On-Site

SUMMER 2017

Play to win
Profitability tips for today's construction companies

Beyond theft: The human side of jobsite security

The challenge of quantifying lost productivity damages

THE CONTRACTOR'S CORNER

Which types of apps are worth a download?

LAPORTE
CPAs & BUSINESS ADVISORS

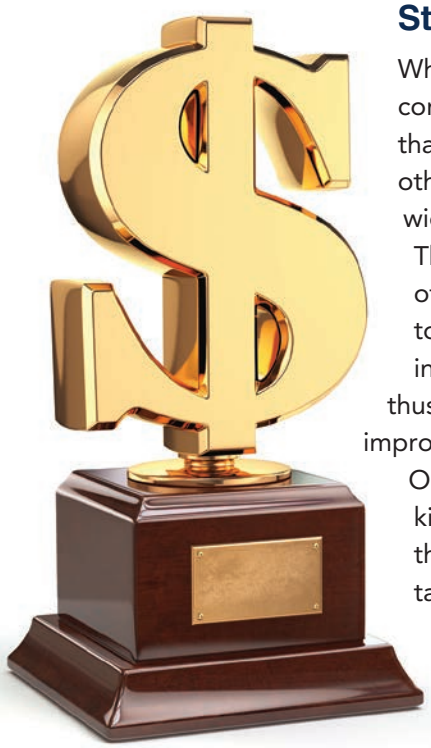
New Orleans | Houston | Baton Rouge | Covington
Check out our industry information and our new blog.
www.laporte.com

Play to win

Profitability tips for today's construction companies

In the construction business, like most others, the focus is on "being competitive." But what does this really mean? For many contractors, it means staying in the game — turning a profit when you can but at the very least breaking even. This is particularly the case when jobs are scarce or perhaps you run into a string of bad luck.

Yet being competitive should mean so much more. To be truly successful, you've got to play to win. And that means always looking to improve the many aspects of your business that either hurt or help profitability. Here are some tips on keeping those margins strong.



Stick to your price

When it comes to pricing, contractors face a challenge that doesn't affect many other business owners. Take widget sellers, for example. They can slash the prices of their widgets from time to time in the hope of selling a higher volume and, thus, maintaining or even improving their profit margins. Or they can make a special kind of widget and raise the price to sell to a certain market. And they can do all of this with little impact on overhead.

This isn't the case for construction companies, because you don't produce widgets — or any other specific (and real) product. You complete *projects*, each of which is slightly or, in some cases, drastically different. Modulating your prices (or artificially increasing or decreasing them in response to customer feedback) will likely only result in the risk of taking a loss on a job (because you underbid) or not getting the job at all (because you overbid).

What's interesting is that many project owners, particularly homeowners looking to build new, don't list "price" as their top concern. They tend to put quality, timeliness and, yes, even customer service before dollars and cents. On the flip side, there are many owners in the private sector who do gravitate toward the lowest price — but these are often the ones who can't pay their bills on time or at all. (Public jobs are a different matter because many government agencies do look specifically for the lowest bidder.)

The bottom line is that construction is a cost-based, not price-based, business. Look carefully at your direct and indirect project costs, as well as your overhead, and establish a fair price from there. Although the cost-based dollar amount will probably vary somewhat from project to project, you'll still likely be within a certain range. That's your price — stick to it and sell your services based on the aforementioned factors (quality, timeliness, service). If you try to cut prices to beat a competitor, your profitability may very well suffer.

Professional development boosts profitability

Among the leading causes of lack of prosperity in construction companies, which tends to get relatively little attention, is simply getting left behind. Contractors who get too set in their ways and don't dedicate the time (and a little money) to professional development often find themselves outmaneuvered and outperformed in the marketplace.

As a construction company owner, you have to lead the charge toward a brighter future for your business. Unfortunately, it's all too easy to feel like you've hit a dead end when it comes to profit margin and can go no further. But there's always hope, and additional ideas, out there.

If you haven't already, join local and national trade associations to keep up with the latest developments in your specialty. But don't make this a passive activity. Get involved by reading what's published, watching what's broadcast and participating in discussions (whether online or in real life). And pass along this same fervor for professional development to your executives and project managers.

Don't give away changes (usually)

The randomness and unpredictability that often makes construction projects so difficult can also serve as a means to boost profits. We're referring, of course, to change orders. Contractors who don't address this process with owners upfront and early may find themselves losing dollars as the job goes on or concludes.

There are two main factors in play here: communication and rates. First, communicate clearly with the owner what constitutes a change and how it should be handled under the contract. Emphasize that you'll need written (or digital) authorization before proceeding on a change.

Second, review your change order rates. Have you checked them recently against local benchmarks and considered updates? If you use a rate sheet with your job, ensure it's up to date and complete — and that the listed prices reflect the current economic environment. Charging inadequate amounts can leave you disappointed when the project is finished and you're reviewing your financials.

Generally, you should almost never give away anything for free. There are, however, very limited instances when a "no-cost" change order could be to your advantage. For instance, if you're dealing with a customer whom you could work with again, performing certain tasks at no extra charge could help cement a relationship that brings additional profitable jobs in the future. Just keep track of these "hidden costs" so you'll be aware of them as the relationship develops.

Know thyself, contractor

Yes, to succeed in today's construction business, you've got to play to win. But, unlike sports, where scouting the competition is usually a key to victory, contractors can't get too focused on who else might be bidding on a job. Know your own costs and what it takes to get a job done right — no matter what might change in progress — and you'll put yourself in a strong position to turn a profit.

Beyond theft: The human side of jobsite security

When the topic of security on a construction site comes up, the discussion usually revolves around one word: theft. *How do we keep people from stealing stuff?* But there's another aspect of jobsite security that tends to get relatively little attention: the human side. All too often, construction company owners don't recognize these risks until it's too late and they must face them in real life.

Beware of personal conflicts

Picture a jobsite and you may envision a massive conglomeration of inanimate objects — bricks, lumber, concrete. But every project is really a coming together of many different types of people with varying backgrounds, perspectives and even objectives under the umbrella of the job itself. Inevitably, conflicts will occur.

> *Ongoing, heated disputes can cause communication breakdowns that slow job progress.*

A single argument probably won't bring any project to a screeching halt. But ongoing, heated disputes can cause communication breakdowns that slow progress. They can turn into "office politics," whereby certain individuals or teams don't share information with others — leading to mistakes and poor quality work.

In severe cases, on-site disagreements can turn physical. This is where the problem really becomes dangerous. A fight can result in injuries,

medical claims and legal costs — not to mention a substantial loss of productivity. Under the most extreme and horrifying of scenarios, you might even have an active shooter on a jobsite. It may sound unfathomable but, as we're all painfully aware, these things do happen.

Train and communicate

A good first step toward securing your jobsites from personal conflicts is to provide training to project managers and other team leaders in conflict resolution. When those in charge know how to recognize, manage and de-escalate a dispute, the fallout from a quarrel is usually much more benign.

For example, project managers and team leaders can learn to listen to both sides and use nonaccusatory language to ascertain the actual basis of the conflict. Then they can apply various logical, equitable approaches to resolving the discord.

You can also establish a process for how employees should address disagreements. (If you're a union shop, such a process is no doubt already in place.) Not every worker will follow company

policies, of course. But if you outline conflict resolution procedures in your employment manual and post reminders on the jobsite, you'll at least have an avenue for dealing with a major clash.

Regarding the aforementioned worst-case scenario — an active shooter — many companies are now creating formal procedures to deal with these terrifying situations as best they can. One commonly suggested and fairly self-explanatory approach is "Run. Hide. Fight."

In addition, consider creating lockable safe zones, both in the office and on jobsites, for employees to seek refuge. (If you're a subcontractor, it will be up to the general contractor to designate these zones.) And set up communication channels to alert authorities and warn anyone off-site or in as-yet unaffected areas of jobsites.

Keep it in mind

You may find it odd to think of your workforce, as well as subcontractors and others with whom you collaborate, as a security threat. But human behavior can be unpredictable. Keep this in mind as you strive to also secure your jobsites from theft and damage.

The challenge of quantifying lost productivity damages

Stick around the construction business long enough and it will happen to you. Maybe it already has. We're referring to the unfortunate circumstance of, through no fault of your own, a project getting severely disrupted. In such cases, you might eventually need to file a claim in court against the owner for lost productivity damages. Among several challenges you'll face in actually obtaining this money is quantifying a defensible amount of damages.

The definition of productivity

In a construction context, "productivity" generally refers to the amount of work a contractor can perform during a given time. Lost productivity simply means that an unanticipated disruption of the project causes the contractor to work less efficiently, which may lead to additional labor, equipment and materials costs.

Lost productivity is often associated with a delay, but lost productivity damages and delay damages aren't the same thing. A contractor may suffer lost productivity even if the project isn't delayed. Of course, when a delay occurs, lost productivity may become a component of the contractor's damages.

Measured-mile method

Generally, when these situations develop, a qualified appraiser should get involved. Appraisers use several methods when quantifying lost productivity damages. Determining the appropriate method depends on the particular job's facts and circumstances. One difficulty in establishing damages is distinguishing whether additional

costs were caused by lost productivity or by the contractor's failure to estimate correctly.

For this reason, one of the most common methods (and the one generally favored by the courts) is the measured-mile. It compares a contractor's productivity levels during periods in which work was disrupted with productivity levels during undisrupted periods. The advantage of using this method is that it reflects only recoverable productivity losses, eliminating the need to determine whether a loss is attributable, in whole or in part, to bidding mistakes.

The measured-mile method won't work, however, if a project is disrupted from start to finish, because periods of optimal productivity for use as a baseline don't exist. Also, for a baseline period to be appropriate, it must involve work that's reasonably similar to the work being done during the disrupted period. Finally, the measured-mile method relies heavily on thorough documentation of the type of work being done, the disruptions to the work and the additional costs attributable to those disruptions.

Other ways to calculate

Appraisers do have other methods for calculating lost productivity damages. For example, under the total cost method, the appraiser calculates lost productivity damages by taking actual contract costs and subtracting the bid amount (taking into account agreed-upon change orders).

Although this method's simplicity may be appealing, it fails to reflect productivity losses caused by bidding mistakes or otherwise attributable to the contractor. It also ignores the reasonableness of costs the contractor incurred. A "modified total cost method" attempts to address these problems by requiring adjustments to account for unreasonable bids or other cost overruns that are the contractor's responsibility.

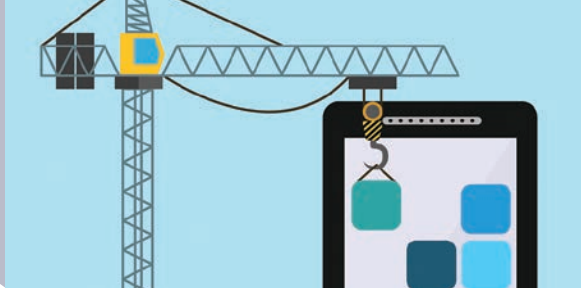
Another avenue for an appraiser is the actual cost method. It relies on actual cost and productivity numbers and is the most accurate, but it may not be practical. Why? First, the labor-intensive nature of the method may render it cost prohibitive. And second, it demands detailed, accurate records that include productivity measurements — something few contractors possess.

In some cases, an appraiser will resort to the jury verdict method. Essentially, this approach involves an educated guess on the part of the trier of fact. Some courts have allowed this method when it's clear that a contractor suffered lost productivity damages but there's no other reliable method of quantifying those damages.

A big plus

Most construction projects begin with high hopes, undergo some struggles and are eventually completed. But, once in a while, you may encounter one that goes so awry that you're left seeking lost productivity damages. In such instances, having a team of professional advisors behind you (including the aforementioned appraiser) can be a big plus.

THE CONTRACTOR'S CORNER



Which types of apps are worth a download?

Lately I've been feeling like there are so many aspects of the building process that are dragging on unnecessarily. I find myself wondering whether putting the right app or two on my smartphone might speed things along. But I don't want to waste time trying them all out. Which ones are worth a download?

You could squander many hours playing with the many construction apps now on the market. That's why it's generally better to begin with an assessment of your company's technology needs and then narrow your download choices from there.

Identifying your gaps

Most construction companies today have various aspects of their businesses covered by technology. For instance, you're likely emailing scanned documents far more often than using a fax machine.

The question is: Where *aren't* you covered? When you identify the gaps in your technology, you'll usually find the processes slowing down your projects. If, like many contractors, you've already invested in big-picture desktop software for accounting and so forth, your technology gaps may be fairly thin. It's within these minor disconnects that you may find an app useful.

Considering the trends

Every construction company's tech needs are a little different, but here are some trends in popular construction apps:

Photography. A picture is worth a thousand words — and could be worth thousands of dollars on the jobsite. The ease with which project managers and others can take photographs is changing how jobs are monitored and completed. Photo annotation apps allow one to take a picture and then mark it up with relevant data. In addition, punch list apps rely on images to visually display outstanding project items to prevent confusion.

Safety. The old saying is "Safety is job #1," but it can be difficult to enforce on multiple jobs and when things get chaotic. There are apps available that provide standard and customizable checklists, which a project manager or worker can pull up instantly. Some apps also offer templates for more readily generating safety audit reports.

> *When you identify the gaps in your technology, you'll usually find the processes slowing down your projects.*

Project management. If you're struggling with certain job-related tasks, maybe it's time to choose an app, put it on everyone's phone and see whether doing so helps. Project management apps help with a wide array of activities such as scheduling, completing time sheets, arranging procurement and deliveries, and processing requests for information.

Proceeding cautiously

You're wise to proceed cautiously when it comes to apps. If only a few people use a solution, it can actually cause more confusion than clarity. But, as the expense of most downloads is minimal, you can get a good return on investment when you choose the right one.

LAPORTE
CPAs & BUSINESS ADVISORS

111 Veterans Memorial Blvd, Suite 600 | Metairie, LA 70005-3057
504.835.5522 | FAX 504.835.5535

The Tax Consequences of Reimbursed and Unreimbursed Employee Expenses

Employees are typically reimbursed for business expenses that are ordinary (common in a line of business) and necessary (helpful to conducting business). Examples include expenses related to business travel, meals and entertainment, tools and supplies, professional dues and education. The employer must be able to deduct the expenses on its income tax return for them to be valid.

The tax treatment of reimbursed and unreimbursed employee business expenses depends on whether the employer uses an accountable or non-accountable plan.

Accountable Plan

To qualify as an accountable plan, the IRS requires:

1. A valid business connection for all reimbursed employee expenses.
2. Employees to substantiate business expenses in a timely manner with documentation (expense report, travel log or receipts).
3. Employees to return excess reimbursements to the employer.

Non-accountable Plan

If the employer does not require employees to substantiate business expenses or return excess reimbursements, the IRS considers the arrangement a non-accountable plan.

Tax Consequences to Consider

Employee expense reimbursements under an accountable plan are generally not included in taxable income. If the employer incorrectly reports the reimbursements under an accountable plan as income to the employee, both the employer and employee will overpay payroll withholding taxes. In this case, the employee could be entitled to some tax benefits.

If the employer does not reimburse the full amount of employee expenses, the employee can report the difference as Unreimbursed Employee Business Expenses (Form 2106) and take an itemized deduction, subject to personal income tax limitations.

Under a non-accountable plan, reimbursed employee expenses are considered taxable income and reported on the employee's W-2. The tax consequences include:

- Paying taxes at a higher tax rate.
- The employee and employer paying higher employment taxes (withholding taxes, FICA, and federal and state unemployment taxes).

The employee may be able to take an itemized deduction (subject to the 2% of adjusted gross income (AGI) limitation) on their personal income tax return if they are reimbursed more than they spent.

Per Diems Exception

An employer may provide per diems or monthly allowances to employees for travel-related expenses. In certain situations, per diems may be considered as an accountable plan, even without documentation. The employee must substantiate the time, place and business purposes related to the expenses.

If per diems are usually higher than expenses, they would be considered a non-accountable plan if the difference is not repaid or treated as income. In this case, all per diems are treated as employee compensation subject to employment tax.

Employers should consider the advantages and disadvantages to each type of plan when deciding how to structure the reimbursement of employee business expenses. If you have any questions or want to discuss your situation, contact a member of the LaPorte tax team.