WEST MICHIGAN – CONSTRUCTION FINANCIAL MANAGEMENT ASSOCIATION

CAUSES OF CONSTRUCTION COMPANY COLLAPSE

February 25, 2016
Internal Controls

- Continuous Improvement Loop
- Cash Flow Forecasting
- Additional Risks to be Managed
Internal Controls – Continuous Improvement Loop

Estimating, Pricing & Project Management Improvement

- Establish Project Types
- Established Standards
  - Hours & Rates
- Update Estimating Guidelines
- Review Line Items
- Estimate Review Protocol
- Testing
- Training
- Variance Reporting
- Review Protocols
- Variance Analysis
  - What
  - Why
- Actions
- TBD

- Strategy Alignment
- Capacity Alignment
- Pricing Review/Approval Protocol
- Definitions
- Training

- Staffing Decisions
- Accountability
  - Service
  - Profit

- Establish Project Types
- Established Standards
  - Hours & Rates
- Update Estimating Guidelines

- Reports
- Pricing
- Project Mgmt.
Internal Controls – Estimating

• Standardized Methodologies
  – Used by all estimators
  – Budget vs. final
  – Fixed price projects vs. time & material
  – Project size and complexity

• Cost Standards
  – Quantities and values
  – Cost categories
    o Material
    o Labor
    o Subcontractor
    o Equipment

• Estimating Theories
  – Cost-Volume-Profit
    o aka: Variable or direct costing
    o Emphasis on contribution margin
  – Full Absorption
    o Includes allocation of fixed costs
    o Emphasis on gross margin

• Documentation and Training

• Internal Review Protocol(s)

• Updated and Revision Protocol(s)
Internal Controls – Pricing

• Alignment with Strategic Plan
• Alignment with Available Capacity
• Pricing Review and Approval Protocol(s)
• Pricing Theories (reference Estimating Theories)
• Connection to Enterprise Forecasts
• Documentation and Training
• Assessment of Risk
Internal Controls – Project Management

- Define Expectations
  - AARA
    o Ability
    o Authority
    o Responsibility
    o Accountability
  - Economic (i.e., meet or exceed estimate)
  - Customer service (i.e., meet or exceed customer expectations)
  - Quality
  - Safety

- Define Staffing
  - Education
  - Experience
  - Project Managers as Estimators

- Communication
  - Field to office
  - Office to finance
  - Frequency
  - Substance
Internal Controls – Reporting

• Information Quality
  – Timely
  – Accurate
  – Relevant

• Standard Reporting
  – Job Cost reports (by cost code and summary)
  – Variance reports (by cost code)
    o Quantitative
    o Qualitative
    o Correction actions
  – WIP reports

• Project Performance Review
  – During project (management by exception)
  – Post project (fade reports)

• Reporting Frequency
  – Accounting
  – Real Time

• Financial Reporting
  – Historical – WIP reports connected to financial statements
  – Forecasts – impact on future performance and cash flow
Forecasting

• 13-week rolling cash flow forecast
  – Predict short- and near-term cash position (relative to collateral)
  – Aid management in its short- and near-term decision making related to cash and collateral
  – Improve communication with the business’ economic stakeholders

• 12 to 24 month forecast
  – Validate and provide confidence that the company’s business model is creating economic value
  – Improve communication with the business’ economic stakeholders
Additional Risks Mitigated with Strong Internal Controls

- Multi-State – Regulatory
  - Licensing and registration
  - Sales and use taxation
  - Workers compensation insurance

- Multi-State - Other
  - Reporting
  - Labor Pool
  - Logistics

- Union/Non-Union (NLRB)

- Michigan Builder’s Trust Fund Act (similar in other states)
  - Understanding the law
  - Internal controls to assure compliance

- Banking Relationships

- Customer Concentration

- Financial Acumen of Owners/Leaders

- Bonding (and insurance)

- Project Due-Diligence
  - Customer (Owner or GC)
  - Suppliers
  - Subcontractors

- Business Succession Planning
  - Leadership (DWH Model)
  - Ownership
Leadership Model

- Are leaders focused on creating economic value?
  - Maximize cash flows
  - Minimize risk

<table>
<thead>
<tr>
<th>Vision (Direction)</th>
<th>Communication (Alignment of Stakeholder Interests)</th>
<th>Implementation (Tactical Execution)</th>
</tr>
</thead>
</table>
| • Values (principles)  
  • Strategies | • Identify stakeholders  
  • Identify needs & expectations of stakeholders  
  • Develop & implement communications method whereby stakeholders see that they benefit from the vision | • Plan  
  • Organize  
  • Direct  
  • Control |

Maximizing Value for all stakeholders

- Customers
- Employees
- Owners/Investors
- Suppliers
- Community

Vision
Communication
Implementation
Doug Wilterdink has more than 35 years of experience in corporate finance, public accounting, management consulting, restructuring and turnaround, and transition situations. Doug earned his B.A. from Michigan State University and is a Certified Public Accountant (non-practicing). He founded DWH in 2006 and currently serves as a Managing Partner.

Doug has led restructure and turnaround situations as an employee (CFO and CEO), an entrepreneur, and an outside advisor. Following employment with a public accounting firm, he took a financial management position with a company that was part of a family-owned portfolio. That evolved to leading turnaround and M&A activities for a number of companies in the portfolio. Doug used this experience to purchase a distressed multi-state industrial construction company, which he turned around and eventually sold. This turnaround involved significant changes in strategies and tactics, recapitalization and refinancing, developing and implementing improved forecasting, financial reporting and other controls, and business development and operations improvement initiatives.

Doug applies his hands-on experience to each unique client situation, taking into account all stakeholders affected by a transition situation. He is able to understand, from an entrepreneurial standpoint, all the business items an owner and manager has to think about, including financial management and modeling, contractual relationships, operations, international practices, and corporate administration.
Additional Information - Forecasting
Forecasting – Purpose & Value

- Cash Management and Decision Making Tool
  - Proactive versus reactive management
  - Improved accuracy

- Predict Cash Flow Relative to Bank Collateral
  - Incorporates caps, ineligibles, advance rates

- Communication with Key Stakeholders
  - Internal - Ownership, Management, Employees
  - External - Lenders, Boards, Investors
Significant improvements and efficiencies gained in administrative processes, as well as with the timeliness and accuracy of information critical for financial management and decisions including, but not limited to the following:

- Capitalization and financing terms negotiations
- Customer pricing and terms negotiations
- Timely invoicing and payables entry
- Vendor cost and terms negotiations
- Capital expenditures and related financing
- Fosters proactive collection of accounts receivable
- Accounts payable cut list generation
- Expense visibility and control
- Improved revenue forecasting
- Clear reporting for effective communication with stakeholders
- Variance analysis
- Capability to expand beyond 13 weeks
Forecasting – Process Overview

**Assessment**
- Needs Identified
- Key Players
- Process Overview
- Roles & Responsibilities
- Client Interview

**Development**
- Information Request
- Client Process Review
- Business Analysis
- Model Configuration
- Customization

**Implementation**
- Weekly Data Load
- Validation
- Analysis of CFF
- Refine Forecast
- Client Process Improvement
- Further Customization

**Client Transition**
- User Training
- Customized Process Instructions
- Review of Client Work
- Ongoing Oversight

< 1 Week  4-8 Weeks  3-4 Weeks
Forecasting – Model Summary

<table>
<thead>
<tr>
<th>Description</th>
<th>Data</th>
<th>Notes</th>
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</thead>
<tbody>
<tr>
<td>Receipts</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Disbursements</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Weekly Cash Flow from Operations</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Non-Operating Cash</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bank Balances &amp; Borrowing Base</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Line of Credit Balance &amp; Availability</td>
<td></td>
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</table>
Forecasting – Model Components

**Setup**
- Configuration parameters
- Beginning balances
- Line of credit parameters
- Aging parameters

**Disbursements**
- Current open accounts payable
- Forecast of future disbursements
  - Repeating, intermittent, tied to sales
- Sorting, filtering & reports for aging, detail, distribution and cut-list

**Receipts**
- Current open accounts receivable
- Forecast of future receipts from sales and other income
- Sorting, filtering & reports for detail and collections

**Checkbook**
- Maintains checkbook and bank balances
- Outstanding checks
- Detail utilized for comparison and variance reporting; actual versus forecast
## Variance Reporting

<table>
<thead>
<tr>
<th></th>
<th>Forecast</th>
<th>Actual</th>
<th>Variance</th>
<th>Explanation of Variance</th>
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</thead>
<tbody>
<tr>
<td><strong>Cash Receipts from:</strong></td>
<td></td>
<td></td>
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<tr>
<td>Accounts Receivable</td>
<td>527,967</td>
<td>602,742</td>
<td>74,775</td>
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<tr>
<td>Forecasted Sales - Division 1</td>
<td>73,324</td>
<td>0</td>
<td>(73,324)</td>
<td></td>
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<tr>
<td>Forecasted Sales - Division 2</td>
<td>0</td>
<td>0</td>
<td>0</td>
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<tr>
<td><strong>Total Cash Receipts</strong></td>
<td>601,291</td>
<td>602,742</td>
<td>1,451</td>
<td></td>
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<tr>
<td><strong>Disbursements for:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Tooling - Material, Components &amp; Subs</td>
<td>239,797</td>
<td>239,797</td>
<td>0</td>
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<tr>
<td>Mfg - Material, Components &amp; Subs</td>
<td>641,774</td>
<td>646,907</td>
<td>(5,133)</td>
<td>Adjusted %</td>
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<tr>
<td>Tooling - Outsourced Die Build</td>
<td>14,320</td>
<td>14,320</td>
<td>0</td>
<td>Adjusted %</td>
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<td>Payroll, PR Taxes, Burden, &amp; Benefits</td>
<td>26,751</td>
<td>45,998</td>
<td>(19,247)</td>
<td>401k is always running a week behind.</td>
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<td>Maintenance &amp; Repairs</td>
<td>7,796</td>
<td>7,796</td>
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<tr>
<td>Supplies</td>
<td>38,520</td>
<td>38,520</td>
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<tr>
<td>Freight</td>
<td>7,178</td>
<td>7,178</td>
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<tr>
<td>Insurance</td>
<td>5,592</td>
<td>5,592</td>
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<tr>
<td>Taxes</td>
<td>0</td>
<td>0</td>
<td>0</td>
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<tr>
<td>Selling, General &amp; Administrative</td>
<td>19,205</td>
<td>21,089</td>
<td>(1,884)</td>
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<tr>
<td>Other Expense</td>
<td>55,966</td>
<td>54,712</td>
<td>1,254</td>
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<tr>
<td>Capital Expenditures</td>
<td>54,372</td>
<td>73,832</td>
<td>(19,460)</td>
<td>Down payment on new equipment paid early</td>
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<tr>
<td>Debt Service</td>
<td>0</td>
<td>0</td>
<td>0</td>
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<tr>
<td>Bond</td>
<td>15,841</td>
<td>15,841</td>
<td>0</td>
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<tr>
<td><strong>Total Disbursements</strong></td>
<td>1,127,112</td>
<td>1,171,583</td>
<td>(44,471)</td>
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</table>
Forecasting – Key Factors Affecting Implementation

• Complexity of business model
  – Ability to forecast revenue and related cost of sales

• Current business processes
  – Timely entry of transactions into financial system
  – Consistent A/R & A/P cut-off processes
  – Holding checks
  – Checkbook reconciliation with bank

• Availability and readiness of data
  – Format
  – Timely inputs and response to questions

• Quality and reliability of data
  – Limitations of financial system

• Client point person
  – Knowledge with all aspects of business
  – Capability with system