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"Mutually Agreeable" Audit Firm

We have all heard of "code" words and phrases that say one thing but mean something entirely different. To this list we respectfully offer the newest code phrase, "mutually agreeable audit firm". Given the forum here, perhaps you can guess what "mutually agreeable audit firm" actually means. Recently, a large software company asked for our assistance in auditing their contractor on a large interior finish project. Their contract with the contractor contained an audit provision that provided that the contractor and Owner would agree on a mutually agreeable audit firm. When the Owner told the contractor that they had hired CCM Consulting Group as their audit firm, the contractor informed them that CCM was not acceptable and that they would only agree to certain auditors. The agreeable audit firms had one thing in common, they did not specialize in construction auditing and they had never audited this contractor.

If the contractor had allowed an experienced construction auditor chances are they would have been a company that had audited this contractor many times. If they had audited this contractor many times they would know where to look. We are sure that the Owner did not contemplate that they could not hire the most experienced audit firms when they agreed to such contract language, but perhaps they now know the code. So should you.

SubGuard and Payment and Performance Bonds

SubGuard use has become ubiquitous by major contractors on projects. However we are seeing something else commonly used by these same contractor's; payment and performance bonds. No, we are not talking about, either bonds or SubGuard, we are talking about billing the Owner for both at the same time.

Recently we audited a project where the contractor had charged the Owner 1.2% of subcontract value for SubGuard as well as including the actual costs of payment and performance bonds in the subcontracts themselves. At first the contractor indicated that they only bonded certain high risk subs. Later they said that the contract did not specifically forbid them from purchasing bonds. When they finally realized that we were going to discover that all subs were bonded they agreed to back out the bond premium cost. On this particular project, the double charge was $450,000.

When is Lease Not a Lease?

Most of us are familiar with leases available for the family car. For this reason, when we hear that a contractor has leased its trucks and that we are being billed the "actual" lease cost, a typical Owner does not see any problems. Not so fast Bunky. What if you found out that the "lease" was actually just a creative financing arrangement where the full value of the truck is amortized over the lease term and that while the title never actually goes over to the Contractor,

when the truck is sold the sale price proceeds are deducted from the Contractor's next lease bill. In this situation the lease payment is no more actual cost than a truck payment to some bank. The real cost of the truck, for reimbursable cost purposes, is the depreciated value of the unit, not what the contractor is calling the lease payment.

Impossible to Tell

It appears as if the larger the contractor the harder or, if you buy the contractor's story, impossible it becomes to tell what the true cost of insurance is. Now if you are a contractor and you can't prove the true cost of general liability insurance you have a potential problem. OK, lets be truthful, the contractor has a darn good idea what insurance costs. It's just that charging actual costs leaves a lot of money on the table.

Your contractor is good at math, audit math that is. Typically, only 10 projects out of 100 are audited. Perhaps only two or three out of 10 are audited by experienced construction auditors. So out of 100 projects, they only have to actually justify their true costs of general liability insurance on 2 or 3. Assuming that the contractor has overstated the actual cost of general liability insurance by double on all projects and has had to charge actual costs on only 3%, it just doesn't make sense to charge actual cost.

Of course that doesn't mean that the contractor is going to roll over and allow the Owner an easy way to deny their billing of 1% or so for general liability insurance. What we have seen recently is a new tactic. Don't let the auditor see any backup for insurance. At first this seems a bad strategy, after all if they won't document the true cost then the Owner can deny the billing in full. However, some contractor's have seen that many Owners are willing to negotiate a cost for general liability insurance. If the contractor had shown the auditor the full documentation for actual cost then the Owner would only pay actual cost. On the other hand if the contractor refuses to show the backup then they have the opportunity to negotiate a better deal. Worst case for the contractor is that the Owner is only willing to pay, based on the auditors recommendation, a sum that is at or less than actual cost. If the Owners offer is less than actual cost the contractor can always change their mind and allow the real costs to be revealed. The end result is that some of these contractor's have figured a way to collect more than actual costs, even when they are audited and the contract has a strong audit clause, by refusing to cooperate. Is this a great country or what?

Savings Sharing on Contingency

Many of you enter into negotiated GMP contracts that have savings sharing clauses. Additionally many of these contracts have a negotiated amount for unforeseen costs labeled as contingency. Some of you, however, do not indicate that this contingency is not to be considered "savings" for the purposes of the shared savings provision. Recently we had the opportunity to audit two large projects, for separate Owners, where the savings sharing on just the unspent contingency was over $1,000,000 on one and $625,000 on the other. Allowing a contractor a safety net called contingency is one thing, allowing a potential windfall is something else.

Fee on Change Orders

We have seen a pattern developing where a Contractor inserts a change in the standard AIA 201 language that allows 10% OH and 5% fee on Construction Change Directives. CCD's are typically only used when there is a disputed cost of a change order and the Owner directs the GC to keep a record of the actual cost. Once the GC has gotten this language inserted then they try to markup all change orders, even non CCD's, using this 10% plus 5%, rather than the AIA Article 5 fee percentage. If you have already had this happen to you, don't panic. One defense is that the CCD language does not apply to non CCD's. A second defense is that AIA 111 Article 1 indicates that the AIA 111 governs if there are conflicts with the other documents.