

Contract Review

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INTRODUCTION

The need for a Contract Audit within the City of Jonesboro can be attributed to the following conditions:

- The value and importance of contractual expenditure in regard to both capital and revenue budgets.
- The high turnover and diversity of contracts (from the supply of stationery right through to the construction of roads).
- The inherent risk of loss, waste and fraud resulting from such turnover and expenditure levels.

Contract Auditing is more generally associated with reviews of major construction and maintenance contracts and in particular with the audits of schemes, which are financed by capital expenditure.

The particular contracts subjected to contract audit would, therefore, most generally fall under the following categories:

- Building Works.
- Civil Engineering Works.
- Mechanical and Engineering Works.

The principles of contract auditing are, however, generally applicable to all types of contracts, whether they relate to minor or major works or whether they are financed from capital or operating budgets.

SCOPE OF WORK

- Encompassed the examination and evaluation of the adequacy and effectiveness of the City of Jonesboro's system of internal controls and the reporting upon such controls and other procedures pertaining to the City of Jonesboro's expenditure for the contractual supply of goods and services. See Appendix A
- The purpose of the review for the adequacy of the system of internal controls is to ascertain whether the system established and maintained provides reasonable assurance that the City of Jonesboro's objectives and goals will be met efficiently and economically.

- The purpose of the review for the effectiveness of the system of internal control is to ascertain whether the system is functioning as intended.

AUDIT OBJECTIVES

- Reviewing and reporting on the extent to which procedures comply with the policies and procedural rules of the City of Jonesboro;
- Reviewing the adequacy of systems for controlling the operation of contract works from initial planning stage to post completion assessment;
- Reviewing and reporting on the extent to which management information is prompt, adequate, accurate and designed for the needs of all the users;
- Appraisal of the system for controlling and recording the utilization of resources including staff;

Contracting has always been an important way in which the City of Jonesboro conducts its business. It is generally conducted adequately, however, its materiality and enough persistent instances or perceptions of “poor” contracting highlight it as an area requiring ongoing scrutiny to protect the public interest.

The reason for conducting a contract audit can therefore be any of the following:-

- **Effectiveness**: are the City of Jonesboro’s contracting objectives being met? That is there a program requirement to justify the contract, is contracting the best means to meet the requirement and has the process been conducted competitively to achieve the best quality, price and equity among potential suppliers?
- **Economy**: were goods and services acquired with the best combination of quality, time and life-cycle costs?
- **Efficiency**: is the contracting process being managed in the most efficient way?
- **Compliance**: are contracting policies and directives being followed?

Contract Policy and Procedure

Houghton Mifflin defines policy as **NOUN:**
pl. policies

1. A plan or course of action, as of a government, political party, or business, intended to influence and determine decisions, actions, and other matters:

2.

- a. A course of action, guiding principle, or procedure considered expedient, prudent, or advantageous:
- b. Prudence or shrewdness in practical matters.

At present the City of Jonesboro does not possess a formal written contract policy or procedures. Various laws, rules and regulations govern how payments, bidding and other matters are handled. However, minimal formalized guidance for the five areas outlined below of sound contract administration exists.

Contract administration

The objective of contract administration is to ensure the successful completion of the contract according to time, cost and performance criteria, respecting the intent of the City of Jonesboro's policies and procedures and the specifics of regulatory controls.

The Mayor has primary responsibility for the negotiation and procurement of contractual relationships for the city. Per State Statute 19-4425: Sec 5 Act 28 of 1959: Sec.1, Act 154 of 1979; Sec 3, Act 745 of 1985. "The Mayor or his duly authorized representative shall have exclusive power and responsibility to make purchases of all supplies, apparatus, equipment, materials and other things requisite for public purposes in and for the city . . ."

Department Heads have the main accountability for contract administration. They ensure that financial controls such as signing authorities and separation of duties are enforced. When required, they receive progress reports on the financial status of the contract and ensure that line management receives technical reports. They also resolve contract disputes and ensure that any necessary contract amendments receive as much scrutiny as the original.

In the case of service contracts, again department heads play an integral role. They are responsible for the day-to-day management of the contract and certification that services have been received per contract specifications.

STAGES OF PROPER CONTRACT MANAGEMENT

Contract Management embraces five distinct areas, namely

- 'A' - Pre-contract planning, review, coordination
- 'B' - Payment of contract
- 'C' - Performance of contracts
- 'D' - Post completion of contracts
- 'E' - Problems of contracts

These areas will be discussed in detail in the body of this report and are means through which the objectives for sound contract management can be achieved.

STAGE 'A' - PRE-CONTRACT PLANNING, REVIEW & COORDINATION

Involvement at the pre-contract stage embraces the examination and assessment of documents pertaining to the contract and of decisions taken by the management team in respect of that contract.

Coordination and review of contract procedures at this stage could result in the detection or prevention of unnecessary or extravagant expenditure and hence provide a substantial saving to the City of Jonesboro. It may also make possible the detection of sub par decisions and poor planning which would otherwise go, undetected.

Pre-contract planning, review and coordination appears to be the weakest area the City of Jonesboro has with the entire contracting process.

The examination of the contracting process involved choosing 30 random contract from 2006. Said contracts were reviewed for proper authorizations, signatures, dated, actual existence of contract, terms, legal review, payments, change orders, bids, final execution and closure. The following summarizes the most notable problems with the contracts reviewed;

- 1.) 19 of 30 were not dated by Mayor
- 2.) 11 of 30 were not signed by counterparty
- 3.) 4 of 30 did not have contracts, bid specifications only were used
- 4.) 3 of 30 were not notarized as required by contract documents
- 5.) 4 of 30 had no problems.
- 6.) 3 of 30 not signed by City of Jonesboro Officials

These contracts were requested from the City Clerk who is the final repository for executed contracts by state law. Items identified are indicative a lax appreciation for detail completion. The Mayor and staff are reminded that accurate execution of contracts is vital to ensure proper management of public funds and trust.

At present city staff is utilizing a new agenda software which should aid in eliminating some of the issues above, however it is imperative that department heads work together and use the software to ensure all areas of contracting are completed in a timely manner.

Another aspect reviewed was larger contractors with city work. Per information from Brenda Sharp five larger contractors were chosen for closer analysis. The five chosen were 1.) Cooper Construction, 2.) Randy Callahan Construction, 3.) Alvin Crabtree and Sons, 4.) Cameron Construction and 5.) Van Horn Construction. These five contracted for work totaling \$1,284,916. Eleven jobs were let among the five aforementioned contractors. Most telling was five jobs had no formal contract only bid specifications while six had contracts. Also four jobs were brought in overbid amounts. Of the five contractors three brought their projects in at bid or below bid, while two completed their projects over budget. However, it is important to relate that each contractor was over

budget due to city staff mismeasurement of the jobs. The total cost of the mismeasurement was \$100,321. This was noted because of the analysis of any contract plus or minus 15% on total dollars versus bid.

STAGE 'B' – PAYMENT OF CONTRACT

The development of multilevel reviews is imperative to prevent loss, waste and extravagance, and hence encourage savings or improved controls throughout the construction period of the contract under investigation, as well as future contracts of a similar nature.

The contract manager must be involved on a continuous basis as part of a routine system and independently examining, assessing and reporting on the management controls and procedures by employing sampling techniques, spot checks, system appraisal techniques and risk analysis.

Invoices submitted for payment were detailed with work performed, however, it was observed that lack of city official or service personnel signing off for payment was the most noted problem. Other authorizing or clearing officials such as architects or outside engineers were also missing in some cases. Given the large dollar volumes the mayor and city staff are reminded to be certain proper authorization is given before payments are made for work performed.

Contract term summary sheets must be developed/implemented to give clear picture to finance staff as to the what, when, where and how much to expect was each contract.

STAGE 'C' – PERFORMANCE OF CONTRACTS

The performance verification is easier to conduct. To be effective, the legal review must be undertaken shortly after the contract is drawn up by the responsible users, but before it is agreed to by the contractor, and before the final certificate is signed by the responsible official. The timing of the review is important, because it may not be contractually possible to make any alterations to the final account once the final certificate has been signed.

The City Attorney's role at this stage is independently to examine in order to detect legal weaknesses or errors in the contract. He/She should avoid being the system relied upon to double check another person's work. His/Her role is to inform management of deficiencies in any contract, so that management can take the necessary steps to improve the relevant contract. However, it is noted that current practice indicates a review as to legal form only, not a business or "sound judgment" review of contract terms.

It is noted that 5 /11 jobs let had no formal written contract. This would cause concern because said jobs would not have had a legal review. Management is reminded and admonished that bid specifications no matter how thorough do not constitute a formal

contract. The City of Jonesboro should never engage in business of any type without written documentation. Such documentation includes, invoices for goods, and contracts for services regardless of amount. Management is encouraged to investigate purchasing department specific software which generates standardized contracts, which could be customized as needed. AIA is one set of such standardized contracts seen by the city. Said software would help city with contracting needs.

STAGE 'D' – POST COMPLETION INVESTIGATIONS

Post completion investigations for the City of Jonesboro are very informal and do not appear to be documented. One of the standards of strong business is learning how to improve each process after completing one. A project task force after a large project such as animal shelter and fire stations would be beneficial to see what worked well and what did not. This would be key here given it would be the first situational use of Construction Manager would be implemented. Learning what went right and how to improve areas of concern would be most beneficial to future projects.

The post completion investigation would include:

- Re-appraising the project to examine whether the benefits expected at the outset have been achieved and whether the criteria for the project were reasonable in the light of up-to-date information.
- Assessing the performance of the contractor to determine if he provided good value for money or if he should be overlooked for future contracts.
- Reviewing the consultant's performance in a similar manner, for example, fees charged, ability, competence, etc.
- Reviewing the City of Jonesboro's own departmental costs and the performance of the departmental staff involved in the project.
- The system for ensuring that when the final accounts is produced; it is complete and accurate.

STAGE 'E' PROBLEMS OF CONTRACTS

Occasionally, contracts are not performed to the satisfaction of either parties. Contract language is imperative in settling the disputes as judiciously as possible. While no party wishes a difficult resolution the City of Jonesboro must address how it wants to resolve issues if and when they arise. The following outlines the policy parameter minimums to include. Particular attention to Section (b) is warranted given the recent bankruptcy of a concrete service provider to the city.

Section (a) The system for the examination and evaluation of any requests for an outside payment

The policy must address the following matters and ascertain whether: -

1. Procedures have been established by the City of Jonesboro for the receipt and consideration of requests for outside payments.
2. In submitting such a request, the contractor is required to furnish the following information:-

- Copies of audited Profit and Loss Account and Balance Sheet of the company for the last three years, together with those of the parent or holding company.
- A forecast of the outturn for the current financial year both for the company and for the group.
- Details of other outside requests made on other Local or Public authorities within the last eighteen months.
- A list of current contracts including values and whether they are fixed price or variable price.
- Details of the actual loss sustained on the contract for which the current request is being made.

3. Any payment recommended represents a contribution only towards a loss sustained.
4. In those cases where a payment is to be recommended, a certificate is obtained from the contractor's auditors indicating that there is a reasonable prospect of the continued solvency of the company after the payment has been made.
5. Appropriate authorization is obtained before any payments are made on behalf of the City of Jonesboro (i.e. Committee approval where necessary)

Section (b) **The system for dealing with liquidation and bankruptcy**

The policy must address the following matters and ascertain whether: -

1. The City of Jonesboro has a system for the collation and dissemination of information on likely failures as part of or in addition to the system for financial vetting.
2. The procedures preclude any further payments being made to defaulting contractors until final settlement.
3. Any Sureties are informed and kept informed of the developing situation.
4. The state of the Works is assessed to established:-
 - The value of work done by the contractor up to forfeiture.
 - The estimated costs, at current rates, of any remedial work.
 - The estimated value of uncompleted work at current rates.
 - The extent and possible value of any outstanding claims including an assessment of any extension of time.
 - The estimated completion date had the forfeiture not occurred.
5. Anything remaining on site (plant, materials etc.) which has become the City of Jonesboro's property under the terms of the contract is listed, valued, marked as being in the City of Jonesboro's possession and made secure.

6. A decision on how the works should be completed has been made in accordance with the City of Jonesboro's approved procedures.
7. Adequate consultations have been held, proper notifications given and approvals obtained where required from the Liquidator and Surety in respect of completing any outstanding works.
8. A separate account has been established and maintained of all costs involved in completing the original contract works.
9. The Engineer has prepared a final account for the work undertaken by the defaulting contractor up to the date of the forfeiture, sent a copy to the Liquidator and the City of Jonesboro and certified any monies due as a result.
10. The total cost incurred in completing the original contract works has been computed.
11. The notional cost of completing the works, had the forfeiture not occurred, has been computed.
12. The difference between 10 and 11 above has been calculated and the difference recovered from or paid to the Liquidator.
13. Any remaining cost up to the value of the bond has been recovered from the Surety.

The cornerstone of contracting for the City of Jonesboro is

“WRITE YOUR OWN CONTRACTS OR OTHERS WILL WRITE THEIRS FOR YOU”!

Recommendations

- 1.) Develop a formal written contracting policy by October 31, 2007.
- 2.) Utilize and refine the Contract Review and Project Approval Policy provided.
- 3.) Purchase and use contracting software such as AIA and other professional software. Each Department head needs to review his/her needs for software.
- 4.) Provide Contract Terms Summary Sheet – Finance Director/ Department head as needed.
- 5.) Utilize Contract Manager – Tracey Cooper at present
- 6.) Final executed contracts, notice to proceed , change orders and closeout documents to clerk

Appendix A

Contract Internal Control Questionnaire

- 1.) If the contract involves an expenditure or revenue of more than \$20,000, and is on other than standard contract form, or includes any unusual terms, or conditions, was it reviewed by appropriate legal, tax or insurance personnel prior to execution?
- 2.) Does contract contain a standard audit clause?
- 3.) Does the Procurement, Requisition and Authorization Form contain a complete description of services to be rendered?
- 4.) Is it properly approved?
- 5.) Were bids received sufficient to assure competition?
- 6.) Does the contract file have adequate documentation supporting the selection of the contractor including both technical and commercial evaluation?
- 7.) If the contract was not bid, is there adequate documented justification?
- 8.) Was the contract signed by the proper authority?
- 9.) Was it properly approved?