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Infrastructure projects

A REVIEW OF BIDDING METHODS FOR FEDERAL CONTRACTS

With the signing of the Infrastructure Investment and Jobs Act in late 2021, things are looking up for federal construction projects in the months and even years ahead. If your company is considering getting in on the action, but perhaps unfamiliar with the road to get there, the journey will begin as most jobs do — with a bid.

The federal government typically procures construction work under one of two methods: sealed bidding or contracting by negotiation. Here's a brief review of each.

Sealed bidding

By far the predominant method for most federal construction work, sealed bidding begins when the government releases an invitation for bid (IFB). The IFB provides the project specifications or statement of work, proposal instructions, and a draft contract. Bids are then opened publicly.

Sealed bidding is used when the specifications are clear, and the determining factor is price. The qualified construction company with the lowest price will win the bid, which will be a firm, fixed price contract.

Generally, contractors who win sealed bids won't have to submit cost and pricing data. The cost principles contained in the Cost Accounting Standards (CAS), a set of standards and rules that the federal government uses to determine costs during negotiated procurement, typically don't apply. However, the Federal Acquisition Regulations (FAR) do apply to sealed bids and, indeed, to all government procurements.

Because CAS doesn't apply, a substantial portion of the regulations governing government contracts relating to cost accounting won't come into play for most construction businesses. Nonetheless, contractors bidding these types of contracts shouldn't completely ignore the regulations because they may come into consideration if:

- Change orders are requested,
- The contractor submits claims for additional compensation, or
- The government terminates the contract for its convenience.

The applicability of cost principles to fixed price contracts is specifically addressed in FAR 31.102, "Fixed Price Contracts." It states, in part, "The applicable subparts of part 31 shall be used in the pricing of fixed-price contracts, subcontracts, and modifications to contracts and subcontracts whenever (a) cost analysis is performed, or (b) a fixed-price contract clause requires the determination or negotiation of costs."

Contracting by negotiation

Although sealed bidding is the most popular procurement method, the federal government

is more frequently using contracting by negotiation for some construction projects. These include multiyear construction management contracts, facilities management work and contracts to be performed overseas.

Essentially, contracting by negotiation is used when the services being procured are complex, difficult to clearly describe and factors other than price may affect the award. Unlike the sealed bidding method, which awards only fixed-price contracts, negotiated contracts can take many forms — including cost reimbursement contracts.

The contracting by negotiation process begins when the federal government publishes a request for proposal (RFP). Like an IFB, an RFP contains the statement of work or specifications, proposal instructions, and a draft contract. In contrast to sealed bidding, however, the contract proposals aren't opened publicly. Rather, the federal government evaluates the proposals against an established list of evaluation criteria addressing technical, management, past performance and cost items.

After the initial evaluation, the government selects the best proposals for inclusion in the competitive range. Then it negotiates with the offerors in the competitive range by seeking clarifications; pointing out weaknesses; suggesting improvements; and discussing terms and conditions, schedules, and other items. On completion of the negotiations, offerors submit a Final Proposal Revision.

The federal government awards the contract to the construction company that offers the best value, all factors considered. Significantly, this isn't necessarily the lowest bidder.

Key differences

There are several factors present in negotiated contracts that aren't found in a sealed bid, fixed-price contract. Negotiated contracts awarded for more than $700,000 require the contractor to submit cost and pricing data before the award is granted.

Also, with a negotiated contract, the award may be subject to an audit to determine the contractor's compliance with cost principles and the accuracy of underlying cost data used in the construction company's estimates.

In many cases, the construction business must certify that it has disclosed current, accurate, and complete cost and pricing data. It's in these situations that contractors who are unfamiliar with the federal procurement process may find themselves unprepared to deal with the many applicable regulations.

Look before you leap

Federal construction projects have their pros and cons. On the plus side, the contract values can be substantial, and you don't have to worry much about the project owner's ability to pay. On the downside, you'll need to follow many rules and the money earned may be slow to arrive. Be sure to look before you leap when bidding on one of these jobs. ■

VARIATIONS ON THE THEME

Sealed bidding and contracting by negotiation are the two primary ways that the federal government bids out construction work, but they aren't the only ways.

Every so often, the federal government will grant a sole source award. These are contracts awarded without competition under the contracting by negotiation process. Sole source awards are generally used only when the sought-after product or service is unique and only one qualified bidder could possibly provide the product or service.

Another variation on contracting by negotiation is the two-step process. With this approach, technical/management proposals are submitted and only the most qualified offerors are asked to submit a cost proposal. Federal construction projects using the design-build method are often procured using the two-step process.

A GOOD IDEA: BUY-SELL AGREEMENTS

Life comes at you fast. Marriages end, illnesses and injuries occur, people decide to change careers or retire — sometimes without much advance notice! Any of these events could pose a major problem to any construction company with multiple owners. That's why having a buy-sell agreement is a good idea.

Keeping it fresh

A buy-sell agreement is a legal contract among business owners that sets forth guidelines for the transfer of ownership interests. The agreement gives the nondeparting owners or the company itself the right — or, in some cases, the responsibility — to buy a departing owner's interest should a "triggering event" occur. Such an event could be any of the circumstances mentioned above, as well as others, such as the loss of a professional license or certification.

To be effective, a buy-sell agreement needs to be periodically reviewed and, if necessary, revised to reflect changing circumstances. Of particular importance is scrutinizing the valuation provision, which establishes the purchase price for a departing owner's shares.

Depending on the mechanism used to value interests in the business, a valuation provision drafted years ago may understate or overstate the company's value. This can lead to undesirable outcomes or disputes. And the risk is especially acute now, given the significant impact the COVID-19 pandemic has had on the financial performance — and, therefore, value — of many construction businesses.

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Negotiating value

Valuation provisions in buy-sell agreements use various approaches depending on how the business owners decide to go about it. Sometimes, when an owner leaves the company, the parties negotiate the buyout price. This approach has some advantages: It's cost-effective and allows the parties to consider recent events in determining a fair price for the shares of the business.

The risk, of course, is that the parties fail to negotiate in good faith, can't reach an agreement and end up in court. One way to mitigate this risk is to provide for a negotiated price but bring in an independent appraiser if the parties are unable to agree within a certain time frame.

Getting an appraisal

To avoid long negotiations, many companies opt for an appraisal. Valuation by one or more independent professional appraisers at or near the time of the buyout is usually the most accurate approach, though it can be costly.

Some buy-sell agreements call for periodic appraisals and use the resulting price for any shares transferred between then and the next valuation date. Others require the parties to conduct an appraisal on the occurrence of a "triggering event," such as an owner's death or disability.

Be sure your agreement provides unambiguous valuation guidelines for appraisers. For instance, it should spell out the valuation date and standard (such as fair market value, fair value or investment value). It should also define the premise of value (for example, controlling interest or noncontrolling interest).

Some agreements provide that the valuation date is the date of the triggering event, but this type of provision is susceptible to manipulation by an owner who, for example, times his or her resignation to maximize the buyout price. A better approach is to set the valuation date as the last day of an accounting period (for instance, the end of the most recent fiscal year or quarter).

Applying a formula

Using a valuation formula tied to book value, earnings or other benchmarks has the advantage of simplicity and predictability. However, it's also risky. Book value, for example, may reflect a company's fair market value at formation, but it tends to significantly undervalue established companies with consistent track records of earnings.

Formulas based on earnings multiples may or may not be reliable indicators of value, depending on a company's particular circumstances at the time of the valuation. One potential solution is to revisit the formula annually and adjust it to produce a price the parties view as fair.

Group effort

Creating or revising a buy-sell agreement should be a group effort involving, not just the owners themselves, but a team of professional advisors. Your CPA can play a helpful role in this process. ■

STRATEGIZE TO MANAGE MATERIALS AND LABOR COSTS

The COVID-19 pandemic's ongoing impact on supply chains and labor have made managing project costs increasingly difficult for construction companies. Over the past two years, we've seen materials costs skyrocket and the availability of supplies and skilled labor plummet.

In today's climate, getting supplies and people to jobsites when they're needed calls for more planning. Here are some strategies to consider.

Prepare for supply delays

Manufacturing delays can't always be predicted. Whether it's a new variant of the virus or a natural disaster, production can stop on a dime in certain plants or regions.

The same goes for shipping. In 2021, we saw container ships get stuck in canals and blocked from entering ports. Be proactive and flexible when considering different materials, systems or manufacturers, so you can pivot if a supplier fails to deliver.

Build a catalog of vetted providers you can turn to as emergency supply sources. The first step is to evaluate vendors you already work with — some may have expanded their offerings to include products and services you're not aware of. Ensure your list includes local suppliers.

Build contingencies into contracts

When bidding a project, include a backup plan of two or more alternative supply sources. When negotiating the contract, ask for a deposit to buy and store materials before construction begins. Procuring materials in advance helps mitigate risks of escalating prices and poor availability when work starts.

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Also, determine whether the owner would agree to a price escalation provision in the contract. It would allow you to adjust the contract price to reflect actual costs if market prices increase over the course of the project.

Review crew structures

Having the right people in the right positions can lessen the strain on supplies and reduce waste. For example, if a team lead is excellent at electrical work but is instead overseeing a lesser-skilled group, your company is wasting labor resources and payroll. Hold regular meetings with project managers to stay apprised of employees' evolving skill sets.

To reduce downtime, consider cross-training workers to handle multiple aspects of a job. For instance, if crew members are skilled in both framing and concrete work, they can move to one crew or the other while waiting on a lumber truck or a load of concrete.

Retain skilled labor

With the skilled labor shortage exacerbated by the pandemic, and "the Great Resignation" hitting businesses of all kinds, it's just as important to keep experienced workers as it is to recruit new ones. Make sure you're offering a competitive salary and benefits package.

Provide training opportunities to help employees grow their skills and map a career path. Set up a mentoring program to help transfer knowledge from seasoned employees to newer hires. Keep lines of communication open between the job sites and the executive suite so employees feel heard and connected. Having a tech-savvy company culture can also help attract and retain younger workers.

Keep hope alive

Although there remains hope that we'll eventually see the economy and labor market stabilize this year, it may take longer than expected for that to happen. Rely on your leadership team and professional advisors to strategize your way through ongoing materials and labor challenges. ■

SHOULD YOU INVEST IN CUSTOM SOFTWARE?

Contractors are regularly urged to buy the latest and greatest high-tech solutions, but no software tool is perfect. Off-the-shelf products don't always provide the specific functionality needed or "play well" with other systems, forcing employees to engage in redundant and potentially error-ridden practices.

All this hassle might lead some contractors to consider engaging an outside firm to help them develop a customized solution. It's an exciting idea, though a potentially costly one as well. If you're thinking about building your own software, here are a few factors to consider:

Budget and time. Obviously, off-the-shelf products are cheaper and faster to implement. Creating custom software will likely entail substantial upfront costs and call for a significant allocation of time and resources. (Note: You might be able to recoup some of the dollars allocated to the effort by qualifying for and claiming the research tax credit.)

Even if an outside firm handles the coding, you'll still have to explain your needs and involve yourself in the development, testing and roll out. That could take months or even years. So, you must *really* want the end product.

Specialized needs. When standard software can't be tailored to meet a company's distinctive needs, employees must find a way. Workarounds may involve resorting to additional spreadsheets or tedious manual processes — activities the software is supposed to eliminate! This could result in bad data and, for contractors, costly mistakes on the job.

Having technology specially designed for your construction company should markedly eliminate inefficiencies and measurably increase productivity. If it doesn't, you probably shouldn't undertake the effort.

Integration. Thanks to cloud-based computing and application programming interfaces, most off-the-shelf software can be integrated with existing systems. Nevertheless, if your business is still having problems with data integration, developing a custom solution that optimally interacts with your systems might be worth the price of admission.

User support. Most of the better software products on the market today include some form of user support or, if not, a qualified expert can figure them out. When deciding whether to develop your own solution, you'll need to factor in the cost and challenge of supporting the software once it goes live.

Return on investment (ROI). Perhaps the ultimate factor to consider in a "buy vs. build" decision is ROI. Only after making a strong and reasonable case that a custom software solution will eventually pay off in a more efficient, productive construction operation should you move ahead with the concept. Your CPA and other professional advisors can help you decide whether, and how, to proceed. ■

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About Wouch, Maloney & Co., LLP

Wouch, Maloney & Co., LLP is a regional certified public accounting firm with offices in Horsham and Philadelphia, Pennsylvania and Bonita Springs, Florida. The firm has provided closely held business and individual clients with a wide array of accounting services for over 30 years. Wouch, Maloney & Co.'s domestic, multi-state and international clients reflect a broad range of industries from real estate and construction to manufacturing, wholesale and professional service. The firm offers a comprehensive group of services including tax, audit and accounting, business consulting, estate planning, business valuation, litigation support and forensic accounting.

Serving the Construction Industry

Wouch, Maloney & Co., LLP prides itself on its niche practice in the construction industry. The majority of our clients are involved in construction and we are adept at recognizing and solving problems common to that industry. For over thirty years, we have represented contractors along with commercial and home builders in Pennsylvania, New Jersey and Florida.

- We develop **relationships with lenders and bonding agents** and understand how to present your financial picture in their preferred format.
- We assist you in **keeping a close eye on debt, cash flow, profit margins** and other measures of financial health.
- We prepare **contracts in progress** schedules that management can understand which clearly illustrate gross profit, job costing and over/under billings per job.
- We have highly trained staff with **expertise in construction accounting** who are detail oriented, but who do not lose sight of the larger goal which is to provide our clients with quality services to meet their many financial needs.

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