CONSTRUCTION
INDUSTRY

CASE STUDY:

Marcum Helps Construction Business Increase Bonding Program through Fixed Asset Analysis

ABOUT THE CLIENT

A premier heavy highway civil contractor with more than 50 years of experience in some of the highest-profile public works projects, as well as the largest commercial and residential projects, in its region. The company's services pertain primarily to water mains, paving, and site preparation.

THE CHALLENGE

The company faced challenges from its bonding company, based on its financial results and presentation of its annual financial statements. The challenges started when the bonding company began questioning the financial integrity of the business and, as a result, hindering the company's ability to obtain the right-size bonding program that would allow it to bid on and procure work. The challenges were primarily focused around the company's accounting for construction estimates, change orders, and indirect overhead rates. In addition, revenue recognition was being presented in a manner consistent with percentage of completion/recognition over time methods based on incorrect contract estimates and cost amounts. The challenges extended to the bank, where the relationship began to falter.

THE GOAL

The company engaged Marcum to take over all compliance roles based on our firm's expertise in the construction industry and our history of resolving such challenges for other Marcum clients. Marcum's Construction Services group was tasked with evaluating the accounting structure for both direct and indirect costs, based on what is included in the contract estimation (bidding) process and actual costs incurred as recorded in the financial reporting system. In addition, Marcum evaluated the accounting method and recognition of construction change orders, including arrangements with the company's customers, approval process, recognition of both costs and billings associated with such change orders, and ultimately, the recognition of revenue. Finally, Marcum reviewed the company's method of depreciation of property and equipment, evaluating the useful lives utilized to determine if they were reasonable in accordance with GAAP and empirical studies based on the useful lives of such assets.

THE PROCESS

Marcum assembled a team to work with company management. The team included assurance and tax partners and managers, who evaluated the positions taken on the tax return and financial statements.

- We first looked at the methods of depreciating property and equipment on the financial statements and tax return, noting they were similar; this indicated that depreciation expense was accelerated for financial reporting purposes, which was not in accordance with GAAP. We obtained the fixed asset useful life (empirical) study from CFMA (Construction Financial Management Association) which provided the average useful life of equipment by asset class/classification, and then analyzed and adjusted the useful lives used by the company to depreciate its fixed assets, in order to align with GAAP and the true useful life of heavy equipment.
- We analyzed the structure of both direct and indirect costs, determining that indirect costs were being estimated as part of the contract estimate, but incorrectly charged to general and administrative expenses. Once properly allocated, each contract showed the accurate percentage of completion, which increased both project revenue and gross profit earned.

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- We analyzed the company's policies and procedures regarding the recording of change orders. In many cases, the value of approved change orders was not added to the contract value; however, costs incurred by the company to complete the change order work was recorded in the estimated and actual costs to complete, which significantly depressed contract gross profits.

THE SOLUTION

The first financial statement following Marcum's corrections to the company's previous accounting practices showed an increase in equity of approximately $2.5 million, and profitability more accurately depicted the status of contracts and recognition of gross margins.

In addition, the Marcum team led multiple meetings between management and representatives of the company's bank and bonding company to discuss the updated financial statement presentation, changes implemented, and the correction of errors, as well as internal changes to substantially strengthen the company's financial reporting. As a result, our client was able to increase its bonding program and eliminate any concerns by the bank and bonding company over its financial reporting and integrity of the numbers.