices, or invoices submitted for personal expenses.

Payroll schemes include payments issued for false claims of compensation (such as overtime hours not worked) or to nonexistent "ghost" employees. Noncash misappropriations refer to stolen or misused equipment, inventory and even confidential customer information.

Other types of fraud included cash-on-hand misappropriations or cash larceny (18%), manipulated financial statements (18%) and expense reimbursements (17%), and check and payment tampering (14%). The lowest instances of occupational fraud in construction were skimming (9%) and register disbursements; that is, false entries made on a cash register to conceal fraudulent removal of cash (3%).

Antifraud measures

According to the ACFE report, nearly half of fraud cases occurred because the organization either lacked internal antifraud controls (29%) or had controls in place that were overridden (20%). Fraud losses were two times higher at companies without a fraud-reporting tip hotline.

Carefully review monthly financials for signs of trouble.

The study found that job rotation/mandatory vacation policies and surprise audits of financial statements can cut losses by half — yet those two antifraud controls were the least common strategies implemented across the organizations. Other measures that quicken fraud detection and prevent losses include proactive data monitoring and analysis, as well as formal fraud risk assessments.

Warning signs

The following behaviors or circumstances were identified as red flags that an employee might be committing fraud:

- Living beyond one's means,
- Financial difficulties,
- Unusually close associations with vendors or customers,
- Control issues, such as an unwillingness to share job duties,
- Irritability, suspiciousness or defensiveness,
- Use of bullying or intimidation tactics,
- Divorce or family problems, and
- A "wheeler-dealer" attitude.

In addition to implementing the antifraud measures already mentioned, if you haven't already, carefully review monthly financials for signs of trouble. Also, delegate job responsibilities directly related to money — such as accounts receivable, accounts payable and payroll — to more than one employee so no one has complete control over them.

Catch it early

Motivation to commit occupational fraud has increased since the start of the COVID-19 pandemic. And smaller construction companies are as much at risk as larger ones. Early detection is critical. According to the ACFE report, most occupational fraud schemes typically last at least a year before they're uncovered. ■

IS IT TIME TO HIRE A CONSTRUCTION TECHNOLOGIST?

There's little remaining debate about the importance of technology in construction. It's everywhere — from building information modeling to virtual design and construction to cloud-based project management software and mobile apps.

As digital options grow and become more integral to the work, who can build and manage your company's technological ecosystem? Perhaps a construction technologist.

Closing the gap

A construction technologist is a management-level employee who combines top-flight tech competency with a demonstrated, practical knowledge of construction processes. This dual expertise allows the person to lead efforts to research, procure, test and launch new systems and software that best fit your operations.

The job description of a construction technologist tends to vary based on a construction business's distinct needs. It may include monitoring the technology budget, addressing pain points experienced by office and field staff, and finding opportunities to increase efficiencies. It could also call for assessing technology providers to explore new opportunities and overseeing integration of new hardware and software into existing systems.

Justifying a new position

Hiring a high-level employee like this is a weighty executive decision. Construction technologists typically command a substantial salary plus benefits. Deciding whether the position is worth adding to your company will depend on your strategic goals and capacity for growth.

A good first step is to review your technology use. You can do this by forming a committee comprised of company leadership and your most tech-savvy employees. Provide the committee with a list of questions to answer, such as "What are our tech priorities?" and "How do we expect our operations to change in the next three to five years?"

You should also look at your current pain points. What systems, software and apps do you currently use? How often do you use them? What's working — that is, saving you time and money — and what's not?

From there, explore the likelihood that better solutions are available. If so, why aren't you using them? They might be difficult to identify, or you could doubt your ability to choose the best product and implement it properly.

Your committee may find that your current tech solutions and capabilities to improve them are sufficient or just need some enhancement. On the other hand, it could discover a deeper need for understanding and managing technology. In the latter case, hiring a construction technologist might be worth the investment.

Pushing tech to the forefront

If you want to push tech to the forefront of your company's strategic plan, a construction technologist could play an integral role in meeting that objective. However, as mentioned, you'll need to be sure the investment will pay off. ■

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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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