

# Surety Bond Quarterly

AN OFFICIAL PUBLICATION OF  
THE NATIONAL ASSOCIATION OF  
SURETY BOND PRODUCERS

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**NASBP** **75<sup>th</sup>**  
*Anniversary  
Edition*

**A Look Back and  
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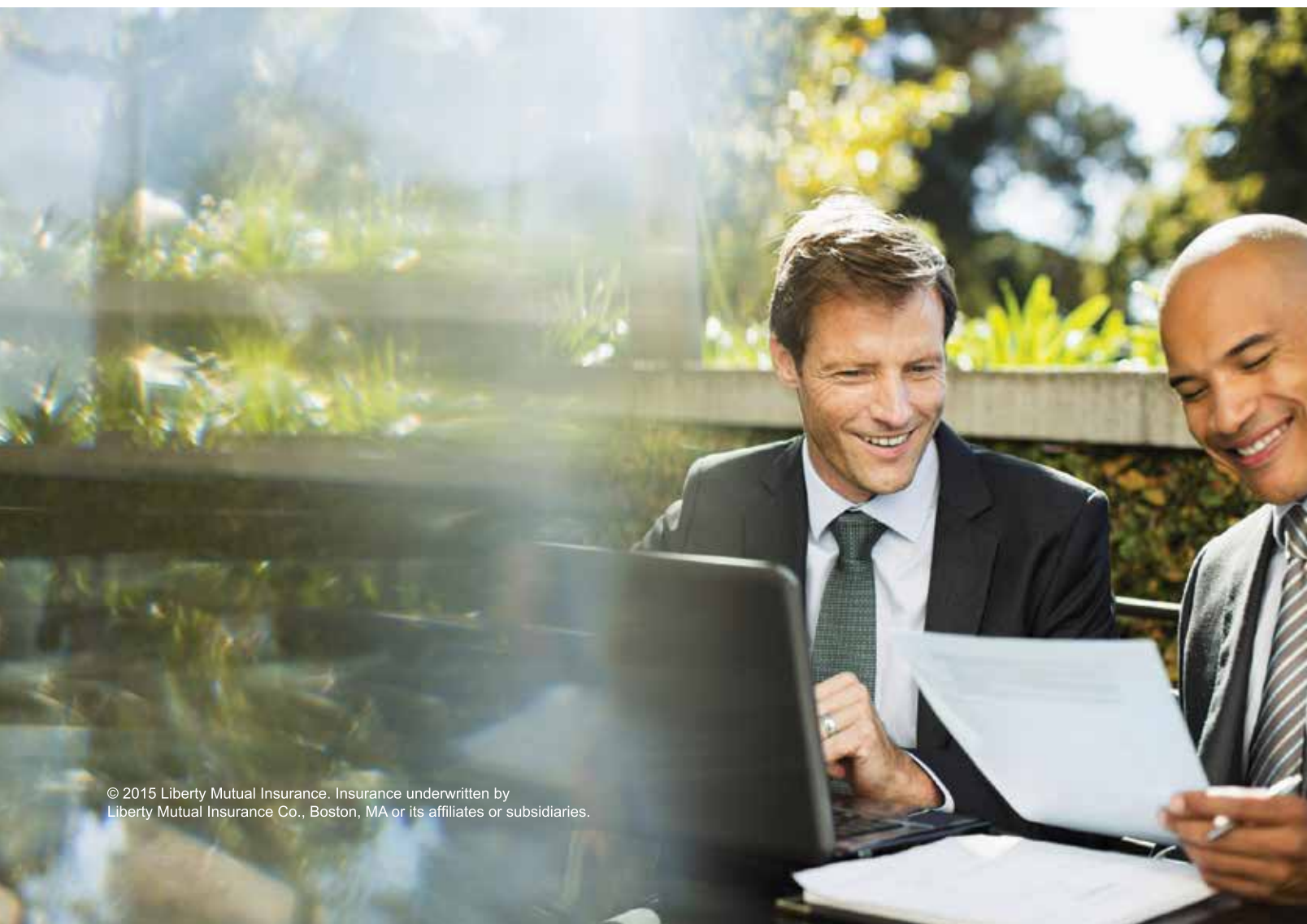


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#### SPRING 2017

2017 marks NASBP's 75th year of existence as an organization devoted to protecting the interests of bond producers and promoting the welfare of surety bonding. The surety community will celebrate this considerable accomplishment this spring at the NASBP Annual Meeting in Boca Raton, Florida. In honor of NASBP's milestone anniversary, this issue examines the past, present, and future of the closely entwined surety and construction industries. Join us in paying homage to—and shaping—your industry's journey.

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# NASBP Upcoming Meetings & Events

## **ANNUAL MEETING & EXPO—75TH ANNIVERSARY**

April 23-26, 2017  
Boca Raton, FL

## **LEGISLATIVE FLY-IN**

June 6-7, 2017  
Washington, DC

## **SUMMER SURETY SCHOOL— Levels I, II & III**

July 30-August 4, 2017  
Dallas, TX

## **REGIONS 8, 9, 10 & 11 MEETING**

September 10-12, 2017  
Miramar Beach, FL

## **REGIONS 4, 5, 6 & 7 MEETING**

September 21-23, 2017  
Chicago, IL

## **REGIONS 1, 2 & 3 MEETING**

October 4-6, 2017  
Deer Valley, UT

## **MID-YEAR BOARD MEETING**

November 9-11, 2017  
Austin, TX

## 2016-2017 Executive Committee



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# IFIC congratulates the NASBP on its 75th anniversary!

As an NASBP affiliate member, IFIC is proud of the NASBP. Our industry's place in the economy is well served due to the remarkable leadership NASBP provides on behalf of the surety profession.



From the CEO

# Looking Backward to Reach Forward



A HISTORY KNOWN  
AND CHERISHED  
ENRICHES A  
COMMUNITY,  
MELDING ITS  
IDENTITY, VALUES,  
AND PURPOSES  
INTO A COMMON  
CORE FROM WHICH  
A SUCCESSFUL  
FUTURE CAN ARISE.

This year, NASBP marks 75 years of existence as an organization devoted to protecting the interests of bond producers and promoting the welfare of surety bonding. The surety community will recognize and celebrate that considerable accomplishment this spring during the NASBP Annual Meeting & Expo at the Boca Raton Resort & Club in Boca Raton, Florida. Such singular occasions give rise to natural inclinations to recall the points of the journey that led to the present and reflect on what may constitute the future. One of my favorite writers, Robert Penn Warren, who penned the classic political novel *All the King's Men*, once remarked: "History cannot give us a program for the future, but it can give us a fuller understanding of ourselves, and of our common humanity, so that we can better face the future." A history known and cherished enriches a community, melding its identity, values, and purposes into a common core from which a successful future can arise.

Organizations fortunate enough to have created a 75-year pedigree invariably demonstrate that they have been the beneficiaries of a lineage of able leaders, who provided essential elements for a sustained advancement: passion, direction, commitment, and vision. This certainly is true of NASBP. As general counsel, then as chief executive officer, I have had the privilege of working closely with and getting to know 12 different NASBP presidents, each of whom brought his or her own style and imprint to the role of leading NASBP, yet kept NASBP initiatives ever mindful of the overall mission of the association: To strengthen professionalism, expertise, and innovation in surety and advocate its use worldwide.

It is fitting that this issue of *Surety Bond Quarterly*, which will be distributed in time for the NASBP Annual Meeting, begins with recollections contributed by some of NASBP's past presidents over the last 25 years. These exceptional leaders navigated NASBP through opportunities and challenges, both large and small, that have shaped NASBP's present and that will continue to inform its future.

I cannot recast all of the sentiments contributed, but I can summarize a selection of highlights: John Hoffman recalled making strides in bringing "diversity of all kinds" to the association to strengthen its community; Robert Saul related the important work of the Task Force of the Future on setting the direction of the association; Don Martin noted that many of his energies, and those of the association, focused on the advent of subcontractor default insurance and explaining the value of bonds versus insurance products; and David Skillings remembered the unsettling emptiness of his airline flights to regional meetings shortly after the tragedy of 9-11. Matt Cashion reminisced about the wonderful connections made and the inevitable twists and turns he faced as a NASBP leader; Craig Hansen remarked on the difficult period of surety losses that ended during his presidency, as well as the successes of NASBP's state legislative efforts to eliminate the practice of directed suretyship; and Ed Heine and Steve Cory both underscored their desires to ensure NASBP's future legacy through, in Heine's case, improvements to the association's structure and capabilities and, in Cory's case, creating a young leaders group: the 5-15 Leadership Circle. Sarah Finn reflected on the hard work it took to add value to the NASBP experience for surety professionals through strengthening membership services and Member engagement; Bill Maroney emphasized showcasing the enduring theme of surety as a protector of the public's trust; and Todd Loehnert recalled the considerable energies expended in reprising the association's federal legislative fly-in, transitioning chief staff executives, establishing the Associates category of membership, and recognizing passionate association contributors with our highest awards. Spence Miller recalled fueling the

*Continued on page 11*



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**THIS SPECIAL MEETING WILL FULLY EMBRACE THE INCREDIBLE COMMUNITY THAT IS SURETY, ALLOWING EACH OF YOU THE OPPORTUNITY TO PAY HOMAGE TO YOUR INDUSTRY'S PAST, TO RELISH ITS PRESENT, AND TO ENGAGE IN DIRECTING ITS BRIGHT DESTINY.**

association's efforts to bolster its electronic communications through the NASBP *SmartBrief*, as well as taking part in the revisions of the American Institute of Architects' bond forms, ensuring they incorporated surety perspectives; John Rindt encouraged the association's effort to make individual sureties accountable and witnessed the first bill introduced into Congress for that purpose; and Carl Dohn recollected his passion for the association's initiative to create a higher educational level—Level III—to the Surety School so that NASBP educational offerings spanned a longer period of a surety professional's career. Larry McMahon related his pride at NASBP's efforts to pass federal legislation addressing the treatment of individual surety assets and at laying the foundation for a new association publication, *Surety Bond Quarterly*; Tom Padilla recounted his personal gratitude to Members, Affiliates and Associates who opened their hearts and wallets to support research for the veteran community suffering with post-traumatic stress; and Susan Hecker recalled "pounding the pavement" to push the federal individual surety legislation through to enactment, as well as the satisfaction at challenging the young producer leaders of the 5-15 Leadership Committee to network with their counterparts on the company side and seeing them rise so successfully to the challenge.

In my many conversations over the years with NASBP Members, the

mention of the importance of relationships in surety bonding is axiomatic. Indeed, it is all about relationships and the community they create, as so well evidenced in the sentiments of these NASBP leaders, which have defined our past, steadied our present, and will impel our future. President Lynne Cook has worked tirelessly to present a 75th Diamond Anniversary Celebration that gives voice to her theme: Building the Bonds of Surety—Honoring our Past.

Defining our Future. This special meeting will fully embrace the incredible community that is surety, allowing each of you the opportunity to pay homage to your industry's past, to relish its present, and to engage in directing its bright destiny.

Warmest regards,

**Mark H. McCallum**  
NASBP CEO



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# The FUTURE OF THE CONST



BY STEVE HALVERSON

A DANGER IN making predictions about the future is that you may live long enough to be held accountable for what you say. So it is with my 1994 article in *Suretyscope*, which is republished here following this article. Looking back on what I wrote almost 23 years ago, I am a little embarrassed. Not so much by what I predicted—I stand by most of it—but rather the overly confident tone and sheer length of what I wrote. Having now been “pickled by the vinegar of experience,” I am more respectful of long-term uncertainty and the value of brevity. This reprise will be a bit more circumspect and a lot shorter. Let me briefly comment on the hits and misses of the 1994 article, offer some predictions about what lies ahead for the industry, and conclude with some thoughts on the implications for industry leaders as they guide this great industry forward.

## Hits and Misses

The 1994 article highlighted six trends for the future and predicted their impact on the construction industry. Most were correct, some were off, and none were completely correct. The biggest miss was underestimating the velocity and magnitude of the trends noted. A brief recap follows:

### Technology advancement

The 1994 article predicted dramatic change and improvement due to technology application, with specific emphasis on communication technology. Even as far back as 1994, this wasn't an especially radical prediction. Perhaps the related prediction that technology would promote greater integration and stimulate industry realignment was a bit more insightful. But completely missed in the analysis was that the exponential growth in computing power, speed, and lowering of cost would continue for another 23 years and counting. The technology applications made possible by this growth were unimaginable in 1994. To help understand how big these developments are, Intel engineers very roughly analogized microprocessor development with automobile development over the last 45 years. Using the iconic 1971 VW Beetle as a baseline, what would the 2017 version look like if

it had improved speed, efficiency, and cost at the same rate as a microprocessors? Roughly, this imaginary Beetle would go 300,000 mph, get 2 million miles to the gallon, and cost four cents. The uninterrupted exponential growth of computing power—Moore's Law—for another two decades and counting was unimaginable in 1994, but it happened. The implications for design and construction can scarcely be overestimated. More on this later.

### Globalization

The 1994 article was largely correct about globalization. Global activity by U.S. firms dramatically increased in both absolute and relative terms. So has foreign activity in U.S. markets. Global M&A activity has been very significant. Several of the most storied names in American design and construction have been acquired by foreign firms and vice versa. In material respects, the global industry has been restructured. The consequences of that restructuring, for the most part, lie ahead.

### Environment

As predicted, environmental concerns and sustainability have become deeply embedded in the industry DNA. LEED certification is a base standard. Net zero carbon



# CONSTRUCTION INDUSTRY 2.0

consumption went from fanciful dream to reality in an astonishingly short period of time. Millennial entrants to the industry virtually demand a culture of environmental sensitivity as a condition of employment. Construction has gone from environmental laggard to environmental leader. Much of the best thinking on sustainability issues comes from U.S. design and construction firms. What the 1994 article missed, however, was the magnitude of the environmental challenges we face. Climate change was a topic mostly confined to scientific circles. Today there is general scientific consensus on the reality of climate change, and the topic has become perhaps the largest geopolitical question facing the world and a question of existential dimensions. The industry has much to be proud of in its environmental accomplishments, but the challenges ahead are dramatically larger than we understood 23 years ago.

## **Privatization**

The predicted growth in privatization and public-private partnership (P3) delivery certainly proved true; many of the largest and most important infrastructure projects over the past 20 years have been delivered through a P3 model. But I

am surprised it hasn't become even more prevalent. The U.S. continues to underinvest in infrastructure. The already staggering infrastructure deficit has only grown larger. Interest rates have been at historic lows for a very long time. Yet P3 delivery remains unnecessarily complex and expensive. The list of proposed P3 projects that didn't go forward is disappointingly long. Capital remains abundant and cheap. The industry largely has developed the capacity and competency to effectively deliver P3 projects. What is needed is public sector engagement to build rational, cost-effective and risk-balanced P3 delivery models to unlock the potential for private sector involvement in infrastructure development. We are squandering an immense opportunity to broadly improve infrastructure and realize the corresponding economic and social benefits modern infrastructure always brings.

## **Training**

The 1994 article predicted a greatly improved training environment in construction with corresponding improvement in productivity. While certainly there has been improvement, this prediction was mostly a miss. The workforce challenges in 1994 were pretty much the same

challenges as today. We continue to suffer an acute labor shortage. We continue to struggle with productivity. Wages in real terms have stayed flat at best. Industry executives overwhelmingly point to labor shortages as their single biggest concern. Some of this can be blamed on the historically deep and long Great Recession but not much. Labor shortages, skill deficiencies, and slow productivity gains were problems before, during, and after the Great Recession. As an industry we simply haven't met this challenge and we must.

## **Industry realignment**

The predicted industry realignment certainly has occurred. A substantial part of industry M&A activity over the past 20 years has been aimed at combining design and construction capabilities into a single firm. Construction firms are adding design capabilities and vice versa. Specialty design firms are joining larger organizations or building larger capabilities not just for reasons of scale, but in order to present a different profile to the market. Strategic partnerships, as distinct from single project joint ventures, are more common. Increasingly, owners seek broad capabilities in large part to better shift risk. The industry looks markedly different today than it did in 1994.



In short, the industry has changed, and improved, in many ways. While still facing significant issues, it is a stronger, healthier industry. Balance sheets are generally stronger. Operations are improved. Workplace injuries have declined by more than half. Construction firms are more resilient. Surety loss ratios have been low for a decade, even through the Great Recession, which is astonishing.

So what lies ahead? What big trends will shape the industry over the next 20 years? What are the implications for industry leaders? I wasn't especially prescient in 1994, and I still am not. But secure in the knowledge I likely won't be asked to revisit the topic 20 years from now, let me take a shot at what I think industry drivers are likely to be and what it means to industry leaders.

### **The New Future of the Industry—A Guess**

The next 20 years for the construction industry likely will be dominated by a continuation/acceleration of current trends and some new emerging trends. Here are my top four, some of which have more than one part:

#### ***The four forces shaping the future—technology, globalization, energy, and climate change***

These four forces will shape much of the future of the world, not just the construction industry. I think about them together, as they are inextricably intertwined. You can't draw meaningful conclusions, or even have very educated guesses, if you don't consider these four big forces together.

Nobody seriously questions the continuing profound impact of technology on the construction industry and pretty much everything else. Once exotic tools like BIM are now commonplace and are becoming industry standard practices. But the continued exponential growth in computing power opens the door to much more profound technology applications. Until recently, we used computers to use and manipulate

## **THE RAPID GROWTH IN RENEWABLE ENERGY HAS VERY POSITIVE IMPLICATIONS FOR CONSTRUCTION.**

structured data in much more efficient ways. But data still were structured. The massive power and speed of computers, now infinitely multiplied in a cloud environment, allow us to analyze immense quantities of unstructured data—"big" data—to discern patterns and insights we couldn't possibly do any other way. The potential applications of big data analysis are limitless. Examples are everywhere. Already in construction, big data applications are helping us think completely differently about safety, using predictive analytics that use sophisticated algorithms to mine extremely large data pools to predict where problems are likely to occur. There are scores of other applications too numerous to describe here. We have barely scratched the surface of technology application. A recent McKinsey study estimates that digitization has only realized 12 percent of total opportunity, and it represents our best chance to address some of the industry's most intractable problems.

The case for continued globalization is a bit harder to make. The recent nationalist wave in the UK, United States, France, and elsewhere marks an abrupt directional shift for global trade and economic interdependence. I think this is best viewed as an aberration. The forces of globalization are powerful, secular, and irreversible. For the sake of our industry, we should hope so. Perhaps the most important development over the last 15 years is that over one billion people have been lifted from extreme poverty. Across the world, poverty is being reduced, a middle class is being enlarged (much too slowly), and the world population is being urbanized. All of these factors are powerful demand drivers for construction. The U.S. remains by far the largest construction market in the

world and will remain so for the foreseeable future. But the big growth opportunities will be elsewhere. Over the last 20 years, the U.S. construction industry has become considerably more able to take advantage of global market opportunities. The steady implementation of free trade agreements has greatly aided globalization of our industry and, not coincidentally, helped reduce poverty throughout the world. Current events certainly create headwinds to continued globalization, but this almost certainly is temporary. The world has become deeply interconnected, and that interconnection has greatly aided global growth. It will continue.

One of the biggest surprises over the past several years is the revolution in energy production. The thought that the U.S. would become the largest producer of energy was unimaginable. The direct and indirect impact on the construction industry is enormous. Energy production and distribution is estimated to account for 23 percent of all construction employment. The emergence of lower energy costs has made the U.S. a more competitive venue for capital expansion. The rapid growth in renewable energy has very positive implications for construction. While very low energy prices are dislocating for firms involved in energy production, the long-term benefits of U.S. energy independence is a strong positive for the industry.

The response to climate change is the overarching issue of our time. Space doesn't permit making the case for the existence and significance of climate change, but rarely has there been greater scientific consensus on anything. It will affect virtually everything, specifically including construction. Everything from the nature of urban areas, the design of infrastructure, power generation and distribution, water/wastewater design, and a host of other things will be influenced by climate change. And it is likely to be much quicker than we expect or are prepared for.



These four forces are intertwined. Technology enables and accelerates globalization. Changes in the energy regime are inextricably linked to climate change. Everything influences everything else.

#### **Privatization will find its feet**

Privatization and P3 project delivery certainly have been a major trend over the last 20 years. What is surprising is that they haven't made bigger inroads. Look for new models and approaches to P3 delivery. The federal government will take the lead. Current models are too complicated, too expensive, and too risky. More standardized approaches are needed that simplify procurement and more rationally distribute risk. Federal infrastructure spending is almost certain to increase. While projects will continue to be executed primarily by states and municipalities, the federal government can influence process reforms through grant conditions tied to federal funds.

#### **New human rights—food, water, and healthcare**

The rise of so many from extreme poverty will reset basic expectations for people everywhere. The world will begin to consider food, water, and healthcare basic human rights. We have the capacity and a moral obligation to make this happen. These will be global mega-markets that will present tremendous growth opportunities for design and construction firms with competencies in these areas.

#### **Employment will be redefined**

One of the most perplexing developments in the U.S. is the steady decline in workforce participation. Only about 61 percent of working-age adults are in the workforce. That means there are about 90 million Americans of working age who aren't working or aren't working as much as they would like. It isn't a gender issue; women and men are nearly equally represented. The issue is a more fundamental disconnect between work and life. This will change. Work will be

## **LOOK FOR NEW MODELS AND APPROACHES TO P3 DELIVERY. THE FEDERAL GOVERNMENT WILL TAKE THE LEAD.**

more transactional in the future. The idea of a full-time job where you go to an office and put in eight hours a day will give way to working on defined tasks or projects. Managers will need to be trained to manage flow processes, not just people. In his recent book, *Thank You for Being Late*, Thomas L. Friedman describes a workforce experiment undertaken by GE. It sought to come up with a better design for a jet engine bracket. "Better" meant lighter and cheaper but still very strong. Rather than turning to its formidable in-house engineering team, GE held an open competition. It published the technical requirements for the bracket and invited submissions from anyone, promising a \$10,000 stipend. The winning entry was a design that met all requirements at 40 percent less weight and significantly lower costs. The winning designer was a third-year student in Eastern Europe who submitted the design to help fulfill a coursework requirement in 3D modeling. My guess is he had a job offer from GE upon graduation. The construction worker of the future will look different from today's, possessed of technology providing actionable analytics, managing robots, and better educated. This isn't fanciful. It already is happening, albeit outside of construction. Just since 2009 the number of industrial robots deployed has quintupled. Conventional wisdom is the growth in robotics comes at the expense of jobs. But that isn't the case. The market sectors that most actively embraced use of robots actually saw employment grow. Robotics isn't about job displacement; it is about improved productivity.

#### **Implications for Industry Leaders**

So what does all this mean to construction leaders? How do you plan

for an uncertain future? In the words of science fiction writer William Gibson, "the future is here today—it's just not evenly distributed." This neatly sums up the challenges for industry leaders. The challenge is less about predicting the future than it is being prepared for any eventuality. Five thoughts for industry leaders:

#### **Creating competitive space through technology—the primary challenge**

The opportunities presented by technology application in construction are virtually limitless. The key is the opportunities aren't the same for every business. A primary challenge for industry leaders is to decide precisely how to use technology in the context of their own business. The answer will be different for every business.

#### **Solving the productivity dilemma is crucial**

I don't know a single industry CEO who isn't worried about the structural labor shortage and the stubborn resistance to achieving productivity improvements. The solution rests somewhere in rethinking the nature of employment and leveraging human capital with machine learning, often called the "internet of things." Automating routine tasks to make better use of valuable labor is essential. The idea is more present than future. Just a few years ago, 80 percent of all devices connected to the internet were communication devices—telephones, computers, iPads. Today that number is only 30 percent. Fully 70 percent of internet connected devices are "things"—appliances, equipment, and the like. That trend is relevant to construction.

#### **Risk management—more complicated and more important than ever**

Traditional risk management revolved around operational risks on a project level, mitigated by insurance with traditional coverages. Industry



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realignment, together with new delivery models, has made risk management much more complex in construction.

#### **New roles for sureties**

Sureties have been a bedrock to the construction industry for over a century. But demand for traditional surety bonds is waning. That doesn't mean sureties are less important; it simply means needs have evolved. Sureties bring at least three core assets: (1) superior risk management processes; (2) very broad industry knowledge; and (3) fortress balance sheets and formidable financial expertise. These assets can be deployed in a wide variety of ways other than traditional surety bonds. Sureties need to continue to develop new products and new services adapted to a new industry.

#### **New kinds of leadership**

Successful leaders in the future will be markedly different than current leaders. The old adage "what got you here won't get you where you are going" is apt. Deep operational knowledge, strong accountability, close management skills, and attention to detail were hallmarks of successful leaders in the past. In the future, curiosity, a passion for innovation, a strategic sense of technology, and an ability to rapidly adapt will also be indispensable qualities for successful leaders. Finding and developing future leaders will be a significant challenge.

So looking to the next 20 years, some of the challenges are the same and some are different. What hasn't changed, at least for the author, is an abiding confidence that the future will be larger than the past. We have a stronger industry. We have numerous markets with tremendous opportunities for growth. We have technology tools that hold the promise of fundamentally transforming the industry. Whatever temporal headwinds may be present are vastly outweighed by future developments that promise to create enormous opportunities. It is a good time to be in the construction

industry. And it always will be for the prepared. ●

*Steve Halverson is Chairman and Chief Executive Officer of The Haskell Company, one of the nation's largest integrated design-build organizations, with operations throughout the United States, Latin America, and Asia and headquarters in Jacksonville, Florida. During his 16-year tenure as CEO, Haskell expanded its operations internationally and its stock value increased*

*over 1,500 percent. He has served as national Chairman of the Construction Industry Roundtable, the Design Build Institute of America and the National Center for Construction Education and Research. He currently serves as a corporate director of CSX Corporation (NASDAQ:CSX), Guidewell Mutual Insurance, a \$13 billion health solutions company, and ACIG, a Texas insurance company. Halverson can be contacted at Haskell Company at <http://haskell.com/contact> or 904.791.4500.*



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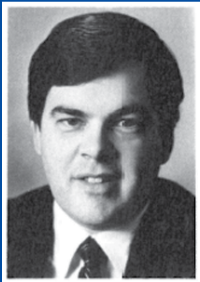
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# A LOOK BACK TO THE "FUTURE"



Steven T. Halverson in 1994

In celebration of NASBP's 75th Anniversary, NASBP is taking time not only to examine the surety industry's past, but also that of the construction industry, as the lifeblood of both industries is so closely entwined. The following article is an adaption of a presentation made at the NASBP Region 3 Meeting in 1994 by Steven T. Halverson, who was then-Regional Vice President of the construction firm of M.A. Mortenson Company in Denver, CO. It is remarkable in hindsight to see how many of Halverson's predictions were on target in the archive article. For example, fundamental restructuring has transformed the construction industry; and, no doubt, privatization of public projects is a major headline of news reports today. Halverson, likewise, was on point with the challenges he described in 1994. Such challenges are similar to those that the industry faces today, more than 20 years later.

Enjoy the following article, which was originally published in the Autumn 1994 NASBP publication, *SuretyScope*, just two years after the NASBP 50th Anniversary. Be sure to also read Halverson's most recent predictions for the surety and construction industries published in this current issue of *Surety Bond Quarterly* on pages 12-17. Based on his previous record, Halverson's latest predictions are well worth close attention.

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# The Future of the Construction Industry

BY STEVEN T. HALVERSON

**BEFORE ADDRESSING THE** future of the construction industry, it is worthwhile to question whether there is a future for the construction industry. I have a positive point of view about this, but the question is valid. Much has been written, and written accurately, about the decline of the U.S. construction industry. For five consecutive years, rates of bankruptcy among construction companies have been higher than almost any other industry in the United States. Over 1.5 million construction jobs have been eliminated since 1990. Backlogs for building contractors, averaged over the past three years, are at their lowest levels in 15 years. Workers compensation premiums, according to some reports, are expected to rise 200 to 300 percent faster than the consumer price index over the next five years. This, in spite of reform legislation in several states. Reliable data regarding financial performance of construction companies are hard to come by. But none of the various reports paint a very positive picture. Average net operating income for general contractors is about 1.85 percent. The biggest, publicly traded firms fare only a little better; maybe 2.0 percent. According to Dun & Bradstreet reports, median current ratios are only about 1.35 percent. Average long-term debt as a percentage of capitalization has increased.

To make matters worse, the risk portfolio faced by most contractors has substantially increased in the past ten years. Environmental risks, product liability risks and a consistent pattern of shifting to contractors various risks previously borne by owners, all contribute to a more dangerous climate for the construction industry.

## STEVE SAYS ...

**1994:** *We are entering a period of fundamental restructuring of the very core of our industry.*

**2017:** Correct. The industry has been considerably transformed.

Worse still, the construction industry, like many industries, faces a future where the workforce will be inadequate for the task at hand. Construction productivity declined almost 20 percent over the past twenty years. By comparison, manufacturing productivity in the U.S. *improved* almost 40 percent over the same period. This may be the greatest threat of all.

## Major Directions

All that said, those that would wring their hands over the sorry state of affairs and predict the demise of the U.S. construction industry are wrong. We are, I believe, entering a period of fundamental restructuring of the very core of our industry. It will be a period of great turbulence, but also one of great opportunity. At the end, I envision a fundamentally stronger construction industry. Peter Drucker, in his book *The Post Capitalist Society*, contends that every few hundred years in western history there occurs a sharp transformation. Within a few decades society rearranges itself: its world view, its basic values and its social and political structures. I think Dr. Drucker is correct and I think his observations apply to our industry. There may be hundreds of trends or factors to watch, but let me focus on six that I think will be transformative.

## Technology advancement

For many, the notion of technology in construction is a paradox. They would contend that construction and its techniques have fundamentally not changed in the last fifty years, perhaps longer. They are right. If you look at a construction project today, it is difficult to discern what fundamental differences there are from the industry half a century ago. Building systems are fundamentally unchanged. The division of craft labor is fundamentally unchanged. With a few notable exceptions, materials are much the same. While there certainly is more heavy equipment on projects than in the past, the means and methods of putting materials in place, and the schedules required therefor, are not a lot different.

But that was then and this is now. There are number of technology developments that clearly will affect the construction industry in the near-term future. Smart tools are being developed that allow workers to perform complex tasks more readily. Sensors are being used for inspection. Composite, high strength materials are being developed. We now use global positioning technology to assist in layout. There is increasing use of modularized building systems, particularly in the mechanical trades.

But no technology offers more promise than the explosion of information and telecommunications technology. Computers, of course, have been around for a long time. They have been used on construction projects for a long time. Until recently, however, they primarily have been used to do the same things we always did, only faster and better. The power of computing has now developed to a

point where it allows us to do things fundamentally *differently* than we ever did before. Construction is an inherently complex business. Even casual observers of the construction process are struck by the enormous amount of information that is required to construct a project. Hundreds, even thousands, of detailed drawings are required. Hundreds of thousands of technical specifications, requests for information, and other forms of documents are needed. Complex calculations are engaged in the design. For years and years, this complexity dictated a labor intensive, highly redundant methodology for doing business. Projects were fragmented and broken into many parts. Different companies undertook different parts of a project. This extends both to design and construction, of course. The Center for Strategic Studies at the University of Reading in England noted this as the central problem that precluded technological innovation for the construction industry. In its 1989 report, the Center noted "it is difficult for many firms to invest in their futures because they do not produce and market a clearly identifiable product. Instead, they are responsible for one part of building a project. There is no clear incentive to invest steadily and consistently in improving the end product."

This, of course, is absolutely correct. We have an exceptionally fragmented industry. On a project of even average complexity, there may be five to fifteen firms involved in design. Forty to one-hundred companies may be involved in construction. Many, many more supply materials, professional services and other elements necessary for completion of the project. We general contractors delude ourselves into thinking we are the center of responsibility for this process. But this really is not so. A great deal happens entirely outside the realm of a general contractor's operation.

But all of this is in the process of changing. There is a major thrust toward integration of design and construction services. Let me emphasize again, this is not a matter of doing things the way we always did faster. It

## STEVE SAYS ...

**1994:** *Our entire notion of what is achievable in construction will dramatically change.*

**2017:** While not an objective statement, I think it is mostly correct and gets more correct all the time.

is a matter of doing things differently than we ever did before. In 1990 there was a book published, *The Machine That Changed The World*. This book provided an in-depth study of how the process of design and production of automobiles was fundamentally reinvented by Toyota. The book reports, correctly, that Toyota and other manufacturers challenged every assumption and bias about building automobiles. Supplier networks were reconstituted, product development processes were redesigned and manufacturing processes were reengineered. I suspect if you went to a worker on an automobile production line and asked what about his job that changed in the last ten years, he or she would say almost everything.

There is a similar prospect for renewal of the construction industry. For the first time, we have technological tools that enable simultaneous and virtually instantaneous sharing of enormous quantities of data relating to the construction of facilities. Many design and construction processes can be done at the same time. Indeed, this is already being done in small ways. Recent studies at MIT have shown how design teams from around the world can be electronically linked with both data and video transmission capabilities, to produce complete designs from locations that are spread literally around the globe. Engineers are able to take CAD produced design documents and electronically control laser cutting machines in sheetmetal fabricators' shops.

These new ways of doing things alter basic relationships within the industry. I think there will be a fundamental restructuring of how the industry is organized. Architectural firms,

engineering firms, and construction contractors will need to fundamentally change in order to remain competitive. There is clear opportunity in recreating and making more efficient processes by which we build buildings in this country. Most readers no doubt heard about the contractor involved in reconstruction of the Santa Monica freeway that earned a fourteen million dollar bonus for early completion. You will hear more stories like this. Our entire notion of what is achievable in construction will dramatically change and application of information technology will be a primary reason.

## Globalization of the construction industry

It is almost trite to note that the world economy is becoming globalized and that this is affecting the construction industry. But different people have different views on the subject. The prestigious Construction Industry Institute, in its report, *The Anatomy of Construction Industry Competition*, reports that the United States secured a declining share of the international construction market. In the period 1966 through 1971, CII estimates that the United States controlled 69 percent of the global construction industry. This percentage declined to approximately 36 percent by 1985. I suspect these figures are right, but the conclusions drawn can be misleading. Since World War II, the United States dominated construction. This resulted as much from the fact that the United States was the only developed country in the world relatively unscathed by the ravages of World War II. The economies of Western Europe, Soviet Russia, and Japan were quite literally destroyed. From the Marshall Plan forward, the United States helped rebuild the world and in the process, rebuild the capacity of the world construction market. It should come as no surprise that these efforts were largely successful and that the unnaturally dominant position of the United States would erode.

The real surprise is that the United States still controls 36 percent of the international construction market. And the real news is elsewhere. From the



period 1986 to 1992, the *Engineering News Record* top 400 saw international contracts grow from \$15 billion to \$75 billion. Perhaps the even bigger news is that the share of the domestic construction market enjoyed by foreign firms, while still small, grew 375 percent in that same period. What is happening is not merely a matter of decline versus ascendancy. The construction market is fundamentally becoming globalized. Foreign firms can compete here and U.S. firms can compete elsewhere. On balance, I think this vastly favors the United States construction industry. Why? The answer is pretty straightforward. Due in part to the collapse of command economies in the former USSR and Eastern Europe and elsewhere, there is an unprecedented boom of developing countries throughout the world. Asian countries, and most particularly China, are enjoying the most rapid expansion perhaps ever witnessed in history. When was the last time you heard about the Latin American debt crisis? It has been awhile. Mexico has a surging economy, a budget surplus and a substantial construction market to show for it. Other countries in Latin America are only a few steps behind. I predict the North American Free Trade Agreement shortly will become the America Free Trade Agreement, as other Latin American countries reach similar accords.

All of this represents substantial new markets in areas where local industry capacity may be inadequate to meet demand. The Construction Industry Institute estimates that by the year 2000, fully 80 percent of the world construction market will be in underdeveloped countries. Moreover, for all of the handwringing about productivity, the United States remains among the most productive in the world. It is fully 35 percent more productive than the much celebrated Japanese construction industry. It is more productive than the United Kingdom and France, in fact every place with the possible exception of Germany. U.S. firms have particular experience in facilities that are much in demand elsewhere in the world, including wastewater treatment plants,

## STEVE SAYS ...

**1994:** *By the year 2000, fully 80% of the world construction market will be in underdeveloped countries.*

**2017:** Not quite, but close — probably closer to 70%. Crucially, I put China in the “underdeveloped” category.

water treatment plants and cogeneration facilities. There is no question in my mind that the globalization of the construction economy is already upon us and that it fundamentally favors U.S. firms.

### Environment

Concerns over the environment have been a driver of the U.S. construction economy since the early 1970's when Congress established the Environmental Protection Agency and passed the Clean Water Act. Since then, literally hundreds of billions of dollars have gone into improving the environment. The resultant improvement, particularly in water quality standards, has been one of the great achievements of the last few decades.

As much progress has been made and money spent, there remains far more opportunity ahead for the construction industry. Internationally, water quality concerns have become acute, and even life threatening. Consider this one sobering statistic; according to the World Health Organization, last year over 35,000 children *each day* died from water-borne diseases. These are easily controlled by wastewater and water treatment facilities as has been done in this country over the past 20 years or so. Importantly, for the first time, developing countries have the economic wherewithal and the political imperative to make similar strides in improving water quality.

In this country, I think you can expect to see a similar push for fundamental improvement of air quality standards. *Engineering News Record* projects it will take \$150 billion to \$200 billion to

comply with current air emission standards in this country alone. Another \$500 billion will be needed to clean up hazardous waste sites. I think there is a new attitude regarding environmental protection. In the past, most people looked at environmental protection as a matter of forced regulation. I really do think that now people view it as a fundamental requirement of everything we do. A safe environment is seen as an inherent right. There will be a major emphasis on recyclability of construction materials. Just as the industry set zero lost-time accidents as the only acceptable standard for safety performance, zero construction waste and emissions will be the standard for future construction operations. This creates all sorts of opportunities for emerging technologies and companies developing niche markets in construction waste management.

Closely related to traditional ideas of environmental construction is power generation. In the past, power generation has been looked on simply as a means to an end. In the future it will be looked upon from the standpoint of the environmental impact of the various, competing forms of power generation. Look for increased use of cogeneration, developments in clean coal technology and yes, even a rebirth of nuclear power generation as plant design allows for absolute certainty that meltdowns, such as the disaster in Chernobyl, simply cannot occur.

Overall, environmental construction will be one of the “megamarkets” of the future and one which favors U.S. firms.

### Privatization

Few trends are more certain than the trend toward privatization, both in the United States and elsewhere in the world. Privatization is a loosely applied term that generally refers to the private operation of traditionally public activities. Examples include the construction and operation of prisons, wastewater treatment facilities, roads and utilities.

A combination of factors makes the trend toward privatization compelling. The U.S. infrastructure is in a state of

serious decay. Net public investment in infrastructure, as a percentage of GDP, declined from a high of 7.3 percent in the late 1960's to a low of 0.4 percent through much of the 1980's. Estimates of necessary public investment range as high as \$3 *trillion* just to maintain levels of service comparable to 1983. Obviously, this level of spending is not in the cards. Furthermore, notions about the role government should play in providing vital services are changing. Government is shifting from a *provider* to a *facilitator* of public services. The strategic use of privatization has been employed with dramatic success elsewhere in the world. Mexico used privatization to transform its staggering budget deficit (13 percent of GDP) to a budget *surplus* in less than six years.

To be sure, privatization is not a panacea. It certainly has the capacity to increase equity in public investment in infrastructure, and it certainly can create substantial opportunities for the industry. But it doesn't really create new wealth or value; it simply transfers it. Nonetheless, construction companies will need to significantly expand the services they provide to meet the coming demand for privatized projects. They will need to combine feasibility planning, design and financial services with traditional construction services in order to compete in this burgeoning future market.

### Training

A recent article in *The Denver Post* reported on the shortage of skilled construction labor in Colorado. The article noted people could expect delays in getting work done on their homes. The report is right; construction unemployment (after adjustment for DIA) is at the lowest level in eleven years. But the real problem is much deeper. The labor needs of our industry and trends in workforce composition are on a collision course. No one seriously argues the proposition that the workforce of the future will need to be more highly skilled, better educated and continuously trained. Rapid technological change and a more complex work environment assure this much.

### STEVE SAYS ...

**1994:** *Few trends are more certain than the trend toward privatization.*

**2017:** Mostly correct. The use of P3 development and project delivery greatly expanded but not as much as I thought it would.

But what is happening to the American workforce? Nothing very positive for our industry. By the year 2000, according to a report from the Hudson Institute, there will be 12 million fewer entrants into the workforce. But the needs of the construction industry are growing. Historically, construction has employed about 5 percent of the U.S. workforce. By the year 2000, this percentage is estimated to grow to 5.8 percent. Researchers, including a study by the Construction Industry Institute, predict the industry will need to attract 200,000 new workers each year to meet anticipated demand. This won't be easy. We have done a terrible job at promoting construction as a career choice for young people.

Survey after survey reveals that construction is perceived as a dirty, dangerous occupation, lacking in prestige and long-term opportunity.

An even greater challenge is getting the workforce trained to meet the future. Historically, the industry has relied on the public school system and trade unions to train its workforce. For different reasons, neither will be adequate in the future. The National Assessment of Educational Progress reports that only 27 percent of all new entrants into the workforce will be adequately trained to meet the skilled trades level. The literacy level is the lowest it has been in forty years. Reportedly, more than 90 million Americans can't read at a ninth grade level. Deductive reasoning skills have slipped more than 40 percent over the last ten years. The situation with trade unions is not much better. Unions simply do not have the resources they once did to apply to craftworker training. This will not change; only

25 percent of the construction workforce is unionized. Try as they might, unions will not, by themselves, be able to train the construction workforce of the future.

These problems are not new; they are just unaddressed. There is a compelling need for the construction industry to take forceful steps to provide comprehensive training and education for its own workforce. This requires a fundamental change in thinking. By any measurement, the construction industry has lagged almost all others in its per capita investment in its workers. We need to provide comprehensive skills and educational training programs for our workforce. We need to be active, supportive partners with our educational system, particularly vocational education, to improve the quality of new entrants to the construction industry. We need to actively promote construction as a career, not as a job, and offer benefits commensurate with the demands of the industry. We need to reinvent the historic relationships between contractors and organized labor to focus more on training.

Let me be clear about something. The training needs of our industry are not limited to the field workforce. The evidence suggests that while labor productivity has declined, the management of labor is more seriously deficient. Our professional managers are ill-suited for the future, and small wonder. In 1992, only 8 percent of the Bachelor's degrees awarded in the United States were engineering degrees. A significant number of them went to foreign nationals, many of whom will not remain in the country. The situation is even worse when you consider graduate degrees. About half of the engineering graduate degrees were awarded to foreign nationals, the majority of whom will return to their native countries. A vastly disproportionate amount of the construction research and development being performed at American universities is being funded by foreign construction and engineering companies. It is a tragic irony that the U.S. has built the world's finest university system and fails to take advantage of it.



The benefits of a new approach to workforce training are enormous. It is estimated that 50 percent of a construction worker's time is spent unproductively. Think of the benefits of improving this percentage! I can't think of a better or surer way to improve productivity and profitability of the industry than to develop a coherent plan for addressing the challenge of training the workforce of the future.

### Industry realignment

Maybe the most noticeable trend of all will be a fundamental realignment of the industry. The present disaggregation of the design and construction process will give way to a much more integrated industry. Look for the relationship among architects, engineers and contractors to change. Contractors will more and more offer engineering services. The most progressive designers will be more closely aligned with the subcontractors and suppliers who produce the work. Many of the routine systems in design and construction will be automated, leading to ever flatter organizations.

Most certainly, the coming years will bring more "strategic alliances", to use an overworked phrase. Firms will combine and collaborate in ways impossible before, due largely to advances in information technology. I truly feel the industry started a revolution with partnering a few years ago. Originally conceived as a means for reducing the incidence of debilitating disputes, partnering will unleash the formidable power of relationship-based collaboration on complex projects. Firms will combine based upon complementary competencies — to produce unique services for their customers.

One trend sure to drive industry realignment is the exponential advances in telecommunications. Work has transformed from a place you go to something you do. The implications for construction are substantial. The industry has always struggled with how to deliver its human resources to projects, particularly with the immobility brought by the increase in dual income families.

### STEVE SAYS ...

**1994:** *Small, fast innovators may cripple or even kill Jurassic era contractors.*

**2017:** Mostly correct but probably overstated. There are a number of examples of then-smaller but innovative firms that grew rapidly, such as DPR Construction.

There now are new ways of delivering human capital to projects, through fax, video and interactive computer communications. William Bridges, author of *Jobshift*, argues that the very concept of a "job" is becoming obsolete. This view may be extreme, but there can be no question that the means of getting work accomplished are undergoing fundamental change. Phil Burgess, President of the Center for the New West, a Denver-based think tank, coined the term "lone eagles" to describe the phenomenon of individuals working from their homes, providing services through electronic networks and travel. Look for construction companies to expand the reach of their managers by making them "lone eagles".

Some may think these trends only affect large businesses. In fact the reverse is true. John Naisbitt, in his recent book *The Global Paradox*, argues that ever larger information and economic systems make the smallest players more important. He's right. Technological advances allow even the smallest firms the opportunity to compete on a relatively level playing field with much larger firms. Innovative competitors of any size can sell knowledge to a willing marketplace, almost without geographic limitation. Knowledge will become a key to construction commerce, every bit as important as labor, capital and equipment. All of this promises great opportunity for large and small construction firms, but also significant risk. Never before have firms faced a comparable prospect of rapid, dramatic competitive change. Small, fast

innovators may cripple or even kill Jurassic era contractors.

### Conclusion — An Industry Ascendant

All of this, of course, has implications for the surety industry. How do you evaluate the health and viability of construction companies when their very nature is changing? What ratios measure innovation and insight into the future? How do you evaluate productivity and profitability when all the rules are being rewritten? How do you really assess the future impact of foreign competitors?

I wish I had answers to these questions, but I don't. I do have a fundamentally optimistic view of the future. With all the problems that beset the industry, the U.S. construction industry still competes, and competes well, with the best in the world. Of five key industries that will help shape the future - civil aviation, telecommunications, micro-electronics, material technology and robotics - the US is competitive in four. The Construction Industry Institute in a 1990 report opined that to improve the position of the U.S. construction industry, three forces must be overpowered: (1) relinquish paradigms that inhibit progress; (2) establish methods to overcome a shortage of qualified human resources; and (3) reestablish the working environment that allowed the U.S. to be a world leader in construction services — U.S. innovation and creativity.

I think this is a great summary of the challenges facing the industry. We certainly have the wherewithal to meet these challenges. In fact, I submit we have an ethical obligation to do so. Our industry lost over 1.5 million jobs already this decade. Construction historically accounted for about 12 percent of GDP. Now it is about 9.5 percent of GDP. Our country simply can't afford the erosion of quality jobs. We directly employ 5.5 million Americans and support many more. As industry leaders, we have an obligation to make construction what it historically has always been; an honest, honorable and satisfying way to lead a life. ●



## OUR MEMBERS

### ALABAMA

#### Russell, Thompson, Butler & Houston, LLP

Michael Thompson, CCIFP  
mike.thompson@rtbh.com

#### Warren Averett

Will Aderholt, CCIFP  
will.aderholt@warrenaverett.com

### ARIZONA

#### BeachFleischman PC

Philip Taylor  
ptaylor@beachfleischman.com  
Bryan Eto, CCIFP  
beto@beachfleischman.com

### CALIFORNIA

#### CliftonLarsonAllen

Julian Xavier  
julian.xavier@claconnect.com  
Ross Cofer, CCIFP  
ross.cofer@claconnect.com

#### Gelman LLP

Warren Hennagin, CCIFP  
when@gmccpa.com

#### RBTk, LLP

Kevin M. Brown  
kbrown@rbtk-cpa.com

#### Soares, Sandall, Bernacchi & Petrovich

Rick Heldwein  
rickh@ssbp.com

#### SorenMcAdam LLP

Cindy Watts  
cwatts@sorenmcadam.com

### COLORADO

#### EKS&H LLP

Shane Brown  
sbrown@eksh.com

### CONNECTICUT

#### CohnReznick LLP

Dan Donofrio  
daniel.donofrio@cohnreznick.com

### DELAWARE

#### Santora CPA Group

Bill Santora  
bsantora@santoracpa.com

### DISTRICT OF COLUMBIA

#### Thompson Greenspon

Nathan White IV  
nsw@tgccpa.com

### FLORIDA

#### E.F. Alvarez & Company, P.A.

Emilio Alvarez  
ealvarez@efacpa.com

#### James Moore & Co., P.L.

Roger Swanger, CCIFP  
roger.swanger@jmco.com

#### Kerkering, Barberio & Co.

Shirley Fieber  
sfieber@kbgrrp.com

#### Warren Averett

Kathleen Baldwin, CCIFP  
kathleen.baldwin@warrenaverett.com

### GEORGIA

#### Coker James & Company P.C.

R. David Coker  
rdc@cokerjames.com

### IDAHO

#### Harris & Co., P.A.

Robert Shappee  
robertshappee@harrisccpas.com

### ILLINOIS

#### Heinold-Banwart Ltd.

Scott Carr  
scarr@hbcpcas.com

#### Martin, Hood, Friese & Associates, LLC

Mark Czys  
mark@mhfa.net

#### Mowery & Scoenfeld, LLC

Tom Keenan  
tkeen@msllc.com

#### Mueller & Co., LLP

Ray Groesbeck, CCIFP  
rgroesbeck@muellerccpa.com

#### Scheffel Boyle

Mark Korte  
mark.korte@scheffelboyle.com

### INDIANA

#### Harding, Shymanski & Company, P.S.C.

Paul Esche, CCIFP  
pesche@hscpcpa.com

#### Katz, Sapper & Miller, LLP

Ron Lenz  
rlen@ksmcpa.com

### IOWA

#### BerganKDV

Brian Collier, CCIFP  
brian.collier@bergankdv.com

### KANSAS

#### CBIZ MHM, LLC

Pepper David, CCIFP  
pdavid@cbiz.com

### KENTUCKY

#### Baldwin CPAs, PLLC

Chris Hatcher  
chris.hatcher@baldwincpas.com

#### MCM LLP CPAs & Advisors

Matt Neely  
matt.neely@mcmcpa.com

### LOUISIANA

#### Daenen Henderson & Company

Jacquelyn S. Daenen, CCIFP  
jdaenen@dhc-cpas.com

#### LaPorte, CPAs & Business Advisors

Christina Chifci, CCIFP  
cchifci@laporte.com

### MAINE

#### BerryDunn

Linda Roberts, CCIFP  
lroberts@berrydunn.com

### MARYLAND

#### KatzAbosch

Kent Thomas, CCIFP  
kthomas@katzabosch.com

### MASSACHUSETTS

#### BerryDunn

Linda Roberts, CCIFP  
lroberts@berrydunn.com

#### CohnReznick LLP

Dan Donofrio  
daniel.donofrio@cohnreznick.com

### MICHIGAN

#### Iannuzzi Manetta & Co.

Chris Iannuzzi  
ciannuzzi@imc-cpa.com

#### The Rehmann Group

John Skukalek  
john.skukalek@rehmann.com

#### Walburg + Associates, P.C.

Curt Walburg  
cwalburg@walburg.com

#### Yeo & Yeo PC, CPAs & Consultants

Carol Patridge  
carpat@yeoandyeo.com

Mike Tribble  
mictri@yeoandyeo.com

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jim.main@claconnect.com

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jeff.stallings@stallingscpas.com

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mkarlins@calvettiferguson.com

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### Lane Gorman Trubitt, LLC

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bgross@lgt-cpa.com

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Jim Phillips  
jimp@pacpas.com

### RSM

Denise Bendele  
denise.bendele@rsmus.com

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steve.scoggan@claconnect.com

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nsw@gccpa.com

### Yount, Hyde & Barbour, P.C.

Kevin Branner  
kevin.branner@yhbcpa.com

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Colette Guckian  
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# Define the Surety Industry's Future — Your Future — by Helping Develop Surety Data Standards

**ONE OF THE** surety industry's challenges, or new frontiers, is to obtain a seamless transmission of information—surety data—between surety accounts, producers, and carriers.

The industry is working diligently to reach a single point of entry of data with distribution to many platforms without multiple touches, according to NASBP Automation and Technology (A&T) Committee Chair Robert M. Coon. "Implementing the use of standards for the surety industry creates increased efficiency, decreased errors, and better client relationships," said Coon of the NASBP Member firm Scott Insurance of Greensboro, North Carolina.

He believes the surety industry of the future will enable agents and brokers to enter information into the Association for Cooperative Operations Research and Development (ACORD) Surety Form with eLabels, making it machine-readable. The agents and brokers will be able to send the form to third-party software vendors or the surety carrier via email or a direct feed, populating their systems without anyone rekeying information.

Critical milestones are being met to reach this goal. Just recently, NASBP proudly announced that the NASBP's A&T Committee, working jointly with the Surety Forms Working Group, has added four surety bond forms to the ACORD Forms Library. ACORD is a global, nonprofit insurance association whose mission is to facilitate the development and use of standards for the insurance, reinsurance, and related financial services industries.

The creation of these forms is a major accomplishment in a tremendous effort of NASBP, Surety &

Fidelity Association of America (SFAA), and ACORD to facilitate the transfer of information and eliminate rekeying data.

These are the first of several forms that will be added to the library, including the following:

- ACORD 0501: Surety Report of Execution
- ACORD 0502: Contract Bond Request Form
- ACORD 0503: Commercial or Miscellaneous Bond Request Form
- ACORD 0504: Additional Entity Schedule

NASBP, SFAA, and ACORD are working to develop a streamlined distribution model for these standard ACORD forms. They are also working to bring XBRL into the surety underwriting process by making contractors' financial information computer-readable with data that can be extracted automatically into sureties' financial systems without rekeying. Currently, they are testing the XBRL taxonomy's capabilities using one of the NASBP Producer's Tool Kit forms: The Work In Progress (WIP) form. They are also working with vendors to offer ACORD eLabel functionality (consistent labeling of the fields on the ACORD forms) to vendors' products and services.

Take this opportunity to have a seat at the table in defining the surety industry—your industry.

To volunteer and participate on one of the groups (business case, use case, or marketing) that are creating surety data standards, contact Dave Golden, NASBP Director of Technology, at [dgolden@nasbp.org](mailto:dgolden@nasbp.org). ●

# JOINT VENTURING

## Under the SBA Mentor-Protégé Program



BY LORI ANN LANGE

IN AN ARTICLE published in the Winter 2016 issue of *Surety Bond Quarterly* (see [suretybondquarterly.org](http://suretybondquarterly.org)), I discussed how two companies can apply to be a mentor and a protégé under the Small Business Administration's (SBA) All Small Mentor-Protégé Program. As noted in the article, one of the main benefits of the mentor-protégé program is the ability of a small business protégé to form a joint venture agreement with its large business mentor on federal government contracts set aside for small businesses, as long as the mentor and protégé comply with SBA's regulations. This article will discuss the requirements of any joint venture agreement between a mentor and its protégé.

### Requirement for a Written Agreement

Any joint venture between a mentor and its protégé must be in writing. The SBA has detailed regulations specifying what must be included in the joint venture agreement.

**First**, the joint venture agreement must set forth the purpose of the joint venture. The purpose may be to bid together on a specific procurement or to work together to bid on a series of procurements over time. The requirement to identify the purpose of the joint venture is not unique to SBA. As a best practice, all joint venture agreements should identify the purpose of the joint venture. This permits the parties to distinguish between the activities of the joint venture and the activities of the individual partners.

**Second**, the joint venture agreement must designate the small business protégé as the managing partner of the joint venture. A key element of any joint venture agreement between a mentor and a protégé is that the protégé must be the entity that controls the joint venture. This can cause tension between partners, as the large business mentor often will wish to be the party in charge, because the large business mentor usually has

greater experience and may have a larger financial stake in the project, especially if the large business mentor is providing the payment and performance bonds on behalf of the joint venture. However, it is imperative that the small business protégé actually be the entity managing the joint venture, both on paper and in practice.

Consistent with this control requirement, the SBA regulations also require that an employee of the small business protégé be the project manager responsible for performance of the contract. The individual identified as the project manager need not be an employee of the small business at the time the joint venture submits its offer; however, if the individual is not a current employee of the small business protégé, there must be a signed letter of intent that the individual commits to be employed by the small business protégé if the joint venture wins the contract. The individual identified as the project manager cannot be employed by the mentor and become an employee of the small business for purposes of performance under the joint venture.

**Third**, if the joint venture is a separate legal entity, the small business protégé must own at least 51 percent





and include a detailed schedule of cost or value of these major pieces of equipment, facilities, and other resources, where practical. If a contract is indefinite in nature (for example, an indefinite quantity contract or a multiple award contract where the level of effort or scope of work is not known), the joint venture must provide a general description of the anticipated major equipment, facilities, and other resources to be furnished by each joint venture party without a detailed schedule of cost or value.

Alternatively, the agreement can specify how the parties to the joint venture will furnish such resources to the joint venture once a definite scope of work is available.

For design-build contracts, it can be difficult for the partners to identify all major equipment, facilities, and other resources to be furnished by the joint venture partners. However, the parties must try to provide as much of this information as possible in the joint venture agreement. Merely including general language, such as “the joint venture partners will provide the necessary equipment, facilities, and other resources that the joint venture will need to execute the contract,” is not sufficient and can result in a finding that the joint venture agreement is not valid and the joint venture is ineligible for contract award.

**Seventh**, the joint venture agreement must specify the responsibilities of the joint venture partners in regard to negotiation of the contract, source of labor, and contract performance. This includes how the joint venture partners will ensure that the joint venture and the small business protégé will meet SBA’s performance of work requirements. If a contract is indefinite in nature or the scope of work is not known, the joint venture must provide a general description of the anticipated responsibilities of

joint venture partners in regard to negotiation of the contract, source of labor, and contract performance. Merely including generic statements that the joint venture will comply with SBA’s regulations is not sufficient.

**Eighth**, the joint venture agreement must obligate joint venture partners to ensure performance of a contract and to complete performance despite the withdrawal of any member of the joint venture. The fact that one member of the joint venture withdraws from the joint venture does not excuse the joint venture from failing to complete the contract.

**Ninth**, the joint venture agreement must designate that accounting and other administrative records relating to the joint venture will be kept in the small business protégé’s office unless the SBA grants a request to keep them elsewhere.

**Tenth**, the joint venture agreement must require that the final original records be retained by the small business protégé upon completion of any set-aside contract performed by the joint venture.

**Eleventh**, the joint venture agreement must state that quarterly financial statements showing cumulative contract receipts and expenditures (including salaries of the joint venture’s principals) will be submitted to the SBA no later than 45 days after each operating quarter of the joint venture.

**Last**, the joint venture agreement must state that a project-end profit and loss statement, including a statement of final profit distribution, will be submitted to SBA no later than 90 days after completion of the contract.

### **Performance of the Work Requirements**

The SBA limits the amount of work a small business—even a small business mentor-protégé joint venture—can subcontract out. For contracts set aside for small businesses, the joint venture itself must perform the applicable percentage of work specified in the SBA regulations. For general construction, the SBA requires that

of the joint venture entity. There is no requirement that a separate legal entity, such as a limited liability company or corporation, be formed in order to have a joint venture. Joint venture partners can use a partnership structure.

**Fourth**, the joint venture agreement must state that each joint venture partner receive profits from the joint venture commensurate with the work performed by that partner. The small business protégé does not have to receive a specified percentage of the joint venture’s profits based on its ownership interest in the joint venture.

**Fifth**, the joint venture agreement must provide for the establishment and administration of a special bank account in the name of the joint venture. All payments made for work performed by the joint venture must be deposited into this account. Similarly, all expenses incurred under the contract must be paid from this account. The account must require the signature of all parties to the joint venture (or designees) before money can be withdrawn from the account.

**Sixth**, the joint venture agreement must itemize all major equipment, facilities, and other resources to be furnished by each joint venture party



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## JOINT VENTURING UNDER A MENTOR-PROTÉGÉ AGREEMENT CAN BE AN INVALUABLE WAY FOR A SMALL BUSINESS TO GAIN GOVERNMENT CONTRACTING EXPERIENCE.

a small business (in this case, the joint venture) not pay (that is, subcontract out) more than 85 percent of the amount paid by the government to it to companies that are not similarly situated. The costs of materials are not considered in determining whether the 85 percent limit has been exceeded

Companies are similarly situated when they have the same small business program status as the prime contractor. In other words, if the joint venture qualifies as a women-owned small business, then the joint venture cannot subcontract out more than 85 percent of the work to companies that do not qualify as women-owned small businesses. If the women-owned joint venture subcontracts out to a women-owned small business, then that subcontract is not counted toward the 85 percent limit. However, any work that a similarly situated subcontractor further subcontracts out will count toward the 85 percent limit.

In addition to having the same small business program status, the subcontractor also must be a small business for the NAICS code that the prime contractor assigned to the subcontract work in order for the subcontract not to count toward the 85 percent limit.

The small business partner must perform at least 40 percent of the work that the joint venture will self-perform. For example, if the joint venture is going to perform 30 percent of the total contract work, then the small business protégé must self-perform at least 40 percent of that 30 percent of the total contract work. The work performed by the small business partner must be more than administrative or ministerial functions in order to ensure that the small business partner gains substantive experience.

The SBA requires that the small business partner report on how it met or is meeting the self-performance

requirements. Annually, the small business partner must submit a report to the contracting officer and the SBA, signed by an authorized official of each partner to the joint venture, explaining how the performance of work requirements are being met for each set-aside contract performed during that year. In addition, at the completion of every set-aside contract, the small business partner must submit a report to the contracting officer and the SBA, signed by an authorized official of each partner to the joint venture, explaining how the performance of work requirements were met for the contract. The small business partner must certify that performance-of-work requirements were met and that the contract was performed in accordance with the provisions of the joint venture agreement.

### Certification of Compliance

Prior to the joint venture performing any set-aside contract, the small business partner must submit a written certification to the contracting officer and the SBA, signed by an authorized official of each partner to the joint venture, stating that the parties have entered into a joint venture agreement that fully complies with the SBA's regulations and that the parties will perform the contract in compliance

with the joint venture agreement and with the performance of work requirements in the SBA's regulations. If this certification is knowingly false, the joint venture partners could face liability under the False Claims Act or the False Statements Act.

### Conclusion

Joint venturing under a mentor-protégé agreement can be an invaluable way for a small business to gain government contracting experience. However, the regulations on how to form such a joint venture are complex and must be adhered to strictly. If the joint venture agreement does not comply with the SBA regulations, the SBA may determine that the joint venture does not qualify for the affiliation exception; that is, the joint venture will be considered a large business and will not qualify for any set-aside contracts. Therefore, it is crucial that any joint venture agreement be reviewed for compliance with the SBA regulations before it is executed. ●

*Lori Ann Lange, a partner in the Washington, DC, office of the law firm of Peckar & Abramson, P.C., specializes in government contract law, bid protests, and corporate compliance counseling. She represents a range of government contractors, including construction contractors, major defense contractors, informational technology contractors, and service contractors. She can be reached at [llange@pecklaw.com](mailto:llange@pecklaw.com) or 202.293.8815 ext. 7103.*



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# Preparation of a Claim Against the Federal Government— It's Not the Same Claim You Would Submit on a Private Project



BY ADRIAN L. BASTIANELLI III AND MICHAEL C. ZISA

**DOING BUSINESS WITH** the federal government is very different from doing business in the private sector, and that spills over to the preparation, presentation, and resolution of claims. The primary differences in the pursuit of claims against the federal government include the following: (1) in the federal sector, claims are governed by federal statutes and regulations; (2) government decision-makers are typically motivated by factors that are different than their private sector counterparts; and (3) federal contractors are subject to stiff penalties for false statements made during the pursuit of claims. Federal contractors pursuing claims



against the federal government need to understand and take these differences into account when drafting and pursuing their claims. In addition, sureties pursuing claims against the federal government, on their own or as a subrogee of a defaulted principal, are subject to the same requirements as the contractor and need to understand how to pursue a claim against the federal government.

### Statutes and Regulations

The primary statute that applies to the pursuit of claims on federal contracts is the Contract Disputes Act (CDA). The CDA confers jurisdiction to parties that have a contract with the federal government. The privity of contract requirement typically prevents third parties, such as sureties or subcontractors, from bringing claims directly against the federal government. However, a takeover agreement between a surety and the federal government is sufficient to satisfy the privity requirement of the CDA. For the claim of a subcontractor, the contractor must sponsor or pass-through the claim to the government. The Federal Acquisition Regulation (FAR) and agency acquisition regulations contain numerous regulations implementing the CDA, as well as other regulations that are important to understand when drafting federal claims.

The term “claim” has a special meaning in federal contracting. The fact that a contractor is seeking payment for extra work, delays, differing site conditions, and other events does not mean that there is a claim. In fact, a claim is typically preceded by a Request for an Equitable Adjustment (REA). Once the parties reach an impasse on the REA, there is a dispute, and the contractor needs to file a formal claim.

The distinction between an REA and a claim has real consequences. The contractor and surety can recover costs of an outside third party to help prepare and pursue an REA as contract administration. However, if the submission is deemed a claim against the government, federal regulations prevent the recovery of the cost to pursue that claim, and those costs become

unrecoverable. As a result, the contractor and surety want to spend the money on outside consultants, such as a scheduling expert, cost expert, or lawyer, to draft a thorough and convincing presentation during the REA stage, because those costs are recoverable if the contractor wins on the subsequently submitted claim. If the contractor waits until the claim phase to retain third-party consultants, the costs are no longer recoverable. Another consideration is that interest does not accrue on an REA. However, once a claim is filed in the proper format, interest begins to accrue. The contractor, therefore, must make a judgment concerning REA preparation costs and interest in deciding when and how to proceed. Further, it is important to remember that a contractor must proceed with diligent performance of the contract during the pendency of the REA or claim.

It normally is good practice to draft a detailed REA that can be converted to a claim with very little effort. Thus, the principles discussed herein regarding the drafting of a claim apply to the drafting of an REA as well.

If the contractor cannot resolve an REA through negotiation, it must then submit a formal claim. A claim must be submitted within six years of accrual, which applies whether the claim is being submitted by the contractor, a surety, or the government. The CDA defines a “claim” as a written demand seeking payment in a sum certain or the adjustment or interpretation of the contract or other relief arising out of the contract. For claims exceeding \$100,000, it must also contain a certification that the claim is made in good faith, that the supporting data are accurate and complete, and that the amount requested accurately reflects the adjustment for which the contractor believes the government is liable. The certification must be made by a person authorized to do so on behalf of the contractor, which may include the surety. The claim must be submitted to the contracting officer (CO) for final decision. Once the claim is submitted, interest begins to run on the claim under the CDA. The CO has

60 days to decide issue a final decision, unless he or she justifies the need for additional time in writing.

If the CO denies the claim in whole or part, the contractor has 90 days to appeal the final decision to the appropriate Board of Contract Appeals (typically, the Armed Service Board of Contract Appeals or the Civilian Board of Contract Appeals) or one year to appeal to the Court of Federal Claims. Final decisions that are not appealed within these time limits become final and binding. Once before the Board or the Court, the parties are permitted to conduct discovery in accordance with the respective rules, which includes requests for production of documents, interrogatories, and depositions. The board and the court make available various forms of alternative dispute resolution but typically require the parties’ voluntary consent. All hold evidentiary hearings and decide the claims *de novo*, which means the CO’s final decision is given no deference. Appeal from a decision of the board or court is taken to the Court of Appeals for the Federal Circuit.

### Subjects of a Claim

In the federal arena, contractors typically pursue claims for costs and/or time resulting from: (1) changes or constructive changes; (2) differing site conditions; (3) suspension of works; and (4) terminations for convenience. Contractors may also pursue a claim for improper termination for default, which, if successful, results in conversion to a termination for convenience and entitles the contractor to submit a claim for its costs. The FAR contains provisions and contract clauses that relate to each of these types of claims.

The contractor’s recovery is normally limited to the increase or decrease in costs and/or time of performance arising out of the events that give rise to the claim. The recovery is cost-based, not price-driven; the government reviews the claimed costs to determine whether the costs are allowable, allocable, and reasonable.



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## SURETIES PURSUING CLAIMS AGAINST THE FEDERAL GOVERNMENT, ON THEIR OWN OR AS A SUBROGEE OF A DEFAULTED PRINCIPAL, ARE SUBJECT TO THE SAME REQUIREMENTS AS THE CONTRACTOR AND NEED TO UNDERSTAND HOW TO PURSUE A CLAIM AGAINST THE FEDERAL GOVERNMENT.

The contractor is not entitled to lost profits, except in unique circumstances where the events constitute a breach of contract that is not recoverable under a clause in the contract. The primary examples of a breach are a cardinal change and a lack of good faith and fair dealing by the government.

### Government Decision-Makers

The decision process used by the federal government differs with each agency. However, the process generally includes the following:

1. **Consideration by the onsite government representative.** While the contractor may resolve the claim at the jobsite level and that opportunity should not be bypassed, the jobsite representatives may be the cause of the claim and likely have already made up their minds.
2. **Review and analysis by procurement professional or a government claims analyst—a person with no involvement in the project.** This normally is the most important person in the claims process from the contractor's perspective, because the representative typically is not invested in the facts of the claim.
3. **Assistance from the counsel's office.** Counsel normally does not become involved until the claim is headed to litigation or unless the claim involves a legal issue.
4. **The CO issues the final decision that starts the litigation process.** He or she is the last resort and seldom has any first-hand involvement in the facts giving rise to the claim. However, the CO often is simply a rubber stamp for the decision of the others in the process.

Private sector decision-makers largely are driven by the profit motive to minimize payment to the contractor, regardless of the validity of the claim. The decision to settle in the private

sector often is less about the merits of the claim, than the cost of litigation and other business considerations. The government decision-maker, in contrast, is seldom motivated by profit and driven to deny or reduce legitimate claims by the contractor. The cost of litigation is not important because the government has in-house counsel, which the government views as having no cost. The issue for the government generally is whether the contractor is entitled to recover on the claim as a matter of right. If the contractor can convince the decision-maker of the merits of the claim, the government likely will pay the full amount of the costs caused by the events. If the decision-maker is not convinced of the merits, the claim will be denied even if the cost of litigation exceeds the amount of a possible settlement. Thus, the claim to the government needs to focus on the contractor's legal right to recover under the contract and the resulting costs.

### Drafting the Claim

By the time the contractor reaches the point of drafting a claim, he or she is usually angry and uses the claim as an opportunity to vent. The claim often refers to government representatives as incompetent, ignorant, liars, vindictive, arbitrary, or capricious. Seldom does this approach cause the government representatives to want to pay the claim. To be most effective, the claim should be logical, clear, well-reasoned, well-documented, and accurate submissions that are written in a measured and respectful tone. The drafter of the claim should put herself or himself in the shoes of the government decision-maker and ask what would convince me that the claim has merits if I were the government.

When dealing with the government, the contractor must understand that

the wheels grind more slowly than in the private sector. As a result, the contractor must exercise patience and persistence.

### Parts of the Claim

#### Executive summary

The claim should contain a short executive summary that summarizes key points and establishes a repeatable theme for the claim. This is the contractor's opportunity to set the tone in a short statement that can be repeated in the future. Often the ultimate decision-maker for the government never gets past the executive summary.

#### Facts

Government claims often turn on the facts, and the claim should always contain a fact section. The factual allegations in the claim should spare no detail and should contain documents to support each allegation. It is a mistake to play "hide the ball" in drafting the claim. Remember, the government representative deciding the claim likely will have no first-hand knowledge of the facts. This is the contractor's opportunity to establish those facts. Further, the government representative must document the record to justify a settlement. The contractor should do the work for the government representative and provide the documents. The contractor does not want to force the government representative to search for justification for the facts or for reasons to deny the allegations, as the representative may find a different answer than the contractor wants.

#### Basis for the claim

The contractor should set out in detail arguments justifying its entitlement to recover under the contract for the facts established in the previous section and should cite to the applicable clauses in the contract.

The contractor should not ignore issues it knows are weak or in dispute. This is the contractor's opportunity to make its best argument. If the contractor fails to address an issue where it is weak, the government



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WHEN DEALING WITH THE GOVERNMENT, THE CONTRACTOR MUST UNDERSTAND THAT THE WHEELS GRIND MORE SLOWLY THAN IN THE PRIVATE SECTOR. AS A RESULT, THE CONTRACTOR MUST EXERCISE PATIENCE AND PERSISTENCE.

decision-maker will still consider the issue but will be without the benefit of the contractor's best position.

#### Legal section

Often the legal issues are so well established and accepted that citation to cases is unnecessary. For example, there is no question that extra work required by the CO constitutes a change to the contract for which the contractor is entitled to an equitable adjustment under the changes clause. No case citation is required to support such a proposition. In fact, the addition of cases may result in more in-depth participation by Counsel's office, which probably is not in the contractor's favor. The contractor does not want to get into a battle of the cases if logic is sufficient to carry the day. However, if the claim involves complex legal issues or there are cases directly on point, a legal section should be included in the claim. Once again, the contractor should do the work for the government.

#### Pricing

There should be a detailed section identifying the additional costs and time resulting from the claim events. The contractor should endeavor to show cause and effect as best it can. The calculations should be detailed and supporting documents should be attached for each item. The contractor should open its books and records to the government. They will get them in the end, and holding back will simply delay the process. In addition, withholding documents likely will cause the government representative

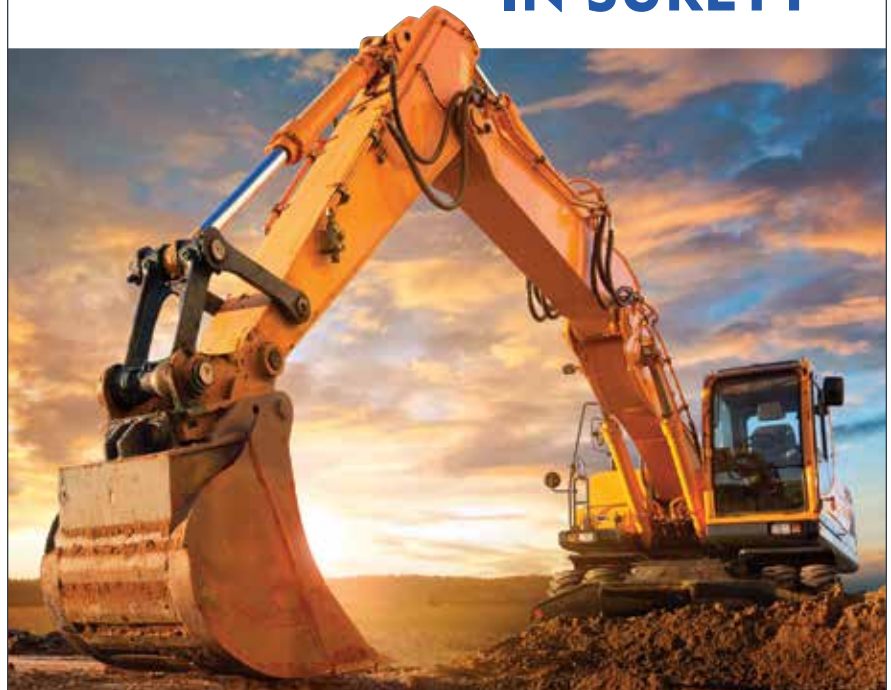
to assume the worst, which will not result in the highest recovery.

#### Certification and false claims

Another important distinction between public and private contracts is the impact of the federal False Claims Act (FCA). In the private sector, contractors may embellish and inflate their claims with the assumption that such action will result in a higher settlement or verdict at trial. While this may be unethical (and bad business),

there are no penalties for doing so short of fraud, which is hard to prove. That is not the case in federal government contracts, because the FCA and other statutes establish severe penalties and sanctions for false statements and false claims. Specifically, the FCA prohibits, among other things, knowingly presenting a false or fraudulent claim for payment or approval and making, using, or causing to be made or used a false record or statement material to a false or fraudulent claim.

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As explained above, if the claim is in excess of \$100,000, it must contain the following certification:

*I certify that the claim is made in good faith; that the supporting data are accurate and complete to the best of my knowledge and belief; that the amount requested accurately reflects the contract adjustment for which the Contractor believes the Government is liable; and that I am authorized to certify the claim on behalf of the Contractor.*

#### **FAR 52.233-1(d)(2)(iii)**

The certification must be executed by someone who is authorized to bind the contractor with respect to the claim, which may include the surety in instances where it is pursuing claims against the government, whether directly or on behalf of its bond principal. This certification implicates the FCA for the contractor or surety submitting the claim, as well as the person signing the certification.

The violating party is liable for civil penalties between \$5,500 to \$11,000 for each false claim or statement and treble the amount of the government's damages. A single claim can have multiple false statements and claims in it, which can result in enormous penalties. However, these dollar penalties should be just one of the contractor's concerns. The FCA also allows for contract termination, contractor suspension and debarment, and forfeiture of the entire claim for a single false statement or claim. So if the contractor overstates its claim amount, it can lose the entire claim amount even though the claim is otherwise completely valid. In addition, false claims can result in a lower past-performance rating, which will hurt the contractor's ability to obtain future contracts. In an effort to crack down on FCA violations, the government created a *qui tam* provision that allows private persons (such as employees or former employees) to file suit for FCA violations on behalf of the government and share in the recovery. This, coupled with the government's focus on weeding out fraud in public procurement, has driven up the number of FCA suits and recoveries dramatically.

As a result, in federal government contract claims, whether you are the contractor submitting your claim or the pass-through claim of your subcontractor or the surety submitting a claim, it is extremely important not to embellish or inflate the claim and to vet claims fully before submission. While this is ethical and good business under any circumstances, in the government arena the failure to do so can be devastating. ●

*Adrian L. Bastianelli, III is a partner of Peckar & Abramson's Washington, DC, office ([www.pecklaw.com](http://www.pecklaw.com)). He has devoted his practice to construction claims and litigation for 40 years, handling numerous large surety bond cases. He has an active alternative*

*dispute resolution practice having served as an arbitrator, mediator, and DRB member on over 500 disputes. Bastianelli serves on the NASBP Attorney Advisory Council. He can be reached at [abastianelli@pecklaw.com](mailto:abastianelli@pecklaw.com) or 202.457.4036.*

*Michael C. Zisa is a partner in the Washington, DC, office of Peckar & Abramson, P.C. and focuses his practice on construction, surety, and government contracts law and chairs his firm's Surety Practice Group. Zisa was recently recognized again by Washington, DC Super Lawyers in the areas of construction litigation, surety and government contracts. Zisa can be reached at [mzisa@pecklaw.com](mailto:mzisa@pecklaw.com) or 202.293.8815.*

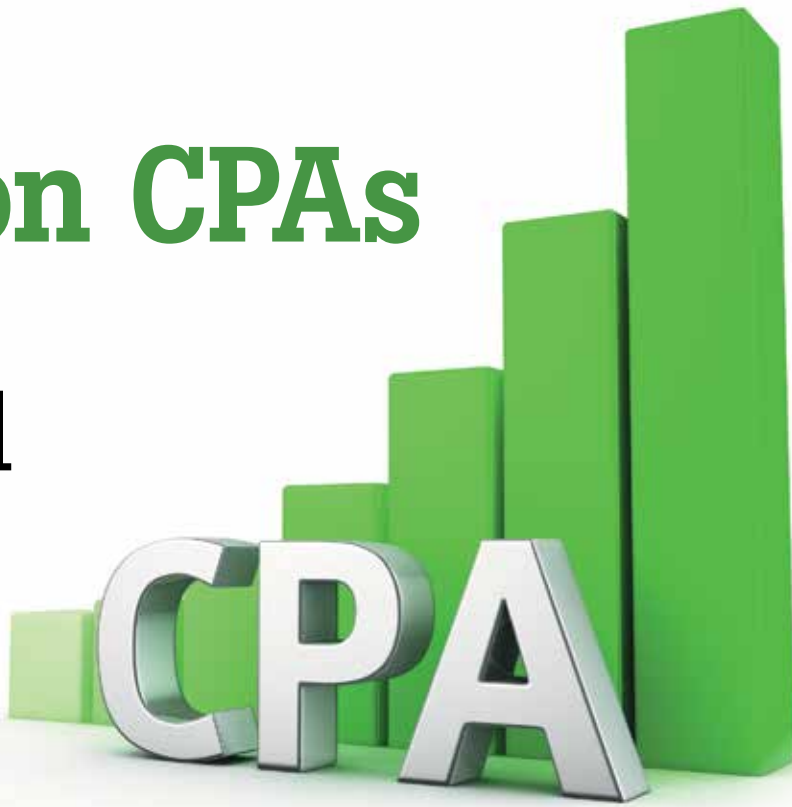


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# Construction CPAs

## Are Critical to the Successful Management of Contractors' Businesses



A **CERTIFIED PUBLIC** accountant (CPA) helps a contractor understand a construction firm's cash flows and needs, considering tax implications, strategies to improve the construction firm's cash flow, and profitability while assisting the firm in selecting and maintaining a strong internal cost accounting system. The CPA also assists the firm with business planning tasks, such as budgeting, tax planning, and strategic planning, to improve profitability and financial strength. The below interviews with five CPAs who serve on the NASBP CPA Advisory Council (see [www.nasbp.org/cpaadvisorycouncil/home](http://www.nasbp.org/cpaadvisorycouncil/home)) describe the critical role CPAs play in ensuring that a contractor's financial management obtains and maintains the firm's surety credit.



### CPAs play an integral role in bonding for construction contractors

Selecting an accounting firm is a critical decision for construction firms—particularly those looking to qualify for bonding for a contract. CPAs and other trusted advisers serve an integral function for construction firms seeking bonding, said **Jack Callahan, CPA, partner and construction industry practice leader at NASBP Associate CohnReznick.**

Callahan said his firm takes its role as an independent CPA for contractor clients incredibly seriously. A key focus of the CPA is presenting financial information in an appropriate format in accordance with generally accepted accounting principles, Callahan said.

The information must be part of an accurate, appropriate disclosure with the right form and content to be a reliable source for the surety and for the bank, he said.

The contractor benefits from using accounting firms with reputations for accuracy and strong customer service, which provides a “comfort zone” even when working on a project that might be outside a contractor's typical comfort zone, Callahan said. Timely and accurate work by the CPA makes the entire bonding process more seamless.

Before the first meeting with a CPA, a contractor should consider whether the accounting firm is a member of the same industry associations and has otherwise made a commitment to understanding the sector, Callahan said.

“When selecting a new firm, exercise due diligence and go with a firm that's a true construction accounting professional,” he said.

A CPA firm also needs open lines of communication and good working relationships with other trusted advisers—accountants, attorneys, bond producers, and bankers—in order to work with those professionals for the contractor's long-term best interests. The CPA should focus on a contractor's specific needs and set appropriate timelines for providing the necessary financial information, he said.

According to Callahan, compliance has become a crucial factor in construction, with governmental agencies increasingly targeting contractors for violations of requirements for minority and women-owned business enterprises, Buy American Act provisions, and a range of other issues.

Callahan said that sureties should ask contractors who are working on a federal contract or other large public project for the first time whether they are up to the challenge.

Sureties should ask what requirements must be met under the contract. They also should examine whether the contractor has the corporate structure and capital



necessary to satisfy the requirements and defend against any challenges to their compliance mechanisms. For example, contracts of a certain size require a contractor to have an ethics compliance officer.

To help get the working relationship off to a good start, exercise due diligence before the first meeting and have a list of requirements.



### **CPAs who know construction can help contractors achieve healthy benchmarks**

Construction contractors need to work with a CPA who knows their industry to help ensure their financial performance is in line with healthy benchmarks and to remedy any signs of financial trouble, said **Julian Xavier, CPA and managing principal at the Walnut Creek, CA, office of NASBP Associate CliftonLarsonAllen LLP.**

CPAs can help contractors understand finances and plan accordingly, allowing them to win business and become more financially prepared. Xavier said healthy benchmarks for contractors include:

- Cash greater than 5 percent of annual revenue.
  - A line of credit of at least 5 percent of annual revenue.
  - Tangible equity (which excludes goodwill prepaid expenses) greater than 10 percent of annual revenue.
  - A current ratio (current assets divided by current liabilities) that is at least greater than 1.0.
  - Tangible working capital of at least 7.5 percent of annual revenue.
  - Minimal underbillings on their projects.
  - Minimal bad debt or aged accounts receivable (past due more than 90 days).
  - No significant gross-profit-margin fade on projects.
- Meanwhile, some of the strongest indicators that a contractor could be in a precarious financial position include:
- Overall underbillings greater than 10 percent of equity.
  - Significant claims or unapproved change orders outstanding on construction projects.
  - Interest-bearing debt greater than 100 percent of equity—i.e., if a company owes more money to banks and lenders than what the company's owners have invested in it.
  - Total liabilities exceeding 300 percent of equity.
  - Significant gross-profit-margin fade on projects.

In severe cases, these financial shortcomings can put contractors at risk of failure. One such example is large past-due accrued liabilities related to payroll taxes or union-benefit liabilities, which are a sign of cash-flow problems and can lead to significant penalties and fines, Xavier said.

Another problematic sign is significant turnover, particularly in key management roles, Xavier said. When project managers and operational managers leave, "that tells you there's danger, and jobs remaining to be completed might have some problems," because those managers would take their knowledge of the projects with them when they go, he said.

Another sign of trouble can be when revenue is decreasing but general, administrative, and overhead expenses are not under control, Xavier said. For example, many contractors "continued to spend like when times were good" in terms of bonuses or headcounts instead of cutting expenses during a financial downturn, he said.

A severe sign of turmoil is when a contractor loses a line of credit or other financial arrangement with its bank. "That's kind of like your safety net when times are tough," he said.

To ensure they are in a strong position with regard to benchmarks, contractors should work with a CPA who has thorough knowledge of the construction industry, Xavier said. Such a CPA can benchmark the contractor's performance against the industry's best practices, as well as address areas of weakness and paths to improvement, he said.

A construction-oriented CPA "can help look at billing and collections processes and analyze what to do better to improve cash flow on projects, which will go a long way to help with unhealthy benchmarks," he said.



### **CPAs bolster construction contractors' financial reporting, address risks**

Construction-oriented CPAs have an advantage in helping contractors produce accurate, timely financial reports and address a wide range of risks, said

**Emilio F. Alvarez, founder and managing partner of NASBP Associate E.F. Alvarez & Co.**

The primary issue a construction-oriented CPA can address to help contractors is accuracy, which includes use of the proper revenue-recognition method, the appropriate representation of underbillings and overbillings, and a conservative approach to revenue recognition on claims, Alvarez said.

The next issue is timeliness, because sureties view timely reporting as a sign of health and late reporting as a sign of trouble, Alvarez said. In addition, construction-oriented CPAs focus on answering as many underwriting questions as possible in the footnotes of financial statements, covering such matters as risk, backlog of work, tax exposure even on pass-through entities, lines of credit, and their covenants and debt, he said.

The top risk issue that a construction-oriented CPA can help a contractor address is cash flow, with priorities also including contract terms, large insurance deductibles, cost-shifting, concentration of credit, large bid spreads, and bonding of subcontractors, Alvarez said.

Overbillings and underbillings also represent major risk issues, with underbillings being a particular concern on jobs in an advanced stage of completion—a scenario in which analysis helps determine whether a cost overrun is occurring.

Another crucial area of risk analysis is the estimate a contractor provides when giving a price on a bid, Alvarez said.

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CPAs also examine whether construction contractors are correctly handling wage determinations under the Davis-Bacon Act, which requires that contracts for federal construction projects and federally assisted construction of more than \$2,000 include a proper listing of wage rates and fringe benefits for all worker classifications.

"The key to the whole [audit] process is to have a knowledgeable analytical review," Alvarez said. Although it is "not an absolute certainty that any CPA is going to detect fraud, a clear analysis of the system of internal controls is necessary," and an "understanding of how the players in the field operate is a big help in detecting fraud," because knowledge of the construction industry helps a CPA interpret the results, he said.

A vetting process can help a contractor ensure that it selects a CPA with a strong understanding of construction. Seeking CPAs known to sureties and surety professionals is a "big step" toward having a CPA with the appropriate expertise, he said.

"Ideally, the contractor should seek a CPA that occasionally teaches construction accounting and taxation," he said.

Such CPAs also tend to be members of construction-related associations, while a CPA having few construction contractors as clients is "an indication the training is not there," he said.



#### **CPAs can help contractors develop sound succession plans**

The number one issue construction contracting companies will face over the next 10 to 20 years is succession planning, according to accounting firm BKD, LLP. As the amount of wealth in the nation transfers generations, that also includes wealth tied to family-owned firms.

The orderly transfer of control and assets is critical to the future success of these owner-managed or family-run enterprises. A lack of planning and clear succession causes many problems for companies and can be incredibly stressful for family members, owners, and employees.

CPAs have a deep involvement in companies' financial operations and owners' personal finances, making them well positioned to help contractors set up orderly succession plans, said **Tim Wilson, CPA, CCIFP, national industry partner at NASBP Associate BKD, LLP.**

The most successful plans can take as long as 10 years to implement as owners identify the type of leadership they want to put in place, said Wilson.

"When you see both sides of the ledger, you can help the owner plan for what that transition looks like and how to achieve the best result for the company and the owner," he said.

Succession planning often must take into account not only the business' needs, but also any plans an owner has for taking care of family members or charitable contributions. Sometimes when a family transitions ownership

## **TO HELP GET THE WORKING RELATIONSHIP OFF TO A GOOD START, EXERCISE DUE DILIGENCE BEFORE THE FIRST MEETING AND HAVE A LIST OF REQUIREMENTS.**

or management to another generation, new leaders will have different ideas or strategies that may not align with company goals, creating conflict.

Many contractors also worry about the business relationships they've cultivated over the years, Wilson said. They typically want to make sure new owners or managers will continue to build on those important relationships to ensure the company's future success. That's where CPAs can play an important role in helping firms take the first step in the planning process by evaluating goals and strategies and determining what role family members will have going forward.

"Bringing some very orderly steps to the process is one of the CPA's primary roles, as well as really helping guide that process," Wilson said.

CPAs can also help owners understand succession planning from both the ownership and management side, because some transition to having non-family members run the company, but still want to retain some stake in the company.

Talking with your CPA about your plans is a good first step for ensuring an orderly succession when you're ready to step away from your business.



#### **CPAs need continuous involvement when emerging contractors seek bonding**

An open dialogue between a surety, contractor, and CPA is crucial to guide emerging contractors finding themselves in new territory when entering the surety market, said **David V. Jean, a CPA and a principal of NASBP Associate Albin, Randall & Bennett.**

"It's pivotal for emerging contractors going to the next level to have strong financial-management practices in place," said Jean, who has expertise in areas including financial issues concerning contract and commercial surety.

The importance of an open dialogue comes with the need for continuous involvement by the CPA in order to help make well-educated decisions as the contractor strives to provide sound financial, work-on-hand, and contract-status reporting, Jean said.

A more established contractor looking to expand business also needs a CPA's ongoing involvement to make sure the contractor's financial-management practices are strong enough to support the desired growth, he said.

Jean emphasized the importance of bank financing and leveraging the balance sheet. "What we're prone to do



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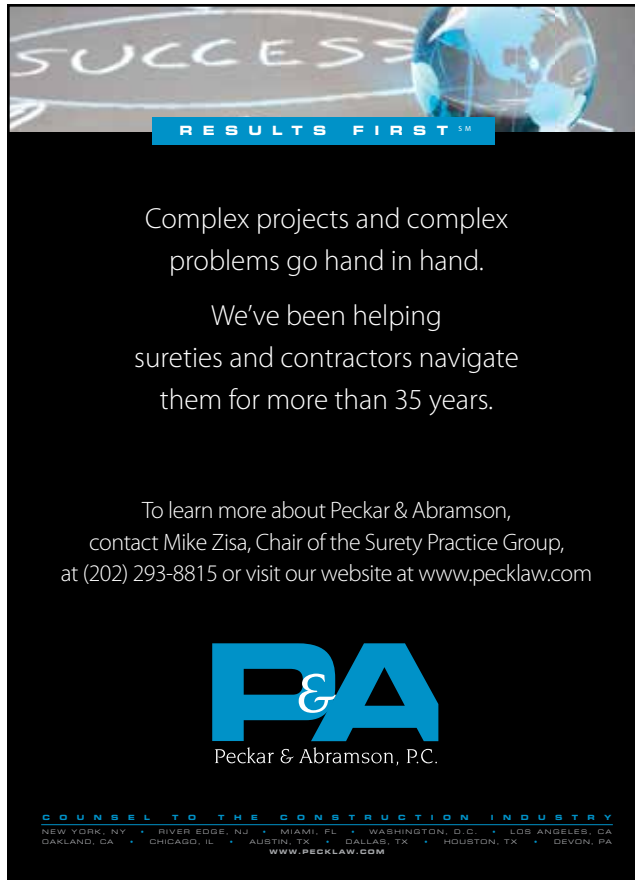
at the end of the day is convert work to cash—that's the end game," he said.

Therefore, cash management and conservatism are crucial to ensure that a contractor doesn't "overextend [itself] from a capacity standpoint," Jean said. A growing contractor needs to make sure it has the capabilities, resources, and management depth needed to support the desired growth, he said.

Meetings between a contractor and a CPA generally should occur more frequently when the contractor is going through a period of growth, Jean said. The necessary frequency, however, varies based on a particular contractor's sophistication. That could mean quarterly meetings for the contractors needing the most help, but less often—perhaps annually—for more seasoned contractors, he said.

Important factors in determining the frequency of meetings include management depth, the chief financial officer's level of expertise, and the strength of the company's board, he said. "If you've got a very experienced, confident team, then the CPA might not need to be as actively involved," he said. ●

*Reprinted, with modifications, from a series of NASBP blogs published at [www.NASBP.org](http://www.NASBP.org). For more information about the services construction CPAs offer contractors seeking or maintaining their surety credit, visit the resources webpage, <http://suretylearn.org/resources/> at [www.suretylearn.org](http://www.suretylearn.org).*



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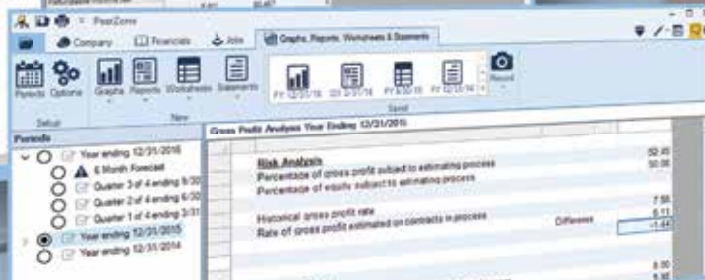
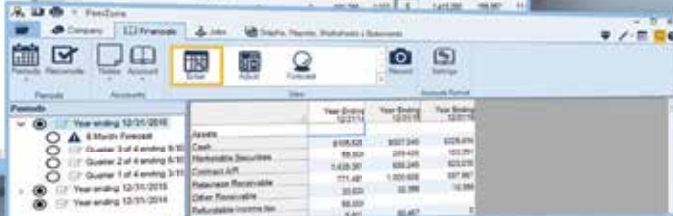
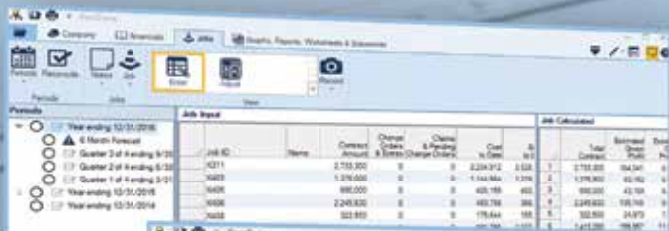
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