

Construction Auditing - the Foundation to Risk Management and Internal Control

As the global economy slowly recovers, companies will begin to invest once again in large construction projects. Many projects that had been on hold through the downturn are now beginning to find funding. These projects include both new construction and significantly upgrading facilities such as: Distribution Centers, Manufacturing Facilities, Shared Service Centers, Retail Sites, Data Warehouses, Educational Facilities, and Healthcare Facilities.

While a multimillion dollar project represents one of a company's largest capital expenditures, it is sometime on of the least controlled expenditures. On October 21st, the Senior Supervisors Group issued a report on the financial crisis and in it they stated, "...weaknesses in risk management and internal controls contributed to industry distress during the financial crisis." Similarly, weak risk management practices and internal controls could lead to significant losses or delays in a large construction project.

Companies need to learn the lessons of the financial crisis and embed risk management and internal control into all processes, especially construction. The first step to improving risk management and internal control is to leverage the principals of audit. An audit, in this case a construction audit, provides the foundation.

Construction Auditing starts with the Construction Contract

A construction contract will include a variety items such as project description, project timeline, cost estimate, payment terms, documentation requirements and sections on insurance and indemnification. However, the contract should also include certain provisions to specifically protect the owner's interest. The American Institute of Architects provides a series of standard construction contracts which can be used as a template for construction projects. While these templates provide a solid framework, they are not necessarily written with a bias towards owners rights. Provisions such as "Right-to-Audit" and "Change Orders" plus other internal control enhancements need to be customized. These modifications will improve the owner's control over project costs, allow for recoveries, and are necessary to strengthen the ability to audit.

"The audit is an integral part of the construction project process. Performed well by seasoned professionals it will assure the Owner that financially they received the product contracted and paid for."

Knowing what to modify and even how to modify is not common knowledge and can't be done through the legal review process. It is critical to have this review completed by an experienced construction audit professional and it should be done prior to executing the contract. Doing so will save thousands, if not hundreds of thousands of dollars throughout the project.

ARTICLES OF INTEREST

This column features relevant news stories for today's busy executive.

Audit Committee Senior Supervisors Group Issues Report on Risk Management Practices

SEC.gov, Oct. 21, 2009
The Senior Supervisors issued a report that evaluates how weaknesses in risk management and internal controls contributed to industry distress during the financial crisis.

[Link to article](#)

Using The Crisis To Create Better Boards

Forbes.com, Oct. 21, 2009
Boards should view the current crisis as an opportunity to review the way they function. A healthy self-assessment can go a long way toward improving a company's performance.

[Link to article](#)

Chief Executive Officer The New Calculus of Offshoring

Cfo.com, Oct. 1, 2009
For years the offshoring boom was driven by one factor: savings. Today the decision is much more complicated.

[Link to article](#)

Chief Audit Executive Shooting the Breeze About Internal Auditing

Complianceweek.com, Oct 21, 2009

Compliance Week sat down with a group of executives to talk about the future of internal auditing and what sort of changes auditing departments are experiencing these days.

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