The CFM’s Horizon for 2019

BY MATT CASH

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**HUMAN CAPITAL. SUCCESSION PLANNING. REVENUE RECOGNITION. LEASES.**

As another busy year ends, let’s take a look at issues that will continue to impact construction financial managers (CFMs) in 2019 and serve as opportunities for **FUTURE GROWTH AND SUCCESS.**

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**Human Capital**

With the demand for talent outpacing the supply, the lack of skilled labor in construction will continue to be a challenge in 2019. Contractors must plan to face this hurdle head-on by seeking unique ways to attract new talent, retain high performers, and grow future applicant pools.

When it comes to attracting new talent, some companies may look to short-term strategies such as sign-on bonuses. While such bonuses can engage new employees, these types of incentives alone are not enough to sustain long-term, mutually beneficial employment relationships.

**Promote Company Brand & Culture**

Some companies have seen more enduring results by promoting company culture and history to recruit new talent and keep high performers engaged. This approach involves clearly communicating the organization’s values and brand – not as selling points to customers, but as uniting principles around which employees rally and support.

This also requires a company to communicate a vision for how new and existing employees fit into its unique culture and long-term strategic plan. When compared to more temporary incentives like sign-on or recruiting bonuses, focusing on company culture has more potential to drive engagement and long-term productivity.

**Invest in Training & Safety Programs**

Effectively retaining talent in the construction industry can often be directly tied to a company’s investment in training and safety programs.

High-performing construction companies set foundations for employee success by establishing standard onboarding processes, which should include technology training as well as clearly communicating employee roles within the company.

Adequate training is a front-end investment that is often necessary to improve productivity in the field and strengthen employee engagement. Training and safety programs should be used to communicate the company’s commitment to every employee.

While construction companies may consider attracting and retaining talent a near-term focus, they must also prioritize growing future applicant pools to succeed in the long term.

**Partner with Colleges to Promote Construction Careers**

Some contractors partner with local community colleges and trade schools to promote training and careers in the trades to develop internship pipelines. Additionally, local associations, chambers of commerce, and government agencies can play critical roles in promoting construction careers to high school and even middle school students.

In some markets, local associations host hands-on events for high school students to showcase what careers in construction are actually like. These one- or two-day events include equipment demonstrations, building competitions, interactions with field and office personnel, and more. Such events can also help provide perspective and information for students and parents, and help combat the stereotype of construction as having less desirable, lower-paying opportunities.
In the same way colleges and universities promote opportunities to high school freshmen and sophomores, so too should the construction industry. CFMs can serve their companies by seeking out these partnerships to engage and cultivate the future workforce.

**Succession Planning**

Management and ownership succession planning is critical to ensure the long-term health of any company, but workforce issues in construction heighten the need for contractors to focus on succession planning within their organizations. The retirement of baby boomers, current and projected growth of the industry, and insufficient levels of applicants entering the industry place constraints on the pool of leadership candidates for all contractors.

According to the report, *CFMA Peer Group Program: Review & Analysis of Topics & Discussions from 2016-17*, surveys that were conducted to assess how construction companies approached succession planning showed 88% of owners identified succession planning as important; however, only 36% of owners reported having a formalized succession plan. Owners are often the top executives within a privately held construction company, so their retirement must be planned and future owners identified. Succession planning can be a deeply personal process for an owner who is looking to transition out of the company, so a successful plan must be driven by a strategic mixture of specific needs, available resources, strategic goals, and timelines. Lack of preparation can be financially costly to owners and negatively impact the company’s values, vision, and culture.

**Tips to Ensure a Successful Ownership Transition**

Since CFMs often play a critical role alongside owners in succession planning, here are three tips to help owners plan their transition:

1. **Demonstrate an understanding that succession can have a significant impact on an owner at a personal level.** It can be difficult for an owner to envision the company without his or her own presence.
2. **Leverage resources by building a team around owners to connect them with advisors who can provide guidance in formulating and executing the plan.**
3. **Make succession planning an ongoing project, and schedule regular check-ins to revisit the plan and assess whether it is meeting the owners’ needs.** (For more on addressing this process, read “But They’ll Never Retire: Overcoming Management Succession Procrastination” in *Building Profits* November/December 2018 issue, page 26.)

**Prepare Other Key Employees for Transition**

While succession planning typically starts with ownership, the planning should not end there. The success or failure of projects is driven by the performance of project managers (PMs) and superintendents. These key positions hold valuable institutional knowledge and management skills that are key to the company’s financial and operational success. These employees may eventually become company leaders or owners, so they should also be prepared to train their future successors.

An effective succession plan would include plans for PMs, superintendents, and other key positions within the company. In addition, it should include future potential positions for those employees, identify likely successors, and determine an appropriate timeline. It must also be articulated to the identified stakeholders in the process.

To maintain the strategic vision of the company, great care should be taken to maximize the time spent planning and communicate to all key personnel affected.

**Integrate Succession & Strategic Planning**

Finally, succession planning shouldn’t be limited to simply refilling the positions as they currently exist. Succession planning must be integrated with strategic planning to identify what company service lines might look like in future years. Some questions to consider include:

- Are there specialty areas the company focuses on today that won’t be in demand in the future?
- Are there areas of the market the company must enter going forward?
- How will human capital be deployed or redeployed to meet the company’s future needs?

There may not be clear answers to these questions today, but they must be considered when developing a well-rounded, well-documented succession plan.

**New Accounting Standards**

While CFMs often take over many company duties for which they may not have previously received formal training, financial reporting is usually an area of strength and expertise.
With that said, most CFMs will be implementing or preparing to implement two significant new accounting standards in the coming year.

The Financial Accounting Standards Board’s (FASB) Accounting Standards Update (ASU) 2014-09, Revenue from Contracts with Customers, will be required to be implemented by nonpublic businesses for annual reporting periods beginning after December 15, 2018; implementation for public companies is already in effect. ASU 2016-02, Leases, will be required to be implemented by nonpublic businesses for annual reporting periods beginning after December 15, 2019.3

REVENUE RECOGNITION

FASB issued ASU 2014-09 to provide a principles-based standard for revenue recognition that covered all industries, as opposed to current generally accepted accounting principles (GAAP) that include pockets of industry-specific revenue recognition guidance. Industry-specific guidance is replaced with the following five-step model:4

1) Identify Contract with Customer
2) Identify Performance Obligations
3) Determine Transaction Price
4) Allocate Transaction Price to Performance Obligations
5) Recognize Revenue When (or as) Performance Obligation Is Satisfied

The AICPA Engineering & Construction Contractors Revenue Recognition Task Force5 has identified seven revenue recognition implementation issues specific to the construction industry:

1) Identifying the Unit of Account
2) Variable Consideration
3) Acceptable Measures of Progress
4) Uninstalled Materials
5) Impact of Termination for Convenience on Contract Duration
6) Contract Costs
7) Disclosures

CFMs will need to identify areas where current company revenue recognition practices differ from the guidance under the new standard and make necessary changes to ensure financial statements are presented in accordance, at implementation, and going forward.

For nonpublic calendar year-end companies, this will start with reviewing the contracts in progress at December 31, 2018, and scheduling for differences between current accounting treatments and appropriate treatment under ASU 2014-09.

The calculated differences related to contracts in progress on December 31, 2018, would be the company’s restatement to equity under the modified retrospective approach outlined in the standard. The modified retrospective approach is expected to be used by nearly all companies adopting the standard – rather than the full retrospective approach – to reduce the investment of time and resources in the implementation.

Depending on the nature of a company’s contracts and current accounting practices, there may not be a change to how revenue is recognized under ASU 2014-09. In such cases, CFMs will still need to go through the exercise of documenting their company’s consideration and conclusion. A CFM’s documentation of the conclusion could reduce the time spent and questions asked by auditors or other third-party users of financial statements.

The following three areas of the standard and related implementation papers will affect construction companies the most and require special attention:

1) Identifying Performance Obligations
2) Variable Consideration
3) Uninstalled Materials

Under ASU 2014-09, revenue is to be recognized based on satisfying performance obligations on a contract-by-contract basis. Management will need to use judgment to determine if contracts include more than one distinct performance obligation or if one performance obligation is to be provided through multiple contracts. Promised goods or services are considered distinct when they are:

• Capable of being distinct because the customer can benefit from the good or service on its own or with other readily available resources
• Distinct within the context of the contract – the good or service to the customer is separately identifiable from other promises in the contract

The third step of the new revenue recognition model, Determine Transaction Price, requires that the transaction price must include the probable amount of variable consideration. In construction, variable consideration includes
items such as performance bonuses, liquidated damages, claims, and unpriced change orders. The contract amount to be used in the work-in-progress (WIP) schedule will now include the probable amount the contract will be increased or decreased by the variable consideration. Variable consideration is one additional estimate added to a construction company’s recognition of revenue.

For contractors that have historically used the percentage-of-completion revenue recognition method based on cost-to-cost measures, the new guidance excludes certain costs from the calculation. Only the costs incurred that contribute to the progress of satisfying the contract will be included in the estimated and actual costs.

FASB has taken the position that the process of procuring materials and delivering the materials to the jobsite is not progress toward the completion of the performance obligation and, therefore, revenue should be recognized only up to the cost of the materials.

This change will result in not recognizing margin on uninstalled materials. CFMs must be aware of significant amounts of uninstalled materials at month- or year-ends. If identified, the materials should be excluded from the percentage-of-completion calculation. In many cases, these uninstalled materials would be considered inventory until installed and charged to job costs.

(To learn about CFMA’s Revenue Recognition Implementation Guide, which offers best practices on developing an implementation task force; identifying a timeline for implementation; and the impact of the regulations on existing internal accounting systems, tax planning, and more, visit www.cfma.org/store.cfm.)

Leases

ASU 2016-02 will require lessees to record a right-of-use asset and lease liability on their balance sheets for any asset with a reasonably certain lease term of greater than one year. One unique estimate in the new standard would be the reasonably certain lease term. This wouldn’t necessarily be the minimum enforceable term of the lease but would include any renewals that would be determined to be reasonably certain. Companies may have month-to-month or year-to-year leases that need to be analyzed under the requirements of the standard if the lease renews automatically and there has been a history of renewals.

The lease liability will be recorded at an amount equal to the present value of future reasonably certain lease payments. The present value will be determined by discounting future reasonably certain lease payments by the implicit rate of the lease or the company’s incremental borrowing rate. If the reasonably certain term includes an option to purchase or termination penalties, then those costs must be included in the present value calculation as well.

The right-of-use asset is recorded as the calculated lease liability plus any initial direct costs (such as realtor commissions) and less any lessor-provided incentives. The recorded asset and liability are not remeasured during the life of the lease unless the lease contract is modified.

The standard lays out two methods for annual expense recognition: the financing approach and straight-line approach. The financing approach is similar to today’s capital lease treatment, in which expense is front-loaded and recognized as amortization and interest expense. The financing approach is required to be used when a lease meets any one of the following criteria:

- Ownership of the asset transfers to lessee by the end of lease term
- The lease grants the option to purchase the asset that the lessee is reasonably certain to exercise
- The lease term is for a major part of the economic life of the asset
  - Criteria aren’t used if the commencement date falls at the end of the asset’s life
- Present value of minimum lease payments equals or exceeds substantially all the fair value of the leased asset
- Leased asset is of such specialized nature that it’s expected to have no alternative use to the lessor at the end of the term

If the finance lease criteria aren’t met, then the lease is considered to be an operating lease and expense is recognized in a straight-line manner over the reasonably certain term of the lease.

If CFMs haven’t yet considered the effect of the lease standard on their company’s financials, 2019 is the time to do so. Nonpublic calendar year-end companies will have to identify all leases outstanding as of December 31, 2019, that will carry into 2020 and beyond to calculate the appropriate
right-of-use assets and lease liabilities to be recorded on the balance sheet on January 1, 2020, under the modified retro-
spective approach.

**Conclusion**

Though the areas discussed throughout this article may appear as more work for CFMs, it undoubtedly highlights crucial opportunities in which CFMs can provide value to their companies, and in turn future growth and success for their businesses.

**Endnotes**

2. Ibid.
4. www.bkd.com/sites/default/files/2018-08/Revenue-Recognition-An-
5. www.aicpa.org/interestareas/frc/accountingfinancialreporting/revenue
   recognition/rrtf-construction.html.

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