



# CONTRACTOR

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## **Boldly, into the future**

Developing leaders in the construction industry

## **Protecting your construction company's data privacy**

## **Make your case with audited financial statements**

### **Plus!**

Construction Success Story

## **Saving a troubled project (without breaking the bank)**

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# BOLDLY, INTO THE FUTURE

## Developing leaders in the construction industry

Many people start construction businesses because they want to control their own destinies. They're willing to work hard and put in long hours, knowing their efforts will directly influence their companies' success and their own financial rewards. Some are inspired and mentored by business owners they'd worked for earlier; others go out on their own to escape incompetent or oppressive managers.

Whatever the impetus was for starting your construction business, you need skilled leadership to make it prosper and grow. And this necessity doesn't pertain only to you as company owner. To build a sustainable enterprise over the long term, owners must develop leaders within the employee ranks — people who can take on increasing responsibilities and thrive.



As the industry continues to struggle with a shortage of skilled workers, as well as the ongoing loss of retiring Baby Boomers, your construction company's long-term profitability may depend on the efficacy of its leadership at every level.

Good leaders take a long-range view of the business and will take calculated risks to make it succeed.

### Management vs. leadership

Management skills and leadership skills are both critical to a construction business, but there are basic differences between the two. Effective managers set clear goals, make short-term plans, solve practical problems and behave in an ethically and, ideally, supportive manner. They're good at directing operations, organizing efforts and keeping score.

Strong leaders, on the other hand, use what could be called "softer" skills. They're good at:

- Foreseeing and articulating a profitable strategic direction,
- Guiding and motivating,
- Influencing ideas and behavior, and
- Encouraging everyone to work toward shared goals.

Good leaders look toward the future. They take a long-range view of the business and will take calculated risks to make it succeed. They don't want just to do things right in the here and now; they want to be first in line to do things right tomorrow.

Strong leadership carries over to your workforce. People want to follow leaders who have a clear vision of the future, a positive attitude and an encouraging manner. It's hard to get fired up by a boss who's always complaining about problems, performance and competitors.

### Where you stand

To improve your own leadership skills, you've got to consider your habits and proactively seek out opportunities for positive change. For example, think about the last time you implemented a new marketing or sales strategy, or delegated key responsibilities to one of your managers. If it's been a long time since you've taken such steps, you may need to step away from the day-to-day and hone your leadership skills.

Your employees may also harbor good ideas about how to become a better leader. Consider issuing a confidential survey to gather ideas for improvements. Be prepared, however, to receive negative feedback as well as positive. And, to the extent possible, act on the suggestions made.

### A culture of leadership

Seeking and paying attention to good ideas from within your company is one mark of good leadership. It not only can spark positive changes in the way you run the business, but also signals to employees that you recognize and value their contributions.

But don't stop there. Talking with employees at all levels in your organization should expose you to those with the talent and capacity to lead. Once you spot that talent, work to provide opportunities for those individuals to develop and bloom.

For instance, establish a task force to solve a problem your construction company is facing and put a promising young employee at its head. Or ask a potential leader to recruit a team charged with proposing new initiatives, processes or

programs. Again, just be prepared to implement the ideas that make the most sense.

### Calm waters

Your business may seem like a ship tossed upon the unpredictable waves of local and national economic changes, building trends and tough competition. But the leadership skills of you and your best employees can guide your company through these storms to the calm waters of manageable expenses and a strong bottom line. ■

## INDUSTRY GROUPS OFFER FORMAL AND INFORMAL LEADERSHIP TRAINING

One function of industry organizations such as the Associated General Contractors of America (AGC) and Associated Builders and Contractors (ABC) is to train and develop effective leaders. These groups and others offer programs at the national, state and local levels, where members can take classes, exchange information and gain leadership experience.

For example, AGC's Construction Leadership Council was established as a conduit for participants to:

- Network with others,
- Exchange ideas about work and the industry,
- Serve local communities, and
- Pursue continuing education in construction management and leadership skills.

It sponsors an Annual Leadership Development Conference in the fall and publishes a quarterly newsletter about professional development activities.

ABC also offers live and online leadership skills training. In addition, the organization sponsors Leadership Week, an annual conference with tracks devoted to construction management, chapter leadership and young professionals' leadership development.

Similar programs are available for subcontractors active in various trades. And large construction industry trade shows often offer leadership training, as well as technical seminars, as part of their educational programs.

# PROTECTING YOUR CONSTRUCTION COMPANY'S DATA PRIVACY

Contractors often use sophisticated digital technology to participate in project design, communicate with project partners and conduct daily operations. While these electronic tools can improve collaboration and streamline the building process, they may also expose you to perhaps unfamiliar liabilities.

Major insurer Chubb recently released an advisory report entitled *New Business Models, Technology Raise Professional Liability Risks for Contractors*. It describes these cyber threats and offers strategies for guarding against them.

## New risks

Contractors have long been at risk for liability associated with participating in design work. But now risks are arising from the use of new project modeling technology and the potential vulnerability of confidential and proprietary data they use or store, such as:

- Construction plans,
- Customer data, and
- Personal information.

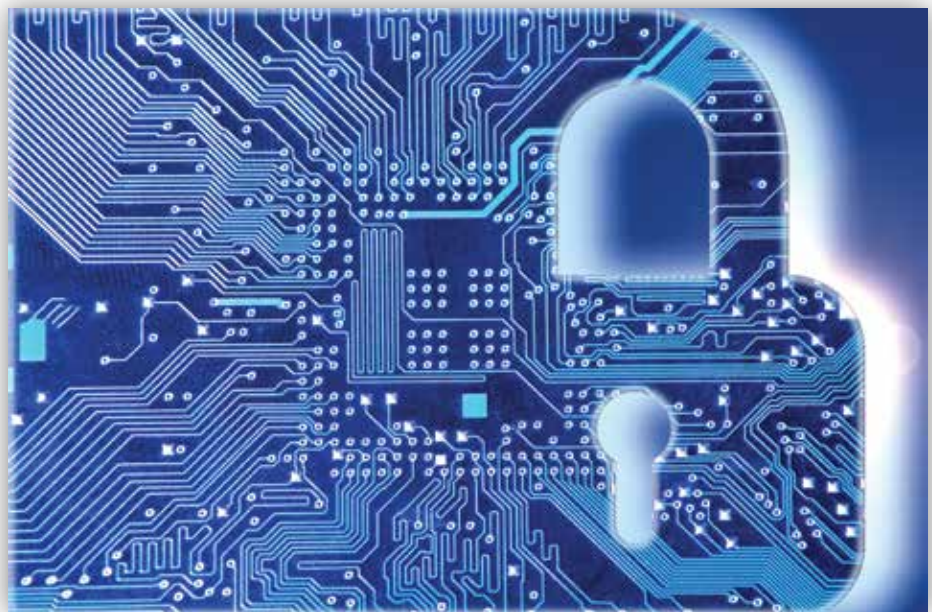
For example, building information modeling (BIM) software produces a three-dimensional model that is shared by the engineers, architects, and general and subcontractors. Each system overlays the others, offering an effective way to detect any potential clashes in component location or work scheduling.

But because BIM systems contain building plans and other project data files, they also pose risk of cyber attack. The Chubb report cites indications that hackers have been targeting building designs and using malware to target CAD programs.

If you're using a cloud service, be sure to assess your risks and responsibilities.

## Persistent problems

Still, the types of cyber crime most likely to occur, according to the Chubb report, remain email phishing (general messages requesting sensitive information) and "spear fishing" (messages that appear to be from someone familiar to the recipient, but which are actually fraudulent). Just one employee who gives in to either of these deceptions could enable a hacker to defraud your business of hundreds or even thousands of dollars.



New mobile technologies such as smartphones and tablets also pose a threat. Employees who use their own devices for work could download malware-infected apps capable of searching for and stealing sensitive company information.

Cloud-based software, data storage and other services potentially create additional exposures through contracts that limit the provider's liability for data security, network outages and regulatory compliance. If you're using a cloud service, be sure to assess your risks and responsibilities.

### Steps to take

Here are more steps you should take (and regularly update, if necessary) to limit cyber risks:

**Know your info.** Identify the data that you use and store, and make sure you know where it's located and how it's being protected. Assign at least one person in your organization ultimate responsibility for data security. (He or she should have a backup.)

**Keep data "need to know."** Strictly limit access to sensitive project information to only those whose jobs require that access.

**Create a hierarchy.** Segment networks to keep sensitive information isolated from less-sensitive data. Rank information by its sensitivity and provide higher levels of protection for valuable proprietary and personal information.

**Provide training.** Educate *all* employees about data security. Train staff on procedures and rules appropriate to their roles. Teach everyone to identify and report suspicious emails or other dubious activities.

### Who can help

For assistance developing an effective cyber security program, the Chubb report recommends that contractors work with data security professionals and consult their insurers' risk engineers. In addition, your CPA can help you set an appropriate budget for managing information technology. ■

## MAKE YOUR CASE WITH AUDITED FINANCIAL STATEMENTS

When trying to grow their companies, business owners often find themselves having to convince others of the viability of their plans. As a contractor, you're no different. Whether you need financing from your bank, greater bonding capacity from your surety or just the strategic support of your managers, you've got to make your case. Something that can really help: audited financial statements.

### GAAP power

Most contractors maintain an in-house accounting system to manage their financials. The documents

your staff prepares are called "internally prepared financial statements."

In many cases, internal financials are perfectly functional for the day-to-day operational needs of a construction company. But they often don't follow every reporting standard prescribed under Generally Accepted Accounting Principles (GAAP).

When an external CPA audits your financial statements, he or she will examine and test various accounting documents to verify whether you're following GAAP and, afterward, offer an opinion on your statements. If the auditor issues an "unqualified" opinion, he or she agrees with the methods your in-house team used to prepare the statements.



If a “qualified” opinion is issued, it usually means the auditor has identified one or more GAAP reporting methods that your construction company hasn’t followed. This doesn’t mean your financial statements are inaccurate; it just signifies that you didn’t prepare them according to GAAP. (There may be other reasons for a qualified opinion, as well.)

### More money, fewer mistakes

Many lenders and sureties require contractors to provide audited financial statements before they’ll approve loans or bonding. Some local and state governments also provide increased work and project award capacity to construction companies with audited statements.

You may even save money. Businesses with audited statements may obtain lower interest rates on loans. And, because of the extra steps an external auditor takes, audited financial statements are more likely to be free of reporting mistakes, such as data entry errors, than are internally prepared statements. For example, if your balance sheet shows that you bought a crane for \$100,000, your auditor will double-check that figure by looking at your receipts/invoices.

Although audited financial statements can provide the benefits mentioned, they’re not something your construction business should leap into without foresight. In addition to requiring a financial investment, an outside audit will call for you and your employees to invest a substantial amount of time and energy toward its completion. You’ll need to

gather and provide extensive documentation and even submit to interviews.

### A variety of documentation

If you decide to try an external audit of your financial statements, you and pertinent staff members will meet with your auditor to establish a good working relationship and discuss timelines and responsibilities before the audit begins.

From there, expect to provide documentation such as a detail general ledger, up to date through the end of the period the audit covers, and the

original source documentation (such as canceled checks, bank statements, vendors’ invoices) for areas being tested. You may also need to provide lease agreements, loan covenants and notes of all lenders. In addition, your CPA may ask for a variety of schedules (and supporting documents), including a schedule of:

- Accounts receivable,
- Priced inventories,
- Fixed assets and depreciation taken on them,
- Prepaid expenses,
- Loans, trade payables, and other liabilities reconciled with the lenders’ and creditors’ records, and
- Other accrued liabilities (for example, employees’ accrued vacation and sick time).

Construction-specific documents will also come into play. The auditor will look at ongoing and upcoming projects and either confirm a certain percentage of the costs or test your entire job cost system. He or she will also test estimates for accuracy and completeness. It’s important to both lenders and sureties that contractors engage auditors with expertise in the construction industry.

### Powerful stuff

As you can see from the wealth of information being collected, audited financial statements are powerful stuff. And, to reiterate, it’s particularly important to have a reputable CPA firm with experience in the construction industry perform your audit. ■

## SAVING A TROUBLED PROJECT (WITHOUT BREAKING THE BANK)

A contractor in a busy suburb was hired to do a large-scale home remodeling project because of his reputation for performing quality, timely and reasonably priced work. He promised the owner that the project would be completed before a family wedding in six months. Unfortunately, nothing went as planned.

First, bad weather delayed the start of the project by two weeks. Then the homeowner requested some design changes that took additional time to make. Then the project manager got sick and needed emergency surgery, while two of the carpenters assigned to the job took off for parts unknown (in a company vehicle, no less).

With only a month left before the completion deadline, the contractor was beginning to panic. He couldn't see a way to avoid disappointing the client, losing a load of money on the job, or maybe both. He met with his CPA to talk job budget and perspective.

### Emergency steps

The CPA urged the contractor to take a breath and assess the situation calmly. Then she suggested taking one or more of the following steps:

**Consider overtime.** Asking remaining crew members to put in extra hours could get the job back on track. But the contractor and his CPA would need to forecast the payroll costs involved and see how substantially they'd affect the project's profit margin.

**Reallocate resources.** He could hire temporary help or pull workers and equipment from other jobs to speed up progress. But,

again, calculations would need to be performed to make sure slowing down other jobs to finish this one would make sense.

**Fast-track what you can.** The contractor could look at remaining job tasks and reconsider how he typically sequences these activities. He might be able to reassign them totally or partially to speed up progress.

**Prevent further scope changes.** Above all, the contractor should have an honest chat with the owner to emphasize that absolutely no unplanned work can be requested or performed if the project is to be completed by the deadline.

**Scale back.** As a last resort, he could try negotiating with the owner to eliminate or postpone some of the originally planned work. The contractor might be able to go back after the wedding to finish up certain punch list items.

### Turnaround strategy

The contractor and his CPA performed the necessary calculations and came up with a detailed turnaround strategy. Ultimately, his profit on the job was less than he'd hoped for — but he didn't take a loss. Perhaps more important, his good reputation remained intact. ■



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# The expertise you need, the service you want.

**A**t Smith & Gesteland, LLP we know that running a successful construction company these days requires more than just dedication and hard work. It takes the assistance of experts who understand the industry and the challenges contractors face, and who have the specialized knowledge, hands-on experience and service commitment it takes to help them achieve their business goals.

Our Construction Industry Services Group consists of experienced professionals focused on increasing the success of companies like yours. For more than 50 years, our firm has served individuals and businesses throughout south central Wisconsin. We are delighted to currently work with more than 100 contractors and to have recently been voted Madison's Number 1 accounting firm. We are ready to assist you with a broad range of services tailored specifically to your needs, including:

- Profitability improvement
- Cash flow projections
- Quality and productivity enhancement
- Estimating/bidding improvement
- Bonding capacity maximization
- Lease vs. purchase analyses
- Tax reduction strategies
- Business valuations
- Succession and estate planning
- Financing assistance / growth management
- Project management and accounting systems
- Litigation and claims support

As specialists in the construction industry, Smith & Gesteland has developed the expertise needed to help contractors address and meet their many challenges. We would welcome the opportunity to help you build your success.

To find out what we can do for you, or for more information about the ideas presented in this newsletter, please contact Sean Auger or Steve Pullara at (608) 836-7500 or [mail@sgcpa.com](mailto:mail@sgcpa.com). We look forward to talking with you.