



## Top List of Don'ts

Writing these newsletters is always a challenge. We try to talk about new things and yet we see a lot of the same issues over and over. Some of these same old issues can be easily avoided and so we lead off with our top list of don'ts.

1- Don't let the contractor bill a GMP job on a percent complete basis. Remember the two O's. Having the *opportunity* to review cost does not create an *obligation* to review. Just this last month we again audited a contractor that was billing on a percent complete from a schedule of values. They had just submitted an invoice to the Owner that was overstated by \$1.4 million. The project had been going on for 18 months and the average monthly over billing amount was \$780,000.

2- Don't agree to fixed labor rates or fixed labor burden rates without auditing the rates upfront and clearly understanding what costs are included. Of course you know that when you agree to a fixed labor or burden rate you are running a high risk of paying too much. If you have agreed to a market fee why pay more than cost for any other element of job cost?

3- Don't allow the contractor to perform any work, even at a fixed price, that is not auditable. We have seen projects where the contractor performed either General Conditions work or some self performed work at a fixed price without the owners ability to verify that all the costs have been charged correctly. On one of these projects we discovered that much of the

self performed work was actually performed by subcontractors and also billed to cost of work. On another project we eventually discovered that the contractor began billing it's superintendent to cost of work as a foreman. We have also found insurance claim payments going to the fixed price work rather than the cost of work where it belonged. Making all records auditable gives the owner one more chance to make sure costs are accounted for properly.

4- Don't assume the contractor has your best interests in mind when subcontracting. Over and over we have seen contractors including unit prices for labor rates to be used on change orders in subcontracts. Sometimes these rates are obtained at bid time sometimes not, but almost always they are not given any weight in the bid process and are given very little scrutiny to consider if they are close to being accurate. We audited a project where the GC provided some union carpentry labor to the project. The owner had us audit the GC union labor cost in advance. After we had set the rates, with agreement from the GC, the GC's project management agreed to unit rates for a carpentry subcontractor at rates that were 30% higher than the audited rates. Even though the GC knew what real cost were they still allowed the sub to set rates that were much higher. After all, the Contractor is not paying for change orders.

5- Don't be fooled when the contractor tells you that fixing some element of job cost for billing purposes is easier. Ask yourself, for whom?

## **Seen it All**

We have been doing this construction audit stuff for a long time, but just when you think you have seen it all, you run into a contractor that is billing vehicle rent to job cost on vehicles they do not own. That's right, the contractor was renting vehicles to the job, four of them to be exact, and they were all owned by employees. But the good part is that the contractor did not stop there. In attempt to set some kind of record, the contractor also billed subsistence charges (preset in the contract for, we assume, employees that were paid subsistence) for employees that were hired locally and therefore were not paid subsistence.

## **Can't Always Rely on Policy Rates**

We have seen some GL insurance policies recently that quote policy rates on rate sheets found in the policy. What is unusual about that, you ask? The rate stated is not the actual rate due to the insurance company. The rate stated actually is both the not subject to losses premium (the amount actually paid to the insurance company regardless of losses) and the subject to losses premium (the amount that may be refunded to the Contractor if losses are minimal). This is just a variation of a high deductible plan that many medium to large Contractors use except for the confusing (on purpose?) rate schedule that makes the cost to the Contractor appear to be fixed, when in fact only a portion of the rate stated is fixed.

## **So You Want to Fix Payroll Burden Rates**

Regardless of what we say, some of you are going to fix payroll burden rates in your contract. If you are going to do it anyway, then be smart and protect yourself as follows:

1- Make sure the contract clearly states what the fixed burden rate covers. Does it cover all payroll taxes, workers compensation insurance and benefits? Do benefits include health insurance, vacation, holiday pay and retirement? Weekly we hear a contractor argue that the fixed

burden did not include one of the items listed above.

2- Clearly state whether or not the burden rate applies to overtime. In almost every situation the burden rate will be significantly less for overtime pay. Typically the payroll burden items that do not apply to the premium portion of overtime include, union benefits, workers compensation insurance, general liability insurance, health insurance, and vacation and holiday pay.

3- It is good idea to state that the fixed rate only applies to full time employees who get full time benefits. The fixed burden rate should not be charged on temporary, part time or intern employees who are not eligible for many benefits like retirement, vacation, and health insurance.

4- If bonuses are a reimbursable expense, then clearly state that the fixed burden rate does not apply to bonus cost. Obviously most contractor benefit costs do not increase when bonuses are paid.

5- Make sure that the contract clearly states that the fixed burden rate is applied to base, or taxable, labor cost. We audited a contractor that snuck in the phrase "gross labor" instead of base labor. They then attempted to charge the fixed burden rate on top of labor and payroll burden. A 50% burden rate became 125%.

6- Don't apply one payroll burden rate to both salaried and hourly labor. On a recent preconstruction audit we found that the payroll burden rate for salaried personnel was 43% and hourly was 49%. Of course the contractor had proposed to charge 60% for both.

7- Lastly, have someone internally or externally, review the proposed rates. Don't think that you can tell what the market is for labor burden rates. Contractors all have a vested interest in telling Owners that payroll burden cost is higher than what it really is. Just because everyone is telling the same story doesn't mean any of them are true.