



The lowdown on time and material and cost-plus contracts

Most construction projects are performed on a bid basis. The contractor reviews the plans and specifications and then tells the owner the amount for which they will perform the work. Many times, however, contractors perform work on a "time and material" or "cost-plus" basis which requires a lot of detail when drafting the contract and invoicing the owner.

Cost-plus contracts and time and material contracts are very similar in that the contractor is accounting to the owner for the actual costs incurred on the job. In a time and material contract the contractor is paid a percentage of the total cost of the project for overhead and profit. Therefore, if the cost of the project increases, so does the amount the contractor is paid for overhead and profit. In a cost-plus contract, the contractor basically tells the owner that he will charge a flat fee in addition to the cost of project, so that if the project cost increases, the fee remains the same.

How do you determine "cost"? Cost seems to be very straightforward, yet it causes a large number of controversies and potential lawsuits. The cost concept is the same for a cost-plus or a time and material contract. It is imperative the contractor specifically defines the term "cost" in the contract so there is no misunderstanding. Let's examine each aspect of cost:

1. Materials — Materials costs are the amount paid for the items incorporated into the work of improvement. The contractor should indicate

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whether he/she is going to pass through the contractor discounts if any and whether the owner will receive the benefit of any price reductions due to early payment of vendor invoices. If this is not specified in the contract, the owner is going to want the lower price and will most likely be entitled to it.

2. Subcontractors — Subcontractor charges are probably the least subject to dispute since the contractor will simply pass through the actual amount paid.

3. Equipment — The issue with equipment or tool purchase is whether the contractor on future projects can use the items being charged to the project. If the answer is no, then clearly the item should be charged to the project. If, however, the contractor on future projects can use the item, the question becomes how much should be allocated to this particular project. The best advice here is not to be greedy. Make a reasonable apportionment and indicate the apportionment on the invoice, i.e., saw (one-third attributed to project due to fact that contractor may be able to use saw on future projects).

A problem can arise when the contractor charges the owner for tool or equipment rental. A contractor should have certain equipment in his possession which he uses on all projects. Do not try to charge an owner for a hammer, screwdriver or ladder, unless you can truly show that it is an unusual design which is necessary for this particular project.

4. Labor — Labor can be a controversial item. Not only does a contractor pay his employees a wage, but there are associated costs, such as social security, retirement and medical benefits, vacation, etc. that the contractor must pay. These costs are rightfully attributable to the job. Trying to account for these charges is a very difficult task. It is much easier if the contractor simply states an hourly wage that will be charged for each type of person associated with the project.

administrative personnel \$15 per hour, etc. These hourly rates should approximately cover all your associated costs.

Two things to remember about labor costs: First, specify that each person working on the project will be responsible for cleanup and also various ministerial tasks. No adjustment in the hourly rate will be made for such tasks, since the overall rate takes into account such tasks.

Second, do not forget to charge for your time. As the owner of the company, many contractors do not charge their own time to particular projects; however, many projects require the contractor to daily supervision or at least visit the site and attend numerous meetings with the owner or architect. This time should be charged at a rate specified in the contract. It is important to let the owner know that your time is valuable.

5. Overhead and Profit — In a time and material contract, the overhead amount is specified as a percentage of the total cost and the profit amount is also specified as a percentage of total cost. In a cost-plus contract, it is inappropriate to charge for overhead and profit since these items are the "fee" amount being charged to the owner.

What if the project significantly increases in size or scope of work? The drawback to the cost-plus contract is that if the size of the project or the scope of work significantly increases, the contractor may lose because he will receive no more for his services. For this reason it is recommended that in the cost-plus contract, the contractor should indicate a maximum amount for the cost of the project. In other words, the contract should state that the contractor will charge a fee of \$10,000 provided that the cost of the project does not exceed \$100,000. If it exceeds, \$100,000, then the contractor shall receive a fee of \$1,000 for every \$10,000 or portion thereof over \$100,000.

When does the profit and overhead/fee get charged? With a time and material contract, the contractor is entitled to a percentage over and above the cost of the project. Therefore, the contractor simply applies the percentage to every invoice. It is not so simple with a cost-plus contract. If the project is estimated to take 10 weeks and your fee is \$10,000, you could charge the owner \$1,000 per week. This procedure, however,

- obligations.
- Make sure your client understands the contract.
 - Make contract adjustments with clients whenever necessary.

may have no relationship to the amount of work completed in a particular week. You may also charge the owner a percentage of the cost of the work as you invoice and simply keep track of the amount so as not to exceed your fee.

6. Accounting — In time and material or cost-plus contracts, accounting is critical. While you do not need to establish a separate bank account for each project, you do need to separately account for the project. Remember that the owner is entitled to review all receipts, time cards, etc., associated with the project.

If you are ordering materials for more than one project, you must be able to separate the costs between projects. It is highly recommended that you get your supplier to issue separate receipts. You must also have your employees keep track of their time, especially if they are working on more than one project. If you are charging one employee out at two different rates depending upon the type of work they are performing, they must specifically track their time on their time cards to indicate the tasks being performed.

Do not forget to keep track of your own time on a time card. Many controversies arise when the general contractor tries to estimate the amount of time he spent on a particular project after the fact. If your accounting procedures are not well established, it is not recommended that you perform time and material or cost-plus contracts.

The general rule when performing cost-plus or time and material contracts is to fully explain how the charges will work prior to starting the work. Your contract should be very clear. When you invoice your clients, they should have no question as to how the amount was calculated. And if they do, you should be able to fully explain it. **QR**

Nancy Chillag is a Menlo Park, CA, attorney specializing in real estate and construction law. Her web site address is www.chillag.com.