



**weber · obrien Ltd.**

CERTIFIED PUBLIC ACCOUNTANTS  
STRATEGIC BUSINESS ADVISORS



# Surviving The Current Market

## Basic Business Principles

### FCA

## Annual Council Meeting



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## INTRODUCTION

### SPEAKERS

#### James F. Weber, CPA

- Developing comprehensive business and personal financial strategies for small business owners.

#### R. David O'Brien, CPA

- Specializing in the construction industry and leads the Construction Industry Practice Group.

- Life, business, and the natural laws that govern the universe all have one thing in common...that is cycles. We are in a cycle now. We cannot predict its depth and duration, but we can say with great certainty that some of us will survive this cycle better than others, and some of us who are not prepared or who do not react until it is too late will not survive at all
- This program is about what it takes to survive a business cycle such as the one we are currently experiencing



- **Financial Statements**
- **Cash Management**
- **Banking**
- **Personal Planning**
- **Fraud/Internal Controls**
- **Management/Leadership**
- **Legal**
- **Key Employees**
- **Appendix**





# **FINANCIAL STATEMENTS**

## FINANCIAL STATEMENTS

### FINANCIAL DEPARTMENT

- ❑ Financial Statements must be prepared monthly, by the 10<sup>th</sup> of the following month.
- ❑ All accounts must be reconciled to the detailed account information monthly.
- ❑ Financial statements should include month-to-date and year-to-date information as well as budgeted data.
- ❑ The Controller should review the financial statements before its release to the President.
- ❑ The Controller should prepare an “executive summary” that provides a one-page overview of all positive and negative positions and trends with recommendations and solutions.



## FINANCIAL STATEMENTS

### FINANCIAL DEPARTMENT

- You, the President of the Company, must understand the financial statements. Your knowledge of the actual financial condition of the Company will serve you well in analyzing the operational needs of the Company in difficult times.
- The Controller and Chief Financial Officer must provide financial leadership, job profitability, cost management, vendor and subcontractor cost, review construction draws, and general and administrative costs must be a principal focus.
- They must meet regularly with the management team and provide proactive solutions.
- The strongest companies have the strongest financial staff.



## FINANCIAL STATEMENTS

### CASH

- Use an Imprest Petty Cash System
- Maintain a positive cash balance (checks held)
- Do you have sufficient cash to fund operations for the next 30, 60 and 90 days (Note the longer the better)
- Do you have a cash budget prepared using a standardized form (see index)
- Is the cash budget prepared regularly
- Are cash disbursements limited to the 10th and 20th of the month
- Other





## WHAT TO LOOK AT IN YOUR F/S

### ACCOUNTS RECEIVABLE/DRAWS

- ❑ Prepare an accounts receivable aging schedule monthly
- ❑ Establish formal credit and collection policies
- ❑ Are all receivables collectable and what steps are taken to make sure they are collected on a regular basis
- ❑ Are draw requests properly completed and given to bank/customer in a timely manner
- ❑ Establish Formal Policies for Collection



## **WHAT TO LOOK AT IN YOUR F/S**

### **RELATED PARTY TRANSACTIONS**

- Make sure these are collectible between the Companies**
- Are they formally documented**
- Are they secured UCC filings**
- Can the related Company pay the balance due the operating Company**



## **WHAT TO LOOK AT IN YOUR F/S RELATED TRANSACTIONS**

- ❑ Can the operating Company pay all balances due the related Company**
- ❑ Are monthly payments made**
- ❑ Are payments made at a fair market value (interest, amortization)**
- ❑ Are management fees considered**
- ❑ Are all transactions at fair market value**
- ❑ Consider tax effects between companies**



## WHAT TO LOOK AT IN YOUR F/S

### FIXED ASSETS

- Is real property held outside of the Construction Company in a separate LLC
- Consider selling Company vehicles to the employees or have the employees lease the vehicle personally
- Evaluate lease versus purchase
  - Remember the Section 179 deduction (\$250,000 in 2009)
- Take bonus depreciation



## WHAT TO LOOK AT IN YOUR F/S

### OTHER ASSETS

- Pay insurance premiums monthly as opposed to quarterly or annually
- Do you make loans to employees
  - Are they collectible
  - Are they formally documented



# WHAT TO LOOK AT IN YOUR F/S

## INVENTORY

- ❑ **Determine the correct amount of inventory**
- ❑ **Compute the carrying cost of inventory**
- ❑ **What is fair market value of inventory (LCM)**
- ❑ **Make sure inventory is properly monitored and controlled**



# WHAT TO LOOK AT IN YOUR F/S

## LIABILITIES

- ❑ Establish proper cutoffs each month
- ❑ Take advantage of all discounts
- ❑ Accrue all appropriate expenses at month end



# WHAT TO LOOK AT IN YOUR F/S

## DEBT

- ❏ Review terms of loan documents
- ❏ Know and monitor all restrictive and negative covenants
- ❏ Evaluate subordination of personal loans to the Company
- ❏ Limit personal guarantees
- ❏ Evaluate carve outs or collateral limitations (personal residence stays with spouse)
- ❏ Make sure collateralized assets at a reasonable fair market value is more than bank debt
  - ❏ Avoid excess collateral positions with the bank
  - ❏ Avoid cross collateralization



## **WHAT TO LOOK AT IN YOUR F/S EQUITY**

- Maintain a positive balance**
- Make sure distributions do not violate bank covenants (tax)**
- Pro rata distributions for S corporations**
- Pay dividends for C Corporation if necessary**

# WHAT TO LOOK AT IN YOUR F/S RATIOS

■ Compute current ratio. It must be greater than one to one

$$\frac{\text{Current Assets}}{\text{Current Liabilities}} = X$$

■ Compute debt to equity ratio. It must be less than six to one

$$\frac{\text{Total Debt}}{\text{Total Equity}} = X$$

■ Compute debt coverage ratio. It must be greater than 1.30

$$\frac{\text{Net Income} + \text{Depreciation} + \text{Interest}}{\text{Debt Payment}} = X$$





## WHAT TO LOOK AT IN YOUR F/S INCOME STATEMENT

- Are sales at projected levels
  - What are sales trends (5 year)
- Review gross margin trends (5 year)
- Know what is in direct costs and indirect costs
- Prepare a breakeven analysis
- Review all expenses monthly to the budget. Identify variances from budget, understand all variances and correct them if they are negative.
- Know what is fixed and what is a variable cost
- Know your general and administrative costs
- Know your interest costs



# CASH MANAGEMENT



## WAYS TO MINIMIZE CASH NEEDS

### CASH CYCLE

- Match the payment of your payables with the collection of cash receipts
- Establish a standard payment cycle
- Do not pay vendors or subcontractors weekly or on request.
- Pay only on the 10<sup>th</sup> (discount) or 20<sup>th</sup> of the month



## WAYS TO MINIMIZE CASH NEEDS

### PURCHASE ORDERS

- Require purchase orders on all purchases
- Require approval on all purchase orders
- Install a purchase order system with your business software or activate the one currently in place
- Note: We have seen a three percent (3%) reduction in cost once a purchase order system is installed

# WAYS TO MINIMIZE CASH NEEDS

## PAYMENT CYCLE

- Expand the payment period for non-discounted vendors to no less than 45-60 days

## DISCOUNTS

- Demand or negotiate discounts with all vendors





# WAYS TO MINIMIZE CASH NEEDS

## COLLECTIONS

- **Establish billing and collection policies in writing**
- **Aggressively seek to collect all billings**
- **Establish follow up protocol and hold regular meetings with staff to make sure all collection policies are followed**



## WAYS TO MINIMIZE CASH NEEDS

### CYCLE TIME

- Make sure that the project cycle time is kept to a minimum
- Reduce the cycle time as much as possible



## **WAYS TO MINIMIZE CASH NEEDS**

### **CHANGE ORDERS**

- Establish a standard process to capture all change orders**
- Bill the customer immediately**
- Consider accelerated payment requirements and fees**

### **SUBCONTRACTORS**

- Bid all subcontractors regularly**
- Seek highly cost effective bids from quality subcontractors**



## **WAYS TO MINIMIZE CASH NEEDS**

### **PRICING INCREASES**

- Allow no opportunity for subcontractors to increase pricing once a contract is signed**

### **CUSTOMER PRICE INCREASES**

- Make sure the contract allows for price adjustments with cost increases**



# WAYS TO MINIMIZE CASH NEEDS

## CASH BALANCE

- **Maintain a balance sufficient to fund operations for 30 to 45 days with no collections**

## DEPOSITS

- **Make sure all deposits are not refundable**

## Ways to minimize cash needs TAXES

- Tax should not be a controlling influence
- Banks want to see profits
- You can report different methods for Book and Tax
- Consider
  - Section 179
  - Section 199
  - Cost Segregation
  - Bonus depreciation
  - Tax Strategies
  - Net operating loss carry backs
  - Capitalization policy



## Ways to minimize cash needs TAXES

- ❑ Be aware of all taxes (sales, personal property, income, real estate, franchise)
- ❑ Establish a savings account for tax estimates as an S Corporation
- ❑ Pay all taxes when due
- ❑ Payroll taxes, penalty, interest, collection, offer in compromise
- ❑ Perform tax planning corporately and individually
- ❑ Be aware of all multi state and multiple local liabilities



## OVERBILLING/ CUSTOMER DEPOSITS

- Always be in a net overbilling position
- Always attempt to obtain customer deposits



# **BANKING**



### TERM DEBT

- Can existing term debt be extended/refinanced to minimize current cash flow requirements
- Request and discuss term debt now for all capital asset purchases in 2009. Do not purchase long-term assets with current working capital



### LINE OF CREDIT

- **Make sure you have available to you a line of credit of a sufficient amount to fund expected cash flow deficiencies**
- **Negotiate the line of credit now for additional amounts needed in 2009/2010**



### BANKER

- **Meet with your banker, tell him your story. Show him your work, have customers tell him about their good experience with your Company**
- **Prepare projections and business plans**
- **Make sure he is connected to you beyond a loan document**
- **Make sure he believes in you and your staff**



## LOAN DOCUMENTS

- Be aware of all restrictive and negative covenants and review monthly
- Know today if you are not going to meet the covenants, find out alternative ways to do so or obtain waivers
- Review all terms and become familiar with them
- Evaluate your personal guarantee and spousal guarantees
- Have attorney and CPA review all documents



## CAPITAL

- **Make sure all personal loans to the Company are secured (UCC)**
- **Consider subordination of personal loans to satisfy banking concerns**
- **Consider personal loans to the Company, if personal guarantee exists anyway**
- **Consider investor capital**



### TERMS

- **LIBOR rate versus Prime versus Bank Rate (What index is it tied to?), fees, termination fees, fixed rate swaps, SBA, state programs, grants, covenants**



### OTHER

- **SBA**
- **More than one bank**
- **Avoid cross collateralization of Company's assets**
- **Avoid excess collateral position, update your personal financial statement (be reasonable and use a standard form)**
- **Finance fixed asset purchases**
- **Lease fixed asset purchases (Capital versus Operating)**





# **PERSONAL PLANNING**

- Hire excellent advisors
- If challenged, meet with a reorganization specialist (lawyer)
- Hire excellent internal financial staff
- Do not borrow from the government. Make sure all trustee taxes are paid. Penalties and interest are high and trust fund liability, if you are a responsible party, goes past bankruptcy
- Split assets between spouses
- Do not have spouse be an officer or owner of operating Company



- Remember that retirement plan assets are not subject to creditor claims. This may also apply to annuities and cash surrender value of life insurance (children accounts, trusts)
- If possible, eliminate or minimize spousal guarantee. Consider carve out provisions



- **Draft a worse case scenario. What would you do if these things happened? Consult a specialist. Develop a written plan**
  - **Terminate staff**
  - **Sell assets**
  - **Liquidate**
  - **Terminate**



- Do you have a worse case personal budget prepared? Is your spouse on board
- Do you know how long you can last financially if you did not sell another project
- What is your liquid net worth? What will it be?
- Know your “Burn” rate





# **FRAUD AND INTERNAL CONTROLS**



## FRAUD / INTERNAL CONTROLS

### FRAUD

- **When the economy is difficult on businesses, it often becomes difficult on employees who work for you**
- **During times like this, it is more important than ever to be aware of employee fraud and to note that it exists with all Companies 20% to 40% of the time**
- **You can take steps to minimize fraud**
- **The following is a brief but not complete list**
  - **Bond all employees who have access to cash**
  - **Segregate duties**
  - **Open the bank statements and review all bank activity**



## FRAUD / INTERNAL CONTROLS

### FRAUD

- The following is a brief but not complete list
  - Review the checks
  - Look for unusual activity
  - Do not use a signature stamp
  - Audit sample disbursements on a regular basis
  - Examine receiving reports
  - Invoice packets
  - Review payroll regularly
  - Control credit cards, PayPal accounts



## FRAUD / INTERNAL CONTROLS

### INTERNAL CONTROLS

- **Have strong internal controls**
- **Review and understand your system:**
  - **Cash receipts and disbursements**
  - **Billing**
  - **Purchases**
  - **Payroll**
  - **Journal entries**
  - **Software**
- **Review the bank statements and credit card statement activities before giving them to the controller**



# FRAUD / INTERNAL CONTROLS

## INTERNAL CONTROLS

- **Bond all employees who have access to cash**
- **Review internal controls system with your CPA to find weaknesses and try to correct them**
- **Small Business Internal Control:**
  - **Segregation of duties**
  - **Reconcile and examine bank statements every month**
    - **Receive the unopened bank statement directly and open it personally**
    - **Scan the front and back of all canceled checks**
    - **Question the purpose of all transfers**

**INTERNAL CONTROLS**

- Small Business Internal Control:**
  - Reconcile and examine bank statements every month**
    - Compare payroll checks with employee records, and ask questions**
    - Have the banks statement reconciled by someone other than the bookkeeper/ controller, if possible**





# FRAUD / INTERNAL CONTROLS

## INTERNAL CONTROLS

- **Small Business Internal Control:**
  - **Signing checks**
    - **Never sign a check without inspecting original supporting documentation including the invoice, shipping documents and the purchase order**
    - **Cancel all supporting documentation after signing a check**
    - **Never sign a check that is not completely filled in**
    - **Do not pay from vendor statements**
    - **Verify the names of your vendors**



# FRAUD / INTERNAL CONTROLS

## INTERNAL CONTROLS

- **Small Business Internal Control:**
  - **Protection of valuables**
    - **Keep blank checks and the signature stamp secure**
    - **Deposit all cash and checks daily**
    - **Get fidelity bond insurance for all accounting and key employees**
    - **Backup all computer files on a regular basis and store the backup at a secure, remote location**
    - **Periodically change computer system passwords**



# FRAUD / INTERNAL CONTROLS

## INTERNAL CONTROLS

### ■ Small Business Internal Control:

- Prepare and use budgets
- Watch out for changes in employee behavior
  - Always verify employee references before hiring
  - Be aware of substance abuse, changes in lifestyle, living beyond means, possessiveness of work
  - Require all employees to take vacations

## INTERNAL CONTROLS

- **Small Business Internal Control:**
  - **Don't abuse your company "IF YOU CHEAT, THEY CHEAT"**
  - **Caveat: There is no assurance that all fraud will be discovered or totally eliminated by your CPA**





# **MANAGEMENT AND LEADERSHIP**

■ You are the leader of your Company. There is a big difference between management of your Company and leadership. Managers do things right and leaders do the right things. Focus your efforts on the three (3) to four (4) things that are critical. Make sure that you have appropriate managers in place

- Project management
- Sales
- Administration



**■ A less than appropriate person in these jobs could destroy you, your Company, and the jobs of all the people in your Company. Recruit and train your people. Make sure you share common vision and business values. Hiring, training and retention of highly qualified people remains the heart of business success. Avoid “political correctness”: and actively seek out and select only the best people to accomplish your goals**



- **Share your goals with your people. Prepare the following:**
  - **Business Plans**
  - **Projections**
  - **Marketing Plans**
- **Measure results often, share the results, good or bad, with your people. Share with them, your success and failures**
- **Meet regularly with your people, share summary results with them, and seek ideas from them**



- **Do your people have job descriptions? Are they evaluated regularly? Do you bonus people based on objective performance measures (project management, gross profit cycle time, and customer satisfaction) or do you give subjective bonuses?**
- **Do you perform random cost cuts?**
- **Terminate employees as necessary, but do not do it every week as your best people will leave for job security.**
- **Seek to aggressively reduce inventory, operating cost, and fixed asset positions now!**



# LEGAL



- Hire competent counsel
  - Make sure all attorneys are specialist in their respective areas (litigation, divorce, business, estate)
- Are all matters of corporate governance complete
  - Related party
  - Notes from/to stockholders
  - Contracts
  - Bank Debt
  - Minutes
  - Leases



- **Key employees agreements**
  - **Non-compete**
  - **Non-disclosure**
  - **Non-solicitation**
  - **Liquidation damages**
- **Review all bank documents**
- **Review personal asset position, ownership, succession planning matters, and estate planning.**
- **Meet regularly and discuss options.**





# KEY EMPLOYEES



## KEY EMPLOYEES

- Identify, recruit, and develop a second level of management
- Create business plans with key people
- Reward key people who deliver results
- Share financial data with key people (how much open book limited, i.e. except for payroll)
  - Sign all non-disclosure
  - Do not release written data
- Evaluate deferred compensation agreements



## KEY EMPLOYEES

- Consider extended benefits
  - Life insurance
  - Disability insurance
  - Auto
  - Travel
- Create detailed job descriptions with goals, responsibility, and accountability (cycle time, gross profit, customer satisfaction)
- Family members – are they really the “right” choice or are they the only choice.



## KEY EMPLOYEES

- Is “key” employee based on performance or subjective factors (“length of time” with the company).
- Conduct an annual retreat
- Do not wait to start this process
- Hire a business facilitator to lead the annual retreat.
- Meet with your Board of Advisors when you return home. Ask of them what should you do? Seek advice, options, demand proactive ideas from them. Fire advisors who do not provide proactive advice.



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# Surviving the Market

**THANK YOU**

**QUESTIONS?**