

Construction Executive

<https://www.constructionexec.com/article/precautions-for-minimized-risk-exposure-and-maximized-loss-recovery>

By Robert Burton | Thursday, August 1, 2019

[Risk Management](#)

Increasingly complex construction projects carry additional risks, and with that comes the elevated likelihood of protracted litigation. Globally, industry analysts have noted increases in both the number of construction disputes, as well as the average length of time for them to be resolved.

With the implementation of prudent accounting practices, contractors can reduce the likelihood of adverse litigation and can maximize recovery in the event of economic loss. And for projects where litigation is unavoidable, proper internal accounting practices can serve to minimize the time and expense of outside consultants.

Contractors routinely face potential losses due to delays and changes in project scope. Recovery of these losses requires an ability to prove damages with reasonable certainty. Such losses may be difficult to quantify with requisite precision if sufficient controls and accounting practices are not in place during the course of the project.

START WITH ACCURATE BIDDING

At the start of each project, contractors should be sure to prepare and maintain accurate bid documents with details on all anticipated project costs. Ideally, such costs will be supported by actual historical costs based on similar completed projects. Accurate bidding can reduce the likelihood of an underbid that makes performance difficult and creates additional exposure.

DOCUMENT CHANGES

Once construction begins, contractors must remain diligent and document changes in labor, materials and equipment costs. In the event of a delay claim, accurate records will be required to quantify the economic impact of such cost changes.

For loss recovery, contractors will often require both fact witnesses and damage experts to prove damage elements. The contractor must show that the damages could have been reasonably avoided, that the job was not underbid, and that the impact of market forces such as labor and material shortages or price increases have all been properly considered and segregated.

The contractor should also document what the costs would have been without delays or scope changes.

BE PREPARED TO PROVE LOSSES

Contractor losses may include components such as additional or expert labor, overtime and idle labor (including salaries and burdens). Experts may be necessary to help prove the reasonableness of the baseline costs or the initial bid.

Losses also may include additional or enhanced materials, storage costs for delayed delivery, price escalation due to delayed delivery, and premiums paid for expedited manufacture, availability and delivery.

Excess equipment costs may include idle equipment rental and depreciation or rental value for contractor-owned equipment during extended delay. Recovery will normally require proof that the equipment could not be utilized on other projects to avoid the unabsorbed costs.

However, it also may be possible to show that demobilization and remobilization of such equipment would have been too costly or impractical due to the unknown length of a delay. With advanced awareness of these areas of potential recovery, contractors can act diligently to monitor accumulating costs.

Similarly, labor cost and workforce utilization should be documented. Reliable accounting records can increase the likelihood of recovery of additional labor costs due to delay. Again, contractors should be prepared to show that the additional labor costs could not have been absorbed by other concurrent projects, or that demobilization and remobilization of the labor force would be too costly.

BACK UP LIQUIDATED DAMAGE PROVISIONS

Contractors may feel a false sense of security based on the inclusion of liquidated damage provisions in their construction contracts. However, for these provisions to be enforced, contractors may have the burden of proving that the amounts set forth as liquidated damages were reasonably estimated.

If liquidated damage provisions are judged to be punitive rather than reasonable, courts may decline to enforce these provisions. Here again, accurate documentation of current and historical project costs and profit measures can help establish reasonableness and increase the likelihood of recovery in litigation.

SEGREGATE COSTS

Contractors also must segregate and account for additional costs associated with scope changes. Contractors are often required to perform work in advance of approved change orders. In these

situations, contractors must prudently segregate all additional costs, rather than comingling them with general project costs. Preemptive segregation is much more cost-efficient than retroactive efforts to segregate and quantify these same costs.

Contractors pursuing total cost claims for widespread impact on projects will be required to have a firm command of their historical business documents. In litigation, they may be required to show that cost overruns were attributable to specific scope changes, rather than to an underbid. In these circumstances, accurate historical accounting records can help show the contractor's ability to perform timely and profitably on past projects.

KEEP AN EYE ON WAGE AND EMPLOYMENT REGULATIONS

Contractors are also finding themselves increasingly the subject of litigation by their own employees in wage and hour lawsuits. Accurately monitoring pay regulations and properly calculating employee wages can be challenging due to ever-changing exemptions of who qualifies for overtime pay. Risk management requires awareness and diligent implementation of applicable employment regulations.

With foresight and properly designed accounting systems, unavoidable risks can be reasonably controlled.



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