Construction projects are typically among the largest, most complex financial expenditures companies undertake. They can be time consuming and expensive, with most projects containing overcharges of 1 to 2 percent.

Your organization can recoup some of that money or avoid overcharges completely by performing a construction audit, which will also help you develop a control system to save costs on future projects.

“A construction audit will give you some additional financial controls around one of your largest capital expenditures,” says Bill Willbrand, partner in charge of Real Estate Advisory Services at Brown Smith Wallace. “It’s an independent, third-party review. Project investors value this independent look to make sure their money is being spent wisely.”

Smart Business spoke with Willbrand about how organizations benefit from construction audits, whom to involve and how to deal with contractors during the process.

**How can an organization with a significant building project benefit from a construction audit?**

A construction audit can help set the tone of the project by establishing oversight. Involving an experienced construction auditor in the contract stage often results in increased savings through cost avoidance. Early involvement yields more savings than a stand-alone, closeout audit. Bringing an auditor in during the contract stage will also help you determine that your risk and rights under the contract are being protected.

Many organizations may not have experienced professionals internally who have the construction expertise to lead an audit. With a construction audit, you look at contract terms, identify overcharges, suggest how to better manage risks and
examine your control procedures to make sure they’re functioning properly. These audits keep all parties honest.

The process doesn’t just benefit the business owner. The construction company often benefits from the audit as well. A construction audit assures you that the financial piece of the project is being well managed and monitored, which strengthens the relationship between the business owner and the construction company. When you perform audits, costs are verified and the cost structure is reviewed. This can significantly shorten the closeout period, the time from when the project is substantially completed until the contractor receives final payment. A shorter closeout period saves you and the contractor a lot of time, money and effort. A well-managed and controlled project also results in fewer conflicts. So, there’s less need for negotiations at the end of the project, helping to avoid litigation.

**How can business leaders determine if a construction audit is right for their organization?**

You need to look at the project size and duration, as well as contract type. There is greater risk, but also greater opportunity for savings, in a cost based contract. Construction audits are suggested for projects with fewer than three bidders, low fees or a fee based on percentage of the cost.

Other indicators include projects over budget, change orders in excess of 10 percent, no reconciliation of job cost to invoices, self-performed work, shared saving clauses, and large contingencies and/or allowances. Audits are also suggested for high-profile or high-risk projects. You should also review the results of previous audits.

Another important consideration is the owner’s experience with construction projects. If the owner only builds something every 10 years, his or her experience level is not high. You should also look at your experience with the contractor. If you have none, it’s typically a high-risk project.

Using the same contractor for five or six years can also increase your risk. Who knows better how to get around your internal controls than somebody you’ve been working with for years? There are a lot of factors that go into getting an accurate risk profile.

**Why do you need to involve an auditor?**

While the construction manager and owner’s representative look at the financial aspects of the project, their roles differ from that of an auditor. Consider the construction manager’s role. He or she is focused on the project, the schedule, the contractors and construction methods. That person also focuses on financials but from the contractor’s point of view.
If an owner’s representative is involved, this person tends to focus on managing construction resources, advising the owner on construction methods and procedures, and assuring adherence to the architect’s plan and schedule. He or she also reviews the contractor’s payment request to determine if it’s reasonable.

What the auditor brings is focus on strengthening financial controls over the process. He or she audits financial transactions to ensure compliance with contracts and works with the owner’s representative to manage the whole process. The auditor looks at the project cost structure, which includes subcontractor costs, purchase order costs, relationships between contractors and contract compliance.

**Can a company benefit by auditing previous construction projects?**

Going back to try to recoup money can be hard to do once the retainer has been paid out. If you can audit before you lose that leverage, your recovery will be much greater.

You can also go back and review the procedures and internal controls for a project. That can help strengthen your process and construction department for upcoming projects.

**Where does a cost segregation review come into play?**

During a construction audit, you’re looking at the underlying cost structure of the project. If you know you’re going to do a cost segregation study at the end of the project, you can definitely obtain synergies and maximize ROI by having the audit team perform the cost segregation work at the same time.

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