



# HARD

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Moss Adams Construction Group Newsletter

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## Managing Contract Changes

Change orders are modifications to construction contracts, initiated by either the owner or the contractor that permits additions, deductions, or changes to the contract after work has begun. Given the many factors that can cause contract changes, contractors must be proficient in handling modifications to minimize any negative impact on project profitability. Owners and contractors alike may face challenges in these economic times such as cash flow concerns, making it imperative that contractors are adept at execution of change orders. This can be accomplished through effective communication among all parties to the contract, ensuring written authorization of contract changes exists, and the implementation of adequate internal controls.

### Identification

A contract should contain a clause for handling change orders otherwise additional work will have to be negotiated or rebid. A contract should specify the parties responsible for review, approval, and payment of change orders, with the inclusion of an accurate and realistic timeline. It may also provide for expedited meetings to facilitate timely resolution of disputes. All members of a project team should have a thorough knowledge of the contract to be able to identify when change orders are warranted. Once identified, the project team, the owner, and other parties to the contract should work together to accurately and timely price the change order work. Attempting to save money in project administration may result in spending it on future litigation.

### Authorization

It is desirable for contractors not to perform change order work until written authorizations have been received by a representative of the owner, documenting the change both in scope and in price. Oftentimes owners and contractors may agree on the necessity of a change order, but disagree on the price. Addressing this issue prior to the commencement of work will enable the owner to consider a less expensive alternative, and will protect the contractor from absorbing unnecessary costs. When reviewing change orders, contractors should be

aware of terminology that may prevent the filing of future claims for unforeseen circumstances. Once change orders are agreed to, effective communication of changes to date can be maintained through up-to-date and timely invoicing. This keeps the owner informed of progress made, as well as more readily alerts contractors to the presence of potential disputes.

### Implement Controls to Manage Costs

Many contractors do not have cost control systems or accounting procedures that can readily or easily isolate the additional costs related to a change order. This is aggravated by the fact that change orders are often initiated by owners with little or no advance notice to the contractor. Consequently, the contractor is often unable to clearly identify or control the additional costs associated with the changes. Another potential shortfall for contractors is the inaccuracy or unrealistic expectations associated with a modified construction timeline as a result of executed change orders. Effective coordination of material deliveries and approval of the schedule by subcontractors and other parties to the contract can help minimize project delays. Change orders frequently become claims when not executed prior to the onset of the work involved and their cumulative impact to the project is more than the owner anticipated. Accounting firms can provide a valuable service to a contractor by helping to install specific safeguards and provisions in the contractor's internal controls to identify and isolate costs associated with changes so those costs can be properly accumulated and billed.

When managed effectively, change orders can be an opportunity for contractors to reap additional profits unforeseen at the onset of a project. Successful contractors effectively manage change order costs, are great communicators, and obtain written authorization prior to commencement of work. Average performing contractors have a tendency to deviate from recommended controls and best practice guidelines, often resulting in claims or profit fade. Need a review of your Company's policies and procedures surrounding change orders? We're here to help.

**MOSS ADAMS** LLP