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Q&A - Performing construction contract risk analysis webinar

Would general conditions costs be included in company overhead?

— General conditions should not include company overhead. General conditions is the contractor's reimbursement for costs to administer the job site. These costs may include mobilization, supervision, project management, cleaning, computers and utilities among others.

Can auditors with no experience in construction perform a construction audit?

— Yes, but it may be difficult. An auditor should understand construction terms, project controls, construction risk pools, and how to test for contract and project control compliance.

I have seen many contracts where general conditions and general requirements costs are considered direct costs of the project, while the fee, bonds and insurance, and taxes are indirect costs not subject to fee calculation. Is this incorrect?

— It is correct. There is no right or wrong interpretation and it really does not matter. What is important is that you test general conditions costs for compliance with contract terms.

Do you equate general provisions with general conditions?

— General provisions define the relationship between the owner and contractor. General conditions define the contractor's reimbursable cost to administer the project. These are very different contract terms.

Have you found that many project team members, both owner and CM, think lump sum CO only require one figure?

— Yes, this is a common problem and what is required is what the owner demands from the contractor. If the owner's project team is satisfied with a single line lump sum change order then that is the requirement. However, we disagree with this practice. In the absence of supporting details, it is difficult to analyze the change order price.

What is the standard rate or percentage that should be charged for SDI? Is 1.75% too high?

— A standard cannot be set because the rate is based on variables like geography, contractor's experience, nature of the work being performed, etc. We recommend setting a rate that is an allowance to be trued up to actual cost at the end of the job. And the cost should be based on only those subcontractors enrolled in the program.

What time is best to perform audit? During the construction phase, at close out, or once project is complete?

— The best time to audit depends on the audit objectives. For instance, cost recovery audits demonstrate great success at closeout because it is easier to quantify the results. If risk mitigation and over-charge prevention are the primary goals then during construction will yield the best results. You don't always have the opportunity to pick the audit timing though, so either timing will enable an auditor to test controls, identify weaknesses and report contract compliance issues. Once the project is complete is not as good a time as closeout or continuous monitoring. If this is the only option available to you though, take it and use it to demonstrate the value of the audit for future opportunities.

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For GMP contracts, how do you convince management that an audit is worth the time?

— It is commonplace for management to not care too much about the specific costs being charged as long as the project is not going over the max price. To overcome this barrier, consider setting the objectives and outline why it is in the annual audit plan. Construction audit is not a cost management tool, it is a risk management tool. So being over or under budget is irrelevant if the goal is to evaluate contract compliance, identify construction project risk and verify that controls are working as expected. We typically do AP cycle audits and revenue cycle audits to verify controls are working, not because we think there is fraud or a control failure. Construction auditing should be viewed with the same risk management lens and be included in the annual audit plan for risk management purposes.

Can you explain what a 'GMP contract' is? Are there other types of contracts?

— GMP stands for guaranteed maximum price contract. This is a cost plus the construction management fee with a maximum price. There are also stipulated sum or lump sum contracts, which are agreements for a fixed price for a fixed scope of work. Regardless of what it costs the contractor to build the facility, the owner is obligated to the fixed price of the contract. These are the two most common contract types. There are a number of other specialty contracts. Design-build agreements are when the architect and contractor are working under a single contract with the owner. Integrated project delivery has a target price and a shared incentive compensation or bonus between the architect, contractor, engineers and owner. Unit price contracts are commonly found on civil, highway and utility projects. They are represented by a rate for a completed unit of construction such as a rate per mile, rate per cubic yard, rate per ton and so on.

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