Concrete Designs

Concrete Designs is an incorporated company that designs, manufactures and installs customized counters and concrete floors. The company is owned and operated by Pierre, John and Gary, who are first cousins. Pierre who manages the company as President; John manages the manufacturing plant; and Gary manages the design division.

Andrea Crawford is responsible for payroll and assists Pierre. Pierre hired Andrea to manage the payroll, (issue payroll cheques bi-weekly, remit payments to CRA as required and manage the employee extended health benefits plan) and to be his assistant. All the accounting is done by Pierre’s wife, Wendy.

### ABOUT CONCRETE DESIGNS

Pierre set up Concrete Designs as a sole proprietorship 15 years ago. Pierre’s father and uncles were concrete mixers and Pierre grew up surrounded by conversations about aggregate, curing times, composition and the impact of weather on their work. Pierre was interested in art and design and convinced his father that he should integrate designs into some of his jobs. Architects soon asked Pierre to create designs for the concrete elements of their projects.

For large projects, Pierre sub-contracted some of the work to other designers and continued to operate as a sole proprietor. Ten years ago, Pierre and his cousin John formed a partnership that kept the name Concrete Designs. John brought his small business that manufactured pre-cast concrete slabs into the partnership.

Each partner managed his part of the business separately. They trusted each other and didn’t question the revenue and expense numbers they reported for the business. Pierre and John declared the net proceeds from the business on their personal tax returns.

Five years after the partnership was formed, Pierre got a call from an insurance agent who described all the benefits available if the company had employees. Pierre and John decided it was time to incorporate Concrete Designs and to formalize the employment arrangement so Pierre, John, the administration employees and workers in the manufacturing plant could be covered for extended health benefits. Since Pierre was spending more time on business development than on designing, they made their cousin Gary, who was their most successful designer, an equal shareholder and an employee so he could participate in the extended health benefits plan.

The designers were independent consultants and were not included in the employee extended health benefits plan. They were free to take on contracts with other firms. The designers used Concrete Designs’ offices and the company provided the software in these offices for the designers to produce the designs for customers. About 20 of the designers worked full-time on contracts from Concrete Designs and used the company
Andrea was surprised when Pierre asked her to attend a meeting this morning as the owners do not usually include her. Pierre began the meeting by pointing out two major problems the company is facing:

- Production is increasing, yet profits are falling
- CRA has ruled that the design consultants are employees and the company will be audited

"John, why do you think our profits fall as your production line increases output. And Gary, can you tell us what the problem is with the CRA and our design consultants?"

John said he didn't think the falling profits were related to the manufacturing operation.

"None of our fixed costs have changed because we are operating a third shift using the same facilities. As Andrea knows, I hired 100 hourly workers for the third shift and I include each worker's $25 per hour wage in calculating the cost per unit of product.

I also have casual workers, but I keep them off the books. Some of our customers like to pay cash and don't want receipts because they don't want to pay GST/HST. I use that cash to pay the casual workers and to pay for parking for all the plant employees in the city lot across the street. They really appreciate that.

Pierre, you are going to have to look somewhere else for the lower profits because it's not coming from my part of the business. What about all those cars you leased for the designers. That must have cost a bundle and you didn't even consult me."

Andrea made a note to follow-up with John because she knew that labour costs were closer to $40 per hour after CPP, EI and company paid insurance premiums. She wasn't aware that John had been providing parking to employees.

Gary, who manages the design and installation part of the business, reported that the notice of an audit from CRA was a shock.

"Pierre, when you started the business, you didn't have enough work for each designer to be full-time, so they worked for other companies as well and invoiced us for the work they did. As we have grown, 20 of our designers are so busy with
contracts from us that they don't need to have other clients. The CRA claims that they have been employees for five years because they have earned all their income from Concrete Designs.”

Andrea knew that the statutory remittances and penalties for 20 employees over five years would be substantial. Because invoices are paid through Accounts Payable, and not payroll, she would have to find out how large these designers’ consulting contracts have been.¹

Pierre turned his attention to Andrea,

“I have to admit Andrea that you have been after me for years to create a more efficient organizational structure. Now we are in a mess. What should we do? I know we have to sort things out with the CRA and we have to figure out the costing system, but what can we do long-term to make sure we don’t get into this mess again?”

Andrea was shocked by the information she had just learned. She wasn't aware that John paid for employee parking and paid casual workers cash instead of putting them on the payroll, nor that there were designers who worked only for Concrete Designs. Wendy never shared information with Andrea about any non-payroll payments.

Andrea knew many changes had to be made and she set about making a list of issues that needed attention.

Advise Andrea on what action Concrete Designs should take.

¹ As sole proprietors, the designers have paid the employee and employer CPP premiums.
Notes
1. Students should read ‘The Case Study’, available on the Supplemental Resources site, for more information on the decision-making process to be used when developing their responses.
2. The student’s response should be based on an understanding of the course material and personal and professional experiences.
3. The following is an example of one approach to this scenario. Students may come up with other approaches.

Issue
Concrete Designs needs an organizational structure that will ensure information flows to the appropriate individual.

This scenario also lends itself to an examination of the payroll issues in Concrete Designs, such as taxable benefits, deciding if someone is an employee or self-employed, and the reporting of cash payments. However, Pierre has asked Andrea to advise him how a different corporate structure could prevent future payroll and accounting problems.

Analysis
(Barriers, Resources, Stakeholders)

Pierre, John and Gary have avoided a complex organizational structure by keeping some payments cash-based and using contractors instead of employees. While the structure may have been simple, it has had negative financial consequences. Undeclared cash payments, such as payments to casual workers, will add to the amount of remittances required by the corporation. The employees will also be dismayed to discover that the parking may be a taxable benefit. The use of contractors, while requiring simple payments of invoices, will create a major tax burden if the CRA determines that the 20 designers who use the company's offices and software are actually employees. Concrete Designs will have to pay the penalties for not reporting employees and for late filing and interest on overdue payments for employer Canada Pension Plan contributions and employee and employer Employment Insurance premiums. In addition, the taxable benefits (personal use of company cars) will be added to their income.
Andrea has not been provided the information she needs to do her job properly. John has not told her, nor anyone else apparently, that he hires casual workers on a cash basis and does not keep records, nor that he provides free parking to the employees.

Andrea also faces the challenge of internal politics. She is Pierre's assistant but appears to have been kept out of key discussions and access to critical information. While Concrete Designs is an incorporated company, the owners keep information to themselves and are comfortable with not reporting cash payments to avoid GST and HST. Wendy, who is the company's accountant and the President's wife, does not share information with Andrea.

**INTERNAL STAKEHOLDERS**

There are four groups of internal stakeholders:

- Shareholders/owners (Pierre, John and Gary)
- Administration (Andrea, Wendy and other employees)
- Employees in the manufacturing plant
- Designers

**Shareholders**

Pierre, John and Gary's lack of attention to an organizational structure that is appropriate for a growing, multi-division company limits the flow of information needed within the company. They need to accept that the corporation is an entity itself and requires information in order to be compliant under the *Canada Business Corporations Act*.

The shareholders need the services of a professional accountant to review the company's procedures and tax filings and a management consulting firm to advise them on an appropriate organizational structure.

**Administration Employees**

Wendy does not communicate with Andrea. We do not know if Wendy is withholding information on purpose because she does not want Andrea to know the details of the family business, or because she does not see that information-sharing is necessary.

Pierre may also want to limit the amount of information that is circulated among the employees, and perhaps more importantly, within the extended family. Accounting, operations and payroll do not communicate. As Pierre has discovered, by keeping each function in a separate silo, critical information has not been shared. Andrea does not know that 20 contract positions are really employees and John is not aware that he is underestimating the cost of labour.
Employees in the manufacturing plant

Andrea processes the company payroll and related remittances. The manufacturing employees may be surprised with the addition of parking as a taxable benefit.

The casual workers must be added to payroll with all statutory remittances. This formality may make it difficult for John to recruit casual workers, many of whom do not want to pay income tax. On the other hand, casual workers could be delighted to be eligible for Employment Insurance and to contribute to the Canada Pension Plan.

The company also offers an extended health benefits package to employees. By adding the casual workers to payroll, Concrete Designs may have to pay more premiums for the employee extended health benefits plan (if part-time workers are eligible) and will have to pay their portion of Canada Pension Plan contributions and Employment Insurance premiums.

Designers

Concrete Designs' remuneration of design services has not changed since Pierre started the company as a sole proprietor.

Many of these designers may want to be considered as employees so they can participate in the company's extended health benefits plan. They will have to pay Employment Insurance premiums, but will not have to pay the employer's portion of the Canada Pension Plan contributions. Their personal use of the company cars will be a taxable benefit.

Some designers may not be interested in the company's benefit plan because their spouses have coverage at their workplace. Also, some entrepreneurs are not interested in the Employment Insurance coverage employees receive because they have faith in their own ability to make an income. However, the CRA may declare those designers who work only for Concrete Designs, operate out of the company's office and use the tools (software) owned by the company as employees.

EXTERNAL STAKEHOLDERS

Canada Revenue Agency (CRA)

Pierre has already been informed that the CRA will audit Concrete Designs' accounts. Since the CRA can go back seven years, the company will likely incur significant costs to retrieve the information requested by the CRA and will be liable for large penalties for not reporting taxable items.
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From the information provided, the company does not appear to have sufficient in-house expertise to prepare for the CRA’s audit. The company needs to hire a professional accountant to conduct an internal audit and prepare for the CRA’s audit.

Concrete Designs’ customers

Prices are too low because John has not included the payroll taxes associated with the labour costs in his bids for contracts. Pierre has pointed out that profits have decreased as production has increased. Either John reduces costs in the manufacturing operation or he will have to raise prices to cover the full labour costs.

John has to consider how price sensitive his customers are. Perhaps these customers buy from Concrete Designs because its prices are lower than the competitors’ prices for similar products. If prices rise, the customers may not think that Concrete Designs’ products are still the preferred brand to buy.

Alternatives

1. Do nothing

   Focus on preparing for the audit and assure Pierre that everything will be fine with the current system.

2. Make the company compliant

   Andrea has a legal and professional responsibility to ensure that Concrete Designs meets its compliance obligations. If the shareholders insist on conducting business without collecting and remitting GST/HST or refuse to put the casual workers on payroll, she should resign her position.

   The CRA is already aware of Concrete Designs’ lack of compliance and Andrea should stress to the shareholders that significant penalties will be incurred if the company does not take immediate steps to become compliant.
Applied Payroll Management – Payroll in the Organizational Structure

Concrete Designs

3. Establish a reporting and communication structure

Regular meetings, such as the one Pierre called today, could prevent many of the difficulties the company faces. The company can ensure that key functions, such as accounting, operations, human resources and payroll are represented. These can be reporting and discussion sessions. For example, Andrea could point out to John that labour costs include more than hourly wages. That discussion could lead to Pierre and John reviewing the company's pricing formula, operations and use of labour. As a payroll specialist, Andrea could also alert the company about the likelihood that some of the contractors are really employees, if she is able to participate in meetings about the financial operation of the company.

4. Hire a consultant to recommend an organizational structure for the company

Concrete Designs has not adapted its organizational structure to its larger corporate activities. Consultants can analyze the company's business and recommend a structure that will accommodate the various operational needs. Since the company needs advice on reporting responsibilities, accounting procedures, reporting systems and integration of computer systems, a larger management consulting firm that can develop solutions for all these requirements would be best.

Action Plan

1. Andrea should advise Pierre to immediately contact a professional accountant to help Concrete Designs prepare for the CRA audit.

2. The shareholders should engage a management consulting company that specializes in helping growth companies adapt their organizational structure, policies and procedures to current business needs. These experts are accustomed to advising entrepreneurs who do not want to move from informal systems to the formal organizational structure necessary for a growing corporation. To prepare for the long-term growth of the company, Pierre, John and Gary have to overcome their tendency to think that there is no need to tell anyone, including each other, how they operate their departments.

Andrea should not think that addressing the immediate issues will resolve the long-term structural needs of the company. If there is no reporting system in place for information about the financial and operational details of the company to be communicated to each department, the profitability of the company is threatened.

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