CCM Consulting Group

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All of our jobs have the potential for getting a little boring at times. Even the life of a jet set construction auditor could become tedious, except for the seemingly infinite creativity of the Contractors and Subcontractors we audit. Below, we have detailed some especially creative attempts at enhancing profit.

Are Union Benefits Wages?

A very large union contractor had negotiated a fixed payroll burden rate for workers comp. ins. and payroll taxes, to be computed as a function of wages. Union benefit costs were to be charged separately at actual cost. Most of you are aware that workers comp. insurance and payroll taxes are paid on taxable wages. For most union hourly employees the base taxable wage is also their gross wage and deductions for taxes and union dues reduce this gross wage down to the amount in their paycheck. What makes this case unique was that the contractor reported to the Owner a gross wage of the taxable wage and the union benefit. In our case the union worker made $16.50 per hour and the union benefit cost was $9.75. By creatively manipulating their labor reports the Contractor was able to charge the fixed burden rate in the contract on a much greater base labor cost. This amount of creative accounting cost our Owner $300,000 over three projects until we caught it.

Are You Contracting With a Joint Venture?

We recently audited a large stadium project where some of the trade work was performed by a joint venture between two large mechanical subcontractors. The contract, in typical fashion, substituted the joint venture name for the subcontractors' name. The interesting part of the story is that when we showed up at the managing joint venture partner's office to perform an audit of cost of work, we were told that the contract was not with either of the individual joint ventures but only with the joint venture entity. Therefore, we could not see any job cost records of either subcontractor but only the billing files assembled by the joint venture because those were the only records auditable.

The billing files were merely a listing of all invoices billed by the joint venture. Since we did not have access to the job cost records of either subcontractor, we had no way of proving that the invoices billed were complete (meaning that they might be missing all of the credits) and not duplicated. As to the completeness issue, we found that out of 36 months of billings and thousands of material cost transactions, not one single credit invoice was billed to the GC and Owner. The subcontractor while generally quite bold and self-assured during our audit did seem to be taken off guard when we discovered restocking charges billed with no credit invoices for the materials returned.

At the date of this writing the GC and subcontractor are still discussing our possible lack of audit rights. A simple remedy would be an inclusion of the name of each joint venture partner as party to the contract and clearly stating that auditable records extend to both parties of the joint venture.

Equipment Charged to Job Cost Weekly and Billed at Weekly Rates

To save face when judgment time comes (audit date) a Contractor needs a story any story. Of course a good one is better than a bad one but any old story will do. So it is for those Contractors that charge rent for their own equipment to job cost on a weekly basis. At least half of the Contractors we audit, that charge their rental cost weekly, base the weekly charge on the weekly rate found in rental guides like AED. Of course it doesn't matter that this equipment is rented for months and years at a time and that the same AED guide has monthly rates in addition to weekly ones. In fact, since a rule of thumb in rental rates is that three days equal a week and three weeks equal a month, a Contractor billing all rentals at weekly rates when monthly rates would apply, would over bill one week out of every four or 25%. On a recent audit this exception alone was worth $312,500 to the Owner.

How Sick Are You?

Determining a fair sick time burden rate for a Contractor's employees depends on if you are buying or selling. When selling, the contractor will generally state the number of sick days allowed in their company policy per year (usually six or so) and convert the days assumed into a percentage to be applied to base labor cost. Asking the same contractor to document the six-day assumption can be an eye opener. First, our audited average sick days taken by salaried employees of contractors over the last 13 years are close to two days per year, not six. Second, many contractors when forced to show the actual days reported (as opposed to taken) by their salaried job site employees, show reported sick days taken of almost zero.

The difference between six days and zero is about 2.5% of base labor. If base labor is $500,000 on your next job you just picked up an extra $12,500 and didn't break a sweat.

Texas Payment and Performance Bond Rebate

Texas is unique in how most bonding companies can charge for payment and performance bonds. These rates are established by the State and little deviation to these State rates is allowed, at least on the front end. After the successful completion of the job many G.C.'s and larger subcontractors receive a rebate, even though we have never seen the rebate passed on to the Owner that paid for the bond in the first place. In the past we have seen this rebate to be 20%. However we audited a project recently where the G.C. got back 40%! The refund credit of $33,000 was a pleasant surprise to our nonprofit Owner.

Don't Send Me the Backup

With good intentions, on GMP projects, many Owners tell the Contractor to keep the backup for general conditions cost but not to send it with the monthly pay requests. We have also seen many situations where the Owner has asked for the Contractor to bill on a percent complete for all costs. Not surprisingly, over the years, these situations have turned out to be the most over billed. One project we audited half way through had the Contractor over billed by $1,500,000 and had cost the Owner $120,000 in interest at that point. Another recent project had the Contractor over billed by $1,600,000 as of the final pay request. The Owner had only retained $600,000 at this point.

Additional Fee for Self-Performed Work

It has become common in parts of the country to see contractors request additional fee for self performed work. This trend seems to have picked up steam as contractors that actually did some trade work began to differentiate themselves from those that brokered 100% of the trade work to subcontractors. Of course the basic arguments for additional fee does contain some logic; an Owner would pay a higher markup to a subcontractor and that there is some additional overhead required in the performance of trade work. Logically, then the reverse would be if work can't be self performed and does not require additional overhead then no additional fee should be paid. You might be surprised when you ask the contractor to define what constitutes self-performed work.

Recently we have heard a contractor explain that in addition to carpentry they intended to charge a self performed fee on clean up labor, dumpsters, labor for OSHA protection and weather protection. While this example may seem absurd we have almost never seen a contractor that was given an extra fee on self performed work separate clean up as a non self-performed item. Since miscellaneous clean up can not be easily subcontracted and is not a drain on overhead no additional fee should be allowed and your contracts should be clear on this point.

Should Contractors be Responsible for Allowance Overruns?

The basic language in the AIA contracts and most other construction contracts states that allowances are to be reconciled to actual cost by a change order. If there is an overrun the Owner adds to the contract and an underrun decreases the contract amount. Both of these events are at no risk to the contractor. This especially makes sense when the Owner or Architect establishes the allowance amount or when the scope has not been defined to any reasonable degree. But, should the same hold true when the contractor is the one establishing the allowance amount or if the scope is reasonably defined but the exact cost to the contractor has not been confirmed? Additionally, should the contractor bear some responsibility in purchasing the allowance work as efficiently as possible?

Unfortunately we have seen two projects in the last couple of years where certain contract allowances where exceeded by many millions of dollars. In some cases the contractor was aware of the insufficiency of the contractor established allowance amounts prior to contract and yet did not inform the Owner. In another case the allowance work was all done T&M with unskilled laborers, presumably because the Owner would pay any cost overruns.

Next time you are calculating your contract GMP, consider if your allowances are clearly defined as to the scope (labor and material, labor only, fixtures, fixtures and pipe, etc.), are truly unknowns, are clear as to how they will be bought out, and if the scope is mostly known and if the allowance was estimated by your contractor, consider capping the allowance as a not to exceed. If the contractor wants to add a little to the allowance amount to make it a not to exceed, so what. All of the risk in not capping the allowance is on the Owner and if the allowance does actually cost less then a deductive change order is in your future.