

Business

Attitude Adjustment: How to Think Like a Company

by Melanie Hodgdon

You could probably come up with plenty of tangible milestones in the growth of your business: hiring your first office person, your first lead carpenter, or your first salesperson; deciding to hang up the toolbelt and leave the field; moving your office out of your home and setting up shop in your own rented office space.

But if these changes aren't initiated and supported by underlying attitude shifts, your business may not be

truly maturing. Having an office, office personnel, and salespeople doesn't make a business mature and successful any more than dressing up in grown-up clothes makes a child an adult.

As long as you see yourself as a person who remodels — rather than as someone who runs a business that delivers the service of remodeling — you run the risk of viewing your business situation as so unique that you do not institute best business practices.

Here are some common examples of this attitude, drawn from my experiences working with dozens of construction businesses:

- ✗ "If I used that kind of markup in *my area*, I'd lose all my customers."
- ✗ "*My guys* just won't fill out timecards accurately."
- ✗ "*I'm* not good at paperwork, so I don't keep those records."
- ✗ "I can't leave the field because I don't have anybody on *my crew* who can take over."
- ✗ "I can't do change orders that way because *my customers* wouldn't accept it."

These are all familiar traps. But once you figure out that you have to make decisions based on the needs of your company — an entity separate from yourself — then you can reach a degree of objectivity that will help in situations where waffling would otherwise prevail. For example, as an owner, you may decide to do an unprofitable job ("it's my friend, it's just a small job, it'll

be a good filler"), but it's harder to justify committing resources to an unprofitable project when you think in terms of what's best for the company.

Recognize That Your Business Is Not an Extension of Yourself

As soon as you begin to see your business as a component of a larger entity (the remodeling or custom-home industry), you are more likely to become open to and interested in learning how to do things better. Owners who believe that their companies are extensions of themselves tend to take things personally, as if the problem is with them instead of their business. That's why it's so important to divorce the challenges your business is facing from your own shortcomings (and there's nobody out there who doesn't possess personal shortcomings that have the potential to adversely affect his business). Then you can look for help from industry trade shows, books, and consultants as ways to stop reinventing bad wheels.

Chase Profit, Not Dollars

When they start out, many builders and remodelers look at sales instead of profit. Their solution to any cash crunch is to sell more jobs. Recordkeeping for job-costing purposes is frequently sketchy at best, and because the profitability of individual jobs isn't analyzed, unprofitable practices — poor estimating and job management, endless punch lists, unrecorded or uncharged change orders — get ignored and perpetuated.

Jobs may be sold to "keep the crew busy," as if that's sufficient reason to remain in business. Owners often talk about sales rather than profit, and are proud of being "booked for the next two years," without knowing whether the jobs they've signed will be profitable or will just "keep them busy" (and therefore unable to work on profitable jobs) for the next two years.

Once owners figure out they must focus on profit, however, they become motivated to do whatever is necessary to produce accurate job-cost reports. This

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allows them to identify the kinds of work their company does well, reliably, and profitably — and, even more important, which jobs are losers. They can then feel more confident about passing up duds and pricing their “niche” jobs profitably. And once they start selling profitable jobs, there is less need to sell *more* and more time to sell *wisely*.

Impart Knowledge, Standards, and Company Image Deliberately

Owners who wouldn't dream of starting a home addition for a client without detailed plans often fall into putting “an

addition” on their business — growing in size or scope — without any planning whatsoever.

In an effort to give up doing the books, banging nails, or supervising crews, an owner may “buy” a new employee and then be disappointed when the person — who was thrown into the maelstrom without any training — fails to meet expectations. Without a training program in place, supported by adequate funding and time from key personnel, new employees can't get up to speed on understanding and reinforcing company culture.

But once you realize that you can't take

off one of your hats and pass it along with confidence until that employee has been trained, you can start using mission statements, procedural manuals, employee manuals, policy statements, and even contracts as training tools to get everybody working on the same page. This, in turn, will help you build an effective team capable of meeting company standards while permitting you to retain only the hats you most enjoy.

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Protect Yourself From Employee Theft

by Leslie Shiner

Many years ago, I received a call from a high-end remodeler who could not understand why he was having trouble with cash flow. Business was booming, and when he looked at the books it appeared that all of his jobs were profitable. Still, there was no money in the bank, so he asked me to help figure out what was going on.

I began by reviewing his financial statements. The bookkeeper was there, so I asked her when the bank statement was last reconciled. She said she had been too busy to do it for a while, apologized profusely, and promised to be caught up by the time I returned the following week. I found several other suspicious clues, but the bookkeeper looked honest and had been working for my client for more than seven years.

After the second visit, I approached the owner with my suspicions. That evening, the bookkeeper called my client, came into the office after everyone had left, and admitted that she had been stealing money. She thought it was probably about \$100,000. She was wrong. After spending several months reconstructing

the last three years of his data, we discovered that she had actually stolen more than \$550,000.

It was the largest embezzlement case in our county. The bookkeeper, a “shopaholic,” started small, but by the time she was caught she was taking \$25,000 per month. It's sad to say, but if she had kept it to \$50,000 per year, her theft may never have been noticed.

Contractors Are Vulnerable

Since that experience, I have become more aware of how common fraud and embezzlement are in the construction industry.

You might think that the problem affects only giant corporations, but according to a 2004 report by the Association of Certified Fraud Examiners, small companies suffer disproportionately large losses from fraud and embezzlement. When these crimes are discovered, victims rarely recover more than a small percentage of what was taken.

Contractors are particularly vulnerable, because a lot

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of money flows through their offices and many of their employees are hard to monitor; often they're working on site, picking up materials, or traveling between jobs.

In addition, it's hard to keep track of all

the tools and materials that are floating around and there are plenty of opportunities for employees to pilfer them.

Unwitting victims. Most thefts are discovered by accident. I had a client who was reviewing costs coded to the "miscel-

laneous job" category. Typically, he never reviewed the details of those costs, but this time he did, because the total seemed to be growing.

What he found was hours and pay for employees who had not worked for the company for several months. It turned out that the bookkeeper was paying "ghost" employees in the accounting system, changing the payee on the paychecks, and cashing them herself. I have also heard of schemes in which bookkeepers cut two paychecks for themselves each pay period.

Illegal activity, of course, is not limited to bookkeepers. Another client installed the Fast Trak system (an automated method for paying bridge tolls) in each company truck. The employees appreciated not having to wait at the tollbooths, but the added advantage for the employer was a monthly report provided by Fast Trak of the time each truck crossed the bridge. If employees' timecards showed they were on the job site at 7 a.m. every morning, why were some of them crossing at 7:30 a.m.?

There is no end to these kinds of stories. If you hire anyone, from a field laborer to office help, you are vulnerable. And the question is not "if," but "when" and "how much." While there are no fool-proof ways to prevent theft altogether, you can certainly take steps to protect yourself. First, you must create an atmosphere in which your employees will not feel justified in stealing from you. Second, you should implement strict internal controls for all accounting and bookkeeping transactions.

Create the Right Atmosphere

Integrity starts at the top. If you do not operate your company with integrity, do not expect your employees to.

Do you lie to employees, vendors,

HiQuality Quality Co.

Profit & Loss Statement

For 9 Months Ended September 30, 2005

Operating Income	\$657,901	100.00%
Direct Expense (Cost of Goods Sold)	<u>\$435,523</u>	<u>66.20%</u>
Gross Profit:	\$222,378	33.80%
Overhead Expense	<u>\$189,339</u>	<u>28.78%</u>
Net Income:	\$33,039	5.02%

The financial statement above is for a fictitious construction company. It contains all of the income and expenses for the first nine months of this year.

HiQuality Quality Co.

Expense by Job

For 9 Months Ended September 30, 2005

101	Smith	\$12,570
105	Jones	\$26,636
109	Lopez	\$18,339
110	Crosby	\$37,513
111	Maple Road Project	\$126,190
115	Crane	\$831
116	Kirk	\$8,854
120	Woods	\$1,580
125	Marx	\$77,193
126	Brennan	<u>\$102,705</u>
		\$412,411

This report is from the same company and shows the expense totals that would appear if you ran a "Profit & Loss by Job" report in QuickBooks. Costs that were not assigned to specific jobs would not show up, so unless you compared the total job costs here with the cost of goods sold (Direct Expense) on the P&L, you wouldn't know \$23,112 ($435,523 - 412,411 = 23,112$) was missing.

subs, or clients? Do you treat your employees fairly? Do the employees get anything extra when the company has a really good year? Are you living high off the hog while paying your employees a minimal salary?

A client once told me that when an employee asks for a raise, he knows he'll end up paying for it one way or another regardless of whether he grants the request. If employees feel underpaid or underappreciated, or perceive they are working for an unscrupulous boss, they may feel justified in taking a little extra here and there.

There are some employees who will never be happy with their pay, but that doesn't mean you should pay as little as you can get away with. Many of the contractors I consult for pay their employees more than average for their area, but they are also more profitable than average. Their attitude is that you get what you pay for.

Institute the Proper Controls

A good atmosphere helps, but when it comes to the office staff, any accountant will tell you there is no substitute for strict internal controls.

In larger companies the key to internal controls is called "segregation of duties." For example, several different people enter the invoices, cut the checks, sign the checks, and reconcile the bank statement. Small contractors can't do this, though, because they typically have one part-time or full-time bookkeeper doing everything. Nonetheless, there are precautions you can take to reduce your chances of loss.

Checking accounts. First, the owner of the company should open all bank statements. In fact, if your office is outside of your house, have the statements sent to your home. Let your bookkeeper

know that it's not a matter of your not trusting him or her; it's simply good business practice.

Second, when you get the bank statement, look through either the actual checks or the copies of the checks. Look for payee names that you don't recognize, and make sure you ask questions. Just *appearing* to pay attention reduces the temptation to steal.

Third, don't use a signature stamp. Many banks will allow you to use one to sign checks, but it's a bad idea even to own one. Someone in the office may need money for a quick loan, and the temptation to write himself or herself a check could be too great. If someone steals one of your checks and forges the signature by hand, the bank may be responsible for the loss. If the thief uses your stamp, the odds are higher that you'll have to pay.

Also, be sure that you know what you're signing for. If a bookkeeper writes your checks, verify the amount by looking at the supporting documents. You want to make sure that the bill you are paying is for a current job, not for something one of your employees is buying for his own house or for a side job.

Finally, before you sign, make sure the invoices add up to the amount on the check. It's better to pay from statements than from invoices because that reduces the likelihood of accidental or intentional overpayments to vendors. If you don't look, you could end up paying the same invoice twice and the vendor might not catch it. Or the vendor could refund the overpayment and the bookkeeper could hang on to it.

Credit cards. If you want to use credit cards to earn airline miles, make sure that only specific employees have access to the cards. The credit limit should be low, and each employee should have his own card and be required to turn in and

justify every single receipt.

Don't use your company credit card for personal expenses, because it sends the message to employees that it's okay to do this. While the focus of this article is on fraud, I must point out that using a company card for personal expenses can get you into trouble with the IRS and put your personal assets at risk if you are incorporated (see "Protect What's Yours: Incorporate," *Legal*, 11/04).

Take the time to run monthly reports on gas cards. With gas prices so high, there's great temptation for employees to use the company card to buy personal gas. If you have company vehicles, make sure each one has its own credit card, and compare bills month to month and vehicle to vehicle to spot extra charges.

Financial statements and data. There are good business reasons to review trended financial statements (see "Looking Beyond The Bottom Line," *Business*, 6/05), and one of them is to detect fraud. If you compare expenses over a period of months or years, you may notice that a cost category has mysteriously increased.

If you're like most contractors, you keep close tabs on job costs, compare them to the budget, and ask questions when they look high. But have you ever added up job costs to make sure they match your financial statement?

You should, because illegitimate costs can be hidden in the "shop job" or "miscellaneous job" categories (places where the bookkeeper knows you don't really look).

For example, QuickBooks allows you to pay for something without assigning that cost to a job. If you run a financial statement, that cost will be mixed in with the cost of goods sold for all of the jobs the company is doing. But if you run the report for Profit & Loss by Job,

that cost will not show up, because it was not assigned to a job (see tables, page 3).

The bookkeeper. Many bookkeeping thefts are uncovered when the bookkeeper takes a vacation. Do not allow yourself to become so dependent on your bookkeeper that no one else can do the job. Make sure at least one other person is capable of performing the bookkeeping functions.

Also, be sure to back up your computer

data — and, if possible, keep the backup off site. When someone is about to be caught, he may find ways to cover his tracks or make your data disappear.

An Ounce Of Prevention

Nothing you can do will absolutely ensure that you won't be a victim of fraud or embezzlement. But if you take the actions described above, you are less likely to be victimized and more likely to detect problems early on, when the

losses are still low.

And remember that the systems you put in place and the procedures you use become especially important as the company grows, because with growth comes a tendency for the owner to lose control.

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