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CONSTRUCTION INDUSTRY ADVISOR

atkinson

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Public projects

Leverage fringe benefits to reduce costs

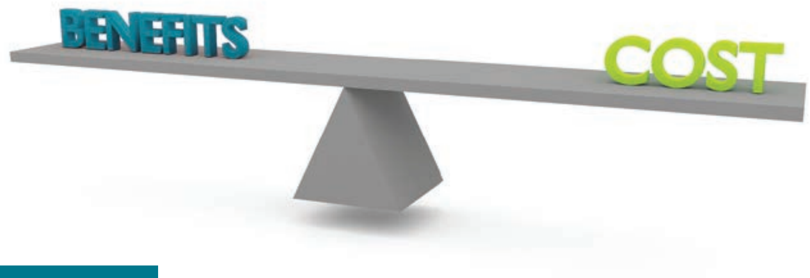
Construction is a highly competitive industry in the private sector. But when it comes to public projects, winning a job can be even *more* cutthroat. That's because government jobs are often subject to prevailing wage laws, such as the federal Davis-Bacon Act or the "little Davis-Bacon acts" that have been adopted in many states.

Government contracts generally go to the lowest bidder. But, in an effort to level the playing field, prevailing wage laws require contractors to pay wages that are comparable to those for similar work in the same geographical area and to meet certain other requirements. The rules are complex, and it's important for contractors to understand how they affect labor costs.

One area that deserves close attention is fringe benefits. Prevailing wage rates — which are established by the U.S. Department of Labor or relevant state agency — contain both a basic hourly rate (paid in cash) and a fringe benefit component. Savvy contractors can leverage fringe benefits to reduce their costs and make their bids more competitive.

Comparing cash with benefits

Government contractors generally can choose whether to pay the fringe benefit component of the prevailing wage in cash or to use those amounts to fund one or more "bona fide" employee benefit plans. You may be tempted to pay fringe benefit amounts directly to employees in cash. After all, this option offers simplicity and administrative convenience. But it can also drive up your costs, making it more difficult to bid competitively.



Why? It's because cash wages are subject to a variety of payroll liabilities, including Social Security and Medicare taxes (FICA), federal unemployment taxes (FUTA), state unemployment taxes (SUTA), workers' compensation insurance and public liability insurance. Depending on the state, these expenses can increase a contractor's labor costs by 25% or more.

Remember, credit toward fringe benefit obligations is only available for "bona fide" benefits.

For most contractors, funding employee benefits is a far more cost-effective strategy. Eligible benefit programs include:

- Health and disability insurance,
- Life insurance,
- Retirement benefits, such as 401(k) or profit-sharing plans, and
- Vacation days, sick days or other paid time off.

Contributions to employee benefit plans avoid the payroll liabilities listed above, significantly reducing a contractor's labor bid costs.

Crunching the numbers

Suppose, for example, that a particular worker is entitled to a prevailing wage of $50 per hour, which includes a $35 base wage and a $15 fringe benefit. If the contractor pays the entire $50 in cash (and assuming the payroll burden in the relevant state is 25%), its labor cost is $62.50 per hour [$50 + (0.25 × $50)].

On the other hand, if the contractor pays the fringe benefit component by funding one or more employee benefits, its labor cost is only $58.75 per hour [$50 + (0.25 × $35)]. Multiply the savings by hundreds of employees working 40 hours a week for several years, and the contractor's bid costs are reduced by hundreds of thousands of dollars.

Contractors can even use existing benefit plans to meet their fringe benefit obligations. Let's say, in the above example, that the contractor sponsors a group health plan and the contractor's premium contribution is $500 per month, or $6,000 per year. Assuming the employee in the example works 2,080 hours per year (40 hours per week × 52), the value of the health benefits is $2.88 per hour, which is credited toward the employee's $15 fringe benefit.

In this example, the health plan covers only a portion of the contractor's fringe benefit obligation. If you wish to avoid paying fringe benefits in cash, consider other types of benefits — including employer contributions to retirement plans — to make up the difference.

Designing a program

To ensure that fringe benefits satisfy your prevailing wage obligations, it's important to design your benefits program carefully. Remember, credit toward fringe benefit obligations is only available for "bona fide" benefits, such as those listed above. It's not available for use of company vehicles, tools, cell phones, travel expenses or benefits a contractor is legally required to provide. (Note, however, that health benefits are considered bona fide even if they're mandated under the Affordable Care Act.)

Contrary to popular belief, contractors can even use self-funded health plans to offset fringe benefit obligations. To be eligible, however, these plans must meet several requirements, including a funding arrangement that provides for irrevocable contributions.

Ignore prevailing wage laws at your own peril

If you fail to comply with prevailing wage laws, the consequences can be severe. For example, penalties for Davis-Bacon Act violations may include:

- Fines,
- Contract termination,
- "Debarment" (that is, exclusion from future federal contracts for up to three years), and
- Withholding of contract payments to cover unpaid wages and other damages.

Contractors or subcontractors that falsify payroll records or solicit kickbacks of wages are subject to civil and criminal prosecution.

Getting the right help

Penalties for prevailing wage violations can be harsh. If you work on government projects — or plan to do so — work with your advisors to ensure that you understand the requirements, make the most of fringe benefits and prepare accurate bids.

In addition, be sure to keep timely, accurate records to establish your compliance. If you're a general contractor or upper-tier subcontractor, you're responsible for prevailing wage violations by lower-tier subcontractors, so it's critical to document their compliance as well. ■

Are you ready for the new revenue recognition standard?

It's been eight years since the Financial Accounting Standards Board (FASB) first proposed an overhaul of its revenue recognition standard and four years since it issued the new standard. Now the standard's effective date is finally approaching — Jan. 1, 2019, for calendar-year nonpublic companies that comply with Generally Accepted Accounting Principles. Is your company ready?

Although some construction businesses will be required to record revenue differently, many will see little change. But regardless of the new standard's impact on your company's revenue, implementing it will take some preparation. You may need to modify systems or processes for tracking and reporting revenues and costs, implement new internal controls, and expand your financial statement disclosures. Plus, applying the new standard's requirements will require you to exercise considerable judgment.

In a nutshell

The new standard establishes a five-step approach to recognizing revenue:

1. Identify the contract. (In some cases, two or more related contracts should be combined into one.)

2. Identify the performance obligations. (One contract may contain a single performance obligation or several distinct obligations.)

3. Determine the transaction price.

4. Allocate the price among the performance obligations.

5. Recognize revenue when (or as) a performance obligation is satisfied.

Many construction contracts involve a fixed price for a single performance obligation satisfied over the life of the contract. For these contracts, revenue will be recognized in much the same way as it is under current rules, often using an approach that's similar to the percentage-of-completion method.

But more complex contracts will demand significant judgment to determine, among other things, whether there are multiple performance obligations that should be accounted for separately, whether performance bonuses or other incentives should be included in the transaction price and how to allocate the price among the performance obligations.

Steps to take

To prepare for the new standard, first take inventory. Review your contracts and identify those that have multiple performance obligations. Examples of contracts with distinct obligations that may need to be accounted for separately include a contract to build a road and a bridge, or a contract to construct a building, as well as to supply and install certain equipment. On the other hand, multiple goods and services may be treated as a single performance obligation if your firm "provides a significant service of integrating the goods and services."

Next, identify contracts with variable consideration provisions such as performance or safety bonuses (or penalties) and liquidated damages. Variable consideration may also result from unapproved or unpriced change orders. Under current rules, variable consideration generally isn't recognized until the contingency is resolved (in other words, the performance standards are met) and the amount can be measured reliably. Significantly, the new standard provides a complex set of rules for estimating the amount of variable consideration if it's likely to be realized and including it in the transaction price.

Review your systems, policies and procedures, too. Be sure that you have controls in place to evaluate contracts and make the right judgment calls. Evaluate your accounting system to ensure that it can accommodate separate tracking and reporting of multiple performance obligations, if necessary. And consider whether contractual or operational changes are appropriate to reduce the impact of the new standard.

Be prepared

As mentioned, the new standard may not affect your construction company all that much. Or maybe it will. The only way to know for sure is to be prepared. Your CPA can help you review your situation. ■

Focus on collaboration: The estimator's changing role

Technological innovations and other recent developments are rapidly altering the job of the estimator in construction. Estimators are taking on a more collaborative, value-added role — enabling them to have a significant impact on project costs, quality and risk management. Let's look at some of the most important changes.

Better software

The latest software products significantly enhance the takeoff process, allowing estimators to work more productively and cost-effectively. But these products also improve quality with "drill down" capabilities that allow estimators to obtain more detailed information about a project's plans and specifications.

In addition, today's software offers version control features that create an audit trail and reduce risk by ensuring that project personnel are working with up-to-date specifications. Meanwhile, increasing reliance on smartphones, tablets and other mobile technologies makes these applications more accessible, which enhances communication and collaboration among estimators, architects, engineers, owners and other team members.

Bolder BIM

As you're probably aware, building information modeling (BIM) technology creates 3-D models that facilitate collaboration by enabling parties to view the completed project from different angles and to better understand the spatial relationships between building components. BIM also incorporates specific materials and other building information into the early stages of the design process, allowing the parties to see how various changes affect the project.

The most advanced BIM technology, known as "5D BIM," links 3-D designs with scheduling data ("4D BIM") and cost-related data. Some in the estimating profession fear that 5D BIM poses a threat to the estimator's role. But many observers believe this technology will enhance that role by allowing estimators to work more efficiently and focus on only the most valuable activities.

For example, 5D BIM allows estimators to get involved early in the construction process to help identify potential design issues and show team members how changes in materials or other specifications will affect a project's costs, quality and timing.

Legal eagles

One should never confuse an estimator with an attorney. Yet there are contractors who ask their estimators to review job contracts. Why? Because, with experience, estimators often develop a keen eye for identifying provisions that may increase financial risk.

For example, one common red flag is a contract that modifies or eliminates provisions requiring an owner to furnish evidence of project financing. Your estimators may learn to spot others common to your jobs.

A continuing evolution

As the estimator's role continues to evolve, the skills and training required for the job will also change. Moreover, as BIM and other software products become increasingly integrated into the estimating process, it will be more and more important for construction businesses to hire technology-savvy employees for these jobs. ■

Lock down financial assets with the right controls

You've got a fence around the jobsite. Your heavy equipment is turned off and the keys stored securely. Your materials are tied down and, where possible, kept out of sight. But what about your financial assets? Are you protecting those as carefully as your physical assets?

Many contractors worry so much about petty theft or misuse of equipment that they overlook the home office or job trailer where so much important information is held and so many financial transactions take place. Here are some ways to lock down your financial assets, too.

Divvying up duties

Smaller contractors may rely on one or two employees to handle several critical duties. In some cases, a single employee may be responsible for opening the mail, signing checks and overseeing accounts payable. That may be practical, but it can leave you susceptible to fraud.

To make it harder for workers to dip into the till, divide accounting and finance-related responsibilities among multiple employees. For example, have someone independent of the vendor payment functions review all new supplier setup entries.

Also, require employees who have disbursement duties to take at least one full week off from work each year. Employees who voluntarily decline vacation time may do so because they're afraid their fraudulent activities will be discovered by those who fill in for them while they're absent.

Building up banking protections

Ask your bank whether it offers the check-matching service known as "Positive Pay." Under this service, you send the bank a list of checks that have been written each day. The bank matches the account number, check number and dollar amount of each check presented for payment against the list you sent. All three components of each check must match exactly or the bank won't pay.

There are many other simple, but effective, steps you can take. Perhaps you've already implemented some of them, but it doesn't hurt to double-check and make sure they're being followed. Assuming you have controls in place is just as dangerous as having none.

For example, store checks in a secure location and limit the number of employees who have access to them. (Has this number crept upward over the years?) Don't use signature stamps for checks or write checks payable to cash.

In addition, set a dollar limit with your bank on the amount for which the bank can clear checks without contacting you for authorization. Many companies require two signatures for amounts over a certain number.

Finally, protect financial transactions, such as wire transfers and authorizations for credit lines and loans, by using passwords and telephone verifications, in which you or another authorized (and trusted) employee approves activities by phone. Such dual-level authorization for sensitive information is now a normal practice.

Putting employees on notice

An effective internal control program requires regular monitoring. For example, have bank statements and canceled checks sent directly to you and review them.

Keep your employees on their toes by performing random, unannounced audits on your disbursement process. If they aren't sure what you're monitoring and when, they may be less likely to attempt to defraud you. In the event fraud does occur, no matter how minor, be sure to take decisive action no matter the identity of the offender. By taking these steps, you're putting employees on notice that preventing fraud and theft is a high priority for your company.

Work with your CPA to create an effective internal control environment. He or she can help you identify areas of greatest risk and develop controls to minimize those risks. Your accountant can also train you on how to monitor bookkeeping records, invoices, bank statements, payments, journal entries, financial reports and other documents.

Securing both fronts

Many types of companies only have to worry about preventing fraud at the office. Contractors don't have it quite so easy. But by being vigilant and ensuring that the right controls are being followed, you can protect your jobsites *and* your money. ■