

January 5, 2015

# Are You Out of Control? Internal Controls for Contractors

CONSTRUCTION  
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Given the holiday season, most individuals would assume that I'm referring to their preparedness for Christmas or New Year's, having relatives in town or having the kids off from school for a few weeks. And while all that may be true, what I'm really asking is about your internal controls. Do you have adequate internal controls to identify and mitigate risk, to allow your company to function properly when you are not around, to give you piece of mind that your company is not overly exposed due to its limited control environment.

## Key Internal Controls Areas

Often, contractors have similar responses when internal control issues are brought to their attention. Limited time, resources and headcount are all too familiar hurdles that enable internal control deficiencies to continue to exist. Here are six internal control areas that you can't afford to ignore any longer.

1. Customer/Owner Selection - What are your processes and controls around customer/owner selection? Do you have past experience (successful) with the owner? Experience (and success) doing that type of project or in that city or state? How are key go/no go decisions reached on difficult projects?
2. Contract Estimate and Bidding - Do you have formalized written procedures and policies around bidding process? How do you ensure that your current backlog and operating results don't influence the estimating and bid process? Do you have appropriate supplier and subcontractor prequalification process? How reliable and accurate is your estimating/bidding process? Are you bidding projects with more than 4 or 5 other bidders? Are there significant bid spreads on contracts that you have been awarded?
3. Monitoring and Estimates to Complete - How timely and accurately do you capture costs and identify issues? Are your procurement processes centralized and complete (invoices not sitting on project manager's desk or at job site)? Are lookback analyses completed by project, project manager, type of work, to identify trends and potential issues?
4. Change Order Management - Are change orders presented and executed in a timely manner? Are costs properly identified and captured within the system? Are there formal written policies and procedures around change orders and claims, including clear and consistent guidance on proper revenue recognition? Is the tone set by management regarding revenue recognition appropriate and consistently in line with the policy (not on a case by case basis or as needed)?
5. Billing Practices and Collection - Do you know your owner's approval and payment process? What is your corporate culture regarding under-billings and past due receivables? What is your process regarding collection of retainage and past due receivables? Are projects evaluated from a "net cash flow" position and followed-up on accordingly?
5. Financial Statements - Are there formal written policies and procedures regarding

financial statements preparation? Are the financial statements completed accurately and on time (without substantial auditor adjustments)? Are the disclosures in the financial statements neutral, consistent and clear with appropriate construction industry requirements? Are your accounting policies, particularly around revenue recognition, consistently and appropriately applied?

While it may seem to be the easiest course of action regarding internal control deficiencies is to continue kicking the can down the street, that inaction does nothing to protect your company's resources, improve the reliability of your financial statements or limit and mitigate risk to your company. If your internal control environment has you feeling out of control, it's time to contact an advisor in the Schneider Downs Construction Industry group to identify solutions for your internal control needs.

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