On-Site

FALL 2016

Managing your workforce
How the new overtime rule will affect the construction industry

Keeping a close eye on contract allowances

Fine-tune equipment costing for a smoother-running company

THE CONTRACTOR'S CORNER
Is pollution liability insurance worth the cost?

HERTZBACH
certified public accountants · consultants

www.hertzbach.com

Baltimore
800 Red Brook Boulevard
Suite 300
Owings Mills, Maryland 21117
410.363.3200

Greater Washington, D.C.
1803 Research Boulevard
Suite 215
Rockville, Maryland 20850
301.315.2150

Northern Virginia
1530 Wilson Boulevard
Suite 700
Arlington, Virginia 22209
703.351.6600

Managing your workforce

How the new overtime rule will affect the construction industry

This past May, the Department of Labor (DOL) released a final rule that dramatically alters how employers across the country will approach overtime pay. And the construction industry stands to be heavily affected by the changes.

Like many contractors, you may have project managers, estimators and other salaried employees who are currently exempt from receiving overtime pay. Well, under the new rule, this may no longer be the case. Let's look at some of the critical points to keep in mind going forward.

3 key tests

As you're no doubt aware, under the Fair Labor Standards Act, certain executive, administrative and professional employees are exempt from overtime pay requirements. To qualify for the exemption, an employee generally must satisfy three tests related to:

1. Salary basis. The employee must be salaried, meaning he or she is paid a predetermined and fixed salary that's not subject to reduction because of variations in the quality or quantity of work performed.

2. Salary level. Until the final rule takes effect, the employee must be paid at least $455 per week or $23,660 annually. See below for more information.

3. Duties. The employee must primarily perform executive, administrative or professional duties.

Neither job title nor salary alone can justify an exemption — the employee's specific job duties and earnings must also meet applicable requirements.

Increased thresholds

First and foremost, the revised final rule increases the salary level threshold for exempt employees to $913 per week or $47,476 per year. It also allows up to 10% of the salary threshold for those not considered highly compensated employees (HCEs) to be met by nondiscretionary bonuses, incentive pay and commissions. But such payments must be made at least quarterly.

So, say you pay a project manager a salary that's under the threshold, but he also receives certain production or performance bonuses based on job

The demise of the duties test?

In creating the most recent final rule for overtime requirements (see main article), the Department of Labor requested comments regarding the effectiveness of the duties test at screening out workers who aren't bona fide white-collar workers. Some wondered whether the test might go away completely.

The agency ultimately determined that the new standard salary level and automatic updating will work with the duties test to establish exempt status. Nonetheless, you probably won't need to consider the duties test as often — if a worker's pay doesn't satisfy the salary level test for exemption, you'll likely have to pay him or her overtime.

phases or goals. Because of these incentives, he may end up exceeding the threshold and remain exempt from overtime requirements (assuming other tests are satisfied).

In addition, the final rule raises the definition of HCEs for purposes of automatic exempt status from those earning $100,000 in annual income to those earning $134,004. These amounts will be automatically adjusted for inflation at three-year intervals, beginning in 2020.

HCEs must still receive at least the full standard salary amount — or $913 — per week on a salary or fee basis without regard to the payment of nondiscretionary bonuses and incentive payments. Such payments will, however, count toward the total annual compensation requirement.

The revised amounts for both non-HCEs and HCEs are scheduled to take effect December 1, 2016. Annual compensation levels will then automatically be updated every three years to maintain prescribed percentiles, beginning January 1, 2020. The DOL will post new salary levels 150 days before their effective dates.

Effects and ideas

The major impact of the rule is that you'll likely find it harder to exempt employees from overtime requirements. What's more, your payroll tax liability may increase if you have to pay overtime to more employees or pay higher salaries to keep workers exempt.

Start projecting your compliance challenges now. You may not need to do anything if your currently exempt employees fall short of the new salary level and don't exceed 40 work hours per week. If they do, as mentioned, you could raise the salaries of those who:

- Meet the duties test,
- Earn salaries near the new salary level, and
- Regularly work overtime.

Paying them at or above the salary threshold will maintain their exempt status.

Beyond that, you could establish various salary arrangements that account for overtime in a projectable and manageable way. For instance, you might establish a salary arrangement that pays a stated amount for the first 40 hours of work per week and then an overtime amount for any hours over 40.

Or you could pay a straight-time salary for more than 40 hours in a week for employees who regularly work more than 40 hours, and pay overtime *in addition to* the salary. In this case, you'd be required to pay an additional half-time overtime premium for overtime hours already included within the salary, plus time and a half for hours beyond those included.

In lieu of adjusting salaries, you might be able to distribute workloads differently or modify job schedules to minimize or prevent employees from exceeding 40 hours per week. And if you've been considering the idea of adding staff, this may be a good time to do so. A larger workforce will decrease the likelihood that staff will need to work overtime.

No time to lose

The DOL did publish a Notice of Proposed Rulemaking on July 6 with an invitation for comments by September 4. But, as of this writing, no material changes to the final rule have taken place. With the effective date coming up soon, your construction company has no time to lose in ensuring compliance.

Keeping a close eye on contract allowances

In construction, and life, uncertainty leads to conflict. When two separate parties are unsure about something, they could very well reach two different conclusions and end up at odds.

So it goes on many construction projects — especially homebuilding jobs — when contract allowances are involved. So if your business deals with contract allowances regularly, you've got to keep a close eye on these often contentious items.

Reviewing the concept

To review, a contract allowance is an *estimated* dollar amount that allocates funds to a particular job task for which a specific dollar amount couldn't be arrived at during bidding. Generally, there are two main types of allowances:

1. Material allowances. This is an amount associated with the cost of a specific construction material, such as carpeting.

2. Installed allowances. These amounts estimate the price of both the material in question and the cost of its installation. For example, different types of cabinetry may take longer to install than others, so the estimated price would be higher.

When it comes to either kind of allowance, the contract language used must be as clear as possible. It should unambiguously state the amount in question and explain how overages or underages will be handled.

Knowing the limits

A "fewer is better" approach to contract allowance is usually advisable. The more allowances in a contract, the greater the chances of a dispute or misunderstanding.

Make sure allowance amounts are well suited to the job in question. It can be tempting to stick to "rule of thumb" or boilerplate figures. But these can lead to problems — particularly for projects with higher materials and installation costs. It's generally advisable to include a schedule of allowances under product specifications in the general conditions of an AIA-form contract.

Contract allowances also may trigger suspicions in some owners. Unfortunately, unscrupulous contractors have used allowances for fraudulent purposes. So it's important to emphasize your construction company's ethical approach to business.

State clearly that you'll make your best effort to obtain fair prices, terms and conditions of purchase. Assure owners that you'll pass along savings from rebates, refunds and discounts. In some cases, you may want to obtain written instructions from the owner on how each cash allowance should be spent.

Writing up changes

If there's a substantial price deviation to an allowance amount, you'll need to issue a change order. This holds true whether the job cost is over or under the stated allowance.

Make sure owners are aware of this possibility going into the project. Should a change order become necessary, write it up immediately. Don't wait until completion to do so or you'll risk dealing with a surprised and unhappy owner.

In some cases, you may want to obtain written instructions from the owner on how each cash allowance should be spent.

"Write" is the operative word. Put the price variation in writing and follow your established procedures for change orders. Simply discussing the change verbally is, again, a risky move that could lead to conflicts and higher job costs for you down the line.

Getting it right

If you're tired of "talking down" irate owners and absorbing excessive job costs, your contract allowances may be at least partly to blame. Regularly review the numbers you're using and the procedures your employees are following.

Fine-tune equipment costing for a smoother-running company

Imagine you're standing on the jobsite and someone says, "Nice piece of equipment. What did it cost you?" Your mind might immediately go to how much you paid for the asset in question. But, as you're surely aware, contractors must continually account for the cost of their equipment over time. It's a good idea to review and, if necessary, fine-tune this critical process regularly.

Allocate accurately

To begin, you must understand the real cost of owning each piece of your equipment. In addition to the purchase price, costs related to fuel, labor, maintenance, off-season or downtime storage, insurance, taxes and depreciation all play a role.

But knowing these expenses isn't enough; you must also allocate them — as direct and indirect costs — to each job. To do so, you'll need to match the cost of the item with its per-project use.

Establishing a consistent costing method is important for both tax and financial reporting. It's also critical in the development of claims for delays and time extensions. Generally, you can recover anything spent on recovering costs in one claim.

Choose the right approach

One option is to use internal equipment rates. Here you estimate the cost of owning and operating each machine over its life span, determine the hourly rate you'll need to charge to cover that cost, and charge each job that rate.

Another possibility is to include equipment costs in the amount you charge for the operator's labor in running the machine. Once you determine the amount of time it'll take to recoup the purchase price, you reduce the asset's cost to an hourly rate that you add to the operator's labor rate.

A third alternative: Charge for use based on rates published in equipment manuals such as the *Rental Rate Blue Book for Construction Equipment* or the U.S. Army Corps of Engineers' *Construction Equipment Ownership and Operating Expense Schedule*. Remember, however, that the rates in these publications are almost always higher than actual costs.

Regardless of how you allocate your equipment costs, you'll need to decide for tax and financial reporting purposes whether to capitalize or expense the equipment. If you don't already have a capitalization policy in place, develop one to establish the purchase price cutoff at which you'll expense or allocate equipment to indirect costs rather than depreciate it.

Last, beware of the effects of idle equipment. They can substantially alter your costing calculations and should be discussed with your financial advisor.

Appreciate depreciation

Depreciation is another key point in accounting for your equipment. Currently, under Section 179 of the Internal Revenue Code, a business can expense up to $500,000 in qualified new or used assets. But this amount does begin to phase out, dollar for dollar, once the taxpayer hits and exceeds $2 million in asset acquisitions.

Bear in mind that depreciation methods for accounting purposes may be different from those for tax purposes. From a tax perspective, depreciation is generally based on a double declining balance, meaning equipment is depreciated more in the earlier years, and then at a given percentage of the remaining balance each year.

For accounting purposes, Generally Accepted Accounting Principles (GAAP) allow various depreciation methods. Contractors often use the straight-line approach, which involves subtracting the equipment's anticipated salvage value from the purchase price and dividing by its total estimated useful life.

But watch out: The estimated useful life of a piece of equipment may differ for tax and accounting purposes. Under GAAP, for instance, the life of a heavy truck is based on its estimated useful life. Meanwhile, the IRS establishes a "recovery period" to recover equipment costs, regardless of how long the asset is expected to last.

Know what you've got

Construction companies often have a variety of equipment, each piece potentially being of a different age and value. As your collection evolves, ensure your equipment costing processes still make sense. Your CPA can be an excellent resource for double-checking your numbers and suggesting helpful refinements.

Is pollution liability insurance worth the cost?

I've been reading some scary stories lately — and they have nothing to do with Halloween. The tales all begin with an innocent construction company going along its merry way and end with a knock on the door from an attorney suing the business for jobsite-related pollution. But is pollution insurance really worth the cost or should I spend those dollars elsewhere?

As you might have already guessed, there's no one-size-fits-all answer. Whether you should invest in a pollution liability policy depends on the type of work you do and the fine print of your existing insurance. Nonetheless, it's a good idea to familiarize yourself with this type of coverage.

What it covers

Pollution liability insurance protects you from third-party claims against your construction company for bodily injuries and property damage attributable to hazardous waste created during a project. Most policies cover you while you're working and after you've "completed operations."

You can buy blanket coverage that will offer ongoing protection, or you can purchase project-specific policies. Insurers also offer coverage options for transporting waste and materials to and from disposal facilities, as well as for mitigating your liability while disposing of waste at those facilities.

When you need it

You might assume your construction company is already covered for pollution under its general liability policy. Decades ago, such coverage was typically packaged with standard commercial general liability policies. But, with litigation so common and as interest continues in green building, this is generally no longer the case.

So, getting back to the question at hand: Is pollution liability coverage worth the investment? That all depends on your specialty and the nature of your projects. Obviously, any contractor who regularly works in areas such as environmental mediation, site restoration and abatement (asbestos removal, lead control and so forth) needs one of these policies. If your construction business already has one in place, don't hesitate to regularly review its terms and costs, and shop around for a better deal.

If you don't typically work in a pollution-related field (so to speak), you may not need blanket coverage. But don't ignore the risk either. For example, let's say you work with HVAC systems and a high volume of carbon monoxide accidentally escapes into a public space, causing people to become sick and dizzy. A pollution liability policy could help cover your losses.

Who can help

A strong backbone of insurance is a critical risk management measure for every contractor. Work with your advisors, namely your insurance agent or risk advisor, to determine whether pollution liability coverage would be cost-effective for you.

HERTZBACH
certified public accountants · consultants

800 Red Brook Boulevard
Suite 300
Owings Mills, MD 21117

Serving the **construction industry** for over 65 years.

We provide the tools for a **successful future.**

- Accounting and Auditing
- Assurance Services
- Tax Planning and Preparation
- Business Advisory Services
- Surety and Bonding Assistance
- Cost Segregation Services
- Construction Industry-Specific Consulting Services

HERTZBACH
certified public accountants · consultants

800.899.3633
www.hertzbach.com
construction@hertzbach.com