



## Higher Deductibles

As most of you know the cost of insurance has gone up again. It seems when interest rates and the stock market returns are low the cost of insurance goes up. One of the ways contractors reduce the fixed cost of insurance is to increase their deductibles. Many GMP type contracts include a provision that makes insurance deductibles reimbursable cost under certain circumstances, however we are seeing some of these deductibles in the hundreds of thousands of dollars. This can be quite a shock if there is an insurance loss on the project. This can become a big issue if savings on the project suddenly disappears.

We suggest you review your contract terms to include a limitation on the deductible liability.

## Request a Final Accounting Before Final Payment

Much of the job of a construction auditor is knowing what to look for or what questions to ask. In fact one of the most interesting aspects of our work is predicting human behavior and anticipating what conditions must be present for a contractor to overstate cost. All of which leads us to the subject at hand, which is that one of the more frequent overcharges we encounter is that the final invoiced amount exceeds the general contractor's cost plus fee.

We usually talk about contractors overstating payroll cost or insurance or rental equipment, but we find many times that the contractor just billed more than their job cost showed. Now

overbilling can easily occur over the course of a job where an overbilling may have happened in pay application #1 or #2 and was not caught by the Owner. Each subsequent pay application could have been correct but the error continues right up to the final payment.

Notice, we did not say that the contractor is not aware of the error, yet they have plausible deniability. The general contractor can still claim that they also did not catch the earlier unnoticed overcharge. This is where the requirement of a final accounting comes in. A contractor can blame accounting error or ignorance of contract terms by billing the complete contract value or not correcting some past undiscovered mistake, but can't readily claim clerical error in falsifying a statement of the final cost of labor, labor burden, materials, subcontracts, general conditions, etc. For this reason we recommend all projects whether audited or not should have a final accounting of costs prepared by the contractor.

Many of you should note that we have advised many owners to obtain a final accounting from the contractor on projects already closed out, final paid and not audited. These final accounting results have recovered hundreds of thousands of dollars for owners in the past 15 years.

## Contradictory Exhibits

If you were a contractor looking to overstate reimbursable cost thereby increasing your effective profit margin you live to find

contradictions in contract terms. One great place to look is in the difference between the base contract definitions of reimbursable cost and information included in exhibits. Over the years we have seen; home office accounting disallowed in the base contract and seemingly allowed in estimate exhibits; actual salary and payroll cost as reimbursable one place and fixed payroll rates mentioned in another; limitations of contractor owner equipment rental cost in the body of the contract and opposite language in rental rates exhibits, and list goes on. Also included in discrepancies found in exhibits is contractors unsolicited comments included on exhibits intended for a different purpose, such as statements at the end of rental rate schedule exhibits that fix labor burden and the like. We have even seen a totally different contract made an attachment. If understanding the intent of one contract is difficult enough, how about two?

Obviously you can see the auditor's dilemma in interpreting these contradictory statements but also think about trying to prove what language governs to a third party, like a judge.

### **What do you mean when you say "Data Processing"?**

You all know auditors are bean counters. A lumber invoice or a payroll entry are both pretty easy to count. That is until the contract call for "Cost to be Reimbursed" for subjective items like data processing, or training, or safety. All of these costs can include only the cost incurred on the project site but can also include a company wide allocation of fixed and variable cost for computer hardware and software, support staff, tuition reimbursement programs for overhead staff and much more. If you were a contractor would you take the narrow view or the broad view in deciding how much to bill the Owner? We have seen amazing creativity from contractors in these areas. One GC in south Florida re-titled its VP of operations as VP of Safety to allow his cost and his department's cost to get billed to projects.

While we love the opportunity to argue these allocations with your contractors, please feel free

to make our job less challenging by limiting these subjective costs.

### **Rental Equipment Cost – Total Duration or Actual Usage**

A GC has no incentive to overpay a third party equipment rental company. If a backhoe is needed for four days, it is rented and returned. Now if the backhoe is owned by the GC we might find that it stays for a week or two or much longer, especially if it is not needed urgently elsewhere.

Even Owners that have a daily job site presence may not notice equipment sitting idle for extended periods. Of course as auditors, after the fact, we might have no evidence at all that an overcharge has occurred. However, occasionally we can pick up on a discrepancy between equipment usage and total duration and recover the owner's money. One recent project returned \$110,000 when we noticed that the monthly progress billings for equipment did not match the contractors restated final accounting of equipment rentals based on equipment's total duration spent on the job. We asked the billing clerk why she failed to rent all of the equipment that was on her project on a monthly basis and she said that much of the equipment, while checked out to the project was not used and that some of the equipment was actually used on other projects at the same site. Because of the difficulty in tracking this item, we recommend that a log of usage accompany all contractor equipment billings and that the contract state that idle time be paid at a lessor rate or not at all.

### **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 results of different contract clauses. Please call for further information.