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Further Perils of Allowing Self-Performed Work

Over and over we see a GC abusing the Owners trust when the Owner allows the GC to self perform work. We could easily fill up this newsletter with just the last month's stories alone, however we try to resist, unless, of course, there is a really great abuse to note. So, on a recent \$40 M project in the Midwest the GC had asked to bid some of the subcontract work. In this case, they turned in prices for Drywall and Concrete. This GC was in charge of soliciting the sub bids and tendering a bid tabulation sheet to the Owner. The GC was apparently low on both scopes of work and the Owner allowed them to proceed to do the work as if they were the subcontractor. After the project was over, the Owner learned that while the GC showed the Owner two sub bids for Drywall, in addition to their own, there were actually three subs bids. The lowest sub bid was not disclosed to the Owner and the GC actually subcontracted the Work to this sub and pocketed the difference. In this case, the difference was \$700,000. As to the Concrete work, the GC showed the Owner two sub bids in addition to their own, as well. The Owner later discovered that only one concrete sub bid the work, and that the other sub bid was entirely fabricated. The GC, by soliciting and obtaining one sub bid for this major scope of work, only had to undercut one sub to show a savings to the Owner. The GC pocketed an additional \$400,000 on this scope of work.

Recruiting Charges

On a recent audit of a project in the Northeast, we noticed numerous charges to job cost for recruiting costs or headhunter fees. On this project there were

four charges total, for employees that were hired at the beginning or during the project. Two of the charges indicated a recruiting agency payee, while two of the largest entries that came to \$37,000, did not. Now you probably can guess that we had no intention of allowing such costs, which are nothing more than outsourcing of home office overhead, but we asked to see the invoices that supported the costs anyway. In this instance the two "invoices", that had no payee listed, were internal generated items. The GC had actually used it's own human resources department to find these employees, but had decided that the Owner needed to contribute to overhead by calling this a cost and creating an invoice. We respectfully disagreed.

Problems with Allowing Fixed Hourly Rates for Salaried Employees

Every Owner knows that salaried employees do not get paid by the hour and yet many times an Owner agrees to an hourly fixed reimbursable rate. The problems with this approach are as follows (in no particular order).

* The fixed rate could be higher than actual cost (and almost always is). Our measured rule of thumb is 20% to 25%, generally.

* The GC could bill based on hours worked vs. hours paid, even though the rate was developed using an assumption of 40 hours in a week. This scheme could generate an additional 10% - 15% (in case you are keeping score).

* The rates could be based on subjective job titles and therefore very difficult to enforce. This weeks project had a PM (that was the title on his business

card) charging as a Sr. PM. The rate difference between one and the other was 15%. On a past project we audited an Architect that employed the same thought process and overbilled \$2 M on a very large forced remodel (earthquake damage).

* The contract may not be clear as to what is included in the rate. Is vacation and holiday time in the rate or outside? Are bonuses, of all kinds, included? What about car allowances? What if one person elects to not get a car allowance but a company car instead? Is the company car also included in the hourly rate, in this case? The potential duplicate billings for vacation and paid time off can increase the amount collected vs. paid by 10% - 15%.

Our solution is to not agree to hourly rates for salaried employees and reimburse actual cost instead. Alternatively, an audit of the rates in advance is always advisable, with care to include a clear list of cost items included in the rates in the contract, a list of persons that should be assigned to each category, and a provision that total weekly billed hours can not exceed 40 hours times, hours worked divided by hours worked and paid. For example, when an employee works 50 hours in a week and is off on Friday for Holiday, the calculated hours allowed to be billed, of a full weeks (40 hrs.) salary, would be $(40 \times (50 / (50 + 8)) = 34.48$ vs. 50.

Another Reason Why we are Concerned about Construction Managers Using SubGuard

On two separate projects, with different GC's, we have recently seen another kind of issue that should make SubGuard problematic for Owners. On these projects the GC had billed the Owner for SubGuard, collected the premiums, had four subcontractors default (two each job), and refused to file SubGuard claims. On both projects, these sub defaults caused or contributed to extensive delays, of which SubGuard should reimburse the GC for, in theory. However, given the GC's self insurance portion of SubGuard, the GC could potentially be out more than a \$1 M per claim, after deductibles and coinsurance. This surely contributed to these GC's deciding to claim that the Owner or the Architect was the true cause of the delays and therefore their refusal to file a SubGuard claim in the Owners and the Projects behalf. These examples are some of the truest explanations of why we do not see SubGuard as an Owner protection instrument. If bonds had been

procured, possibly the bonding company would have made a case that some of the claim events and delays were not their subcontractors doing, but a claim would have been filed and the GC would have been on the Owners side in such a case. To add insult to injury, in both of these cases, the GC talked the Owner to paying the GC more in SubGuard premium than sub bonds would have cost. Don't say we did not warn you.

When the Owners Development Partner is also the CM/GC

We have audited several projects recently where our client had a partner that acted as development manager and also the GC. You can already imagine the possible conflicts of interest that could develop as one partner trusts the other partner to manage the development of the project and that partner employs an in house or affiliate to estimate and build the building. Yes, everything you can imagine was present in our last three audits with this type of arrangement. On a project last month, the development partner agreed to a savings bonus with it's in house construction company. When we audited the final cost we saw that there was over \$1.2 M in savings on a \$25 M project, which the GC kept \$400,000 as its shared savings bonus. After investigation, we determined that \$1 M of the total savings was generated by the GC not using the low steel bidder in it's GMP estimate and then promptly (in fact prior to the contract date) subcontracting with the actual low bidder.

Did the development partner know of the true steel bid or were they lazy given the possible trust they had in their own company? We do not know, but this same lackadaisical oversight is common with this arrangement. Also common is a development partner that refuses to, or cannot for internal political reasons, hold its contracting arm accountable when it is needed, against both Owner partner's best interests.

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