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8 steps for taking over a troubled project

In the current economic environment, opportunities often arise for contractors to take over troubled projects. These jobs can be rewarding, but they also present significant dangers. Following are eight steps you should take to maximize the rewards and manage the risks:

1. Stay in your comfort zone. Given the inherent perils of taking over a troubled project, don't increase your vulnerability by stepping out of your comfort zone. Be sure the job is within your construction company's core competencies. Remember, troubled project opportunities often arise because another contractor failed to perform. Given this history, the owner and surety will likely scrutinize your every move.

2. Find out what went wrong. Make sure you understand how the project became troubled. Was the original contractor unqualified? Did he or she run into financial difficulty? Were the owners or subcontractors part of the problem?

Keep in mind that, because a project is troubled, it's likely to require a higher degree of management oversight and documentation than an ordinary job.

To get a feel for the situation, visit the site; review meeting minutes and other key project documents; and speak to the owner, subcontractors, architects and engineers. Also, if possible, meet with the original contractor's representatives to get their insights into what went wrong. This information will help you decide whether to take the job and, if you do, to avoid similar problems.

And make sure you know the owner's and surety's teams that you'll be working with in completing the job. Do they seem competent, trustworthy and reliable?

3. Rebid the work. Because the project is partially complete, it makes sense to rebid the work based on current site conditions, a new scope of work in light of what's been done and what's left to be done, and the current status of materials and equipment. Obtain bids from existing or new subcontractors, taking steps to replace any subcontractors that contributed to the job's troubles.

Keep in mind that, because the project is troubled, it's likely to require a higher degree of management oversight and documentation than an ordinary job. Be sure to provide ample workers and assign a project manager who's adept at handling difficult jobs and reacting quickly to problems.

In developing your bid, it's a good idea to incorporate contingency funds to cover uncertainties, such as additional work to correct latent defects left by your predecessor.

4. Review the contract. Scrutinize the existing contract. Although the owner may expect you to "step into the shoes" of the original construction company, your contract to complete the project may require some adjustments. Review

its language to, again, identify any changes in the scope of work or other disputed issues that must be addressed in the new agreement.

Given the circumstances, it's likely that the project has been delayed. If the original contract's completion date is no longer realistic, determine a reasonable completion date and negotiate appropriate changes. Also, determine the extent to which completion of the job depends on work performed or materials and equipment supplied by the owner, subcontractors, suppliers or other third parties. Confirm the status of these parties and build appropriate lead times into your schedule.

Consider using "lean construction" techniques to minimize delays and streamline completion of the project. (See "Lean construction can enhance efficiency, speed and profitability" at right.)

5. Check on funding. Be sure that the lender is willing to sign off on a new contract. Also, because the cost to complete the project may be more than originally anticipated, confirm that there's sufficient funding to cover monthly draws.

6. Document the original contractor's work. Create a record of the job's status — using photographs or video — before you begin your work. This will help protect you against any claims for defective work attributable to your predecessor.

7. Manage change orders carefully. This is particularly important if the original contractor was bonded and the surety has taken over the project. Make sure you understand the change order procedures and that you obtain proper authorizations from the owner, the surety or both, if necessary, before you proceed.

Surety approval may be required, for example, for all change orders or for change orders that increase the contract price by a certain percentage. Or it may be required for all change orders once cumulative changes exceed a certain amount.

8. Don't hesitate to ask for help. In truth, there are many issues you should address when presented with an opportunity to take over a troubled project. Your financial and legal advisors can help you evaluate the risks associated with a particular project and take steps to minimize those risks. ■

Lean construction can enhance efficiency, speed and profitability

When you take over a troubled project (see main article), it's virtually certain that the job is behind schedule. Although meeting the original contract's schedule may not be realistic, you can provide added value by incorporating lean construction techniques to streamline completion.

Lean construction, which is derived from lean manufacturing concepts, involves optimizing your resources (labor, equipment and materials) to reduce waste, increase efficiency and improve the flow of activities — thereby increasing the value you provide to customers and enhancing your own profitability. Here are a few examples:

- Working closely with architects and engineers and using computerized design systems to produce better design and construction information and reduce the need for redesign work.
- Incorporating look-ahead planning to provide for just-in-time materials delivery and resource (labor and equipment) availability. By having materials and resources available at the point of use exactly when needed, you avoid the costs associated with on-site storage and double-handling or idle resources.
- Identifying tasks that can be completed simultaneously.
- Using cross-trained personnel who can work in several different project areas.

Profits can go up or down: Which way are yours headed?

As the U.S. economy continues to be a bit lackluster, it's critical that contractors stay on top of their bottom lines. That, of course, will require that you fully understand what a hit to your profitability can do to your construction company. Here are some key items you simply can't ignore if you want to stay in the black.

Managing overhead

Expenses that aren't directly related to your projects, commonly referred to as "overhead" or "indirect costs," are easy to ignore. Some examples of indirect costs include project management, purchasing, contract administration, safety oversight and salaries.

Other indirect costs are small tool, fuel and supply, and freight charges. Taxes, title transfers, permits, bonds and job insurance, and shop and marketing costs are all typically considered indirect costs, too.

Construction companies that fail to properly allocate indirect job costs to their projects are missing out on opportunities to recoup expenses and submit accurate bids. When looking for ways to reduce these costs, consider your history. An analysis of indirect costs and their relationship to your operating results, for instance, can help you determine which costs are fixed, which are variable and which are a little of both.

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You likely can't do much to change fixed costs beyond, perhaps, negotiating with your lenders, landlords, utility providers, etc. But you may be able to trim variable costs by cutting out (or down on) unnecessary expenses.

Once you're armed with that knowledge, you can construct a budget for indirect costs to plan for the coming year. Then you can regularly compare your budgeted amounts for indirect costs with your actual spending. If you're going over budget, look for ways to cut back.

Conquering receivables and payables

You do the work, you generate an invoice and you send it out. Bills come in and you pay them the best you can. The management of construction receivables and payables, however, is easily taken for granted.

One receivables strategy that plays well with many contractors is front loading contract billings. This involves shifting some profits into earlier phases rather than applying a flat rate to all phases as usual. Be careful not to be too aggressive, as overbilling can alienate your owner

or general contractor, which can cause problems down the line. But, when done properly, this strategy can help you collect some of your profits before the retainer is paid on completion.

If you've always paid vendors within 30 days and are experiencing a cash flow shortage (easy to do in today's economy), consider extending your payment cycles. Just as you're sometimes flexible with parties that owe you money, ask for a break from your creditors to help you handle the cash crunch and deal with cost overruns.

Minding the change orders

It's critical that you address change orders properly. Doing so can help protect and even bolster your bottom line in tough times. But, first, you need to know your contract. It's next to impossible to quickly identify a change unless you know how it differs from the original agreement.

Also, be sure you have a well-managed change order system. Ultimately receiving a written, signed and authorized change order that will get you paid requires careful recordkeeping. Maintain daily reports, project correspondence, meeting minutes, schedules, cost records, photos and other documentation to help indicate an operational change.

Last, be sure to provide written notice and an explanation of how your revised work will affect the schedule and delivery date, including a date on the document to prove you gave owners plenty of time to react to the associated costs. Lack of notice can be a strong defense for owners, so following these steps will help increase the likelihood you'll get paid for the extra work.

The bottom line

Having a healthy bottom line is crucial for contractors in this day and age. So look at which of the ideas presented here you're already implementing and which you should start. Then talk to your financial advisor about other ways to ensure that your profitability continues to grow. ■

Bar-code systems can help protect small tools

Throughout the year, many construction companies tend to see a ton of small tools mysteriously disappear at the hands of petty thieves and dishonest employees. The good news is that you can nip tool thefts in the bud by integrating the right technology into your operations. One intriguing option is bar-code technology.

Miniature assets

Think of tools as miniature assets that can be coded and tracked just as easily as a 17,000-pound backhoe. For example, electronic bar-code systems easily and efficiently label, coordinate, trace and catalog tools in real time. These systems usually involve, as you may have guessed, bar codes displayed on polyurethane labels on each tool. These labels are designed to hold up under repeated on-the-job wear and tear.

The systems also come with hand scanners, which project or equipment managers use to scan the bar codes when assigning tools and accepting returns. Tracking software sends the pertinent information to a database that you

can also use for browsing, billing and running reports. In addition, the program records repair histories and maintenance schedules.

To take bar-code tracking to the next level, integrate it into your accounting system. Doing so can boost the value of your tool-related data and streamline procurement of these assets.

The cost of bar-code technology varies, depending on the number of features included in a given system configuration. How complex a system you'll need will, of course, depend on the number of tools you're looking to track as well as the number of job sites you typically maintain.

Improved efficiency

Bar-code technology also improves management efficiency. How? You can let managers know that, if the system doesn't show tools as coming back from job sites at completion, you'll charge the project for them. Thus, managers will more closely monitor and protect these items to avoid going over budget.

The right system may also reduce your legal liability. Federal regulations often require workers to wear safety gear such as goggles, hard hats and respirators. And it may enable you to show that you issued employees the proper equipment, which could in turn limit your accident liability.

Greater accountability

To take bar-code tracking to the next level, integrate it into your accounting system. Doing so can boost the value of your tool-related data and streamline procurement of these assets.

For instance, you might create a "live" (constantly updated) list of tool information, such as descriptions, warranties, purchase dates, costs and maintenance schedules. You can then generate a report of employees or job sites responsible for each of the small tools on the list.

An integrated system may also enable you to assign tools by employee name, job code, project number, date, time, location or other criteria. This can give you some valuable insights into how that tool is being used and prevent it from being left lying around unused on a job site.

In turn, you'll foster an atmosphere of accountability by making managers and employees more responsible for these assets. There's no better way to drive home a point about wasted assets or money than to sit down with employees and show them, in dollars and cents, how a tool is being misused.

Bottom line results

Bar-code technology has been around for some time. But its "age" doesn't affect its effectiveness in tracking small tools. Of course, if you're working with the technology already, good for you! But you might want to see whether there are any upgrades that you might have missed.

Many smaller construction businesses may still be using a paper checklist system to ensure small tools are accounted for. If that's the case for your company, you may want to go ahead and implement a higher level of tool management. Work with your financial advisor; he or she can help you make the right buying decisions. ■

Calculating the true cost of labor

When bidding on projects, it's critical to understand your true labor costs. For most construction companies, employee compensation is the single largest expense — so even small errors in calculating labor rates can lead to substantially inaccurate estimates.

Two keys to developing accurate labor rates are: 1) factoring in *all* direct and indirect costs associated with an employee or class of employees, and 2) accounting for the cost of nonproductive time.

In addition to wages, employee costs include, but aren't limited to:

- State and federal payroll taxes (Social Security, FICA, unemployment),
- Vacation, sick days and other paid time off,
- Employee benefits, including insurance (health, disability, life and so forth), bonuses and retirement plan contributions,
- Workers' compensation, liability and auto insurance,
- Training expenses,
- Job-related clothing, safety gear and tools, and
- Company-provided vehicles, cell phones and tablets.

Once you know the annual costs associated with an employee, you need to calculate the number of hours the employee is available to work on construction jobs. Why? Because an employee's true hourly rate must be sufficient to cover the cost of both productive *and* nonproductive time. Consider this example:

Nancy earns $20 per hour working for a construction company. Assuming she's paid for 40 hours per week, 52 weeks per year (2,080 hours), her annual wages are 2,080 × $20, or $41,600. Taking into account taxes, employee benefits and other expenses, the company's total cost associated with Nancy is $49,160 per year.

Of course, Nancy doesn't spend all 2,080 hours working on jobs. Some of those hours are nonproductive time, such as paid vacation, holidays and sick days, plus time spent at company meetings and training sessions. Suppose that Nancy's paid, but unchargeable, time totals 204 hours per year, so her total billable time is 1,876 hours each year.

To ensure that it charges enough to cover Nancy's annual costs, her company should calculate her labor rate by taking those costs ($49,160) and dividing them by the number of chargeable hours (1,876) to arrive at a rate of $26.20 per hour. ■

Rosen Seymour Shapss Martin & Company LLP ("RSSM") has been an active member in the construction industry for the past 45 years providing innovative tax, accounting, auditing, risk management and advisory services helping clients stay ahead of the "curve" to meet and achieve their goals.

Our experienced professionals understand how the industry operates and what makes it unique. This blend of seasoned knowledge and experience allows RSSM to provide advice that helps our clients stay competitive in an increasingly complex marketplace. RSSM has developed a thorough understanding of the highly competitive and demanding concerns of project management, state and local regulations, bonding and surety relationships, tax compliance, job cost estimation and percentage-of-completion accounting.

RSSM offers tax services that can be tailor-made for your individual companies. Using our knowledge of the industry, construction law and years of construction experience, we work hand-in-hand with our clients, often acting as their most trusted financial and tax advisor. We can help you take advantage of often-overlooked tax savings opportunities available, and minimize taxes without impacting the working capital required for bonding. We also provide timely and accurate audits, reviews and compilations and we are available to discuss your financial statements.

In addition to our basic accounting and tax services, we provide companies of all sizes with a broad range of services that address improved operational efficiency and bottom-line results: Job Cost Control, Bid Formulation and Estimating Controls, Bonding, Insurance and Licensing, Project and Sales Strategy, Financial and Strategic Planning, Multi-State Operating Issues, On-Time and Overrun Performance, Executive Searches, Business Continuation, Executive Compensation and Succession Planning, Payroll Reporting, Business Valuations and Litigation Services and Internal Control Evaluations.

Lastly, RSSM construction experts can assist in compliance issues due to contractors being subject to fiscal monitors and Federal Acquisition Regulations because of the number of jobs financed by Federal and municipal funds.