



## News, Notes & Commentary

### Does Paying for Home Office Employees Mean Their Desk Also?

On cost reimbursable contracts, sometimes Owners will allow the Contractor to bill some or all of the actual cost of certain office-based, non-jobsite employees. Over the past 10 years we have seen a trend in Contractors taking liberty to bill for overhead costs associated with these employees also. These costs can include; desktop computers, cell phones, printers and home office parking. Some Contractors even include an overhead absorption percentage on the actual wage to cover rent, utilities etc. when a Owner believes they are paying for labor cost only.

We have heard Contractors argue that if these home office personnel were at the job site the Owner would pay; the trailer rent, computers, phones and utilities. Therefore it is only fair to charge the jobs for a portion of these same costs at the main office. The fairness of the issue mainly can be analyzed based on Control, Variability of the expense, and what does the fee cover anyway?



**Control** – At the jobsite the Owner can see the person and the equipment that they are using. The Owner can decide not to purchase the latest P.C with the super graphics card and surround sound for the job site.

**Variability of the Expense** – If the job did not exist there would be no need for a job site trailer. The home office rent and utilities would go on as usual. Home office management employees and their perks not to mention rent and utilities, are not variable to our project and therefore not reimbursable.

**Fee** – The Contractor's fee is stated as a percentage or a fixed amount. This fee is either bid or negotiated based on the market. The fee is used to cover overhead expense first and if any is left over, profit. How much goes to each is not the Owner's concern until the Contractor tries to argue that fee does not cover some types of overhead expenses. Remember that the fee agreed-on covers all overhead expense.

Consider making this issue clear next time you are tempted to agree to reimburse for home office personnel.

### Does Your Contractor Do a Good Job in Subcontracting?

Many Owners believe that it is the Contractor's responsibility to define the terms and conditions of its subcontracts. Clearly the Contractor has the contractual relationship but what is done or not done in the subcontract can cost an Owner dearly.

Recently we have seen a Contractor negotiate a GMP contract with a subcontractor without any definitions of reimbursable cost or fee. The Owner believed that they were getting protection against overstatement of the contract price with a savings provision, only to find a subcontract where the accounting of cost plus fee was impossible.

Not to long ago we ran across a similar situation where the Owner directed the Contractor to negotiate subcontracts with two large subs on a GMP basis only to discover after the job was over that the Contractor converted the GMP quotes to lumpsum.

Just as bad was the Contractor who subcontracted for a design build system with four subcontractors yet never defined the criteria for electrical or plumbing fixtures to be used. Don't think that when a subcontractor and the general contractor get into a dispute that it doesn't cost the Owner money.

Our recommendations are; (1) If you agree to a GMP subcontract, make sure that the terms are understandable and consistent with the Owner/GC contract. (2) Even if you have lumpsum subs, verify that allowance reconciliation language is consistent and there are limitations of sub mark-up on change orders that are acceptable.

## Penalty for Audit Findings

It comes to no surprise to most of you that we at CCM have a thriving business. After all, we pay for ourselves on almost every audit assignment. Why? We could say it's because we are skilled at what we do and it would be partially true, but if Contractors did not attempt to overstate cost there would be no need to audit for contract compliance. Why do some Contractors attempt to overstate cost and not comply to the terms of the contract?



Part of the pressure to overstate the Owners cost may come from very competitive market fees. Contractors sometime feel forced to sell work at fees that will not sustain the company and they resort to overstating cost to close the gap. Also there is a very fundamental micro economic reason for widespread non-compliance. There is usually no penalty for doing so.

We all know the potential penalty for filing a false income tax return. If the only penalty for errors on your income tax return was paying the amount you would have owed anyway and at no interest, how many correct returns would be filed?

Most construction contracts require a contractor to pay at its own expense, work discovered to be faulty and not in conformance to the contract documents, including the cost to uncover the work. In the case of cost overstatement by the Contractor, the cost of uncovering the work to determine an overstatement is the audit expense. If the audit discovers faulty billings shouldn't the Contractor be required to pay for the Owner's cost just as clearly as if the Owner had hired a backhoe operator to find utility lines misplaced?

Consider on all of your contracts to insert some audit reimbursement language if an audit discovers overstatements of cost to the Owner.

## Relocation Expense Limitation

We recently performed an interim audit on a \$30,000,000 project where the Contractor had charged over \$150,000 to job cost for relocation. The project was located in the Contractor's hometown, and the GMP estimate had no money for relocation. Should the Owner be obligated to pay for relocation of employees without its prior approval? Is there a limit on reasonable relocation? Is it possible that a Contractor will chose to relocate employees on a GMP job back to its home office location and use its local employees on its lumpsum work?

This issue comes up in an audit at least once a year. A local Contractor is hired to work on a local project. The GMP estimate has no amount for relocation, yet \$20K - \$40K and even \$150K is charged to the Owner. If your expectation is that there will be no cost for relocation, state that expectation in your contract.

## Construction Cost prior to Contract Award

On GMP contracts, Contractors want to be reimbursed for all of their project expense. Sometimes these project expenses include bid cost, sales and marketing trips to the client and more. Generally cost expended prior to contract award or intent to award are non-reimbursable. It will come to no surprise that we have seen cost charged to job cost as much as a year prior to contract award. On one project we even found a Contractor reclassifying the relocation expense of an employee from two years earlier.

## Free!

As always, we will be glad to review any contract you may be considering. While not a substitute for review by your legal counsel, we are in a good position to spot potential problems due to our extensive exposure to the result of different contract clauses. Please call or write for further information.

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