



CITY OF HAMILTON
CITY MANAGER'S OFFICE
Audit Services Division

TO:	Chair and Members Audit, Finance and Administration Committee
COMMITTEE DATE:	February 10, 2014
SUBJECT/REPORT NO:	AUDIT REPORT 2013-11 - Public Works - Construction Contracts Review (AUD14003) (City Wide)
WARD(S) AFFECTED:	City Wide
PREPARED BY:	Ann Pekaruk 905-546-2424 x4469
SUBMITTED BY:	Ann Pekaruk Director, Audit Services City Manager's Office
SIGNATURE:	

RECOMMENDATION

- (a) That the Management Action Plans, as detailed in Appendix "A" of Report AUD14003 be approved; and
- (b) That the General Manager of Public Works be directed to instruct the appropriate staff to have the Management Actions Plans (attached as Appendix "A" to Report AUD14003) implemented.

EXECUTIVE SUMMARY

The 2013 Internal Audit work plan approved by Council included a review of construction contracts. The audit included a review of the adequacy of controls and management of two selected Roads construction contracts. Payments were tested and contractors' compliance with contract terms and conditions were evaluated.

The results of the audit are presented in a formal Audit Report (2013-11) containing observations, recommendations and management responses. Audit Report 2013-11 is attached as Appendix "A" to Report AUD14003.

Alternatives for Consideration – Not Applicable

FINANCIAL – STAFFING – LEGAL IMPLICATIONS (for recommendation(s) only)

Financial: The annual capital budget process would benefit from improved disclosure of funding sources and expenditures for individual projects. Progress payment quantities that align with quantities in Inspectors' diaries provide assurance the contractor is only paid for completed work.

Staffing: None.

Legal: None.

HISTORICAL BACKGROUND (Chronology of events)

The audit was scheduled as part of the 2013 Internal Audit work plan approved by Council. The audit fieldwork was completed in October 2013. The results of this audit are attached as Appendix "A" of Report AUD14003.

The Audit, Finance and Administration Committee receives and approves final audit and review reports as part of its responsibilities for the oversight of governance and control.

POLICY IMPLICATIONS AND LEGISLATED REQUIREMENTS

City of Hamilton Procurement Policy

Capital Recovery Process & Methodology

RELEVANT CONSULTATION

Appendix "A" to Report AUD14003 includes action plans which reflect the responses of management responsible for the contracts that were reviewed in the City's Engineering Services Division of the Public Works Department.

**ANALYSIS AND RATIONALE FOR RECOMMENDATION
(Include Performance Measurement/Benchmarking Data if applicable)**

As Internal Audit wished to review the contract management process and administration, two specific, completed or substantially completed by the spring of 2013, capital projects and their related major construction contracts were selected for detailed examination. Each contract had a value of over \$2,000,000.

The review of files, the contracts, the accounting records and other documentation as well as discussions with relevant staff provided information on project management and controls over payments to the contractors. The two projects were also assessed as to any change orders, their nature and approvals.

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Review (City Wide) - Page 3 of 4**

A formal Audit Report (2013-11) containing observations, recommendations and resulting management action plans was issued. Four recommendations were included in Audit Report 2013-11 (attached as Appendix "A" of Report AUD14003). The recommendations made are as follows:

- Disclosure to Council regularly of funding sources and expenditures for individual projects as well as explanations of surplus/deficits and extra work and/or change orders on completed contracts.
- Compliance with City's Procurement Policy for add-ons of extra work valued at \$100,000 or greater unrelated to the original projects.
- Progress payment quantities that agree with quantities as noted in the Inspectors' diaries to avoid pre-payments to contractors.
- Comprehensive written procedures in areas associated with contract deficiencies during the warranty period.

Management has agreed to all the recommendations. Specific action plans can be found in the attached Audit Report.

Audit Services conducted this review in conformity with the *International Standards for the Professional Practice of Internal Auditing*. These standards require that Audit Services plan and perform the review to obtain sufficient, appropriate evidence to support the findings and conclusions based on the review objectives. Audit Services believes that the work performed provides a reasonable basis for the review findings and conclusions.

ALTERNATIVES FOR CONSIDERATION

(Include Financial, Staffing, Legal and Policy Implications and Pros and Cons for each alternative)

Not applicable.

ALIGNMENT TO THE 2012 – 2015 STRATEGIC PLAN

Strategic Priority #2

Valued & Sustainable Services

WE deliver high quality services that meet citizen needs and expectations, in a cost effective and responsible manner.

Strategic Objective

- 2.1 Implement processes to improve services, leverage technology and validate cost effectiveness and efficiencies across the Corporation.

Strategic Priority #3

Leadership & Governance

WE work together to ensure we are a government that is respectful towards each other and that the community has confidence and trust in.

Strategic Objective

3.4 Enhance opportunities for administrative and operational efficiencies.

APPENDICES AND SCHEDULES ATTACHED

Appendix "A" to Report AUD14003

ap:jg

**CITY OF HAMILTON
INTERNAL AUDIT REPORT 2013-11
CONSTRUCTION CONTRACTS REVIEW**

#	OBSERVATIONS OF EXISTING SYSTEM	RECOMMENDATION FOR STRENGTHENING SYSTEM	MANAGEMENT ACTION PLAN
1.	<p><u>Extra Work and Change Orders</u></p> <p>The construction contracts agreed to between the City and the contractor specify the work to be performed at specific geographic locations. Similarly, a formal purchase order is also created between the contractor and the City specifying the same geographic location where the work is to be performed.</p> <p>Both construction contracts reviewed included extra work and/or change orders, some of which were necessary to accommodate work by the same contractor but carried out at a different location than that stipulated in the original contract and corresponding purchase order.</p> <p>For one of the two projects reviewed, the value of the work at the different location totaled \$285,000. This represented approximately 11% of the value of the total work performed under that Purchase Order. As the work at this different location exceeded \$100,000 and there was neither a separate purchase order nor a written legal agreement for this work, the project violated the City's Procurement Policy #7. The inclusion of work not related to the original contract in these projects' costs results in inaccurate contract costing and reporting as well as making further analysis time consuming.</p>	<p>That the status of funding sources and expenditures for individual projects be disclosed in regular Council reporting along with reasons for the completed project surplus or deficit and details of extra work and/or change orders.</p> <p>That the City's Procurement Policy requiring both a purchase order and the written legal agreement for construction contracts of \$100,000 or greater be adhered to when assigning extra work and/or change orders to contractors.</p>	<p>Agreed. Contract Status is reported to standing committees on a regular basis. This disclosure will be added to that reporting. To start with the June 2014 reporting cycle.</p> <p>Agreed. Extra work, when paid from the contingency fund of the contract, is covered under the terms of the existing contract and agreement. Work authorized under the Procurement Policy 11 and paid for under an existing purchase order and/or contract is also compliant with the Policy. Policy 7 and Policy 11 requirements will be strictly enforced.</p>

**PUBLIC WORKS – CONSTRUCTION CONTRACTS REVIEW
 DECEMBER 2013**

#	OBSERVATIONS OF EXISTING SYSTEM	RECOMMENDATION FOR STRENGTHENING SYSTEM	MANAGEMENT ACTION PLAN
2.	<p><u>Contract Administration</u></p> <p>The materials used and the work performed by the contractor are tracked each day by the Inspector using a journal. At the end of each month, the amounts in the journals are summarized and submitted by the Inspector to the Project Manager. The volume of the work tracked is used to calculate the progress payment remitted to the contractor for the work performed.</p> <p>A comparison of the Inspectors' journals with the total progress payments indicated that, at the completion of the project, the contractor was paid only for the work performed and the materials used. However, for the first two progress payments of one of the contracts reviewed, the contractor was pre-paid for work before it was recorded by the Inspector. Such pre-payment for work and materials is not a good practice as it removes the urgency of completing the work in a timely manner by the contractor. It also places the City's funds at risk should the contractor meet with financial or performance difficulties.</p>	<p>That progress payment quantities agree with quantities as noted in the Inspectors' diaries on a payment-to-payment basis in order to ensure the contractor is only paid for completed work.</p>	<p>Agreed. It is current practice that the payment certificate quantities are based on Inspector diary measurement notations. There may be instances where there is a minor variance between certificate payment quantities and Inspectors' notes. These minor temporary variances are a function of pending work and rationalization of available resources. All final quantities are subject to multiple levels of review and work flow scrutiny.</p>

**PUBLIC WORKS – CONSTRUCTION CONTRACTS REVIEW
 DECEMBER 2013**

#	OBSERVATIONS OF EXISTING SYSTEM	RECOMMENDATION FOR STRENGTHENING SYSTEM	MANAGEMENT ACTION PLAN
3.	<p><u>Procedures</u> Management in Construction Services has no written formal procedures to guide its staff in the identification, tracking and correction of contract deficiencies during the warranty period.</p> <p>When written procedures do not exist, staff carrying out the process rely on personal understanding and experience which could result in incorrect, incomplete or inconsistent application. It would also be problematic and inefficient for a successor to commence his/her duties within a short period of time.</p>	<p>That comprehensive procedures for the identification, tracking and correction of contract deficiencies during the warranty period be written, approved by management and implemented by staff in the Construction Services section.</p>	<p>Agreed. Construction Services will formalize and document existing policies and procedures with respect to warranty period issues.</p>