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Have a question?

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Points to Ponder

“The greater danger for most of us lies not in setting our aim too high and falling short; but in setting our aim too low, and achieving our mark.”

Michelangelo



PROFIT CLUE™

Profitability Tips for Construction Businesses

Spring 2008

Scrutinize Contracts to Manage Risk



Risk is a way of life for a construction company owner. Still, there's no reason to walk into the fire if you can avoid it. Contracts, in particular, are full of pitfalls and traps. But if you know your options, you're in a better position to minimize risks and maximize profitability.

Keep the following points in mind when reviewing contracts.

1. **Don't agree to an unlimited indemnity clause.** Limited indemnity – meaning you agree not to hold the owner responsible for damage caused by others – is reasonable. But unlimited indemnity releases the owner from claims for virtually all damages, injuries or losses – even ones the owner causes. On the flip side, only accept responsibility for damages your company causes.
2. **Who pays for stored materials?** You didn't cause the delay, so why should you pay storage fees on

the few tons of sheetrock sitting in storage? A reasonable charge for stored materials can shift the burden toward responsible parties.

3. **Contain retainage.** Propose using a letter of credit as a substitute for a retainage agreement. But if you can't avoid retainage, be sure it's limited to a percentage of labor costs only, not materials.
4. **Watch scope creep.** No, it's not a law of nature. You can hold scope creep in check by making sure the contract explicitly holds you responsible only for the work required of you by the drawings or specifications it references.

Remember, you get what you negotiate. And if you just can't come to a mutually satisfactory agreement, walk away.

No matter the size, no job is worth signing a contract that you know could come back to bite you in the end. ■

The Pen is Mightier: Get Change Orders in Writing

Resist pressure to act on verbal agreements, or you may end up working for free.

Case in point: It's a month into the project and the customer's project manager wants you to change the size and material for a retaining wall adjacent to the building. You know you should issue a change order before getting started, but the project manager is impatient. This is one of your larger and more influential customers, so you ignore your better judgment and proceed with just a verbal agreement.

But a month later the owner says he never approved the change and disputes the additional charges. What to do?

Unfortunately, at that point you have few viable options. You can file a claim against the owner, but your chances of recovery without a signed change order are slim. Or you can take the loss and chalk it up to the learning process. Either way, you're looking at an interruption in cash flow and a soured client relationship.

Remember: Insist during contract negotiations that all change orders be in writing. After all, if it's worth doing, it's worth writing down – and that's worth saying so in the contract. ■



Who's Who in ProfitCrew™

Who: Joel Dzedzic, CPA, is a partner and member of Wolf & Company's Construction client service team. Joel works with clients in many industries including construction, real estate, manufacturing, and distribution. In addition to providing traditional accounting, audit and tax services to his clients, Joel focuses on profit improvement issues, internal operation reviews, cost accounting procedure analysis, and growth and acquisition strategies.

What he does best: Joel devotes the majority of his time working with clients in the construction industry. He has testified as an expert witness in contract disputes and cost accounting discrepancies. He has presented various seminars on issues including work paper presentation, audit and accounting software usage and construction productivity improvement. Joel is a member of the American Institute of Certified Public Accountants, Illinois CPA Society, and American Subcontractors Association.

In his spare time: Joel is a devoted father to his two young sons. A former college athlete and an Eagle Scout himself, Joel is a Cub Scout den leader and Little League baseball coach. He enjoys hunting, fishing, golfing, and cheering on the Chicago White Sox, Bears, and Blackhawks.



Questions & Answers

Question

My accounts receivable is getting out of control. How do I get my customers to pay on time?

Answer

Here are some straightforward steps you can take to ring collections under control:

- 1. Before accepting a new customer, check the company's credit, litigation and lien history carefully.** Target clients with a strong financial base and a solid track record of fair business practices.
- 2. Agree on the rules ahead of time.** During a pre-construction meeting with the owner, the contractor and the financing source, resolve payment terms, documentation requirements and other issues that might delay payment.
- 3. Understand your customer's payment cycles and bill accordingly.** Don't suffer a 30-day delay because your invoice arrived after your customer's processing deadline.
- 4. Get senior management involved** with aged receivables – especially those that exceed 60 days.
- 5. Focus on customer service.** Satisfied customers tend to pay on time. There may be an underlying reason for slow payment that you need to address. ■