Subcontracts: Audit Strategies for Effective Management and Cost Control

Park MGM ~ Las Vegas

September 9, 2019

Presented By: John L Wisz

WiszCo, LLC
Subcontracts:

- Can they be audited (if they are Lump Sum)?
- Is there a “Right to Audit” provision in the contract?
- What can Be Audited? What can’t?
- What is there to audit?

The construction industry has always *hidden* behind the ole’ “That was competitive bid (or that was agreed to), so it’s not subject to audit”
What are you smoking? Put the Pipe Down!
Rule #1

Do not assume that the competitive bid process hasn’t been contaminated or compromised.

- Look carefully at sole-source arrangements or other arrangements that “appear” competitive.
- Who participates in the bidding and award of subcontracts?
- What kind of business deals are being made without owner oversight?
- Evaluate the bid normalization process and understand the basis for contract award amount.

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When is the best time to perform an audit?

- Before the contract is signed?
- Right after the contract is signed?
- During the construction process (interim)?
- At the end of the project?

Does it matter? Will a final audit “fix” everything?

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Procurement Considerations:

- Procurement method (Competitive bid, negotiated, hybrid involving elements of both, sole-source)
- Selection of contract type (Lump Sum, Cost Plus; Cost plus with a GMP; Unit Price)
- Contract Language (Right to Audit; Change Order pricing; GMP Considerations)
- Pre-contract audits (to verify data prior to execution of the contract)
Ingredients necessary for kickbacks, “off book” payments and other improprieties:

- Extra Money (above and beyond the necessary costs to perform the work + a reasonable profit)

- Lack of Transparency (not “open book” or not auditable)

“In this country, you gotta make the money first. Then when you get the money, you get the power.”
“I work hard for this. I want you to know that.”

Scarface
What is there to Audit (for Lump Sum)?

- Compliance w/Scope (quality, quantity and construction methods)
  - Cutting corners/taking shortcuts ➔ Extra Profit
- Insurance and Bonds (or SDI/Subguard)
- Allowances
- Change Orders - Common misunderstandings, difficulty in the Lump Sum environment and the role of The Truth in Negotiations Act.

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Information to evaluate when auditing Lump Sum subcontracts:

- Bids/Proposal Documentation
- INCLUSIONS and EXCLUSIONS
- Deductive Subcontract Change Orders
- Unaccepted Alternates
- Budget vs. Actual Cost Incurred (Line Item basis)
- Subcontract Allowances (especially for undefined work, if needed)
Change Order Considerations:

- Is it worth the fight? **We think so.** But, we’re in the minority (seemingly 😊).

- **Know your contract.** **After a change order is signed, what audit rights remain?** The time conundrum.

- **The Big 4:** Labor Units/Hours; Labor Rates; Material Quantities, Material Prices.

- **Markup Fee %’s – what’s normal, what do they cover?** Mark up Fee = Overhead **and** Profit

- **See prior presentations from 2012 and 2016 (included with package)**

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Contract Administrative Considerations:

- Summary page summarizing the key business terms:
  - Contract Date
  - Contract Amount and Basis of Compensation (Lump Sum; GMP; Unit Price, etc.)
  - Unit Prices and Labor Rates for Extra Work (Change Orders) – ** with “Caveat”
  - Change Order Mark Up %’s for OH&P
  - Allowances and accepted VE included in Contract Sum
  - Insurance, Bonding and/or SDI Provisions, as applicable
  - Alternates not included in the Contract Sum

- Contract Financial Summary (in additional to a Schedule of Values); Obtain/retain native file format (Excel)

- Establishment of acceptable Payment Application format for billing purposes

- Narrative of INCLUSIONS and EXCLUSIONS (Exhibit)

- GMP Considerations (If applicable)
GMP Contract Considerations:

- **Sandbagging:** The strategy of lowering the expectations of an organization’s strengths and core competencies, in order to produce relatively greater-than-anticipated results.

- **Definitions of Reimbursable and Non-Reimbursable Cost** (cost-based contract)

- **Contingency**

- **Fee Calculation**

- **Savings (and related Split)**

- **Allowances**

- **Change Orders and related Pricing**

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Questions, Comments or Thoughts?
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