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MANAGING THE CONTRACT CLAIM PROCEDURE



Appropriately designed and implemented internal controls that target contract compliance and recordkeeping can help contractors protect their rights to recover and preserve evidence that claims have occurred.

A properly utilized accounting system designed for contractors, in addition to proper job costing, will also help a contractor prove damages. CFMs must also understand and be able to identify situations that might lead to a claim and ensure that PMs and superintendents do, too.

This article will provide general information about how contractors can avoid and effectively manage contract claims.

Before pursuing a claim, contractors should seek guidance from experienced construction attorneys, as many factors – from the contract itself, to whether the contract owner is a governmental or private entity, to the laws in the jurisdiction that govern the claim – can vary significantly.

IDENTIFYING CONTRACT CLAIMS

Contractors should hold regular project status meetings and require attendance by management, PMs, CFOs, and/or controllers.

CFMs should prepare for these meetings by reviewing contract schedules, budget-to-actual reports by phase, and other financial records. PMs should be prepared to explain any underbillings, cost overruns, delays, past due receivables, and any other identified problems. The project management team should discuss any unresolved issues or problems with contracts including delays, and any problems with the contract owner or subcontractor.

Obtaining this detailed information from all parties will assist management in effectively allocating the company's resources, monitor issues as they develop, and work to minimize the impact of problem jobs – and perhaps, ultimately, the occurrence of contract claims – while increasing the accuracy of financial reporting.



Properly administered, these meetings provide the perfect opportunity to identify, and, in many cases, avoid contract claims. Problems (i.e., future claims) that are identified and communicated to the owner early are more likely to be amicably resolved than those that go unnoticed, or are not communicated, for extended periods of time. The CFO should maintain minutes of these meetings and follow up on any identified issues.

NOTICE PROVISIONS, WAIVERS & RELEASES

Most construction contracts have provisions requiring timely written notice of claims, delay-causing events, differing site conditions, and various other items. Many courts strictly enforce notice provisions, and failure to comply with these provisions could invalidate a contractor's claim.

Additionally, contractors are frequently required to provide waivers and/or releases when submitting applications for payment. These commonly contain language that waives all claims against the owner. Care must be taken to ensure the contractor preserves claim rights when completing these forms.

PREPARING TO FILE A CLAIM

Management should consider consulting with an experienced construction attorney early in the claim process. The attorney can evaluate the facts and circumstances relevant to the claim and provide guidance as to how the contractor should proceed, in addition to the remedies that are available under the applicable law.

Obtaining a timely and favorable outcome on a claim can be critical to the profitability of a contract, and seeking expert assistance early in the process ensures quick resolution. Management should consider the costs and any potential future consequences associated with pursuing the claim.

The claims process typically requires devoting significant time to resolving the claim, and the contractor may incur significant costs to prepare and defend a claim. The relationship with the contract owner should also be considered; if the owner is an important customer, pursuing a claim against them may have long-term costs that significantly exceed any potential recovery from the claim.

CALCULATING DAMAGES

Contractors should be using an accounting system that accurately codes job cost into the system. Phases that reflect the

different elements of a contract, from planning and design through completion, should be set up in the accounting system, and all direct contract costs should be phase-coded.

Contractors should allocate indirect costs, both on a systematic and rational basis, to contracts to ensure there is a reliable source to quantify damages.

Contractors that do not have effective job costing systems will only be entitled to recover damages they can prove with reasonable certainty. The procedures involved in calculating damages vary based on the type of claim and governing law.

DOCUMENTATION

In addition to the contract, plans and specifications, and change orders, it is imperative that contractors maintain records that are complete, accurate, and timely throughout the life of the project.

Contractors should require daily field reports and project schedule maintenance for all contracts. Daily reports and project schedules are critical to a contractor's ability to support and defend claims. Sage Consulting Group found that claims on contracts with Federal Agencies "were most likely to be denied due to a lack of evidence."¹

Daily Field Reports

When prepared accurately and timely by the foreman, daily field reports document actual progress, site conditions, and other important and relevant information on a daily basis. The report should include the date, weather, site conditions, materials received, employees and hours worked, equipment and hours used, subcontractors (labor and equipment) on site, and a description of work completed that day.

The report should also include documentation of any conversations with inspectors, contract owners, or others, as well as verbal instructions to perform additional or changed work. Additionally, the foreman should confirm significant verbal communications in writing, should submit a change order request, and should not perform additional or changed work until a written change order is received.

Many contractors have adopted the use of tablets or other mobile devices for the maintenance of daily reports. These devices typically allow the foreman to include photographs as part of the daily report; dated photographs showing site conditions and any unusual or unexpected situation should be included when possible.

Common Construction Claims

Implied Warranty

“When an owner supplies the plans and specifications for a construction project, the contractor cannot be held liable for an unsatisfactory final result attributable solely to defects or inadequacies in those plans and specifications.”² For example, if an owner specifies which pumps to install at a water treatment facility, he or she is warranting that those specific pumps are suitable for the project. The contractor would have had a defense against the owner for a claim if the pumps were properly installed, but unable to produce the required rates of flow.

Constructive Changes

These occur when the contract owner requires or causes the contractor to perform additional or different work than specified in the contract.³ It is important to note that most construction contracts include provisions that prohibit a contractor from performing additional or changed work without a written change order signed by both parties. Courts have upheld the prohibition against performing additional work without a written change order; therefore, contractors should demand a written change order before performing additional or changed work.

Cardinal Changes

These occur when changes ordered by an owner result in the contractor performing work that is “substantially different” from the scope of the contract.⁴ An example of a cardinal change would be an owner insisting that a roofing contractor install solar panels instead of shingles on half of a roof.

Differing Site Conditions

Such claims occur when physical conditions encountered while performing the work are materially different from conditions believed to exist at the time of bidding.⁵ Generally, claims for differing site conditions will fall into one of two categories:

- Type I describes changed conditions that “differ materially from those indicated in the contract.”⁶
- Type II describes changed conditions as unknown and of an unusual nature, “which differ materially from those ordinarily encountered and generally recognized as inhering in the work of the character provided for in the contract.”⁷

Misrepresentation & Duty to Disclose

These claims occur “when actual conditions encountered were not as they were represented.”⁸ Claims related to duty to disclose occur when a contract owner does not disclose all available information.⁹ For example, if a contract owner did not disclose the presence of concealed asbestos in a remodeling project, then the contractor may have a claim to recover costs.

Delays

Delays are one of the most common issues that lead to a contract claim. In general, both the contractor and contract owner have a duty to work with each other and maintain effective communication. The following are two types of delays:

- Excusable delays are typically as defined in the contract and include delays caused by the contract owner. Excusable delays can also fall into one of two categories: compensable, which “permit ... the recovery of both time and money” or noncompensable, which “permit ... solely the recovery of time.”¹⁰
- Nonexcusable delays are the responsibility of the contractor and provide no compensation in time or money. Whether a contractor may have a claim for an extension of time to complete a contract, extra compensation, or both is dependent on a number of factors including whether the contract includes “no-damages-for-delay” or other exculpatory clauses, and other factors.¹¹

Contractors should be wary of offers of additional time as the sole remedy for a compensable delay. The costs associated with delays are real and too often lead to losses for contractors.

Acceleration

This occurs when the owner requires completion by a date earlier than the contract completion date. Constructive acceleration occurs when the owner does not honor compensatory time extensions for excusable delays. Under an acceleration of the contractor’s work, the contractor is typically entitled to damages related to the increased costs resulting from the acceleration.¹²

Project Schedule

The PM should maintain a project schedule showing the planned timing of work through completion, and should update the schedule periodically to show actual work performed to-date as well as the impact of delays, change orders, etc., on project completion.

In addition to being an effective project management tool, the project schedule and its revisions establish a timeline for the contract and demonstrate the impact of any delays on project completion.

The value of appropriate documentation in a contract claim cannot be understated. In addition to potentially preserving a contractor’s rights to additional cost, time, and damages, proper documentation may allow a job to progress while retaining the contractor’s rights and positions.

Furthermore, the contractor may avoid costly litigation and the need to file a claim altogether as appropriate documentation combined with timely communication limits disputes.

Conversely, the failure to maintain complete, detailed, and accurate records can be consequential, as illustrated in *Ray D. Lowder, Inc. v. North Carolina State Highway Commission*:

“In *Lowder*, the contractor’s first job superintendent had kept daily reports showing the progress of the work, the number of men, and the equipment on the job. The second superintendent did not show this information on his daily reports.

“When the contractor was preparing a differing site conditions claim, it rehired the first superintendent to go over the daily reports and prepare a cost summary.



“The Court held this cost summary was inadmissible, and would not let the contractor use it to prove damages. Further, the court held that the daily reports themselves were incomplete and unreliable because even the ones the first superintendent filled out did not show how many hours each machine was in operation, whether any machines were broken for part of the day, or even if any had been used all day.”¹³

A dispute with the Army Corps of Engineers, against which contractors prevail only 11% of the time,¹⁴ demonstrates the importance of maintaining accurate daily logs. The Armed Services Board of Contract Appeals (ASBCA), relying on daily logs, ruled in favor of Dick Pacific Constr. Co., Ltd.’s claim that the government was responsible for certain delays on the project.

“The ASBCA explicitly declared, ‘We consider daily logs to be the most reliable evidence of what actually happened during construction.’” Similarly, the ASBCA noted that “[d]aily inspection reports have been held to be prima facie evidence of the daily conditions as they existed at the time of performance.”¹⁵

POST-COMPLETION REVIEW

Contractors should perform post-completion reviews for all contracts, not just those resulting in losses or claims. The post-completion review should cover all phases of the contract from estimating through final acceptance by the contract owner and include an evaluation of all internal and external parties involved with the project.

The CFM should prepare and analyze a phase-coded budget-to-actual report. From the budget-to-actual report, minutes of the project status meetings, and a review of daily reports and project schedules generated during construction, management should evaluate the performance of the entire construction team.

The post-completion review should involve the estimator, foreman, and PM to facilitate teamwork and an understanding of how decisions made in different functional areas impact the entire company. The review should include an evaluation of external members of the construction team, and the results of this evaluation should be kept on file for future reference.

Following the post-completion review process, management should communicate lessons learned, identify areas for improvement, and implement best practices.

CONCLUSION

A CFM plays a critical role in identifying and preventing potential claims. CFMs should ensure that the contractor is complying with notice provisions and maintaining adequate documentation in order to protect its rights should a claim occur.

Contractors that proactively identify and communicate issues to owners improve their prospects of obtaining a favorable resolution and can frequently avoid the frustration of a contract claim altogether. The best way to mitigate a contractor’s risk related to contract claims is to avoid them. ■

Endnotes

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