

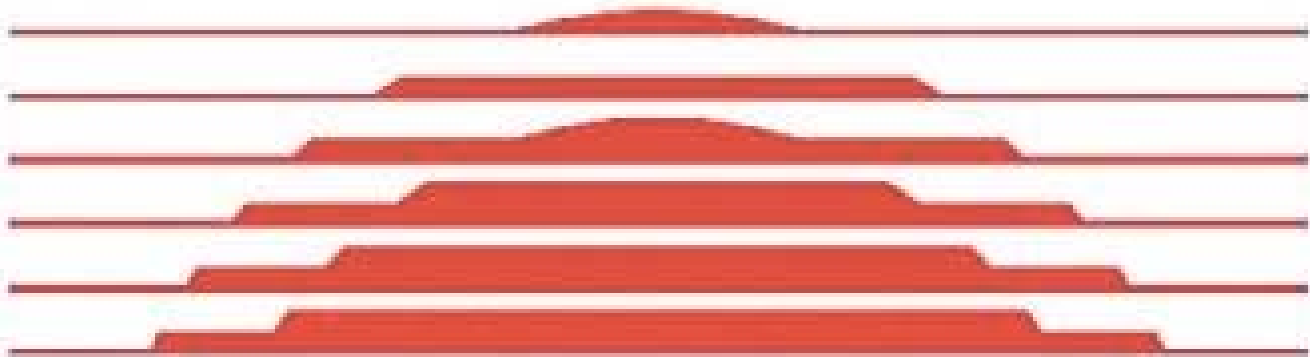
**SEVENTEENTH ANNUAL
SOUTHERN SURETY AND FIDELITY CLAIMS
CONFERENCE**

St. Pete Beach, Florida
MAY 4th - 5th , 2006

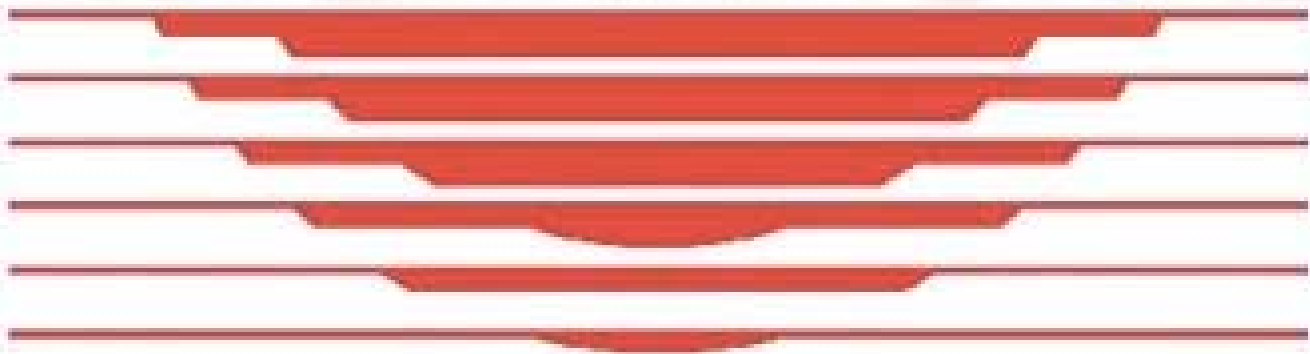
**“A PRIMER ON EXTENDED PERFORMANCE COSTS IN A
CLAIMS ENVIRONMENT (EMPHASIS ON THE EICHLAY
FORMULA)”**

PRESENTED BY:

**VICTOR M. OSTROWSKI, P.E.
FORCON INTERNATIONAL CORP.**
1216 Oakfield Drive
Brandon, FL 33511
813-684-7686



FORCON
INTERNATIONAL



**EXTENDED PERFORMANCE
COST
IN A CLAIMS ENVIRONMENT**

(With Emphasis on the
Eichleay Formula)

Alternate Name

FOOH

HOOH

&

EICHLEAY

FOOH

Field **O**ffice **O**ver **H**ead

aka General Conditions

HOOH

Home Office Over Head

Eichleay

Famous Formula

Used to calculate

HOOH

Remember

FOOH

HOOH

&

EICHLEAY

**EXTENDED PERFORMANCE
COST
IN A CLAIMS ENVIRONMENT**

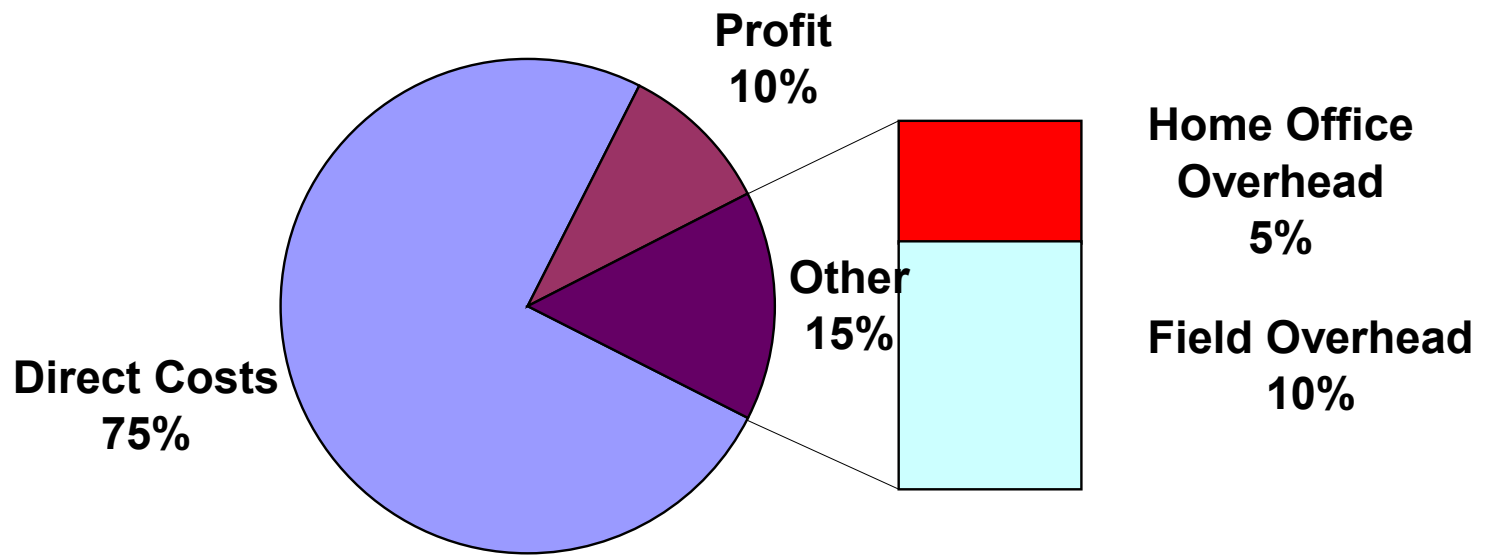
(With Emphasis on the
Eichleay Formula)

What Does This Mean?

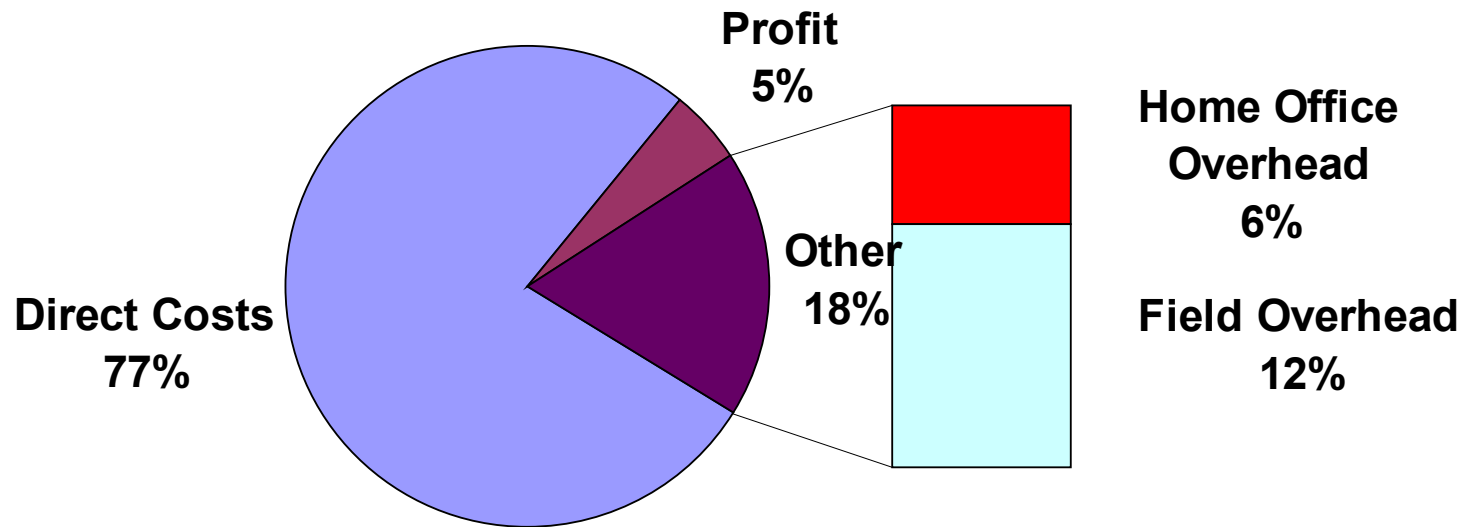
- A Contractor Expects to Complete a Project in a Planned Amount of Time
- When That Time is Extended the Contractor incurs Additional Cost
- If the Delay (Extended Project Time) is Caused by the Owner then the Time is Excusable to the Contractor and;
- The Contractor can Recover the Cost incurred Over the Extended Contract Period

What Are Those Costs?

Job Cost with Overhead Breakout



Job Cost for Delayed Project



Extended Performance Costs

- Extended General Conditions (FOOH)
- Additional General Conditions (added FOOH)
- Home Office Overhead (HOOH)
- Increased Labor and Material Costs
- Loss of Efficiency in Labor Crews

Extended General Conditions (FOOH)

- Field Office Rent
- Field Office Equipment (Computers Fax etc)
- Salaries of Non-Productive Personnel
- Equipment Rentals (Lifts, Cranes, etc)
- Security
- **Calculated by Using Actual Cost Records**

Added General Conditions

- Supervision Added to Handle Increased Work due to Delay
- Includes all Costs such as Per Diem and Travel Expenses
- **Calculated by Using Actual Cost Records**

Increase in Labor and Material Costs

- Delays Cause Contractor to Incur Costs
Increases in Labor or Material
- Delay from Summer to Winter will Cause
Concrete Placement to be Higher Costs
- Material Cost Increases due to Economic
Conditions (steel or drywall)
- **Calculated by Using Actual Cost Records**

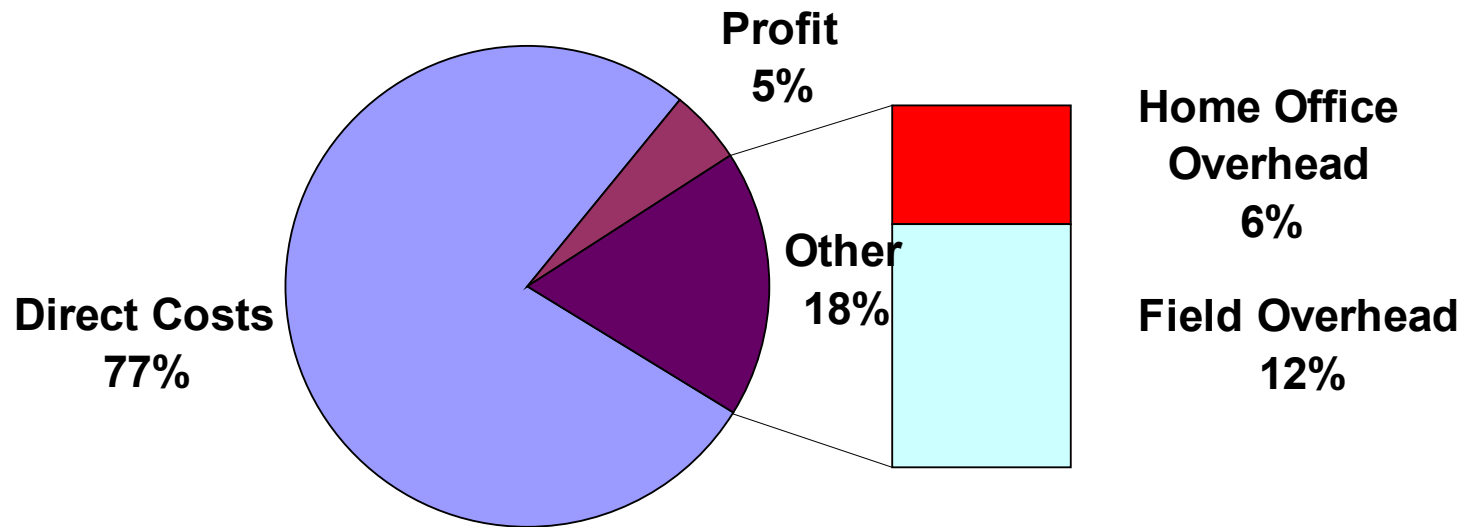
Loss of Efficiency

- Delays can Cause a Loss of Labor Efficiency
- Same Crew takes Twice as Long to Accomplish Same Task
- Acceleration to Make Up Lost Time
- Calculated by Various Methods (Soft Dollars)

Extended Home Office Overhead (HOOH)

- When Job is Extended Home Office Cost is Also Extended
- Without Additional Increase in Contract Home Office Costs are **Unabsorbed** by Project
- Eichleay Formula is Used (mis-used) to Calculate Amount
- Soft Dollars

Job Cost for Delayed Project



What is Home Office Overhead?

- Rent and Utilities for Home Office Facility
- Salaries for Officers and Administrative Staff
- Office Equipment and Supplies
- Officer and Staff Vehicles and Maintenance
- Other Costs of Running Business
- Called General and Administrative Costs
- G&A on Financial Statement

How Does Home Office Costs Relate to Project Costs?

- A Portion of Each Job is Dedicated to “Absorbing” Home Office Costs
- The More Projects the Less Each will Have to Absorb
- A 2M Project will Absorb Twice as Much Home Office Overhead as a 1M Project

What is Unabsorbed Overhead?

- Overhead is paid by the income from jobs
- When income is stopped or delayed there is not enough income to pay for (or absorb) the home office cost
- Income from other jobs must be used to pay for the shortfall in income

Small Company Example

- Company Has Only One Job
- \$1,000,000 Total Contract
- To be Completed in 10 Months
- Scheduled to earn \$100,000 each month
- Company Overhead (G&A) is \$5,000/month

Fully Absorbed Home Office Overhead (the way it is suppose to be)

| Sample Home Office Cost Analysis for a \$1,000,000 Project for 10 Months | | | | | | | | | | | | |
|--|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-------|------|
| Month | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | Total | % |
| Amount | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 1000 | 100% |
| Home Office Overhead Paid | 5 | 5 | 5 | 5 | 5 | 5 | 5 | 5 | 5 | 5 | 50 | 5% |
| Home Office Overhead Incurred | 5 | 5 | 5 | 5 | 5 | 5 | 5 | 5 | 5 | 5 | 50 | |

- Project Earns \$100,000 Each Month
- \$5,000/Month Goes to Pay Home Office Expense
- Home Office Stays Constant for Project
- \$50,000 for Home Office Overhead (G&A)
- Actual Home Office is \$50,000

Unabsorbed Home Office Overhead (classic Eichleay)

| Sample Home Office Cost Analysis for a \$1,000,000 Project with 1 Month Stop Work | | | | | | | | | | | | | |
|---|-----|-----|-----|-----|-----|-----|---|-----|-----|-----|-----|-------|------|
| Month | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 11 | Total | % |
| Amount | 100 | 100 | 100 | 100 | 100 | 100 | | 100 | 100 | 100 | 100 | 1000 | 100% |
| Home Office Overhead | 5 | 5 | 5 | 5 | 5 | 5 | | 5 | 5 | 5 | 5 | 50 | 5% |
| Home Office Overhead Incurred | 5 | 5 | 5 | 5 | 5 | 5 | 5 | 5 | 5 | 5 | 5 | 55 | |

- Project Stopped for 1 Month
- No Income for that Month
- Home Office Expense Stay the Same
- \$55,000 in Actual Home Office Expense
- \$50,000 Paid in Contract
- \$ 5,000 of “Unabsorbed” Home Office Expense

Under-absorbed Home Office Overhead (most common occurrence)

| Sample Home Office Cost Analysis for a \$1,000,000 Project with Delay of 1 Month | | | | | | | | | | | | | |
|--|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-------|------|
| Month | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 11 | Total | % |
| Amount | 100 | 100 | 100 | 100 | 100 | 100 | 50 | 50 | 100 | 100 | 100 | 1000 | 100% |
| Home Office Overhead | 5 | 5 | 5 | 5 | 5 | 5 | 2.5 | 2.5 | 5 | 5 | 5 | 50 | 5% |
| Home Office Overhead Incurred | 5 | 5 | 5 | 5 | 5 | 5 | 5 | 5 | 5 | 5 | 5 | 55 | |

- Delay During Months 7 and 8
- Drop in Revenue
- Drop in Amount for Home Office Revenue
- Actual Home Office Expense Remains the Same

Eichleay Formula

$$\frac{\text{Contract Billing}}{\text{Total Company Billing}} \times \text{Total Overhead for Contract Period} = \text{Overhead Allocable to Contract}$$

then:

$$\frac{\text{Allocable Overhead}}{\text{Days of Performance}} = \text{Daily Contract Overhead}$$

then:

$$\text{Daily Contract Overhead} \times \text{No. of days of Delay} = \text{Amount of Claimed Overhead}$$

Eichleay Formula

$$\frac{\text{Contract Billing}}{\text{Total Company Billing}}$$

Eichleay Formula

$$\frac{\text{Contract Billing}}{\text{Total Company Billing}} = \% \text{ Percentage of Total Company Income}$$

Eichleay Formula

Total Overhead
for Contract Period

Eichleay Formula

Total Overhead
for Contract Period = **G & A**

Eichleay Formula

$$\frac{\text{Contract Billing}}{\text{Total Company Billing}} \times \text{Total Overhead for Contract Period} = \text{Overhead Allocable to Contract}$$

Eichleay Formula

$$\frac{\text{Contract Billing}}{\text{Total Company Billing}} \times \text{Total Overhead for Contract Period} = \text{Overhead Allocable to Contract}$$

$$\% \times \text{G \& A} = \text{Amount for Period}$$

Eichleay Formula

$$\frac{\text{Contract Billing}}{\text{Total Company Billing}} \times \text{Total Overhead for Contract Period} = \text{Overhead Allocable to Contract}$$

then:

$$\frac{\text{Allocable Overhead}}{\text{Days of Performance}} = \text{Daily Contract Overhead}$$

Eichleay Formula

$$\frac{\text{Contract Billing}}{\text{Total Company Billing}} \times \text{Total Overhead for Contract Period} = \text{Overhead Allocable to Contract}$$

then:

$$\frac{\text{Allocable Overhead}}{\text{Days of Performance}} = \text{Daily Contract Overhead}$$

$$\frac{\text{Amount}}{\text{Days of Period}} = \text{Amount per Day}$$

Eichleay Formula

$$\frac{\text{Contract Billing}}{\text{Total Company Billing}} \times \text{Total Overhead for Contract Period} = \text{Overhead Allocable to Contract}$$

then:

$$\frac{\text{Allocable Overhead}}{\text{Days of Performance}} = \text{Daily Contract Overhead}$$

then:

$$\text{Daily Contract Overhead} \times \text{No. of days of Delay} = \text{Amount of Claimed Overhead}$$

$$\text{Amount per Day} \times \text{Days from Claim}$$

Eichleay Applied to Example

$$\frac{\$1,000,000}{\$1,000,000} \quad \mathbf{X} \quad \$55,000 \quad = \quad \$ 55,000$$

then:

$$\frac{\$55,000}{11 \text{ months}} \quad = \quad \$5,000/\text{month}$$

then:

$$\begin{array}{l} \$5,000/\text{month} \\ \text{of Delay} \end{array} \quad \mathbf{X} \quad 1 \text{ month} \quad = \quad \$5,000$$

Eichleay with Two Jobs

$$\frac{\$1,000,000}{\$2,000,000} \quad \mathbf{X} \quad \$55,000 \quad = \quad \$27,500$$

then:

$$\frac{\$27,500}{11 \text{ months}} \quad = \quad \$2,500/\text{month}$$

then:

$$\$2,500/\text{month} \quad \mathbf{X} \quad 1 \text{ month of Delay} \quad = \quad \$2,500$$

Wasn't that Simple
and
Easy to Understand?

Then Why is Eichleay Such a Controversy?

Misapplication of Eichleay

- Real World Claims are Never Simple
- The Amount of G&A is Always Suspect
 - (Gov't Projects don't allow many standard G&A expenses)
 - Use of Audited Financial Statements is normal
- Time Element is Sometimes Confusing
- Eichleay Does Not Look at Actual Absorption of Overhead by other Profitable Projects

Real World Claims

- Company has Many Projects
- At Various Stages of Completion (Billing)
- Project Starts and Stops in Middle of Financial Year
- Changes in Billings
- Changes in G&A

G & A

(the bad boy)

- General and Administrative Expenses are
 - Usually determined by Financial Statement
 - Can include costs not allowed
 - Box seats at Pro Football Stadium
 - Satellite office in the Bahamas
 - Mercedes Benz autos and not Fords
 - Are variable year to year
 - G&A expenses can be absorbed by One Good Job – leaving the others to add to profit

Time Element

- Eichleay Formula requires a definite “Contract Time”
- This is defined as the “Total Time of Contract – including the extended time
- Periods used for calculation cause difficulty in calculating “total billings” and “G&A for the period”
- Final Amount dependant on time period because of other jobs starting or stopping

Duration

(as opposed to time)

- Number of Days of Delay
- Calculated from Time Impact Analysis
- Always Suspect
- May Include “non-compensable” time such as weather delays
- Lower Days = Lower Costs

Is Home Office Overhead Really Unabsorbed

- One Profitable Project can Pay Overhead for Year
- Other Projects need not contribute to absorbing overhead
- Amount goes to Company “Profit”

How Can This Be?

- Assume our small Company has a G&A of \$55,000
- Assume the Large Job Completes on time with a NET of 25%
- That would be \$500,000 and would easily pay for the entire years G&A
- It would ABSORB all the G&A

What do you do?

- Reality Checks
- What % of total revised contract is Eichleay
- Does it exceed amount expected in original bid
- Example:
 - Our project was to absorb 5K a month
 - Eichleay shows absorbing 10K per month

Extended Performance Cost Summary

- Contractors are indeed delayed by owners
- They often have valid claims for being forced to remain on the project longer than anticipated
- Home Office is the Softest of all the Extended Performance Costs
- Eichleay is the Best calculator for these costs
- Eichleay is OFTEN (almost always) misinterpreted and abused
- Understand Eichleay and question source and validity of each component of the “**Famous Formula**”

What do you do?

Call Forcon

