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CERTIFIED PUBLIC ACCOUNTANTS
STRATEGIC BUSINESS ADVISORS



Financial Tools
For The
Construction
Industry



Understanding Homebuilders Financial Statements

2013 NAHB International Builders Show
Las Vegas, NV
January 22, 2013



- ❶ A “snapshot in time.” The balance sheet presents the financial picture of the Company as of a specific date.
- ❶ $\text{Assets} = \text{Liabilities} + \text{Equity}$ or; stated another way, what you own (assets) = what you owe (liabilities) + value to owners (equity)



- ❶ **Assets are everything you own (cash, inventory, investments, property and equipment) or have a right to receive in the future (accounts and notes receivables)**
- ❷ **Assets are presented on the balance sheet in order of liquidity (how easily the asset can be converted to cash)**



- ❶ **Cash**
- ❷ **Accounts receivable**
- ❸ **Speculative homes under construction**
- ❹ **Residential lots held for sale or speculative construction**
- ❺ **Land held for development**
- ❻ **Land and Land development costs**
- ❼ **Developed Lots**
- ❽ **Costs and estimated earnings in excess of billings on uncompleted contracts (under billings)**



- ⑥ **Finished Units (spec homes)**
- ⑥ **Other current assets**



PROPERTY AND EQUIPMENT

- ④ Land**
- ④ Building**
- ④ Vehicles**
- ④ Construction Equipment**
- ④ Office Furniture**
- ④ Leasehold improvements**



- ❶ **Loan acquisition cost**
- ❶ **Cash surrender value of life insurance**
- ❶ **Deposits**



- ❶ **Liabilities are obligations of the Company to others such as money owed to vendors, lenders or employees**
- ❶ **Liabilities are presented on the balance sheet in two primary categories**
 - ❶ **Current liabilities**
 - ❶ **Long-term liabilities**
- ❶ **Current liabilities are those obligations, which are due within one year from the balance sheet date**



- ⑥ **Accounts payable – trade**
- ⑥ **Line of credit**
- ⑥ **Customer Deposits / Construction Draws**
- ⑥ **Billings in excess of costs and estimated earnings on uncompleted contracts**
- ⑥ **Development and construction loans payable**
- ⑥ **Payroll taxes withheld and accrued**



- ⑥ **Accrued wages**
- ⑥ **Accrued taxes**
- ⑥ **Accrued expenses**



- ⑥ **Accrued losses on contracts in process**
- ⑥ **Notes payable - Shareholders**



- ⑥ **Notes payable – Bank**
- ⑥ **Notes payable – Shareholder**
- ⑥ **Notes payable – Related Party**



SHAREHOLDER'S or MEMBER'S EQUITY

- ⑥ **Shareholder's (S-Corporation) or Member's (LLC) Equity is what remains after you deduct total liabilities (what you owe) from total assets (what you own). Stated another way shareholder's/member's equity is the value of the Company to its owners.**



SHAREHOLDER'S or MEMBER'S EQUITY

UNDERSTANDING FINANCIAL STATEMENTS

- Capital Stock or member's capital
- Retained Earnings
- Treasury Stock



- ❶ **Items you do not want on your balance sheet include:**
 - ❶ **Cash overdraft**
 - ❶ **Loans to officers**
 - ❶ **Loans to employees**
 - ❶ **Current liabilities in excess of current assets**
 - ❶ **Negative equity**



- ⑥ **The income statement provides information on the profitability of a Company over a specified period of time, generally one year.**
- ⑥ **Contract Revenue – Cost of Contract Revenue = Gross Profit – Selling, General and Administrative Expenses = Net Income**



- ④ **Contract revenue**
- ④ **Cost of contract revenue**
- ④ **Gross profit**
- ④ **Selling, general and administrative expenses**



- ④ **Operating income**
- ④ **Other income**
 - ④ **Interest income**
 - ④ **Interest expense**
 - ④ **Gain (Loss) on sale of property and equipment**



- ⑥ Income before taxes
- ⑥ Taxes
- ⑥ Net Income
- ⑥ Net Income Does Not Equal Cash



STATEMENT OF CASH FLOWS

- ⑥ **The statement of cash flows provides information on the sources and uses of cash over a specified period of time, generally one year.**



STATEMENT OF CASH FLOWS

- ❶ **The statement of cash flows reconciles the Company's accrual basis financial statements (balance sheet and income statement) to the cash basis focusing on three major business activities including operating, investing and financing**



STATEMENT OF CASH FLOWS

- ❶ **Cash flows from operating activities are:**
 - ❶ **Cash inflows and outflows from routine activities of the Company**
 - ❶ **Cash flows from operating activities include:**
 - ❶ **Payments received from customers**
 - ❶ **Disbursements to vendors and suppliers**
 - ❶ **Payments made to employees for salaries and wages, etc.**



STATEMENT OF CASH FLOWS

- ❶ Cash flows from investing activities are:
 - ❶ Cash inflows and outflows from the Company's productive assets such as:
 - ❶ Property
 - ❶ Equipment
 - ❶ Investments



- ❶ **Cash flows from investing activities include:**
 - ❶ **Payments made to purchase property and equipment**
 - ❶ **Gross proceeds from sales of property and equipment**



STATEMENT OF CASH FLOWS

- ❶ Cash flows from financing activities are:
 - ❶ Borrowing money
 - ❶ Repayment of principal amounts borrowed
 - ❶ Issuing stock
 - ❶ Purchasing stock and paying dividends
 - ❶ Distributions to owners



STATEMENT OF CASH FLOWS

- ❶ **Non-cash transactions are activities, which do not provide cash inflows or outflows and are shown on the statement of cash flows as reconciling items**
- ❷ **Depreciation and amortization**
- ❸ **Gains and losses on the sale of property and equipment**
- ❹ **Purchase of property and equipment by issuing notes payable or entering into a capital lease obligation**



NOTES TO THE FINANCIAL STATEMENTS

UNDERSTANDING FINANCIAL STATEMENTS

- ④ **Summary of significant accounting policies**
 - ④ **Business activity**
 - ④ **Use of estimates**
 - ④ **Cash equivalents**
 - ④ **Method of accounting for speculative homes and contract homes**



NOTES TO THE FINANCIAL STATEMENTS

UNDERSTANDING FINANCIAL STATEMENTS

- ⑥ **Accounts receivable**
- ⑥ **Concentration of credit risk**
- ⑥ **Income taxes**



NOTES TO THE FINANCIAL STATEMENTS

UNDERSTANDING FINANCIAL STATEMENTS

- ⑥ **Costs and estimated earnings on uncompleted contracts**
- ⑥ **Line of credit**
- ⑥ **Long term notes payable**
- ⑥ **Retirement plans**



NOTES TO THE FINANCIAL STATEMENTS

UNDERSTANDING FINANCIAL STATEMENTS

- ⑥ Lease commitments
- ⑥ Related party transactions
- ⑥ Commitments and contingencies



- ⑥ Schedule of cost of contract revenue**
- ⑥ Schedule of general and administrative expenses**
- ⑥ Schedule of completed contracts**
- ⑥ Schedule of contracts in process**



- ④ **Liquidity Ratios**

- ④ **Number of Days Cash**

- ④ **Cash times 360 divided by annual revenue**

- ④ **Number of day's cash should be seven (7) days or more**



- ❶ **Accounts payable turnover**
 - ❶ **Cost of contract revenue divided by average accounts payable**
- ❶ **Age of Accounts Payable**
 - ❶ **360 days divided by accounts payable turnover**
 - ❶ **Age of accounts payable should be 45 days or less**



- ⑥ **Current Ratio**
 - ⑥ **Current assets divided by current liabilities**
 - ⑥ **Current ratio must be greater than 1.25 to 1.0**



- ❶ **Leveraged Ratios**
 - ❶ **Debt to Equity Ratio**
 - ❶ **Total liabilities divided by equity**
 - ❶ **Debt to equity not greater than 3 to 1**
 - ❶ **In today's market getting tighter than that**



- **Long-Term Debt to Equity**
 - **Long-term debt divided by equity**



④ Profitability Ratios

④ Gross Profit to Sales

④ Gross profit divided by annual revenue

④ NPBT

④ Net profit before taxes divided by annual revenue



- Return on Assets
 - Net income before taxes divided by total assets



- ❶ **Current assets should be assets collectible in the operating cycle**
- ❶ **Accounts receivable not collected within one year should be classified as other assets**
- ❶ **Analysis of costs and estimated earnings in excess of billings on uncompleted contracts**
 - ❶ **A function of the Company's ability to properly and timely get bills out**



- ❶ **Current liabilities should be any liabilities due within twelve (12) months**
- ❶ **Long term liabilities are payments due after one year**



- ❶ **Over billings**
 - ❶ **If this number is large, is the Builder using funds from current jobs to pay off old liabilities**
 - ❶ **Will lead to cash flow problems down the road**



- ❶ **Format should be correct**
- ❶ **Titles should also be correct**



- ❶ **Income Statement is compared Year to Year**
- ❶ **Comparison of revenue from one year to the next year**
 - ❶ **Also compared to gross profit percentage**
- ❶ **Overhead analyzed as a percentage and also analyzed as a percentage to sales increase**



STATEMENT OF CASH FLOWS

- ❶ Analyze to see if the Company has the ability to pay bills in a timely fashion
 - ❶ Trade vendors
 - ❶ Payroll
 - ❶ Subcontractors
 - ❶ Debt payment



- ❶ **Schedule of cost of contract revenue**
 - ❶ **Breakdown of:**
 - ❶ **Labor**
 - ❶ **Materials**
 - ❶ **Subcontractors**
 - ❶ **Analysis done to compare work subbed out versus self performed**



- ❶ **Schedule of general and administrative expense**
 - ❶ **Increase in general and administrative expenses from one year to the next**
 - ❶ **Increase in all general and administrative expenses**
 - ❶ **Increase in certain items due to tax planning**
 - ❶ **Bonuses**
 - ❶ **Retirement Plan Contribution**



- ❶ **Schedule of contracts in process and completed contracts is a must for banks**

- ❶ **Schedule of Contracts in Process**
 - ❶ **Number of jobs**
 - ❶ **Size of jobs**
 - ❶ **Gross profit by job**



- ❶ **Schedule of Completed Contracts**
 - ❶ **Ability to estimate**
 - ❶ **Compare gross profit from prior year or period to gross profit on contracts in process**
- ❶ **Schedule of Completed Contracts**
 - ❶ **Contract fade (decline in gross profit)**



- ❶ **Income earned on contracts in process schedule and income earned on completed contract schedule must equal contract revenue on income statement**
- ❶ **Costs on contracts in process schedule and costs on completed contract schedule must equal costs of contract revenue on income statement**



 **Banks**



OTHER ITEMS ANALYZED BY THIRD PARTY

- ⑥ Excessive overhead expenses
- ⑥ Collectability of accounts receivable
- ⑥ Proper payment of accounts payable



OTHER ITEMS ANALYZED BY THIRD PARTY

- ❶ **Balance to bill on the contracts in process schedule minus the estimated cost to complete which gives available gross profit**
 - ❶ **Compare to operating costs for the next year**
- ❶ **Third parties like to see backlog that will produce enough gross profit dollars to cover overhead for the next twelve (12) months**





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THANK YOU!
Questions?