

## **Contracts Audit – Guidance Notes**

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## **INTRODUCTION**

The need for a Contract Audit function within an organization 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 audits 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**

- The scope of Contract Auditing should encompass the examination and evaluation of the adequacy and effectiveness of the organization's system of internal controls and the reporting upon such controls and other procedures pertaining to the organization's expenditure for the contractual supply of goods and services.
- It is recognized that the Chief Executive Officer and senior management of the organization provides general direction as to the scope of work and the activities to be audited.
- 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 organization'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.

## **PERFORMANCE OF AUDIT WORK**

Audit work should include planning the audit, examining and evaluating information, communicating results and following up.

### **Planning the audit**

Planning should be documented and should include:

- Establishing audit objectives and scope of work.
- Obtaining background information about the activities to be audited.
- Determining the resources necessary to perform the audit.
- Communicating with all that need to know about the audit.
- Performing a survey to become familiar with the activities, risks, and controls to identify areas for audit emphasis, and to invite auditee's comments and suggestions.
- Determining how, when, and to whom audit results will be communicated.
- Obtaining approval of the audit work plan.

### **Examining and evaluating information**

The process of examining and evaluating information is as follows:

- Information should be collected on all matters related to the audit objectives and scope of work.
- Information should be sufficient, competent, and relevant and useful to provide a sound basis for audit findings and recommendations.
- Audit procedures, including the testing and sampling techniques employed, should be selected in advance and expanded or altered if circumstances warrant.
- The process of collecting, analyzing, interpreting and documenting information should be supervised to provide reasonable assurance that the auditor's objectivity is maintained and those audit goals are met.
- Working papers that document the audit should be prepared by the auditor, should record the information obtained and the analyses made and should support the bases for the findings and recommendations to be reported.

### **Communicating results**

Internal auditors should report the results of their audit work.

- A signed, written report should be issued after the audit examination is completed. Interim reports may be written or oral and may be transmitted formally or informally.
- Conclusions and recommendations should be discussed at appropriate levels of management before issuing final written reports.
- Reports should be objective, clear, concise, constructive and timely.

- Reports should present the purpose, scope and results of the audit and where appropriate, reports should contain an expression of the auditor's opinion.
- Reports may include recommendations for potential improvements and acknowledge satisfactory performance and corrective measures.
- The auditee's views about audit conclusions or recommendations may be included in the audit report.
- The Chief Internal Auditor should review the final audit report before issuance and should decide to whom the report will be distributed.

### **Following up**

Internal auditors should follow up to ascertain that appropriate action is taken on reported audit findings.

- Internal auditors should determine that corrective action was taken and is achieving the desired results, or that senior management has assumed the risks of not taking corrective action on reported findings.

### **AUDIT OBJECTIVES**

Although the audit approach to building and engineering contracts in the organization will vary, the overall audit objective should be universal and should include:

- Assessing and reporting on the adequacy of the organization's standing orders relating to contracts and associated financial regulations;
- Reviewing and reporting on the extent to which procedures comply with the policies and procedural rules of the organization;
- 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;
- Reviewing the use of consultants and agency services provided by other organizations;
- Monitoring the arrangement for the security of the organization's assets and for recovering the cost of re-chargeable works;
- Prevention and detection of fraud, errors, irregularities and illegal acts; and
- Identification of losses due to waste, inefficiency, etc. and recovery where appropriate.

Contracting has always been an important way in which the organization conducts its business. It is generally conducted adequately, however, its materiality and enough persistent instances or perceptions of "bad" 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 organization's contracting objectives being met? That is, 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?

### **Methods to be used in attaining these objectives**

To attain the objectives stated above, it will be necessary for the auditor to be concerned with all stages of capital works and the checklist attached, whilst not necessarily exhaustive, gives some indication of the areas which should be included in the audit plan for examination.

### **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 organization's policies and procedures and the specifics of regulatory controls.

Material management staff has the primary responsibility 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, line managers have an integral role to play. They are responsible for the day-to-day management of the contract and certification that services have been received.

### **Qualities and Attributes of a Contract Auditor**

The contract auditor is primarily expected to examine and interpret financial information pertaining to contracts but should ideally also possess a working appreciation of technical and legal matters connected with such contracts. This additional knowledge will add depth to investigations, allow meaningful discussions with staff from other disciplines on matters of common interest and concern and provide for a more management-type of approach to the audits.

The variety and diversity of work connected with contracts auditing require substantial on-the-job training and the use of highly developed communication skills (both oral and written) in order to liaise with the professional person managing the contracts.

Clearly, a proficient contract auditor should also be academically or professionally well qualified and thoroughly experienced in normal auditing techniques.

## **STAGES OF CONTRACT AUDITING**

Contract auditing embraces five distinct areas, namely

- ‘A’ - Pre-contract investigations
- ‘B’ - Currency of contract investigations
- ‘C’ - Final account investigations
- ‘D’ - Post completion investigation
- ‘E’ - General investigations

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

## **STAGE ‘A’ - PRE-CONTRACT INVESTIGATIONS**

Audit’s 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.

The involvement of the auditor in 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 organization. It may also make possible the detection of bribery and corruption, which would otherwise go, undetected, for example, submission of tenders after closing date by employees working in collusion with contractors.

The tendering procedures and the acceptance of tenders are areas susceptible to illegal or immoral practices and the operation of a weak system of control could result in considerable loss to the organization.

### **Section (a): The system for and effectiveness of project appraisal within the Organization**

The auditor should pay attention to the following matters and ascertain whether: -

#### **General**

1. The organization has a policy for project appraisal and the extent to which it is applied.
2. The system provides for consultation at appropriate times with:-
  - Relevant disciplines, eg finance, technical, planning and legal;
  - External bodies, eg other public authorities and statutory undertakings.

### **Needs**

3. Potential needs, current, medium and longer term are channeled into a single appraisal centre.
4. Needs are defined broadly into categories determined by the organization having regard to any requirements. Possible examples are as follows:-
  - Compliance with legal requirements;
  - Growth in demand;
  - The removal of risk or nuisance;
  - The improvement of an existing service where below an acceptable standard;
  - To effect cost savings through increased efficiency.
5. Needs are verified by a person other than the person initiating the need.
6. Needs are given a preliminary ranking of priority within the appropriate category.

### **Options**

7. The system provides for preliminary assessments of the options available to meet the identified needs together with broad indications of their likely costs.
8. The feasible options are ranked in order of preference, taking into account such matters as cost, disruption and timing.
9. The options are summarized in a written report with a broad estimate of cost, as follows:-
  - The total expenditure;
  - Cash flow input;
  - Operating costs;
  - Priority rating;
  - Phasing;
  - Quantifiable and unquantifiable benefits;
  - Impact on related projects.
10. The options report is submitted to the organization for preliminary approval of the likely preferred solution.

### **Design Brief**

11. A detail design brief is produced in accordance with the projects approved solution.



12. The detailed design brief leads to the production of comprehensive accurate and timely:-

- Design calculations;
- Tender documents;
- Consent and land acquisitions.

### **Tendering**

13. The tender documents dispatched to tenderers are in accordance with the project's approvals and the requirements of the detailed brief.

14. The organization has an opportunity to confirm the intention to proceed with the contract before acceptance of a tender.

15. The preferred tender is in accordance with the project's approvals and the detailed design brief is not qualified in a manner which would invalidate such approvals or exceed the detailed design brief requirements.

### Section (b): **The systems for admitting contractors to the approved list and for reviewing their performance and current viability.**

The auditor should pay attention to the following matters and ascertain whether: -

1. Procedures exist for the compilation and subsequent amendment of the approved list and frequency of overall review.
2. A committee or designated officer is responsible for compiling and maintaining the approved list.
3. Public notice has been given regarding the intention to compile the approved list.
4. Specified requirements have been prescribed in relation to advertising in local newspapers, etc and the closing date for applications.
5. Applicants for inclusion have been asked to supply full information from their operational capacity, ability and financial standing could be assessed.
6. Financial and operational appraisals of contractors have been carried out. Such appraisals should cover the following criteria:-
  - **Financial**
    - Examination of the latest three years published accounts including the application of accounting ratios and trend analysis;

- Examination of external auditors certificates;
- Consideration of the contract value in relation to the turnover of the company;
- Bank or business information reports;
- Consideration for the need to obtain performance bonds.
- **Technical**
  - Particulars of recent contracts completed by the contractor, their nature and value;
  - Trade references and personal visits, if necessary, by technical personnel;
  - Assessment of the contractor's management, labour and plant resources;
  - Information from in house systems for monitoring contractors performance.

Section (c): **The methods for the selection of contractors invited to tender**

The auditor should pay attention to the following matters and ascertain whether: -

1. The organization's policies states the methods to be adopted for the selection of tenderers e.g. open, competitive, selective, restrictive or negotiated.
2. The policies stipulate the circumstances in which the formal tendering procedures, as opposed to quotations, will apply and state the contract value above which tendering procedures are mandatory.
3. Exemption procedures exist for emergency work, single source of supply, arrangements where all suppliers charge the same price, goods and services supplied under the Provisions of the Local Authorities Act 1970.
4. A rotation system applies and the degree of flexibility allowed e.g. to include the lowest tenderer on a previous similar contract or a Contractor of the manager's choice.
5. Requirements are stated in connection with advertising in local newspapers, the period of public notice to be given and the closing date for application.
6. Final selection is based on a financial and technical appraisal.
7. Final selection of contractors is made by members or authorized officers and such selection are properly recorded.

Section (d) **The system for regulating the tendering procedures and the letting of contracts**

The auditor should pay attention to the following matters and ascertain whether: -

1. The organization has a set of policies or procedures concerning tendering and the letting of contracts and that they are formally reviewed periodically taking into account of technical, legal and financial advice.

### **Receipt of Tenders**

2. Tenders are submitted in envelopes which are clearly endorsed “Tender” giving closing date and time for receipt and some form of reference to the subject matter.
3. Instructions exist requiring that:-
  - All tender envelopes received should be endorsed with the time and date of receipt and passed to the post room even if not received through the post;
  - The post room staff or subsequent custodian do not open any tender envelope;
  - Any envelope inadvertently opened and found to contain a tender is resealed immediately and endorsed by the person opening it together with a witness;
  - Delivery is not refused simply because a tender is received late;
  - All matters pertaining to tenders are strictly confidential.

### **Custody of Tenders**

4. An officer is designated as custodian of all tender envelopes received.
5. The custodian is informed of the names of the contracts, the number of tender invitations and the closing dates and times for the receipt of tenders.
6. The custodian keeps a register of all tenders “received in time” as recorded on the tender envelope.
7. The custodian keeps a similar record of tenders “delivered late” and notifies late deliveries immediately to the officer responsible for convening opening sessions.
8. The custodian keeps all unopened tenders in a fire-proof locked cupboard until they are requested on or after the date for receipt of tenders by the officer convening an opening session.
9. The custodian keeps a record of any tenders received after tender opening and immediately informs the convenor of opening sessions of the late receipt.

### **Opening of Tenders**

10. All tender envelopes are opened at the same time, which time may not be earlier than the time prescribed for the receipt of tenders.
11. All tenders are opened by at least two senior designated officers of different disciplines, neither of whom has been involved in the tender invitation.

12. The tender openers sign the tender documents including the summary of bills of quantities as well as any correspondence from the tenderer.
13. The organization must have a policy for dealing with late tenders (received earlier before of after the time for opening) and that this policy is followed.

#### **Recording of Tenders Received**

14. A register of tenders received is compiled containing:-

##### **(a) for each contract:-**

- contract name and reference number;
- the latest date and time for receipt of tenders and;
- the names of the contractors invited to tender.

##### **(b) for each tender opened:-**

- date and time received;
- date and time of opening;
- amount of tender and;
- any qualification/ alternative offer/ unsigned tenders.

##### **(c) for each contract after the tenders have been opened and recorded:-**

- the signatures of the tender openers;
- signature of person to whom the opened tender have been passed;
- the names of those contractors not submitting a tender;
- the name of the successful tenderer recorded after evaluation and acceptance and;
- the reason for considering any late tenders.

#### **Tender Evaluation**

15. They are procedures for tender evaluation which relate to:-

- Security and confidentially,
- Any contact with tenderers,
- Any changes in tenders as submitted,

16. These procedures require, inter alia, a formal record of the following matters:-

- the Engineer's estimate;
- arithmetical check;
- rates and prices;

- percentage adjustments;
- balancing items;
- ambiguities/ qualifications;
- alternative offers;
- adjustment to tendered rates or prices made subsequent to tender;
- all contacts made with tenderers;
- running costs and;
- Technical officers' recommendation.

### **Acceptance of Tenders**

17. The Engineer's report is available to the person-authorizing acceptance of tender.
18. Acceptance of tenders, including any changes thereto, is properly reported and duly authorized.
19. Unsuccessful tenderers are informed to that effect.
20. Procedures exist for the adequate retention of all unsuccessful tenderers.

### **Section (e) The system for reviewing the suitability of Conditions of Contract and Tender documents**

The auditor should pay attention to the following matters and ascertain whether: -

1. The organization has a policy as to the Conditions of Contract to be used for civil engineering works.
2. Procedures exist for the periodic review of Conditions of Contract and the making of recommendations to the organization concerning modifications to standard forms.
3. Such procedures take account of technical, legal, and financial advice and any modification to the Conditions of Contract approved by the organization's legal services.
4. A system exists to report points of weakness or uncertainty centrally for consideration and action is taken as a result of any such report by way of examination, correction and notification to users.
5. Specific points, where considered necessary, are taken up with the Conditions of Contract Standing Joint Committee.
6. The organization has determined the type and content of documents for tendering including, for example, specific requirements relating to bribery and corruption, power to accept the tender in whole or in part etc.

7. A checking system exists to ensure that:-

- Tender documents do not contain conflicting provisions;
- Specifications do not contain conditions of contract and vice versa;
- Bills of quantities are checked for compliance with the Civil Engineering Standard Method of Measurement and that any departures are properly incorporated;
- Tender documents contain adequate particulars as to the nature of the site and soils, such information excluding statements of opinion;
- The appendix to the Form of Tender is completed as far as required by the Council e.g. minimum amount of insurance, liquidated damages.
- All sets of tender documents are identical;
- The correct documents are sent out;
- Detailed instructions are given to the tenderer as to the organization's regulations and other requirements concerning the submission and consideration of tenders.

#### Section (f) **Insurance and Bonding procedures**

The auditor should pay attention to the following matters and ascertain whether: -

##### **Insurances**

1. The inclusion of an amount of insurance cover in contracts is in accordance with the policy of the organization.
2. The minimum amount of Third Party cover required for any one occurrence is included in the Appendix to the Form of Tender.
3. Insurances are re-checked when renewal premiums become due.
4. Any recoveries made by the contractors under insurances are not duplicated by contract claims payments.
5. The contractors insurances are checked for adequacy of cover and current premiums are paid prior to him entering on the site.

##### **Performance Bonding (Surety Bonds)**

6. Performance bonds are required on contracts according to the policy of the organization.
7. Tenderers are notified of the organization's intention to require a surety bond.
8. The Bondsman is acceptable to the organization i.e a reputable financial institution.

9. The surety bond is received prior to the commencement of the work.
10. The method of payment for the surety bond is clear, e.g. included in the contractors tender price.
11. The bondsman is notified, by the organization, of any event likely to effect his responsibilities and obligations under the terms of the bond.
12. The surety bond is held in safe custody during its currency.
13. The release of the surety bond is in accordance with its terms.

### **STAGE 'B' – CURRENCY OF CONTRACT**

The continued development of interim or current audits is an attempt 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.

As with many audit activities, the auditor is not involved on a continuous basis (i.e. he is not part of a routine system) but independently examines, assesses and reports on the management controls and procedures by employing sampling techniques, spot checks, system appraisal techniques and risk analysis.

#### **Section (a) The system and documentation for providing financial information to enable costs to be adequately controlled including reporting procedures.**

The auditor should pay attention to the following matters and ascertain whether: -

1. The system provides for written monthly reports on contract and project expenditure to the organization. (Much of the detailed information will be submitted by the Engineer)
2. The contract report by the Engineer covers the following:-
  - (a) Expenditure to date and a projected final value compared with the original contract sum with a detailed breakdown over the following heads with any significant differences being subject to a detail explanation:-
    - Measured works,
    - Prime cost items,
    - Expenditure against provisional sums,
    - Dayworks,

- Contract variations excluding dayworks,
- Contractual claims,
- Contract price fluctuations.

(b) Contractual claims being listed as:-

- Those accepted in principle and value ascertained,
- Those accepted in principle but not ascertained in full,
- Those not accepted in principle.

(c) A request for additional financial provision where it is likely that the authorized sum for the contract will be exceeded beyond the authorized tolerance.

3. The project report by the Project Controlling officer covers the following:-

(a) Expenditure to date and expected final cost compared with the original estimated cost for the project including, where appropriate, all “oncosts” and listed under the following heads of expenditure:-

- Site investigation,
- Design,
- Supervision,
- Fees,
- Land acquisitions,
- Compensation payments,
- Direct works carried out by the organization,
- Materials and other services provided by the organization.

(b) A request for additional financial provision where it is likely that the authorized sum for the project will be exceeded beyond the authorized tolerance.

4. The above reports are forwarded to the organization in conjunction with technical reports on the progress of the contract works.

Section (b) **The system of on- site control regulating valuations of work for Interim payments**

The auditor should pay attention to the following matters and ascertain whether: -

1. Monthly statements are submitted by the contractor and are strictly in accordance the Conditions of Tender or the organization’s requirements.
2. Valuations of work for interim payment are based on the Contractor’s monthly statement.
3. Quantities are supported by site measurement records.



4. Rates and prices are checked to the Contract Bill of Quantities.
5. Valuations of ordered variations (including dayworks) are substantiated.
6. Amounts payable in respect of Provisional Sums and Prime Costs items are supported by receipts or other vouchers where appropriate.
7. Contract Price Fluctuations are calculated in accordance with Conditions of Contract.
8. Amounts payable in respect of any claims submitted are substantiated by particulars supplied by the Contractor.
9. Retention is determined in accordance with the Conditions of Contract.
10. Amounts payable in respect of any goods or materials on or off site and not yet incorporated in the Permanent Works are calculated as provided in the Appendix to the Form of Tender, and are subject to ascertainment of title.
11. The arithmetic correctness is checked.
12. Any amendments made by the Engineer to Contractor's monthly statements are shown clearly.
13. Contractor's monthly statements are annotated to indicate the checks carried out.
14. The net amount payable is determined by deducting any previous payments on account.

Section (c) **The system for the examination and control of price fluctuations**

The auditor should pay attention to the following matters and ascertain whether:-

1. The contract includes the formula adopted by the organization.
2. The elements and proportions of the work attributable to the price indices are included in the tender documents.
3. In those cases where tenderers challenge any elements prior to tender submission, any ensuing revisions are communicated to other tenderers.
4. The contractor submits price fluctuations claims.
5. There is a designated person responsible for checking the claims received.
6. The measurement data is consistent throughout the contract.

7. All the agreed Contract Price Fluctuation claims are properly certified.
8. Adequate records are maintained of all calculations and amounts paid.

Section (d) **The system for the control and issue of variations**

The auditor should pay attention to the following matters and ascertain whether: -

1. Variations are issued solely by those authorized to do so under the contract.
2. Variations are ordered in writing.
3. Variations specify the particular Conditions of Contract under which the order/instruction is given.
4. Copies of orders for variations are sent to the:-
  - Contractor.
  - Engineers representative.
  - Engineer.
5. A numbering sequence identifies each variation.
6. Contractors confirmation notes (of oral instructions given by the Engineer and which involve a variation to the Works) are immediately dispatched to the Engineer for acceptance or rejection.
7. Contractors written confirmations of oral instructions, if accepted, are taken into and form part of a numbered sequence.
8. Proposed major variations, and reasons therefore, are reported, and considered by organization before ordering (emergencies accepted).
9. Variations specify the method of payment at the time of issue.
10. Any payments on account are not certified until an order (for contractors written confirmation as duly accepted) exists.
11. Payments for variations are identified against a discrete order or instruction.
12. The Engineer informs the organization, on a monthly summary basis, of the net effect of variations on the cost of the Works and any necessary action required by the organization.

13. Daywork sheets are endorsed to identify the variation to which they refer, are signed (when agreed) by the Engineer's representative and are sent to the organization with original supporting documents at each monthly valuation.
14. Daywork payment rates and calculations are correct.
15. Daywork sheets are used solely for processing payments for daywork and are not used merely as a means of recording time spent on claims items and valued elsewhere.
16. The organization reviews the valuations of variations periodically and tests compliance with the organization's valuation principles and the order in which those principles are to be applied in the valuation of variations.

Section (e) **The system for the receipt and evaluation of contractual claims**

The auditor should pay attention to the following matters and ascertain whether: -

1. Consideration is given solely to claims submitted by notice in writing from the contractor.
2. Claims state the clause in the contract under which they are being made.
3. The receipt of each claim is acknowledged by the Engineer and copied to the organization.
4. Claims are numbered consecutively as they arise.
5. Any claim for a rate higher than one notified by the Engineer is properly substantiated.
6. Acknowledgements of claim notification contain instructions as to any records to be kept by the Contractor.
7. Engineer notifies the organization and the contractor of any decision in principle reached in connection with any claim.
8. On receipt of each claim (and without prejudice to the Engineer's consideration), the contractor is instructed to submit monthly interim valuations of amounts he considers due together with supporting particulars.
9. The principle of the claim has been decided by the Engineer before any payment is made.

10. Following the Engineer's decision in principle, interim payments are made on account of the claim, and that they are based on the degree of substantiation produced to date and accepted by the Engineer.
11. Payments in respect of claims are listed separately in valuations.
12. Claim settlements identify the payment of costs separately from those for profit.
13. Claims based on "cost" are ascertained as costs actually and reasonably incurred by the contractor.
14. Claims clearly identify any inclusion for price fluctuation.
15. Claims are settled individually and that no duplication of payments occurs between two or more claims.
16. The Engineer reports on claims to the organization, preferably at monthly intervals, stating:-
  - Claim number and brief details,
  - Decision in principle (if any),
  - Amount claimed to date,
  - Amount paid to date,
  - Estimate of total amount likely to be paid against the claim.
17. Claim settlements are reviewed periodically by the organization and any points of difference taken up with the Engineer using the dispute procedures in the Conditions of Contract, if necessary.

### **STAGE 'C' – FINAL CONTRACT INVESTIGATIONS**

The final account audit is easier to conduct and has more of an accounting format. To be effective, the audit be undertaken shortly after the account 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 audit is important, because it may not be contractually possible to make any alterations to the final account once the final certificate has been signed.

Where the auditor is in disagreement with the officials responsible for drawing up the account, any relevant matters should be brought to their attention at the time of the audit and should also be pointed out in an appropriate minute or report to management.

The auditor's role at this stage is independently to examine the account in order to detect weaknesses, error or fraud in the contract system. He should avoid being part of the system and relied upon to double check another person's work. His role is to inform

management of deficiencies in any system, so that management can take the necessary steps to improve the relevant system.

Section (a) **The system for ensuring that when the final account is produced, it is complete and accurate**

The auditor should pay attention to the following matters and ascertain whether: -

1. The final account is supported by detailed documentation showing how the final account value is built up.
2. The rates and prices have been checked to the contract.
3. A full arithmetical check has been carried out.
4. The measured work items have been re-measured on completion and are supported by site measurement records.
5. Variations are valued in accordance with the contract; dayworks being supported by daily agreed records of labour, plant and materials.
6. Variations are supported by the written authorization to carry out the work.
7. Where applicable, amount payable in respect of Prime Cost Items and Provisional Sums are supported by invoices accompanied by proof that these invoices have been paid.
8. On variable price contracts the Contract Price Fluctuation calculations are in accordance with the contract.
9. Where contractual claims are part of the final account, their entitlement and evaluation are in accordance with the contract.
10. Any retention monies or outstanding obligations under the contract are allowed for in determining any final amounts payable.
11. In determining the final amount payable, allowance is made for previous payments, tax matters, credits and deletion of Prime Cost Items, Provisional Sums and Contingency Items not used.

Section (b) **The system to ensure that liquidated damages have been recovered where appropriate**

The auditor should pay attention to the following matters and ascertain whether: -

1. The liquidated damages incorporated in contracts are in accordance with the policy of the organization.

2. The organization's policy on the deduction of liquidated damages is adhered to.
3. The calculation of amounts of liquidated damages represent the "genuine pre-estimate of loss" and there is a consistent method used in the calculation.
4. A permanent record is held of the calculation of the damage figure.
5. The Appendix to the Form of Tender contains amounts of damages and the periods for which each amount is to be deducted.
6. The original due date for completion of the Works, or any Section, can be ascertained from the contract.
7. The Engineer's assessment of any extensions of time granted to the contractor prior to the original due dates for completion are notified to the organization.
8. The Engineer considers "time" at the original due date for completion and notifies the organization of any initial extension of time.
9. The Engineer considers "time" again at the end of any extension of time and notifies the organization of any further extension of time.
10. The organization records all decisions as to time in the contract register.
11. The organization reduces the appropriate amount of damages recoverable by virtue of completed parts or sections of the Works.
12. The correct amount of damages is being deducted according to the extension of time and completion information on hand.
13. There has been a correct repayment of damages as a result of a revised period of extension of time being granted.
14. Where damages are repaid with interest, the correct payment of interest is made.
15. Liquidated damages are deducted by the organization when paying the certified sum and not by the Engineer on his certificates.
16. There is proper authorization for any decision not to deduct for damages.

## **STAGE 'D' – POST COMPLETION INVESTIGATIONS**

**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 organization'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' GENERAL INVESTIGATIONS**

The role of the contract auditor can include that of auditor, information specialist, liaison office or manager, dependent on the circumstances. Generally, however, the contract auditor assists management through assessing and reporting on management's efficiency and systems of controls from an independent standpoint.

#### **Section (a) The system for the examination and evaluation of any requests for an ex- gratia payment**

The auditor should pay attention to the following matters and ascertain whether:-

1. Procedures have been established by the organization for the receipt and consideration of requests for ex- gratia 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 ex- gratia 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 organization (i.e. Committee approval where necessary)

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

The auditor should pay attention to the following matters and ascertain whether:-

1. The organization 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 organization's property under the terms of the contract is listed, valued, marked as being in the organization's possession and made secure.
6. A decision on how the works should be completed has been made in accordance with the organization'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 organization 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.

### **RELATIONSHIP WITH OTHER PROFESSIONS**

Although primarily financed based, the contract auditor must be capable of liaising with persons from other disciplines and professions, which would include, architects, engineers, quantity surveyors, clerks of the works, legal officials, consultants and contractors.

The auditor is an observer of matters that are managed by these persons and therefore takes no responsibility in the running of such projects, although recommendations can and should be submitted.

It is essential that a strong working relationship between audit and other professions be established, that access to contracts matters is readily offered to the auditor by these professional persons and that they are not offered grounds for scepticism.

As a final comment, working without assistance of other professions would be detrimental to the effectiveness of the contract auditor and would in fact be unprofessional and shortsighted.

### **GENERAL**

The above information is a guideline to assist all contract auditors to fulfil their responsibilities and to perform the audit with due professional care and competence. Based on the requirements of a specific audit, it is the auditor's responsibility to develop the direction given in this guideline into a detailed audit program. It is accepted that auditors are already familiar with the planning, examination and reporting stages of an audit.

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