To Live and Die by Change Order Management

Presented by
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FMI Corporation
• Participants are in a listen-only mode.

• To ask a question during the event, use the chat feature at the bottom left of your screen. Technical questions will be answered by ReadyTalk. Questions for our speakers can be asked at any time and will be answered during the Q&A at the end of the session.

• Visit constructionbusinessowner.com in the coming days to access the recording of the webinar or download the presentation.
As a principal with FMI, management consultants and investment bankers for the construction industry, Gregg specializes in the areas of productivity and project management. He also leads FMI’s project management consulting practice.

Gregg has served as a senior project manager for a general contracting firm and holds a Florida General Contractors license. He has completed complex and sophisticated construction projects in the medical, pharmaceutical, office, heavy civil, industrial, and manufacturing markets.

Gregg holds a bachelor’s degree and master’s degree in civil engineering from the University of Florida and a master’s of business administration with a concentration in international business from the University of Tampa.
“No work shall be done without a written, signed and approved change order...”
Common Issues With Change Orders?

- Timely approval
- “The negotiation”
- Details
- Ambiguity
- “The pass through”
- Labor productivity
- The real costs (and what isn’t charged or collected)
Over the last year, we have seen the following occur relative to change orders?

- **Improvements** – We are collecting better than before
- **Declines** – We are seeing our collections on change orders get worse
- **No change**
**Profit Erosion**
- Schedule Delays: • No baseline schedule • No schedule updating • No look-ahead planning • No urgency
- Change Order Mismanagement: • Failure to identify changes • Failure to negotiate changes • Failure to get paid for changes • Failure to manage changes

**Customer Attrition**
- Poor Document Control: • No RFI process • Reactive document control • Poor submittal management • Lack of documentation
- General Conditions Overruns: • No feedback on budget • No field influence on budget • Reactive management • No inclusion in change orders

**Legal**
- Poor Billings/ Collections: • Poor invoicing • Poor collections • Lack of knowledge on finances • Poor cash management
- Customer Dissatisfaction: • Reactive customer strategy • Lack of “Client Ownership” • Lack of pertinent information

**Cash Shortages**
- Ultimate Consequences

**Systemic Problems**
- Strategic Initiatives to Project Management Improvement

**Process Improvement Features**
- Creates Proactive Management
- Creates Well-Informed Customers
- Provides Strong Documentation
- Provides Project Controls
- Inspires Entrepreneurial Instinct
- Provides Project Performance Measurement

**Process Improvement Benefits**
- Increased Customer Satisfaction
- Increased Profit Margin
- Increased Customer Base
- Decreased Legal Expenses
Change Order Management (1 of 2)

• Huge profit leak for most contractors
• You rarely get paid for the complete costs of a change
• Great change order management begins in pre-job planning
• Negotiate change order limits
  – Establish dollar limits for unresolved changes that trigger forced resolution
  – Know the contract
  – Know the scope
Change Order Management (2 of 2)

• When do you have the most leverage to negotiate a fair resolution?

• Documentation is critical

• If you are adding changes quicker than you are resolving them...you are headed for a problem

• Quantifying the cumulative impact of change orders is difficult...but doable

• Make the first change a credit

• Track costs incurred on unapproved changes
Steps to Successful Change Order Management

• A Process is Essential (The XYZ Way)
• The Right Tools
• Alignment with The Firm’s Strategy
• Accounting for ALL the Costs
• Proactive in Nature
The Process

Questions for the firm:

- Does everyone use the same form?
- Who defines the level of risk you take?
- How proactive is your process?
- Speaking of process, what is it?

Defining the White Space

- What happens in the process that creates the controversy?
- Who is responsible for the process?
- What level of escalation is created when a component of the process is not done?
- Is there a way to streamline the process to improve the efficiency?
Define your change order policy within your firm:

- No work shall be done without a signed change order – PERIOD!
- No work shall be done but we let the PM’s handle their change orders...
- Wish we had a policy but we are very loose.
- Wish we had a policy but our contracts demand we do the work regardless
Dealing With Controversy Two Perspectives

CHANGE ORDER PROPOSAL EXAMPLE #1

MECHANICAL - Change Units
TOTAL COST = $16,500

NOTE – Keep in mind the specified product will result in extending the schedule by 3 weeks due to production.

CHANGE ORDER PROPOSAL EXAMPLE #2

MECHANICAL
Provide two additional HVAC units (20 tons) to meet the City of Anywhereville mechanical codes (See Exhibit A) and letter provided by Arthur Dumore (See Exhibit B), Engineer of Record. The roof plan is attached to show the location of the units. Below are three options to aid in the decision process:

ExpenseAire Units (10 Year Warranty)
(Per Specifications)
MATERIAL COST = $15,000
PROFIT = $1,500
TOTAL = $16,500

Middleburg Cooling Units (5 Year Warranty)
MATERIAL COST = $10,000
PROFIT = $1,000
TOTAL = $11,000

CheapieAire Units (6 Month Warranty)
MATERIAL COST = $5,000
PROFIT = $500
TOTAL = $5,500

NOTE – Keep in mind the specified product will result in extending the schedule by 3 weeks due to production.
Dealing With Controversy: Two Perspectives

Time & Material Change Order – Over Excavation of Lot 13

Projected Value (Proposed Change Order 7) = $25,000

Commencement Date – 12/01/14

<table>
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<th>UPDATE</th>
<th>Current Labor Spent to Date</th>
<th>Current Equipment Spent to Date</th>
<th>Total Costs to Date</th>
<th>Anticipated Cost at Completion</th>
<th>Projected Overrun</th>
<th>Discussion</th>
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<td>12/5</td>
<td>$2,500</td>
<td>$2,000</td>
<td>$4,500</td>
<td>$25,000</td>
<td>$0</td>
<td></td>
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<td>$5,000</td>
<td>$10,000</td>
<td>$27,000</td>
<td>$2,000</td>
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<tr>
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<td>$7,000</td>
<td>$19,000</td>
<td>$30,000</td>
<td>$5,000</td>
<td>Rock formation at Station 100+10</td>
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Frequently Overlooked Change Order Costs

- Additional time
- Consumable supplies
- Small tools
- Clean up
- As-built drawings
- Bond
- Project management time
- Overtime
- General conditions
- Lost productivity
- Drawings
Alignment With the Firm’s Strategy

- Misalignment breeds frustration – Mixed messages
- Lack of consistency

**Misalignment Examples**

- Aggressive Change Order “Policy” but “Customer-centric” Philosophy
- Loose cash collection process with risk-prone customers
- Detailed projects and/or customers with no control systems
- Sophisticated systems with no training/education
Define your change order process:
• Every manager within our firm follows our process and uniformly creates the same change orders
• We could use some improvement but most of our managers are sort of consistent on change orders
• We are all over the place – No consistency and we are probably losing money on top of that…
Metrics

“That which is measured is taken seriously.”
Project Controls

Understanding the Readings on the Dashboard

Change Order Liability – “Unapproved Change Orders”

Approved Change Orders

Project Liability Measure

$15K $10K $5K

$12,000

$15,000

Change Order Liability – Approved, Uncollected

Collected Change Orders

Change Order Collections

$15K $10K $5K

$7,000

$20,000

$12,000

$15,000

$5K

$10K

$15K

$7,000

$20,000

$5K

$10K

$15K
Project Performance and Firm Performance

Project A

Project B

Project C

Project D

Project E

Project F

Orig. Contract Value
Unapproved CO
Approved CO
2013Write-Offs

$50K $100K $150K $200K $250K $300K

10 Days 15 Days 30 Days
13 Days

Everglades Office Project
Current CO Approval Rate = 13 Days

2005 BM – 15 Days
12 Days
15 Days

ABC Drywall Inc.
Firm CO Approval Rate = 33 Days

33 Days
10 Days
30 Days

10 Days 15 Days 30 Days
Change Orders – Are They Bad for Our Business?

• Change Orders are inevitable but not necessarily bad

• Strategies to maximize the benefit of changes and minimize the number of claims or their effects on a project:
  – Build creditability: critical to maintain a good working relationship with all parties
  – Get ahead by getting ahead: the sooner the work is done, the better, usually
  – Document, document, document!
  – Work to mitigate the problem
  – A claim is always a last resort
Change Order Process - Summary

• If the field manager does not know the scope, they will not recognize a change
• Documentation and notification is critical
• Time is no on your side!
• People tend to delay the things they like to do least and avoid conflict
• Remember…update “budgeted costs” and “budgeted hours” as changes occur
• Know your style of negotiating and your opponents’ style as well. Use that information to your advantage
Founded in 1953 by Dr. Emol A. Fails, FMI provides management consulting and investment banking for the worldwide construction industry.

FMI delivers innovative, customized solutions to contractors; construction materials producers; manufacturers and suppliers of building materials and construction equipment; facility owners, managers and developers; engineers and architects; surety companies; and industry trade associations.

FMI’s experienced professionals assist businesses with strategic planning, leader and organizational development, business development, research, mergers and acquisitions, peer groups, private equity placement, project execution and training.
Q&A Session

To contact today’s presenter:

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