ON-SITE

Spring 2013

The calm before the storm

Preparing for possible health care coverage penalties

The Patient Protection and Affordable Care Act was big news when signed into law in 2010. And the act got its fair share of play this past year, with the U.S. Supreme Court's decision upholding most of its provisions and as a hot topic of debate in the presidential election. But you may not have seen it talked about much on the evening news lately.

Don't let that fool you — it's just the calm before the storm. Substantial penalties are due to take effect beginning in 2014 for certain employers that don't meet health care coverage requirements. So contractors should start reviewing their workforces and evaluating the health care benefits they're providing.

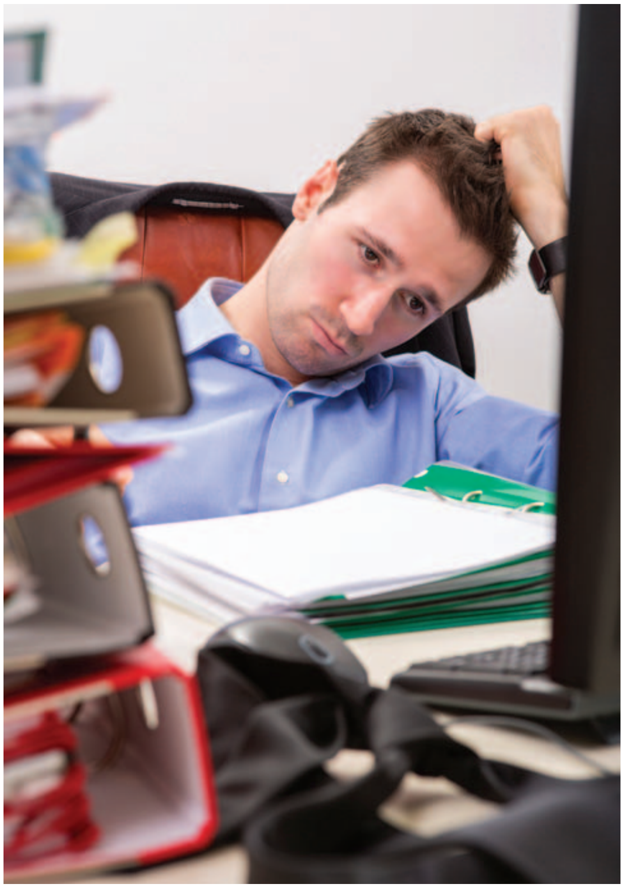
Penalties looming

The penalties in question won't affect every construction company — just any deemed a "large employer" that doesn't offer adequate or affordable health care coverage under the law's definitions. (Your CPA can provide more information on these definitions.)

Projecting your exposure to the health care act's penalties now is critical.

Here's how it will work: The health care act makes premium tax credits available to employees who fall under specified income requirements and don't have access to adequate or affordable employer-provided insurance.

If even just one employee of a large employer receives a premium tax credit, and that employer



provides at least 95% of full-time employees with coverage that doesn't qualify as adequate/affordable under the law, a penalty will apply equal to the lesser of $3,000 for each employee receiving the credit or $2,000 for each full-timer beyond the first 30 full-timers.

If the large employer *doesn't* provide health care coverage to 95% of full-time employees, the penalty will be $2,000 for each full-timer beyond the first 30 full-timers.

Workforce review

So will your construction company be deemed a large employer? Yes, if it employed 50 or more full-time-equivalent employees (FTEs) in the preceding calendar year — that means 2013.

FTEs include full-time employees, defined as those who work 30 or more hours weekly, excluding — and this is key for contractors — seasonal workers employed for fewer than 120 days per year. But the FTE number also takes into account part-time workers. This requires totaling their hours of service for a given calendar month and dividing that figure by 120.

For instance, a construction company with 30 part-timers who average 100 hours per month would have 25 FTEs ($30 \times 100 = 3{,}000$; $3{,}000/120 = 25$) who must be added to the number of full-timers to determine whether the 50-FTE threshold has been crossed.

The uncertain state of exchanges

Among the most prominent provisions of the Patient Protection and Affordable Care Act is the establishment of government-run "exchanges" — online marketplaces where:

- Individuals can buy health insurance if they don't receive adequate/affordable coverage from their employers, and
- Small businesses can buy a health care plan if they can't afford to buy on the private market.

If you're thinking that your construction company may go this route, keep an eye on how the exchanges, all of which are supposed to be established by the end of this year, are coming along. The answer so far: Quite slowly.

State governments were meant to establish and run the exchanges. But the federal government agreed to launch and handle them in states that couldn't (or wouldn't) set one up. As of this writing, it's looking like the federal government will be running at least 50% of exchanges nationwide — a much higher percentage than was expected.

Strategic moves

Projecting your exposure to the health care act's penalties now is critical to determining whether you'll want to make changes to your workforce or benefits coverage.

If the coverage you currently offer already meets the act's adequacy and affordability standards and you plan to offer the same coverage next year, you have nothing to worry about. Likewise, if you don't have anywhere near 50 FTEs, you needn't worry about the penalties.

But, say your construction company sits on the border of the 50-FTE threshold, and you don't provide coverage or your coverage doesn't meet the adequacy or affordability requirements. In this case, you may opt to reduce the size of your staff and start engaging more independent contractors (keeping in mind that the IRS actively pursues employers that it believes have misclassified employees as independent contractors) or using more seasonal workers.

If you can't reasonably reduce your workforce to avoid large-employer classification, you'll need to compare the cost of enhancing your health care coverage with the expense of paying the penalties. Bear in mind, health care coverage costs generally are tax-deductible while the penalties aren't.

The health care act requires employers to annually determine whether they'll be considered a large company for the following year. The good news is that 2014 is a transitional year, for which you generally may use any six-consecutive-month period in 2013 to perform your FTE calculation. So you could choose six months early in the year and then use the rest of 2013 to plan your workforce or coverage adjustments.

An important issue

Health care coverage is no longer an ancillary issue to running a construction company. The health care act has made it an important part of doing business that could bring considerable risk and expense if not monitored carefully.

Checking up on your construction company's estimates

How do construction businesses lose money? One typical and often-overlooked way is a drastically faulty or even slightly inaccurate estimate. Although estimating is no doubt one of your "bread and butter" skills, accuracy can slip over time if you don't occasionally check up on this mission-critical process.

Methodical review

The first thing to review when looking at your estimates is how they're being generated. Estimating methods tend to fall into two categories: fixed price and approximate.

Because they incorporate detailed information, fixed-price estimates are typically the most reliable method. Of course, as you well know, the contractor bears a bigger portion of the risk than the owner does because the job is set at a fixed price — even if costs rise higher than expected.

Many construction companies prepare fixed-price estimates on a lump-sum basis. That is, estimators compile a job's price after closely analyzing drawings, specifications and other bidding documents. They then calculate the costs of material, labor, equipment, subcontractors, overhead and other job-related expenses before applying a markup to the total cost to obtain a lump-sum estimate.

You may also produce fixed-price estimates on a unit-price basis. Here, you submit the bid based on the individual line items. As with a lump-sum estimate, the result determines the total project cost. Your estimator, however, segregates expenses according to each line item's unit price.

The second method — an approximate estimate — is a shortcut that gives you only a rough idea of a project's cost. Estimators primarily look at expenses derived from previous jobs, refining their figures as they learn more project specifics.

Over a selected period — one calendar year is sufficient, though a two- to three-year sample size is best — look at how your construction company's estimates were generated. Are too many approximate estimates creeping in and hurting profitability? Are your fixed-price estimates using updated materials costs and realistic labor data?

Beneficial software

Estimates are math — and the more complex the calculation, the more likely it will account for the many variables involved. Failing to apply an evolving profit margin calculation algorithm can reduce the value of jobs over time.

For example, if you estimate profitability on a flat, 10% sales price across most projects, you could lose money as changes and delays occur. Breaking down costs more specifically can prevent such losses. And there's no better way to do so than with today's estimating software.

Construction-specific estimating applications reduce errors and create a historical database to help you refine procedures and generate more accurate data for future projects. They can also relieve much of the drudgery associated with routine, repetitive and time-consuming calculations. So make sure your software is up to date.

The people factor

Your first and last line of defense in generating accurate estimates is the people doing the job. When reviewing estimators' performance or when hiring new ones, make sure you're employing professionals who can visualize project phases in great detail. They should also have:

- Good organizational and communication skills,
- A thorough knowledge of construction materials, processes and software, and
- The ability to understand today's more detailed drawings and specification documents.

No matter how skilled your estimators or what methods they use to prepare bids, it doesn't hurt to have another party occasionally check their work for accuracy. This person could be you, a project manager or even an outside consultant. When reviewing estimates, verify that the projected gross profit of each job is in line with your profitability objectives and the current bid market.

Make sure you're employing professionals who can visualize project phases in great detail.

To help ensure accurate reviews of estimates, encourage estimators to work transparently. No matter how experienced the estimator or accurate the estimate, you must know how he or she arrived at the quoted job price.

Balancing act

Construction estimates are a tricky balancing act. Your estimators need to account for the company's need to generate profits while respecting each customer's desire to pay a reasonable price. Regularly reviewing and, if necessary, adjusting your estimating process is an important risk management task. ☒

Phantom stock plans can draw profit leaders

Like most contractors, you're probably always looking for a way to break through to that higher level of profitability. Although you should never stop trying, the answer may lie in a person, not an idea. One way to draw profit leaders to your business — or keep ones who are already on staff — may be offering select employees additional incentive in the form of a phantom stock plan.

Equity stake

The concept behind a phantom stock plan is relatively simple: offering certain employees an equity stake in your construction business without actually transferring any stock to them.

Instead, you allocate a number of shares in the designated employee's name and pay that individual the increase in value of those shares at an agreed-on time. That plan "participant" doesn't buy any stock or receive a stock certificate — thus the name *phantom* stock plan.

There are various ways of establishing share value. These include:

- Using the company's book value as a starting point,
- Estimating the fair market value of each share, and
- Engaging an appraiser to independently value the business.

Once established, the value of a participant's shares should increase as his or her presence bolsters your construction company's bottom line. The participant would then receive payment for the increased share value at the time specified under the plan. This could be at a fixed date or in installments over several years, or perhaps only on retirement or the sale of the company.

A phantom stock plan can help you to attract and retain the best employees without having to pay drastically above-market salaries.

From an accounting perspective, you record the shares as a bookkeeping entry. Appreciation is charged to earnings and expensed out annually over the plan's duration. Your company receives a tax deduction only when it pays a participant for an increase in share value. And the participant recognizes income only when funds are received.

Benefits and risks

The primary benefit of a phantom stock plan is that it can help you to attract and retain the best employees without having to pay drastically above-market salaries.

By tying participants' personal financial success to that of your construction business, the arrangement also helps you to motivate key employees to do what they can to boost profitability. Meanwhile, they can earn additional income without the risks associated with buying stock.

Naturally, there are dangers to phantom stock plans. Your cash flow will likely take a major hit when a participant receives his or her payout. You'll also be exposing yourself to a certain amount of legal risk should a dispute arise. In addition, there will be soft costs associated with maintaining the plan and monitoring share value.

Last, there's a hazard of granting a phantom stock plan to someone who merely coasts along and doesn't truly contribute to the growth of your business. Participants must be carefully vetted.

Not for everyone

Phantom stock plans aren't for every contractor. But one could help you find the profit leaders you've been looking for (or keep ones already in-house). If you're interested, discuss the idea further with your financial and legal advisors.

The Contractor's Corner

How do we guard against the risk of mobile devices?

A smart phone just cost me a lot of money. I don't mean I bought one; I mean one of my employees was on the phone while driving and got into an accident. The legal fees are mounting, and I could be on the hook for an out-of-court settlement. Plus, I learned that the device in question belonged to the worker — he was using it for company purposes! How can I do a better job of guarding against these risks?

Your predicament, while unfortunate, is not uncommon in today's construction industry. Mobile devices are now about as widely used as hammers and nails. But you're actually facing two separate issues: 1) mobile device safety, and 2) the Bring Your Own Device (BYOD) phenomenon.

Safety first

When it comes to mobile device safety, you must be formal and forthcoming. Every contractor should have a carefully written, highly visible policy that addresses mobile device usage.

Specifically, it should prohibit the use of any device for voice, e-mail, texting or any other purpose while driving or operating construction equipment. The policy should also include an "engine off" provision that orders employees to pull over and park before communicating via a mobile device.

Creating such a policy, however, isn't enough. You must promote it. Have every employee sign a waiver indicating they've read and agree with the policy. Review its provisions during prejob meetings. Post signage in vehicles and on job sites. Most of all, enforce the policy when violations occur — with no exceptions.

Data dangers

Workers using their own devices for company purposes — BYOD — isn't so much a personal safety issue as a *data* safety one. An employee roaming around with sensitive company information such as bid figures and corporate bank account numbers could expose that data to theft or corruption.

In response, many businesses are implementing BYOD policies. These stipulate, for instance, that employees may use personal devices for work but, if something goes wrong, their employer may deploy a "remote wipe" that clears the entire device of data.

A BYOD policy may also require users to install specified safeguards on their devices (such as password locks). It may even oblige employees to inform the company when they're going to discard a device so the employer can verify it's been cleared of sensitive data.

Fully rounded policies

We hope this gives you some ideas for mitigating the risks of your — and your employees' — mobile devices. Your attorney and business advisors can help you craft fully rounded policies for both mobile device safety and BYOD.