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Recognize this

New accounting rules for contracts are coming soon

Last year, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2014-09, *Revenue from Contracts with Customers* (Topic 606). For construction companies that follow U.S. Generally Accepted Accounting Principles (GAAP), this was a significant development that will likely grow in importance over the next couple of years.

What's happening here?

For decades, external parties with a vested interest in companies' financial statements have had to deal with a confusing multitude of industry-specific revenue-recognition approaches. For contractors, such external parties largely include lenders and sureties.

The new rules are intended to eliminate such inconsistencies and improve financial statement comparability. To do so, ASU 2014-09 establishes five steps to follow when determining the proper time to recognize revenue on your financial statements:

1. Identify the contract. The guidance applies to each contract that a company has with a customer. In some cases, two or more contracts might be combined for financial reporting purposes, so it will be critical to identify these situations. Helpfully, the rules do address change orders. (See "Accounting for change orders under ASU 2014-09" on page 3.)

2. Define the company's performance obligations. This is a critical concept of the new rules. Unfortunately, as of this writing, it's not completely clear how to define a "performance obligation" in a construction context.

Typically, a contractor will treat each contract as a singular promise to do something. But, under the new standard, you may need to analyze your contracts and account for each "distinct" good or service — or bundle of goods or services — as a separate performance obligation.

3. Determine the transaction price. You'll need to determine how much you expect to be paid in exchange for transferring the aforementioned promised goods or services to the customer. Some or all contingent consideration (such as incentive payments) may be included in the transaction price and, therefore, recognized earlier than previously done. The transaction price also may require adjustment if the arrangement includes a "significant financing component."

4. Allocate the transaction price to performance obligations under the contract. In many cases, you'll have to allocate the transaction price to each performance obligation based on the relative "standalone selling price" of each distinct good or service promised.

5. Recognize revenue as performance obligations are satisfied. When you satisfy a performance obligation — that is, when the customer gains control of the promised good or service — you must recognize the revenue.

Has anything really changed?

Step No. 5 may concern you. Like most contractors, you don't typically recognize the revenue from a job all at once. You do so over time as project phases are completed — more commonly known as the percentage-of-completion method.

First, the good news: At this point in time, the percentage-of-completion approach isn't in danger of being eliminated. In fact, the methods prescribed under the new rules are generally expected to yield results similar to those of that very method.

Nonetheless, the new rules are, well, new. They still may change the timing of some revenue recognition. Generally, under ASU 2014-09, revenue is recognized over time if the customer gains control of the work as it's performed or if the contractor has no alternative use for the resulting asset and has an enforceable right to payment for work completed to date. Several factors may specify customer control, including:

- The contractor's right to payment,
- The customer's legal title to the asset, and
- The customer's possession of the risks and rewards of ownership.

ASU 2014-09 offers several ways to measure progress, including input methods (such as cost-to-cost or labor hours) and output methods (such as surveys or appraisals). Again, these are similar to the percentage-of-completion method — clear distinctions between previous guidance and this new guidance are forthcoming.

How shall we proceed?

We've provided here only a brief overview of ASU 2014-09. The new rules also expand and standardize the contractual details that must be provided in financial statements. And the guidance further delineates accounting for some costs related to obtaining or fulfilling a contract — such as whether to capitalize or expense them.

Accounting for change orders under ASU 2014-09

The number and frequency of change orders tend to differentiate construction from many other industries. They are addressed directly in the Financial Accounting Standards Board's Accounting Standards Update (ASU) No. 2014-09, *Revenue from Contracts with Customers* (Topic 606; see main article).

Under the new rules, contractors must account for a change order as a separate contract if the additional work provides a separate distinct benefit to the customer or the asset can be transferred to the customer separately from other promises in the contract. To further qualify as a separate contract, you also must increase the contract price for the standalone selling price of the additional work. If the change is combined with other related tasks and services — and doesn't provide a separate, distinct benefit — it will generally be considered part of the original contract.

Because companies haven't yet applied ASU 2014-09, specific examples of construction change orders that do or don't qualify as separate contracts are hard to come by. Work with your CPA to anticipate some distinctions based on your company's typical projects.

Ready for some more good news? You've got time. For nonpublic companies, compliance isn't required until annual reporting periods beginning after Dec. 15, 2017, though you may need to begin the implementation process a year earlier. There are also differing standards for public companies, which could affect nonpublic businesses owned by public companies. Nonetheless, if your construction company follows GAAP, now is a good time to begin determining whether and how these changes may affect you.

Recent law promotes training for skilled construction workers

The signing into law of the Workforce Innovation and Opportunity Act (WIOA) this past July didn't garner many headlines. But the act's potential impact on the construction industry is indeed newsworthy. Although it pertains to many industries, the WIOA represents a chance to do something about the skilled labor shortage that's been plaguing contractors for years.

Purpose and objectives

The law's purpose is to consolidate and enhance a wide variety of federally run job-training programs. Each of these programs must track and report the number of participants who ultimately find jobs. So there's an underlying effort not only to provide training, but also to identify the most effective approaches.

WIOA programs will look to establish on-the-job training while also helping businesses identify in-demand skills.

On a state and local level, the WIOA aims to create smaller, more agile and strategically effective workforce development boards. The boards can focus job-training programs on regional needs, such as infrastructure improvements or housing development, that drive construction projects.

The act's objective is also to support education and workforce development opportunities in the real world — not just the classroom. Some WIOA programs will look to establish on-the-job training while also helping businesses identify in-demand skills and avail workers of opportunities to build those skills.

Certain underemployed populations are targeted by the act as well. Youth program services will look to recruit and train not only young people who are in high school, but also those who aren't regularly attending classes or have formally dropped out. In addition, programs will try to connect people with disabilities to appropriate programs and, ultimately, competitive, integrated employment.

Industry impact

Upon the act's signing, the Vice President of Government Affairs for the Associated Builders and Contractors said, "WIOA is an important step toward addressing the shortage of qualified workers in the construction industry."

Indeed, according to employment projections for 2012 to 2022 by the Bureau of Labor Statistics (BLS), construction businesses may eventually face a shortfall of 1.6 million workers. Per the same BLS study, five of the 30 occupations projected to have the largest percentage increase in growth during that period are construction-related. In addition, the BLS expects jobs that generally call for an apprenticeship — which include many construction positions — to grow 22.2% in those years.

This may sound like bad news, but it's not entirely. The need for these workers is driven by something quite positive: construction industry growth. The BLS projects the construction sector will continue to grow at a rate exceeding twice that for all other industries measured. Contractors prepared for this growth can put themselves in a position to take strategic advantage of it.

Prime opportunity

The passage of the WIOA represents a prime opportunity for your construction company and hundreds of others like it. By getting involved with a job-training program and promoting awareness of such programs, you can help boost the ranks of tomorrow's skilled workforce. In turn, you'll ensure that your business will have the expertise needed to operate successfully and profitably, while the national economy benefits from a stronger rate of employment.

3 key factors in succession planning

The day-to-day demands of running a construction business can make it difficult to think about the future. And by "future," we don't mean how your tax liability will look at year end or how you might grow profits over the next decade. We're referring to the future in which you don't own your company anymore.

Succession planning is an important activity for every business owner. Moreover, it's never too early to start thinking about the general concepts involved. Here are three key succession planning factors to consider.

1. The family

You'll first need to ask whether you plan to transfer or sell the business to a family member or someone else inside the company, or sell it to an outside party.

If your children are involved in the business or there's another logical successor — someone who, with good training and sound business experience, could fill the seat behind your desk — you should start grooming that person as early as possible. Depending on the amount of support

and knowledge your prospective replacement needs, this may take several years or just a few months.

Remember, succession planning and estate planning are generally linked. So you'll want to create a clear, legally defensible ownership transfer plan while you also fund your retirement and formulate an estate plan that reasonably divides your wealth among family members who participate in the business and those who don't.

2. The buyer

If none of your family members are qualified or want to assume the mantle, there are a number of ways you can transfer ownership of your construction

company to a buyer. Who might that buyer be? There are various answers to this question.

The buyer could be your employees. Selling the company to them through an employee stock ownership plan (ESOP) is an approach used by a wide variety of businesses. The cash flow challenges faced by contractors can make this a tough sell, however.

There are also somewhat less complex options. You might set up a purchase via an internal buy-sell agreement — making your management team the buyer. Or you could simply sell to an external party, such as a private equity firm.

Each of these options has its pros and cons. An ESOP or management buyout can save you the time and expense involved in finding an outside buyer. On the other hand, if you can find the right third party, you may be able to sell your business at a premium.

To do so, you'll need to start preparing. Continually upgrade your business processes, with special emphasis on financial management and reporting. A well-run, efficient construction business will carry less risk and command a higher price.

Next, regularly estimate the market value of your company. Doing so will likely require the expertise of a professional business appraiser. The right expert will assess your business's tangible and intangible assets and project future revenue. Appraisers can also help determine whether it makes sense to sell your business intact or sell individual assets piecemeal.

3. The market

Some construction company owners overlook this factor. When you're ready to put your business on the market, will there *be* a market? Are mergers and acquisitions relatively common in your area or are they infrequent? In short, will you be able to sell when you're ready?

A well-run, efficient construction business will carry less risk and command a higher price.

Start developing a list of potential buyers, such as competitors, business associates and private equity firms, *now*. Once you've identified a few, formulate a plan for marketing your business to them. You may need to enlist the assistance of merger and acquisition specialists, such as business brokers and investment bankers, to act as a go-between with certain types of outside buyers.

Critical process

Again, these three factors are fairly general in nature. There will be many specifics regarding your construction company that you'll need to cover in your succession plan as you get closer to retirement or whatever you intend to do after leaving the business. So be sure to involve your financial and legal advisors in this critical process.

The Contractor's Corner

What's the big deal about telematics?

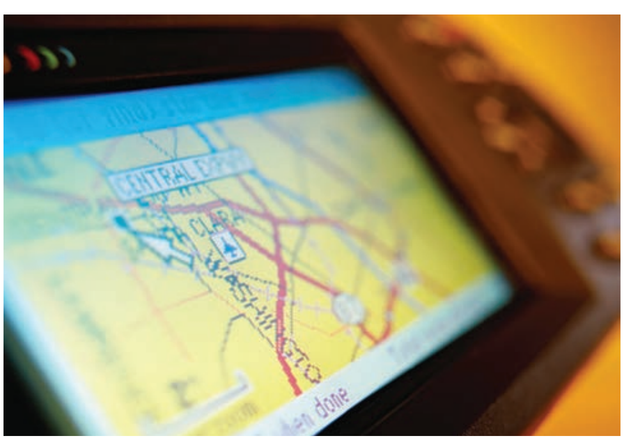
The other day, our package delivery guy pulled up outside the office. On the side of his truck, in brand-new lettering, were the words "Tracked by telematics." I asked him what that meant. "Eh, it means they're keeping a close eye on this wreck," he joked, gesturing toward his truck. As the vehicle in question roared away, I started thinking about my own fleet's skyrocketing maintenance costs. Could telematics help me?

Indeed, it could. Under a simple definition, telematics is the electronic transmission of information from machine parts to a central database. In the last few years, software developers have stepped up their games in offering systems that deliver practical data about vehicles and heavy equipment to contractors and their fleet managers.

How it works

With a telematics system, sensors are placed on key operating parts of a vehicle or piece of heavy equipment. These sensors gather usage and maintenance data and deliver it to a modem, also installed on the asset.

The modem transmits information to a software-driven database accessible at your offices or even remotely. The database then allows you to generate regularly scheduled, detailed reports about the vehicle or equipment.



Most of the modems in question can use either cellular or satellite networks. That means, even if you're operating in a far-flung location, you'll still get the info. And you'll receive regular software updates for the system just as you do for any current application.

What it does

So what good does all of that data do? Quite a bit. You're probably aware of the benefits of GPS tracking to promote effective routing, deter inappropriate vehicle use and catch thieves. Telematics also provides this; but it goes a step further.

A good system will track and deliver information regarding functions such as fuel efficiency, brake usage and engine life. So, instead of feeling as though you have to perform maintenance at certain intervals, you can incur that cost and downtime only when absolutely necessary. The software also assigns error codes to certain sensors, immediately telling you why a given asset has broken down.

No one rides for free

Naturally, the technology doesn't come free of charge. If you're serious about deploying telematics, you may want to wait until you're ready to buy new vehicles or equipment — many of which come with the pre-equipped sensors and manufacturer-provided software.

You can also engage a third-party provider to install sensors on existing assets and help you implement a fully integrated system. In either case, set a strict budget and shop carefully to ensure you'll get the desired return on investment.