

New Castle County
Change Orders & Contractor Payments Audit – Construction Projects
Executive Summary

To: Tracy Surles, Acting General Manager of Special Services
Yvonne Gordon, Chief of Administrative Services
Christopher A. Coons, County Executive
Paul G. Clark, County Council President

Scope

This audit evaluated the internal controls over change orders on construction projects. The audit also analyzed the controls over payments to contractors.

A change order is requested upon the occurrence of differences between the construction specifications/drawings and actual conditions encountered during the execution of the contract, and when the work required by the change order is within the scope of the contract. Change orders are the result of elements beyond the contractor's control, unforeseen conditions, material delivery delays, etc. The owner always reviews change order requests and approves for further processing or denies. We were informed by Special Services Management that change orders for special services contracts are governed by Chapter 2, Article 5, Section 2.05.303.D.16 of the New Castle County Code.

Our audit testing encompassed six construction projects, two involving buildings and four involving sewers. We evaluated all change orders over \$10,000 for each of these projects and also tested a sample of contractor payments for each project. Our testing encompassed the period July 1, 2005 through May 2, 2007. **It should be noted that the majority of this timeframe occurred during the tenure of the former General Manager of Special Services. The Acting General Manager assumed responsibility for her function in March 2007.**

Opinion

In our opinion, during the period July 1, 2005 through May 2, 2007, adequate internal controls existed in all material respects over the change order and contractor payment functions. We do have five comments which are discussed in the Other Reportable Items section of this report. Other Reportable Items are opportunities for improvements in the system of internal control.

Overall we believe the Special Services Department (and Purchasing Review Committee) is thorough and diligent in its review and approval of change orders. We believe the people involved in the process take their responsibilities very seriously. We were particularly impressed with the Special Services Fiscal Unit. The comments in this report generally relate to two large building projects: Public Safety Building and Woodlawn Library. Each of these projects was peculiar for circumstances detailed in the full audit report.

Cc: Jeffrey Bullock, Chief Administrative Officer
Edward Milowicki, Acting Chief Financial Officer
Members of New Castle County Audit Committee
Members of New Castle County Council

COMMENTS AND RECOMMENDATIONS

We had the following comments and recommendations in our audit report. Each of these comments and recommendations is an opportunity to strengthen the existing internal controls.

Change Order Processing

Definition of Change Orders

We were informed by Special Services Management that change orders for special services contracts are governed by Chapter 2, Article 5, Section 2.05.303.D.16 of the New Castle County Code. **The additional work must be within the scope of the original contract and "... will only be allowed when there is a difference between the construction specifications and drawings and the actual conditions encountered during the execution of the contract."** However, we found during our testing that not all of the change order transactions (a "CO" on the Purchasing System) were "true" change orders based on the above definition.

Of the \$13,517,163 in change orders over \$10,000 processed between July 1, 2005 and May 2, 2007 for the six projects we tested, at least \$5,461,223 (or 40%) of these change orders were not "true" change orders according to the wording in the previous paragraph. Thus, the amount of "true" change orders over \$10,000 processed between July 1, 2005 and May 2, 2007 for these six projects was at the most \$8,055,940.

Although these observations do not have an impact upon the amount of dollars actually approved for particular projects, it does significantly misrepresent to an independent observer the amount of County dollars approved for projects that were due to "true" change orders.

Public Safety Building Change Orders

Administrative Services Policy #42, "Purchasing Review Committee, Emergency Purchases, and Legal Review", established the PRC. We were informed by both Special Services and Administrative Services managements that every change order on capital projects must be approved by the PRC.

There were several change orders in which work was performed before the change order was created and/or was approved by the PRC (Purchasing Review Committee).

The Acting General Manager of Special Services informed us that (1) weekly meetings were held with both Gilbane Building Company, Remington Group Inc., and Tevebaugh Associates to monitor and assess the status of the project and (2) either she or the prior General Manager of Special Services often provided verbal approvals at these meetings. However, when approval is given to a contractor to proceed with work prior to the date the PRC reviews the Change Order, it is too late for the PRC to object to the work should it have concerns. We did not see any evidence/documentation indicating that the people involved in these weekly meetings had the authority to authorize the final approval of these change orders without the consent of the PRC.

Woodlawn Library

We were informed by the prior General Manager of Special Services that, due to unusual circumstances not mentioned in this report, the original Project Manager was late in processing several change order requests.

There were several change orders, relating to the Woodlawn Library Project, presented at the 8/17/06 PRC meeting. These change orders were for 20 items that were submitted by the contractors during the February through June 2006 timeframe. Our review revealed that the work on many of these change orders was performed prior to 8/17/06. Neither the Special Services Fiscal area nor the PRC was aware of these items because the Special Services Project Manager had not made these areas aware of the change orders. Thus, these change orders were approved by the Special Services Project Manager (and apparently by the outside Construction Manager) prior to the PRC reviewing and approving them.

Recommendations:

1. Special Services management discuss with Administrative Services management the possibility of using a code other than "CO" for the types of situations where the item is not a "true" change order.
2. If there are projects involving an outside Construction Manager and/or Owner's Representative, Special Services work with the PRC to develop special procedures (if necessary) for the PRC's role in the project.

Response from Special Services Department Management

1. The Special Services Department will follow through with the first recommendation.
2. The Special Services Department will follow through with the second recommendation. However, please note that for most projects, the PRC's role will be consistent with past practice and existing policies. This comment appears to be based primarily on the Public Safety Building Project, which was unusual due to its magnitude and due to the fact that the County retained both a Construction Manager and an Owner's Representative. The need for retaining both a Construction Manager and an Owner's Representative was due to both project complexity and staffing restrictions (no in-house project manager). While the department does not foresee a future project similar to the Public Safety Building, it would certainly work with the PRC to develop special procedures if a similar situation did arise.

Response from Administrative Services Management

Administrative Services will work with Special Services to expand and clarify the definition of a change order.

Purchasing Review Committee (PRC)

We were informed by Special Services and Administrative Services managements that every change order on capital projects must be approved by the PRC. Our testing of change orders on capital projects revealed:

- There were 24 of 92 change orders, for a total of \$3,028,100, (a percentage of 26% and 42%, respectively, of the number and dollar amount of change orders we tested) where the approval of the PRC was not documented in written minutes. Regardless of whether or not there are written minutes, the Law Department representative on the PRC initials the hard copy of the Advice of Change as evidence that the PRC approved the change order.

We believe it is important to have written minutes that record the discussions of the Committee members.

- Our review of the PRC minutes indicated that the minutes do not usually reflect the reasoning behind why the PRC approved the change order. That is, how did the PRC ascertain that the work was within the scope of the original contract and was due to a difference between the construction specifications / drawings and the actual conditions encountered during the execution of the contract? Examples are included in the detailed audit report.

Given the dollar materiality of many of the change orders, we believe it is important to document why the PRC approved the change order in case anyone were to question the approval at a later point in time.

Recommendations:

1. Written minutes be recorded for all PRC meetings. These minutes should document how the PRC reached its decision that the contractor was entitled to the change order.
2. The PRC evaluate and clarify the procedure which states that the PRC "... will hear and respond to requests for contract/project amendments/change orders, add-ons, and overruns." For example, is it really the intent of the PRC to review every single change amendment, change order, add-on, and overrun? Also, do users reading the policy really understand what each of these terms mean?
3. Management inform County Council that they are welcome to attend a PRC meeting if they have questions on the role and responsibilities of the PRC.

Response from Administrative Services Management

Written minutes will be discontinued and replaced with the following: Purchasing will see that all correspondence and notes regarding the approval of a change order will be scanned and attached to the appropriate purchase order. All information pertaining to each change order will be available via the online document in Tier.

Written Policies and Procedures for Change Orders, Particularly for Construction Contracts.

Overall, we believe that the Special Services and Administrative Services Departments need to develop better policies and procedures for the initiation, approval, and processing of change orders. The lack of comprehensive, documented policies and procedures increases the risk that change order activity may not be managed in the best interest of New Castle County. We reviewed several publications on construction contracts as well as the purchasing manuals for a few municipalities and have several suggestions for improving the existing policies and

procedures regarding change orders. We believe the Administrative Services Department should establish an enterprise policy for change order management and that each individual department (particularly Special Services) that manages contracts should have its own written policies and procedures. The departmental policies and procedures should include sufficient detail for project managers and staff to properly administer change orders in accordance with management's directives.

Recommendations:

The detailed audit report provides many recommendations for enhancing written policies and procedures for change orders.

Response from Special Services Department Management

The Special Services Department concurs with these recommendations.

Public Safety Building Contracts

Possible Duplication of Contracts

The County engaged a Construction Manager (Gilbane Building Company) and an Owner's Representative (Remington Group Inc.) for the Public Safety Building Project. Also, Tevebaugh Associates was the architect for the project and was involved in many management decisions. The previous General Manager of Special Services said Remington was hired because he needed a dedicated resource to New Castle County, since none of his internal project managers had the time to devote to this project.

We reviewed the contracts for both Gilbane and Remington and found apparent similarities in the work required of each company. Thus, there appears to be duplication of work and we can't help but question whether some of Remington's services were already included in the contract with Gilbane. Examples of these similarities are included in the detailed audit report.

It is not our intention to minimize the work of the Owner's Representative or the Construction Manager. Rather, we merely want to point out that the County may have been able to save money by (1) specifically assigning work to one or the other of these two companies – not both, or (2) hiring a full-time project manager internally to fulfill Remington's role.

Recommendation:

We recommend, in the future, that Special Services management attempt to minimize instances in which contracts for a single project include apparent duplications in the contracts for two or more entities.

Response from Special Services Department Management

The Special Services Department will try to minimize duplications in contracts related to a particular project. As noted above, the Public Safety Building project was unusual and the

department does not foresee the need to duplicate the same management structure (construction manager and owner's representative) on future projects.

Remington's Savings and Cost Avoidance Report

During the Public Safety Building project, Remington periodically provided to the Administration and County Council a "Savings and Cost Avoidances" report. The final report provided by Remington identified "Total Savings to Date" of \$4,439,221. In the detailed audit report, we make several observations regarding the fact that Remington itself was not responsible for all of these cost savings. We also make an observation concerning the fact that the Special Services Fiscal Unit had to spend a great deal of time with the Remington staff person in reconciling Remington's numbers to New Castle County's. This appeared to be due to the inexperience of the staff person Remington assigned to the job. As a result, the periodic Project Cost Report provided by Remington to Council was not always ready on a timely basis.

Recommendation:

Our detailed audit report did not provide a recommendation for this comment. Rather, we just pointed out that the cost savings on the "Savings and Cost Avoidances" report were not entirely attributable to Remington Group.

County's Standard Contract Language.

In our "Audit of the Procurement Function", report dated 2/12/07, we were informed that the County would be engaging a law firm to assist in reviewing the terms and conditions of the standard County construction contracts, professional services contracts, and goods/materials contracts, and to recommend revisions to such contracts based upon current law and best practices. In that audit, we recommended that the law firm determine whether adding a "right to audit" clause to County contracts would be beneficial in any particular situations.

The law firm performing the Contract Review Project agreed that a "right to audit" clause should be included in the County's standard contracts and provided the County with suggested language.

Recommendations:

1. The Special Services Department include a "right to audit" clause in its standard construction contracts.
2. The Special Services and Administrative Services Departments evaluate, and implement if beneficial, all suggestions provided by the outside law firm.

Response from Special Services Department Management

The Special Services Department plans to implement suggestions provided by the outside law firm. The law firm has assisted the department in updating its standard specifications and special services construction contracts. The firm has also assisted in developing new professional services contracts. The right to audit clause has been added to professional services contracts and will be added to Special Services construction contracts (still in the process of revising the overall format for these contracts).

Contractor Payments

We selected a random sample of payments to contractors from the purchase order files relating to the change orders we selected in our change order testing. Each sample item was inspected for the appropriate payment form and for the appropriate signatures. Overall, our testing revealed that internal controls over contractor payments were functioning as intended.

A response to this conclusion is not necessary.