Spring 2025

CONSTRUCTION INDUSTRY ADVISOR

Building your construction company's bonding capacity

Infrastructure jobs call for due diligence

Is your construction business ready for connected jobsites?

Stay on guard against supply chain fraud

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Building your construction company's bonding capacity

As you know, every construction project doesn't require bonding. However, once your company starts working on jobs that do, your ability to obtain performance bonds of the requisite value becomes critical. They call it "bonding capacity" — and the strength of yours depends on your construction company's past financial performance and future viability.

Capacity basics

A performance bond is a legally binding agreement involving a principal (the construction business), an obligee (the project owner) and the surety (the bond provider). The bond is a form of insurance that guarantees the construction company will fulfill the performance obligations of its contract with the owner. If it can't, the surety assumes liability for replacing the principal or compensating the obligee for its losses.

More formally defined, individual or "single-job" bonding capacity is the maximum dollar value of any construction contract for which a surety will issue a bond. Sureties may also assess aggregate capacity — the total bonding limit for multiple jobs handled by one construction business.

Generally, bonding is required for publicly funded projects and some bigger or more complex privately funded ones. So, the higher your bonding capacity, the wider the selection of these potentially lucrative jobs you'll have. Some owners may look into your capacity even when a bond isn't required because an elevated capacity indicates a history of successfully completed projects.

Information, please

For smaller bonding needs — say, jobs valued at less than $500,000 — you may be able to secure a performance bond rather quickly based on just your business credit score. However, sureties typically engage in lengthier approval processes when larger dollar amounts are involved.

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In these cases, they'll scrutinize your company profile. This is basically a comprehensive summary of essential information about your construction business — such as its name, contact information, history, organizational structure, mission and vision statements, range of services, and notable awards or other achievements.

They'll also want to study one or more sets of your financial statements, as well as additional documentation such as liquidity statements, cash flow projections and work-in-progress schedules. Sureties will likely request copies of your bank

Bond claims can prove more costly than you think

No construction business embarks on a project expecting its surety to enforce a performance bond. Unfortunately, unexpected circumstances can sometimes arise that make it impossible to complete a job as promised. As you might guess, what happens next is … not good.

Bond claims are usually filed by the obligee (project owner) when it's clear the principal (construction company) has defaulted on the contract. In such a case, your surety will investigate and may give you the opportunity to remedy the situation. Absent a feasible remedy, you'll be responsible for reimbursing the surety for its costs to find a new contractor or cover the owner's losses. A financial hit like this could drastically undermine your cash flow and potentially threaten the solvency of your construction business.

Bond claims also damage your reputation, leaving project owners wary about awarding you bids and referral sources hesitant to recommend you. Moreover, just one bond claim, much less a history of them, makes it much harder to obtain performance bonds going forward.

statements, too. And they may ask for a list of references and details about your most recently completed projects.

Method to madness

Sureties' underwriting and decision-making processes can seem perplexing. Rest assured, there's a method to their madness. The information they collect provides them with critical insights into your:

Financial stability. Sureties want to know you can pay the bills while you're fulfilling your contractual obligations. To gather evidence, most use key performance indicators. A particularly important one is working capital, which is commonly calculated as current assets minus current liabilities. Other critical metrics include equity-to-backlog ratio and operating cash flow. More broadly, they look for sound accounting and financial management practices, such as reasonable budgeting and accurate cash flow projections.

Backlog. Sureties want to see that you're steadily landing new contracts — without overcommitting operational resources, such as people and equipment. A sound number of projects in the pipeline provides evidence of future revenue, cash flow and the capacity for additional work. They want to be sure you'll likely earn enough to cover your overhead and indirect costs.

Past performance. Sureties typically work from the premise that history is the best predictor of the future. Thus, they scrutinize the size and profitability of your recently completed jobs, including how your projections played out against actual costs.

Sureties also consider whether your construction company is experienced in the type of project for which you're seeking a bond. At the very least they want evidence that you're likely able to transition to that kind of job based on your established services and the skill sets of your leadership team and key employees.

In fact, if you're particularly keen on increasing your bonding capacity, start diversifying your project types now to demonstrate the ability to execute various jobs. Varying your revenue streams can also protect your business from downturns in a specific sector.

Just ask

If you're already working with a surety, don't hesitate to ask your rep what you need to do to boost your bonding capacity. On the other hand, if you're new to bonding, work with a qualified broker or advisor to find the right provider. In either case, your CPA can help you prepare financial statements and other forms of documentation to build your case. ■

Infrastructure jobs call for due diligence

Since its enactment in 2021, the Infrastructure Investment and Jobs Act (IIJA) has spurred tens of thousands of projects nationwide. And the IIJA — along with state and local efforts to improve roads, bridges and so forth — is expected to keep creating jobs this year and beyond. But just because plenty of projects are available doesn't mean you should bid on every one.

Assess funding

As with any job, first assess whether the entity funding the project can realistically bankroll it. Although one of the appealing things about publicly funded jobs is the low likelihood that you'll get "stiffed," it doesn't hurt to identify precisely where the money is coming from.

Government-funded jobs mean government-mandated rules and regulations.

The IIJA allocates about $1.2 trillion for various eligible projects over a five-year period. So, the federal money is likely there. State and local governments also typically set aside funds for infrastructure jobs, but their financial stability isn't always as certain. Research whether the funding agency has incurred any major revenue losses recently.

Check the supply chain

Supply chains have largely returned to normal since the widespread slowdowns caused by the pandemic and other world events. Unfortunately, that doesn't mean you're guaranteed a wide-open market and lightning-fast delivery times. Look into the state of the supply chain you'll deal with on any infrastructure project you're considering.

Some contractors continue to maintain high inventory levels of critical or hard-to-get materials to insulate themselves against future disruptions. This strategy may be effective if you have enough cash on hand to cover the acquisition and storage costs. Other helpful measures include diversifying your supplier base and identifying alternate suppliers who can deliver materials of similar type and quality.

Look at the labor market

Before bidding on an infrastructure job, be sure you'll have enough reliable, skilled workers available to complete the project. If you'll probably need to hire more people, factor in the associated time and costs. The profit you ultimately make from the job, and perhaps others like it, may make hiring more workers worthwhile. But you'll need to forecast the cash flow impact carefully.

If you're a general contractor, also evaluate whether the subcontractors you'd typically use will probably be available. Prequalifying subs and maintaining a strong list of go-to providers can help ensure you have multiple options from which to choose.

Read up on compliance

Government-funded jobs mean government-mandated rules and regulations. Specifics will vary depending on the type of project and agency (or agencies) involved. Just be sure to know what you're getting into.

First and foremost, refresh your understanding of the concept and specifics of prevailing wage rates. Also, learn about bonding requirements, safety and health standards, environmental regulations, and reporting and recordkeeping guidelines.

Get familiar with the tech

Look into what kinds of technology will be involved in the project. For example, many infrastructure jobs now use building information modeling (BIM) systems. Are you and your employees experienced with BIM software? If not, will you be able to get up to speed quickly?

In addition, jobs involving government agencies and multiple other parties could involve videoconferencing and a centralized project management platform. To comply with rigid safety protocols, you might need to invest in "wearable tech" to monitor workers' whereabouts and physical conditions. Some publicly funded projects use paperless ticketing for materials deliveries.

Delve into delivery method

Infrastructure jobs don't always follow the traditional design-bid-build approach. Some projects operate under more collaborative methods, such as:

- Public-private partnerships,
- Design-build, and
- Integrated project delivery.

Under such methods, job parties work together much earlier in the construction process to develop the scope, schedule and budget.

Choose carefully

Infrastructure projects and other publicly funded jobs undoubtedly present attractive opportunities for many construction businesses. However, they come with plenty of risks, too. Choose your targets carefully in consultation with your leadership team and professional advisors. ■

Is your construction business ready for connected jobsites?

Construction jobsites used to be decidedly unfriendly places for mobile technology. You wouldn't, after all, want to lose your laptop to a steamroller or drop your smartphone in a cement mixer. And connecting these or other devices to a network was often difficult, if not impossible.

These days, mobile technology is playing an increasingly critical role in construction — so much so that jobsites have become much more readily networked. There's even a term for project locations that are truly tech-friendly: connected jobsites.

Key features

A connected jobsite digitally tracks *all* resources — including workers, equipment, tools, materials and information. Generally, it does so through a centralized, cloud-based system. This central hub provides a single, real-time data stream to project stakeholders both on-site and off. Key features of connected jobsites include:

Real-time worker and equipment monitoring. Tracking worker locations and equipment usage enhances safety and productivity. For example, knowing workers' whereabouts can prevent "right person, wrong place" delays and speed up emergency response. Similarly, tracking equipment usage identifies inefficiencies, such as excessive idling, that can drive up fuel costs.

Digital documentation and communication. Connected jobsites largely eliminate manual, paper-based processes. Permits, schedules and reports can be generated or updated via the internet, reducing time spent waiting for approvals and managing documentation. For instance, if a subcontractor encounters a delay affecting concrete pouring, the system immediately notifies the project manager, who can adjust the schedule accordingly.

Integrated applications. As mentioned, well-planned connected jobsites use a unified platform stocked with construction-specific software. This allows project managers and other authorized users to manage timesheets, safety logs, blueprints, schedules and more — streamlining workflow and minimizing miscommunications.

How it happens

Connected jobsites typically rely on three primary elements to share data from the location:

1. Hardware. This includes sensors, cameras, wearable tech on workers, and equipment and devices equipped with global positioning system technology.

2. Software. Construction management platforms and mobile apps receive input from the hardware and users, enabling team members to monitor workers, assets and activity. In turn, the business can better update its job schedules, track costs and generate financial forecasts.

3. Internet connectivity. Construction businesses have a much wider array of options for establishing connectivity nowadays. These include satellite communications, portable Wi-Fi, Bluetooth and cellular networks.

Potential benefits

Creating a connected jobsite will naturally call for a substantial upfront investment in information technology resources. However, if your company invests carefully and has employees with the skill sets to support the concept, the potential return can be worth it.

For instance, tracking assets electronically helps deter theft and more quickly recover stolen or lost equipment, tools and materials. Additional benefits may include:

- Fewer accidents and injuries, and therefore lower workers' comp costs, thanks to more carefully monitored jobsites, and
- Better financial management as more timely, accurate data enhances bidding, scheduling, job costing and accounting.

One way to ease into connected jobsites is to start small with subscription-based hardware and software, then scale up as you eliminate problems and get more comfortable.

Sooner or later

To be clear, connected jobsites may not be feasible for every construction business or project. However, as technology evolves and expands, you'll likely find yourself on one eventually. ■

Stay on guard against supply chain fraud

Most contractors are no strangers to supply chain problems. Slow deliveries, out-of-stock items, wrong orders — what else could go wrong? Well, fraud, for one.

How does it happen?

The sheer volume of ordering and shipping transactions conducted by busy construction businesses can provide cover for dishonest workers or outside parties to hide criminal acts. Examples of supply chain fraud include:

- Falsified billing and payment schemes (for instance, an employee submits duplicate or inflated invoices for materials and pockets the difference),
- Misrepresentation of goods or services provided (such as a supplier that knowingly fails to meet contract specifications),
- Embezzlement or other financial crimes, and
- Theft of tools or materials (sometimes by substituting lower quality items for stolen ones).

Dishonest employees may act alone. However, multiple staff members often band together to commit crimes or collude with outside parties, such as supplier reps.

Where should we start?

Preventing supply chain fraud begins with strong internal controls. These are policies and procedures to help ensure efficient operations, reliable financial reporting, and compliance with relevant laws and regulations. Examples include physical restrictions on assets, regular account reconciliations and segregation of job duties.

Appropriate internal controls depend on your construction company's size, specialty, and the number and dollar value of projects you typically undertake. As the business grows, you'll likely need to update your internal controls and add new ones.

What else?

Internal controls are fundamental, but don't stop there. A best practice to consider is conducting annual targeted risk assessments of your supply chain.

One newer element to assess is cybersecurity. With networked technology becoming increasingly common on construction projects, hackers and internal bad actors are a constant danger. Look closely at the hardware and software you use to manage your supply chain. Identify access points that could expose you to wrongdoing and tighten up safeguards as necessary.

In addition, investigate any recent abnormalities in supply chain management — especially incidents that occurred suddenly and didn't adhere to company policies and procedures. Maybe you reached a critical point in a job and were short on key materials. Perhaps your project manager handled the crisis by quickly finding a new supplier. That may have solved the problem in the short term, but you still need to backtrack and vet the replacement supplier.

Who can help?

Your construction business can't operate at its best without an efficient, trustworthy supply chain. Fraud can slow it down or even bring it to a grinding halt. Work with your CPA to reinforce your internal controls and conduct targeted risk assessments of supply chain transactions. ■

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Winning in the construction business requires the same focus, drive and skill as coming out on top in sports. To compete effectively, you continually need to improve your game. And that's where Gelman LLP comes in.

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We would welcome the opportunity to answer any questions you may have about the topics discussed or others affecting your business. Please contact us at 714-667-2600 or info@gelmanllp.com and let us know how we can put our construction industry expertise to work for you.

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