ON-SITE

SUMMER 2008

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Know when to say when

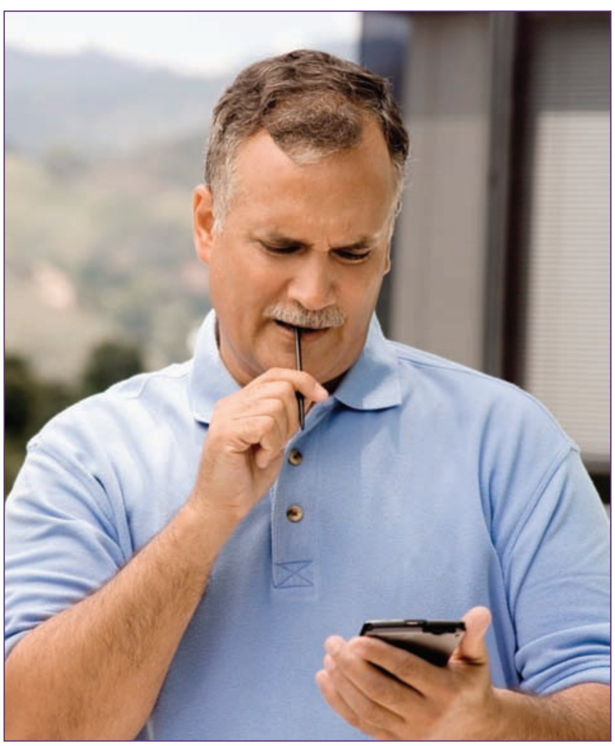
Reviewing the repair vs. replace equipment decision

For contractors, deciding whether to repair or replace a piece of equipment is a recurring or, in some cases, ongoing dilemma. Wait too long to replace a piece of equipment and it could (and probably will) break down at the worst possible time. Buy too impetuously and you could be throwing away dollars better invested elsewhere. The key is knowing when to say when.

Not all repairs are the same

When it comes to repairs, it's important to recognize that they're not all the same. Moreover, because repair costs will increase as an asset ages, it's usually better to budget these costs on an increasing scale, rather than as a constant over the life of the equipment.

Perhaps the most common form of repair (at least we hope it's common) is regular preventive maintenance. View it as an investment, not just a cost, because it can extend the lives of your assets. An effective preventive maintenance program also limits downtime and lost productivity.



Then you have minor repairs: These don't extend the life of a machine — just bring it back into operation. They're generally worth doing because they're inexpensive, at least compared to replacing the equipment. But if you lack an efficient system for handling minor repairs, they can stack up and become a big problem.

Last, there's the doozy — major repairs. This is where the repair vs. replace question really comes into play, because major repairs are usually expensive. Still, contractors tend to repair equipment because, on its face, a repair often seems less expensive than the commitment of a new purchase. But this isn't always true.

View regular preventive maintenance as an investment, because it can extend the lives of your assets.

You have many factors to consider. In addition to assessing the actual cost of the repair (parts and labor), you need to look at the cost of the downtime you'd incur (which includes lost labor hours) while the equipment is being repaired.

You also need to think about the equipment's age and efficiency. Making expensive repairs on old, inefficient equipment may not make sense in the long run if these assets are constantly breaking down and slowing job progress.

And you must consider the future — if the asset is likely to sit idle for the next project (or next several), there may be no point in fixing it.

New equipment has rewards, risks

In many situations, new equipment can provide a value advantage. New machines will likely have higher productivity rates than older ones. And initial maintenance costs should be lower and project delays fewer because new assets are generally more reliable.

You also can enjoy valuable tax advantages when you purchase new equipment — especially if the old equipment has already been fully depreciated. And a couple of bigger-than-usual tax breaks are available this year. (See "2008 tax act bolsters asset acquisition deductions" below.)

Yet just because you buy new doesn't mean you'll guarantee yourself greater value. The lowest price, for instance, isn't always the best choice; the quality of the equipment and the availability and terms of dealer financing and support are critical. So research these thoroughly before making a repair vs. replace decision.

Also familiarize yourself with the operational costs and maintenance requirements of a prospective asset. Every machine breaks down eventually — look at the average speed of repairs and cost of returning it to service. Historical resale or salvage value is important, too.

Finally, think about your workforce. Will you have the time and wherewithal to properly train operators to use the new equipment? Failing to do so can drastically affect the life and effectiveness of the piece.

Hardly an easy decision

The repair vs. replace decision is hardly easy. One way to make it somewhat easier is to keep good records of your equipment use. By doing so, you can more easily calculate your total ownership costs of each piece and make the best choice as to whether to repair it or replace it.

2008 TAX ACT BOLSTERS ASSET ACQUISITION DEDUCTIONS

One factor that may affect any repair vs. replace decision you're mulling is the Economic Stimulus Act of 2008. It provides some tax breaks intended to spur businesses to further invest in assets, which, for contractors, may include all types of equipment, office technology and computer software.

The act increases the Section 179 limit for initial year expensing to $250,000 (from $128,000). The Sec. 179 expensing election allows a current deduction for newly acquired assets you'd otherwise have to depreciate over a number of years. It begins to phase out dollar for dollar, however, when total asset acquisitions for the tax year exceed $800,000 (up from $510,000 before the act).

The new higher limits apply only for calendar year 2008 or your fiscal year that begins in 2008. You can claim the expensing election currently only to offset net income from the business, not to create or add to a loss.

Another depreciation-related provision allows special 50% "bonus" depreciation for certain property, generally only if put into service in 2008. For eligible property, the depreciation amount is equal to 50% of its adjusted basis. Types of property that may qualify include tangible property with a recovery period of 20 years or less, computer software, and qualified leasehold improvement property.

This includes all types of equipment, trucks, office furniture and technology. The break can be useful if you've used up your Sec. 179 expensing election or your ability to use the election is unavailable because your net income has been partially or fully phased out.

Employee stock ownership plans

A multifaceted strategy for contractors

Drive your vehicle to the crossroads of succession planning, corporate finance and employee benefits and what will you find? The employee stock ownership plan (ESOP).

For any business, including a construction company, these arrangements offer a multifaceted strategy for facing these challenges. Of course, ESOPs have their risks as well — particularly for contractors, who work in an industry with some distinctive characteristics.

Creating a trust

An ESOP is, essentially, a qualified retirement plan, similar to a profit-sharing plan. But, as its name indicates, the arrangement enables employees to own part of their employer's company.

Generally, to start an ESOP, a business sets up a trust and contributes new shares of its own stock to the trust. It also can contribute cash that is then used to buy shares from existing owners. The company then makes annual contributions in either stock or cash that are allocated to individual employee accounts within the trust. This is an unleveraged ESOP.

Because employees' ESOP accounts grow in value over time, participants may think twice about leaving your company.

Alternatively, in a leveraged ESOP, the business sets up the trust but the trust borrows money from a financial institution and uses the loan proceeds to buy new or existing shares that are allocated to individual employee accounts within the trust. The company then makes cash contributions to the trust over a period of years so the trust can repay principal and interest on the loan.

Whichever approach you choose, an ESOP must predominantly invest in "qualifying" employer securities. A qualifying security is any common stock of the company or a member of its controlled group (an entity with 50%-or-greater common ownership).

Reaping the benefits

What makes leveraged ESOPs particularly attractive is that they're not only a viable employee benefit, but also a tax-advantaged business financing or succession planning tool.

This is because, unlike traditional profit-sharing plans, leveraged ESOPs may borrow to buy stock from company shareholders or newly issued stock from the company — enabling the company to raise needed capital or the shareholders to cash out of some or all of their holdings.

Regardless of how the plan acquires stock, there are also potential tax advantages for either the company or its shareholders. Company contributions to the trust are tax-deductible, within certain limits, and shareholders may be able to defer capital gains on their sale of company stock to an ESOP.

Last, an ESOP can serve as an employee retention tool. Because employees' accounts grow in value over time, participants may think twice about leaving your company. And with labor shortages being all too common in the construction industry, retaining a stable workforce gives you a considerable edge over the competition.

Considering the risks

As a contractor, you'll need to consider some industry-specific risks when pondering an ESOP.

For starters, you'll have to record the money you borrow for the ESOP as a liability. The resulting reduction in your business net worth may not be operationally significant, but it could affect your bonding capacity. Plus, employees who leave your company may require you to buy back their shares — creating an off-balance-sheet liability for you.

There are also risks that apply to all types of businesses. For instance, ESOPs are prohibited from paying more (or less) than adequate consideration for the employer's stock. A qualified, independent appraiser must determine the fair market value of a closely held company's ESOP shares both annually and when shares are acquired from the existing owners.

Plus, plan fiduciaries are responsible for arranging regular appraisals, and those who fail to act in the participants' best interests risk liability for breach of fiduciary duty. They may also be subject to excise taxes on prohibited transactions, such as selling stock to the ESOP at inflated prices.

Looking before you leap

ESOPs have been growing in popularity for some time. Yet what's good for one business may not be good for your construction company. With your CPA's help, look into the feasibility of an ESOP before you leap into the arrangement itself.

4 ways to tighten up job-site security — and save time and money

Along with the obvious physical losses that job-site theft creates, there are hidden costs to such crime. These include looking for missing items, reordering and restocking stolen materials and tools, and filling out and filing the pertinent administrative reports. By tightening up your job-site security measures, you may be able to save time and money. Here are four ways to get started:

1. Think locally. Before work begins, meet with local law enforcement. Discuss the job's scope and duration, gather information about the prevalence of theft and vandalism in the area, and request nightly patrols past the job site.

When working in residential areas, see whether a neighborhood watch program has been set up. If so, speak with the group's leadership or attend a meeting to notify them of the project and ask for help. (Doing so will also help build goodwill with residents of the area.) Sometimes commercial establishments have similar organizations.

2. Act nationally. Be sure to register your equipment with the National Equipment Register (NER), which was formed in 2001 to combat the growing problem of construction theft.

The organization maintains databases of registered and stolen equipment, assists in tracking stolen equipment through its 24-hour hotline, and works with law enforcement agencies and the insurance industry to identify stolen equipment.

The NER is also involved with a national training program that teaches police officers what to look for when investigating equipment theft. For more information, visit nerusa.com.

3. Go high-tech. If you wake up worried at 2 a.m., you can save yourself from a lonely car ride and some lost sleep by installing a Web cam (or two) on your job sites. A Web-cam system typically involves a digital camera that uploads images to a Web server continuously or at regular intervals.

Install a camera on a pole or robotic arm at a job site and you'll be able to access the images it captures via the Internet. Web cams can produce high-resolution snapshots and panoramic images — and even shoot streaming video. Type "construction Web cam" into your favorite search engine, and you'll likely find a bevy of vendors to choose from.

4. Mind your fundamentals. For instance, make sure you have adequate lighting in areas of the job site vulnerable to theft. Also, check your fencing and gate placement. Are fences too low or not strong enough? Are there too many entrances to the job site?

Finally, don't underestimate the importance of signage. Post signs on gates and throughout the site informing everyone that you have security measures in place and you will prosecute thefts to the fullest extent of the law. Sometimes just giving a clear indication of a zero-tolerance policy toward crime is enough to deter a would-be thief.

Futurescope: Construction Business Trends

Design-build gains ground on traditional model

The popularity of design-build — under which one entity performs both architecture/engineering and construction under a single contract — has been growing steadily over the last decade. About eight years ago, design-build represented only about 35% of the construction market, according to the Design-Build Institute of America (DBIA). The DBIA predicts it will overtake the traditional design-bid-build model as the preferred project delivery method for nonresidential construction by 2015.

So what's so great about design-build? Well, design-build proponents say the approach allows the design-build team to deliver a project on accelerated schedules and at lower costs than the design-bid-build model. One reason why is that there's less "back and forth" between the job's architects or engineers and its builders. And because no bidding is involved, no time is lost to this process.

In addition, because the designer and contractor are working together, change orders as a result of errors and omissions, ambiguities, and inconsistencies are greatly reduced, if not eliminated. This isn't to say that disputes between the design and build factions of a project won't occur, but they're often easier to resolve with one team as opposed to two.

One reason design-build may continue gaining ground is that it's often a good complement to "green building." Design-build teams can create a design based on environmentally friendly components rather than try to work them in later, when work is actually in progress.

Of course, under the traditional design-bid-build model, an architect could still do this. But design-build often eliminates many of the time-consuming conflicts over precisely which environmentally friendly components to use.

Granted, design-build has its potential shortcomings. One risk of having designers and builders on the same team is that fewer, if any, checks and balances exist. For instance, an independent design firm may be more likely to catch deviations — inadvertent or otherwise — from the stated plans.

Alternatively, builders not directly related to the design team may be more adamant about sticking to the original design, whereas design-build teams may be at greater risk for constant tinkering with the plans, which can slow down progress and increase costs.

Whether a proponent or opponent of design-build, no one can deny that it remains a force to be reckoned with in the construction industry. Any contractors who have yet to participate in one of these projects would more than likely be doing themselves a favor by learning more about this increasingly popular building model.

The Contractor's Corner

Can symbol recognition software help my estimators?

I recently hired a new estimator who's quite the techie. One product he's been practically begging me to buy is symbol recognition software. Could you tell me a little more about this application?

It's getting to the point now where very few, if any, tasks in the construction process aren't affected by technology. Estimating is, of course, a key stage in any job, and the more accurate and timely an estimator can be, the better. Symbol recognition software is a stab in this direction.

Help with counting

In recent years, like so many other things, estimating has gone digital. Instead of bulky, easy-to-damage blueprints, on which inadvertent mistakes are all too common, estimators have been provided with AutoCAD-generated and other electronic files to gather data on a given project.

The challenge to these files, however, is that they typically contain hundreds of symbols representing material counts and measures for the job at hand. And transferring and counting these symbols into the estimate has been time consuming and difficult. That's where symbol recognition software comes in.

Essentially, such an application locates and counts all of the pertinent symbols on a set of architectural drawings. In addition, the software can determine distances between specified points in the plans, allowing the estimator to calculate linear or area measurements.

Above all, symbol recognition software speeds up the estimating process immensely. The program can often generate data in a matter of minutes, saving the estimator the time and effort of having to hand count and transfer the many symbols in a typical blueprint.

Additional features

Naturally, symbol recognition software does more than simply count symbols and measure distances. Estimators can also assign material, labor and unit costs to each symbol and measurement, creating your "take-off," and then channel that information into a job cost report.

The solution also allows users to add symbols to a set of drawings via a palette of predefined symbols. Also helpful: The software can scan a variety of file types other than the typical AutoCAD-generated documents, including TIFF, JPEG and PDF files.

Perhaps the most well-known symbol recognition software (as of this writing) is designed by SureCount. The application costs about $4,000 for the initial purchase, with additional fees for added licenses and support. Other products, however, may be available.

A champion is helpful

Like any relatively new form of technology, symbol recognition software does come with the inherent risk that your construction company just isn't ready to adapt to its demands. Misusing it could slow down your estimating process, or even lead to errors. But if your new estimator is prepared to champion its implementation, a symbol recognition application could indeed improve your estimating process.

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The Right Team...
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Because today's construction industry is constantly changing, it's more important than ever to stay up to date on issues affecting the growth and profitability of your company. More importantly, you need the right team of experts to help you understand and implement the necessary improvements that help to ensure your continued success.

At GRASSI & CO., we consider it our mission to help you succeed. That is why we are providing this issue of On-Site. We hope you find it helpful and informative.

GRASSI's staff of CPAs, Certified Construction Industry Financial Professionals (CCIFP), Certified Fraud Examiners (CFE), Certified Internal Auditors (CIA), and Certified Valuation Analysts (CVA) are here to help you every step of the way.

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