

## **Q&A: Cost Effective Assurance webinar**

**4 November 2016**

*These are the left over questions together with suggested answers from the cost assurance webinar on 4 November 2016 and assume the use of the unamended NEC3 Engineering and Construction Contract (ECC).*

**Q. Does the panel think that the ECC Schedule of Cost Components (SCC) which permits recovery of some costs as amounts paid and others on some surrogate basis, such as open market rates or a percentage (Working Area Overheads % or Fee) complicates and adds to the burden of the cost assurance process?**

**A.** The assurance process follows the agreed contractual rules. Its role is to provide enhanced confidence that the mechanisms under the SCC are correctly applied.

The bigger risk is that the application of the SCC can add to the administrative burden of the parties. This is particularly the case where the parties depart from the SCC to, for example use rates as an approximation to people costs which need then to be actualised.

**Q. If the Contractor has appointed a Subcontractor through competitive tendering on an ECC Option A contract, then a compensation event quotation is submitted to the Project Manager, should the Contractor have to re-affirm cost assurance by going to the market again for a price comparison on this compensation event?**

**A.** Under an Option A contract compensation events are dealt with through the Shorter Schedule of Cost Components. The Project Manager will agree the quotation and may well require the Contractor to provide evidence that the quotation is appropriate by going to the market.

**Q. Can you comment on the advantages and disadvantages of using ECC Option C back-to-back - eg promoting incentivisation vs potentially increasing the complexity of the Project Manager's assessment of Defined Cost? The alternative could be the Contractor using an NEC3 Engineering and Construction Subcontract (ECS) Option A downstream.**

**A.** In our experience clients may mandate a particular type of contract option, regardless of risk. This can create unnecessary administration and complexity if Option C or E arrangements are used inappropriately. The strategy for subcontracting should be based on the level of risk transfer which both parties feel is most appropriate. If a package is very straightforward it may well be appropriate to use an Option A contract and to pass the risk on to the subcontractor. For more complex packages where there is uncertainty, an Option C or potentially an Option E contract may be more appropriate.

It is difficult to generalise on the advantages and disadvantages of using back to back Option C arrangements as they will depend on the maturity of the subcontractor's accounting and administration and its competence to deliver an open book approach. Any advantages in a back to back relationship may be undermined by a subcontractor which cannot operate the administration required effectively.

Using back to back Option C arrangements effectively creates two Project Managers, one at the Employer level and one at the Contractor level. As such, as long as each fulfils their responsibilities, there should be no increased complexity for the Employer's Project Manager.

Assurance activities have a part to play in providing the Employer's Project Manager with enhanced confidence that the Contractor is administering the Option C arrangement properly.

**Q. Do you think it would be appropriate to convene a cost assurance briefing to the Parties (Employer & Contractor) during the tendering process to provide all parties the clarity required to ensure the project starts off on the correct mutual understanding?**

**A.** Avoiding problems by taking pre-emptive actions is always more preferable to dealing with the consequences of a lack of clarity. Therefore, yes, this is a good idea.

**Q. What kind of activities would you expect to see the Contractor doing from a self-assurance perspective?**

**A.** A Contractor should be confident that it is complying with the contract and not rely on the Employer and its assurance activities to find any problems. Part of this activity could well be undertaking self-assurance activities.

**Q. You mentioned possible fraud in applications for payment - for a representation to be fraudulent, the person making it must know or consider that it may be untrue. The common excuse for a contractor is therefore that they did not do it knowingly (i.e. it was a mistake) so it is very hard to prove otherwise! Do you have any thoughts on this?**

**A.** Agreed. This is a big subject! There are a number of things the parties can do to avoid and detect fraud including the creation of the appropriate fraud risk oversight and ownership, specific fraud risk assessments; creating fraud risk tolerance and risk management policies; putting in place effective environment level anti-fraud controls and undertaking proactive fraud detection. Suggest this could be the basis of a further webinar.

**Q. From a Contractor's perspective, what can we do over and above the norm to facilitate cost assurance for our clients (e.g. ensuring Subcontractor terms and conditions include auditing rights etc)?**

**A.** We suggest it would be useful to review the contract and build compliance into your application for payment processes and to record how you have achieved that. A document analysing the SCC and showing how you comply would facilitate cost assurance. If an auditor visited you, and you were able to demonstrate that you were aware of the requirements of the Contract and that you had taken active steps to meet those requirements, the auditor would start to develop a warm feeling. It would also give the auditor a starting point for an assurance review.

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