Construction Industry Accounting Financial Reporting, Audit/Review, Taxation & Valuations 2025

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Construction Industry Accounting & Taxation

Session 1 – Construction Industry Accounting & Financial Overview

- Construction Industry Financial Trends and Developments – Interesting Stuff
- New OBBB Tax Law - Applicable to Contractors
- Surety and other Users reliance on financial statements

Session 2 – Construction Financial Reporting, Disclosures and Benchmarking

- Financial Reporting Issues
- Contractor Financial Disclosures
- Financial Benchmarking Analytics

Session 3 – Audit, Review and Analytical Procedures Unique to Contractors

- Contract Audit and Review Analytical Procedures and Risk Assessment
- Required Contractor Engagement Documentation (and internal analytics / controls)

Construction Industry Accounting & Taxation

Session 4 – Construction Taxation

- Contractor Tax Methods & Strategies – New OBBB tax changes
- Code Section 460 exemptions
- Review of Differences in GAAP POC and IRS 460 POC
- Lookback

Session 5 – Bonus Session – *(If we have time!)*

- Contractor Internal Controls and Best Practices
- Contractor Valuations for M&A Transactions

Session 1

CONSTRUCTION INDUSTRY OVERVIEW

Construction Industry
Trends, Developments and Interesting "Stuff"

1. Construction industry is the 2nd riskiest business in America.
   a) Construction is generally defined as "making or providing improvements to real property"
   b) CPA audits and reviews of contractors are the 2nd highest industry "attest" practice (Yellow book is #1)
      - CPA construction attest malpractice litigation is top-5 annually (Tax is #1)
      - <u>75% of malpractice claims and litigation against CFOs / Controllers is related to Contract WIP</u>
   c) According to the Small Business Administration:
      - 74.3% of new contractors survive 1-year
      - 33.2% survive 5-years
      - 24.8% survive 10-years
2. The construction industry reported record net income for 2015-2024. <u>Profits have more than doubled.</u>
   a) Profits dropped temporarily in 2021-2022 due to Covid, supply chain, and inflation issues
   b) Profits in 2023 and 2024 were all-time records
   c) **<u>The last 10-years have been the most profitable construction period ever.</u>**
   d) <u>Profits for 2025 are projected to be even higher.</u>
   e) Publicly-traded construction stock prices have exploded

Publicly Traded Construction Company Stock Analysis 8/12/2025 RAD

August 11, 2025

	Symbol	52-Week High	Close 8/11/2025	*Pre-Covid* Close 3/1/2020	65-month Increase (Decrease)	65-month Change %	P/E Price to Earnings	Enterprise Value to EBITDA*	EPS	Dividend Yield	Debt to Equity %	(in millions) Levered Free TTM Cash Flow
HEAVY HIGHWAY												
Granite Construction	GVA	$ 107.71	$ 107.22	$ 17.50	$ 89.72	512.7%	**32.09**	**12.23**	$ 3.33	0.49%	75.78%	$ 173.40
Construction Partners (CPI)	ROAD	$ 116.53	$ 115.50	$ 17.27	$ 98.23	568.8%	**83.11**	**25.57**	$ 1.39	0.00%	176.01%	$ 99.70
Knife River (spin-off 2023)**	KNF	$ 108.83	$ 88.90	$ 36.48	$ 52.42	143.7%	**32.93**	**14.86**	$ 2.70	0.00%	95.96%	$ (163.47)
Sterling Infrastructure, Inc.	STRL	$ 321.79	$ 292.56	$ 9.76	$ 282.80	2897.5%	**31.88**	**16.91**	$ 9.19	0.00%	37.65%	$ 246.32
Martin Marietta	MLM	$ 633.23	$ 610.89	$ 238.75	$ 372.14	155.9%	**33.37**	**19.04**	$ 18.06	0.53%	62.02%	$ 639.50
Vulcan	VMC	$ 298.31	$ 286.57	$ 127.44	$ 159.13	124.9%	**39.61**	**20.14**	$ 7.22	0.69%	65.38%	$ 1,070.00
Oldcastle	CRH	$ 110.97	$ 108.26	$ 34.31	$ 73.95	215.5%	**22.82**	**12.05**	$ 4.77	1.38%	74.47%	$ 2,070.00
			$ 1,609.90	$ 481.51	$1,128.39	659.9%	**39.40**	**17.26**				
GENERAL CONTRACTORS			**8/11/2025**	**3/1/2020**								
Emcor Group	EME	$ 667.64	$ 618.41	$ 76.95	$ 541.46	703.7%	**25.51**	**16.48**	$ 24.10	0.16%	22.16%	$ 975.09
MasTec, Inc.	MTZ	$ 194.00	$ 180.60	$ 28.50	$ 152.10	533.7%	**53.19**	**16.98**	$ 3.37	0.00%	88.60%	$ 455.15
Fluor	FLR	$ 60.10	$ 41.84	$ 8.85	$ 32.99	372.8%	**1.72**	**10.54**	$ 24.17	0.00%	17.90%	$ (6.38)
Skanska	SKBSY	$ 25.26	$ 24.68	$ 22.50	$ 2.18	9.7%	**15.82**	**8.94**	$ 1.56	3.36%	29.14%	$ 6,180.00
AECOM	ACM	$ 121.73	$ 119.97	$ 44.78	$ 75.19	167.9%	**23.67**	**13.43**	$ 5.04	0.87%	118.08%	$ 628.93
Tutor Perini	TPC	$ 63.96	$ 57.49	$ 13.57	$ 43.92	323.7%	**-**	**-**	**$ (2.54)**	0.00%	38.68%	$ 633.90
			$ 1,042.99	$ 195.15	$ 847.84	351.9%	**23.98**	**13.27**				
EQUIPMENT COMPANIES			**8/11/2025**	**3/1/2020**								
Caterpillar	CAT	$ 441.15	$ 411.00	$ 121.41	$ 289.59	238.5%	**20.97**	**15.75**	$ 19.65	1.48%	218.34%	$ 4,530.00
Komatsu Ltd.	KMTUY	$ 37.27	$ 33.53	$ 19.68	$ 13.85	70.4%	**10.45**	**6.65**	$ 3.21	3.82%	43.64%	$ 415.04
Astec	ASTE	$ 44.24	$ 42.38	$ 36.32	**$ 6.06**	16.7%	**21.37**	**9.72**	$ 2.01	1.23%	14.34%	$ 100.20

* "Value to EBITDA" formula: [(Total market capitalization + debt - excess cash) ÷ EBITDA]

** Note KNF issue spin-off price $36.48 on 6/1/2023 - 26-month change is reported.

3. Construction backlog has remained steady, but signs of a construction slow-down are developing in some areas and niches:

a) Retail, religious/charity, and office construction work has declined
   - Amazon and on-line shopping damaged retail construction – pandemic accelerated the trends
   - Remote working technology was reducing office space demands

b) Healthcare, education, warehousing and manufacturing remain very strong – data centers

c) Multi-family residential is strong in most markets (rents are softening finally)

d) <u>Heavy / highway / infrastructure is booming</u> with new Federal infrastructure spending
   - Major Federal infrastructure program will increase spending 40%+ through 2028
   - <u>Disaster work in NC, Texas, California, Tennessee</u>

e) Home building remains good in some areas, but home prices have outpaced earnings for 10-years
   - <u>**A residential price correction is expected**</u> – (happened 8 times since 1945 – last in 2008)
   - Mortgage rates are still high

f) "<u>***Nervous" optimism for 2025-2026-2027***</u>

4. Look for these trends and developments

a) **<u>Recruiting and retaining people is still #1 issue</u>**

- Incentive & deferred bonus compensation, benefits, and workplace improvements are critical
- **Employee ownership is trending – stock, Newco, phantom stock, equity based golden handcuffs, etc.**
- ESOPs are not recommended for most contractors – "too many cooks in the kitchen"

b) Possible reductions in private construction in 2026-2027 due to:

- Oversupply – retail, office space, multi-family, hotel are reporting lower occupancy
- **<u>Cost inflation</u>** - $1.00 = $3.61(2003 highway cost index) and $1.80 (2009 building cost index)
- Interest Rates (3.25% in 2020 – 7.50% in 2025) have slowed new starts

c) More merger and acquisition transactions – consolidation continues rapidly

- M&A transactions are up significantly; **<u>2024 was a record year</u>** and more expected in 2025-26
- Driven by people issues, aging owners with no successors, pandemic, ***<u>owner fatigue</u>***
- Diversification trend for more self-performed work

d) Tight bid market for GCs; subs continue to bid at a premium (labor shortage)

e) Increase in contractor failures and surety claims – see 2024 surety results

f) Is the construction industry overdue for a recession? 2008-2012 was last recession

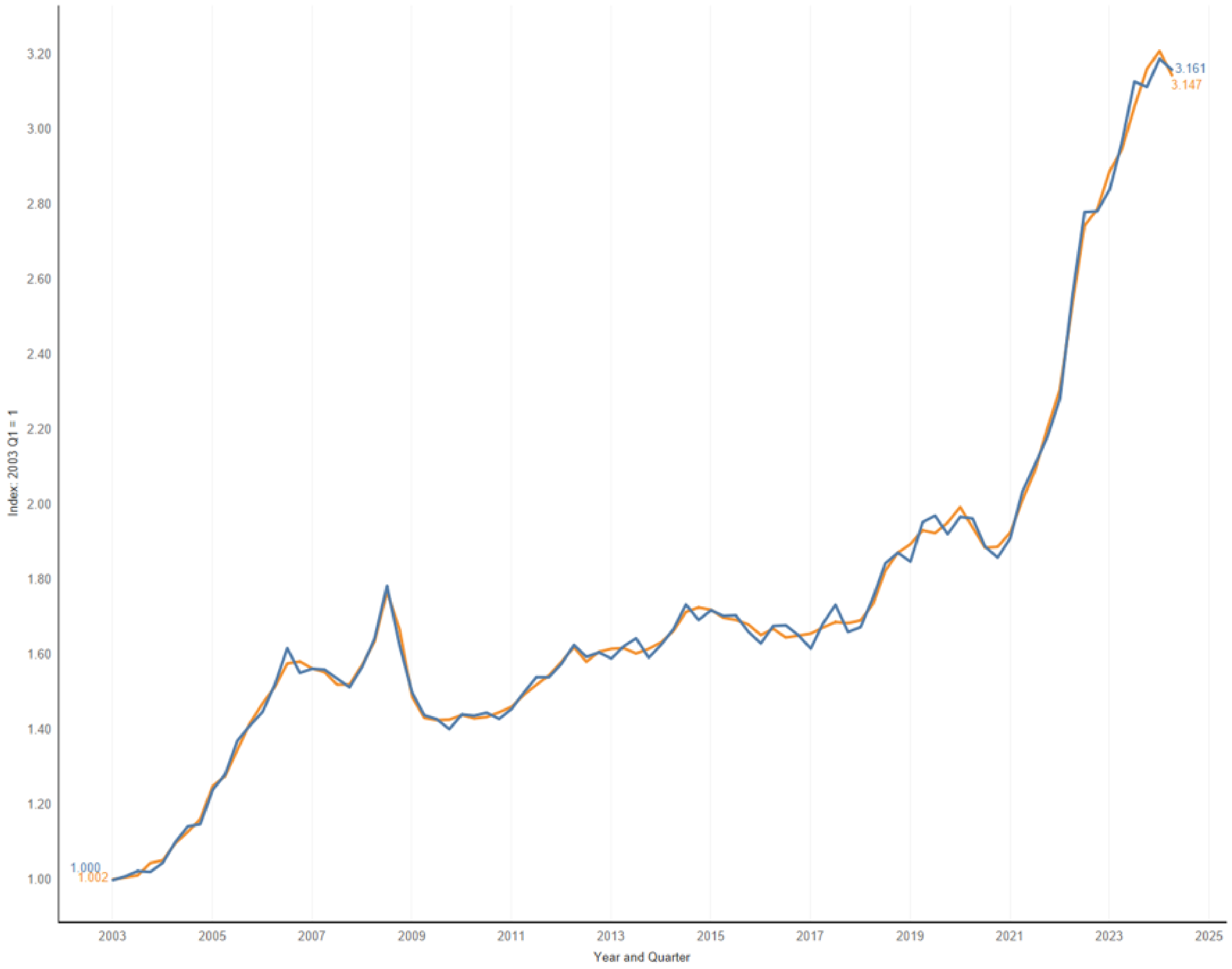
- Construction recession every 5-8 years since 1945 (13-year 2025 run is longest in history)

U.S. Department of Transportation
Federal Highway Administration

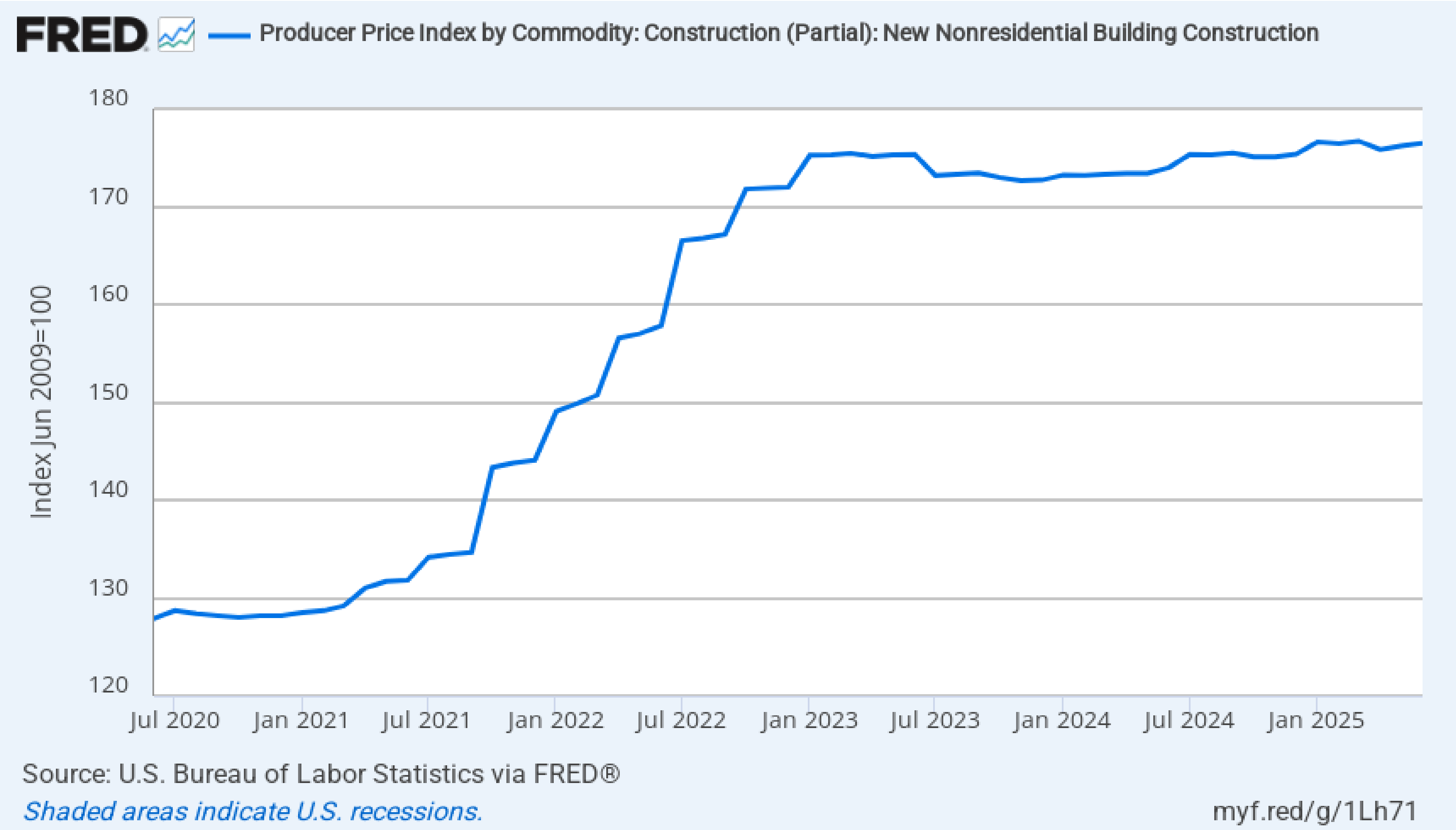
National Highway Construction Cost Index (NHCCI)

Select Year and Quarter:
2003 Q1 to 2024 Q2
and Null values

Select Series:
NHCCI
Seasonally Adjusted NHCCI



2024 Q2 index is preliminary.
2023 Q4 and 2024 Q1 indexes are revised.


FRED
Producer Price Index by Commodity: Construction (Partial): New Nonresidential Building Construction
Index Jun 2009=100
180
170
160
150
140
130
120
Jul 2020
Jan 2021
Jul 2021
Jan 2022
Jul 2022
Jan 2023
Jul 2023
Jan 2024
Jul 2024
Jan 2025
Source: U.S. Bureau of Labor Statistics via FRED®
Shaded areas indicate U.S. recessions.
myf.red/g/1Lh71

5. Reliance on contractor's financial statements – More "Users" than most industries

a) Internal statement and contract WIP – quarterly reporting is standard due to significant risk
b) Audit, review, compilation (year-end compilation is rarely accepted by Sureties)
c) Top "users" that rely on a contractor's financial reporting:

- Surety bonding company (Big-6 - Travelers, Liberty, Chubb, Zurich, C.N.A., Hartford)
- Banks and lenders (Cat Finance, Komatsu Financial)
- Contract owners including government (DOT, DOD, FHA) and private owners/developers
- Licensing Boards and Prequalification Boards
- GC prequalification of subcontractors (SDI)
- Contractor stockholders (members) and investors

6. What do Contractor statement users need from the CPA, CFO and Controller in 2025?

a) Honesty and Integrity
b) Timeliness – 60 to 90-day year-end reporting deadline; "Pandemic delay mentality" no longer acceptable

- Internal financial reporting within 25-days including contract WIP

c) Competency and understanding of construction accounting GAAP and Contract WIP
d) Presentation of financial statements with adequate disclosures unique to contractors

- Discontinue misinterpretation of ASC 606

e) Knowledge of Section 460 and other tax laws applicable to contractors

The Surety & Fidelity Association of America

Top 100 Writers of Surety Bonds
United States & Territories, Canada & Aggregate Other Alien
Calendar Year 2024
(Preliminary)

	GROUP/COMPANY	Direct Premium Written	Market Share	Direct Premium Earned	Direct Losses Incurred *	Direct Loss Ratio	DCCE	DCCE Ratio	Loss+DCCE Ratio	Net Premiums Earned	Net Losses Incurred	Net Loss Ratio
1	LIBERTY MUTUAL GROUP	1,367,033,436	12.8%	1,246,386,606	146,455,040	11.8%	33,614,508	2.7%	14.4%	1,347,472,454	83,089,415	6.2%
2	TRAVELERS BOND	1,363,718,752	12.8%	1,240,417,902	221,819,723	17.9%	17,333,679	1.4%	19.3%	1,178,260,207	192,091,731	16.3%
3	ZURICH INSURANCE GROUP	718,931,861	6.7%	650,833,636	146,308,736	22.5%	24,698,466	3.8%	26.3%	309,181,288	67,675,207	21.9%
4	CNA SURETY GROUP	678,197,257	6.3%	636,103,684	95,183,935	15.0%	11,444,601	1.8%	16.8%	621,861,569	90,574,351	14.6%
5	CHUBB LTD	558,405,347	5.2%	483,618,076	35,370,102	7.3%	2,923,755	0.6%	7.9%	457,627,116	32,686,707	7.1%
6	INTACT INSURANCE SPECIALTY SOLUTIONS	293,454,038	2.7%	293,665,186	25,872,860	8.8%	6,120,521	2.1%	10.9%	281,428,877	26,670,534	9.5%
7	HARTFORD FIRE & CAS GROUP	291,001,518	2.7%	266,272,210	28,584,684	10.7%	1,405,654	0.5%	11.3%	322,304,401	65,377,689	20.3%
8	MERCHANTS BONDING CO GROUP	260,866,825	2.4%	243,624,235	26,663,397	10.9%	3,099,041	1.3%	12.2%	230,652,192	24,050,684	10.4%
9	CRUM & FORSTER GROUP	227,998,367	2.1%	210,264,788	30,632,154	14.6%	5,935,044	2.8%	17.4%	197,600,681	27,174,727	13.8%
10	NATIONWIDE CORP GROUP	207,342,742	1.9%	174,044,004	118,061,160	67.8%	853,067	0.5%	68.3%	151,093,912	36,953,964	24.5%
11	BERKSHIRE HATHAWAY GROUP	205,040,145	1.9%	158,194,172	48,511,312	30.7%	13,529,149	8.6%	39.2%	291,869,735	59,390,345	20.3%
12	HCC SURETY GROUP	198,798,632	1.9%	194,893,762	14,195,223	7.3%	14,698,856	7.5%	14.8%	212,406,904	12,806,319	6.0%
13	SOMPO GROUP	188,205,186	1.8%	186,045,583	43,832,458	23.6%	14,200,679	7.6%	31.2%	187,543,524	33,884,786	18.1%
14	MARKEL SURETY	187,997,985	1.8%	170,238,142	55,823,875	32.8%	2,516,526	1.5%	34.3%	157,428,344	40,838,010	25.9%
15	ARCH INSURANCE GROUP	186,635,792	1.7%	201,562,543	9,451,376	4.7%	(14,622,737)	-7.3%	-2.6%	162,896,965	2,904,842	1.8%
16	PHILADELPHIA CONSOLIDATED HOLDING GROUP	174,900,965	1.6%	169,107,429	86,097,029	50.9%	4,467,157	2.6%	53.6%	150,889,291	9,898,416	6.6%
17	SWISS RE CORPORATE SOLUTIONS	170,848,447	1.6%	167,145,115	21,491,244	12.9%	4,705,388	2.8%	15.7%	44,511,664	9,444,234	21.2%
18	RLI INSURANCE GROUP	157,539,519	1.5%	152,846,196	75,106,416	49.1%	8,944,937	5.9%	55.0%	138,920,834	11,103,424	8.0%
19	IAT SURETY	147,883,925	1.4%	145,923,553	18,641,374	12.8%	1,098,589	0.8%	13.5%	137,879,399	12,358,856	9.0%
20	OLD REPUBLIC GROUP	147,266,606	1.4%	134,175,205	47,772,720	35.6%	9,612,488	7.2%	42.8%	122,419,127	39,360,513	32.2%

7. New "OBBB" Tax Law – Quick Review of Contractor Changes

a. The provisions of the 2017 TJCA are now permanent
   - 21% C-Corporation tax rate
   - Individual tax brackets (10% to 37%)
   - QBI deduction of 20% for LLC and S-Corp
   - Pass-through rate is still 29.6%

b. 100% Bonus Depreciation is reinstated for purchases after 1/19/2025

c. 100% Bonus for 39-yr real property used in <u>manufacturing & production</u>
   - New or "original use" by taxpayer
   - Construction started after 1/19/2025
   - Used property allowed if "not in use" since 1/1/2021
   - Production space only – office, parking, lodging, sales, etc. excluded
   - Cost seg required to allocate

d. Section 179 increased to $2.5M subject to $4M aggregate limit

e. Opportunity zone law is permanent – allows 5-year and 10-year deferral

f. Business interest deduction is based on 30% of EBITDA instead of EBIT

g. R&D expense is 100% deductible – no longer amortized

h. SALT increased to $40,000 on 1040 – $600,000 AGI phase out; <u>2030 expiration</u>
   - <u>PTE election still a good idea</u>

7. (continued) New "OBBB" Tax Law – Contractor

i. Overtime pay exemption - $12,500 max; only "extra OT pay" exempt
   - Base $30 x 1.5 = $45 OT; $15 excess is non-taxable
   - FLSA-7 definition limitation – hourly workers only (salary < $58k)

j. Estate tax exemption increase to $15M in 2026 ($13.99 in 2025)

k. Section 179D and most energy deductions and credits phase out in 2026

l. 1099 MISC threshold increased from $600 to $2,000

m. Residential contracts are now 100% exempt from Section 460
   - Residential multifamily housing – apartments, condos, dorms, barracks, prisons
   - Excludes contracts to build transient housing (hotels)
   - Home contracts were already exempt (less than 4-dwellings per unit)
   - Old law allowed 30% exemption for residential
   - Included infrastructure and support costs if 80% attributable
   - Elect Completed Contract method or Cash method (if eligible)
   - **Applies to <u>contracts started after 1/1/2026</u>** (for calendar year companies)

n. Small contractor 460 exemption
   - $31M 3-year average remains – indexed annually
   - 2-year completion estimate has been increased to 3-years

Ten Most Common Causes of Contractor Failure

CFMA Article written in 1986 by Robert Davidson and Danny Parrish

1. Poor bidding and estimating – not knowing “true job cost”
2. Growing too fast
3. Catastrophic job loss – excessive single job risk
4. New contracts outside of your experience, expertise or region
5. High employee turnover and inexperienced workforce
6. Inadequate capitalization and poor cash flow (not losing money, just ran out of cash – “I can’t make payroll!”)
7. Excessive litigation, job claims, or legal issues (including safety issues)
8. Poor accounting system, job costing & financial discipline
9. Subcontractor (non bonded) or supplier failure (price/supply)
10. Buying dumb stuff

CONTRACTOR FAILURE TRENDS

REVIEW OF TRAVELERS CONSTRUCTION SURETY CLAIMS

FAILURE HAS MANY DIFFERENT CAUSES

58% DUE TO A CATASTROPHIC PROJECT:*

- PROBLEM ON A LARGE JOB
- POOR ESTIMATE/LARGE BID SPREAD
- NEW JOB TYPE/LOCATION

49% DUE TO INTERNAL COST SYSTEM FAILURES:*

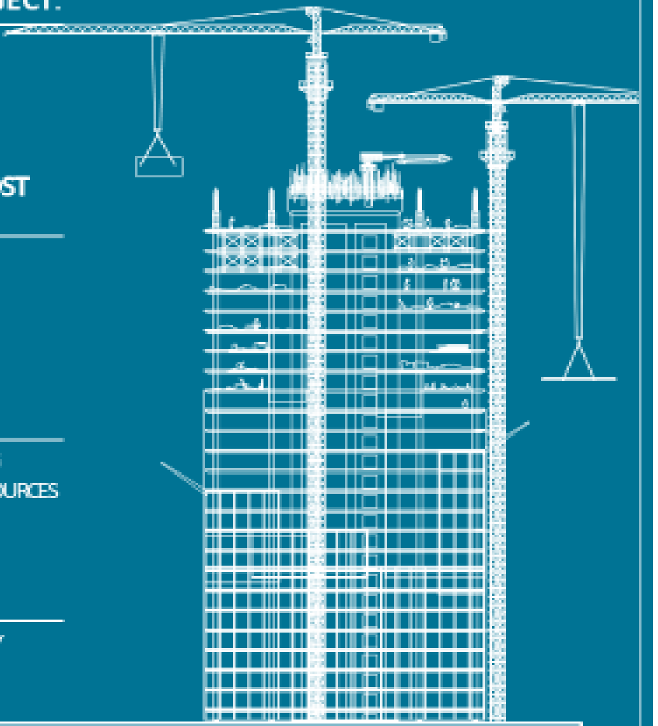
- INABILITY TO IDENTIFY ISSUES
- LACK OF COMMUNICATION/COHESION BETWEEN FELD AND MAIN OFCE

37% DUE TO OVEREXTENSION:*

- MULTIPLE LARGE JOBS/LARGER BACKLOG
- STRAIN ON WORKFORCE/FNANCIAL RESOURCES

24% DUE TO EXCESSIVE DEBT:*

- FXED AND LONG-TERM DEBT NEGATIVELY IMPACT CASH L OW



DIICULT PROJECT + WEAK INTERNAL CONTROLS = CATASTROPHIC SITUATION*

We understand the complexities involved in the construction industry and have solutions to help you build a better business.

AT TRAVELERS, WE'RE IN THE BUSINESS OF HELPING CONTRACTORS SUCCEED.

For more information, contact your agent.

*Information based on an internal review of Travelers largest construction surety claims over the last 11 years (2009-2019). In many cases, multiple factors were identified as contributing to the failure of the construction company.

Session 2

FINANCIAL REPORTING, DISCLOSURES & BENCHMARKING

Contractor Financial Reporting – Issues and Considerations

1. Most Common Contractor Financial Reporting Issues

a. Income not reported using cost-to-cost percentage of completion (“POC”) method

b. **Excessive under-billings** – “Dumb or dishonest?”

- Underbillings include claims receivable or unapproved change orders

c. **Inadequate over-billings –** reserve for collectability, profit fade, front-end loading, sub failure, etc.

d. Losses on uncompleted contract WIP not recognized 100% in-full on reporting date

e. No contract schedules (completed, WIP, and reconciliation) included in supplemental information

f. Indirect costs not allocated to direct job cost resulting in excessive G&A overhead costs

g. Disclaimer or qualification of opinion on contract WIP schedules– “mathematical malpractice”

h. Unique contractor disclosures omitted (such as backlog, claims, job fade, retainage, insurance reserves)

i. Distributions for pass-through tax liabilities (LLC, S-Corp) are not disclosed or accrued in the statements

j. JVs are not consolidated proportionately and disclosed properly

k. Revenue from claims and unapproved change orders improperly recognized in overbilling

l. Working capital is overstated

- Inclusion of non-current “cash generating” assets (related party A/R, old inventories, underbillings)
- Short-term “13-month” LOC misclassified as long-term

2. Working capital required to fund WIP backlog contract costs

a. Working capital of 5% to 10% of total annual revenue – depending on work type and operations

- GCs that do not self-perform = 3% to 5%
- Labor intensive contractors = 10% - 12%
- Heavy highway 7%-10%
- Contract backlog – self performed amount must be funded by working capital

b. Working capital must cover 30 to 45-day collection period

c. Insufficient Liquidity or "Tangible" working capital - Will working capital "make payroll"?

- Cash at least 5% of annual revenue (non-borrowed)
- Cash balance in excess of net-over billings on WIP

d. Working capital includes fake long-term loan – "phony 13-month line of credit loan"

- Collateral for a "true" working capital loan should be long-term assets (equipment, land, personal assets)
- If working capital loan is secured by current assets (cash and receivables), surety will adjust WC

3. Investment of required capital in unrelated assets and ventures

a. Stock market investments should be from "excess" working capital and cash only – only excess cash

b. Coal mines, marinas, farms, aircrafts, boats, restaurants – dumb stuff!

4. Significant under-billings and /or inadequate over-billings

a. Excess under-billings are the **#1 red flag** indicator of contract risk. (>5% of total working capital)
b. Dumb or dishonest? Poor cash flow (at best); job losses/fades (at worst)
c. **Insufficient over-billings** on the balance sheet indicate inadequate reserves for front-end loading, job completion, punch list costs, contingencies, and collectability issues. **#2 red flag.**

- **Over-billings should generally be at least 2% of uncompleted contract WIP backlog or annual revenue**
- **ASC 606 emphasizes that "over-billings" include, punch list costs, clean-up, demobilization, collectability issues and other contract completion costs in excess of remaining pay items.**

5. Claims or unapproved change orders

a. A receivable from claim litigation is NOT an under-billing
b. Must be segregated on the balance sheet and recorded to the extent of costs incurred only – no profit allowed to be recognized until collected
c. Job costs and revenue for claim recognition must be reported separately on the contract schedule with full disclosure in financial statement footnotes
d. Contract revenue and costs related to claim (if material) must be segmented as a separate performance obligation on WIP schedule

6. Excessive inventories & prepaid expenses (discounted by Surety)

a. Best of class contractors purchase materials as needed

b. No such thing as “jobsite” inventories – stored materials are job cost

- Uninstalled generic materials are excluded from cost-to-cost POC calculation only – not reclassified as inventories
- This requirement was already included in SOP 81-1 – NOT a NEW requirement

c. Scrap materials returned from jobsite are not inventories “held for resale”

d. Pre-contract costs must be expensed unless contract in certain in “near term”

e. Prepaid expenses should be minimized (insurance, deposits)

7. Interest bearing bank debt above 100% of equity

a. The bank has more invested than the contractor owners

b. Determine bank collateral does not include “all receivables” – conflict with surety indemnity

c. Understand and disclose bank covenants – could be going concern issue

d. Include non-cancelable off balance sheet leases – new GAAP requirement

e. Interest bearing debt ratios vary, but generally under 50% is good. 80% if significant equipment assets.

f. Total balance sheet liability ratio of greater than 3.00 to 1.00 (too big for your britches ratio)

8. Accounts receivable

a. POC calculation is based on cost-to-cost; A/R and billings are less important

b. Receivable disclosures are inadequate (subject to materiality)

- No disaggregation between contract receivables
- No separation between current receivables and retainage
- No aging of receivables provided (if material)
- **Old retainage balances on completed contracts are not disclosed (incorrectly netted with other contract assets or liabilities)**
- Receivables from claims and change orders are not segregated and disclosed properly

c. Related parties and owners – ***if collectible, why wasn't it paid back prior to year-end?*** Can the related party pay? CFO, CPA, Auditor should use skepticism and value the related party asset at net realizable value

9. Personnel and related issues

a. High key employee turnover

b. No recruiting and retention plan

c. Bonus program based on WIP (uncompleted) contract profits – bad internal controls

10. Other yellow flag risk indicators

a. Inadequate contract backlog – less than 50% of annual revenue (50% coverage of fixed costs)

b. Excessive contract backlog – more than 150% of annual revenue

c. Excessive G&A percentage – indicating job costs are improperly charged as a period cost

d. Poor indirect / equipment costing

e. Non-bonded subcontractors and poor prequalification controls

f. Significant bid spreads

g. Fixed asset reporting – excessive useful lives and unrealistic equipment repair capitalization

- **Repair must extend useful life or increase usage capacity**

h. Signing bonds for other contractors

i. Delayed issuance of monthly financial statements (25-day max) and year-end audit (90-day max)

j. WIP Schedules are not disaggregated and do not contain adequate disclosures for "onerous" contract provisions and backlog risks

k. Misinterpretation of ASC 606 with inappropriate segmentation, netting assets and liabilities, discontinued use of legacy account descriptions and other errors

Contractor’s Financial Statement Disclosures – Best Practices

1. Description of operations note should include:

a. Type of work – retail, commercial, healthcare, multi-family, infrastructure, residential, etc.

b. Hard bid or negotiated

c. Contract terms: lump sum / fixed price, unit price, cost plus, cost plus with guaranteed maximum price (GMP), cost plus with shared savings, time and material, force account, etc.

d. Surety bonding requirements – percentage of bonded work with collateral and other requirements (owner personal guarantee)

e. Subcontracted vs. self-performed

f. Geographic location of work – consider disaggregation

g. Major customers – disaggregation of revenue

h. Contractor licensing and prequalification

i. Materials manufacturing and mining (asphalt, concrete, aggregates, steel fabrication, etc.)

2. Summary of Significant Accounting Policies

a. Consolidating / Combining information

- Subsidiaries and affiliates
- Variable interest entities (VIEs) – Litmus test: Consolidate if VIE affiliate will "materially affect the conclusion of the user"

b. Joint Venture consolidation

- Proportionate consolidation recommended – no equity or cost basis; combine proportionate share of assets, liabilities, revenue and costs; report full contract on WIP schedule with reduction for JV Partner share

c. Revenue Recognition – Percentage of Completion (POC) method and calculation

- Separate performance obligation and segmented contracts, if any
- Cost to cost calculation or other method (tonnages)
- Loss contract accruals
- Zero profit estimate policy, if applicable – including 10% election for GAAP

d. Use of estimates
  - Subsequent transactions and event consideration
  - **Adjust total costs on completed contracts for amounts incurred subsequent to year-end – required for “estimates” at year-end**
  - **Revise estimated costs to complete on WIP schedule if subsequent costs indicate costs have exceeded projections**

e. Subsequent events
  - Include information on significant events or transactions
  - **Significant subsequent event impact on contract (WIP) estimates**

f. Equipment information (if significant like heavy/highway)
  - Depreciable lives used for major categories – it matters
  - Capitalization policies
  - Impairment of long-lived assets
  - Job cost allocation method

g. Tax Methods and calculation of liabilities

- Current and deferred tax for C-Corporations, S-Corporations and LLCs
- Deposits and credits paid prior to year-end
- Remaining distributions accrued or anticipated before 1/15 or 4/15
- Material impact to working capital and available cash?
- Uncertain tax positions (if any)

h. Concentration of risk

- Cash, investments, revenue, customers, type of work, supplier limitations
- **No escalation clauses or "index" on bid prices (steel, concrete, asphalt, diesel,** etc.)
- Licensing or prequalification issues

3. Required Footnote Disclosures – Unique to Construction Industry

a. Contract Assets and Contract Liabilities account detail (if combined on balance sheet)
   - Contract A/R and retainage, A/R aging, under billings, claims revenue recognition, etc.
   - Subcontractors A/P, Subcontractor retainage payable, overbillings, claims payable, LDs, loss contract accruals

b. Contract Backlog
   - Disaggregation of backlog revenue (new standard)
   - Reconciled to contract WIP schedule
   - Add subsequent contracts signed from year-end to opinion date
   - Subcontracted amounts and net self-performed work (including bonded sub info)
   - Surety information – total outstanding surety bond exposure

c. Significant Changes in Contract Estimates – SOP 94-6 / ASC 275
   - Reporting significant "fade / gain" or "lookback" impact
   - Current and job-to-date adjustment related to the change in estimate
   - Loss contracts and accrued amount
   - Explanation for estimate change or loss accrual "egg on your face"
   - Anticipated completion dates for problem jobs

d. Pending claims or change order litigation

- Plaintiff and defendant (owner / subcontractor)
- Brief explanation of issue, legal basis for claim, management opinion and accounting recognition
- Recognized to the extent of costs incurred only – no profit
- Allowance for collectability, legal costs, hazards of litigation
- Consideration of prior experience / historical claims collection
- Total amount of claim and reported amounts, if any
- Mediation, arbitration, court process – with timetable for conclusion
- Collateral issue – restricted cash, receivables, bond, etc.

e. Other footnotes unique to contractors

- Unique surety covenants such as segregated fund requirements, specific bond underwriting collateral, minimum bond indemnification benchmarks, personal guaranty from owners, etc.
- Bank line of credit reported as a long-term liability to enhance working capital. Footnote disclosure must support classification decision
- Contractor provided "Gap" financing or full financing of project costs during construction phase
- Subcontractor default insurance – SDI or "Sub-guard"
- Self-insured and captive insurance policy liabilities and requirements
- Retirement and pension plan issues – multi-employer liabilities

Note 10 – Contract Revenue Backlog and Related Disclosures

The following schedule is a reconciliation of contract backlog representing the amount of revenue the Company expects to be realized in future periods from signed contracts:

Contract revenue backlog on January 1, 2021	$	40,000,000
Change orders and contract adjustments		3,000,000
New contracts executed in 2021		69,000,000
Total contracted revenue	$	112,000,000
Less: Contract revenue earned for the year-ended		
on December 31, 2021		(74,000,000)
Contract revenue backlog on December 31, 2021	$	38,000,000
Contract revenue backlog on contracts awarded		
and executed subsequent to year-end through		
Febrary 25, 2022 (reporting date)		29,000,000
Total contract revenue backlog in 2022	$	67,000,000

Subsequent to year-end through February 25, 2022, the Company executed additional construction contracts with total revenues of $29,000,000 with the Tennessee DOT for asphalt paving work.

None of the estimated backlog is related to variable consideration such as unapproved change orders, claims or early completion bonuses.

Note 10 - Contract backlog footnote (continued)

The disaggregated contract backlog revenue for 2021 is disclosed as follows:

	Tennessee DOT & County Road Contracts	Private Commercial Contracts	Total Contract Backlog
Asphalt Paving	$28,000,000	$3,000,000	$31,000,000
Grading & Excavation	4,000,000	500,000	4,500,000
Bridge & Concrete	2,000,000	500,000	2,500,000
Total Contract Backlog	$34,000,000	$4,000,000	$38,000,000

The Company is generally required to furnish performance and payment surety bonds to contract owners. During the year ended, Liberty Surety Company issued $60,000,000 of new surety bonds to contract owners. The bonds are secured by receivables from bonded contracts and a general guarantee from the Company. Also, Liberty required a personal guarantee from the Company's stockholders. On December 31, 2021, surety bonds for contracts totaling $72,000,000 remained outstanding on uncompleted contracts with a current backlog amount of $30,000,000.

Of the $38,000,000 backlog amount, $4,000,000 has been subcontracted to various specialty subcontractors. The Company's policy requires a surety bond from all subcontractors for work in excess of $500,000, with few exceptions. As of December 31, 2021, surety bonds from the subcontractors support approximately $3,000,000 of the subcontracted backlog. Due to the Company's internal controls over subcontractor prequalification, no accrued liability was considered necessary by management for financial guarantee related to the $1,000,000 of non-bonded subcontractors.

Note 11 – Significant Changes in Contract Estimates (Fade/Gain disclosure)

During the year ended December 31, 2020, certain contracts required significant changes in estimated contract costs, costs to complete and gross profit amounts.

Contract Number	Description	Est / Actual Contract GP (Loss) 12/31/2020	Estimated Original Gross Profit 12/31/2019	Change in Contract to Date GP (Loss)	Current Year to Date GP (Loss)
2017-14	Nashville 1-40 bridge*	$100,000	$250,000	($150,000)	($ 25,000)
2017-45	Atlanta 1-75 bridge*	400,000	200,000	200,000	300,000
2018-46	Knoxville Hwy 11 bridge	(300,000)	400,000	(700,000)	(500,000)
2018-82	Memphis Parkway	(20,000)	120,000	(140,000)	(80,000)
		$180,000	**$970,000**	**($790,000)**	**($305,000)**

*Indicates that contract was 100% completed and accepted at 12/31/20

1) Contract profit fade due to failure by non-bonded guardrail subcontractor
2) Contract profit gain due to quantity overrun of high profit excavation pay item
3) Contract profit fade and loss due to bid error in mix design and liquid asphalt pricing. Contract 2018-46 is 90% complete at 12/31/20
4) Contract profit fade and loss due to delays caused by excessive rain and flood damage on jobsite. Contract is 62% complete at 12/31/20

Note: ***For illustration purposes, all contracts were 50% complete at 12/31/19***

Note 12 – Accrued Loss on Uncompleted Contract

The Company anticipates a loss on contract #1218-10, Tennessee DOT I-24 Asphalt Paving. The total estimated loss was caused by the failure of a concrete retainage wall subcontractor to honor their pre-bid quotation. The concrete subcontractor submitted a quote that failed to meet the contract specifications. The replacement of the subcontractor resulted in an increase to concrete budgeted costs of $450,000 over the original bid amount, resulting in an estimated total contract gross loss of $150,000. As explained in Note 1, it is the Company's policy to recognize the entire anticipated loss on a contract during the period when such a loss becomes apparent, as required by GAAP. At December 31, 2020, the contract was 20% complete and is scheduled to be completed prior to the contract completion date of September 1, 2021.

The contract revenue has been adjusted to recognize the entire $150,000 estimated loss on December 31, 2020 and is reflected as an accrued loss on the balance sheet.

Sample Footnote – Income Taxes for Pass-Through Entities

Note 13 – Income Taxes

The Company uses the POC method of reporting revenue from long-term construction contracts for financial reporting purposes & uses the Code Section 460 tax POC method for tax purposes. Non-long-term contracts are reported for tax purposes on the cash basis method.

The Company has elected to be treated as a Partnership LLC under the Internal Revenue code. As required, the LLC Company passes through items of income and expenses to the Members (owners) each year & thus pays no federal or state income taxes itself. However, the operating agreement and prior year practices require the LLC Company to distribute cash to the Members as capital distributions or bonuses to pay income taxes attributable to LLC Company earnings.

At December 31, 2020, current federal and state income tax liabilities passed through to the Members using an estimated effective tax rate of 32% are summarized as follows:

Estimated taxable income	$6,200,000
Estimated blended effective tax rate	x 32%
Income tax liability related to 2018 pass-through income	1,984,000
Less: Withholdings & estimated tax payments	(800,000)
Estimated stockholder's current income tax liability	$1,184,000

Subsequent to year-end the Company distributed $1,184,000 to the Members for the payment of their 2020 income tax liabilities on January 15, 2021. ***These distributions have been accrued in the accompanying balance sheet at December 31, 2020 & were paid as disclosed in the subsequent event footnote.***

Note 13 – Income Taxes (continued)

Significant deferred tax liabilities have been created due to the 100% tax depreciation law passed in 2017. Using an effective tax rate of 30%, the cumulative non-current deferred federal and state income taxes passed through to the Members on December 31, 2020, are summarized as follows

	Deferred Revenue (expense)	Deferred Tax
Fixed asset depreciation	$5,000,000	$1,500,000
Prepaid Expenses	200,000	60,000
Insurance reserve accrual	(400,000)	(120,000)
Contract revenue recognition (cash basis)	400,000	120,000
Deferred compensation	(500,000)	(150,000)
Net deferred amounts	**$4,700,000**	**$1,410,000**

Sample Footnote – Contract Claim / Unapproved Change Order Receivable

Note 14 – Contract Claims Receivable

The Company has filed 2 contract claims with the TDOT totaling approximately $920,000 on contracts completed in 2020. The contract require mandatory arbitration to settle the claims and related disputes. The arbitration is scheduled for September 12-15, 2021. A mediation is scheduled for April 2021. Management and company legal counsel anticipate the settlement of both claims at mediation but are prepared for arbitration if necessary. If the litigation is settled or arbitrated in favor of the Company, payment is required within 60 days.

Both claims are related to a delay by TDOT in obtaining the right-of-way prior to awarding the contract. TDOT failed to complete negotiations with utilities and landowners as required by the contract resulting in approximately 130 days of delay in starting the contracts. TDOT has offered approximately $400,000 to settle the claims prior to arbitration

As of December 31, 2020, management has recorded revenue related to the claims equal to the current offer form TDOT, which is less than the net costs incurred, but is considered the most likely outcome with a bias toward conservative revenue recognition:

	Contract 1216-3	Contract 1216-4	Total
Total claim including profit	$720,000	$200,000	$920,000
Cost incurred	645,000	175,000	820,000
Estimated litigation cost	(45,000)	(25,000)	(70,000)
Subtotal – net cost limitation	600,000	150,000	750,000
Discount*	(300,000)	(50,000)	(350,000)
Contract claim recognized	$300,000	$100,000	$400,000

*Although management anticipates recovery of the full claim amount, a discount was taken for conservative accounting recognition to match the amount offered by TDOT to record the most likely outcome.

Benchmarking Best Practices

1. Every contractor should develop their own unique benchmarking analytics
   a. Working capital
   b. Tangible working capital
   c. Under/over billing
   d. Contract profit fade / gain
   e. Bid spreads
   f. Equipment ratios
   g. Debt ratios
   h. Gross profit percentage
   i. Equipment usage and utilization rates
   j. Employment turnover
   k. Safety metrics
2. Meet with surety to discuss the key analytics and benchmarks that they track
3. Comparison to industry averages such as CFMA
4. Comparison to "yourself" and tracking improvement is best practice
5. SAMPLE benchmark schedules

Construction Company, Inc. - Benchmarking and KPIs					
Balance Sheet	Goal	12/31/2022	12/31/2021	12/31/2020	12/31/2019
Cash and equivalents		$ 11,800,000	$ 14,100,000	$ 11,800,000	$ 9,400,000
Cash to revenue percentage	>5%	9.7%	8.2%	7.0%	6.1%
Cash to tangible working capital	>80%	109.3%	108.5%	100.9%	105.6%
Working capital		14,300,000	16,500,000	15,200,000	12,400,000
Working capital to revenue	>10.0%	11.7%	9.6%	9.0%	8.0%
Tangible working capital		10,800,000	13,000,000	11,700,000	8,900,000
Tangible working capital to revenue	>7.5%	8.9%	7.6%	7.0%	5.7%
Tangible WC to self performed revenue	>10%	13.0%	10.1%	9.4%	6.7%
Stockholders equity		36,500,000	37,800,000	34,500,000	29,000,000
Stockholders equity to revenue	>15%	29.9%	22.1%	20.5%	18.7%
Tangible Stockholders equity		31,500,000	34,800,000	30,500,000	26,000,000
Tangible equity to revenue	>15%	25.8%	20.4%	18.2%	16.8%
Tangible equity to self-performed revenue	>15%	38.0%	27.0%	24.6%	19.5%
Total related party receivables		1,500,000	2,000,000	2,000,000	2,500,000
Underbillings		1,600,000	400,000	500,000	250,000
Overbillings (job borrow)		5,400,000	7,200,000	6,800,000	4,000,000
Net overbilling		**3,800,000**	**6,800,000**	**6,300,000**	**3,750,000**
Net overbilling to revenue	> 2.0%	**3.11%**	**3.98%**	**3.75%**	**2.42%**
Cash to net overbilling ratio	>150%	310.53%	207.35%	187.30%	250.67%
Total interest bearing debt		4,900,000	5,700,000	6,000,000	6,500,000
Interest debt to equity ratio	< 50%	13.4%	15.1%	17.4%	22.4%
Interest debt to tangible equity ratio	< 80%	15.6%	16.4%	19.7%	25.0%

Construction Company, Inc. - Benchmarking and KPIs					
Operations	Goal	12/31/2022	12/31/2021	12/31/2020	12/31/2019
Revenues		$ 122,000,000	$ 171,000,000	$ 168,000,000	$ 155,000,000
Subcontract expense		(39,000,000)	(42,000,000)	(44,000,000)	(22,000,000)
Revenues - self performed - net of subs		83,000,000	129,000,000	124,000,000	133,000,000
Gross profit		6,700,000	16,500,000	15,400,000	9,600,000
Gross profit percentage	> 8%	5.5%	9.6%	9.2%	6.2%
GP % - net of subs	>10%	8.1%	12.8%	12.4%	7.2%
General and administrative		7,000,000	9,200,000	8,900,000	7,400,000
G & A to revenue	<4%	5.7%	5.4%	5.3%	4.8%
G & A before owner profit bonus		6,800,000	7,100,000	7,700,000	6,200,000
G & A to rev. before profit bonuses	<4%	5.6%	4.2%	4.6%	4.0%
Net income (loss)		(300,000)	7,300,000	6,500,000	2,200,000
Net income before profit bonus		(100,000)	9,400,000	7,700,000	3,400,000
Net income % before profit bonus	> 2%	-0.1%	5.5%	4.6%	2.2%
Net income before profit bonus & deprec		2,400,000	11,800,000	9,900,000	6,000,000
Cash flow coverage - over 40% of debt	> 150%	122.4%	517.5%	412.5%	230.8%
Contract backlog revenue		110,000,000	127,000,000	144,000,000	78,000,000
Contract backlog - estimated gross profit		9,200,000	10,200,000	11,900,000	5,900,000
Contract backlog - estimated gross profit %	>10%	8.4%	8.0%	8.3%	7.6%
Contract backlog - gross profit to G&A	> 50%	131.4%	110.9%	133.7%	79.7%
Contract backlog - gross profit to revenue	> 60%	90.2%	74.3%	85.7%	50.3%

Construction Company, Inc. - Benchmarking and KPIs					
Equipment and Shop	Goal	12/31/2022	12/31/2021	12/31/2020	12/31/2019
Original cost of equipment		$ 20,000,000	$ 19,400,000	$ 16,400,000	$ 14,000,000
Book value of equipment, net		3,700,000	5,600,000	5,000,000	4,800,000
Newness ratio (BV / cost)	> 40%	19%	29%	30%	34%
Average age of equipment		5.90	5.10	5.20	6.20
Average age of vehicles		5.10	4.90	5.80	6.20
Number of equipment pieces & trucks		148	131	126	128
Mechanics & shop - average number employed		9	9	8	7
Equipment / trucks per mechanic/shop	< 20>	16.4	14.6	15.8	18.3
Total budgeted hours per piece @1200		177,600	157,200	151,200	153,600
Hours charged to job cost		121,000	126,000	134,000	151,000
Utilization rate - company average	> 80%	68%	80%	89%	98%
Pieces of equipment per field employee	< .90	0.86	0.72	0.69	0.75

Construction Company, Inc. - Benchmarking and KPIs					
Employee / Workforce	Goal	12/31/2022	12/31/2021	12/31/2020	12/31/2019
Total persons employed - total for the year		266	272	269	249
Average full time equivilent employees		216	229	227	212
Turnover amount		50	43	42	37
Turnover rate	< 15%	23.15%	18.78%	18.50%	17.45%
1st year (rookie) employees on year-end payroll		21	35	41	22
Percentage 1st year employees	< 10%	9.72%	15.28%	18.06%	10.38%
Number of project managers (average)		26	29	27	25
Revenue per PM		$ 4,692,308	$ 5,896,552	$ 6,222,222	$ 6,200,000
Self Performed Revenue per PM		$ 3,192,308	$ 4,448,276	$ 4,592,593	$ 5,320,000
Revenue per employee (average full-time)		$ 564,815	$ 746,725	$ 740,088	$ 731,132
Self performed Revenue per employee (average)		$ 384,259	$ 563,319	$ 546,256	$ 627,358

Exhibit 1: Key Ratios Detail

	All Companies	Under $10 Million	$10-25 Million	$25-50 Million	$50-100 Million	$100-300 Million	More Than $300 Million
Liquidity Ratios							
Current Ratio	1.7	2.6	1.9	1.7	1.4	1.4	1.3
Quick Ratio	1.3	2.1	1.5	1.4	1.2	1.1	1.0
Days of Cash	23.4	30.3	24.8	21.8	20.6	20.0	18.6
Working Capital Turnover	7.6	4.4	5.9	7.4	10.5	12.6	15.4
Profitability Ratios							
Return on Assets	9.3%	9.9%	11.6%	10.9%	8.4%	8.4%	6.7%
Return on Equity	24.3%	17.0%	25.0%	26.9%	26.1%	27.9%	26.1%
Times Interest Earned	28.5	20.5	29.9	31.4	26.6	26.4	40.0
Leverage Ratios							
Debt to Equity	1.3	0.7	1.0	1.3	1.9	2.3	3.1
Revenue to Equity	5.4	3.7	4.4	5.5	7.9	8.9	10.6
Asset Turnover	2.3	2.0	2.2	2.3	2.6	2.6	2.5
Fixed Asset Ratio	23.6%	21.1%	28.0%	25.1%	20.8%	26.3%	14.7%
Equity to SG&A Expenses	1.9	1.9	1.9	1.8	1.8	2.1	2.1
Underbillings to Equity	9.2%	3.1%	8.0%	10.2%	10.8%	11.5%	13.6%
Average Backlog to Equity	5.1	2.9	2.5	4.4	5.5	7.0	10.7
Efficiency Ratios							
Average Backlog to Working Capital	7.1	3.0	3.1	5.6	9.2	8.9	14.0
Average Months in Backlog	8.9	8.6	6.4	9.1	9.5	8.9	11.1
Days in Accounts Receivable	58.7	59.0	59.2	59.0	59.0	55.8	60.1
Days in Inventory	6.5	10.9	6.5	4.1	6.6	4.0	5.5
Days in Accounts Payable	33.4	21.2	30.4	34.2	37.0	39.2	47.8
Operating Cycle	52.3	72.8	60.2	53.8	46.0	40.8	30.7
Sales Performance							
Sales Growth	15.0%	6.2%	15.6%	13.9%	16.1%	18.4%	25.3%

Metric	CFMA Construction Co.	Industry	2022 Primary Role: General/Prime Contractor	2022 Legal Form of Business: S Corporation	2022 Region: Midwest U.S.	2022 Revenue: $50 - 100 Million	2022 Best in Class Revenue: $50 - 100 Million
FINANCIAL INFORMATION							
KEY RATIOS - ALL SHOWN AS MEDIANS EXCEPT INVENTORY DAYS							
Number of Participants		1,270	114	196	279	199	56
LIQUIDITY RATIOS							
Current Ratio		1.7	1.4	1.5	1.6	1.4	1.4
Quick Ratio		1.3	1.2	1.3	1.3	1.2	1.2
Days of Cash		23.4	25.6	21.7	18.9	20.6	22.9
Working Capital Turnover		7.6	11.1	9.1	7.5	10.5	11.6
PROFITABILITY RATIOS							
Return on Assets		9.3%	8.4%	9.4%	10.4%	8.4%	22.0%
Return on Equity		24.3%	23.7%	26.3%	25.8%	26.1%	57.8%
Times Interest Earned		28.5	39.6	38.9	37.1	26.6	255.5
LEVERAGE RATIOS							
Debt to Equity		1.3	1.6	1.9	1.1	1.9	1.8
Revenue to Equity		5.4	6.4	6.9	5.4	7.9	8.9
Asset Turnover		2.3	2.6	2.5	2.5	2.6	3.2
Fixed Asset Ratio		23.5%	27.0%	21.5%	28.8%	20.8%	12.9%
Equity to SG&A Expenses		1.9	2.1	1.7	1.8	1.8	1.5
Underbillings to Equity		9.2%	10.9%	11.7%	6.9%	10.8%	10.7%
Average Backlog to Equity		5.1	6.1	6.0	4.6	5.5	4.9
EFFICIENCY RATIOS							
Average Backlog to Working Capital		7.1	8.6	8.0	7.8	9.2	7.2
Average Months in Backlog		8.9	9.6	9.3	7.5	9.5	7.9
Days in Accounts Receivable		58.7	53.2	59.8	61.4	59.0	53.3
Days in Inventory		6.5	4.5	3.1	6.9	6.6	5.3
Days in Accounts Payable		33.4	39.7	36.7	30.4	37.0	29.5
Operating Cycle		52.3	38.5	44.5	52.5	46.0	43.4
PRODUCTIVITY RATIOS							
Revenue per FTE Employee		$410,509	$629,941	$429,452	$390,257	$421,719	$512,902
Gross Profit per FTE Employee		$61,937	$66,305	$62,229	$56,931	$63,612	$91,217
Revenue per Production FTE Employee		$548,437	$814,853	$567,746	$538,325	$638,817	$767,235
Gross Profit per Production FTE Employee		$78,513	$86,744	$79,566	$75,582	$86,707	$113,369

Session 3

AUDIT, REVIEW AND ANALYTICAL PROCEDURES – UNIQUE TO CONTRACTORS

“Having audited your accounts, we can’t find anything at all suspicious. Which makes us very suspicious.”

Construction Contractor Attest Engagements
Critical Audit and Review Procedures and Considerations

1. **Construction contractor audit and review engagements**
   a. Construction industry ranks 2nd in attest function engagements for CPA firms (Yellow Book is #1)
   b. Construction audit/review is Top 5 malpractice litigation practice niche
   c. Non-attest Compilation Engagements have responsibilities and risk
      - ***<u>CPA cannot hide behind a Compilation that is knowingly misleading</u>***
   d. CPA must know the "users" of the financial statements and the reason for their reliance on the audit or review
      - Surety
      - Lenders, banks, investors
      - Contract owners and "short-list" prequalification process
      - Joint venture partners
      - Contractor licensing and prequalification boards

2. **<u>The primary focus of audits and reviews of construction contractors is on the contracts</u>**. – AAG-CON 7.02
   a. *"Evaluation of the profitability (revenue and costs) of contracts is central to the audit and review process and the determination of whether the information is presented in accordance with GAAP."*
   b. The balance sheet and income statement of a contractor is the product of the contract WIP schedules
   c. Analyzing and evaluating the reasonableness of contract estimates is critical

3. Contract Audit (and Review Procedures)

a. Identify contract risk
- Large contracts, long duration (performance over multiple periods or years)
- New type of work, location, or contract owner
- Significant bid spreads
- Underbilled jobs or negative cash flow (#1 indication of contract profit fade)
- Subcontractor failure or non-bonded subs
- No index or escalation clauses – materials and subcontractor exposure-Best practice IC

b. **Review and analyze 5-year contract average gross profit report – Exhibit D – Best Practice IC**
- Sort by type of work, location, size, etc.
- Compare contract WIP schedule to 5-year gross profit results and focus on excess estimated profit jobs
- **Analyze contract gross profit estimate risk – Exhibit C**

c. Review 5-year contract gross profit fade / gain report – **Exhibit O – Best practice IC**
- Track prior-year under and over billings to recognition in subsequent period
- Determine average fade/gain by type, location, size of projects ***(Surety shortcut)***

d. Review bidding and estimating procedures and cost budgets – meet with estimators and PMs to perform "inquiries"
- Review and analyze significant bid spreads – **Exhibit E- Best practice IC**
- Review bid budgets (schedule of values) with estimators and project managers (PMs) – **Exhibit G**
- Determine front-end loading and mobilization values and compare to contract WIP overbilling – **Exhibit F**
- Discuss subcontractor and supplier buyout issues if any
- Review escalation clauses and other cost controls

Construction Company, Inc. **Exhibit D**

5-Year Trend Analysis - Historical Completed Contract Gross Profit %

General Contractor	2020	2021	2022	2023	2024	Average
Healthcare division	4.85%	3.80%	3.93%	5.40%	5.89%	**4.77%**
School & Education	3.33%	2.45%	2.77%	3.10%	3.50%	**3.03%**
Multi-family	2.66%	2.98%	2.99%	3.00%	3.20%	**2.97%**
Distribution & warehouse	6.40%	5.50%	4.70%	6.30%	6.90%	**5.96%**
All jobs	4.31%	3.68%	3.60%	4.45%	4.87%	**4.18%**
Bridge Contractor	2020	2021	2022	2023	2024	Average
Municipal (County/City)	8.30%	6.90%	10.30%	10.60%	11.00%	**9.42%**
DOT Prime	10.69%	8.50%	11.20%	12.35%	12.44%	**11.04%**
DOT Sub	8.22%	7.20%	9.00%	9.62%	10.12%	**8.83%**
Private commercial	9.90%	8.23%	9.45%	11.93%	12.22%	**10.35%**
All jobs	9.28%	7.71%	9.99%	11.13%	11.45%	9.91%
Asphalt Contractor	2020	2021	2022	2023	2024	Average
Private commercial	14.00%	13.80%	13.93%	14.30%	13.75%	**13.96%**
Municipal (county/city)	9.80%	7.26%	10.60%	7.60%	6.90%	**8.43%**
DOT Prime	11.20%	12.60%	15.35%	12.90%	11.78%	**12.77%**
DOT Sub	9.30%	10.22%	11.30%	9.80%	9.72%	**10.07%**
All jobs	11.08%	10.97%	12.80%	11.15%	10.54%	**11.31%**

Davidson Construction Company, Inc. Session 3 **Exhibit A**

Uncompleted Contract Schedule

For the Period Ended 12/31/25

Job #	Description / Type / Location	1 Contract Amount	2 Total Estimated Cost	3 (1 - 2) Estimated Gross Profit	4 (3/1) Estimated Gross Profit Percentage	5 Billings to Date	6 (1 x 12) Revenue Recognized	7 Accrued Loss	8 Cost to Date	9 (6 - 7 - 8) Gross Profit to Date	10 (6 - 5) Underbilling	11 (5 - 6) Overbilling	12 (8 / 2) Cost to Cost Percentage of Completion	13 (2 - 8) Estimated Cost to Complete	14 (3 - 9) Backlog Gross Profit
13022	Front end loaded job Nashville, TN; Dolly Partin Arena	20,000,000	16,000,000	4,000,000	20.00%	11,000,000	10,000,000	0	8,000,000	2,000,000	0	1,000,000	50.00%	8,000,000	2,000,000
13032	Under-billed job Miami, FL; Shula's Steakhouse	6,000,000	5,000,000	1,000,000	16.67%	4,600,000	4,800,000	0	4,000,000	800,000	200,000	0	80.00%	1,000,000	200,000
14002	Zero billed job Anchorage, AK; Goldmine	10,000,000	9,200,000	800,000	8.00%	0	978,261	0	900,000	78,261	978,261	0	9.78%	8,300,000	721,739
14004	Loss Job Nashville, TN; Vanderbilt Stadium	5,000,000	5,500,000	(500,000)	-10.00%	4,000,000	3,250,000	500,000	3,750,000	(500,000)	0	250,000	68.18%	1,750,000	0
14007	New job* Nashville, TN; CMT studios	1,000,000	850,000	150,000	15.00%	300,000	111,765	0	95,000	16,765	0	188,235	11.18%	755,000	133,235
15001	Davidson-Acme Joint Venture Seattle WA; Bill Gates Bridge	80,000,000	73,000,000	7,000,000	8.75%	35,000,000	31,561,644	0	28,800,000	2,761,644	0	3,438,356	39.45%	44,200,000	4,238,356
	Less 40% attributable to Acme	(32,000,000)	(29,200,000)	(2,800,000)		(14,000,000)	(12,624,658)	0	(11,520,000)	(1,104,658)	0	(1,375,342)		(17,680,000)	(1,695,342)
	JV subtotal - 60% owned	48,000,000	43,800,000	4,200,000	8.75%	21,000,000	18,936,986	0	17,280,000	1,656,986	0	2,063,014		26,520,000	2,543,014
	Total Uncompleted Contracts	90,000,000	80,350,000	9,650,000	10.72%	40,900,000	38,077,012	500,000	34,025,000	4,052,012	1,178,261	3,501,249		46,325,000	5,597,988
									Net overbilling			2,322,988			

Davidson Construction Company, Inc.

Completed Contract Schedule

For the Period Ended 12/31/2025

Job #	Description / Type / Location	Final Contract Revenue	Total Cost	Gross Profit (Loss)	Gross Profit (Loss) Percentage	
13025	Completed job #1 Nashville, TN; Taylor Swift Theater	20,000,000	18,300,000	1,700,000	8.50%	
13035	Completed job #2 Miami, FL; Marino's Steakhouse	25,000,000	25,200,000	(200,000)	-0.80%	
14001	Completed job #3* Chicago, IL - Air Jordan Arena	17,000,000	15,691,000	1,309,000	7.70%	
14005	Completed job #4 Tuscaloosa, AL - Tide Pizza	3,000,000	2,750,000	250,000	8.33%	
	Total Completed Contracts	65,000,000	61,941,000	3,059,000	4.71%	8.15%

Davidson Construction Company, Inc.

Reconciliation of Contracts to Statement of Income

For the Period Ended 12/31/25

	Revenue Recognized	Total Cost	Gross Profit (Loss)	
Completed contracts at 12/31/25 (job-to-date)	65,000,000	61,941,000	3,059,000	4.71%
Uncompleted Contracts at 12/31/25 (job-to-date)	38,077,012	34,025,000	4,052,012	10.64%
Idle equipment costs - unallocated - See Note 11		400,000	(400,000)	
	103,077,012	96,366,000	6,711,012	
Less revenue and cost recongnized thru 12/31/24	(19,293,609)	(17,881,489)	(1,412,120)	7.32%
Statement of income - FYE 12/31/25	83,783,403	78,484,511	5,298,892	6.32%

* Designates cost-plus contracts. All other contracts are lump sum.

Davidson Construction Company, Inc. **Session 3** **Exhibit B** ***Adjusted to Historical or Revised Gross Profit Percentages***

Uncompleted Contract Schedule

For the Period Ended 12/31/25

Job #	Description / Type / Location	1	2	3	4	5	6	7	8	9	10	11	12	13	14
				(1 - 2)	(3/1)		(1 x 12)			(6 - 7 - 8)	(6 - 5)	(5 - 6)	(7 / 2)	(2 - 7)	(3 - 8)
		Contract Amount	Total Estimated Cost	Estimated Gross Profit	**Revised Gross Profit Percentage**	Billings to Date	Revenue Recognized	Accrued Loss	Cost to Date	Gross Profit to Date	Underbilling	Overbilling	Cost to Cost Percentage of Completion	Estimated Cost to Complete	Backlog Gross Profit
13022	Front end loaded job	20,000,000	18,000,000	2,000,000	**10.00%**	11,000,000	8,888,889	0	8,000,000	888,889	0	2,111,111	44.44%	10,000,000	1,111,111
	Nashville, TN; Dolly Partin Arena														
13032	Under-billed job	6,000,000	5,400,000	600,000	**10.00%**	4,600,000	4,444,444	0	4,000,000	444,444	0	155,556	74.07%	1,400,000	155,556
	Miami, FL; Shula's Steakhouse														
14002	Zero billed job	10,000,000	9,500,000	500,000	**5.00%**	0	947,368	0	900,000	47,368	947,368	0	9.47%	8,600,000	452,632
	Anchorage, AK; Goldmine														
14004	Loss Job	5,000,000	5,500,000	(500,000)	**-10.00%**	4,000,000	3,250,000	500,000	3,750,000	(500,000)	0	250,000	68.18%	1,750,000	0
	Nashville, TN; Vanderbilt Stadium														
14007	New job*	1,000,000	900,000	100,000	**10.00%**	300,000	105,556	0	95,000	10,556	0	194,444	10.56%	805,000	89,444
	Nashville, TN; CMT studios														
15001	Davidson-Acme Joint Venture	80,000,000	72,000,000	8,000,000	**10.00%**	35,000,000	32,000,000	0	28,800,000	3,200,000	0	3,000,000	40.00%	43,200,000	4,800,000
	Seattle WA; Bill Gates Bridge														
	Less 40% attributable to Acme	(32,000,000)	(28,800,000)	(3,200,000)		(14,000,000)	(12,800,000)	0	(11,520,000)	(1,280,000)	0	(1,200,000)		(17,280,000)	(1,920,000)
	JV subtotal - 60% owned	48,000,000	43,200,000	4,800,000	**10.00%**	21,000,000	19,200,000	0	17,280,000	1,920,000	0	1,800,000		25,920,000	2,880,000
	Total Uncompleted Contracts	90,000,000	82,500,000	7,500,000	**8.33%**	40,900,000	36,836,257	500,000	34,025,000	2,811,257	947,368	4,511,111		48,475,000	4,688,743
									Net overbilling			3,563,743			

Davidson Construction Company, Inc.

Completed Contract Schedule

For the Period Ended 12/31/25

Job #	Description / Type / Location	Final Contract Revenue	Total Cost	Gross Profit (Loss)	Gross Profit (Loss) Percentage	
13025	Completed job #1	20,000,000	18,300,000	1,700,000	8.50%	
	Nashville, TN; Taylor Swift Theater					
13035	Completed job #2	25,000,000	25,200,000	(200,000)	-0.80%	
	Miami, FL; Marino's Steakhouse					
14001	Completed job #3*	17,000,000	15,691,000	1,309,000	7.70%	
	Chicago, IL - Air Jordan Arena					
14005	Completed job #4	3,000,000	2,750,000	250,000	8.33%	
	Tuscaloosa, AL - Tide Pizza					
	Total Completed Contracts	65,000,000	61,941,000	3,059,000	4.71%	8.15%

Davidson Construction Company, Inc.

Reconciliation of Contracts to Statement of Income

For the Period Ended 12/31/25

	Revenue Recognized	Total Cost	Gross Profit (Loss)	
Completed contracts at 12/31/25 (job-to-date)	65,000,000	61,941,000	3,059,000	4.71%
Uncompleted Contracts at 12/31/25 (job-to-date)	36,836,257	34,025,000	2,811,257	7.63%
Idle equipment costs - unallocated - See Note 11		400,000	(400,000)	
	101,836,257	96,366,000	5,470,257	
Less revenue and cost recongnized thru 12/31/24	(19,293,609)	(17,881,489)	(1,412,120)	7.32%
Statement of income - FYE 12/31/25	82,542,648	78,484,511	4,058,137	4.92%

Davidson Construction Company			**Exhibit C**						
Contract Risk Analysis Worksheet									
For the Period Ended December 31, 2025		1	2	3	4	5	6	**7**	8
				Historical or	(2-3)		Gross Profit	**(5-6)**	(7/6)
			Estimated	**Revised**	Over (Under)	Gross Profit	at Historical	**Excess**	Percentage
		Contract	Gross Profit	**Gross Profit**	Gross Profit	Recognized	or Revised	**(Deferred)**	of Excess
Job #	Description / Type / Location	Amount	Percentage	**Percentage**	Percentage	To Date	Percentage	**Gross Profit**	(Deferred)
13022	Front end loaded job	20,000,000	20.00%	10.00%	10.00%	2,000,000	888,889	**1,111,111**	125.00%
	Nashville, TN; Dolly Partin Arena								
13032	Under-billed job	6,000,000	16.67%	10.00%	6.67%	800,000	444,444	**355,556**	80.00%
	Miami, FL; Shula's Steakhouse								
14002	Zero billed job	10,000,000	8.00%	5.00%	3.00%	78,261	47,368	**30,892**	65.22%
	Anchorage, AK; Goldmine								
14004	Loss Job	5,000,000	-10.00%	-10.00%	0.00%	(500,000)	(500,000)	**0**	0.00%
	Nashville, TN; Vanderbilt Stadium								
14007	New job*	1,000,000	15.00%	10.00%	5.00%	16,765	10,556	**6,209**	58.82%
	Nashville, TN; CMT studios								
15001	Davidson-Acme Joint Venture	48,000,000	8.75%	10.00%	-1.25%	1,656,986	1,920,000	**(263,014)**	-13.70%
	JV subtotal - 60% owned								
	Total Uncompleted Contracts	90,000,000	10.72%	8.33%	2.39%	4,052,012	2,811,257	**1,240,755**	44.14%
			Net overbilling - based on estimated gross profit %					$ 2,322,988	2.77%
			Net overbilling - based on historical / revised gross profit %					3,563,743	4.32%
			Net impact to working capital and gross profit (pre-tax)					$ (1,240,755)	
						% of Revenue		-1.48%	
						% of Gross Profit		-30.62%	
						% of Equity (Assume $5M)		-24.82%	

Sample Construction Company			9/30/2024		**Exhibit G**		
Contract Accounting Report							
Contract: I-40 Bridge		**Job No. 30092**					
	Location: Nashville, Tennessee		Owner: Tennessee DOT				
	Project Manager: RAD	Liberty Surety Bond - dated 3/1/24					
	Bid spread	$ 319,568	4.95%				
		Revenue	Cost	Profit	Percentage		
	Original Contact Amount	$ 6,450,540	$ 5,819,387	$ 631,153	9.78%		
	Change Order No. 1	(27,500)	(23,560)	(3,940)	14.33%		
	Change Order No. 2	222,548	122,569	99,979	44.92%		
	Cost adjustment (Column 5)	-	356,238	(356,238)			
	Revised Contract Amount	$ 6,645,588	$ 6,274,634	$ 370,954	5.58%		
Contract Cost Analysis Report		1	2	3	4	5	6
Phase		As Bid	Actual Cost	(Over) Under	Estimated	Cost	Revised Total
Code	Description	Cost	to Date	Variance	Cost to Complete	Adjustment	Estimated Cost
1001	General conditions & mob	$ 381,500	$ 178,564	$ 202,936	$ 190,000	$ (12,936)	$ 368,564
1005	Engineering / surveying	64,000	52,000	12,000	12,000	-	64,000
1010	Clearing & grubbing	112,000	112,000	-	-	-	112,000
1015	Erosion control	89,560	92,555	(2,995)	3,500	6,495	96,055
1020	Roadway borrow excavation	949,590	958,501	(8,911)	37,090	46,001	995,591
1040	Rock excavation	269,000	289,699	(20,699)	100,000	120,699	389,699
1090	Topsoil & finish excavation	62,000	9,600	52,400	52,400	-	62,000
1100	Bridge excavation	426,954	458,906	(31,952)	18,000	49,952	476,906
2001	Bridge pier No. 1	646,000	728,956	(82,956)	-	82,956	728,956
2002	Bridge pier No. 2	549,000	562,531	(13,531)	79,801	93,332	642,332
2010	Bridge beams	988,900	118,000	870,900	840,000	(30,900)	958,000
2015	Bridge deck & wall	656,923	82,561	574,362	575,000	638	657,561
3001	Guardrail	79,500	-	79,500	79,500	-	79,500
4001	Base stone	86,500	-	86,500	86,500	-	86,500
4002	Asphalt paving	378,900	-	378,900	378,900	-	378,900
4050	Signage	29,500	-	29,500	29,500	-	29,500
5001	Landscaping	49,560	-	49,560	49,560	-	49,560
	Change Order No. 1	-	(23,560)	23,560	-	-	(23,560)
	Change Order No. 2	-	122,569	(122,569)	-	-	122,569
		$ 5,819,387	$ 3,742,883	$ 2,076,504	$ 2,531,751	$ 356,238	$ 6,274,634

Construction Company, Inc.				Exhibit O											Contract to	Yearly	Yearly	Yearly	Yearly	Yearly
Contract Gain / Fade Analysis		Est./Actual		Est./Actual		Est./Actual		Est./Actual		Est./Actual		Est./Actual		Contract to	Date Profit	Profit	Profit	Profit	Profit	Profit
5-Year - 12/31/2024		Gross Profit		Gross Profit		Gross Profit		Gross Profit		Gross Profit		Gross Profit		Date Profit	Gain / (Fade)	Gain/(Fade)	Gain/(Fade)	Gain/(Fade)	Gain/(Fade)	Gain/(Fade)
Job #	Contract Description	12/31/2019	%	12/31/2020	%	12/31/2021	%	12/31/2022	%	12/31/2023	%	12/31/2024	%	Gain / (Fade)	Percentage	2020	2021	2022	2023	2024
	WIP 12/31/19																			
101	Contract Description	1,000,000	10.0%	900,000	9.0%	850,000	8.5%	-	0.0%	-	0.0%	-	0.0%	(150,000)	-15.0%	(100,000)	(50,000)	-	-	-
102	Contract Description	800,000	10.0%	820,000	10.1%	850,000	11.0%	800,000	10.0%	-	0.0%	-	0.0%	-	0.0%	20,000	30,000	(50,000)	-	-
103	Contract Description	1,200,000	10.0%	900,000	9.0%	900,000	6.0%	950,000	6.0%	-	0.0%	-	0.0%	(250,000)	-20.8%	(300,000)	-	50,000	-	-
		3,000,000		2,620,000		2,600,000		1,750,000		-		-		(400,000)	-13.3%	(380,000)	(20,000)	-	-	-
	WIP 12/31/20																			
201	Contract Description			1,000,000	10.0%	900,000	9.0%	850,000	8.5%	800,000	8.0%	-	0.0%	(200,000)	-20.0%	-	(100,000)	(50,000)	(50,000)	-
203	Contract Description			2,000,000	10.0%	2,400,000	9.0%	2,450,000	8.5%	2,500,000	10.0%	-	0.0%	500,000	25.0%	-	400,000	50,000	50,000	-
204	Contract Description			1,000,000	10.0%	1,100,000	9.0%	900,000	0.0%	700,000	8.0%	650,000	9.5%	(350,000)	-35.0%	-	100,000	(200,000)	(200,000)	(50,000)
				4,000,000		4,400,000		4,200,000		4,000,000		650,000		(50,000)	-1.3%	-	400,000	(200,000)	(200,000)	(50,000)
	WIP 12/31/21																			
205	Contract Description					1,000,000	10.0%	1,000,000	9.0%	1,000,000	8.5%	1,050,000	8.0%	50,000	5.0%	-	-	-	-	50,000
206	Contract Description					280,000	10.0%	270,000	9.0%	270,000	8.5%	260,000	8.0%	(20,000)	-7.1%	-	-	(10,000)	-	(10,000)
207	Contract Description					1,000,000	10.0%	1,000,000	9.0%	850,000	8.5%	800,000	8.0%	(200,000)	-20.0%	-	-	-	(150,000)	(50,000)
208	Contract Description					1,000,000	10.0%	950,000	9.0%	900,000	9.0%	800,000	8.0%	(200,000)	-20.0%	-	-	(50,000)	(50,000)	(100,000)
						3,280,000		3,220,000		3,020,000		2,910,000		(370,000)	-11.3%	-	-	(60,000)	(200,000)	(110,000)
	WIP 12/31/22																			
301	Contract Description							1,000,000	10.0%	900,000	9.0%	1,100,000	8.5%	100,000	10.0%		-	-	(100,000)	200,000
302	Contract Description							1,000,000	10.0%	1,100,000	9.0%	900,000	8.5%	(100,000)	-10.0%		-	-	100,000	(200,000)
303	Contract Description							2,000,000	10.0%	2,100,000	9.0%	2,150,000	8.5%	150,000	7.5%		-	-	100,000	50,000
304	Contract Description							900,000	10.0%	600,000	9.0%	450,000	8.5%	(450,000)	-50.0%		-	-	(300,000)	(150,000)
								4,900,000		4,700,000		4,600,000		(300,000)	-6.1%	-	-	-	(200,000)	(100,000)
	WIP 12/31/23																			
404	Contract Description									1,000,000	10.0%	900,000	8.5%	(100,000)	-10.0%			-	-	(100,000)
405	Contract Description									2,000,000	10.0%	1,600,000	8.0%	(400,000)	-20.0%			-	-	(400,000)
406	Contract Description									1,000,000	9.0%	800,000	7.0%	(200,000)	-20.0%			-	-	(200,000)
407	Contract Description									1,600,000	10.0%	1,100,000	6.5%	(500,000)	-31.3%			-	-	(500,000)
										5,600,000		4,400,000		(1,200,000)	-21.4%			-	-	(1,200,000)
	WIP 12/31/24																			
501	Contract Description											1,000,000	10.0%	-	0.0%					
502	Contract Description											800,000	11.0%	-	0.0%					
503	Contract Description											900,000	10.0%	-	0.0%					
504	Contract Description											750,000	12.0%	-	0.0%					
												1,400,000	11.5%	-	0.0%					
												4,850,000		-		-12.7%	5.7%	-2.5%	-4.9%	-8.4%
		3,000,000		6,620,000		10,280,000		14,070,000		17,320,000		17,410,000		(2,320,000)		(380,000)	380,000	(260,000)	(600,000)	(1,460,000)

Sample Construction Company		Exhibit E		
Bid Spread Analysis - Variable v. Fixed Costs				
	Low Bidder	2nd Bidder	Bid Spread	Spread %
Final bid tabs	$ 7,000,000	$ 8,000,000	$ 1,000,000	12.5%
Fixed components:				
Liquid asphalt & aggregates	$ 3,000,000	$ 3,000,000	$ -	
Diesel and supplies	$ 500,000	$ 500,000	$ -	
Subcontracted items (same subs)	$ 1,000,000	$ 1,100,000	$ 100,000	
Subtotal fixed bid components	$ 4,500,000	$ 4,600,000	$ 100,000	2.2%
Variable components:				
Plant mix production	$ 1,000,000	$ 1,000,000	$ -	
Trucking (haul distance)	$ 500,000	$ 750,000	$ 250,000	
Profit and other variables	$ 1,000,000	$ 1,650,000	$ 650,000	
Subtotal variable bid components	$ 2,500,000	$ 3,400,000	$ 900,000	26.5%
	$ 7,000,000	$ 8,000,000		

Davidson Construction Company, Inc. **Exhibit F**

Front-End Loading to Overbilling Analysis

December 31, 2024

Contract #	Description	(1) Mobilization Front-End Loading*	(2) % Complete	(3) % Uncompl.	(4) Pro-Rated Front-End Loading (1) x (3)	(5) Overbilling Reported	(6) Front-End Surplus (Deficit) (5) - (4)
Bridge and Concrete Division							
101	TDOT	$1,000,000	50.0%	50.0%	$ 500,000	$ 1,000,000	$ 500,000
102	TDOT	100,000	20.0%	80.0%	80,000	100,000	20,000
103	Nashville Public Works	200,000	60.0%	40.0%	80,000	-	(80,000)
		1,300,000			660,000	1,100,000	440,000
Grading & Excavation Division							
501	TDOT	1,000,000	50.0%	50.0%	500,000	200,000	(300,000)
502	TDOT	200,000	90.0%	10.0%	20,000	100,000	80,000
504	Alabama DOT - Jefferson	2,600,000	30.0%	70.0%	1,820,000	1,000,000	(820,000)
		3,800,000			2,340,000	1,300,000	(1,040,000)
		$5,100,000			$3,000,000	$ 2,400,000	$ (600,000)

* Mobilization and front-end load amounts from bid tabs and most recent pay application/estimate.

At a minimum, contracts should have a front-end **surplus**. In addition to a front-end surplus, each contract must have an overbilling reserve sufficient to cover contract completion, punch list, collection reserves, etc. Front-end deficit indicates significant risk that POC estimates may be incorrectly optimistic.

Analyze the following to support adequacy of overbilling to front-end billing allowance:

1. Surety bond or special insurance deposit
2. Front-end payments to subcontractors or supplier
3. General conditions, jobsite set-up, etc.
4. Estimated punch list, completion costs, unbalance bid item costs at back end of job.

e. **Evaluate subcontractor risk and exposure to price/cost escalation**
   - Determine bonded vs. non-bonded subcontractor backlog
   - Review subcontractor prequalification process
   - Evaluate subcontractor verification of supplier payment process
   - Review internal controls for subcontractor insurance certificates

f. **Perform job cost reasonableness testing procedures to determine cost shifting or inadequate allocation of indirect and equipment costs** – **Exhibit Q**
   - Compare equipment or other indirect costs to labor % - look for significant variances
   - Compare subcontract costs to original schedule of values

g. Review subsequent job costs recorded and posted after year-end to completed and WIP contracts

h. Review completion dates for potential liquidated damages or early completion bonuses (variable consideration)

i. Compare committed costs for subs and materials to estimated costs to complete on WIP schedule
   - Determine reasonableness of costs to complete budget amount

4. **Audit only procedures include**

   a. Contract confirmations to owners (or prime) using **AAG recommended format**
      - Claims, LDs, change orders, issues

   b. Subcontract confirmations using **AAG recommended format**

   c. Supplier confirmations (if significant exposure)

   d. Test job costing internal controls to detect cost shifting **Exhibit N**

Indirect Job Cost Analysis		**Exhibit Q**						
Equipment to Labor Reasonableness Test		Total	Actual Job Cost Charged to Date				Equipment	
		Contract	Labor	Equipment	Equip to	Units	Cost per	
Contract #	Job Description/Location	Amount	Cost	Cost	Labor %	C.Y./L.F.	Unit	
Example # 1	I-95 Excavation	$ 42,600,000						
	Clearing		$ 400,000	$ 500,000	125.0%	150,000	$ 3.33	CY
	Unclassified excavation		$ 5,000,000	$ 5,400,000	108.0%	700,000	$ 7.71	CY
	Drainage and pipe		$ 2,400,000	$ 3,700,000	154.2%	98,000	$ 37.76	LF
			$ 7,800,000	$ 9,600,000	123.1%			
Example # 2	Amazon Distribution Center	$ 20,000,000						
	Clearing		$ 300,000	$ 380,000	126.7%	100,000	$ 3.80	CY
	Unclassified excavation		$ 1,000,000	$ 1,250,000	125.0%	250,000	$ 5.00	CY
	Drainage and pipe		$ 2,400,000	$ 2,900,000	120.8%	82,000	$ 35.37	LF
	Topsoil		$ 225,000	$ 290,000	128.9%	25,000	$ 11.60	CY
			$ 3,625,000	$ 4,440,000	122.5%			
Example # 3	US Highway 41	$ 16,000,000						
	Clearing		$ 100,000	$ 240,000	240.0%	100,000	$ 2.40	CY
	Unclassified excavation		$ 1,000,000	$ 600,000	60.0%	600,000	$ 1.00	CY
	Drainage and pipe		$ 800,000	$ 625,000	78.1%	82,000	$ 7.62	LF
	Topsoil		$ 225,000	$ -	0.0%	25,000	$ -	CY
			$ 2,025,000	$ 1,225,000	60.5%			
Example # 4	Johnny Cash Parkway	$ 8,000,000						
	Unclassified excavation		$ 1,000,000	$ 3,000,000	300.0%	200,000	$ 15.00	CY
	Drainage and pipe		$ 200,000	$ 700,000	350.0%	120,000	$ 5.83	LF
	Topsoil		$ 5,000	$ 40,000	800.0%	1,000	$ 40.00	CY
			$ 1,205,000	$ 3,740,000	310.4%			

Contract Cost Shifting Illustration					Exhibit N								
FYE	12/31/2024	1	2	Contr	4	5	6	7	8	9	10	11	12
				(1 - 2)	(3/1)		(1 x 11)		(6 - 7)	(6 - 5)	(5 - 6)	(7 / 2)	(2 - 7)
					Estimated							Cost to Cost	Estimated
		Contract	Total Estimated	Estimated	Gross Profit	Billings	Revenue	Cost	Gross Profit			Percentage of	Cost to
Job #	Description	Amount	Cost	Gross Profit	Percentage	to Date	Recognized	to Date	to Date	Underbilling	Overbilling	Completion	Complete
Actual contract costs													
Contract in Progress													
1801	Sam's Building	10,000,000	8,000,000	2,000,000	20.00%	6,000,000	5,000,000	4,000,000	1,000,000	0	1,000,000	50.00%	4,000,000
Complete													
1802	Costco Building					22,000,000	22,000,000	22,000,000	0				
						28,000,000	27,000,000	26,000,000	1,000,000	0	1,000,000		
After cost shifting													
Assume cost shift - Move $1 million of cost from Costco (completed job) to Sam's (Uncompleted job)													
Contract in Progress													
1801	Sam's Building	10,000,000	8,000,000	2,000,000	20.00%	6,000,000	6,250,000	5,000,000	1,250,000	250,000	0	62.50%	3,000,000
Complete													
1802	Costco Building					22,000,000	22,000,000	21,000,000	1,000,000				
						28,000,000	28,250,000	26,000,000	2,250,000	250,000	0		
	Material Misstatements - Increase (Decrease)					**0**	**1,250,000**	**0**	**1,250,000**	**250,000**	**(1,000,000)**		

5. **Jobsite visits (audit and review procedure)**
    a. Optional – CPA discretion
    b. Percentage of completion observation
    c. Inquiries of jobsite PM and superintendent
    d. Reconciliation of subcontractors on jobsite and recorded in job cost
    e. Uninstalled generic materials observation – not inventory

6. **Other unique audit and review procedures (and best practice IC)**
    a. Equipment accounting and costing
        - Capitalization policies
        - Useful lives and depreciation calculation
        - Internal rental rate system or other GAAP job cost allocation method
    b. Litigation disclosures
    c. Reserves for high-deductible insurance coverages (self insurance loss reserves)
    d. Subsequent events and the effect on year-end contract estimates

7. Skepticism and analysis required for GAAP balance sheet classification
One more quick reminder!

a. Cash – restricted for retainage or insurance reserves
b. Contract receivables (disaggregation required)
c. Retainage – completed jobs and WIP jobs
d. Claims and unapproved change orders – to the extent of costs incurred only
e. Related party A/R and owner "notes receivable" – Can the related party pay?
   - Requires review and analysis of related party's collateral and cash flow
f. Under billings - ***#1 reporting error***
g. Inventories – should not include job cost materials
h. Bank lines of credit – reported inappropriately as "long-term"
   - Phony long-term LOC classification
i. Insurance – self-insured deductibles and reserves
j. A/P to Subcontractors – including retainage (analyze negative retainage amount)
k. Over-billings - ***#2 reporting error*** – insufficient overbilling deferral
l. Loss contract accrual, liquidated damages, or claims payable
m. Off balance sheet liabilities for current tax distributions & deferred taxes
n. Off balance sheet liabilities for deferred taxes

Session 4

CONSTRUCTION TAXATION – FUNDAMENTALS & STRATEGIES

A. Review of Construction Taxation Basics & New Tax Law

1. Construction industry is a Top-10 sector of the U.S. GDP and consistently one of the Top-5 employment sectors. Home and residential construction has always been an economic bell-weather indicator.

2. Congress has always passed laws giving tax breaks and incentives to contractors including OBBB law

3. Four basic construction contractor tax methods:
   a. Cash basis
   b. Accrual basis (<u>generally the worst tax method</u>)
   c. Completed contract method for long-term contracts (used by 97% of contractors until 1986)
   d. Percentage of completion contract method for long-term contracts
   e. **FACT: Most contractors have multiple tax methods depending on type of contract, duration or contract, and revenue size of contractor.**
   f. **Cash and CCM will generally result in largest tax deferral**

4. Code Section 460 Exemptions that CPAs, CFOs, and PMs should know

a. **Non-long-term contracts are exempt** from POC method and should be reported on cash or accrual methods under Code Section 451

- ***Contracts not completed in the same tax year as started. 12-month length is NOT the definition.***

b. Contracts performed by contractors with average annual revenues below **$31 million** (adjusted for inflation from $25M (original) - $30M in 2024) – tax method gross revenue

- If average revenues are below $31 million in for 3-years ending prior to 2025, new contracts started in 2025 are eligible for alternative method (CC or cash)
- Old law required 2-year estimated completion to be exempt. **New law increase to 3-year completion.**
- Uncompleted contracts at 12/31/24 will continue to be reported on POC until completed
- **No 3115 is required or should be filed. This is an automatic transition.**

c. **Home construction contracts** (and related work) – defined a 4 dwelling units or less per structure

d. **Residential contracts** – multi-family with more than 4 dwellings per unit

- Old law 30% exempt – 70% reported under Sec 460 POC
- **New OBBB 2025 – 100% exempt starting 2026; tax reporting same as home contracts (CC or cash)**

e. 10% election – revenue and costs on contracts less than 10% complete can be deferred similar to completed contract method

f. Long-term exempt contracts are eligible for completed contract method or cash and accrual methods (subject to C-Corp limitations)

5. Tax rates for 2025

	C-Corp	S-Corp	LLC	PTE Election
Taxable income	$ 10,000,000	$ 10,000,000	$ 10,000,000	$ 10,000,000
Assume 7% state income tax*	$ (700,000)	$ -	$ -	$ -
Assume 2 equal owners**	$ -	$ (20,000)	$ (20,000)	$ -
Assume 7% state PTE tax election				$ (700,000)
Taxable income after state deduction	$ 9,300,000	$ 9,980,000	$ 9,980,000	$ 9,300,000
Tax rate - estimate	21.00%	29.60%	29.60%	29.60%
Federal tax due	$ 1,953,000	$ 2,954,080	$ 2,954,080	$ 2,752,800
Effective federal rate MAX	19.53%	29.54%	29.54%	27.53%
* New tax law increased SALT deduction for individuals to $40,000 annually (joint or single filer)				
** SALT phase-out at $500,000 MAGI - reverts back to $10,000 limit above $600,000 MAGI				
2025 Individual tax brackets (Joint)		QBI Rate		
< $89,450	10% to 12%	9.60%		
< $364,200	22% to 24%	19.20%		
< $462,500	32%	25.60%		
< $1,000,000	35%	28.00%		
> $1,000,000	37%	29.60%		

6. **Pass-through entity (S-Corp, LLC, etc.) vs C-Corporation debate is continuing**
   - **Contractors should consider pros/cons of lower rate v. double taxation exposure**
   - **Are excess comp and double tax liquidation benefits worth extra additional tax?**

7. Most states have passed a PTE (pass through entity) election to avoid non-deductible state tax.
   - SALT deduction increase to $40,000 will provide deduction for owners under $600,000 income
   - Keep your PTE election

8. Bonus depreciation restored to 100% for purchases after 1/19/2025
   - 40% for purchases between 1/1/25 and 1/19/25

9. Bonus depreciation of 100% added for qualified production real property
   - **Construction / purchase must have begun after 1/19/2025**
   - New or original use by the taxpayer
   - Manufacturing / production space of building only – no office, sales, parking, etc. (cost seg analysis)
   - If property dormant since 1/1/2021, the purchase will qualify for bonus

10. Section 179 increased to $2.5M with $4M purchase cap phase out

Tax Methods Available to Contractors

1. **Cash Method**
   a. Revenue recognized when cash is received, and expenses deducted when paid
   b. Eligibility includes:
      - C Corporations with average annual gross receipts less than $30,000,000 (2024) $31,000,000 (2025) (TCJA increased from the previous $5,000,000 to $25 million with index)
      - Additional index for 2026 is probable - $32 million?
      - **Non-long-term contracts performed by pass-through entities (S-Corp and LLC) are not subject to the $31M revenue limitation**
      - This is currently a non-automatic change, but IRS does not enforce it if cut-off method used.
        - 3115 should make clear that materials are purchased for jobs and not maintained as inventories
   c. IRS alert to possible abuses – simply not depositing cash prior to year-end is still fraudulent

2. <u>Accrual Method</u>

a. Revenue recognized the earlier of when earned or received

b. Expenses are deducted when the “all-events” test has occurred, but not before economic performance

c. Rev. Proc. 2004-34 (deferral of advance payments) – allows the deferral of deposits paid by an owner to a contractor

- This does not allow the deferral of front-end loading (over-billing) since the contractor had the “right to receive” the revenue under the contract terms

d. <u>Worst method for contractors (overbilled = taxable!)</u>

e. Accrual basis contractor can exclude retainages receivable (Rev. Rule 69-314) subject to TCJA changes to Section 451 requiring the tax return recognition to match the audited financial statement recognition

- Included in income only after final acceptance of work performed
- Election to use method is required
- Method change “automatic” per Rev. Proc. 2008-52
- Must also exclude any retainages payable from expenses (Shepherd Construction Co. v. Commissioner)
- Available for contracts exempt from POC including non-long-term jobs

f. Subject to final regulations, contractors using the accrual method for tax reporting may need to defer recognition of retainage for financial reporting too

g. Pay when paid or pay if paid argument for inclusion of subcontractor retainages in job cost for POC purposes is questionable due to TCJA

h. Prepaid insurance

- Regs. Sec. 263(a)-4(f)
  - Allows a deduction for prepaid expenses (specifically including prepaid insurance) that does not cover a period extending more than 12 months beyond the end of the taxable year in which the expense is incurred
  - The expense must meet all other requirements for deduction
    - ➢ All events that establish a liability exists have taken place
    - ➢ The amount of the liability can be determined with reasonable accuracy
    - ➢ Economic performance has occurred with respect to the liability
  - Allowed as an automatic change under Rev. Proc. 2005-9

3. Completed Contract Method

a. Revenue and costs incurred on a contract are not recognized until the contract is completed and accepted (*Ball, Ball & Brosamer v. Commissioner, T.C.* Memo 1990-454 (Space Shuttle Runway)

b. Regulations require completion when 95% complete and owner occupies (1.460-1(c)(3))

c. Generally, results in the greatest deferral of income

d. Use of CCM is limited to certain contracts performed by "small contractors". Prior to 2018, the small contractor revenue test was $10,000,000 or less. The TCJA increased the test to average gross receipts of $25,000,000 indexed to $31,000,000 in 2025.

e. **Available for certain contracts (home and residential) which are exempt from Code Section 460**

- **Not "home builders" – home contracts which includes all cost such as grading, utilities, electrical, etc.**
- **Residential 30% in 2025 – 100% eligible for contracts started after 1/1/26**

4. <u>Percentage of Completion Method (POC)</u>

a. Recognizes revenue on the percentage of contract completion, determined by the total cost to date over total estimated cost

b. Tax POC and GAAP POC Differences:

- Cost to cost required for tax; GAAP allows other methods such as labor%, units, etc.
- Loss contracts must be deducted based on percent complete for tax; full loss required by GAAP
- 10% election (***although this is becoming a best practice for GAAP and is permitted***)
- Stored materials (uninstalled) must be included for tax in POC income recognition – omitted for GAAP
- **No exceptions to POC for GAAP**
- G&A allocations for tax required –
  - ***<u>However, the revenue recognition will be the same unless the G&A percentage changes for future tax periods</u>***

c. Applies to all contracts non-exempt from IRC 460. Generally, POC is required to be used by large contractors with average annual revenue over $31,000,000 (2025).

d. Contracts that are generally exempt form POC under IRC 460:

- Non-long-term contracts – (stated and completed during the tax year)
- Home construction contracts (including infrastructure attributable to dwelling unit)
- Residential contracts (prior to 2025 30%) – multi-family, condos, barracks, prisons, dormitories, etc.
- Contracts performed by small contractors ($31 million "small contractor" test)
- 10% election (Under 10% complete – defer 100% to subsequent year)

e. Other issues affecting POC revenue recognition

- All-events test required by 461(h) economic performance rules
- *Tutor-Saliba Corporation v. Commissioner (115 T.C., No. 1)*(claims taxable when filed)
- G&A allocation to long-term contracts (Reg. 1.460-5)
- Exclusion of retainages payable from costs incurred to date (ISP MSSP IRPO 180, 118)
  - ➢Exclusion not allowed if "Pay when Paid" clause applies (varies from state to state)
- Claim revenue recognized to extent of cost incurred (Coordinated Issues Paper 7/20/06)

5. Taxpayer allowed to use more than one method of accounting IRS Revenue Ruling 92-28

a. Recommend tax trial balance to track changes form year to year

b. M-1 and M-3 adjustments can be confusing

6. TJCA mandated that IRS revenue recognition must occur no later than recognition required by GAAP and reported in the taxpayer's "applicable financial statement" (annual audit or review?). This sets the stage for the new Revenue Procedure 2018-29 (see below). <u>This rule does not apply when a special method of accounting is specifically permitted – i.e., Code Section 460 exemptions and completed contract method. This rule could limit the ability to report income differently in audited financial statements and the tax return for:</u>

   a. Retainage exclusion (accrual method)
   b. Claims recognition (not recommended anyway)

The IRS had issued Revenue Procedure 2018-29 which allows certain provisions of the new ASC 606 Revenue Recognition Standards to be adopted as a tax method - Automatically

Rev. Proc. 2018-29 added a new section 16.11 to Rev. Proc. 2018-31 (Automatic consent list) entitled "Changes in the timing of recognition of income due to the new ASC 606 Revenue Recognition Standards." This change applies to taxpayers that wish to change their method of accounting for

1. Identifying performance obligations,
2. Allocating transaction price to those performance obligations, and / or;
3. Considering performance obligations satisfied. A change in method of accounting may only be requested under this procedure if the proposed method is otherwise permissible for federal income tax purposes and the change is being made for the year in which the taxpayer adopts ASC 606.

The automatic procedure does not apply to the following changes that may be a part of the taxpayer's implementation of the new revenue recognition standards: A change in the contract price and the inclusion / exclusion of variable consideration

4. A change in method which does not comply with Section 451 or other guidance

5. Any change related to income from long-term contracts under Section 460, unless the contracts are exempt (home construction contracts and, or $31M revenue exception)

Accordingly, segmentation of separate performance obligations under ASC 606 should qualify as a separate contract for IRS reporting purposes.

Contractor Tax Deductions and Credits

1. **Section 179D – New tax law phase-out for projects started after 6/30/2026**
   a. The deduction is currently $5.81 per square foot max for energy efficient improvements
   b. Who can take the deduction
      - Owner of building (if owner is a private taxable entity)
      - Contractor and design team if owner is a government entity and tax-exempt entities

2. Historical tax credits – 20% of rehabilitation improvements (not cost of structure)
   a. Structure must be certified by National Park Service as historic
   b. Rehab costs must exceed 100% of original building cost

3. Fuel tax credit (off road) – Form 4136 (if not purchased exempt) $18.4 cents per gallon (jobsite pumps, generators, etc.)

4. Work opportunity tax credits – hiring employees from targeted groups (veterans, ex-felons, etc.) – max $2,400 per employee

5. Employee Retention Credits has been ended, but still subject to IRS audit.

Lookback Calculation – Form 8697

1. Long-term contracts, subject to POC, completed during the year are subject to lookback calculation (includes alternative minimum tax)
2. Interest refund rom IRS on job profit fades and warranty costs
3. Interest owed to IRS on gross profit gain jobs or claims collection
4. **Current lookback interest rate for 2025 is 7%**
5. Exempt from lookback
   a. **Mandatory de minimis for small jobs (below 1% or $1 M annual revenue)**
      - **Strategy – use low profit estimate on de minimis jobs since no lookback**

   b. Home construction contracts (not just "homebuilders")
   c. Non-long-term jobs
6. Final contract cost includes costs allocated as required by Code 460(c) and regulations
7. Lookback interest due on post completion "claims collections" may be discounted from completion year until claim collected
   a. Elect no discount for post completion claims paid
8. Calculated and paid at owner level (1040) for flow-through entities (S-Corp and LLC)
9. IRS Form 8697 – attach contract lookback POC calculations – **Exhibit R**

Construction Compnay, Inc.		**Exhibit R**		(1 - 2)	(3/1)		(1 x 12)		(6 - 7 - 8)	(6 - 5)	(5 - 6)	(8 / 2)		
Contract Lookback True-Up Calculation		1	2	3	4	5	6	8	9	10	11	12		
For the Period from 12/31/24 (closing) to 12/31/25 (true-up)												Cost to Cost		
		Contract	Total Estimated	Estimated	Estimated	Billings	Revenue	Cost	Gross Profit			%		
No.	Description / Type / Location / Owner	Amount	Cost	Gross Profit	%	12/31/2024	Recognized	12/31/2024	to Date	Underbilling	Overbilling	Completion		
Contract WIP as Reported on 12/31/24														
1801	Completed Gain Job	10,000,000	8,000,000	2,000,000	20.0%	9,000,000	7,500,000	6,000,000	1,500,000	-	1,500,000	75.00%		
1802	Completed Fade Job	10,000,000	8,000,000	2,000,000	20.0%	4,000,000	5,000,000	4,000,000	1,000,000	1,000,000	-	50.00%		
1803	Completed Gain Job	10,000,000	8,000,000	2,000,000	20.0%	7,000,000	6,000,000	4,800,000	1,200,000	-	1,000,000	60.00%		
	WIP - as reported	30,000,000	24,000,000	6,000,000		20,000,000	18,500,000	14,800,000	3,700,000	1,000,000	2,500,000			
														12/31/2024
		REVISED ESTIMATES / COMPLETED AT 12/31/25					**REVISED**		**REVISED**			Cost to Cost	Gross Profit	Profit
				Estimated	Estimated	Billings	Revenue	Cost	Gross Profit			%	Recognized	Increase
		Amount	Cost	Gross Profit	%	12/31/2024	Recognized	12/31/2024	Lookback	Underbilling	Overbilling	Completion	Prior Year	(Decrease)
Contract WIP adjusted for final (or WIP) Contract Profit at 12/31/25														
1801	Completed Gain Job	10,000,000	7,000,000	3,000,000	30.0%	9,000,000	8,571,429	6,000,000	2,571,429	-	428,571	85.71%	1,500,000	$1,071,429
1802	Completed Fade Job	10,000,000	9,000,000	1,000,000	10.0%	4,000,000	4,444,444	4,000,000	444,444	444,444	-	44.44%	1,000,000	(555,556)
1803	Completed Gain Job	12,000,000	9,000,000	3,000,000	25.0%	7,000,000	6,400,000	4,800,000	1,600,000	-	600,000	53.33%	1,200,000	400,000
	WIP - Lookback True-up	32,000,000	25,000,000	7,000,000		20,000,000	19,415,873	14,800,000	4,615,873	444,444	1,028,571		3,700,000	915,873
									U/O change	(555,556)	1,471,429			
									Net		915,873			
Contract Lookback Adjustment		Revenue	Total											
		Recognized	Cost	Gross Profit										
Contract WIP True-up at 12/31/25 - lookback		19,415,873	14,800,000	4,615,873				Lookback						
Contract WIP at closing - As Reported		(18,500,000)	(14,800,000)	(3,700,000)	Tax Rate	Tax	IRS rate	Interest						
Increase (decrease) profit / taxable income		915,873	-	915,873	30%	274,762	7.0%	$ 19,233						

Session 5 – Bonus Sessions

CONTRACTOR INTERNAL CONTROL BEST PRACTICES

VALUATION CALCULATIONS FOR CONTRACTOR M&A TRANSACTIONS

Bonus Session

Contractor Internal Controls
&
Best Practices

Job Costing Internal Control Procedures

1. The <u>#1 Problem</u> in the construction industry today: <u>Contractors do not know their true job costs</u>
2. Accounting controls should verify that <u>job costing, and phase coding</u> of labor, direct materials, and subcontractors is a routine and reliable process.
    a. System should lock out unauthorized cost-shifting by PMs or others
        - Shifting costs from one job to another can create fake profits or hide cost overruns

    b. Accountants should be skeptical of invoices not matching P.O.s and Sub Agreements
3. Allocations of indirect costs must be systematic, rational and consistently applied to all jobs
    a. Unallocated indirect costs (idle equipment) should be scrutinized

    b. Incorrect or under allocation of indirect costs is the most common job cost error

    c. <u>Calculate overall % of indirect costs to labor or job costs and look for anomolies</u>
4. Comparison of bid to actual job cost by phase (cost) code is a key internal control

Labor Internal Control Procedures

1. Daily times sheets are mandatory – prevent 10-10-10 phenomenon
   a. Daily field reporting using I-pad or phone
   b. Daily reporting will result in more accurate phase coding
   c. Consider face recognition or fingerprint check-in to prevent "10-hour rounding"
2. Consider Foreman and Superintendent bonuses based on labor budget savings
   a. Prevents hour inflation
   b. Deters unnecessary OT
3. Payroll clerk should be "locked out" of creating new employee or changing rates without HR approval process (separation of duties)
4. Scrutinize turnover ratios
   a. Develop retention policies
   b. Incentives

Equipment Management and Costing Internal Control Procedures

1. Equipment costs includes depreciation, repairs, fuel, tires, shop costs, GPS, etc.
    a. Indirect equipment costs allocated using an internal rental rate “standard cost system”
    b. Depreciation is a real cost for contractors – not “free cash flow”
    c. Hourly rates (wet rate or dry rate) should be based on budget hours
    d. Controllers, equipment foreman and management should review rates periodically
    e. Depreciable life and recovery is determined based on three subjective factors:
        1) How many years to recover the cost – 5, 7, 10?
        2) Expected useful life to the company – not how long the asset will exist
        3) Future replacement
    f. Depreciable life is the largest component of the hourly rental rate
        1) Cost of equipment divided by useful life = annual depreciation (recovery) amount
        2) Annual depreciation (recovery) amount ÷ budgeted hours = hourly rate (excl op. costs)
    g. Some contractors depreciate equipment based on hours rather than years

2. Calculation of hourly rental rate for equipment allocation is a key component of job cost

Equipment Rental Rate Calculation Worksheet			
Equipment : Make / Model		Cat 980 M Wheel loader	
Serial Number		3345xxxx - 2024 model	
Purchased		10/1/24 - purchased new	
Original cost basis		$ 800,000	
Less salvage value at trade-in	10.00%	$ (80,000)	
Cost recovery basis		$ 720,000	
Estimated useful life (recovery)		10	years
Annual equipment cost		$ 72,000	
Estimated repair, maintenance & tires	2.00%	16,000	(non-warranty)
Annual insurance, taxes, permits, & fees	0.15%	1,200	
Other costs		1,000	
Total fixed costs		$ 90,200	
Budgeted annual hour usage	Hours	1,200	
Rate per hour w/o fuel (dry rate)		**$ 75.17**	
Round		**$ 75.00**	
Add: Diesel cost per hour			
Estimated (factory spec) gallons per hour	4.50		
Diesel / Gas cost per gallon	$ 3.10	13.95	
Maintenance, filter, oil, lube		1.00	
Rate per hour with fuel (wet rate)		**$ 90.12**	
Round		**$ 90.00**	
Other Considerations:			
Finance / interest costs			
Blue (or Green) Book rate comparison (monthly rate ÷ 176 hrs x 75%)			

Equipment Management and Job Costing (Continued)

3. Capitalization of equipment repairs and maintenance should be limited.
   a. 100% bonus depreciation negates tax benefit
   b. Capitalization is not permitted unless it:
      1) Extends the USEFUL life (Not depreciable life) OR:
      2) Increases the CAPACITY of the equipment
   c. <u>The dollar cost of the repair is irrelevant</u>
   d. If the intended useful life of a Cat D-6 dozer is 7-years (depreciable life is 5-years), then the repair must extend the life into an 8th year to be capitalized. A dozer might be "overhauled" twice in the 8-year period but did not "extend" the useful life.
   e. If capitalized, book depreciation should be based on conservative useful life estimate
      1) Tax bonus depreciation 100% for purchases after 1/20/2025
      2) Write off previously capitalized repair to the same piece of equipment. (I have seen 3 sets of tracks capitalized for the same D-10 – all three were still on the books!)

Equipment Management and Job Costing (Continued)

4. Internal rental rate system is the most accurate method of allocating equipment costs to job cost.
   a. Review rates:
      1) Dry rates (annually) vs. wet rates (monthly)
      2) Rates should be based of capacity and capability, not age and depreciation of equipment. If not, jobs are "penalized" for being assigned newer piece.
      3) Rates should account for normal idle time such as winter shut down
      4) Rates include depreciation, shop costs, repairs, insurance, taxes, etc.
   b. Field reporting system should prevent under / over reporting hours for equipment
      1) GPS, bar code or payroll system should report daily
      2) Avoid 10-10-10 field report
   c. Review equipment utilization and equipment P&L reports periodically / annually
      1) Look for "loss" on equipment pieces
      2) Look for utilization rates below 80% - sort by equipment class
      3) Consider eliminating unprofitable equipment.
   d. If utilization rates are consistently under 90% by class of equipment – budgeted hours are too high, and hourly rates are too low.

Equipment Utilization and Internal Rental Rate System		
	Asphalt Paver	CAT 980 Loader
Budgeted Hours		
Maximum weekly hours	40	40
Calendar weeks (excl holidays)	50	50
Total maximum hours	2,000	2,000
Budgeted utilization hours		
Estimated working weeks	32	48
Estimated working days per week	4	5
Estimated working days	128	240
Estimated running hours per day	8	5
Budgeted ownership hours	1,024	1,200
Productivity		
Job charged hours - actual	650	1,250
Budgeted Hours	1,024	1,200
Utilization	63.5%	104.2%

Bidding and Estimating Controls

1. Realize you are a "Market Maker" – Is the problem with bid prices you?
2. Pre-Bid Considerations
   a. People – are crews available to perform the work within the contract period?
   b. Equipment availability and plant capacity
   c. Location
   d. Competition
   e. **Does the project have too many "News"?**
3. Design and utilize a private work owner / project prequalification form
   a. Completed form should be reviewed and approved by management before submission of bid and / or signing contract
   b. Obtain certificate of financing and credit report for private projects
4. Bid spread analysis should be performed periodically
   a. Calculate spread on variable costs – excluding fixed costs

Sample Construction Company		Exhibit E		
Bid Spread Analysis - Variable v. Fixed Costs				
	Low Bidder	2nd Bidder	Bid Spread	Spread %
Final bid tabs	$ 7,000,000	$ 8,000,000	$ 1,000,000	12.5%
Fixed components:				
Liquid asphalt & aggregates	$ 3,000,000	$ 3,000,000	$ -	
Diesel and supplies	$ 500,000	$ 500,000	$ -	
Subcontracted items (same subs)	$ 1,000,000	$ 1,100,000	$ 100,000	
Subtotal fixed bid components	$ 4,500,000	$ 4,600,000	$ 100,000	2.2%
Variable components:				
Plant mix production	$ 1,000,000	$ 1,000,000	$ -	
Trucking (haul distance)	$ 500,000	$ 750,000	$ 250,000	
Profit and other variables	$ 1,000,000	$ 1,650,000	$ 650,000	
Subtotal variable bid components	$ 2,500,000	$ 3,400,000	$ 900,000	26.5%
	$ 7,000,000	$ 8,000,000		

Contract Bidding & Estimating			
Bid Risk Calculator			
Too Many "News" Assessment	Risk		
	Contingency	Additional	Bid Cost
	.25% to 1.0%	Contingency	& Margin
Total estimated costs - per bid software			$ 10,000,000
Contingencies for "New" risk factors:			
New first-time owner	0.50%	$ 50,000	
New state or new geographic area	0.50%	$ 50,000	
New project manager or superintendent	1.00%	$ 100,000	
New job revenue size (> 20% of normal)	0.50%	$ 50,000	
New type of work - unique work item	1.00%	$ 100,000	
New subcontractors (critical path)	0.50%	$ 50,000	
New material suppliers (major item)	0.50%	$ 50,000	
New contract type (i.e. lump sum)	0.25%	$ 25,000	
"New" contingency subtotal			$ 475,000
Contingencies for other contract risks			
Working day/hours limitations	0.00%	$ -	
Night work	0.50%	$ 50,000	
Short completion date (significant LDs)	0.00%	$ -	
Heavy traffic	0.00%	$ -	
Other contingencies subtotal			$ 50,000
Total estimated costs with contingencies			$ 10,525,000
G&A overhead margin	3.50%		$ 368,375
Profit margin	8.00%		$ 842,000
Bid amount			$ 11,735,375

5. Scrutinize and monitor social, family or other relationships of suppliers, subcontractors or other vendors with Company estimators and PMs.
    a. Are relationships creating a conflict of interest on bid day?
    b. Does management look for unusual trends?
    c. Does the contractor have a policy prohibiting travel, entertainment and “gifts” to estimators and project managers?
    d. Suppliers and subcontractors should be notified about company policy prohibiting “soft” kickbacks without approval.
6. Prior to submission of bid to owner:
    a. Estimate must be reviewed and approved by a 2nd person for financial accuracy
    b. Estimates on contracts above $xxx,xxx must be reviewed and approved by management
    c. Contract estimating files should be reviewed periodically to verify that multiple quotes were obtained for significant subcontractors, suppliers and vendors. Company policy should be followed
    d. Management must approve of utilization of non-low quotes?
    e. Management must approve use of very low quotes?
    f. Management must approve non-bonded subs and suppliers?
7. Are standard labor and equipment rates updated in the bidding software regularly?

8. What policies and procedures are in place to protect the company from significant price increases from material suppliers post-bid? Or supply chain issues?
    a. Consideration of supply chain and inflation during total contract period should be included in bid.
    b. Are escalator clauses included in contracts?
    c. Does the company obtain fixed price quotes supported by supply bonds?
    d. Does the company purchase hedge contracts? If so, are hedge contracts purchased for correct quantities and maturity dates to offset contract material purchases?
9. Are transfer prices for plant costs reviewed and approved prior to bid?
10. Are estimators prohibited from telephone and email usage during last few hours of bid preparation process?
11. If successful low bidder
    a. Analyze bid spread
    b. Bid, build, collect system?
    c. Lock in subs and suppliers
    d. Estimators and PMs must work with accounting personnel in conversion of bid pay items to phase code job cost budgets

12. **Implement a post-completion internal job “audit / review” process**

a. Target under-performing or loss contracts
b. Compare original bid quantities to actual quantities purchases and final quantities paid by owners (or DOT)
c. Compare original bid prices from subs and vendors with actual paid invoices
d. Discuss potential unpaid quantities or change orders with PMs and job site superintendents
e. Reconcile quantities paid to subcontractors with final quantities paid by owner
   - Scrutinize contract items split between multiple subcontractor or self-performed by Company
f. Review phase codes with significant variances
g. Reconcile final pay application (or DOT estimate) with deposits
h. Review final DBE reports and reconcile to pay items
   - Report errors or inaccuracies to Contract Owner / Agency (DOT) promptly
i. Review certified payrolls – Company and Subcontractors

Subcontractor management and controls

1. Implement a subcontractor prequalification process
   a. Utilize subcontractor prequalification form
   b. Obtain financial statement and credit report annually on major subs (unless bonded)
   c. Obtain safety experience mod information
   d. "We have used this subcontractor for years, without a problem" is not adequate internal control
2. Utilize a written subcontractor bonding process
   a. For example, all subs over $500k or based on type of work
   b. Validate the surety bond authenticity when received
   c. Utilize payment lock-out until bond received
   d. Does the Company use SDI – Subcontractor Default Insurance – also known as "Sub-Guard Insurance"?
3. Verify authenticity of certificate of insurance and "named insured"
   a. Utilize payment lock-out for expired insurance date
   b. Determine if company is "named insured" on policy

4. Develop approval process for:
   a. "Too low" sub quote
   b. Use of "non-low" sub quote
   c. Obtaining fewer than 3 sub quotes
   d. Using "friend or family" as sub
5. Develop and implement monthly procedure to verify subcontractor payment of suppliers prior to release of monthly check to sub:
   a. Obtain list of subcontractor suppliers and contact information
   b. Send monthly email to major suppliers to verify payment through prior month pay request
   c. Consider payment with joint check if credit issues
      - Inform supplier to request joint check if payment is delinquent
6. Verify Subcontractor DBE compliance
   a. Have bidding and project management personnel been adequately trained regarding DBE laws and Company policies?
   b. Are subcontractors used to perform "non-commercially useful" functions?
   c. Are joint checks issued to DBE subcontractors without vendor request or DOT approval?
   d. Are Company materials or equipment provided to DBE and inappropriately included in the DBE %?

Bonus Session

Construction Contractor Valuation Methods & Principles

Construction Contractor Valuation Methods & Principles

1. Three basic valuation methods to consider
   a. **Adjusted book value ("ABV")** (asset-based approach)
   b. **Earning capitalization value** (income / cash-flow based approach) **EBITDA** capitalization
      - "Cash Free / Debt Free"
   c. **Market value** (market approach) – comparison to public company stock PE and EBITDA multiples/value
      - *Not relevant to M&A – except "interesting" info*

2. Working capital minimum target/benchmark – Included in Earning Cap value as "asset"

3. Other considerations
   a. Discounts for less than 51% (not considered in controlling interest M&A valuations)
      - Minority interest (lack of control)
      - Lack of marketability
      - Risk and cyclical earnings are built into the multiples
   b. Excluded assets, affiliates, subsidiaries, life insurance, etc.
   c. Cash free / debt free transaction concept – misleading due to minimum working capital target
   d. Discounted cash flow – used more for a reasonableness test

4. Adjusted Book Value Method (ABV)

a. Adjusted Book Value is typically the “floor” value for buy/sell or gift/estate before discounts
  - Also known as “liquidation value”
  - If low EBITDA, ABV will be the highest value

b. Audited/reviewed/interim book value adjusted for:
  - Fair market value of land, buildings & equipment (less tax liability and fix-up/selling costs)
    - Remember deferred tax on recapture if not step-up basis
  - Fair market value of non-business assets (included or excluded?)
  - Reductions for impaired goodwill and other soft assets
  - Off balance sheet tax liabilities (if no basis step-up)
  - Off balance sheet obligations (leases, contingencies, etc.)
  - Unrecorded job fade or gain
  - Contingencies

c. **Consider a contract fade liability for completion of contract backlog for liquidation value**

d. **Recommended basis for most owner buy / sell formulas – instead of EBITDA with discounts**
  - ***Annual Stated Value is best practice***
  - ***Preferred method for Newco valuations***

e. ABV method is used by buyers to determine goodwill calculation, cash at closing, and other matters for transactions based on earnings capitalization method

f. ABV method is often supplemented by "rule of thumb" calculations for niches like asphalt, ready mix concrete, aggregate or similar operations to add value for intangible market area
- Per yard or per ton multiples
- Based on net expected cash flow per unit
- Aggregate average annual tonnage sold x $100 (10-year x $10)
- Asphalt average annual tonnage sold x $70 (7-year x $10)
- Concrete average annual yards sold x $100 (7-year x $15/yard)

g. ABV generally requires a qualified third-party appraisal for equipment, vehicles, land, and buildings if the value is materially significant.
- If ABV is used for goodwill calculation or comparison purposes, estimated FMV of fixed assets will be sufficient to include in ABV.
- Judgment is required, but based on the age of the vehicle and equipment fleet the valuation can be based on an average of 50% to 70% of original cost.
  - Note – 60% is generally close based on 2025 equipment values

Davidson Contractors			
Adjusted Book Value Calculation			
Stockholders' Equity - per audited financial statement		$ 20,000,000	9/30/2024
Balance sheet adjustments at closing:			
Inventory adjustment	$ -		
Prepaid expenses and related party A/R	(150,000)		
Contract WIP adjustment	(1,200,000)		
Unrecorded liability contingency	-		
Off balance sheet tax liabilities	-		
		$ (1,350,000)	
Estimated FMV of trucks and equipment			
Estimated FMV - per appraisal	$ 25,000,000		
Less book value	(14,700,000)		
Estimated FMV of trucks and equipment		10,300,000	
Estimated FMV of asphalt plants			
Estimated FMV - per appraisal	$ 18,000,000		
Less book value	(9,000,000)		
Estimated FMV of trucks and equipment		9,000,000	
Estimated Adjusted Book Value	Net to seller	**$ 37,950,000**	
Less excess working capital distributed to seller at closing		(8,010,000)	
Add debt to be paid off by seller at closing		1,000,000	
Total purchase price based on ABV (debt-free)		**$ 30,940,000**	

5. **Earnings Capitalization Method (EBITDA)**

a. The “Earnings Cap” method uses “history” to predict the future
   - Is that safe in the construction industry?
   - Are earnings steady or cyclical?

b. Calculation of the expected cash flow (adjusted EBITDA) available to purchaser for a period of years equal to an expected return rate – known as the “cap rate”

c. Capitalization rate is simply the number of years required for the acquired operations to “pay for itself” assuming the historical cash flow continues 20%=5x; 14.3%=7x; 10% = 10x
   - Assumes all after tax cash flow is 100% dedicated to pay back

d. What are the risks that cash flow will continue / increase / decrease post valuation?
   - Are historical earnings a reliable basis for projections?
   - Can cash flow be realized by buyer for the capitalization period? 5-years? 10-years? What about a down-turn? Recession? Pandemic? New competitor in the market?
   - Supply chain problems?
   - Are key personnel responsible for historical earnings still employed?
   - What if they left and now work for a competitor?

e. EBITDA for equipment intensive contractors is generally reduced for annual cap-ex
   - **EBIT “DA” is not free cash flow for heavy highway contractors**

f. Calculation of "normalized" EBITDA – pre-tax net income adjusted for:

- Non-recurring revenue and expenditures
- Excess owner compensation and benefits (standard benchmark is $300k per owner)
- Extraordinary contract gross profit or non-operating damage recovery
- Catastrophic job loss, liquidated damages, or subcontractor failure
- Excessive rents paid to owners or related parties
- Interest (passive) income and expense
- Depreciation net of replacement capex
  - Review capitalization policy and useful life practices
- Deduction for cumulative effect of job fade / gain (most important adjustment in contract revenue normalization process) – **"Contract WIP Adjustment"**
  - Reduction of current year backlog to historical profit average
- Pandemic non-recurring revenue and expenses
  - Deduct extraordinary income for employee retention credits or SBA loan forgiveness
  - Addback supply chain or unprotected cost escalations

g. Construction industry earnings capitalization multiples range from 3x to 15x EBITDA (adjusted for replacement capex) depending on contractor type, niche, barrier to entry, etc.

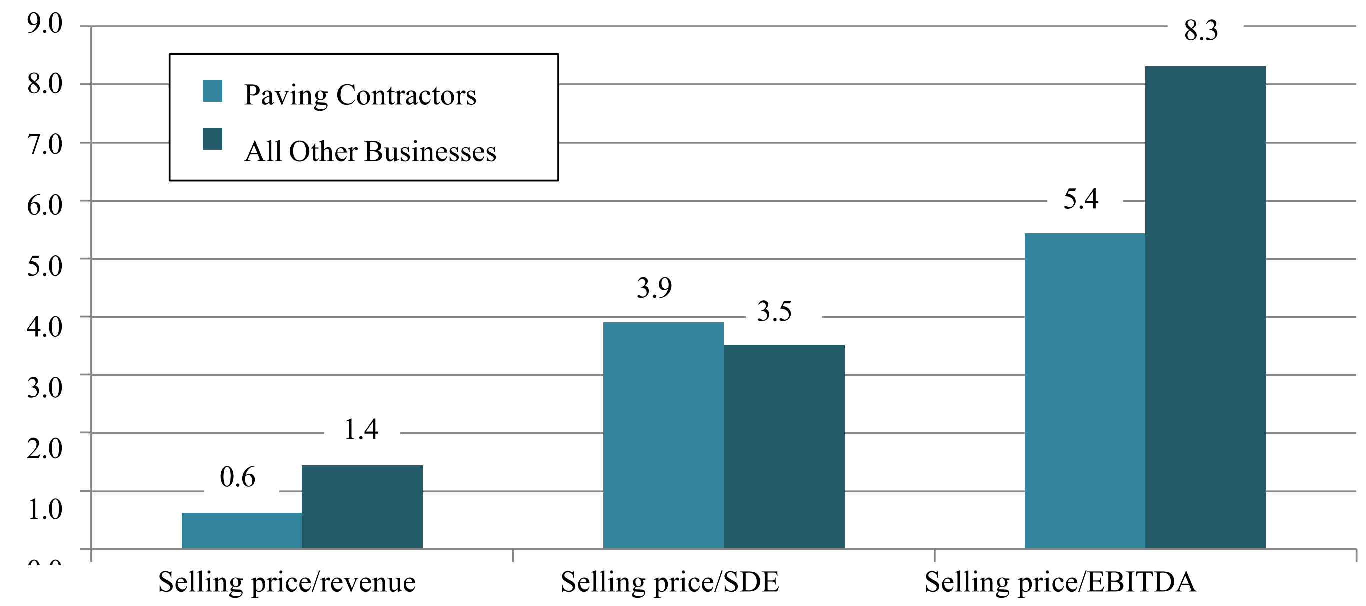
Based on my experience with over 500 transactions, standard multiple ranges are:

- General contractor – no niche 3x to 5x with golden handcuffs and earn-outs
- Electrical, mechanical, HVAC, plumbing – 6.5x to 8x range (healthcare and high-tech are highest)
- Grading, excavation, utility EBIT – 3x to 4x (ABV more common) – equipment cost replacement
- Bridge and concrete construction – 4.5x to 6x (earn-out common)
- Ready mix concrete materials – 7x to 8x
- Asphalt materials and construction – 7x to 9x
- Aggregates – limestone hard rock – 10x to 15x (reserves must be 30+ years)
- Aggregates – gravel, sand, fill rock – 8x to 10x

h. Pratt's Stats is now Deal Stats owned by BVR Business Valuation Resources

- Valuations of Contractors resource DealStats (formerly Pratt's Stats) | Business Valuation Resources (bvresources.com)
- In my experience, BVR Deal Stats multiples are not accurate and tend to be over-stated
- Deal Stats rely on public company reporting too much

Exhibit 5. Average Selling Price Multiples



SDE = seller's discretionary earnings

i. Other EBITDA and x-multiple considerations:
   - Barrier to entry contractors (asphalt, quarries, etc.)
   - Significant % of public, DOD, government, DOT and municipal work (higher multiple)
   - Negotiated (higher) vs. hard bid (lower) work
   - Bonded vs. non-bonded work – same, but affects working capital retention
   - Workforce and retention of key personnel
   - Expected post-transaction market changes
   - Site lease, licensing or permit renewal issues
   - Supply issues – aggregate reserves, cement, liquid asphalt, steel, copper

j. Working capital at closing in excess of benchmark (target) amount is added to valuation
   - Normal benchmark is 5% to 15% of annual net revenue (10% is most common)
     - Analysis of trailing 12-month working capital cycle
   - Only tangible working capital is included
   - Inventories are counted at closing
     - Obsolete, non-turning and excess inventory (asphalt RAP or scrap) is de-valued
   - Excess working capital is usually put in escrow pending A/R collections
   - 90-day working capital true up period

k. Add back value of non-business assets (land, investments)

l. Earnings capitalization method assumes "debt free" calculation
   - Long term debt is deducted from net value calculation (including leases)
   - Short term debt is deducted from working capital adjustment

m. "Can I afford the payments" calculation exercise
   - Prepare projected cash flow and debt service calculations

n. Lookback true-up on work in progress backlog is standard
  - One year is common – but longer is significant long-term job
  - Purchase price is adjusted up or down depending on final profit
  - Usually some amount held in escrow (equal to POC backlog gross profit)

o. Use of "Earn Out" provision is popular in acquisition or redemption
  - Eliminates some risk for lack of work
  - Tied to key employee retention
  - Generally based on cumulative EBITDA target 3-year or 5-year

p. Consider golden handcuffs for key employees post transaction
  - Employment 3 years after sale will share "pool" of funds set aside in purchase price
  - Deferred bonus or phantom stock
  - Newco ownership participation

q. Consider <u>tag-a-long</u> type provision in a buy/sell stock redemption valuation
  - If company is re-sold subsequent to valuation transaction (3 to 5 years)
  - Allows participation in subsequent windfall – "fairness provision"

Davidson Contractors			**12/31/2024**				
Purchase / Sale Valuation - Earnings Capitalization Method							
Adjusted EBITDA Computation		Year Ended	Year Ended	Year Ended	Year Ended	Year Ended	
		9/30/2020	9/30/2021	9/30/2022	9/30/2023	9/30/2024	
Net Income (loss) pre-tax		$ 1,000,000	$ 1,300,000	$ 4,750,000	$ 5,290,000	$ 7,350,000	
Additions to net income							
Excess comp to owners (> $300k each)		260,000	240,000	360,000	1,500,000	650,000	
Related party rent paid in excess of FMV		80,000	80,000	90,000	100,000	100,000	
Depreciation		2,470,000	2,410,000	3,320,000	3,480,000	3,510,000	
Less capex (actual annual replacement)		(2,000,000)	(1,500,000)	(2,100,000)	(2,400,000)	(2,000,000)	
Interest expense		42,000	42,500	16,000	18,000	2,200	
Loss on sale of fixed assets		-	-	140,000	-	-	
Other nonrecurring expenditures		85,000	-	-	-	-	
Net additions to income		937,000	1,272,500	1,826,000	2,698,000	2,262,200	
Deductions from net income							
Investment and interest income		(4,780)	(2,470)	(17,000)	(25,000)	(46,500)	
Gain on sale of assets - nonrecurring		(162,761)	(249,136)	-	(61,867)	(81,172)	
Contract WIP adjustment				(400,000)	(400,000)	(400,000)	(1,200,000)
Other nonrecurring income - ERC		-	-	(800,000)	-	-	
Other nonrecurring income - SBA PPP loan		-	(1,200,000)	-	-	-	
Net deductions from income		(167,541)	(1,451,606)	(1,217,000)	(486,867)	(527,672)	
Less contingency discount	0%	-	-	-	-	-	
Estimated Normalized EBITDA, net of capex		$ 1,769,459	$ 1,120,894	$ 5,359,000	$ 7,501,133	$ 9,084,528	
		5-Year	3-Year				
Average EBITDA		**$ 4,967,003**	**$ 7,314,887**				
Weighted Average EBITDA		**$ 6,367,695**	**$ 7,935,808**				

Davidson Contractors			**12/31/2024**		Page 2	
Valuation - Excess Working Capital						
Excess tangible working capital computation:						
Reported working capital		$ 14,850,000	9/30/2024	Adjust at closing		
Add (Deduct) Adjustments:						
Add current portion of debt		$ 250,000				
Inventory valuation adjustment		$ -	Adjust at closing		Net O/B	Backlog
Contract WIP adjustment	5%	(1,200,000)	(Adjustment to net deferral)		$ 1,800,000	$ 60,000,000
Deduct prepaid expenses and soft assets		(150,000)				
Unrecorded liabilities - contingency	0%	-	(24-month escrow)			
Off balance sheet tax liabilities		-	(internal valuation only)			
Tangible working capital		13,750,000				
Less working capital target	7.0%	(5,740,000)	Trailing 12-month		Annual revenue	$ 82,000,000
Excess working capital retained by Sellers		$ 8,010,000				

Davidson Contractors													
Trailing 12-Months Working Capital Calculation													
	January	February	March	April	May	June	July	August	September	October	November	December	Average
Current Assets	8,550,000	8,550,000	8,550,000	8,550,000	8,550,000	8,550,000	8,550,000	8,550,000	8,550,000	8,550,000	8,550,000	8,550,000	8,550,000
Current Liabilities	(4,000,000)	(4,000,000)	(4,000,000)	(4,000,000)	(4,000,000)	(4,000,000)	(4,000,000)	(4,000,000)	(4,000,000)	(4,000,000)	(4,000,000)	(4,000,000)	(4,000,000)
Working Capital - As Reported	4,550,000	4,550,000	4,550,000	4,550,000	4,550,000	4,550,000	4,550,000	4,550,000	4,550,000	4,550,000	4,550,000	4,550,000	4,550,000
Less:													
Cash & equivalents	(2,500,000)	(2,500,000)	(2,500,000)	(2,000,000)	(2,000,000)	(2,000,000)	(2,000,000)	(2,000,000)	(2,000,000)	(2,300,000)	(2,300,000)	(2,300,000)	(2,200,000)
Excluded A/R	-	-	-	-	-	-	-	-	-	-	-	-	
Tax deposits and credits													
Other	-	-	-	-	-	-	-	-	-	-	-	-	
Add:													
Current debt	150,000	150,000	150,000	150,000	150,000	150,000	150,000	150,000	150,000	150,000	150,000	150,000	150,000
Tax liabilities													
Other													
Working Capital - Adjusted	2,200,000	2,200,000	2,200,000	2,700,000	2,700,000	2,700,000	2,700,000	2,700,000	2,700,000	2,400,000	2,400,000	2,400,000	2,500,000
Additional information:													
Retainage receivable	1,200,000	1,200,000	1,200,000	1,200,000	1,200,000	1,200,000	1,200,000	1,200,000	1,200,000	1,200,000	1,200,000	1,200,000	1,200,000
Retainage payable to subs	1,350,000	1,350,000	1,350,000	1,350,000	1,350,000	1,350,000	1,350,000	1,350,000	1,350,000	1,350,000	1,350,000	1,350,000	1,350,000
Net retainage	(150,000)	(150,000)	(150,000)	(150,000)	(150,000)	(150,000)	(150,000)	(150,000)	(150,000)	(150,000)	(150,000)	(150,000)	(150,000)

Davidson Contractors				Page 3	
Purchase / Sale Valuation - Earnings Capitalization Method					
Earnings Capitalization Valuation 5-Year	6.5x EBITDA	7.0x EBITDA	8.0x EBITDA		
EBITDA	**$ 6,367,695**	**$ 6,367,695**	**$ 6,367,695**	Weighted	
Cap rate - years	6.5	7.0	8.0		
Earnings Capitalization	**41,390,015**	**44,573,862**	**50,941,557**	Purchase price	
Add excess working capital	8,010,000	8,010,000	8,010,000	9/30/2024	Adjust at closing
Less installment note balance	(1,000,000)	(1,000,000)	(1,000,000)	9/30/2024	Adjust at closing
Valuation - debt free	**48,400,015**	**51,583,862**	**57,951,557**		
Earnings Capitalization Valuation 3-YEAR	6.5x EBITDA	7.0x EBITDA	8.0x EBITDA		
EBITDA	**$ 7,935,808**	**$ 7,935,808**	**$ 7,935,808**	Weighted	
Cap rate - years	6.5	7.0	8.0		
Earnings Capitalization	**51,582,754**	**55,550,658**	**63,486,467**	Purchase price	
Add excess working capital	8,010,000	8,010,000	8,010,000	9/30/2024	Adjust at closing
Less installment note balance	(1,000,000)	(1,000,000)	(1,000,000)	9/30/2024	Adjust at closing
Valuation - debt free	**58,592,754**	**62,560,658**	**70,496,467**		

Davidson Contractors
Valuation Summary / Goodwill Calculation

	6.5x EBITDA	7.0x EBITDA	8.0x EBITDA
Valuation Summary - 5-Year	6.5x EBITDA	7.0x EBITDA	8.0x EBITDA
Valuation - Earnings Cap Method	$ 41,390,015	$ 44,573,862	$ 50,941,557
Valuation - ABV	$ (30,940,000)	$ (30,940,000)	$ (30,940,000)
Goodwill (intangible value)	$ 10,450,015	$ 13,633,862	$ 20,001,557
Goal <50%	25.25%	30.59%	39.26%
Valuation Summary - 3-Year	6.5x EBITDA	7.0x EBITDA	8.0x EBITDA
Valuation - Earnings Cap Method	$ 51,582,754	$ 55,550,658	$ 63,486,467
Valuation - ABV	$ (30,940,000)	$ (30,940,000)	$ (30,940,000)
Goodwill (intangible value)	$ 20,642,754	$ 24,610,658	$ 32,546,467
Goal <50%	40.02%	44.30%	51.27%

Davidson Contractors

Post-Closing Projection

Growth	3%	2024	2025	2026	2027	2028	5-Year Total	2029	2030	2031	2032	2033	10-Year Total
Revenue		$ 80,000,000	$ 82,400,000	$ 84,872,000	$ 87,418,160	$ 90,040,705	$ 424,730,865	$ 92,741,926	$ 95,524,184	$ 98,389,909	$ 101,341,607	$ 104,381,855	$ 917,110,345
Direct costs		(71,063,858)	(73,195,773)	(75,391,647)	(77,653,396)	(79,982,998)	$ (377,287,671)	(82,382,488)	(84,853,962)	(87,399,581)	(90,021,569)	(92,722,216)	$ (814,667,487)
Gross profit	11.17%	8,936,142	9,204,227	9,480,353	9,764,764	10,057,707	47,443,194	10,359,438	10,670,221	10,990,328	11,320,038	11,659,639	102,442,858
Add operational synergies		-	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
G&A overhead	3.14%	(2,514,258)	(2,589,685)	(2,667,376)	(2,747,397)	(2,829,819)	(13,348,535)	(2,914,714)	(3,002,155)	(3,092,220)	(3,184,986)	(3,280,536)	$ (28,823,145)
G&A expense reduction		-	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Net income		$ 6,421,885	$ 6,614,541	$ 6,812,978	$ 7,017,367	$ 7,227,888	34,094,659	$ 7,444,725	$ 7,668,066	$ 7,898,108	$ 8,135,052	$ 8,379,103	73,619,713
Less tax provision	35%	(2,247,660)	(2,315,089)	(2,384,542)	(2,456,078)	(2,529,761)	(11,933,131)	(2,605,654)	(2,683,823)	(2,764,338)	(2,847,268)	(2,932,686)	$ (25,766,899)
Add Tax Benefit - goodwill		667,582	667,582	667,582	667,582	667,582	3,337,910	667,582	667,582	667,582	667,582	667,582	$ 6,675,820
Add Tax Benefit - depreciation		6,020,000	-	-	-	-	6,020,000	-	-	-	-	-	$ 6,020,000
Net income after-tax		$ 10,861,807	$ 4,967,034	$ 5,096,017	$ 5,228,871	$ 5,365,709	$ 31,519,438	$ 5,506,653	$ 5,651,825	$ 5,801,352	$ 5,955,366	$ 6,113,999	$ 60,548,634
Less annual capex		$ -	$ (3,000,000)	$ (3,090,000)	$ (3,182,700)	$ (3,278,181)	$ (12,550,881)	$ (3,376,526)	$ (3,477,822)	$ (3,582,157)	$ (3,689,622)	$ (3,800,310)	$ (30,477,318)
Add back depreciation		$ 6,142,857	$ 6,142,857	$ 6,142,857	$ 6,142,857	$ 6,142,857	$ 30,714,286	$ 6,142,857	$ 6,142,857	$ 6,142,857	$ 6,142,857	$ 6,142,857	$ 61,428,571
Cash flow before debt service		$ 17,004,664	$ 8,109,891	$ 8,148,875	$ 8,189,028	$ 8,230,385	$ 49,682,843	$ 8,272,984	$ 8,316,860	$ 8,362,053	$ 8,408,601	$ 8,456,546	$ 91,499,887
Debt service (10-year amort)		$ (7,283,654)	$ (7,283,654)	$ (7,283,654)	$ (7,283,654)	$ (7,283,654)	$ (36,418,271)	$ (7,283,654)	$ (7,283,654)	$ (7,283,654)	$ (7,283,654)	$ (7,283,654)	$ (72,836,543)
Net cash flow		$ 9,721,010	$ 826,237	$ 865,220	$ 905,373	$ 946,731	$ 13,264,572	$ 989,329	$ 1,033,206	$ 1,078,398	$ 1,124,947	$ 1,172,892	$ 18,663,344
Projected cash flows before debt		$ 17,004,664	$ 8,109,891	$ 8,148,875	$ 8,189,028	$ 8,230,385		$ 8,272,984	$ 8,316,860	$ 8,362,053	$ 8,408,601	$ 8,456,546	$ 91,499,887
Discounted cash flows	7.5%	10-year	$ 64,811,540										
Discounted cash flows	7.5%	7-year	$ 51,634,066										

Davidson Contractors					
Post-Closing Projection					
Debt service (ROI) Calculation		6.5x EBITDA	7.0x EBITDA	8.0x EBITDA	
Purchase price 3-year EBITDA		$ 51,582,754	$ 55,550,658	$ 63,486,467	
Downpayment	10%	$ (5,158,275)	$ (5,555,066)	$ (6,348,647)	
Post-closing capex		$ -	$ -	$ -	Add one-time capex post-closing
Less sale of excess assets		$ -	$ -	$ -	Proceeds from sale
Loan or capital invested		$ 46,424,479	$ 49,995,593	$ 57,137,820	
Cost of Capital - ROI	7.5%	7.50%	7.50%	7.50%	
Annual payment	10-yr	$ 6,763,393	$ 7,283,654	$ 8,324,176	
Tax benefits - Rough estimate		Assume 5x		Assume 7x	
Depreciable assets FMV		$ 43,000,000	**Goodwill**	$ 28,610,658	
40% bonus - pending 2024		$ 17,200,000	Annual 15-yr	$ 1,907,377	
Tax rate		35%		35%	
Tax benefits		$ 6,020,000		$ 667,582	

Davidson Contractors			
Contingent Earn-Out Payment - Illustration Only			
Total cash to Seller (purchase price at closing)	Assume 7x		$ 55,550,658
Post closing operations	Actual EBITDA		
Year-1	$ 8,000,000		
Year-2	$ 6,000,000		
Year-3	$ 10,000,000		
Total cumulative EBITDA during earnout period		24,000,000	
Less payback of investment to Buyer			
Annual EBITDA (less cap-ex) goal	$ 6,367,695		
Earnout period - years	3		
Cumulative EBITDA goal during earnout period		$ (19,103,084)	
Excess EBITDA during earnout period		$ 4,896,916	
Earnout percentage payable to Seller		50%	
Earnout payable to Seller after Year-3 (90-days after YE)	No cap		$ 2,448,458
Total cash to Seller after Earnout Period from Buyer			$ 57,999,116
Total proceeds to Seller - purchase price and earnout			
Purchase price	$ 55,550,658		
Excess working capital at closing less debt	$ 7,010,000		
Received at closing	$ 62,560,658		
Earnout - contingent payment 3-years after closing	$ 2,448,458		
Total proceeds to Seller assuming Earnout	$ 65,009,116		

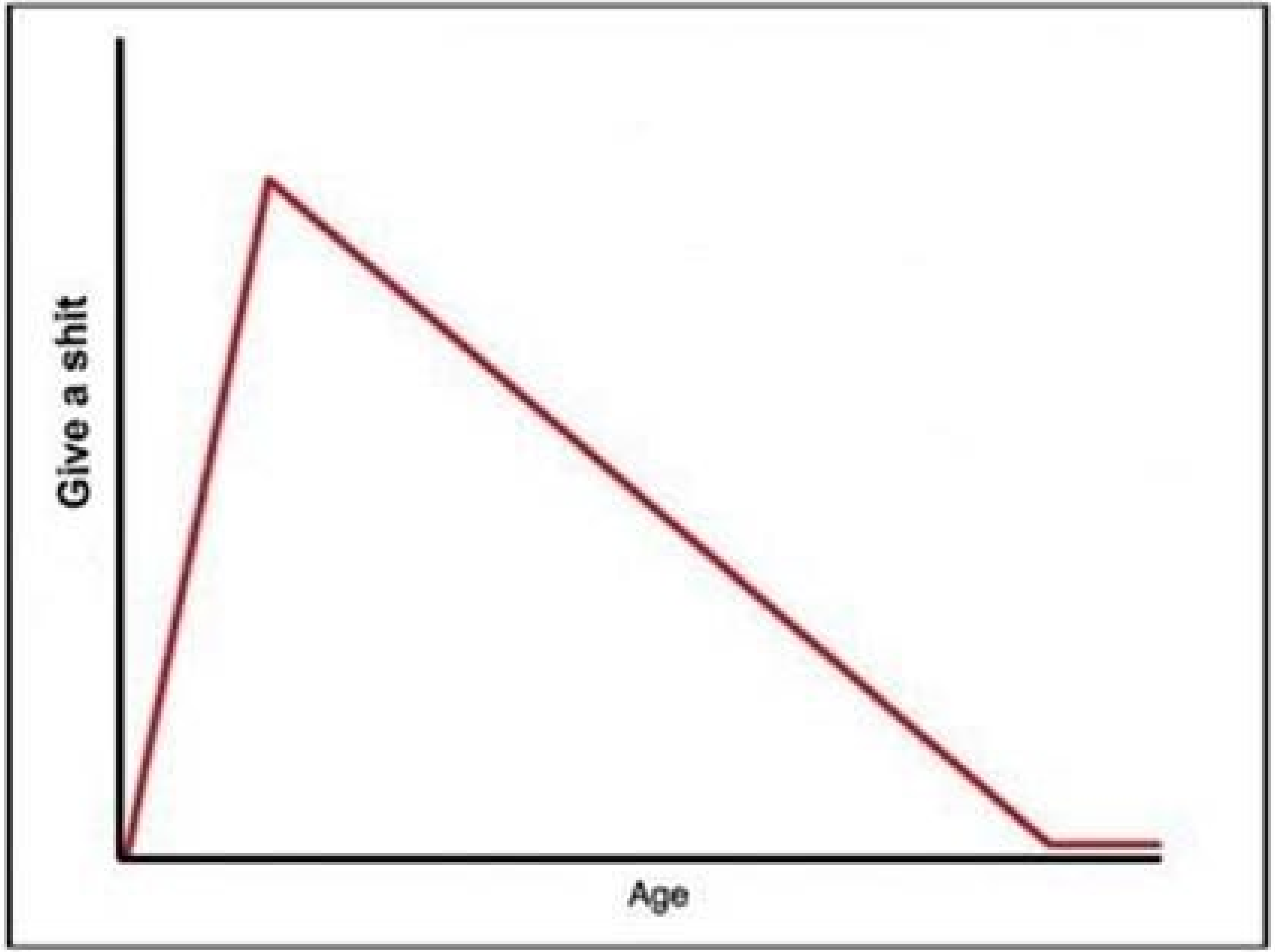
Construction Compnay, Inc.														
Contract Lookback True-Up Calculation		1	2	3	4	5	6	8	9	10	11	12		
For the Period from 6/30/25 (closing)				(1 - 2)	(3/1)		(1 x 12)		(6 - 7 - 8)	(6 - 5)	(5 - 6)	(8 / 2)		
	to 10/31/25 (true-up)				Estimated							Cost to Cost		
		Contract	Total Estimated	Estimated	Gross Profit	Billings	Revenue	Cost	Gross Profit			%		
No.	Description / Type / Location / Owner	Amount	Cost	Gross Profit	Percentage	at closing	Recognized	at closing	to Date	Underbilling	Overbilling	Completion		
Contract WIP as Reported at Closing as of 6/30/25														
1801	Completed Gain Job	1,000,000	800,000	200,000	20.00%	900,000	750,000	600,000	150,000	-	150,000	75.00%		
1802	Completed Fade Job	1,000,000	800,000	200,000	20.00%	400,000	500,000	400,000	100,000	100,000	-	50.00%		
1803	WIP gain job	1,000,000	800,000	200,000	20.00%	700,000	600,000	480,000	120,000	-	100,000	60.00%		
	WIP - as reported at closing	3,000,000	2,400,000	600,000		2,000,000	1,850,000	1,480,000	370,000	100,000	250,000			
														True-up
		REVISED ESTIMATES AT 10/31/25			Estimated		**REVISED**		**REVISED**			Cost to Cost	Gross Profit	Profit
				Estimated	Gross Profit	Billings	Revenue	Cost	Gross Profit			%	Recognized	Increase
		Amount	Cost	Gross Profit	Percentage	at closing	Recognized	at closing	at True-up	Underbilling	Overbilling	Completion	at closing	(Decrease)
Contract WIP adjusted for final (or WIP) Contract Gross Profit at 10/31/25														
1801	Completed Gain Job	1,100,000	800,000	300,000	27.27%	900,000	825,000	600,000	225,000	-	75,000	75.00%	150,000	$ 75,000
1802	Completed Fade Job	1,000,000	1,100,000	(100,000)	-10.00%	400,000	363,636	400,000	(36,364)	-	36,364	36.36%	100,000	(136,364)
1803	WIP Fade job	1,200,000	1,100,000	100,000	8.33%	700,000	523,636	480,000	43,636	-	176,364	43.64%	120,000	(76,364)
	WIP - Lookback True-up 90-days 8/3	3,300,000	3,000,000	300,000		2,000,000	1,712,273	1,480,000	232,273	-	287,727		370,000	(137,727)
									U/O change	(100,000)	(37,727)			
Contract Lookback True-Up - Adjustment									Net		(137,727)			
6/30/25 (closing) to 10/31/25 (true-up)		Revenue	Total											
		Recognized	Cost	Gross Profit										
Contract WIP True-up at 10/31/25 - lookback		1,712,273	1,480,000	232,273										
Contract WIP at closing - As Reported		(1,850,000)	(1,480,000)	(370,000)										
	Increase (decrease) to working capital	(137,727)	-	(137,727)										
	Contract WIP adjustment bucket / dimin	370,000	10.0%	37,000										
	Adjustment to purchase price for working capital true-up			**$ (100,727)**										

Final Seminar Parting Thoughts from Robert Davidson
Bonus Best Practices

a. **Be Positive and Enthusiastic.**
   "If you act enthusiastic, you'll be enthusiastic and so will the people around you!"
   – Dale Carnegie
b. **Give back to Community, Charity, Civic, Church, Industry & CPA Profession.**
c. **Pay your taxes. Your clients or company would be out of business, and you wouldn't have a job if no one paid their taxes. Quit complaining about taxes and the IRS.**
d. **Grab the check. I never bought a lunch that didn't come back to me.**
e. **Tell the truth. Honesty and integrity are the best ingredients for success.**
f. **"Work" is anything you have to do…**
   "Fun" is anything you want to do…
   Always have fun.


2
+2
7
Audit CPA-
What is 2+2? It depends...
what do you want it to be?
LEO CULLUM

Thank you!


Give a shit
Age