



Contractor Web Exchange

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*Accounting Basics for Contractors:
Transforming Financial
Statements into Management
Tools*

March 2, 2010

John Garofalo

General Partner, John N. Garofalo & Associates
garofaljohn@yahoo.com; 713-857-9701
2466 Bering Dr., Houston, TX 77057

About John Garofalo



- 30 years of industry and consulting experience
- Southern Bell in the early 1970s , John began his dual career focusing on marketing and leadership development, with stints in sales and sales management, as well as serving as an instructor and manager for their Executive Learning Center.
- Dealer Marketing Manager for Lennox Industries
- General Manager for an \$5 million HVAC service business in Mobile, Alabama (with 15% net and 7,000 service agreements)
- Operations Manager of GroupMAC's Residential Group
- President for Encompass Residential Services, responsible for 35 acquired businesses generating \$350 million in annual revenue and \$35 million in free cash flow.





“I’ve Never Met A Contractor Who Failed Because of A Lack of Technical Skills”

Take This Warm Up Quiz:

1. The current assets of the business should always be greater than the current liabilities. *(true or false?)*
2. Investing most of your capital in fixed assets (land, buildings, trucks, etc.) is a good business move. *(true or false?)*
3. Working capital should be equal to 10% of the company’s annual sales. *(true or false?)*
4. Current liabilities are debts that must be paid within one year. *(true or false?)*
5. Job mark-up is the same as job margin. *(true or false?)*



Guess Your Best!

1. **Overhead is calculated as a percentage of:**
 - a. Gross margin
 - b. Sales
 - c. Cost of sales
 - d. Budget

2. **In order to get 40% Gross Margin on a job you should mark up job cost by:**
 - a. 40%
 - b. 66 2/3%
 - c. 80%
 - d. 140%

3. **The Balance Sheet does not include:**
 - a. Assets
 - b. Liabilities
 - c. Net worth
 - d. Sales



Guess Your Best!

4. **The Profit and Loss statement includes:**

- a. Sales
- b. Cost of Sales
- c. Overhead
- d. All of the above

5. **Bad-debt Expense should never exceed:**

- a. 5% of sales
- b. 10% of sales
- c. 1/2% of sales
- d. 25% of sales



Are You Paying Attention?

1. Do you have an annual budget? **Y N**
2. Do you know your break-even volume? **Y N**
3. Do you have a formal job cost system? **Y N**
4. Do you receive monthly financial statements? **Y N**
5. Do you use a purchase order system? **Y N**
6. Do you have a consistent pricing policy? **Y N**
7. Do you know your service department overhead? **Y N**
8. Do you project your cash flow needs? **Y N**
9. Do you have an adequate line of credit? **Y N**
10. Are you satisfied with your company's profitability? **Y N**



What is a Financial Statement?

Balance Sheet

- What we own (assets)
- What we owe (liabilities)
- What we're worth (net worth)

The Balance Sheet indicates the financial status of a business at a given moment in time.

Income and Expense Statement

- What we sold (sales)
- What we spent (cost of sales+ overhead)
- What is left (profit or loss)

The Income and Expense Statement indicates that financial transactions of a business over a specific period of time.



What is a Balance Sheet?

- **Current Assets** are assets that can be turned into cash within one year. They include Cash, Accounts Receivables, Inventory and Pre-paid Expenses.
- **Other Assets** are those assets that will not turn into cash within one year. They include Machinery & Equipment, Furniture & Fixtures, Autos & Trucks, Leasehold Improvements and Land & Building (if owned by the Company).
- **Current Liabilities** are liabilities that the company must pay within one year. They include Accounts Payable, Lines of Credit, Taxes Payable, Service-Agreement Deferred Income and that portion of Notes Payable that are due within the year.
- **Long-Term Liabilities** are those items that are not payable within one year. They include all payments on Loans, or Mortgage beyond one year.
- **Reserve for Depreciation** is the amount (allowed by the IRS) to be deducted annually from the purchase price of major items to compensate for wear. Depreciation may be straight-line or accelerated.
- **Capital Stock** is the amount of money initially invested in the company.
- **Retained Earnings** are the amount of profits remaining in the company from its beginning.
- **Net Worth** is the value of the business defined as: Total Assets - Total Liabilities — Reserve for Depreciation + Capital Stock + Retained Earnings



What is an Income & Expense Statement?

- **Sales** - The revenue that is generated during a specific period of time (one month or one year or year to date)
- **Cost of Sales** - the direct costs incurred in completing the work
Equipment Materials Direct Labor Commissions Subcontracts Permits Other miscellaneous costs
- **Gross Margin** - revenues minus Cost of Sales. This is the amount of money remaining to pay for overhead and profit
- **General & Administrative Expenses (Overhead)** - The costs incurred in running the business. Generally, Overhead is broken into two categories:
 - **Fixed Expenses** - Those expenses that are the same every period (rent, clerical salaries, etc.)
 - **Variable Expenses** - Those costs that fluctuate depending on sales revenue (fuel expense, workers compensation, etc.)
- **Net Operating Profit** - The amount of money that remains (or is lost) after all cost of sales and overhead are calculated.



Liquidity Ratios Measure Your Ability to Pay Bills When They Are Due

Working Capital = Current Assets – Current Liabilities 10% of Sales
Where...

Current Assets = Cash, Accounts receivable, Retention, Inventories, Work in Process, and Prepaid Expenses.

Current Liabilities = Those liabilities due this year: Accounts Payable, Notes Payable, Taxes Payable, accrued expenses and billings on uncompleted contracts.

- Determines whether the company has adequate liquidity to meet current debts as they come due.
- Working capital is used for normal increase in operations and for emergencies. The larger the working capital, the better the company will be able to meet emergencies.
- Don't expand fixed assets at the expense of the working capital.



Leveraging Ratios Compare What You Have Invested In Firm Compared to What Your Suppliers/Bankers Have

- **Debt Equity Ratio = Total Liabilities 1:1 Net Worth**
General rule is not to have more in Total Liabilities than Net Worth. However, leverage properly utilized allows for better growth.
- **Total Assets to Net Worth = Total Assets 2:1 Net Worth**
A sign of the average total leverage employed by the firm.



Activity Ratios Measure How Well You Use The Firm's Assets

- **Age of Accounts Receivable =**
Acct's Receivable X 365 days

Days Annual Sales

Guide is 30-45 days. Has effect on total capital requirements. Age depends on strength of credit policy, collection effort and use of discounts, charge cards, and sales financing. Also, builder accounts typically are slow pay. Receivables should be aged 30-60-90 days. Past due amount should not exceed 20% of total receivable.

- **Average Age Accounts Payable =**
Average Accounts Payable X 365 days

Annual Equipment and Materials Cost Sales

Guide is 30 Days Less than 30, if discounts are available. Shows to some extent the capitalization of the firm or its credits. A good firm takes discounts, if available.



Profitability Ratios

- **Gross Operating Margin =**
$$\frac{\text{Gross Operating Profit}}{\text{Sales}}$$

Determines whether markup procedure covers costs and allows adequate margin to cover expenses and allow for profit

- **Operating Income Percent =**
$$\frac{\text{Net Operating Profit Before Taxes}}{\text{Sales}}$$

Guide is 5% minimum



Profitability Ratios

- **Gross Operating Margin =**
$$\frac{\text{Gross Operating Profit}}{\text{Sales}}$$
- **Operating Income Percent =**
$$\frac{\text{Net Operating Profit Before Taxes}}{\text{Sales}}$$



Residential Replacement Sales

**Go to first Worksheet
(D – Res Replace)
in Workbook.**



Building a Proforma a

**Go to second Worksheet
(A – Proforma)
in Workbook**



Balance Sheet

**Go to third Worksheet
(B – Balance)
in Workbook**



Department Break Even

**Go to fourth Worksheet
(C – Dept. Breakeven)
in Workbook**



Department Break Even

**Go to fifth Worksheet
(E – Service Sales)
in Workbook**



Department Break Even

**Go to sixth Worksheet
(F – Res Sales)
in Workbook**



Department Break Even

**Go to last Worksheet
(G – Cash Flow)
in Workbook**



Other Templates Available for Free

- **Residential Break Even Worksheets**
 - Custom Construction
 - Tract Homes

- **Commercial Break Even Worksheets**
 - Replacement
 - Service /Repair
 - Maintenance



To Learn More.....

National Capital Contractor Forum

April 6-7, 2010

www.utilityexchange.org/nationalcapital

National Capital Contractor Forum
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National Capital Contractor Forum
Growing Your Business in a Difficult Market
April 6 - 7, 2010

National Capital Contractor Forum's goal is to facilitate networking and professional development for residential and small commercial building contractors.

General sessions will feature interactive panel presentations with successful contractors and industry experts who will discuss the potential for incorporating energy efficiency and renewable energy initiatives into traditional contracting business practices to leverage federal, state and utility-sponsored incentive programs aimed at green collar workforce development.

Who Should Attend: Owners, department managers and other key employees with companies focused on residential and small commercial remodeling, replacement and service contractors with annual sales of at least \$500,000 annually. This workshop was suited for company owners and presidents who attended with their sales, service, installation and financial managers; and other key employees in the organization.

View photos below from a similar event--the 2010 Southern CA Contractor Exchange.

Roles & Responsibilities

 Presented by Building Performance Institute and Electric and Gas Industries Association in support of the U.S. Environmental Protection Agency's Home Performance with ENERGY STAR Program.





UtilityExchange.org serves as consultant to the Agenda Advisory Committee and supports the host by handling event logistics and helping to identify/recruit /manage event sponsors and exhibitors.



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