



## News, Notes & Commentary

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### Andersen Impresses Once Again

Rarely do we take the opportunity to praise a contractor that treats an Owner fairly. One such contractor is Andersen Construction, Co. located in Portland, OR. CCM has had the occasion to audit Andersen four times over the last six years and each time we have struggled harder to find any fault with their accounting of job cost. We could tell you stories that you would be sure to be fiction about how Andersen has ignored contract provisions that would have resulted in greater fees because "it wasn't right". Andy Andersen will have been in business 50 years in July, 2000. He told us recently that many years ago when he was first starting out that someone told him a well treated Owner was a free salesman on the road. "You don't have to pay their salary or mileage but they are out selling for you every day." Since we realize that it is just as valuable to know who you can trust as who you can't, Andy again has a free salesman.

### Off the Record Insurance Settlements

Last newsletter we talked about subcontractor backcharges that occur off the job cost record. The same can occur with insurance settlements on claims for builder's risk and contractors equipment. Over the years we have discovered hundreds of thousands of dollars in claims settlements that were not credited against job cost and instead went in miscellaneous income for the contractor. Most of these cases occurred when the Contractor provided it's own builders risk insurance. In these situations a claim can be filed (and payments made) without the Owner knowing a loss has occurred. Of course all of these cases were clerical errors and were corrected once the Owner became aware of the situation. It is very likely that many more cases have occurred than we have

uncovered though. If you are aware that a loss has, or could have occurred, a good practice is to make sure the Contractor knows you know and then follow up in checking on a job cost credit.

### Unit Rates and Their Limitations

Some years ago we wrote about unit rates in contracts and how sometimes the rates are used for quantities that were not contemplated when the contract and the rates were established. The example used then was a unit of contaminated soil on a cubic yard basis. The proposal to the contractor instructed that there might be 100 cubic yards at the site. 15,000 cubic yards were removed using the same unit rate established for 100 cy.

This time we want you to think about rates for heavy equipment quoted on an hourly unit cost basis. What might be fair for several hours or days of T&M work might not be fair to the Owner when the T&M dirt work lasts for three months. Assuming the hourly unit rate is in fact a daily rental equipment rate divided by eight hours in a day, then a fair monthly rate would be 40% less than the sum of four weeks of the daily charges. We assume, as is common in the industry, that three days equal a week's rental and three weeks equal a month.

Next time you are forced to perform an extensive amount of T&M work, review your unit rates and see if they still apply or should be renegotiated.

### Should Your Contractor Have the Right to Approve the Auditor

We recently were asked to perform an audit of a large general contractor on the West Coast. The contractor had gotten the Owner to agree to allow the contractor to approve the auditors. We had audited this contractor several times in the past two years with the Owner receiving credits of \$700,000 on one and \$200,000 on the other. The contractor, understandably from their point of view, refused to allow our firm to perform the audit. In fact the contractor insisted that only auditors that are not specialists in construction auditing would be allowed to audit the contract. Obviously, the Owner did not contemplate this situation when the contract language was

inserted. Be aware that few contractors welcome an audit and even fewer want an auditor that knows the business.

## **Should You Audit the GMP before You Sign**

Many GMP contracts start out at preliminary amounts and after documents are finalized a final GMP is agreed to as a change order. Often our clients will ask us to audit the GMP estimate to insure it is a reasonable, bonafide estimate of cost. Unfortunately, one client recently had an experience on a large project that underscored the reason why it pays to review estimated cost prior to signing the GMP. This GMP change order had numerous adds for insurance's, bonds, taxes and permits and a credit for owner controlled insurance program. Our review after the GMP was signed showed that the GMP was overstated on these items alone by \$2,500,000.

While the magnitude of the overstatement in this case was large it is not atypical of the items that we find are overstated. Other audit steps might include reviewing the basis for the subcontract values used in the estimate, focusing on the sub bids and if the lowest subcontractors bids were used and auditing the estimated labor rates and payroll burden cost in the estimate to name a few. Since there is no guarantee at the time the GMP is agreed to that the contractor will be in a savings position at the end of the project every dollar saved in the estimated cost might equate to a dollar saved at the end. Additionally, a dollar saved at project completion may not be as valuable as savings in contract price in the beginning.

## **Related Parties**

You have a contract with your GMP Contractor who is self-performing the millwork. When you finally get around to auditing the actual cost of millwork, your Contractor tells you that the millwork was performed lump sum by a subsidiary of the Contractor.

Or, you audit your contractor and discover insurance payments that are 50% higher than on your last project. Turns out that your current contractor "buys" insurance through an affiliate insurance company.

Or, you think that the limitation of monthly and maximum equipment rent is covered in your contract only to find out that equipment is rented to the contractor by a separate company with the same mailing address.

Or, you discover that all craft labor is "subcontracted" to a company that is controlled by the Contractors majority Owners. Of course the billing rates for this labor are 20% higher than actual employee cost from your last job.

These are actual examples from projects we have audited in the last year. The value of the difference between actual cost and the lump sum amounts billed on these four examples was \$860,000. Every quarter or so we see a

Contractor that argues that they have entered in to a lump sum agreement with a related party and therefore, even if the contract gives the Owner the right to audit the Contractor, this right does not carry over to the related party.

Suprisingly most contracts do not address such an event. One suggestion is to include a definition of the Contractor that mentions parent companies, all companies owned or controlled by the parent company, all companies owned or controlled separately by the Contractors Owners and all subsidiaries of the Contractor. Additionally, in the "Cost to be Reimbursed" section of the contract, you might state that any related party cost will be reimbursed at the actual cost to that related party.

## **Contract Review**

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 for further information.

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