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Statement of Position

Contract Change-Orders and Contractor's Bonds

Public entities are required to obtain both a payment bond and a performance bond for all public work contracts over \$100,000.¹ Payment and performance bonds protect both the public entity and the subcontractors and persons providing labor and materials. Payment and performance bonds are collectively referred to as contractor's bonds.

When a public work contract is let, the amount of the bond needs to be equal to the contract price. However, if the contract price increases "for any reason, the public body may require additional bonds, the penalties of which shall be not less than the amount of the increase" Therefore, if, after the contract is signed, the contract price increases due to change orders, unforeseen conditions, cost overruns or for any other reason, the governing body has the option of increasing the amount of the contractor's bond.

Often our audit staff will see a series of change orders that substantially increase the amount of a public work contract with no indication that the governing body was aware of the change orders or ever considered requiring additional contractor's bonds. Public entities have the authority to increase the contractor's bond when the amount of the contract increases. With this statutory discretion, however, comes the responsibility for the governing body to actually consider whether it is in the best interest of the public to require additional contractor's bonds. We recommend that public entities address these issues in a written policy adopted by the governing body.

We suggest the policy provide that:

- All increases to the contract price, whether through change orders or otherwise, be approved by the governing body; and
- When the governing body approves an increase to a contract price, it also considers requiring additional contractor's bonds, and votes to require or waive such bonds.

For public entities with many contracts, a policy of obtaining governing body approval for all contract price changes may not be practical. In such cases, we would recommend that the governing body delegate to a contract manager, such as a department head, the

¹ Minn. Stat. §§ 574.26 and 471.345.

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This Statement of Position is not legal advice and is subject to revision.

entity's administrator or manager or the town clerk, the authority to approve small changes in the contract. The contract manager would be authorized to approve change orders including those that increase the contract amount up to a specified amount. For those change orders that do increase the contract price, the contract manager would have the authority to decide whether additional contractor's bonds would be obtained. The decision should be in writing with reasons given for an increase or for a waiver of the contractor's bond. The policy could provide that all change orders, and the written decisions regarding contractor's bonds, be presented to the governing body at its next meeting.

"Small changes" should be defined in the policy using either a specific dollar amount or a percentage of the contract, or both. For instance, a policy could define a "small change" as a change of \$500 or 5% of the contract price, whichever is less. However the amount is defined, it should represent the governing body's comfort level in light of its legal responsibility to manage the affairs of the public entity.

We recommend that the policy regarding change orders and increased contractor's bonds be referenced in all bid specifications and written contracts entered into by the public entity. For that reason, the policy should be forwarded to any person preparing bid specifications or contracts on behalf of the public entity.