

**FINANCIAL MANAGEMENT OF A DISTRESSED CONSTRUCTION PROJECT
UNDER CONTRACTOR’S FINANCIAL INCAPACITY OR STRESS OF IMMINENT
BANKRUPTCY**



BY

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**A PAPER PRESENTED AT THE 2026 QS ASSEMBLY AND THE INDUCTION OF
NEWLY REGISTERED QUANTITY SURVEYORS THEMED “UPSKILLING
QUANTITY SURVEYORS’ EFFICIENCY IN FINANCIAL MANAGEMENT OF
BUILDING, ENGINEERING AND INFRASTRUCTURE DEVELOPMENTS”
ORGANISED BY QSRBN IN ASSOCIATION WITH THE NIQS AND AAQS HELD AT
MARIAM BABAGINDA NATIONAL CENTRE FOR WOMEN DEVELOPMENT,
ABUJA, FCT, NIGERIA FROM TUESDAY, 31ST MARCH TO WEDNESDAY, 1ST APRIL,
2026**

MARCH/APRIL, 2026

Abstract

The Standard Form of Building Contract envisages that a contractor will diligently progress with construction works and complete by the date for completion. However, this is not always so as a result of distress of construction project. A distressed construction project is one whose performance falls below expectation. Some of the early warning signs of distress in construction project are schedule slippage and payment delay to vendors by contractors. In most cases, these symptoms can be due to a contractor's financial incapacity or stress of imminent bankruptcy. By observing the alert signs of project distress, proactive actions can be taken early enough to salvage such projects. One of such proactive actions is direct payment for construction resources by a client. Prevention of project distress is a less expensive route than the intervention strategies applied to an already distressed project. The intervention strategies on a distressed construction project include termination of contractor's employment, corporate recovery and insolvency, determination of the value of work carried out at the date of termination, negotiation with new contractor and the preparation of notional final account. This paper presents the financial management functions of a Quantity Surveyor on a distressed construction project under a contractor's financial incapacity or imminent bankruptcy. The methodology comprised a review of relevant literature on the subject matter and tabular presentation of data to illustrate the practice procedures. The paper concluded by affirming that if proactive actions are taken on the alert signs of project distress early enough, project distress can be prevented thereby saving scarce resources for the client and nation.

Keywords: Bankruptcy, contractors, financial, incapacity, management

1. Introduction

The Royal Institution of Chartered Surveyors (RICS) described the role of a Quantity Surveyor (QS) as “ensuring that the resources of the construction industry are utilised to the best advantage of society by providing, among others, the financial management of projects and a cost consultancy service to clients and designers during the whole construction process”. Going by the above role description, the RICS anticipates that a QS should be in charge of the cost management of all construction types, be they Building, Civil Engineering or Industrial Engineering Construction. However, the two questions which should border our minds as Quantity Surveyors in Nigeria are: ‘Are we really in charge of the financial management of all these construction types in this country?’ and ‘How effective/efficient are we in carrying out the financial management of these construction works?’

Arising from the above, the theme: “Upskilling Quantity Surveyors’ Efficiency in Financial Management of Building, Engineering and Infrastructure Developments” for this year’s QS Assembly is quite apt for several reasons. First, it is an encouragement for Qs to develop their

competences in the financial management of Civil and Industrial/Heavy Engineering in addition to Building projects as envisaged in the RICS role description. Second, the theme will encourage Qs and indeed our new inductees to perform their financial management roles using appropriate tools and more efficient strategies to save scarce resources for clients. One cannot but congratulate the President and Board members of QSRBN in association with the NIQS and AAQS for the foresight in selecting this most illuminating theme.

Efficiency is the way to go in line with global best practices. For example, in the United Kingdom (UK), the Latham Report 1994 emphasised how team performance could be improved; the Egan Report 1998 called for rethinking how the construction industry could be more efficient, profitable and better satisfy the client. Similarly, in 2015, the United Nations (UN), rolled out 17 Goals with 169 Targets which emphasised efficiency and innovative strategies on how the Planet earth could be better managed in a most sustainable manner. The same go for the services of Quantity Surveyors which must not only be rendered using appropriate innovative tools and strategies but also efficiently to save scarce resources for clients and the nation.

This paper is on subtheme 8: ‘Financial Management of a Distressed Construction Project under Contractor’s Financial Incapacity or Stress of Imminent Bankruptcy’. After the introduction, the paper is subdivided into sub-sections like Financial management, Early warning signs of financial distress, Prevention of project distress, Distressed construction projects, Bankruptcy, Management/Intervention strategies for distressed construction projects, and Conclusion. The major position canvassed in this paper is that prevention is less expensive than treatment. Thus, a QS should use his best endeavours to prevent project distress rather than wait to apply intervention strategies provided in Contract Forms to manage an already distressed construction project. This is in line with RICS (2025) which recognised that there may be alternatives to best practice that achieves the same or better outcome. Preventing project distress will definitely make projects less expensive for clients and the nation.

2. Financial Management

Financial or cost management involves the processes of planning, estimating, budgeting, control and reporting of all cost-related issues from project initiation to closure (Ajator, 2018). From the perspective of Quantity Surveyors (Qs), financial management includes measurement and

description, estimating and pricing, bidding and contract award, valuation, cost control/claims management (financial reports, fluctuations, variations), contract audit and final account preparation.

The cost management of Civil and Industrial Engineering Infrastructures has not been properly situated in Nigeria. Osubor (2017) observed that although QSs are the cost experts in charge of value for money spent on construction, the relevance of QSs in Civil and Heavy Engineering projects has not been maximised in Nigeria. Some of the factors adduced to be responsible for this include role encroachment by rival professional groups in the built environment, inadequate capacity and publicity, inadequate political will, among others. Njoku (2014) attributed the high cost of procuring Civil and Heavy Engineering projects in Nigeria to the low involvement of QSs. To change this trend, there is the need for a concerted tripartite efforts of Tertiary institutions of learning, the Industry, and the Professional bodies like NIQS and QSRBN. The institutions of learning will provide the basic knowledge to Quantity Surveying students; the graduate Quantity Surveyors should be able to rely on the industry for career prospects; and the professional bodies should be there for them for life-long learning. This synergy will produce the much needed QSs who will continue to propagate the standard practices and procedures of the Profession. It is worthy to note that both the NIQS and QSRBN have admirably discharged their mandates in this regard over the years.

3.Early warning signs of project distress

Ayele (2021) opined that all projects are potentially vulnerable to distress. However, a project will be less expensive for a client if it is prevented from financial distress than providing intervention strategies to manage a distressed project. Financial distress of a project can be prevented by observing the early alert signs and taking appropriate corrective actions early enough. Thus, the success or failure of a project depends on the prevention and intervention strategies employed. Some of the early warning signs of project distress include: declining performance trends, unmet milestones, substantial cuts in project resources and time, grossly over-valued applications for payment or request for on-account payments, frequent changes of suppliers, and so on.

When these signs are observed, appropriate actions should be taken without delay to salvage the project before severe consequences like bankruptcy set in. Tebogo (2011) suggested that by taking proactive actions on early warning signs, severe consequences of financial distress like bankruptcy and insolvency can be avoided. By recognising these signs early, necessary measures can be taken to mitigate the situation and potentially avoid severe consequences.

4.Prevention of project distress (The less expensive route)

Prevention of project distress is in the interest of both the client and contractor. For the client, it will make the project less expensive. Similarly, prevention will leave the contractor better off. Moreover, it will be in the interest of the relationship between both parties. Clause 25 of the Federal Ministry of Works (FMW) Conditions of Contract states that the employer's right to termination of Contractor's employment shall be 'without prejudice to any other rights or remedies'. So, to seek a less expensive way to complete a project will not be against the intents and letters of this clause. In the corporate business world, operational restructuring is the first to operate to avoid bankruptcy. Operational restructuring aims to generate adequate cash-flow with a view to stabilise operations. In this paper, a break away from the tradition of the construction industry is being canvassed whereby a QS advises the client to adopt innovative management approaches like paying directly for plants, materials and labour costs so as to prevent imminent bankruptcy. Mitchell (2009) posited that four conditions are necessary for a project to run smoothly: adequacy of plants and tools, materials, labour, and information. The shortage or delay in the delivery of these could be adverse to finishing times and costs. Therefore, timely information on labour, materials, and tools and plants can avert project distress. Timely information facilitates effective planning and proactive decision making.

5. Distressed construction projects

A distressed construction project is one that is enmeshed in myriads of problems which makes its timely completion in doubt (Tebogo, 2011). Ayele (2011) posited that the causes of project distress include insufficient planning, inadequate documentation of requirements, poor risk management, and unresponsiveness to changing situations. A construction project can become distressed either financially or non-financially. Financial distress is a general financial concept used to describe lack of control and success in satisfying financial obligations for an individual or entity. A

financially distressed construction project is one that cannot meet short-term obligations from current earnings. In other words, the project has problem paying its short-term obligations as they become due. A project is distressed non-financially if it experiences problems in meeting deadlines set due to shortage of raw materials, labour or other resources, operational under-performance, high labour or staff turnover, and loss of key customers.

Yigit (2018) described financial distress as a concept used for lack of control over the financial obligations of individuals and entities. Financial distress is a state in which obligations to creditors are broken or honoured with difficulty. Enumah and Chang (2021) described financial distress as a condition where a company cannot fulfill its obligations. Muparuri and Gumbo (2022) opined that a company is in financial distress when its cash-flow cannot cover its debt forcing it to change its debt payment plan. The authors further stated that if a company receives losses in its financial statements for two consecutive years, then, it is in financial distress. Elbannan (2021) claimed that financial distress causes a company to have difficulty in paying its obligations due to inadequate liquidity. Chen and Du (2009) claimed that the causes of financial distress include managerial inability, inadequate knowledge of financial management, poor debt management, poor risk control, lack of integration among project units, and failure to follow financial markets.

Kristanti et al. (2023) reported that whether a company is distressed or not can be measured using financial ratios obtained from both the balance sheet and the profit and loss accounts of a company. The computation of a company's financial ratios is presented in Table 1.

Table 1: Financial Ratios

Financial Ratio	Formula
1. Return on assets/profitability	$\frac{\text{Net income}}{\text{Total assets}}$
2. Debt to assets/Leverage	$\frac{\text{Total liabilities}}{\text{Total assets}}$
3. Current ratio/Liquidity	$\frac{\text{Current assets}}{\text{Current liabilities}}$
4. Total assets turnover/Activity ratio	$\frac{\text{Sales}}{\text{Total assets}}$
5. Cash flow from operation to total debt ratio	*Cash flow from operation/Total liabilities

6. Bankruptcy

The term bankruptcy originated from Italian terms, banco rotto, meaning broken bench, and Latin terms, bancus (bench) and ruptus (broken), meaning one whose place of business is broken or gone. Bankruptcy is a financial and legal result of a personal or organisational failure to pay up outstanding debt (Yigit, 2018). Bankruptcy is used to describe a firm's formal declaration which involves the demand to liquidate its assets or attempt a reorganisation plan. Bankruptcy is a long and challenging process with some costs to the firm in default. Yigit (2018) reported that bankruptcy costs is about 3% of total book assets. Bankrupts generally have some assets to pay some of their debts, but assets of bankrupts are not enough for all debts. Some countries discourage bankruptcy because of the serious economic problems associated with it. Bankruptcy used to be considered a shameful last resort.

Four generic technically-related terms are used in connection with unsuccessful business enterprise: Failure, insolvency, default, and bankruptcy. There is the need to clarify their differences.

A). Failure: If a company's capital costs exceed approximate return on investment.

B). Insolvency: Inability to meet obligations due to lack of liquidity. It can lead to bankruptcy.

C). Bankruptcy: When the total liabilities of an individual or entity exceeds total assets.

D). Default: This is a technical or legal relationship between a debtor company and creditors: Technical default is when a debtor violates the agreement with a creditor. This can be resolved by negotiation and may not lead to bankruptcy. Legal default, on the other hand, is when a debtor firm misses a scheduled payment.

7. Intervention strategies (The more expensive route)

Intervention strategies apply to a project that was not salvaged at the early warning signs stage of distress. According to Eric (2020), once a project is distressed, prevention becomes meaningless and intervention takes the platform. The project will become much more expensive for the client at this stage. This stage contains termination of the Contractor's employment after necessary contractual notices, security of the site by the client, taking inventory and technical audit of the progress to date, preparation of a notional final accounts assuming the works were completed as planned, commissioning of another Contractor to complete the outstanding works, and the preparation of another final account after possession.

Clause 1 of the Federal Ministry of Works (FMW) Conditions of Contract and Section 1 of the Joint Contract Tribunal (JCT) Standard Form of Contract with Quantities (SFCQs) stipulate the major article of agreement of the Contractor: '...carry out the works...and complete them by the date for completion. In the event of the failure of the Contractor on this, Clause 25 of FMW Conditions and Section 8 of the JCT Conditions empower the client to terminate the employment of the Contractor with regard to subsections (a) to (d), respectively, after all due notices. In the event of a successful termination of the Contractor's employment, the major financial management roles of a QS are preparation of a notional final accounts and the final account.

A. A notional final account

A notional final account is one that is settled at the middle of a project, before the client takes possession of a project. The preparation of a notional final account can be due to any of the following reasons:

- A. the contractor or employer going into liquidation or administration;
- B. the termination of the contract due to performance or other reasons, in accordance with the contract; and
- C. the contract being terminated by the contractor.

It should be noted that the agreed value of works carried out at the date of termination should be determined as soon as possible before negotiating with a new contractor. Moreover, the possibility of termination should reinforce the importance of accuracy of interim valuations to Qs. If a contractor goes into administration, it may be very difficult to reclaim any over payment. A notional final account should put a client back into the position it was before insolvency. This means that the costs of outstanding works, defects and making good, engagement of new contractor to complete the works, and so on, will be added to the value of the works at insolvency to get the revised cost of the project. From this will be deducted the value of the works of the previous contractor before insolvency (contract sum plus value of additional works: variations, etc.). The resultant is the monies due from the former contractor. Table 2 presents some contents of a sample notional final account.

Table 2: Sample notional final account

Project	N	N
Client		
Contractor		
Value of Contract Works		75,000,000.00
Value of Additional Works(Variations, etc.)		17,500,000.00
Total Value of Works		92,500,000.00
Liability for Client to carry out construction works		
Payment to contractor(net) to date	45,000,000.00	
Add cost of works to completion by others:		
1. Cost of outstanding works and additional costs	54,000,000.00	
2. Defective works	900,000.00	
3. Making good defects	1,050,000.00	
Total Revised cost of the project works		100,950,000.00
Less contractor total value of the works		92,500,000.00
Total		8,450,000.00
Resultant monies due from contractor		8,450,000.00

Source: Adapted from RICS (2025)

B. A Completion final account

The JCT Form requires a QS to prepare a statement of all final valuations including those relating to the work of nominated subcontractors within the period of final measurement and valuation subject to receiving all necessary documents from the contractor. In preparing the final account, the provisions of Clause 13 (FMW) shall be strictly complied with: ‘the contract sum shall not be adjusted or altered in any way whatsoever otherwise than in accordance with the express provisions of the contract’. Clause 30 sets out all the matters which must be dealt with in order to adjust the contract sum in accordance with the Conditions.

The documents required for the preparation of the completion final account are: a priced copy of the contract bill, Conditions of contract, full set of contract drawings, original dimension sheets, correspondence files, copies of official variation orders, variation drawings, day work sheets, nominated contractors’ and suppliers’ quotations and accounts, copies of interim valuations and

certificates, fluctuations claims, and minutes of site meetings. Tables 3 and 4 present sample summaries of the completion final account.

Table 3: Sample Summary of Completion final account

Items	Omissions(N)	Additions(N)
1. Contract sum as contract dated 13/03/2026		20,000,000.00
1. Adjustment of PC sums	250,000.00	
2. Adjustment of provisional sums	270,000.00	
3. variations		300,000.00
4. Re-measured provisional quantities	50,000.00	
5. Fluctuations in materials and labour costs		280,000.00
6. Claims for loss and expense		25,000.00
Totals	570,000.00	20,650,000.00
Less omissions		570,000.00
Total of final account		20,080,000.00
Less total payment to date		19,000,000.00
Balance due to the contractor		1,080,000.00

Table 4: Summary of the final account

The Final Account shall be prepared by the QS in accordance with Conditions of Contract and presented in the following format.			
Project Name			Contract ref Number
Scope of Work	Shell & Core work		Contract commencement Date
Location			Contract End date
S.NO	Description	Amount	Remarks
1	ORIGINAL CONTRACT VALUE	2,500,000.00	
2	ADD /DEDUCT - VARIATIONS (NET ADJUSTMENT)	25,000.00	
3	REVISED CONTRACT VALUE	2,525,000.00	
4	FINAL ACCOUNT	2,525,000.00	
5	PREVIOUSLY PAID AMOUNT	1,925,000.00	
6	FINAL AMOUNT DUE	600,000.00	
We confirm that the Final Amount Due of 600,000.00 (Six Hunderd Thousand only) is the full and final settlement due to us against this contract.			
We (COMPANY NAME) hereby confirm that upon receipt of the Final Amount Due, the Employer shall be deemed to have fully discharged all contractual obligations, and we shall not raise any further claims related to this contract.			
CONTRACTOR		STAMP	
NAME			
SIGNATURE			
DATE			

Conclusion and Recommendations

The foregoing has explained the concepts of financial management, early warning signs of imminent bankruptcy, prevention of project distress, causes and indicators of project distress, bankruptcy, and the intervention strategies for managing a distressed construction project. Starting with the introduction, the paper interrogated the extent to which QSs are in control of the financial management of Building and Engineering infrastructures in Nigeria despite the RICS role description. The paper also describes what project distress implies and identified the early warning signs of project distress. Moreover, the paper observed that the prevention of project distress is a less expensive route to take than post-distress intervention in the financial management of construction project. Accordingly, the paper recommends the adoption of innovation approaches to project financial management like direct payment by clients for project resources in the interest of the client-contractor relationships and to save the scarce resources for the client.

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