

PRACTICE NOTES FOR QUANTITY SURVEYORS

Valuation for Interim Payment Certificates

Preface

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A Working Committee with representatives of the Hong Kong Institute of Surveyors, the Association of Consultant Quantity Surveyors and the Hong Kong Construction Association was set up in October 2010 to establish a set of Practice Notes for the benefit of Quantity Surveying professionals in Hong Kong.

The Practice Notes are not intended to promulgate a standard of practice, but rather to produce some basic guidelines for the following core practices :

1. Tendering
2. Cost Control and Financial Statements
3. Valuation for Interim Payment Certificates
4. Valuation of Variations
5. Handling of Contractual Claims
6. Settlement of Final Account

As different client organisations will have their own procedures and requirements, the Practice Notes, which are prepared mainly for private sector projects using the HKIA/HKIS Standard Forms of Building Contract, should be adapted as appropriate.

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1. Introduction

Most standard forms of building contract state an entitlement on the part of the Contractor to receive interim payments. Interim payments are vital for the cash flow of contractors and if they are delayed the Contractor can bear unreasonable costs without income, which can potentially effect a Contractor's profitability and ultimately solvency. Because of the importance of interim payments, failure to comply with clauses which set out the obligations of Quantity Surveyors, Architects and Employers in respect of interim certificates is likely to amount to a fundamental breach of contract. It is therefore crucial for Quantity Surveyors to acquaint themselves and strictly observe the timing and the contract rules under which valuations for interim payments are to be conducted.

2. Method and Period of Valuation

While the actual determination of the Contractor's final entitlement is not made until the final certificate, the valuation for interim certificates shall be made as accurately as is reasonably possible. When preparing an interim valuation the following items may be included, depending on the contract terms:

- (a) Preliminaries
- (b) Works carried out
- (c) Variations
- (d) Works carried out by Nominated Sub-contractors and Nominated Suppliers
- (e) Materials on site
- (f) Materials off site (if allowed by the terms of contract)
- (g) Remeasured items of works
- (h) Fluctuations
- (i) Assessed loss and expense claims

Quantity Surveyors have to ascertain how and when interim payments should be made under the contract. Most commonly the stipulated

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interval for interim payments is one month. However, the contract might include for stage payments (popular in lift installation contracts) or the interim payments might be weekly (in case of cost-plus contracts) or controlled by milestone events.

Note should be taken of the contract commencement and completion dates, the retention percentages and limits, the minimum amount of certificates (if any), whether there are any advance payments and corresponding repayment of advance payments, or any credit values (e.g. scrap value of steel reinforcement in demolition contracts), etc. which may have a bearing on the valuation. It is advisable that this information (the Contract Particulars) should be listed and attached to the interim payment valuations folder or file for easy reference.

3. Preparatory Work

If the payment valuations are to be based on work done valued at the rates in the Bills of Quantities (the BQ), the Quantity Surveyor should carry out the following preparatory works prior to the preparing of the first interim payment valuation:

- (a) Break down the contract sum into stages according to the anticipated works progress (e.g. breakdown the cost of the structure into floors or zones by abstracting quantities from the BQ take-off when necessary) and list them in the order of their respective completion sequence on site.
- (b) Discuss the breakdown with the Contractor and agree with him how he would make interim payment applications to facilitate the valuation;
- (c) Agree the proportion of "set-up", "removal", "time-related" and "works-related" Preliminaries with the Contractor;
- (d) Agree with the Contractor the dates on which he will submit his applications with due allowance for the time required for the Quantity Surveyor and the Architect to process the application; and

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- (e) Check whether the Contractor has submitted the insurances and bond in accordance with the Contract.

4. Carry Out the Valuation

Pursuant to clause 32.1(5) of the New Standard Form of Building Contract 2005 for Private Projects (the SFBC), the Quantity Surveyor shall make an interim valuation of the work in progress and shall submit his valuation to the Architect at least 7 days before the Interim Certificate is due to be issued.

Although clause 32.1(4) of the SFBC requires the Contractor to submit an application to the Quantity Surveyor at least 14 days before the date on which an Interim Certificate is due to be issued, it is noteworthy that the SFBC does not explicitly make the Contractor's submission of an application a pre-condition for interim payment.

Clause 32.1(1) of the SFBC provides that an interim certificate shall be issued regularly at the end of each Period of Interim Certificates stated in the Appendix to the Conditions of Contract. Clause 32.1(3) further provides that after the issue of the Substantial Completion Certificate, interim certificates shall only be issued when further amounts are, in the Quantity Surveyor's opinion, due to the Contractor. In forming his opinion, the Quantity Surveyor shall take into account the value of variations assessed in the settlement of the accounts which have not been paid in previous valuations.

5. Site Visits

Interim valuations should normally be backed up by a site visit report. When making site visits for interim valuations, adhere to the following guidelines:

- (a) Whenever possible, agree with the Contractor on the date of visit so that the Contractor can have a representative to accompany the Quantity Surveyor during the inspection.

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- (b) Upon arrival on site, the Quantity Surveyor shall record his name, company name, time of arrival and departure in the visitor's book.
- (c) Make records of the progress on site as seen on the date of valuation. When possible, take photographs to show the extent of work completed and keep in the payment valuation back-up file. If any measurements are jointly taken with the Contractor, request the Contractor to initial against the measurements.

Upon completion of the calculation subsequent to the site visit, the Quantity Surveyor shall notify the Contractor if he thinks the Contractor's application has been over-stated. Such a courtesy will avoid unnecessary arguments and ill-feeling.

6. Valuation of Preliminaries

Each valuation will take into account the pricing of the Preliminaries Bill. This may have a number of items separately priced, or there may be one single sum. In the former case each priced item should be considered and a fair proportion of each included. For example the price for provision of offices, sheds, etc., could be split up into delivery cost, weekly rent and removal cost and valuation made accordingly while the item for cleaning up on completion would not be included at all till the end of the project.

Practices vary in respect of interim payment for insurances and bond in connection with the Works. It is advisable to make it clear in the preambles to the Preliminaries Bill whether payment for insurances and bond shall be made in proportion to the value of work done or the whole value of the item shall be paid once the insurances and bond are in place.

If there are signs that the contract may be prolonged, suitable reductions should be made to the valuation of the running costs to relate payments on account more accurately to the whole.

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7. Assessment of Materials on Site

Check the conditions of contract to see the conditions that apply in respect of payment for materials on site.

Request the Contractor to submit a List of Materials on site together with his payment application. For materials which are distributed around the site rather than in a central storage area (e.g. on an estate of several buildings or on a high rise building with limited ground level storage areas where materials are stored on various levels within the building) ask the Contractor to state, on the List of Materials, where the materials are stored.

Carry out visual inspection of the materials on site and make an approximate record by means of counting and physical measurement.

Most contractors back up their List of Materials with copies of delivery notes/orders or invoices for the materials, sometimes confirmed by the Clerk of Works. It should be borne in mind that whilst these documents are of assistance in determining the amount of materials claimed to have been purchased they are by no means conclusive proof that the materials are still on site.

The following points should be observed in the valuation of payments for materials on site.

- (a) Do not rely solely on the prices given in the invoices. If the claimed price is disproportionate to the respective all-in contract rates, suitable adjustments shall be made to avoid over-payment.
- (b) Compare the quantities of the delivered materials with the BQ quantities. Ensure that no excessive quantities of materials are included in the valuation of payment for materials on-site. A reasonable allowance for wastage should be made.
- (c) Check that materials included in previous valuations are still on site if they have not yet been incorporated into the Works.

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- (d) SFBC clause 32.2(d)(i) provides that materials on site for incorporation into the permanent Works are to be paid in interim payments. Formworks materials, as they do not form part of the permanent works, should not be included in payments for materials on site.
- (e) Unless the Contract specifies otherwise, Contractors are generally not entitled to payment for materials stored off-site. If payment for materials off-site is to be made pay particular attention to the relevant conditions of contract and ensure that all pre-conditions e.g. proper security and insurances, etc., are complied with.
- (f) Remember to deduct the amount of materials that have already been incorporated in the permanent works (with due allowance for wastage) from the cumulative quantities of materials delivered to the site. In addition, verify the residual amounts so derived with rough quantity checks on the site.

8. Keeping of Valuation Notes

All calculations, notes, records, etc. made for the valuations should be properly kept on file. In the event of a dispute resulting in legal proceedings, these papers could be primary evidence. It is suggested that all the papers relating to one valuation should be fastened together with a strong fastener, with the copy valuation being on the top. The attached papers will include such things as Sub-contractors' applications, list of unfixed materials, interim statement of fluctuation adjustments, etc.

9. Notification of Payments to Nominated Sub-Contractors / Suppliers

Upon issuance of an Interim Payment Certificate by the Architect, the Quantity Surveyor should notify the various Nominated Sub-Contractors / Suppliers in writing of the amounts included in the Interim Payment Certificate in respect of their works.

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It is advisable to obtain documentary proof from the Contractor showing that the payments in respect of the Nominated Sub-Contractors / Suppliers certified in last interim payment have already been duly settled by the Contractor.

10. Retention

The amount to be retained will be found from the conditions of contract. A special note should be made of any maximum retention amount. In most standard forms of building contract, retention is set at 10% and subject to a limit of 5% of the contract sum, but these may vary.

Where the stipulated retentions for Nominated Sub-Contracts or Nominated Supply Contracts are to be added to the Main Contractor's Retention, attention shall be paid to the possibility that the applicable percentages and limits may vary among the sub-contracts.

It is noteworthy that SFBC clause 32.4(a) provides that the Contractor's entitlements to loss and expense are not subject to retention.

When work is substantially complete, part of the retention sum is to be released, the balance being held as security for making good of defects that may be found necessary within the defects liability period. Most standard forms provide that one-half of the retention is to be released. Before release of the retention, check that all guarantees and warranties as specified in the Main Contract, Nominated Sub-Contracts and Supply Contracts have been provided.

11. Liquidated Damages and Employer's other Rights to Set Off

If the project is not completed by the Date or Extended Date for Completion, Liquidated and Ascertained Damages (LAD) may accrue to the Employer. Under the SFBC, the Employer may serve a notice to the Contractor requiring the Contractor to pay LAD for the delay in completion subject to the Architect's certification, in accordance with clause 24.1(1) that the Contractor has failed to complete on time.

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However further extensions of time may be granted to the Contractor. In any event if the works are not complete by the Date or Extended Date for Completion, all subsequent Valuations should be made with a statement to the effect that:

"This valuation is issued without prejudice to the right of the Employer to claim, subject to the Architect's certification in accordance of clause ____ of the Conditions that the Contractor has failed to complete on time, Liquidated and Ascertained Damages for the non-completion of the Works by the Date (or Extended Date) for Completion. No reserve has been made for this in this valuation for Interim Certificate No."

Under clause 32(4)(a) of the SFBC, deduction from the gross valuation shall be made for (i) correction of Contractor's errors in setting out the Works, (ii) materials or work not in accordance with Contract and (iii) rectification of defects under clause 32(4)(a) of the SFBC.

It is noteworthy that under the SFBC, the set off for LAD should have no effect on the gross valuation.

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