



Blueprint

Building Profits for Construction & Real Estate Companies

FOR SALE
SOLD

Property disposal: careful planning pays off

by Bill McDowell & Kim Hamm,
Springfield

Are you considering disposing of real property? Because there's more than one way to go about it, acquaint yourself with the alternatives before you sign on the dotted line.

Many tax advantages tied to property disposal are only available with proper planning up front. Before closing the deal, learn more about your options: Like-kind exchange, involuntary conversion, installment sale and bargain sale to charity.

Like-kind exchange

Like-kind exchange, also known as 1031 exchange, allows you to defer the recognition of gain or loss on the exchange of "like-kind" property.

To receive tax-deferred treatment, the exchange must meet several technical requirements. . .

"Like kind" refers to the nature or character of the property, not to its grade or quality. It means that real business property may not be exchanged for personal-use real estate because the nature or character of the property is not "like kind."

To receive tax-deferred treatment, the exchange must meet several technical requirements, including:

Did you know?

Did you know that business equipment also can be exchanged for like-kind property on a tax-deferred basis?

This planning strategy can be especially helpful if your equipment is subject to built-in gains tax pursuant to an S election made since 1993. □

- ✓ The property received and the property given up in the exchange must be qualified property (business or investment property)
- ✓ The property must not be property held for sale (inventory)

- ✓ The property to be exchanged must be identified within 45 days
- ✓ The transaction must be completed within 180 days after the exchanged property transfer
- ✓ If you received or control the funds, you will be taxed and lose the ability to defer the gain; instead, you must use a qualified intermediary to handle them

Involuntary conversion

If a public official or government body notifies you of plans to acquire your property, you can elect not to recognize gain on the transaction. This is known as involuntary conversion.

Nonrecognition treatment is contingent on using the condemnation award to purchase replacement property, similar in service or use to the converted property, within three years after the tax year in which the involuntary conversion occurs.

Installment sale

Recognized gains from the sale or exchange of real estate are generally reported the year the sale or exchange occurs, after title passes or when the burdens and benefits of ownership shift from the seller to the buyer.

Subject to certain limitations, an installment sale permits gain to be recognized as the buyer's payments are actually received.

The installment method is available on the disposition of qualified property when the seller will receive at least one payment after the close of the taxable year in which the disposition occurs.

Bargain sale to charity

When real estate is sold or donated to a charitable organization, a charitable deduction may be available for the amount of discount between the proceeds re-

ceived and the appraised value of the property. Before the sale, refer to the following checklist:

- ✓ Obtain an appraisal to support the fair market value
- ✓ Consider alternatives to determine your after-tax cash flow
- ✓ Charitable deductions may be limited

A parting thought

Sometimes, the cash flow from a transaction may not cover the tax imposed on the transaction; therefore, it's always important to run the numbers before disposing of property.

Contact your BKD tax advisor before you sign on the dotted line. □

Inside

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Industry cycles effect change in surety credit

by Doug Joyce, CIC, Member & Surety Manager Thomas McGee, L.C.

As with other segments of the insurance industry, there is a cyclical aspect to the surety business. If your company uses surety bonds, you may have experienced recent changes while working with your agent and underwriter.

Surety reinsurance market incurs losses

During the 1990s, operating profitability and abundant, cheaply priced reinsurance capacity caused some companies to try to increase

their premium volume. As a result, underwriting discipline and pricing deteriorated.

Since 2000, the surety industry has experienced a reversal of fortune, incurring losses of unprecedented magnitude in both the contract and commercial lines of business.

This has caused changes in the surety reinsurance market, including a significant reduction in capacity and a sizeable increase in the cost of available capacity.

As a result of the industry's poor performance, reinsurers remaining in the business have required underwriting companies to retain a much greater degree of

the risk on a per-account basis.

These developments, along with pressure from boardrooms to generate profits, have spurred senior management teams of underwriting companies to address the issue.

Help your business weather changes

If your business uses surety credit, these developments may have a critical impact. Going forward, what should you anticipate, and how should your business respond?

Underwriting has become more restrictive, a trend that should continue through at least 2004. The surety is likely to be more conservative in terms of the credit amounts it is willing to extend on both individual projects and an aggregate program basis.

Sureties will be more particular in the type of work performed and the geographic spread of company operations, and there may be less flexibility negotiating release of personal guarantees.

Pricing is on the rise. A significant number of companies have already instituted rate increases, and the potential exists for additional increases as underwriting companies manage increasing reinsurance costs.

Strengthen internal controls

The quality of internal controls is enjoying renewed attention. Years of underwriting neglect and numerous contractor failures caused by weak internal controls and flawed financial and accounting management, cost the surety industry considerable sums.

Problem areas needn't become insurmountable as long as

you base business decisions on timely, credible information, which is a direct function of the quality of internal controls and the accounting system.

Allocate funds to strengthen both areas, and you may be able to increase available surety credit. More efficient project management and more consistent job profits are additional financial benefits.

Analyze support team's experience

In addition to increased scrutiny of underwriting clients, sureties also evaluate the qualifications of the contractor's nonconstruction-related professional support team members:

- ✓ How well do they understand the construction industry
- ✓ What is their professional experience
- ✓ Will they provide constructive input even if the message is not what the client wants to hear

Remember to analyze the skills and experience of your professional support team, as well as your relationships with financial institutions, certified public accountants and insurance/surety agents.

Industry niche experience and expertise help determine a professional service provider's value. It's important for the team to share a commitment to help clients achieve business objectives.

To successfully navigate times of transition, align your business with a strong team of professionals that can help position your company for long-term financial success. □

BKD stands for PRIDE values

You care about what your accountants and consultants stand for. Values matter.

BKD's most valuable asset has always been our people. Their collective values of **passion, respect, integrity, discipline and excellence** have become the firm's values of **PRIDE**.

You see our partners and employees "**living the PRIDE**" everyday as they provide solutions to your business and financial needs.

Here is a synopsis of what our values mean for our clients. For a more complete explanation, ask your BKD advisor for details or for a copy of our values information sheet.

Passion - BKD's mission is to first "strive for excellence in providing services to clients." This commitment drives our practice and accounts for the dedication of our partners and

staff to meeting your deadlines and needs. Consistent with our values, we are enthusiastically committed to making tomorrow better than today by helping you make informed decisions to improve business and financial outcomes.

Respect - BKD respects diversity. You benefit from our diverse client service teams, which bring a broad mix of skills and approaches to bear on your needs.



Integrity - "Do the right thing" has been the tone from the top of BKD since our founding. You and your stakeholders and customers rely on our integrity and objectivity to help you make smart—but right—business decisions. We are com-

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Financial benchmarking: an effective management tool

by Dan Holt, Indianapolis

Financial benchmarking is an effective management tool

that can help contractors identify key trends, compare their performance to competitors' and drive continuous improvement to the company's standards and goals.

To build and use benchmarking tools effectively:

- ✓ Select appropriate financial measurements or ratios
- ✓ Calculate and gather your company's financial information with consistency
- ✓ Use reliable benchmarking information to compare your company with others in the industry
- ✓ Research the companies behind the benchmarking data; know their size, geographic region and type

To identify meaningful trends, it is important for your company to gather the same information and calculate the same ratios using methods that remain consistent year after year.

The data and ratios gleaned from your benchmarking source also should be collected and calculated in the same way; otherwise, you won't obtain a true indication of your company's performance.

Finding reliable information for benchmarking purposes isn't always easy in the construction industry.

Trade associations sometimes provide industry information to their members, but the most comprehensive source is the Construction Financial Management Association's **Construction Indus-**

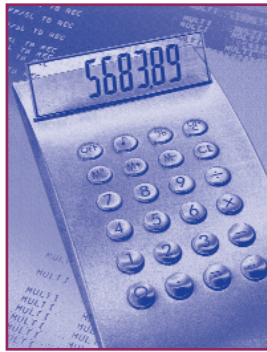
try Annual Financial Survey.

The survey provides aggregate benchmarking information about financial performance, which is

organized by contractor type, dollar volume and geographic region.

Information from areas such as cash management, bonding, risk management and human resources also is included.

Financial benchmarking benefits will be



apparent after appropriate benchmarking information has been identified, and your company's ratios have been calculated.

First, know what factors or events within and outside the company led to the ratios generated by the company for the given period of time, why they occurred and what can be done to correct or improve them.

Second, compare results to that of previous years and to competitors' numbers. Use your findings to analyze trends, identify strengths and weaknesses, establish goals and targets and form

improvement plans to meet them.

Finally, give access to this information and the opportunity to offer insight into various ratios to key management personnel, project managers, etc. Have them help establish subsequent goals and targets.

* * *

BKD regularly provides benchmarking information to clients. For more information about financial benchmarking and how it can be an effective management tool for your company, contact your BKD advisor. □

Financial ratios are key for contractors

This schedule is a sample of some of the most basic key performance indicators for contractors. For a more complete list of ratios, contact your BKD advisor or the article's author at dholt@bkd.com.

Ratio	Formula	Purpose	Target
Current ratio	$\frac{\text{Current Assets}}{\text{Current Liabilities}}$	Measures ability to meet current obligations	Greater than 1.2 to 1.0
Return on assets	$\frac{\text{Net Income}}{\text{Total Assets}}$	Indicates profit generated by assets	Greater than 1%
Gross profit	$\frac{\text{Gross Profit}}{\text{Revenue}}$	Job profitability to cover G&A expenses	Varies by type of contractor
Debt to equity	$\frac{\text{Total Liabilities}}{\text{Total Equity}}$	Indicates relationship of owner's investment to creditor's investment	Less than 3.0 to 1.0
Underbillings to equity	$\frac{\text{Unbilled Work} + \text{Underbillings}}{\text{Total Equity}}$	Level of contract volume financed by owners	Less than 20%
Revenue to equity	$\frac{\text{Total Revenue}}{\text{Total Equity}}$	Indicates level of revenue being supported by each dollar of equity	Less than 15.0 to 1.0
G&A expenses as a % of revenue	$\frac{\text{G\&A Expenses}}{\text{Total Revenue}}$	Represents funds available to cover G&A expenses	Varies by type and size of contractor
Profit fade	$\frac{\text{Final Gross Profit}}{\text{Original Estimated Gross Profit}}$	Measures estimating ability	Less than 10% of original estimate



Executive retention & nonqualified deferred compensation plans

by Sarah Farrell, Kansas City

Nonqualified deferred compensation plans are a key tool for providing incentives for current and future leaders of an organization.

This type of deferred compensation is typically limited to a relatively small number of executives.

Providing employee incentives

As part of a business continuation strategy, a nonqualified deferred compensation plan can achieve several objectives:

- ✓ Acts as incentive to retain talented employees and executives for a specific length of time (referred to as "golden handcuffs")
- ✓ Reinforces a noncompete covenant or expands the terms of an existing agreement

- ✓ Rewards individual performance on a long-term basis
- ✓ Ties an executive's compensation more closely to the company's future performance
- ✓ Provides a means of wealth enhancement for executives without making an initial cash outlay to purchase stock

Advantages of nonqualified plans

Nonqualified plans have flexibility and a number of advantages, including:

- ✓ Plan's design can be uniquely tailored for individual executives
- ✓ The plan can provide a tangible reward for current efforts without using current cash resources
- ✓ No compensation limits
- ✓ Annual Internal Revenue Service reporting not required
- ✓ Tax consequences deferred for the organization and the executive

Plan design considerations

When designing a plan, determine the amount of deferral each year and how it will be calculated.

One of the design's most

important components is the plan's vesting feature. The vesting schedule's length sets parameters for determining the deferral amount to which an executive is entitled in the future.

The schedule is influenced by the plan's objectives, usually based on a long-term strategy. Therefore, the vesting schedule of many nonqualified deferred compensation plans are designed to span several years.

A payout schedule determines how and when the executive receives benefits:

- ✓ Intermittent payments
- ✓ Trigger date or at retirement
- ✓ Lump-sum payment
- ✓ Death benefit to surviving beneficiary

Other considerations during the design phase are tax reporting implications and the cash position of the organization.

Common tools used for incentive, deferred compensation include:

- ✓ Stock grants or options
- ✓ Phantom stock plans
- ✓ Dividend unit plans
- ✓ Performance unit plans

- ✓ Stock appreciation rights

Nonqualified deferred compensation plans are popular options for many organizations trying to attract and retain valuable executive talent necessary for fulfilling future goals and objectives. BKD can help your company design and implement an effective plan to enhance other components of your overall business strategy. □

BKD stands. . .

continued from page 2 mitted to telling you what you need to know vs. what you want to hear.

Discipline - Discipline is a hallmark of BKD, and you benefit from our well-established and successful protocols, standards and processes.

Excellence - We are committed to lifelong learning to continually improve the technical and analytical skills we apply to your needs. Our desire to "be the best" means we seek to consistently surpass your expectations. □

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