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Winter 2009

Making the right choice remains critical

For contractors, the question of which accounting method to use for tax purposes has never been an easy one to answer. For starters, there's often no single right answer. Many, if not most, construction companies must choose two methods — one for the business itself and another for its long-term contracts. Let's take a closer look at both.

2 common approaches

From an overall business perspective, IRS rules require you to choose a tax accounting method that clearly reflects your income. Although you have a number of options, there are two commonly recognized approaches:

1. The cash method. A cash-method taxpayer recognizes gross income (whether in the form of cash, property or services) in the tax year in which those items are actually or constructively received, and by deducting expenditures in the tax year in which they're actually paid. But a taxpayer can't use the cash method if they have inventory.

Taxpayers with $1 million or less in average annual gross receipts, however, are exempt from the required accounting for inventories and use of the accrual method for buying and selling merchandise. Thus, most contractors can't use this method because they have more than $1 million in gross receipts.

2. The accrual method. Because the cash method often isn't a viable option in the construction business, many contractors rely on the accrual method. Generally, under this method, income is to be included for the taxable year when all the events have occurred that fix the right to receive the income, and the amount of the income can be determined with reasonable accuracy.

Liability is incurred and generally is taken into account, for federal income tax purposes, in the taxable year in which:

- All the events have occurred that establish the fact of the liability,
- The amount of the liability can be determined with reasonable accuracy, and
- Economic performance has occurred with respect to the liability.

A major benefit of the accrual method is that it provides a more accurate matching of revenue and expenses, as both are recorded when incurred, not necessarily when paid. This method can also allow additional tax planning opportunities through year end accruals.

Long-term contracts

Because of the accounting complexities of long-term contracts, the IRS requires contractors to choose a specific method for these arrangements. A contract is considered "long term" if it isn't completed in the same year it's started, regardless of the time needed to actually complete the job. You must pick an accounting method in the first year of the contract.

One of the two most common long-term contract approaches is the percentage-of-completion method. Here you report income according to the percentage of the contract that's completed during the year. This percentage is calculated by comparing expenses allocated to the contract and incurred during the year with the estimated total contract costs.

One benefit of this method is a more accurate allocation of income and expenses. However, under this method, the IRS requires you to do a separate calculation for tax purposes that may result in interest charges.

The other common approach is the completed-contract method. Under this approach, income isn't reported until you complete a contract, even though you may receive payments in years before completion. Thus, the completed-contract method is advantageous because you can defer taxes.

The downside, however, is that you can't include the cost of supplies or materials you allocated to the contract yet never used as an allocable contract expense. These supplies must remain on the books as an asset until they are used in a project. They may be deducted at the time the project is completed.

What determines whether you can use the completed-contract method? The size of your construction company as measured by gross receipts. Larger construction businesses (those with average gross receipts over $10 million for the previous three years) must always use the percentage-of-completion method, while smaller ones must do so only for contracts that will take longer than two years to complete.

If you have average gross receipts for the previous three years under $10 million, you may use the completed-contract method for contracts you'll complete in less than two years.

Not a one-time decision

Picking the right accounting method, whether for your overall business or for long-term contracts, won't likely be a one-time decision. The IRS, the Tax Court and even Congress itself take varying perspectives on the rules, and changes could occur at any time.

For this reason, revisit this topic regularly with your CPA to be sure you're not at risk for additional tax charges and penalties.

Are there alternatives?

It's important to note that, for both the overall tax accounting method and the long-term contracts method (see main article), a variety of alternatives are available.

Regarding the overall approach, the accrual-excluding-retentions method, for instance, is similar to the accrual method except that revenue from retainages isn't recognized until the contractor is entitled to receive it. And a few contractors may opt for a hybrid method that combines the cash and accrual methods.

Like your overall business methods, long-term contract methods have other, less widely used varieties as well. The percentage-of-completion–capitalized-cost method and the exempt-contract–percentage-of-completion method are two such examples.

In either case, these methods are seldom used and too complex to describe in this article. Occasionally, however, they do come into play. Your tax advisor can explain them in detail.

Be vigilant, not a victim

Fraud remains a huge threat to contractors

Over the last few months, the economy has been very much in the news. While economic struggles can bring many challenges, one in particular is the increased likelihood of fraud. As a contractor, now more than ever you need to be vigilant — so you don't end up a victim.

Checks and payroll

Fraud can affect a construction company in many ways. One of the most common methods is through check tampering.

Here a thief forges, alters or steals a company-issued check. For instance, say you made out a check to the IRS. It's not difficult for a dishonest staff member to intercept the check and change the "IR" to "MR." or "MRS." and then add his or her name. Fraudsters might also hand you a check made out to "Visa" — but it's not your account, it's theirs.

One good way to combat such fraud is to insist that an invoice or other supporting document be attached to every check. Furthermore, avoid signature stamps.

Although convenient, these devices are often too tempting for a dishonest employee to resist.

Another type of check that invites fraud is a paycheck. Specific payroll scams to watch out for include fake (or "ghost") employees and false wages (hourly wages based on exaggerated or fabricated hours recorded on time cards).

To ensure you're compensating only your employees and only in the right amounts, review and *personally* hand out paychecks at least once a year. And, when you do, ask for ID.

Insidious invoices

Construction companies process a lot of invoices, leaving them vulnerable to accounts payable fraud.

One common scheme is for a fraudster to set up a shell company that outwardly appears legitimate but, of course, doesn't provide any products or services. Another one is for a corrupt employee to work with an actual vendor's rep to inflate prices and then split the difference.

Again, you can fight back against these schemes by checking invoices attached to outgoing checks regularly. Also ask your CPA to review your vendor payouts. Are you paying costs well above local industry norms?

In addition, your CPA can help you run a vendor history showing invoice numbers. If every invoice you receive from a vendor is in perfect numerical order (3001, 3002, 3003, etc.), something might be up.

Work with your bank as well. It can set up a list of approved vendors and stop checks going to any company not on the list. Also consider instructing your bank to stop payments going to individuals rather than businesses.

Zero tolerance

Along with the specific ways to catch various fraud schemes — of which we've mentioned but a few — there's also one overall way to fight back: Establish a zero-tolerance policy toward fraud.

This policy should start with your hiring process. Perform criminal and credit background checks on anyone who will be handling the company's financial assets. (Consult with your attorney to be sure you're within the law.) Additionally, look into bonding select employees who will be working in high-risk areas.

Next, develop solid internal controls. For example, segregate banking responsibilities from accounts receivable and accounts payable functions. It's harder for fraudsters to conceal their schemes if they can't cover their tracks in the bank reconciliation process.

If every invoice you receive from a vendor is in perfect numerical order (3001, 3002, 3003, etc.), something might be up.

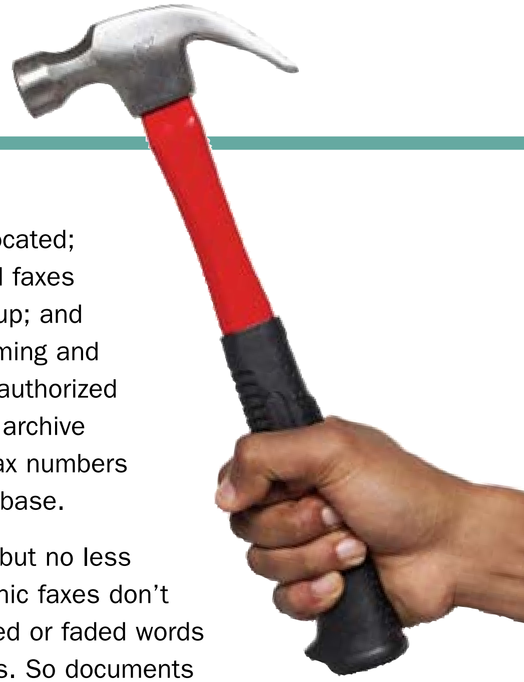
Another effective measure is to enforce mandatory vacations of at least two weeks per year. Many fraudsters don't like to take time off because doing so might expose their actions when someone else fills in. Also keep an eye out for any unusual changes in an employee's lifestyle, material possessions or behavior.

Last, educate your employees about the kinds of fraud that can occur as well as the effect these wrongdoings can have on the company. Mix a firm hand with a kind voice, explaining the consequences of fraud, as well as how losses hurt the company and how staff can help.

Above all, prosecute

Ultimately, your best weapon against fraud is action. If you catch someone stealing from you, prosecute — no matter how long he or she has been with your construction business or whose feelings might get hurt. There's perhaps no greater fraud deterrent than the knowledge that those caught will pay for their crimes. ☒

Break out of your fax funk with Internet-based service



No matter what a construction company's purpose or specialty, just about every business in the industry has one thing in common: the fax machine. Bids, contracts, change orders and material invoices have long flowed in and out of those clunky, odd-sounding machines.

Like many contractors, you're probably used to your old fax machine. It sits in the corner of your office or job trailer and, as long as you feed it paper and toner, gets the job done. But have you ever wondered whether there's a better way? Internet-based fax service may well hold the answer.

Saving time (and paper)

An Internet-based fax service allows you to send, receive, manage and track documents via a computer, cell phone or PDA. And, yes, you can send and receive documents from either a traditional fax machine or another Internet-fax-enabled computer.

Using an Internet-based fax service can be a big time — and paper — saver. It enables you to not only send faxes almost instantly, but also automatically route incoming faxes to the right recipients no matter where they're located; send, copy and forward faxes to one person or a group; and restrict access to incoming and outgoing faxes to only authorized users. Plus, users can archive their faxes and store fax numbers in a companywide database.

On a more superficial (but no less practical) level, electronic faxes don't suffer from the smudged or faded words that plague paper faxes. So documents critical to your projects won't slow progress or hinder relationships with owners because of unclear facts and figures.

Assessing the costs and risks

Assuming you already have an Internet-enabled computer, you've already won half the battle of implementing Internet-based fax service. But you'll likely also want to invest in a scanner, so you can sign, scan and fax documents. These aren't terribly expensive, but it's an additional cost worth mentioning.

Regarding the service itself, providers generally charge monthly fees, and many limit the number of documents you can send and receive. It pays to shop around and find the package that best suits your construction company's needs. Simply type "Internet fax service" into your search engine and a bevy of choices should appear before you.

Last, because online faxes are typically converted to PDF or TIFF file formats, you may find it difficult or impossible to edit a faxed document on your computer. For instances when you need to do a lot of back-and-forth editing — working with contract documents or drafts of bid submissions, for example — you may want to stick with e-mail and fax only the finished product.

Moving on

Faxing isn't dead; it's just become more versatile — like so many aspects of doing business today. If you think your construction company might be ready to move on from its old fax machine, an Internet-based service may offer the speed and functionality you're looking for.

Futurescope: *Construction Business Trends*

Green building evolves under new LEED standards

Sustainable — or "green" — building is among the most significant construction trends of the last 10 years. In that time, it's gone from being a "nice idea" to virtually a competitive necessity in some markets.

When it comes to sustainable building standards, the chief governing organization is the U.S. Green Building Council (USGBC). In fact, it has been responsible for certifying construction projects as green under its Leadership in Energy and Environmental Design (LEED) standard system. On Jan. 1, 2009, however, all that changed.

On that date, the USGBC handed over LEED certification to the Green Building Certification Institute (GBCI). This nonprofit sister organization was set up by the USGBC to, in part, administer the LEED Accredited Professional (LEED-AP) program, which it has done since January 2008.

Beginning this year, the GBCI will work closely with 10 "certification bodies" to provide LEED certifications that are also compliant with International Organization for Standardization (ISO) standards. Many of these certification bodies may be familiar to anyone who has worked on a LEED certified project in the past. Organizations such as Bureau Veritas North America, Intertek and Underwriters Laboratories-DQS have been certifying jobs on a contract basis for some time.

Another change effective this year is a move from the old 69-point certification system to a 100-point certification system, weighted by categories that reflect priorities. Weighted most heavily are climate change and indoor environmental quality. Ozone depletion and acidification received the lowest weightings.

In addition, previous LEED ratings allowed only 17 points for protecting the atmosphere and 14 for sustainable sites. But green projects may now qualify for up to 35 points related to protecting the atmosphere and 26 points for creating sustainable sites. Potential points for water efficiency have also doubled from 5 to 10, and materials and resources have gone up to 14 points from 13. Environmental quality remains unchanged at 15 points.

The USGBC revised point system also accounts for regional differences. The organization has divided the United States geographically and, working with regional councils, developed six environmental priorities per region, offering credits for up to four per project. So, for example, a project that excels at promoting water efficiency in Arizona will reap more benefits from doing so than would a similar job in Florida.

The Contractor's Corner

4 smart ways to improve job-site productivity

It seems as if, even though I do all the right things to keep my construction company profitable — minimize my tax liability, manage my expenses, stick to sound bidding practices — I'm still struggling to turn a profit. Of course, the economy doesn't help, but I still feel like I'm missing something. What more can a construction company do to stay profitable?

Although these are hardly easy times for construction companies — homebuilders, in particular — you at least have a *tangible* place where you can focus your profit-building efforts: the job site. By cutting waste and getting more done there, you stand a better chance of bringing projects in on time and at (or under) budget. Here are four smart ways to improve job-site productivity:

1. Plan early, plan often. Having a game plan going into a job can make a world of difference in how many dollars that project drives to the bottom line.

To ensure everyone is equally informed and motivated, hold a prejob planning meeting with the estimator, project manager and field manager. Encourage all attendees to review the plans, budgets and initial schedule in advance, so they arrive armed with questions and input.

Once the job is underway, train your field managers to meet daily with the crew to provide adequate lead time and notice for resource needs such as materials, labor and equipment. Use these meetings to set and review production goals collectively. Ideally, daily meetings will result in accountability and buy-in among the crew.

2. Keep an eye on the numbers. Because of cost overruns, dollar amounts planned for going into a job often disappear once work begins. Set productivity expectations in a prejob planning meeting, and provide your field managers with meaningful cost reports regularly.

Following completion, hold a formal job cost review meeting with your estimator, project manager and field manager to compare the actual cost results of the project with those submitted by the estimator. Use the points raised to improve future estimates and project procedures.

3. Turn technology to your advantage. Technology may not be a cure-all, but it could very well contribute to your construction company's fiscal fitness.

Take global positioning system (GPS) technology. It grants you the ability to track vehicles and equipment, dispatch crews and supplies, and even map job sites. In doing so, you can ensure that your crews travel and work more efficiently as well as curtail wasteful side trips and, most important, theft.

Another important technological tool to consider is a remote time-card system. It requires workers to punch in electronically, giving you *precise* hours-worked data anytime, anywhere. And that's information you can later analyze to determine how to better allocate your workforce.

4. Make your presence known. Construction business owners have a lot on their plate and just as much, if not more, on their minds. For this reason, it's not surprising that many contractors don't show up on their job sites on a regular basis. Yet your absence could be costing you.

When the construction company owner isn't around, managers and laborers alike can lose focus or fall into bad habits. To keep your teams on track, visit the job site often. And, as often as possible, make those visits unannounced. ☒