IOWA SOCIETY OF CPAs

Construction Industry – Financial Reporting, Audit/Review Procedures, Internal Control Best Practices and Taxation

2026

Iowa Society of CPAs
Professional Education

Construction Industry: Financial Reporting, Auditing & Taxation



Session 2 — 2026

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Agenda

Financial Reporting & Taxation – 2026

1. Session 1 – Construction Industry Accounting & Financial Overview
2. Session 2 – Construction Financial Reporting, Disclosures and Benchmarking
3. Session 3 – Audit, Review and Analytical Procedures Unique to Contractors
4. Session 4 – Construction Taxation



Session 1

Construction Industry Overview

Construction Industry Trends, Developments and Interesting "Stuff"

CONSTRUCTION INDUSTRY BASICS

RISK PROFILE
2nd riskiest business in America

DEFINITION
"Making or providing improvements to real property"

SCOPE
GAAP applies to long-term contracts —building a ship, Manufacturing Conveyors lines, software, etc.

CONTRACTOR SURVIVAL RATES • U.S. SMALL BUSINESS ADMINISTRATION

74.3%
survive 1 year

33.2%
survive 5 years

24.8%
survive 10 years

PROFITABILITY TRENDS (CFMA Survey — reported through 2024; 2025 projected)

2015–2025
Record net income across the industry

2021–2022
Temporary dip — Covid, supply chain, inflation

2023–2025p
All-time record profits — continuing; 2025 projected

WORKFORCE EFFICIENCY (record highs)

$514,587
Revenue per FTE — record high

$83,554
Gross profit per FTE — record high

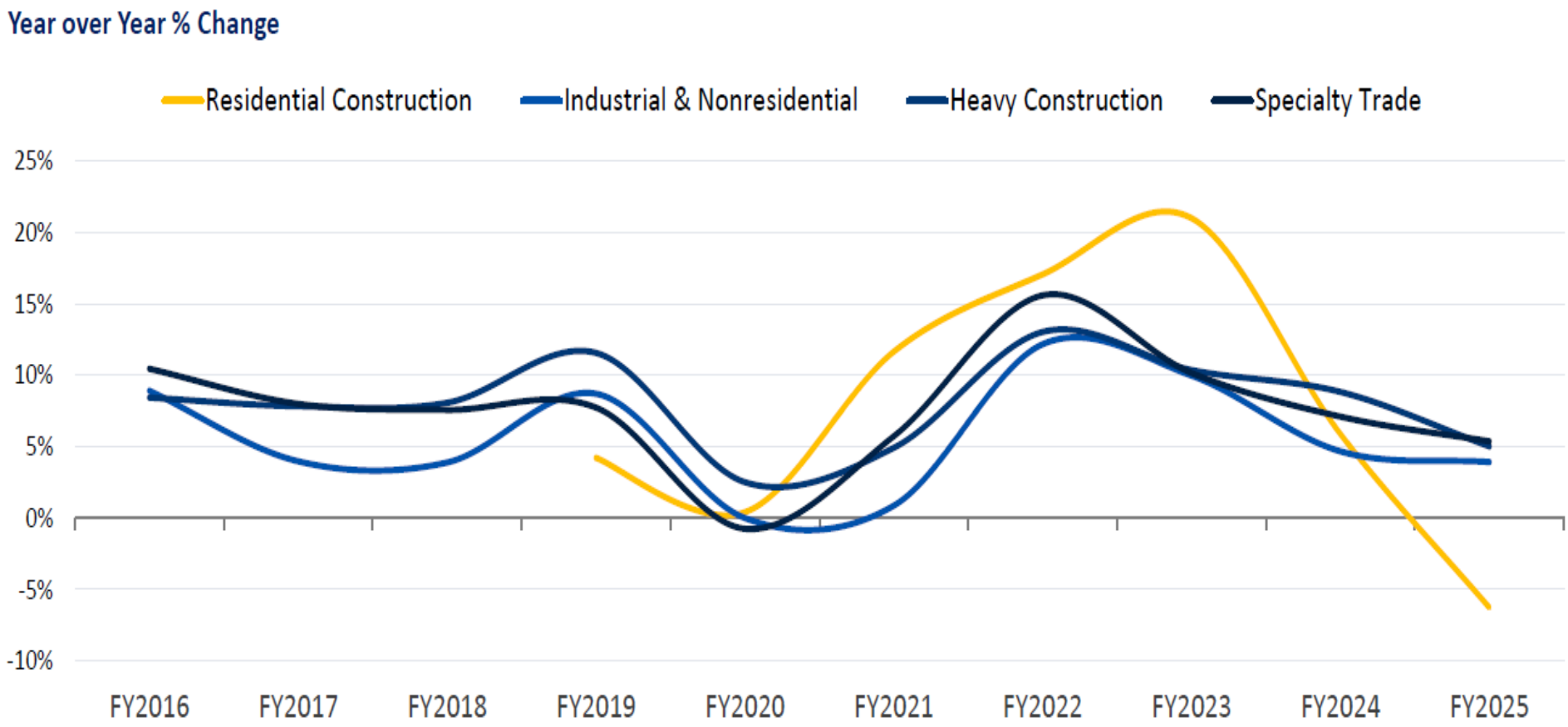
Records hold even after inflation — above the mid-$60K profit and mid-$400K revenue levels of the past decade

The last 10-years have been the most profitable construction period ever

Sales Growth

Growth moderated in FY2025, with Residential moving negative.

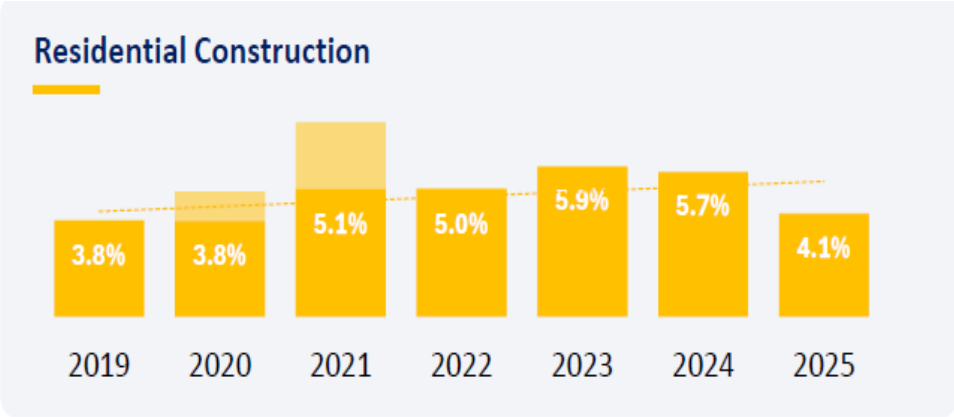
2026 BENCHMARKER SURVEY RESULTS

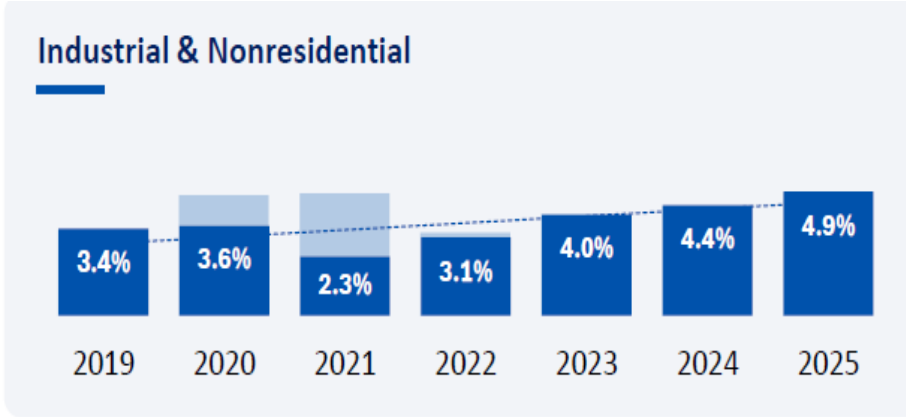


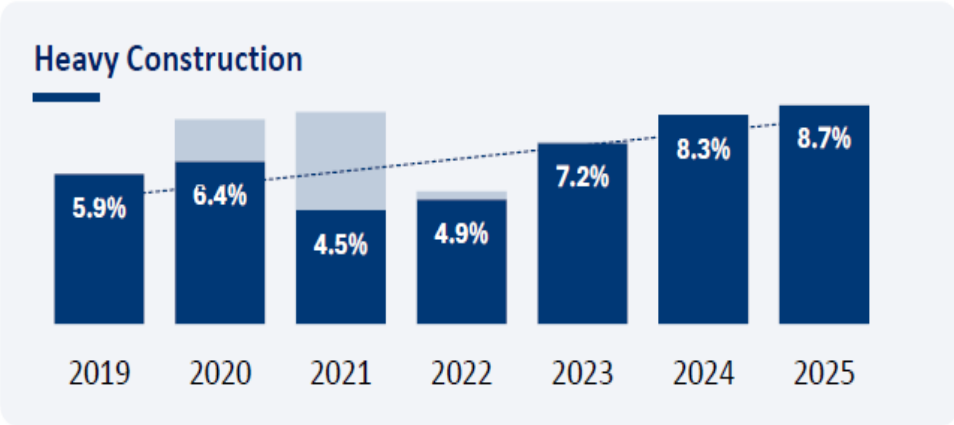
Source: CFMA, 2026 Benchmarker Survey Results, p. 18. cfma.org

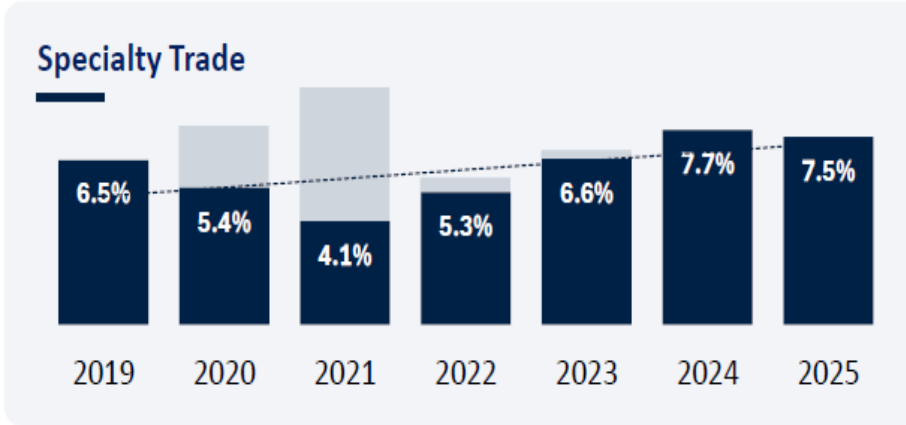
Net Income before Tax (% of Total Revenue)

2026 BENCHMARKER SURVEY RESULTS









Light-colored bars reflect values that include Paycheck Protection Program (PPP) Loans and/or Employee Retention Credits (ERTCs), where applicable.

Source: CFMA, 2026 Benchmarker Survey Results. cfma.org

Publicly Traded Construction Company Stock Analysis

Stock prices as of July 28, 2026 • Pre-Covid baseline 3/1/2020

Company	Symbol	52-Wk High	Close 7/28/26	Pre-Covid 3/1/20	77-Mo Incr/(Decr)	77-Mo Change %	P/E Ratio	EV/ EBITDA*	EPS	Div Yield	Debt/ Equity	Levered Free TTM CF ($M)
HEAVY HIGHWAY												
Granite Construction	GVA	$162.08	$121.85	$17.50	$104.35	596.3%	33.20	12.63	$3.67	0.41%	129.13%	$127.46
Construction Partners (CPI)	ROAD	$151.00	$106.14	$17.27	$88.87	514.6%	46.31	17.42	$2.29	0.00%	188.43%	$70.02
Knife River	KNF	$96.28	$78.94	$36.48	$42.46	116.4%	30.72	12.01	$2.57	0.00%	95.10%	$(42.73)
Sterling Infrastructure, Inc.	STRL	$1,005.68	$528.95	$9.76	$519.19	5,319.6%	47.24	32.72	$11.17	0.00%	28.63%	$346.89
Martin Marietta	MLM	$710.97	$583.72	$238.75	$344.97	144.5%	36.55	19.02	$15.96	0.58%	50.35%	$841.75
Vulcan Materials	VMC	$331.09	$288.16	$127.44	$160.72	126.1%	34.03	17.56	$8.45	0.73%	61.25%	$244.39
Oldcastle	CRH	$131.55	$103.56	$34.31	$69.25	201.8%	19.21	11.00	$5.39	1.52%	83.23%	$786.12
Cardinal Infrastructure**	CDNL	$96.40	$60.25	$21.00	$39.25	186.9%	44.64	17.57	$1.35	0.00%	86.94%	$(28.57)
Heavy Highway Subtotal			**$1,871.57**	**$502.51**	**$1,369.06**	**900.8%**	**36.49**	**17.49**				
GENERAL CONTRACTORS												
Emcor Group	EME	$951.96	$706.13	$76.95	$629.18	817.6%	23.71	16.17	$29.78	0.22%	13.35%	$891.52
MasTec, Inc.	MTZ	$441.43	$312.23	$28.50	$283.73	995.5%	54.49	24.16	$5.73	0.00%	88.05%	$12.57
Fluor	FLR	$57.50	$49.32	$8.85	$40.47	457.3%	22.52	11.00	$2.19	0.00%	36.29%	$345.12
Skanska	SKBSY	$31.50	$27.74	$22.50	$5.24	23.3%	16.91	9.60	$1.64	5.49%	25.14%	$2,034.00
AECOM	ACM	$135.52	$74.44	$44.78	$29.66	66.2%	15.54	8.73	$4.79	1.68%	135.21%	$443.98
Tutor Perini	TPC	$100.00	$81.96	$13.57	$68.39	504.0%	56.13	13.54	$1.46	0.28%	36.84%	$665.89
Orion Group Holdings	ORN	$17.40	$11.92	$5.31	$6.61	124.5%	54.18	15.49	$0.22	0.00%	78.50%	$(4.76)
General Contractors Subtotal			**$1,263.74**	**$200.46**	**$1,063.28**	**426.9%**	**34.78**	**14.10**				
EQUIPMENT COMPANIES												
Caterpillar	CAT	$1,073.46	$840.85	$121.41	$719.44	592.6%	41.85	29.38	$20.00	0.75%	230.79%	$3,780.00
Komatsu Ltd.	KMTUY	$52.74	$41.59	$19.68	$21.91	111.3%	16.44	9.48	$2.53	2.86%	38.49%	–
Astec	ASTE	$65.69	$54.89	$36.32	$18.57	51.1%	49.01	15.43	$1.12	0.93%	57.94%	$2.73

* "EV / EBITDA" formula: [(Total market capitalization + debt – excess cash) ÷ EBITDA].

** Cardinal Infrastructure IPO on 12/10/25 – new Raleigh, NC civil contractor roll-up.

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

DECLINING

- **Retail** — online & pandemic
- **Office** — remote work
- **Religious / charity** — shrinking

GROWING

- **Healthcare & education** — strong demand
- **Warehousing & manufacturing**
- **Data centers**
- **Multi-family residential** — rents softening
- **Infrastructure / highway / Utility** — Federal +40% by 2028
- **Disaster recovery** — NC, TX, CA, TN

Watch

- **Home building**— price correction expected (8th since 1945), Certain markets are starting to level-off nationwide



Look for these trends and developments

Workforce & Talent

Recruiting & retaining people is still the #1 issue

- Incentives, deferred bonuses, benefits & workplace upgrades are critical
- Employee ownership trending – stock, co, phantom stock, equity "Talent Retention"
- ESOPs are not for every contractor—highly effective in the right circumstances

Possible Slowdown in Private construction

Possible private construction pullback in 2026–2027

- Oversupply – retail, office, multi-family & hotels report lower occupancy
- Cost inflation: $1.00 = $3.23 (2003 highway index), $1.81 (2009 building index)
- Interest rates rose from 3.25% (2020) to 6.75% (2026), Rates are falling back from peak rate

M&A Consolidation

M&A activity up significantly across the industry

- Specialty trade tends to be highest focus with a level of scalable service revenue
- Self-perform diversification
- 2024/2025 was a record year, with more expected in 2026
- Driven by aging owners, no successors, owner fatigue

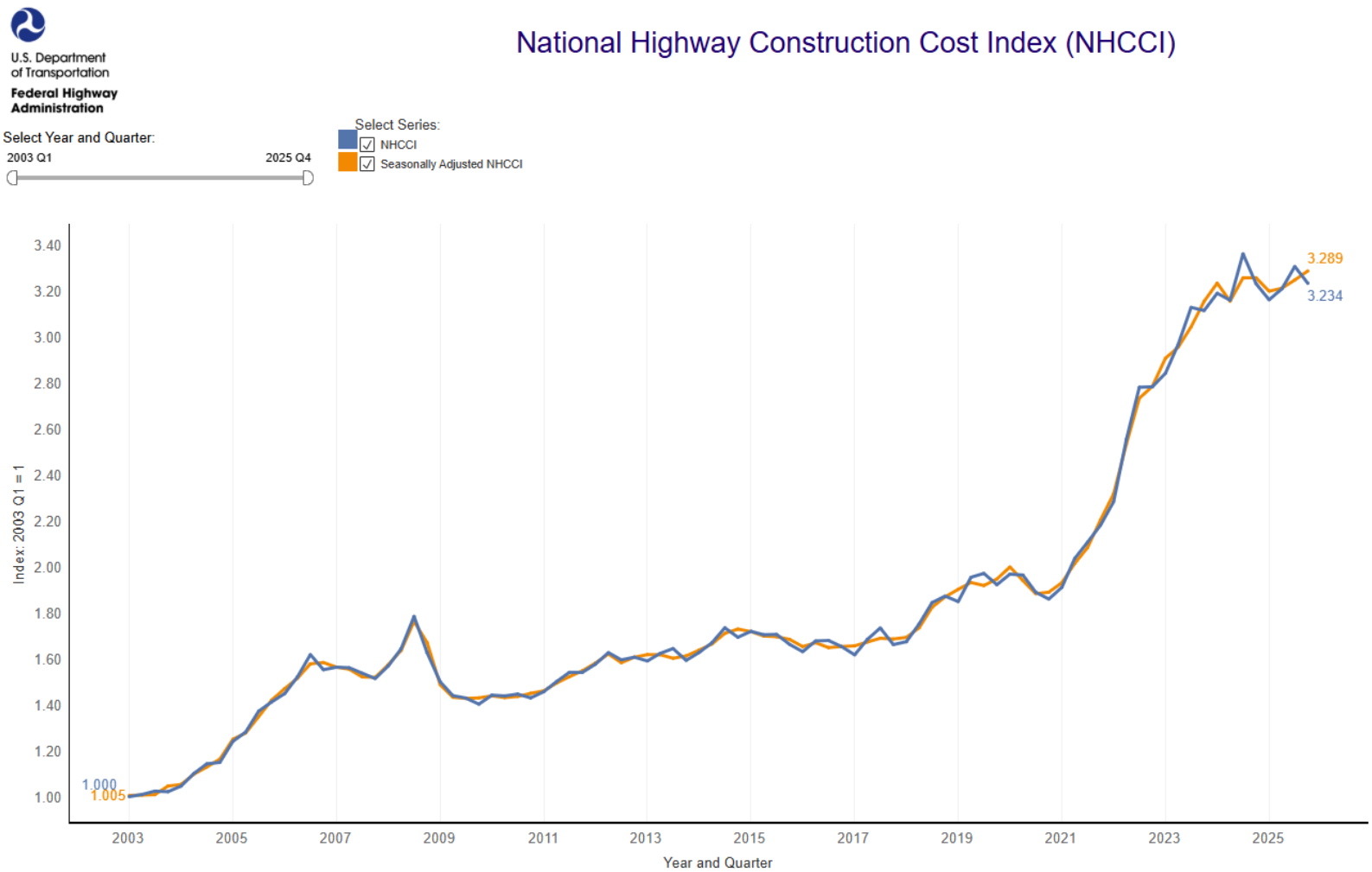
Recession & Market Risk

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

- Increase in contractor failures and surety claims – see 2025 surety results
- 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)

National Highway Construction Cost Index (NHCCI)

Highway construction costs have more than tripled since 2003, with the steepest acceleration coming after 2020.



3.2×
Index level vs. the 2003 baseline (2003 Q1 = 1.0)

~57%
Share of the total rise occurring since 2020

2003–25
Quarterly cost history tracked by the FHWA

Source: U.S. Department of Transportation, Federal Highway Administration (NHCCI), quarterly index through 2025; 2003 Q1 = 1.000. Most recent quarters are subject to revision.

ECONOMIC INDICATOR | U.S. BUREAU OF LABOR STATISTICS — PRODUCER PRICE INDEX

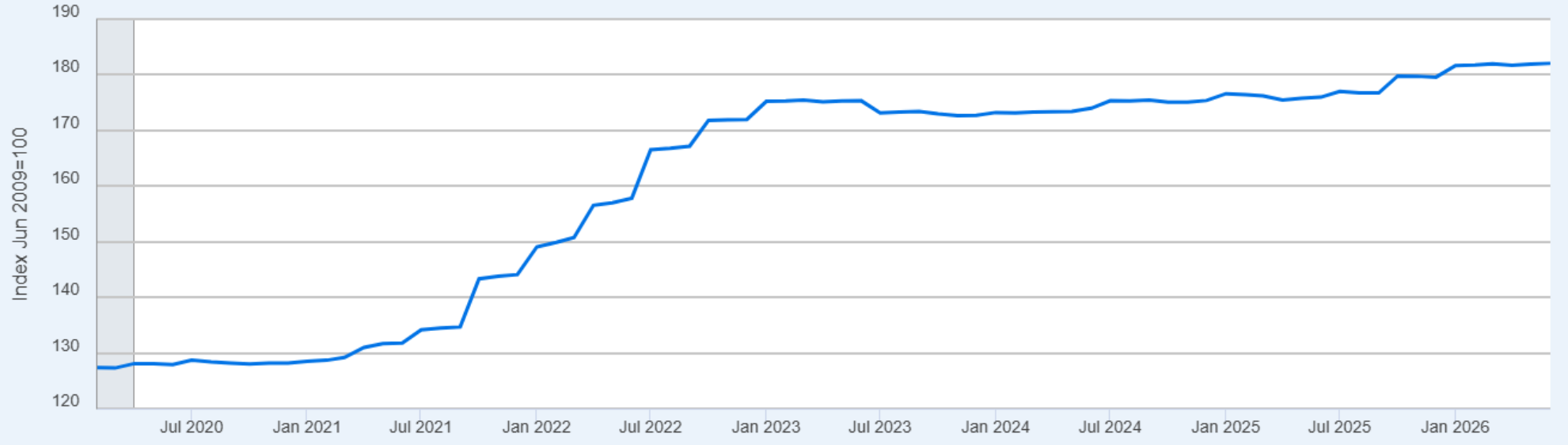
Nonresidential Building Construction Costs (PPI)

Nonresidential building construction input costs have climbed roughly 43% since mid-2020, with the steepest jump in 2021–2022 and only gradual increases since.

~43%
Rise in input costs since mid-2020 (127 → 181)

~85%
Share of the rise occurring in 2021–2022

2020–26
Monthly index tracked by BLS via FRED



Source: U.S. Bureau of Labor Statistics, Producer Price Index by Commodity via FRED® (Index, Jun 2009 = 100). Shaded areas indicate U.S. recessions.

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

Surety Bonding
Big-6: Travelers, Liberty, Chubb, Zurich, C.N.A., Hartford

Banks & Lenders
Cat Finance, Komatsu Financial

Contract Owners
Government (DOT, DOD, FHA) & private developers

Licensing Boards
Licensing and prequalification boards

GC Prequal of Subs
Subcontractor default insurance (SDI)

Owners & Investors
Contractor stockholders, members and investors

What do Contractor statement users need from the CPA, CFO and Controller?

- **Honesty and integrity**
- **Timeliness** – 60 to 90-day year-end reporting deadline; the "pandemic delay mentality" is no longer acceptable
- Internal financial reporting within **25 days**, including contract WIP
- Competency and understanding of **construction accounting GAAP** and contract WIP
- Presentation of financial statements with adequate disclosures unique to contractors
  - *Discontinue misinterpretation of ASC 606*
- Knowledge of Section 460 and other tax laws applicable to contractors
- Understanding of the Key Performance Indicators (KPI) that users of the financial statements are measuring

INDUSTRY BENCHMARK | SURETY & FIDELITY

Top 20 Writers of Surety Bonds — Calendar Year 2025

The Surety & Fidelity Association of America · U.S. & Territories, Canada & Aggregate Other Alien · Preliminary

#	Group / Company	Direct Premium Written	Market Share	Direct Premium Earned	Direct Losses Incurred*	Direct Loss Ratio	Net Premiums Earned	Net Losses Incurred	Net Loss Ratio
1	LIBERTY MUTUAL GROUP	1,449,405,745	12.4%	1,333,344,994	154,109,974	11.6%	1,232,359,737	235,012,848	19.1%
2	TRAVELERS BOND	1,424,368,525	12.2%	1,317,689,513	144,508,552	11.0%	1,259,066,751	138,885,573	11.0%
3	CNA SURETY GROUP	736,434,238	6.3%	684,853,233	106,420,490	15.5%	662,489,507	103,706,555	15.7%
4	ZURICH INSURANCE GROUP	694,711,214	6.0%	688,834,174	500,435,975	72.6%	291,212,035	93,742,405	32.2%
5	CHUBB LTD	605,162,143	5.2%	553,313,421	38,594,918	7.0%	527,599,567	8,490,743	1.6%
6	INTACT INSURANCE SPECIALTY SOLUTIONS	350,920,495	3.0%	318,505,764	34,972,116	11.0%	318,395,305	31,352,879	9.8%
7	HARTFORD FIRE & CAS GROUP	308,457,055	2.6%	284,560,039	12,012,125	4.2%	344,203,239	38,044,275	11.1%
8	MERCHANTS BONDING CO GROUP	294,127,661	2.5%	279,408,232	4,208,819	1.5%	262,809,664	6,634,893	2.5%
9	CRUM & FORSTER GROUP	249,289,310	2.1%	243,284,210	48,661,403	20.0%	238,425,242	33,841,689	14.2%
10	NATIONWIDE CORP GROUP	239,227,608	2.1%	214,941,147	60,581,915	28.2%	187,650,608	44,475,417	23.7%
11	BERKSHIRE HATHAWAY GROUP	237,894,554	2.0%	203,846,700	74,399,767	36.5%	345,071,350	88,492,896	25.6%
12	HCC SURETY GROUP	215,287,209	1.8%	205,130,106	18,783,449	9.2%	216,233,191	15,676,687	7.2%
13	SOMPO GROUP	212,828,089	1.8%	202,039,993	120,079,005	59.4%	162,409,274	39,980,860	24.6%
14	SIRIUSPOINT GROUP	207,835,824	1.8%	198,174,130	65,536,713	33.1%	62,486,662	25,944,921	41.5%
15	MARKEL SURETY	194,891,568	1.7%	183,324,174	192,345,926	104.9%	156,907,866	51,999,883	33.1%
16	SWISS RE CORPORATE SOLUTIONS	191,210,596	1.6%	182,223,904	61,841,761	33.9%	(33,049,945)	(42,373,937)	128.2%
17	PHILADELPHIA CONSOLIDATED HOLDING GROUP	183,728,453	1.6%	175,862,292	97,093,378	55.2%	157,230,541	42,875,546	27.3%
18	ALLIANZ TRADE	177,402,357	1.5%	139,091,133	64,161,321	46.1%	9,513,772	4,147,190	43.6%
19	ARCH INSURANCE GROUP	176,503,818	1.5%	179,014,110	36,228,966	20.2%	165,548,745	58,948,380	35.6%
20	SKYWARD SPECIALTY INSURANCE	168,432,281	1.4%	150,130,295	31,311,157	20.9%	143,303,445	24,336,619	17.0%

* Direct Losses Incurred. Figures in U.S. dollars; ranked by Direct Premium Written. Source: The Surety & Fidelity Association of America (SFAA), Calendar Year 2025 (Preliminary).

INDUSTRY BENCHMARK | SURETY & FIDELITY

Surety Loss Growth — Notable Carriers with Rising Loss Ratios

Direct losses incurred, calendar year 2024 vs. 2025 · Ranked by percentage increase in direct losses

Group / Company	2024 Direct Losses	2025 Direct Losses	Change	% Change	2025 Direct Loss Ratio
ZURICH INSURANCE GROUP	$146.3M	$500.4M	+$354.1M	+242%	72.6%
SOMPO GROUP	$43.6M	$120.1M	+$76.5M	+175%	59.4%
CRUM & FORSTER GROUP	$30.6M	$48.7M	+$18.1M	+59%	20.0%
BERKSHIRE HATHAWAY GROUP	$48.5M	$74.4M	+$25.9M	+53%	36.5%
CNA SURETY GROUP	$95.2M	$106.4M	+$11.2M	+12%	15.5%
LIBERTY MUTUAL GROUP	$146.5M	$154.1M	+$7.6M	+5%	11.6%
SIX CARRIERS COMBINED	**$510.7M**	**$1,004.1M**	**+$493.4M**	+97%	—

A few observations

- Zurich Insurance Group posted the sharpest deterioration — direct losses incurred rose from roughly $146 million to roughly $500 million, and its direct loss ratio jumped from 22.5% to 72.6%.
- Sompo Group losses nearly tripled, climbing from roughly $44 million to $120 million.
- Several other major writers — including Berkshire Hathaway and Crum & Forster — recorded meaningful increases in both losses and loss ratios.

Direct Losses Incurred, in U.S. dollars. Source: The Surety & Fidelity Association of America (SFAA), Calendar Years 2024 and 2025 (Preliminary).

Ten Most Common Causes of Contractor Failure

From the CFMA article (1986) by Robert Davidson & Danny Parrish

1. Poor bidding & estimating — not knowing the "true job cost"
2. Growing too fast
3. Catastrophic job loss — excessive single-job risk
4. Contracts outside your experience, expertise or region
5. High employee turnover & an inexperienced workforce
6. Inadequate capitalization & poor cash flow

   Not losing money, just ran out of cash – "I can't make payroll!")
7. Excessive litigation, job claims or legal/safety issues
8. Poor accounting system, job costing & financial discipline
9. Subcontractor (non bonded) or supplier failure (price / supply)
10. Undisciplined spending (Buying Dumb Stuff)



Session 2

Financial Reporting, Disclosures, and Benchmarking

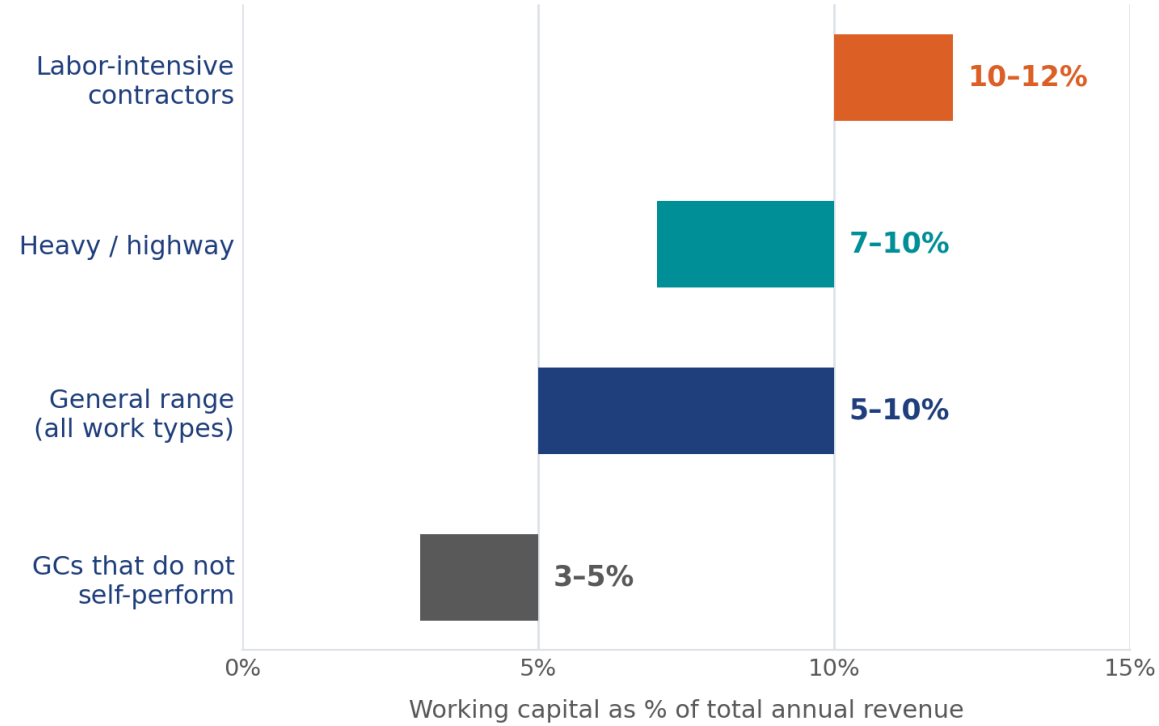
Most Common Contractor Financial Reporting Issues



1. Income not reported using cost-to-cost percentage of completion ("POC") method
2. Excessive under-billings – "Dumb or dishonest?"
3. Underbilling's include claims receivable or unapproved change orders:
   - *Variable consideration under ASC 606*
   - *Cost are included in wip*
   - *If collectability is not probable, the job needs to reflect the anticipated write down.*
4. Inadequate over-billings – reserve for collectability, profit fade, front-end loading, sub failure
5. Losses on uncompleted contract WIP not recognized 100% in-full on reporting date
6. No contract schedules (completed, WIP, reconciliation) in supplemental information
7. Indirect costs not allocated to direct job cost – excessive G&A overhead
   - *Have you benchmark G&A and GP to the industry as a sanity check?*
8. Disclaimer or qualification of opinion on WIP schedules – "mathematical malpractice"
9. Unique contractor disclosures omitted (backlog, claims, job fade, retainage, insurance reserves)
10. Distributions for pass-through tax liabilities (LLC, S-Corp) not disclosed or accrued

Working capital required to fund WIP backlog contract costs

How much working capital? (% of annual revenue)



Liquidity test

Will working capital "make payroll"?

- Self-performed backlog costs must be funded by working capital
- Cover the 30–45 day collection period
- Cash at least 5% of annual revenue (non-borrowed)
- Cash balance in excess of net over-billings on WIP

Watch out: working capital that includes a fake long-term loan – the "phony 13-month line of credit loan."

Issue: Significant under-billings and /or inadequate over-billings

Under- & over-billing red flags

- Excess under-billings are the **#1 red flag** indicator of contract risk. (>5% of total working capital)
- Dumb or dishonest? Poor cash flow (at best); job losses/fades (at worst)
- 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.

Claims or unapproved change orders

- Claim amounts that do not meet the ASC 606 **variable consideration** recognition threshold should not be included in contract assets (underbillings).
- **ASC 606 -** Claims should be recognized only to the extent that the estimated variable consideration is not **constrained** under ASC 606.
- **Surety preference (Not GAAP):** Material claims should be separately identified and adequately disclosed so users can understand the impact on contract revenue and profitability.
    - Separate presentation and disclosure is often considered **best practice**
- **Contract revenue and costs related to a claim** should generally be accounted for as part of the underlying performance obligation unless the contract modification creates a separate distinct performance obligation under ASC 606.

Issue: Investment in unrelated assets and ventures

Capital diverted from the business

- Investment of required capital in unrelated assets and ventures
- Working capital committed outside the core operation weakens bonding and borrowing capacity
- Stock market investments should be from "excess" working capital and cash only – only excess cash

- **Recommendation**: If you are a flow through entity get excess working capital out of the business to mitigate legal risk exposure.
  - Keep cash in business for bonding
  - Distribute excess
  - The business is not your bank account, it's your income generation tool to build wealth outside of the business.
  - Paying taxes means you are making money – its not always a bad thing

Distractions that drain cash

- Coal mines, marinas, farms, aircraft, boats, restaurants – dumb stuff!
- These ventures rarely relate to the contractor's core competency
- Sureties and lenders discount these assets and question management focus

Excessive inventories & prepaid expenses (discounted by Surety)

Inventories & Materials

- Best of class contractors purchase materials as needed
- No such thing as "jobsite" inventories – stored materials are job cost
- Uninstalled materials – ASC 606 - Revenue is recognized to the extent of costs – No margin (Elevator Example)
- Scrap materials returned from jobsite are not inventories "held for resale"

Pre-Contract and Contract Fulfillment Costs & Prepaids

- Prepaid assets should be reviewed periodically to ensure they continue to meet the definition of an asset and are appropriately supported. **Surety discount prepaid on the balance sheet - viewed as a dead asset**
- Pre-contract costs are generally **expensed as incurred** unless they qualify for capitalization under ASC 340-40 or ASC 606.
- Costs that would be incurred regardless of whether a contract is obtained should be expensed as incurred.
- Incremental costs of obtaining a contract may be **capitalized** when recoverable.
- Contract fulfillment costs may be capitalized only when they relate directly to a specific contract, generate or enhance resources used to satisfy performance obligations, and are expected to be recovered.

Bank Debt & Collateral

- Interest bearing bank debt above 100% of equity
- The bank has more invested than the contractor owners
- Understand and disclose bank **covenants** – could be going concern issue
- ASC 842 Leases: Impact ration that were once off balance sheet
- Determine bank collateral does not include "all receivables" – conflict with surety indemnity
- Interest bearing debt ratios vary, but generally under 50% is good. 80% if significant equipment assets.
- Total Leverage Ratio greater than 3.00 to 1.00 (too big for your britches ratio)

A/R disclosures – required by ASC 326-20-50-11

Policy & methodology

- A description of how expected loss estimates are developed
- Accounting policies and methodology used to estimate the allowance for credit losses
- Factors that influenced management's current estimate: past events, current conditions, and reasonable and supportable forecasts about the "future" **(Practical Expedient for Private companies available)**
- Risk characteristics relevant to each portfolio segment

Changes to explain

- Changes in the factors influencing the current estimate and the reasons for those changes – portfolio composition, underwriting practices, and significant events or conditions not relevant in a prior period
- Changes to accounting policies or methodology, the rationale for them, and the quantitative effect
- Reasons for significant changes in the amount of write-offs, if applicable

Other required items

- The reversion method applied for periods beyond the reasonable and supportable forecast period
- The amount of any significant purchases of financial assets during each reporting period
- The amount of any significant sales of financial assets or reclassifications of loans held for sale during each reporting period

Significant accounting policy – example disclosure *Illustrative –*

*"Accounts receivable consist of amounts due from customers under construction contracts and are stated at the amount management expects to collect, net of an allowance for expected credit losses. The Company estimates expected credit losses over the contractual life of the receivable using historical loss experience, disaggregated by delinquency status and adjusted for current conditions and reasonable and **supportable forecasts,** and considers customer creditworthiness, project status and disputed amounts. Retainage is evaluated separately, as amounts are withheld under contract terms rather than as a result of customer credit deterioration. Balances are written off when management determines collection is no longer probable; recoveries are recorded when received."*

Excerpt from ASC 326-20-50-11; disclosures are subject to materiality.

CECL practical expedient and policy election (ASU 2025-05)

The practical expedient

- Available to all entities for current accounts receivable and current contract assets arising from ASC 606 contracts
- Election to assume conditions existing at the balance sheet date persist over the life of the asset
- Removes the need to develop a reasonable and supportable forecast and a reversion method

Private company add-on

- Non-public business entities that elect the expedient may also elect to consider collections received after the balance sheet date but before the statements are issued
- This second election is not available to public business entities
- Both are accounting policy elections and should be disclosed as such

What does not change

- Still a lifetime expected credit loss model – not an exemption from CECL
- Historical loss experience and current conditions still drive the estimate
- Long-dated retainage outside current receivables should be evaluated separately
- Effective for annual periods beginning after December 15, 2025; early adoption permitted, applied prospectively

Contracts receivable – example policy election disclosure *Illustrative*

*The Company's contracts receivable balance consists of amounts due from its customers based on contracted prices. An allowance for credit losses is established for amounts expected to be uncollectible over the contractual life of the receivables. The Company calculates the allowance using an expected loss model that considers the **Company's actual historical loss rates adjusted for current economic conditions.** During 2025, the Company adopted the Financial Accounting Standards Board (FASB) Accounting Standards Update ASU No. 2025-05, Financial Instruments – Credit Losses (Topic 326): Measurement for Accounts Receivable and Contract Assets. The Company has elected the practical expedient for estimating expected credit losses on current accounts receivable and contract assets. **Under the practical expedient, the Company also adopted the accounting policy option to consider subsequent cash collections in developing expected credit loss estimates. Subsequent collections were evaluated through January 31, 2026.** The Company adopted the new guidance on January 1, 2025 on a prospective basis, and adoption of this guidance did not have a material effect on the financial statements. Uncollectible receivables are written off based on individual credit evaluation and specific circumstances of the customer in the period they are determined to be uncollectible. No allowance for credit losses or allowance for doubtful accounts has been recorded as of December 31, 2025, and no receivables have been written off in the period. Recoveries of amounts previously written off are recognized when received.*

ASU 2025-05, Measurement of Credit Losses for Accounts Receivable and Contract Assets.

Accounts receivable (disclosure issues)



- POC calculation is based on cost-to-cost; A/R and billings are less important
- Receivable disclosures are inadequate (subject to materiality)
- Open Jobs - No separation between current receivables and retainage (Contract Liability)
- Closed Jobs - Old retainage not disclosed (incorrectly netted with other contract assets/liabilities)

  Once a job completes and there is an unconditional right to consideration → retentions are moved from contract assets to A/R.
- 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**

Receivable disclosure example – credit quality & allowance

Note 3 – Accounts receivable and retainage ($000s)

Surety and Prequal Preference (Not required by GAAP

Trade accounts receivable	2025 <90 days	2025 >90 days	2025 total	2024 <90 days	2024 >90 days	2024 total
Completed contracts	350	—	350	720	100	820
Uncompleted contracts	6,380	510	6,890	14,620	490	15,110
Total trade receivables	**6,730**	**510**	**7,240**	**15,340**	**590**	**15,930**
Retainage receivable	—	—	600	—	—	2,950

Allowance for expected credit losses ($000s)

Allowance rollforward	Amount
Beginning balance	$100
Provision for expected credit losses	$50
Write-offs charged to allowance	$(30)
Recoveries	$10
Ending balance	**$130**

What makes it compliant

- Delinquency status is used as the credit-quality indicator
- Retainage is shown separately; it is withheld by contract terms, not customer credit deterioration but assessed separate as apart of CECL
- Loss rates are adjusted for current conditions and reasonable, supportable forecasts – historical rates alone are the old incurred-loss model
- No year-of-origination (vintage) table – that disclosure applies only to public business entities

CECL calculation example

Step 1 – Historical loss rate

$ in 000s	2021	2022	2023	2024	2025	Avg.
Net write-offs	130	140	5	300	90	133
Revenue	48,000	50,000	58,000	41,100	50,600	49,500
Loss rate	**0.27%**	**0.28%**	**0.01%**	**0.73%**	**0.18%**	**0.27%**

Step 2 – Adjusted rate applied to the exposure

Rate build-up	
Average historical loss rate	0.27%
Current conditions / forecast adjustment **(NOTE)**	0.01%
Credit loss rate applied	**0.28%**

Exposure ($000s)	
Trade receivables	25,000
Retainage	1,200
Contract assets	5,000
Less related-party receivables (Assessed separately)	(5,000)
Amortized cost basis in the pool	**26,200**
Expected credit loss (26,200 x 0.28%)	**74**

How it works

- Pool receivables and contract assets with similar risk characteristics.
- Derive a historical loss rate from write-offs over revenue across a full look-back period.
- Adjust for current conditions and reasonable, supportable forecasts.
- Apply the rate to the amortized cost basis at the reporting date.
- Evaluate related-party balances separately – common control means different risk.
- Retainage is included in the pool but may warrant its own rate given longer collection.
- **NOTE** – Practical Expedient removes this if adopted
- **Optional Subsequent Collections-** Can reduce A/R outstanding by subsequent collections.

Illustrative amounts only – rounded and not client specific. Method follows ASC 326-20 (loss-rate approach).

Other yellow flag risk indicators

- Inadequate contract backlog – less than 50% of annual revenue (50% coverage of fixed costs)
- Excessive contract backlog – more than 150% of annual revenue
- Excessive G&A percentage – job costs improperly charged as a period cost
- Poor indirect / equipment costing
- Non-bonded subcontractors and poor prequalification controls
- Significant bid spreads
- Fixed asset reporting – excessive useful lives and unrealistic repair capitalization
- Capitalized repair must extend useful life or increase usage capacity
- Signing bonds for other contractors
- Delayed financial statements (25-day max) and year-end audit (90-day max)

Personnel and related issues
- High key employee turnover
- No recruiting and retention plan
- Bonus program based on WIP (uncompleted) contract profits – bad internal controls

Contractor's Financial Statement Disclosures – Best Practices

Description of operations note should include:

✓ Work Profile

- **Type of work** – retail, commercial, healthcare, multi-family, infrastructure, residential, etc.
- **Geographic location of work** – consider disaggregation
- **Major customers** – disaggregation of revenue

✓ Contract Structure

- **Hard bid or negotiated**
- **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.
- **Subcontracted vs. self-performed**

✓ Capabilities & Compliance

- **Surety bonding requirements** – percentage of bonded work, collateral and other requirements (owner personal guarantee)
- **Contractor licensing and prequalification**
- **Materials manufacturing and mining** – asphalt, concrete, aggregates, steel fabrication, etc.

ASC 606 Disclosure Relief for Private Companies

What a private company may elect out of:

- Disaggregation of revenue – may present only by timing of transfer with qualitative information
- Contract balance rollforwards – opening and closing balances still required
- Remaining performance obligations (backlog) – quantitative disclosure not required
- Certain significant judgment disclosures about timing of satisfaction
- Capitalized contract cost disclosures under ASC 340-40

What still has to be disclosed

- The overall objective – nature, amount, timing and uncertainty of revenue
- Methods, inputs and assumptions used to determine the transaction price
- How variable consideration is estimated and whether it is constrained
- Material claims, unapproved change orders, incentives and liquidated damages
- Near-term uncertainty in contract estimates under ASC 275

Bottom line: the relief narrows the volume of disclosure, not the objective. If a claim or unapproved change order in the transaction price is material, the amount, its nature and status, and how the constraint was applied still belong in the notes.

Summary of Significant Accounting Policies

✓ Consolidating / Combining Information

- Subsidiaries and affiliates
- Variable interest entities (VIEs): Complex standard, but if you have control, have risk of loss, and ultimately benefit from the operations of the entity VIE standards requires consolidation
  - Common control practical expedient (private companies): elect not to apply VIE guidance to a legal entity under common control – sister entities stay unconsolidated.
    - All three criteria must be met:
    - The reporting entity and the legal entity are under common control
    - Neither is a public business entity, and neither is under common control of a public business entity
    - No controlling financial interest in the legal entity under the voting interest model
    - If elected, apply to all common-control arrangements and provide expanded related party disclosures – nature of the relationship, terms and amounts, and balances outstanding.
- 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

✓ Revenue Recognition – Percentage of Completion (POC)

- Type of contracts
- Method and calculation of the POC measure of progress - Cost to cost calculation or (tonnages or hours)
- Payment Terms
- Determination of Performance obligations
- Determining the transaction price
- Timing of performance Obligation
- Variable Consideration
- Costs to Obtain or Fulfill a Contract with a Customer
- Agency or principal role in the contract (CM Agency)
- Defined Operating Cycle when beyond 12 months
- Warranty
- Loss contract accruals

Significant Accounting Policy (Cont.)

Subsequent transactions & events

- Adjust total costs on completed contracts for amounts incurred after year-end
- Revise estimated costs to complete on WIP when subsequent costs exceed projections

Subsequent events

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

Equipment information (heavy / highway)

- Depreciable lives used for major categories – it matters
- Capitalization policies
- Impairment of long-lived assets
- Job cost allocation method

Capitalization & impairment

- Capitalization policies
- Impairment of long-lived assets



Estimates drive the numbers

Sound cost-to-complete judgment keeps the WIP schedule honest.

Tax Methods and calculation of liabilities

✓ Tax Methods and Disclosures

- Current and deferred tax for C-Corporations
- Disclosure of flow-through entity distributions for tax (S-Corporations and LLCs) – preferred, not GAAP required
- Deposits and credits paid prior to year-end
- IRS deposits held for off year end fiscal and tax years.
- Remaining distributions accrued or anticipated before 1/15 or 4/15
- Material impact to working capital and available cash?
- Uncertain tax positions (if any)

✓ Concentration Risk Disclosures

- Cash (In excess of FDIC insured funds,
- 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

Footnote Disclosures – Unique to Construction Industry

Contract Assets, Liabilities and Receivables

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

Contract Backlog (Optional under US GAAP – preferred but not required)

- Disaggregation of backlog revenue
- 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

Changes in Contract Estimates

Significant Changes in Contract Estimates ASC 250/275

- Reporting significant “fade / gain” or “lookback” impact
- Current and job-to-date adjustment related to the change in estimate
- Loss contracts and the accrued amount
- Explanation for the estimate change or loss accrual – “egg on your face”
- Anticipated completion dates for problem jobs

Illustrative disclosure Note X – Use of estimates and changes in contract estimates

The Company’s contract revenue and cost estimates require judgment and are revised as work progresses. It is at least reasonably possible that these estimates will change in the near term and that the effect could be material to the financial statements. During the year ended December 31, 20X5, revisions in estimated contract profit on contracts in progress increased (decreased) gross profit by approximately $(1,250,000), of which $(900,000) related to a single contract on which the Company encountered unanticipated site conditions and rework. Included in the revisions is a provision for estimated losses on uncompleted contracts of approximately $400,000 at December 31, 20X5. Management expects the affected contracts to reach substantial completion during 20X6.

Illustrative amounts only. Changes that already occurred are disclosed under ASC 250-10-50-4; the near-term uncertainty language comes from ASC 275-10-50-8.

Contingent Liabilities – Accrual and Disclosure

	Probable	Reasonably possible	Remote
Likelihood	Future event is likely to occur	More than remote, less than likely	Slight chance of occurring
Accrue the loss?	**Yes – if the amount is reasonably estimable**	No	No
Disclose?	**Yes – if accrued and material, or if probable but not estimable**	**Yes**	Generally no – guarantees are an exception
What to disclose	Nature of the contingency and, where needed, the amount accrued	Nature of the contingency plus an estimate of the possible loss or range, or a statement that it cannot be made	–
Unasserted claims	Accrue when assertion is probable and an unfavorable outcome is probable	Disclose when assertion is probable and an unfavorable outcome is reasonably possible	No disclosure

- If a range of loss is estimated and no amount within the range is a better estimate, accrue the low end of the range and disclose the range.
- Contingencies arising after the balance sheet date but before issuance are disclosed, not accrued, when the condition did not exist at year-end.
- Gain contingencies are not recognized until realized – avoid disclosure that implies realization is assured.
- Guarantees under ASC 460 are disclosed even when the likelihood of payment is remote – relevant to bonded work and parent guarantees.

Framework per ASC 450-20 (loss contingencies) and ASC 450-30 (gain contingencies). Summarized for discussion – not a substitute for the standard.

Pending claims or change order litigation

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

Other footnotes unique to contractors

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

Illustrative Backlog Disclosure

Note X – Backlog

The following schedule shows a reconciliation of backlog representing the amount of revenue the Company expects to realize from work to be performed on uncompleted contracts in progress at December 31, 2025 and 2024 and from contractual agreements on which work has not yet begun. Subsequent to year end, the Company entered into additional contracts with total estimated contract amounts of approximately $20,000,000. None of the estimated backlog is related to variable consideration such as unapproved change orders, claims or early completion bonuses.

	2025	2024
Balance - January 1	$ 200,000,000	$ 210,000,000
New contracts	90,000,000	105,000,000
Contract adjustments	5,000,000	5,000,000
Total	295,000,000	320,000,000
Contract revenue earned	(145,000,000)	(120,000,000)
Balance - December 31	$ 150,000,000	$ 200,000,000

Illustrative disclosure only – amounts are rounded and not client specific.

Note X – Backlog (continued)

Disaggregated contract revenue backlog and surety bonding

The disaggregated contract backlog revenue for 2025 is disclosed as follows:

Work Type	Public Highway & Road Contracts	Private Commercial Contracts	Total Contract Backlog
Asphalt Paving	$ 105,000,000	$ 12,000,000	$ 117,000,000
Grading & Excavation	16,000,000	2,000,000	18,000,000
Bridge & Concrete	13,000,000	2,000,000	15,000,000
Total Contract Backlog	**$ 134,000,000**	**$ 16,000,000**	**$ 150,000,000**

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, 2025, surety bonds for contracts totaling $280,000,000 remained outstanding on uncompleted contracts with a current backlog amount of $120,000,000.

Of the $150,000,000 backlog amount, $16,000,000 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, 2025, surety bonds from the subcontractors support approximately $12,000,000 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 $4,000,000 of non-bonded subcontractors.

Note X – Significant Changes in Contract Estimates

Fade / gain disclosure on contracts with material estimate changes

Note X – Significant Changes in Contract Estimates

During the year ended December 31, 2025, certain contracts required significant changes in estimated contract costs, costs to complete and gross profit amounts.

Contract Number	Description	Est / Actual Contract GP (Loss) 12/31/2025	Original Estimated Gross Profit 12/31/2024	Change in Contract to Date GP (Loss)	Current Year to Date GP (Loss)
2021-14	Interstate bridge – Project A*	$ 100,000	$ 250,000	$ (150,000)	$ (25,000)
2021-45	Interstate bridge – Project B*	400,000	200,000	200,000	300,000
2022-46	Highway bridge – Project C	(300,000)	400,000	(700,000)	(500,000)
2022-82	Parkway reconstruction	(20,000)	120,000	(140,000)	(80,000)
Total		**$ 180,000**	**$ 970,000**	**$ (790,000)**	**$ (305,000)**

Explanation of significant changes in contract estimates

2021-14 Contract profit fade due to failure by non-bonded guardrail subcontractor.
2021-45 Contract profit gain due to quantity overrun of high profit excavation pay item.
2022-46 Contract profit fade and loss due to bid error in mix design and liquid asphalt pricing. Contract is 90% complete at 12/31/25.
2022-82 Contract profit fade and loss due to delays caused by excessive rain and flood damage on jobsite. Contract is 62% complete at 12/31/25.

*Indicates that the contract was 100% completed and accepted at 12/31/25. For illustration purposes, all contracts were 50% complete at 12/31/24.
Illustrative disclosure only – amounts are rounded and not client specific.

Note X – Accrued Loss on Uncompleted Contract

Illustrative footnote presentation

Note X – Accrued Loss on Uncompleted Contract

The Company anticipates a loss on contract #1218-10, State DOT interstate 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. At December 31, 2025, the contract was 20% complete and is scheduled to be completed prior to the contract completion date of September 1, 2026.

The contract revenue has been adjusted to recognize the entire $150,000 estimated loss on December 31, 2025 and is reflected as an accrued loss on the balance sheet.

Illustrative disclosure only – amounts are rounded and not client specific.

Note X – Income Taxes (Surety Preferred – Not GAAP required)

Pass-through entity tax distributions and deferred taxes

The Company uses the percentage-of-completion method of reporting revenue from long-term construction contracts for financial reporting purposes and uses the Code Section 460 tax percentage-of-completion 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. The LLC passes through items of income and expense to the members each year and thus pays no federal or state income taxes itself. However, the operating agreement and prior year practices require the LLC to distribute cash to the members as capital distributions or bonuses to pay income taxes attributable to LLC earnings.

At December 31, 2025, 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 2025 pass-through income	1,984,000
Less: withholdings and estimated tax payments	(800,000)
Estimated members' current income tax liability	**$ 1,184,000**

Significant deferred tax liabilities have been created by the 100% bonus 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 at December 31, 2025 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**

Subsequent to year end, the Company distributed $1,184,000 to the members for the payment of their 2025 income tax liabilities on January 15, 2026. These distributions have been accrued in the accompanying balance sheet at December 31, 2025 and were paid as disclosed in the subsequent event footnote.

Illustrative disclosure only – amounts are rounded and not client specific.

Note X – Contract Claims (Variable Consideration)

Sample footnote – Variable Consideration - Claims and unapproved change orders recognized as a contract asset

The Company has filed two contract claims with the State DOT totaling approximately $920,000 on contracts completed in 2025. The contracts require mandatory arbitration to settle the claims and related disputes. Arbitration is scheduled for September 12-15, 2026 and a mediation is scheduled for April 2026. Management and Company legal counsel anticipate settlement of both claims at mediation but are prepared for arbitration if necessary. If the matter is settled or arbitrated in favor of the Company, payment is required within 60 days.

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

The claims represent variable consideration. Management estimated the amount to which the Company expects to be entitled using the most likely amount method and constrained that estimate to $400,000, the amount currently offered by the State DOT, because it is not probable that a significant reversal of cumulative revenue recognized would not occur for amounts above the offer. Because the Company's right to the consideration is conditional on resolution of the dispute, the amount recognized is presented as a contract asset rather than a receivable. Legal costs are expensed as incurred and are not netted against contract revenue.

	Contract 1216-3	Contract 1216-4	Total
Total claim submitted, including profit	$ 720,000	$ 200,000	$ 920,000
Less: amount constrained*	(420,000)	(100,000)	(520,000)
Included in the transaction price – contract asset	**$ 300,000**	**$ 100,000**	**$ 400,000**
Memo: costs incurred on claim-related work	645,000	175,000	820,000
Memo: estimated legal costs, expensed as incurred	45,000	25,000	70,000

*The constrained amount is not a discount for conservatism. It represents claim consideration that does not currently meet the constraint on variable consideration and will be recognized in the period the constraint is resolved. Management continues to pursue the full claim amount.

Illustrative disclosure only – amounts are rounded and not client specific.

Benchmarking Best Practices

Every contractor should develop their own unique benchmarking analytics

Financial strength	Contract performance	Equipment	People and safety
• Working capital • Tangible working capital • Debt ratios • Equity as a % of revenue or Backlog • Revenue and GP per FTE	• Under / over billings • Contract profit fade / gain • Bid spreads • Gross profit percentage • Open and Closed gross profit trends	• Equipment ratios • Equipment usage and utilization rates	• Employee turnover • Safety metrics

Putting the benchmarks to work

- Meet with the surety to discuss the key analytics and benchmarks they track
- Compare results to industry averages such as CFMA
- Compare to "yourself" – tracking your own improvement is best practice
- Build sample benchmark schedules and repeat them each year

Construction Company, Inc. — Benchmarking & KPIs

Balance Sheet

Benchmarking

Balance Sheet	Goal	12/31/2025	12/31/2024	12/31/2023	12/31/2022
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 & KPIs

Operations

Benchmarking

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 — est. 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 & KPIs

Equipment & Shop

Benchmarking

Equipment & 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
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 & KPIs

Employee / Workforce

Benchmarking

Employee / Workforce	Goal	12/31/2022	12/31/2021	12/31/2020	12/31/2019
Total persons employed — total for year		266	272	269	249
Average full-time equivalent 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 at year-end		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 (avg full-time)		$564,815	$746,725	$740,088	$731,132
Self-performed revenue per employee (avg)		$384,259	$563,319	$546,256	$627,358

2024 CFMA Construction Financial Benchmarker

Exhibit 1: Key ratios detail — all figures shown as medians

Key ratios — medians	All Companies	Under $5 Million	$5 to $10 Million	$10 to $25 Million	$25 to $50 Million	$50 to $100 Million	$100 to $300 Million	Over $300 Million
Number of participants	1,639	74	134	344	312	284	255	154
Liquidity ratios								
Current ratio	1.7	3.2	2.5	2.0	1.8	1.5	1.4	1.3
Quick ratio	1.4	2.4	2.0	1.7	1.5	1.3	1.2	1.1
Days of cash	27.0	39.2	29.0	28.3	29.8	23.8	24.7	27.4
Working capital turnover	7.4	4.4	4.7	5.8	6.6	8.5	10.2	13.0
Profitability ratios								
Return on assets	12.5%	6.6%	11.9%	13.1%	14.3%	13.1%	12.6%	8.8%
Return on equity	32.7%	14.4%	24.3%	28.5%	31.2%	39.4%	37.6%	34.5%
Times interest earned	30.4	5.0	13.5	28.2	34.7	26.6	51.6	44.8
EBIT to total revenue	7.1%	4.6%	7.1%	8.2%	7.8%	7.4%	6.7%	5.1%
EBITDA to total revenue	8.8%	7.1%	9.2%	10.2%	9.6%	8.9%	8.0%	6.2%
Leverage ratios								
Debt to equity	1.3	0.6	0.6	0.9	1.1	1.7	2.0	3.0
Revenue to equity	5.3	3.9	3.9	4.5	4.9	6.0	7.6	11.2
Asset turnover	2.3	2.0	2.1	2.2	2.3	2.5	2.6	2.5
Fixed asset ratio	25.4%	33.6%	21.0%	28.7%	26.6%	25.3%	22.9%	21.3%
Equity to SG&A expenses	1.9	1.6	1.8	1.7	2.1	1.8	2.1	1.9
Underbillings to equity	8.1%	1.0%	7.7%	7.9%	6.2%	9.8%	10.2%	13.1%
Average backlog to equity	4.6	1.0	1.2	2.7	3.5	5.1	5.4	11.3
Efficiency ratios								
Average backlog to working capital	6.2	1.3	1.5	3.4	4.8	7.2	7.8	14.4
Average months in backlog	9.1	4.4	4.6	6.9	8.0	9.8	9.7	12.4
Days in accounts receivable	55.2	47.2	50.7	58.1	54.8	56.2	58.5	55.1
Days in inventory*	4.7	8.0	4.1	5.1	4.7	5.4	3.9	3.4
Days in accounts payable	32.8	14.9	23.0	28.0	31.2	37.2	38.2	43.9
Operating cycle	54.0	79.5	69.7	60.1	57.5	47.9	45.3	40.4
Productivity and sales measures								
Revenue per FTE employee	$514,587	$195,621	$231,412	$278,871	$399,961	$560,818	$679,468	$1,146,452
Gross profit per FTE employee	$83,554	$42,659	$60,620	$66,134	$87,026	$91,024	$84,458	$90,239
Total revenue ($000s)	$41,384	$3,361	$7,764	$16,611	$35,276	$68,385	$147,340	$532,141
Sales growth	7.3%	-3.8%	7.2%	3.3%	5.9%	10.2%	10.4%	10.3%

2024 CFMA Construction Financial Benchmarker

Exhibit 2: Key ratios by business type and legal form — all figures shown as medians

Key ratios — medians	All Companies	General / Prime Contractor	Sub-contractor	Construction Manager	C Corporation	S Corporation	LLC	Minority Business Enterprise	Women-Owned Business Enterprise
Number of participants	1,639	163	168	81	54	288	78	13	21
Liquidity ratios									
Current ratio	1.7	1.5	1.8	1.3	1.8	1.5	1.4	1.6	1.6
Quick ratio	1.4	1.3	1.6	1.2	1.4	1.3	1.3	1.4	1.3
Days of cash	27.0	30.5	25.7	29.8	28.4	28.7	26.9	35.1	29.0
Working capital turnover	7.4	9.3	6.1	17.2	6.0	8.9	9.4	7.5	8.7
Profitability ratios									
Return on assets	12.5%	12.0%	14.2%	10.2%	10.2%	13.3%	12.7%	9.3%	10.9%
Return on equity	32.7%	30.5%	34.8%	45.4%	22.3%	36.7%	35.4%	27.8%	24.8%
Times interest earned	30.4	36.7	30.5	80.2	19.8	40.2	25.7	12.8	17.7
EBIT to total revenue	7.1%	6.4%	8.7%	4.0%	6.7%	7.0%	6.1%	5.4%	4.6%
EBITDA to total revenue	8.8%	8.4%	10.2%	4.4%	8.5%	8.5%	7.7%	7.1%	6.2%
Leverage ratios									
Debt to equity	1.3	1.5	1.1	3.7	0.9	1.5	2.4	1.5	1.5
Revenue to equity	5.3	6.0	4.6	14.5	4.0	6.1	7.4	5.4	4.9
Asset turnover	2.3	2.3	2.2	3.1	2.0	2.5	2.5	2.1	2.5
Fixed asset ratio	25.4%	40.7%	25.9%	12.5%	32.9%	26.6%	22.5%	41.5%	16.9%
Equity to SG&A expenses	1.9	2.1	1.7	1.5	2.7	1.8	1.6	2.0	2.1
Underbillings to equity	8.1%	8.0%	10.6%	7.3%	9.0%	8.3%	9.1%	11.9%	11.9%
Average backlog to equity	4.6	5.1	3.0	15.4	2.3	5.1	6.1	2.9	4.7
Efficiency ratios									
Average backlog to working capital	6.2	7.8	4.2	17.0	3.3	7.8	7.7	5.9	7.3
Average months in backlog	9.1	10.1	7.3	12.0	7.3	10.1	8.7	10.2	9.9
Days in accounts receivable	55.2	48.5	65.2	47.9	52.6	56.6	52.5	62.9	50.3
Days in inventory*	4.7	6.0	5.2	0.1	14.9	4.4	3.1	3.5	5.6
Days in accounts payable	32.8	36.4	27.4	47.7	29.2	35.6	37.2	38.6	37.8
Operating cycle	54.0	43.9	66.0	28.5	60.6	51.0	41.5	59.8	52.5
Productivity and sales measures									
Revenue per FTE employee	$514,587	$615,832	$324,976	$1,520,122	$397,751	$520,555	$705,381	$418,680	$468,649
Gross profit per FTE employee	$83,554	$85,940	$69,682	$115,522	$74,386	$86,687	$87,071	$74,188	$74,188
Revenue per production FTE employee	$710,990	$817,927	$427,689	$2,124,929	$593,332	$689,732	$862,131	$700,591	$769,877
Gross profit per production FTE employee	$113,211	$117,010	$89,515	$158,975	$102,806	$112,089	$118,977	$94,944	$113,730
Total revenue ($000s)	$41,384	$91,656	$55,327	$96,263	$95,075	$79,282	$54,825	$68,175	$61,935
Sales growth	7.3%	9.8%	9.0%	-0.4%	9.3%	8.8%	5.9%	12.3%	8.3%



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

2nd | Construction ranks 2nd in attest engagements for CPA firms (Yellow Book is #1)

Top 5 | Construction audit/review is a Top 5 malpractice litigation practice niche

✓ Engagement Considerations

- **Construction contractor** audit and review engagements
- **Non-attest Compilation Engagements** have responsibilities and risk. **CPA cannot hide** behind a Compilation that is knowingly misleading

✓ Know the "Users" – Understand Risk Assessment

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

The primary focus of audits and reviews of construction contractors is on the contracts. – AAG-CON 7.02

- *"Evaluation of the profitability (revenue and costs) of contracts is central to the audit and review process and to determining whether information is presented in accordance with GAAP."*
- **The balance sheet and income statement** of a contractor are the product of the contract WIP schedules
- **Analyzing the reasonableness of contract estimates** is critical

Contract Audit – Identify Contract Risk

Identify Contract Risk

- **Large contracts, long duration** — multiple periods or years
- **New type of work, location, or contract owner**
- **Significant bid spreads**
- **How many New items do you have?** The more you have the higher the risk on the job
- **Underbilled jobs or negative cash flow** — #1 indicator of profit fade
- **Subcontractor failure or non-bonded subs**
- **No index or escalation clauses** — materials & sub exposure
- **Overbilled Jobs** with little subsequent costs with out supporting reason

Contract Audit – Review & Analyze Procedures

5-Year Average Gross Profit

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

5-Year Fade / Gain Analysis

- **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 and size of projects ***(Surety shortcut)***

Bidding & Estimating

- **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 – 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. — 5-Year Trend Analysis

Historical Completed Contract Gross Profit % • Exhibit D

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%**
FOB Plant Mix Sales						
Private	26.66%	20.90%	25.36%	28.50%	30.02%	**26.29%**
Municipal	17.50%	16.66%	18.30%	18.50%	18.88%	**17.97%**

Contract Schedules

Davidson Construction Company, Inc. | Contract Schedules — WIP | For the Period Ended 12/31/25 | Exhibit A

Uncompleted Contract Schedule — Work in Progress

Job #	Description / Job / Location	(1) Contract Amount	(2) Total Est. Cost	(3) Est. Gross Profit	(4) GP %	(5) Billings to Date	(6) Revenue Recog.	(7) Accrued Loss	(8) Cost to Date	(9) GP to Date	(10) Under-billing	(11) Over-billing	(12) Cost-to-Cost %	(13) Est. Cost to Compl.	(14) Backlog GP
13022	Front end loaded job Dolly Partin Arena — Nashville, TN	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 Shula's Steakhouse — Miami, FL	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 Goldmine — Anchorage, AK	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 Vanderbilt Stadium — Nashville, TN	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	job* CMT Studios — Nashville, TN	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 Bill Gates Bridge — Seattle, WA	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**			

Completed Contract Schedule — 12/31/25

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

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

Reconciliation of Contracts to Statement of Income

Reconciliation to Statement of Income — 12/31/25	Revenue Recognized	Total Cost	Gross Profit (Loss)	GP %
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 (Note 11)		400,000	(400,000)	
Subtotal	**103,077,012**	**96,366,000**	**6,711,012**	
Less revenue and cost recognized through 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%**

Contract Schedule — Adjusted to Historical or Revised Gross Profit %

Davidson Construction Company, Inc. | Adjusted to Historical or Revised Gross Profit % | For the Period Ended 12/31/25 | **Exhibit B**

Uncompleted Contract Schedule — Work in Progress

Job #	Description / Job / Location	(1) Contract Amount	(2) Total Est. Cost	(3) Est. Gross Profit	(4) Revised GP %	(5) Billings to Date	(6) Revenue Recog.	(7) Accrued Loss	(8) Cost to Date	(9) GP to Date	(10) Under-billing	(11) Over-billing	(12) Cost-to-Cost %	(13) Est. Cost to Compl.	(14) Backlog GP
13022	Front end loaded job Dolly Partin Arena — Nashville, TN	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
13032	Under-billed job Shula's Steakhouse — Miami, FL	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
14002	Zero billed job Goldmine — Anchorage, AK	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
14004	Loss Job Vanderbilt Stadium — Nashville, TN	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	job* CMT Studios — Nashville, TN	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
15001	Davidson-Acme Joint Venture Bill Gates Bridge — Seattle, WA	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
	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**			

Completed Contract Schedule — 12/31/25

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

Reconciliation of Contracts to Statement of Income

Reconciliation to Statement of Income — 12/31/25	Revenue Recognized	Total Cost	Gross Profit (Loss)	GP %
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 (Note 11)		400,000	(400,000)	
Subtotal	**101,836,257**	**96,366,000**	**5,470,257**	
Less revenue and cost recognized through 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%**

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

Contract Risk Analysis Worksheet

Davidson Construction Company | Estimated vs. Historical / Revised Gross Profit | For the Period Ended December 31, 2025 | **Exhibit C**

Contract Risk Analysis — Excess (Deferred) Gross Profit

Job #	Description / Job / Location	(1) Contract Amount	(2) Estimated GP %	(3) Historical / Revised GP %	(4) Over (Under) GP % (2-3)	(5) GP Recognized to Date	(6) GP at Hist. / Revised %	(7) Excess (Deferred) GP (5-6)	(8) % of Excess (Deferred)
13022	Front end loaded job Dolly Partin Arena — Nashville, TN	20,000,000	20.00%	10.00%	10.00%	2,000,000	888,889	**1,111,111**	125.00%
13032	Under-billed job Shula's Steakhouse — Miami, FL	6,000,000	16.67%	10.00%	6.67%	800,000	444,444	**355,556**	80.00%
14002	Zero billed job Goldmine — Anchorage, AK	10,000,000	8.00%	5.00%	3.00%	78,261	47,368	**30,892**	65.22%
14004	Loss Job Vanderbilt Stadium — Nashville, TN	5,000,000	-10.00%	-10.00%	0.00%	(500,000)	(500,000)	**0**	0.00%
14007	job* CMT Studios — Nashville, TN	1,000,000	15.00%	10.00%	5.00%	16,765	10,556	**6,209**	58.82%
15001	Davidson-Acme Joint Venture (60% owned) Bill Gates Bridge — Seattle, WA	48,000,000	8.75%	10.00%	-1.25%	1,656,986	1,920,000	**(263,014)**	-13.70%
	Total Uncompleted Contracts	**90,000,000**	**10.72%**	**8.33%**	**2.39%**	**4,052,012**	**2,811,257**	**1,240,755**	**44.14%**

Impact on Working Capital & Gross Profit

Net Impact Summary	Amount	% Basis
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%

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

Contract Cost Analysis — I-40 Bridge

Sample Construction Company | Job No. 30092 — Nashville, TN | Owner: Tennessee DOT | PM: RAD | Liberty Surety Bond 3/1/24 | Bid spread $319,568 (4.95%) | **Exhibit G**

Contract Summary	Revenue	Cost	Profit	Percentage
Original Contract 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%**

Phase Code	Description	(1) As Bid Cost	(2) Actual Cost to Date	(3) (Over)/Under Variance	(4) Estimated Cost to Complete	(5) Cost Adjustment	(6) Revised Total 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)	37,000	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
2020	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)
	Change Order No. 2	–	–	–	–	122,569	122,569
	Total	**$5,819,387**	**$3,742,883**	**$2,076,504**	**$2,531,751**	**$356,238**	**$6,274,634**

Contract Gain / Fade Analysis — 5-Year

Construction Company, Inc. | 5-Year through 12/31/2024 | Estimated / Actual Gross Profit by year, with annual and contract-to-date gain / (fade) | **Exhibit O**

Job #	Contract Description	12/31/19	%	12/31/20	%	12/31/21	%	12/31/22	%	12/31/23	%	12/31/24	%	Contract-to-Date G/(F)	CTD %	Yearly 2020	Yearly 2021	Yearly 2022	Yearly 2023	Yearly 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	–	–
	Contract Description	**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	9.0%	700,000	8.0%	650,000	9.5%	(350,000)	-35.0%	–	100,000	(200,000)	(200,000)	(50,000)
	Contract Description			**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%	280,000	8.5%	260,000	8.0%	(20,000)	-7.1%	–	–	(10,000)	–	(10,000)
207	Contract Description					1,000,000	10.0%	900,000	9.0%	850,000	8.5%	800,000	8.0%	(200,000)	-20.0%	–	–	–	(100,000)	(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)	(100,000)	(100,000)
	Contract Description					**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)
	Contract Description							**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	10.0%	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)
	Contract Description									**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%	–	–	–	–	–
505	Contract Description											1,400,000	11.5%	–	0.0%	–	–	–	–	–
	Contract Description											**4,850,000**		**–**		**–**	**–**	**–**	**–**	**–**
	Total — All WIP	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)
	Annual gain / (fade) %															-12.7%	5.7%	-2.5%	-4.9%	-8.4%

Sample Construction Company — Bid Spread Analysis

Variable v. Fixed Costs • Exhibit E

	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	$ –	
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%**
Total bid	**$7,000,000**	**$8,000,000**		

Front-End Loading to Overbilling Analysis

Davidson Construction Company, Inc. | December 31, 2024 | **Exhibit F**

Contract #	Description	(1) Mobilization / Front-End Loading*	(2) % Complete	(3) % Uncompl.	(4) Pro-Rated FE Loading (1x3)	(5) Overbilling Reported	(6) FE 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)
	Division subtotal	**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)
	Division subtotal	**3,800,000**			**2,340,000**	**1,300,000**	**(1,040,000)**
	Total — All Divisions	**$5,100,000**			**$3,000,000**	**$2,400,000**	**$(600,000)**

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

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

Analyze adequacy of overbilling vs. the front-end allowance:

- Surety bond or special insurance deposit
- Front-end payments to subcontractors or suppliers
- General conditions, jobsite set-up, etc.
- Estimated punch list, completion & unbalanced bid-item costs

Evaluate subcontractor risk and exposure to price/cost escalation

Job Cost Reasonableness Testing – Exhibit Q

- **Compare equipment / indirect costs to labor %** – look for significant variances
- **Compare subcontract costs** to original schedule of values

Additional Job Cost Procedures

- **Test for cost shifting** or inadequate allocation of indirect and equipment costs **(Exhibit N)**
- **Review post year-end job costs** on completed and WIP contracts
- **Review completion dates** for liquidated damages or early-completion bonuses **(Variable Consideration)**
- **Compare committed costs** for subs and materials to estimated costs to complete - Determine reasonableness of costs to complete budget amount

Subcontractor Risk Controls

- **Bonded vs. non-bonded** subcontractor backlog
- **Subcontractor prequalification** process review
- **Verification of supplier** payment process
- **Internal controls** for subcontractor insurance certificates

Indirect Job Cost Analysis

Equipment-to-Labor Reasonableness Test

Davidson Construction Company | For the Year Ended 12/31/2024 | **Exhibit Q**

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

Contract Cost Shifting Illustration

Davidson Construction Company | For the Year Ended 12/31/2024 | Effect of shifting $1M cost between a completed and an uncompleted job | **Exhibit N**

Job #	Description	(1) Contract Amount	(2) Total Est. Cost	(3) Est. Gross Profit (1-2)	(4) GP % (3/1)	(5) Billings to Date	(6) Revenue Recog. (1x11)	(7) Cost to Date	(8) Gross Profit to Date (6-7)	(9) Under-billing (6-5)	(10) Over-billing (5-6)	(11) Cost-to-Cost % (7/2)	(12) Est. Cost to Compl. (2-7)
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				
	Subtotal					**28,000,000**	**27,000,000**	**26,000,000**	**1,000,000**	**0**	**1,000,000**		
After Cost Shifting — move $1M of cost from Costco (completed) to Sam's (uncompleted)													
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				
	Subtotal					**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)**		

Jobsite visits (audit and review procedure)

Optional — at CPA discretion

Jobsite Observations – audit and review procedure

- **Percentage-of-completion** observation
- **Inquiries of jobsite** PM and superintendent
- **Reconcile subcontractors** on jobsite vs. recorded in job cost
- **Uninstalled generic materials** observation – not inventory

Other Unique Audit and Review and Best Practice IC

- **Litigation disclosures**
- **High-deductible insurance reserves** self-insurance loss reserves
- **Subsequent events** and the effect on year-end contract estimates

Equipment Accounting & Costing

- **Capitalization policies**
- **Useful lives** and depreciation calculation
- **Internal rental-rate system** or other GAAP job-cost allocation method

Skepticism and analysis required for GAAP balance sheet classification

One more quick reminder — skepticism required for GAAP balance-sheet classification

Assets & Receivables

- **Cash** — restricted for retainage or insurance reserves
- **Contract receivables** (disaggregation required)
- **Retainage** — completed jobs and WIP jobs
- **Claims & unapproved change orders** — Assess under the variable consideration model
- **Related-party A/R & owner "notes receivable"** — can they pay? Review collateral and cash flow
- **Inventories** – should not include job-cost materials

Billings & Liabilities

- **Under-billings** – #1 reporting error
- **Over-billings** – #2 reporting error: insufficient overbilling deferral
- **Insurance** – self-insured deductibles and reserves
- **A/P to subcontractors** – including retainage (analyze negative retainage)
- **Loss contract accrual**, liquidated damages or claims payable
- **Off-balance-sheet liabilities** – current tax distributions and deferred taxes
- **Bank lines of credit** – reported inappropriately as "long-term"



Session 4

Construction Taxation – Fundamentals & Strategies

A. Review of Construction Taxation Basics & New Tax Law

Construction industry is a Top-10 sector of the U.S.

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

Four basic construction contractor tax methods

1. **Cash basis**
2. **Accrual basis**
   (generally the worst tax method)
3. **Completed contract method (CCM)**
   for long-term contracts – used by 97% of contractors until 1986
4. **Percentage of completion (POC)**
   contract method for long-term contracts

FACT: Most contractors use multiple tax methods depending on type of contract, duration, and revenue size of the contractor.

Cash and CCM will generally result in the largest tax deferral.

Tax Rates

21%
C-Corporation rate

20%
QBI deduction

29.6%
Top pass-through rate



2017 TCJA Provisions Now Permanent

- 21% C-Corporation tax rate
- 20% QBI deduction for LLC and S-Corp
- Pass-through rate is still 29.6% – C-Corp v. S-Corp / LLC debate continues
- SALT deduction increased to $40,000, $600,000 AGI phase-out, expires in 2030
- PTE election is still a good idea

Construction Contractor Tax and Applying the Section 460 Exemptions (Continued)



Long-Term Contract Basics

- Long-term = a contract not completed in the same tax year it started
- A 12-month length is NOT the definition
- Non-long-term contracts are exempt from POC and reported on cash or accrual under §451



Small Contractor Exemption

- Average annual tax revenues under $32 million for the 3 prior years – indexed in 2027
- Test the 3 years ending before the year a contract starts
  - Qualifying contracts may use completed contract or cash
- Contracts estimated to finish within 3 years of start also qualify (was 2 years)



Home & Residential

Home construction contracts

- 4 dwelling units or less per structure, plus related work
- Exempt under long-standing law

Residential contracts

- Multi-family over 4 dwellings – apartments, condos, dorms, barracks, prisons; excludes hotels
- 100% exempt for contracts started after 1/1/2026 (old law allowed 30%)

Construction Contractor Tax and Applying the Section 460 Exemptions (Continued)



Transition & Filing

- Contract WIP at 12/31/2025 stays on POC until the contract is complete
- New contracts started in 2026 move to the exempt method
- No Form 3115 is required or should be filed – this is an automatic transition



Methods Available

- Long-term exempt contracts qualify for the completed contract method
- Cash and accrual are also available, subject to C-Corp limitations
- The method applies contract by contract, not company-wide



Elections & Details

10% election

- Revenue and costs on contracts less than 10% complete can be deferred
- Deferral works similar to the completed contract method

Support costs

- Infrastructure and support costs count when 80% attributable
- Confirm eligibility contract by contract each year

Construction Contractor Tax Methods

4
Basic tax methods

2
Long-term contract methods

§460
Governs long-term contracts

CCM
King of deferral



The Four Basic Methods

- Cash basis
- Accrual basis – generally the worst tax method for contractors
- Completed contract method for long-term contracts
- Percentage of completion for long-term contracts
- All four remain available after the 2025 law changes



Two Facts Worth Remembering

- Most contractors use multiple tax methods
- Cash and completed contract are kings of deferral
  - Driven by contract type, duration, and size
  - Accrual is rarely the right answer for a contractor
- Method selection is a major deferral lever

Other Construction Tax Issues



Lookback – Form 8697

- Required for Section 460 percentage-of-completion contracts
- Profit gain results in interest due on the prior-year underpayment
- Profit fade results in an interest refund on the overpayment



Claims & Change Orders

- Claims, change orders, and disputed amounts require careful timing
- 1% revenue de minimis threshold, capped at $1M
- IRS has released a lookback interest calculator



Guidance & Other Changes

Revenue procedures to know

- Rev Proc 2018-19 – "applicable financial statement" exempts Section 460 exemptions and similar provisions
- Rev Proc 2018-29 – automatic contract segmentation

Other 2025 changes

- Estate exemption $15M in 2026 (indexing starts 2027); 1099-MISC threshold $600 to $2,000
- Employee OT implementation; 179D and most energy credits phase out in 2026

Pass-through entity (S-Corp, LLC, etc.) vs C-Corporation debate is continuing

$40,000
SALT deduction for owners under $600K income

Entity Choice: PTE vs. C-Corp

- **Weigh lower C-corp rate** vs. double-taxation exposure
- **Excess comp & double-tax liquidation** — worth the extra tax?
- **Most states now offer a PTE election** to avoid non-deductible state tax
- **Keep your PTE election**

100%
restored for purchases after 1/19/2025

Bonus Depreciation (OBBB)

- **100% permanent** for property acquired after 1/19/2025 (40% for 1/1–1/19/2025)
- **New §168(n)** – 100% expensing of qualified production real property, otherwise 39-year
- **Qualifying activity** – manufacturing, agricultural / chemical production and refining that substantially transforms the product
- **Construction** must begin after 1/19/2025 and before 1/1/2029; in service before 1/1/2031
- **Original use** by the taxpayer; used property can qualify if not in production use since 1/1/2021
- **Production space only** – office, parking, lodging, sales and R&D excluded (cost seg allocation)
- **Elective and irrevocable** – §1245 recapture with a 10-year clawback if use changes
- **Section 179** increased to $2.5M with a $4M purchase phase-out

Entity Tax Comparison

2025

Tax 2025

2025 Tax Comparison	C-Corp	S-Corp	LLC	PTE Election
Taxable income (Owner Salary Included***)	10,000,000	10,000,000	10,000,000	10,000,000
Assume 7% state income tax*	(700,000)	—	—	—
Assume 2 equal owners** (10K Each)	—	(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 (net of state deduction)	**19.53%**	**29.54%**	**29.54%**	**27.53%**
$1.5M Dividend/Distribution*** Taxed at **23.8%** Effective rate	357,000	—	—	—
Total tax	**2,310,000**	**2,954,080**	**2,954,080**	**2,752,800**

Net Cash to Owners	C-Corp	S-Corp	LLC	PTE
Salary — 2 owners at $250,000	500,000	500,000	500,000	500,000
Tax on salary (29.6%)	(148,000)	(148,000)	(148,000)	(148,000)
Distribution ($1.5M total)	1,500,000	1,500,000	1,500,000	1,500,000
Tax on distribution***	(357,000)	—	—	—
Net cash to owners	**1,495,000**	**1,852,000**	**1,852,000**	**1,852,000**

2025 Individual Tax Brackets (Joint)	Tax Rate	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%

Double Taxation – 19.53% is only the first layer

- **Distributions are dividends** to the extent of E&P – IRC §§301, 316
- **Taxed again** at qualified-dividend rates up to 20% plus 3.8% NIIT – §1(h)(11), §1411
- **Combined ≈ 38.7%** on distributed earnings; pass-through owners are not taxed twice

Source: IRS Pub. 542; IRS Topic No. 559

*" SALT deduction $40,000 (joint or single). ** SALT phase-out at $300,000 MAGI; $10,000 limit above $600,000.*
*** SALT phase-out at $300,000 MAGI; reverts to $10,000 limit above $600,000 MAGI*
**** Qualified dividend at 20% plus 3.8% NIIT. Salaries of $250,000 per owner assumed already deducted in arriving at taxable income.*

Cash Method

Revenue & Expense Recognition

- **Revenue recognized** when cash is received
- **Expenses deducted** when paid

Eligibility & Method Change

- **C-corps under $31M (2025) / $32M (2026)** average annual gross receipts — TCJA raised the prior $5M to $25M with index
- **Indexed annually** — a further increase is expected for 2027
- **Caution — watch out for AMT if:**
  1. You have a long-term contract
  2. For regular tax you are NOT using PCM
  3. The contract is not an exempt residential construction contract
  4. Largely repealed by TCJA for C-Corps – relevant for pass through
- **Non-long-term contracts by PTEs** (S-corp, LLC) are not subject to the $32M revenue limit
- **Currently a non-automatic change,** but the IRS does not enforce it if a cut-off method is used
- **Form 3115 should make clear** materials are purchased for jobs, not held as inventory

IRS alert to possible abuses — simply not depositing cash before year-end is still fraudulent

Accrual Method

Revenue & Expense Recognition

- **Revenue recognized** the earlier of when earned or received
- **Expenses deducted** when the "all-events" test is met, but not before economic performance
- **Rev. Proc. 2004-34** — deferral of advance payments
- **No deferral of front-end loading** (over-billing) — contractor had the "right to receive" the revenue

Retainage & Elections

- **Exclude retainages receivable** (Rev. Rule 69-314)
- **Included in income** only after final acceptance of work
- **Election to use the method** is required
- **Method change "automatic"** per Rev. Proc. 2008-52
- **Exclude retainages payable** from expenses (Shepherd Construction Co. v. Commissioner)

Worst method for contractors — overbilled = taxable!

Contractors using the accrual method for tax reporting (subject to final regulations)

Pay-when-paid / pay-if-paid inclusion of subcontractor retainages in job cost for POC is questionable under TCJA

Prepaid Insurance

Reg. 263(a)-4(f)

- **Prepaid insurance deduction**
- **Allowed for prepaid expenses** that do not cover a period extending more than 12 months beyond the end of the tax year in which incurred
- **Automatic change** under Rev. Proc. 2005-9

Deduction Requirements — all-events test

1. **All events establishing the liability** have occurred
2. **The amount of the liability** is determinable with reasonable accuracy
3. **Economic performance** has occurred with respect to the liability

Completed Contract Method

Eligibility & Limits

- **Limited to "small contractors"** on certain contracts
- **Small contractor revenue test** — $10M or less before 2018; TCJA raised it to $25M average gross receipts, indexed to $32M in 2026

Home & Residential Contracts

- **Available for certain contracts** (home and residential) that are exempt from Code Section 460
- **Not "home builders"** — home contracts include all costs such as grading, utilities, electrical, etc.
- **Residential 30% in 2025** — 100% eligible for contracts started after 1/1/26

How CCM Works

- **Revenue and costs deferred** until the contract is completed and accepted (Ball, Ball & Brosamer v. Commissioner)
- **Completion at 95%** complete with owner occupancy (Reg. 1.460-1(c)(3))
- **Greatest deferral of income** in general

Completed Contract Method generally results in the greatest deferral of income

Percentage of Completion Method (POC)

Recognizes revenue on the % of contract completion — total cost to date over total estimated cost

Tax POC Treatment

- **Cost-to-cost method** required for tax
- **Loss contracts** deducted based on percent complete
- **Stored materials (uninstalled)** must be included in POC income
- **10% election** — becoming best practice; permitted
- **G&A allocations** required for tax - However, the revenue recognition will be the same unless the G&A percentage changes for future tax periods

GAAP POC Treatment

- **Other methods allowed** — labor %, units, etc.
- **Full loss** required by GAAP
- **Stored materials omitted** for GAAP
- **No exceptions to POC** for GAAP

Contracts that are generally exempt from POC under IRC 460

Exempt Contract Types

- ✓ **Non-long-term contracts** — started and completed within the tax year
- ✓ **Home construction contracts** (including infrastructure attributable to the dwelling unit)
- ✓ **Residential contracts** (pre-2025, 30%) — multi-family, condos, barracks, prisons, dormitories
- ✓ **Small-contractor contracts** ($32M "small contractor" test)
- ✓ **10% election** — under 10% complete, defer 100% to the next year

Other POC Issues

- ! **All-events test** required by 461(h) economic-performance rules
- ! **Tutor-Saliba Corp. v. Commissioner** (115 T.C., No. 1) — claims taxable when filed
- ! **G&A allocation** to long-term contracts (Reg. 1.460-5)
- ! **Exclude retainages payable** from costs incurred to date (ISP MSSP IRPO 180, 118)

TJCA: IRS revenue recognition no later than GAAP recognition

This rule applies to income reported in the taxpayer's "applicable financial statement" (annual audit or review).

It does **not** apply when a special method of accounting is specifically permitted – i.e., Code Section 460 exemptions and the completed contract method.

The rule could limit the ability to report income differently in audited financial statements and the tax return for:

Retainage exclusion
(accrual method)

Claims recognition
(not recommended anyway)

IRS Revenue Procedure 2018-29: adopting ASC 606 as an automatic tax method

Rev. Proc. 2018-29 added a new Section 16.11 to Rev. Proc. 2018-31 (Automatic consent list): "Changes in the timing of recognition of income due to the new ASC 606 Revenue Recognition Standards."

It applies to taxpayers that wish to change their method of accounting for:

1. **Identifying** performance obligations
2. **Allocating** transaction price to those performance obligations
3. **Considering** performance obligations satisfied

The automatic procedure does not apply to the following changes

Changes that may be part of implementing the new revenue recognition standards – the automatic procedure does **not** apply to:

1. A change in method which does not comply with Section 451 or other guidance
2. Any change related to income from long-term contracts under Section 460 – unless the contracts are exempt (home construction contracts or the $32M revenue exception)
3. Segmentation of separate performance obligations under ASC 606 should qualify as a separate contract for IRS reporting purposes

Section 179D – New tax law phase-out for projects started after 6/30/2026

$5.81 / sq ft

max deduction for energy-efficient improvements

Section 179D Deduction

- **Owner of the building** (if a private taxable entity)
- **Contractor and design team** if owner is a government or tax-exempt entity
  - Have see some negotiation between contractor and owner regarding some return to the owner for contractor taking the credit (generally informal in a negotiated bid process)

Other Credits & Incentives

- **Historical tax credits** — 20% of rehabilitation improvements (not cost of structure)
- **Structure certified historic** by the National Park Service
- **Rehab costs must exceed** 100% of original building cost
- **Fuel tax credit** (off-road)
- **Work opportunity tax credits**
- **Employee Retention Credits Ended** — but still subject to IRS audit

Long-term contracts subject to POC, completed during the year - subject to lookback

7%

current lookback interest rate for 2025

Lookback Interest

- **Interest refund from IRS** on job profit fades and warranty costs
- **Interest owed to IRS** on gross-profit gain jobs or claims collection
- **Final contract cost** includes costs allocated per Code 460(c) and regulations
- **Post-completion "claims collections"** interest may be discounted from completion year until collected

Exemptions & Strategy

- **Mandatory de minimis** for small jobs (below 1% or $1M annual revenue)
- **Strategy:** use low profit estimate on de minimis jobs since no lookback
- **Home construction contracts** (not just "homebuilders")
- **Non-long-term jobs**

Contract Lookback True-Up — Tax Adjustment

Construction Company, Inc. · Period 12/31/24 (closing) to 12/31/25 (true-up)

No.	Description / Type / Location / Owner	[1] Contract Amount	[2] Total Estimated Cost	[3] Estimated Gross Profit	[4] Gross Profit %	[5] Billings at closing	[6] Revenue Recognized	[8] Cost at closing	[9] Gross Profit to Date	[10] Underbilling	[11] Overbilling	[12] Cost-to-Cost % Completion	Rev. Rec. at closing	Profit Increase (Decrease)
Contract WIP as Reported at Closing — as of 12/31/24														
1801	Completed Gain Job	10,000,000	8,000,000	2,000,000	20.00%	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	20.00%	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	20.00%	7,000,000	6,000,000	4,800,000	1,200,000	–	1,000,000	60.00%		
	WIP – as reported at closing	**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**			
Revised Estimates / Completed at 12/31/25 — Contract WIP at final (or WIP) Gross Profit														
1801	Completed Gain Job	10,000,000	7,000,000	3,000,000	30.00%	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	10.00%	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	25.00%	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 at 12/31/25	**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**

12/31/24 (closing) → 12/31/25 (true-up)	Revenue Recognized	Total Cost	Gross Profit
Contract WIP True-up at 12/31/25 – lookback	19,415,873	14,800,000	4,615,873
Contract WIP at closing – As Reported	(18,500,000)	(14,800,000)	(3,700,000)
Increase (decrease) profit / taxable income	**915,873**	**–**	**915,873**

Tax on increase in taxable income
915,873 × 30% = 274,762

Look-back interest at IRS rate
274,762 × 7.0% = $19,233



Thank you!

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Anson Martens, CPA
Partner · Scan to view full bio



Appendix

Change Order Segmentation Illustration

Davidson Construction Company, Inc. | Chapter 3 — Separate Performance Obligation | **Exhibit I**

Original bid on 3/1/23				
	Highway & Bridge Construction	Change Order	Total	
Total contract amount	$20,000,000	$–	$20,000,000	
Total estimated contract costs	18,000,000	–	18,000,000	
Estimated Gross Profit	**$2,000,000**	**$–**	**$2,000,000**	
Estimated Gross Profit % of Revenue	10.00%	0.00%	10.00%	
At 12/31/23				
	Original Contract	Unapproved Change Order	Combined	
Billings to date	$10,000,000	$–	$10,000,000	
Cost incurred to date	$9,000,000	$500,000	$9,500,000	
Percentage complete (÷ $18.5 M cost)	50.00%		51.35%	
Revenue recognition	$10,000,000	$–	$10,270,270	
Gross profit recognition ($1.5 M revised)	$1,000,000	$(500,000)	$770,270	
Net over-billing (under-billing)	**$–**		**$(270,270)**	
On 7/1/24 — Negotiated Change Order				
	Original Contract	Change Order	Combined	
CO Contract Amount	$20,000,000	$3,000,000	$23,000,000	
CO Estimated Cost	18,000,000	2,000,000	20,000,000	
CO Estimated Gross Profit	**$2,000,000**	**$1,000,000**	**$3,000,000**	
CO Estimated Gross Profit %	10.00%	33.33%	13.04%	
At 12/31/24 — Original Contract Completed				
	Original Contract	Change Order	Total Segmented	Non-Segmented
Billings to date	$20,000,000	$1,800,000	$21,800,000	$21,800,000
Cost incurred to date	$18,000,000	$1,500,000	$19,500,000	$19,500,000
Percentage complete	100.00%	75.00%	97.50%	97.50%
Revenue recognition	$20,000,000	$2,250,000	$22,250,000	$22,425,000
Gross profit recognition	$2,000,000	$750,000	$2,750,000	$2,925,000
Net over-billing (under-billing)	**$–**	**$(450,000)**	**$(450,000)**	**$(625,000)**
Segmented v. Non-Segmented Comparison				
	Total Segmented	Non-Segmented	Over (Under) Recognition	
GAAP Contract Revenue Recognition	$22,250,000	$22,425,000	$175,000	
GAAP Contract Profit Recognition	$2,750,000	$2,925,000	$175,000	
IRS Contract Revenue Recognition	$22,250,000	$22,425,000	$175,000	
IRS Contract Profit Recognition	$2,750,000	$2,925,000	$175,000	

Warranty & Maintenance Segmentation

Davidson Construction Company, Inc. | Extended Period Warranty & Maintenance — Separate Performance Obligations | Exhibit H

Original bid on 3/1/23				
	Hwy & Bridge Construction	7-Year Warranty & Maintenance	Combined Total	
Total contract amount	$80,000,000	$7,000,000	$87,000,000	
Total estimated contract costs	74,000,000	5,000,000	79,000,000	
Estimated Gross Profit	**$6,000,000**	**$2,000,000**	**$8,000,000**	
Estimated Gross Profit % of Revenue	7.50%	28.57%	9.20%	
At 12/31/23				
	Construction Segment	W & M Segment	Non-Segmented	
Billings to date	$24,000,000	$–	$24,000,000	
Cost incurred to date	$18,500,000	$–	$18,500,000	
Percentage complete	25.00%	0.00%	23.42%	
Revenue recognition	$20,000,000	$–	$20,373,418	
Gross profit recognition	$1,500,000	$–	$1,873,418	
Net over-billing	**$4,000,000**	**$–**	**$3,626,582**	
At 12/31/24 — Construction Completed (warranty period started 8/1/20)				
	Construction Segment	W & M Segment	Combined Segments	Non-Segmented
Billings to date	$80,000,000	$1,000,000	$81,000,000	$81,000,000
Cost incurred to date	$74,000,000	$250,000	$74,250,000	$74,250,000
Percentage complete	100.00%	5.00%	93.99%	93.99%
Revenue recognition	$80,000,000	$350,000	$80,350,000	$81,768,987
Gross profit recognition	$6,000,000	$100,000	$6,100,000	$7,518,987
Net (under) over-billing — warranty reserve	**$–**	**$650,000**	**$650,000**	**$(768,987)**
Segmented v. Non-Segmented Comparison				
	Segmented	Non-Segmented	Excess	
GAAP Contract Revenue Recognition	$80,350,000	$81,768,987	$1,418,987	
GAAP Contract Profit Recognition	$6,100,000	$7,518,987	$1,418,987	
IRS Contract Revenue Recognition	$80,350,000	$81,768,987	$1,418,987	
IRS Contract Profit Recognition	$6,100,000	$7,518,987	$1,418,987	
Deductible overbilling on warranty work	$650,000	$–		
Taxable underbilling or warranty reserve		$(768,987)		

Claim Contract WIP Illustration

Davidson Construction Company | For the Period Ended 12/31/20 | Five claim-accounting scenarios for a single arena contract | **Exhibit J**

Job #	Description / Type / Owner	(1) Contract Amount	(2) Total Est. Cost	(3) Est. Gross Profit	(4) GP %	(5) Billings to Date	(6) Revenue Recognized	(7) Cost to Date	(8) Gross Profit to Date	(9) Under-billing	(10) Over-billing	(11) Cost-to-Cost %	(12) Est. Cost to Complete
#1 Contract — As Reported (cost to date includes additional $1 million unexpected costs)													
13022	Johnny Cash Arena	20,000,000	18,000,000	2,000,000	10.00%	10,000,000	11,111,111	10,000,000	1,111,111	1,111,111	0	55.56%	8,000,000
13022C	Additional cost claim							0					0
	Total	**20,000,000**	**18,000,000**	**2,000,000**	**10.00%**	**10,000,000**	**11,111,111**	**10,000,000**	**1,111,111**	**1,111,111**	**0**		**8,000,000**
#2 Cost — Total Estimated Cost revised for additional $1 million costs													
13022	Johnny Cash Arena	20,000,000	19,000,000	1,000,000	5.00%	10,000,000	10,526,316	10,000,000	526,316	526,316	0	52.63%	9,000,000
13022C	Additional cost claim							0					0
	Total	**20,000,000**	**19,000,000**	**1,000,000**	**5.00%**	**10,000,000**	**10,526,316**	**10,000,000**	**526,316**	**526,316**	**0**		**9,000,000**
#3 Cost — Estimated Cost and Contract Amount both revised for additional $1 million													
13022	Johnny Cash Arena	21,000,000	19,000,000	2,000,000	9.52%	10,000,000	11,052,632	10,000,000	1,052,632	1,052,632	0	52.63%	9,000,000
13022C	Additional cost claim							0					0
	Total	**21,000,000**	**19,000,000**	**2,000,000**	**9.52%**	**10,000,000**	**11,052,632**	**10,000,000**	**1,052,632**	**1,052,632**	**0**		**9,000,000**
#4 Claim — Segmented costs only / no increase in contract amount													
13022	Johnny Cash Arena	20,000,000	18,000,000	2,000,000	10.00%	10,000,000	10,000,000	9,000,000	1,000,000	0	0	50.00%	9,000,000
13022C	Additional cost claim	0	1,000,000	(1,000,000)		0	0	1,000,000	(1,000,000)				0
	Total	**20,000,000**	**19,000,000**	**1,000,000**	**5.00%**	**10,000,000**	**10,000,000**	**10,000,000**	**0**	**0**	**0**		**9,000,000**
#5 Claim — Segmented with increase in contract amount (claim receivable)													
13022	Johnny Cash Arena	20,000,000	18,000,000	2,000,000	10.00%	10,000,000	10,000,000	9,000,000	1,000,000	0	0	50.00%	9,000,000
13022C	Additional cost claim	1,000,000	1,000,000	0		1,000,000	1,000,000	1,000,000	0			100.00%	0
	Total	**21,000,000**	**19,000,000**	**2,000,000**	**9.52%**	**11,000,000**	**11,000,000**	**10,000,000**	**1,000,000**	**0**	**0**		**9,000,000**

Contract Cash Flow Analysis

Davidson Construction Company | For the Year Ended December 31, 2024 | Net cash flow position by project manager | **Exhibit P**

Job #	Description	(1) Contract Amount	(2) Total Est. Cost	(3) Est. Gross Profit (1-2)	(4) Billings to Date	(5) Contract Recv. & Retainage	(6) Cash Collected (4-5)	(7) Cost to Date	(8) Accounts Payable	(9) Cash Paid (7-8)	(10) Net Cash Flow Pos. (6-9)	(11) CF to Contract (10/1)	(12) CF to Gross Profit (10/3)
Project Manager: Jack Daniels													
99001	Nashville I-40 Bridge	6,645,588	6,233,275	412,313	3,758,900	830,514	2,928,386	3,643,674	458,659	3,185,215	(256,829)	-3.86%	-62.29%
99002	Memphis Airport	750,000	712,000	38,000	709,000	183,000	526,000	599,000	66,500	532,500	(6,500)	-0.87%	-17.11%
99005	Lynchburg - Jack Daniels	1,800,000	1,550,000	250,000	150,000	150,000	0	130,000	65,000	65,000	(65,000)	-3.61%	-26.00%
99006	Carthage - Al Gore Home	450,000	410,000	40,000	0	0	0	36,000	12,000	24,000	(24,000)	-5.33%	-60.00%
	Subtotal	**9,645,588**	**8,905,275**	**740,313**	**4,617,900**	**1,163,514**	**3,454,386**	**4,408,674**	**602,159**	**3,806,515**	**(352,329)**	**-3.65%**	**-47.59%**
Project Manager: Elvis Presley													
99-12	Heartbreak Hotel	350,000	225,000	125,000	350,000	35,000	315,000	218,000	45,000	173,000	142,000	40.57%	113.60%
99-02	Dr. Nick Hospital	750,000	745,000	5,000	719,000	225,000	494,000	722,000	166,000	556,000	(62,000)	-8.27%	-1240.00%
99-04	Graceland Road	2,500,000	2,300,000	200,000	650,000	380,000	270,000	640,000	285,000	355,000	(85,000)	-3.40%	-42.50%
99-08	Cadillac Factory	80,000	75,000	5,000	0	0	0	10,000	8,000	2,000	(2,000)	-2.50%	-40.00%
	Subtotal	**3,680,000**	**3,345,000**	**335,000**	**1,719,000**	**640,000**	**1,079,000**	**1,590,000**	**504,000**	**1,086,000**	**(7,000)**	**-0.19%**	**-2.09%**
Project Manager: Dolly Parton													
99-09	Porter Waggoner Home	780,000	727,000	53,000	780,000	78,000	702,000	720,000	95,000	625,000	77,000	9.87%	145.28%
99-13	Country Music Hall of Fame	1,650,000	1,480,000	170,000	1,100,000	185,000	915,000	988,000	225,000	763,000	152,000	9.21%	89.41%
99-14	Dollywood	1,100,000	910,000	190,000	380,000	166,000	214,000	100,000	25,000	75,000	139,000	12.64%	73.16%
	Subtotal	**3,530,000**	**3,117,000**	**413,000**	**2,260,000**	**429,000**	**1,831,000**	**1,808,000**	**345,000**	**1,463,000**	**368,000**	**10.42%**	**89.10%**
	Company Totals	**16,855,588**	**15,367,275**	**1,488,313**	**8,596,900**	**2,232,514**	**6,364,386**	**7,806,874**	**1,451,159**	**6,355,715**	**8,671**	**0.05%**	**0.58%**