

# 5 WAYS TO MAINTAIN PROFITABILITY ON CHANGE ORDERS



Changes during a construction project are often inevitable. In fact, change orders are so common that they affect more than one-third of projects. While these changes can lengthen a project's schedule and increase labor and material costs, they can also mean a more profitable job if the change is approved by the customer. But if not managed correctly, it can result in under or lack of payment for the additional work completed. The following includes five ways to help you get the most profitability from your change orders.

## Clearly define the scope of work

Confirming that the scope of work associated with a job is agreed to amongst all parties is an important step in safeguarding profitability. In preconstruction meetings, it's best practice to review the contract and any building plans. Some contractors use contracts as a "boilerplate," only to later learn that it includes language well outside the normal scope of a certain type of job. Make sure that you gain an understanding and clarification on any language that may be unclear. Request clarification when needed to clarify such language and definition around undefined terms. Verify those clarifications are included in your executed contract.

## **Make sure plans are complete and accurate**

Sometimes bid documents name the contractor responsible for all field measurements and building applications, which can be interpreted to mean that contractor assumes responsibility for all costs when changes arise related to these elements. Ask questions. Understand the origin and responsibilities. Know what you're responsible for, including field measurements and building applications.

## **Limit exposure to contracts that limit your profitability**

Many owners want to discourage contractors from submitting low bids to "win" and subsequently overcharging on the change orders to break even or make their profit. However, contracts that limit maximum overhead and profit markup percentages can prevent a construction company from generating the revenue needed to cover its costs — especially when changes are substantial.

If owners and/or architects write complete bid specifications upfront, they don't need to control pricing on change orders because fewer changes are necessary. Ideally, you should try to avoid signing an agreement that restricts you from making changes on a job without your full markup. At the very least, try to avoid agreements that limit you to "cost" or "cost plus 10%."

## **Changes need to be documented when agreed upon**

Without a change order documenting the newly expanded scope of work and impact on the price, it's easy to see where problems can occur. By documenting changes (scope of work, labor increases, schedule, deadlines, price, etc.), unnecessary disputes can be avoided. It is crucial that all parties understand and agree to any changes to their agreement in real-time.

Be sure your project managers are following a formal change order process.

Review the Contract

Look for any clauses regarding change orders which may include requirements for initiating a change, specific information or documentation required to approve.

#### Review the Plans

Failing to review and identify any issues with the scope of work, plans and specifications will lead to unnecessary change orders down the line.

#### Don't Delay

Changes need to be handled as expeditiously as possible. Once a change order is initiated, you need to quickly negotiate the cost, get authorization to begin the work in writing, make schedule adjustments and get underway with the amended work.

#### Communicate

Include all parties involved and start with identifying the reason for the requested change and how it will be managed. Disputes over change orders can be magnified if not properly managed.

#### Negotiate

Work with the owner to establish how the additional work will be estimated and agreed upon a cost. This can be done through unit pricing, time and materials pricing or as a lump sum cost. This might already be laid out in the contract documents, or you may need to work with the owner to work out a mutually agreeable solution.

#### Document

Avoid disputes by documenting every step of your change order process. Best practice is to create templates for initiating and requesting change orders. Keep written records of all communication regarding the change and don't begin any change order work without an authorized, signed and executed document from the owner covering costs and any other negotiated terms.

## **Do not let change orders go unaddressed**

Delays in changes can have a substantial impact on project viability and be the difference between profitable and unprofitable jobs.

A good way to mitigate delays is to consider including specific language in your proposals. It should include instructions for submitting invoices as well as a payment schedule. You might also consider including language around your

policies that if a change order isn't approved/denied within a set period, you will assume that it has been approved. (Be sure to check with your legal counsel on appropriate language to use.)

[BMF Advisors](#) can help you create streamlined processes to reduce the frustration of the dreaded change order and keep your projects moving forward.