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General Contractors Should Know Subcontractors' Finances

To minimize potential difficulties with subcontractors, general contractors should request financial information, such as current banking institutions, financial statements, and bonding company information.

by Michael B. Ceschini, CPA

General contractors frequently have subcontractor problems, but the headaches are worse when the subcontractor is financially weak. To minimize these difficulties, general contractors should understand subcontractors' finances.

One recent example of a subcontractor with poor finances involved a roofer who removed the roof on the wrong house with no bonding or funds to repair the damage. The state licensing board is investigating the general contractor. The homeowner is also suing for damages and trespass. Lack of supervision aside, a financially sound subcontractor could have avoided these financial problems.

There are many aspects to subcontractor financial management, including insurance and safety. The three major financial areas under the general contractor's control are prequalification, schedule of values and payment.

Prequalification

All subcontractor problems begin with a general contractor using an unqualified and/or financially strapped subcontractor. The general contractor should ask the subcontractor to provide the following information:

- Current banking institutions
- Financial statements
- Bonding company information
- History of any bankruptcy, judgments or suits in the last three years

In addition, the general contractor should request references from:

- General contractors on the last three jobs, including information on payment history for labor and suppliers
- Three major material suppliers in the past calendar year
- Three owners in the past calendar year

Schedule of Values

Joe Kellogg, president of Kellogg Corporation LLC, Denver, Colo., one of the nation's leading construction consultants, likened today's construction jobs to a "Pier Six brawl - where subcontractors and their crews fight for information on the budget, schedule and production rates." I agree.

Nothing creates a "win-win" relationship between the general and subcontractor more than agreeing on an integrated schedule of values consisting of:

- Budget. The subcontractor must provide relevant cost information for each major

task. For example, a heating, ventilation and air conditioning (HVAC) subcontractor might have costs relating to 1,000 linear feet of ductwork, controls, handling equipment and electrical work.

- **Schedule.** Each task should have a tentative time for start, duration and completion. This task schedule is incorporated into the general contractor's master schedule. Thus, each subcontractor knows when the prior task items must be completed, and who follows and when.
- **Production Rates.** The subcontractor should provide production rates for each task.

For example, the subcontractor estimates completion of 50 linear feet of ductwork per day, and projects average crew size necessary to complete that amount. The general contractor should monitor the subcontractor's daily crew size and production rate.

Payment

The subcontractor should be paid based on a percent of completion rate for each task. This prevents the subcontractor from submitting unverified invoicing.

Toward the end of the month, the general contractor and the owner's representative should walk the job, deciding on the percent completion for each task and what is to be paid at the month's end. The subcontract should state that payment is not made until received by the general contractor.

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