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## The Rise in Audited Construction Projects: What You Need to Know

**Legal Update**

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With the rise in construction projects that are audited, it is important for owners, general contractors and subcontractors of all tiers to understand both the basics and specific concepts regarding construction audits and seek legal counsel as needed.

This article focuses on the financial aspects of an audit, but audits can certainly also include auditing of other aspects of the project, including contract review, bid process, funding process, other process audits, system implementation, regulatory compliance, contractual compliance, efficiency and project close out.

Private and public owners engaging in cost-plus projects, with or without a guaranteed maximum price, are the owners most likely to conduct an in-house or outside financial construction audit at the end of the project. Audits can take on many shapes and forms, so it is crucial that all parties to the project—the owner, general contractor and all tiers of subcontractors—have clear understanding and expectations regarding the scope of and procedures for the audit from the outset of the project. Such understandings and expectations should be incorporated into the contract documents as much as possible.

Some of the financial factors most commonly assessed in a construction contract audit are listed below, along with various potential questions that parties may need to be asking at the outset of the project regarding the audit:

**Labor Charges of the General Contractor and Subcontractors**

- Are the hourly rates listed in the contract agreed upon and not subject to audit, or are they still subject to audit despite an apparent agreement on rates, and, if so, on what basis are such rates audited?
- Is allowable labor burden defined in the contract?
- Are there prohibitions or restrictions regarding billing for certain portions of labor burden, including taxes, worker's compensation, health insurance, unemployment, other benefits, pension, tools, PPE and other compliance/safety costs, equipment fuel/maintenance, equipment depreciation, etc.?

## Equipment-Related Charges

- Are equipment-related charges subject to audit?
- What restrictions, if any, will be imposed upon equipment rental and/or purchase charges?
- Can a contractor bill for contractor-owned equipment, and, if so, at what rate/amount?
- Are equipment rental charges capped at the fair market value purchase price?

## Charges for Materials, Tools/Supplies and Other Reimbursables

- Are material charges and other Reimbursables subject to audit, and if so, how?
- Are charges for materials purchased from a supplier capped at the fair market rate or industry standard charge, regardless of the amount actually paid to the supplier?
- What are the allowable Reimbursables that can be billed?
- Can small or large tools be billed separately?
- Can safety equipment and training be billed separately?
- Can delivery and freight be billed separately?

## In-House Fabrication

- What is the proper method for billing for in-house fabrication time (both for the materials and labor involved in fabrication)?
- What restrictions are placed on such billed amounts?
- Are charges for materials fabricated in-house capped at the fair market or industry standard rate, regardless of the amounts incurred for such in-house fabrication amount?

## Profit and Overhead Charges

- How should profit and overhead be billed?
- Are overhead charges subject to audit, and, if so, on what basis?

## Change Orders/Additional Work

- How can change order work be priced: lump sum, hourly or a combination thereof?
- Which portion of the change order costs will be audited?
- Will the change order hourly rates of the contractors and their subcontractors be audited?
- What is the maximum mark-up for in-house labor and subcontractor charges for change order work?

- How are extended general conditions and/or overhead/profit to be billed for change order work; are such charges subject to audit; and if so, on what basis?

## **Prime Contract vs. Subcontracts**

- If there are different rates/percentages (e.g., maximum mark-ups, change order rates, hourly rates, etc.) in the prime contract versus a subcontract, which rates/percentages apply for the subcontractor?
- How does the flow down provision in a subcontract affect the audited portions of the subcontract?

## **Scheduling/Time/Delays**

- What aspects of scheduling, time, reasons for time extensions and delays are audited and in what fashion are they audited?
- Are mutually agreed time extensions subject to audit and, if so, how?

If you have questions regarding anything addressed in this article, please contact Jodie McDougal at [jmcdougal@fredlaw.com](mailto:jmcdougal@fredlaw.com) or your Fredrikson relationship attorney.