



CITY AUDITOR

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September 26, 2014

Honorable Patty Lent, Mayor
Members of the City Council

The City Auditor has completed the attached review of public works contracts. This project was scheduled on the 2014 work plan.

The purpose of this report was to review the process for change orders, review contract documents, and review insurance and business licenses. The recommendations are presented for city management to implement.

Responses to the recommendations from the Risk Manager and Director of Public Works & Utilities are attached. Please contact me if you have any questions or would like further assistance.

Sincerely,

Gary W. Nystul

cc: City Attorney
Director of Public Works & Utilities
Director of Financial Services
Director of Parks and Recreation

REVIEW OF PUBLIC WORKS CONTRACTS

Purpose

The City Auditor routinely reviews various funds, departments, divisions and processes. This review of public works contracts entered into or completed in 2013 was scheduled in the 2014 work plan.

Scope

This report includes public works contracts over \$25,000 either approved in 2013 or when a portion of the work of a 2012 contract was completed in 2013.

Statement of Auditing Standards

This performance audit was conducted in accordance with Generally Accepted Government Auditing Standards, except section 3.82 which requires an external peer review. Those standards require the auditor to plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for findings and conclusions based on audit objectives. The auditor believes that the evidence obtained provides a reasonable basis for the findings and conclusions based on the audit objectives.

Objectives

- Review the process for change orders
- Report compliance with requirements for insurance and business licenses
- Review contract documents

Summary of Results

- Change orders or work change directives were generally approved in a reasonable manner
- Several certificates of insurance were not obtained before work started on contracts
- There is no established procedure to obtain, review or file certificates of insurance
- When using required contract forms, the city did not always complete filling in the forms

Methodology

Minutes of the City Council meetings were searched to identify contracts or change orders that were approved in 2013. An additional review of electronic records of contracts was performed to identify any additional contracts. The documents in the official record files of the City Clerk and the electronic copies on Laserfiche were also utilized.

Background

In 2013 the city entered into more than 30 contracts with a total value in excess of \$13 million. Most were public work projects with two for materials. State law defines a “public work” as all work, construction, alteration, repair, or improvement other than ordinary maintenance.

These contracts were managed by various divisions of the Department of Public Works & Utilities including administration, water, facilities maintenance, streets, and engineering. One was managed by the Department of Parks and Recreation. Each department or division manages their own contracts.

At a November 2013 exit conference, the State Auditor’s Office released a management letter for their financial and accountability audit of the city for the year ending December 31, 2012. One matter stated that controls over change orders should be improved. Specifically, some change orders were prepared and approved after the work was completed and some appeared to be approved after the original contract end date. This report was originally intended to be a review of the change order process.

After starting this review of various contracts it was noted that the insurance certificates were not always present in the official city contract files. In addition, it appeared that many insurance certificates had not been reviewed and approved by the Risk Manager. As a result, a review of insurance coverage and certificates of insurance was added to the scope of this audit.

Businesses doing work for the city are required by most contracts to have a city business license. Section 5.02.060 of the Bremerton Municipal Codes requires any person who engages in a business activity in the city limits must first obtain a general business license. Therefore a review of licenses for businesses or firms the city contracted with was added to the scope of this audit.

Some projects were funded by various agencies of the state of Washington which require the contracts be on forms they provide. An initial review of documents indicated an inconsistency in completing the required information on some of these contract forms.

There are generally two primary types of public works projects: One is a “lump sum.” An example is to build a building or do a project for a fixed dollar amount (lump sum). Another type of contract is “unit pricing.” This is composed of several tasks, each with an estimated quantity and a stated cost. For example, a water line construction project may estimate the lengths of pipe, square footage of pavement replacement and estimated quantities of fill material. Payment on this type of contract is based on actual quantities of the various components at the stated bid price.

FINDINGS AND RECOMMENDATIONS

1. CHANGE ORDERS

Conditions or quantities on public works projects often differ between the quantities estimated in the engineering plans, specifications and bid documents, and what the contractor finds during actual construction. For example, the actual amount of fill material removed or installed may be different from the quantities listed in the bid documents. In addition, as work progresses, hidden or unknown conditions, such as unsuitable soil, can be discovered. To address changes in quantities, conditions or circumstances the standard procedure is to use a change order or a work change directive. It is very expensive to stop a contractor’s work while calculating new quantities.

A change order can be defined as a written agreement between the contractor and the city to modify the work that is listed in the contract documents as long as it is within the scope of the original project. A work change directive can be defined as a direction from the city to a contractor to perform an additional task that is not specifically stated in the contract but for which time is of the essence.

On each project there is a designated city representative. This may be either a city employee or an employee of a consulting firm. Their duties include preparing journals or logs of daily activities. They also include recording quantities of materials imported or exported. The city representative and the contractor’s representative should agree at the end of the work day on quantities and values of work completed.

When actual conditions find quantities materially in excess of quantities in the bid, a “change order” or “work change directive” should be proposed. Ideally, these changes would be approved and agreed in advance of the work being performed. However, it is often not practical to stop a project, compute quantities, and approve documents. In other situations, the final changed quantity may not be determined for some time. In some circumstances it is more practical

to adjust quantities and costs at the end of a project when there are a large number of small quantities.

City policy established in Chapter 2.76 of the Bremerton Municipal Code, gives the mayor authority to amend or change contracts. This authority is to approve change orders up to:

- 30% of a contract less than \$100,000
- 20% for contracts between \$100,000 and \$500,000
- 10% for contracts greater than \$500,000.
- Changes in excess of these amounts must be approved by the city council.

Thirteen of the reviewed contracts had change orders or work change directives. In total there were 5 work change directives and 26 change orders. The work change directives appeared to be processed in a timely manner and were all approved by the mayor.

Three change orders were to adjust quantities at the end of the project. Other change orders adjusted for changes in conditions or adding additional services to be performed. The approval process for these changes appears reasonable.

RECOMMENDATION:

Staff should continue to process work change directives or change orders as soon as practical.

2. INSURANCE

The various contracts require the vendor, consultant, or contractor to provide the city with evidence of liability and other types of insurance. This is evidenced by a certificate of insurance and should be obtained before work starts. Some contracts specifically state, for example: “before beginning work on the project described in this Agreement, the Consultant shall provide a Certificate of Insurance...”

Of the 28 contracts reviewed, only 14 had certificates of insurance in the official records file of the City Clerk. Of these, only 5 had been reviewed by the Risk Manager and one had deficiencies that were not corrected. Several certificates were found in files in other offices or were obtained after inquiry during this audit. The following table reflects the status of certificates.

Certificates of Insurance in Clerk’s File	14
Certificates in a file in another office	5
Certificates obtained after start of review	6
Contracts with no certificate	3
Certificates not reviewed by the Risk Manager	20

The documents for major projects are in a binder, which includes many pages of specifications and conditions, and has a specific place for the certificate of insurance. Professional service contracts and small works contracts do not have a bound document and thus no specific place to include a certificate. However, project managers should be aware of the requirements of the contracts and obtain the appropriate certificates.

One maintenance contract was signed by the department since the total amount was originally under \$25,000. However, after tax was added, it exceeded the \$25,000 limit requiring council approval. There is no evidence that a certificate of insurance was obtained.

One insurance certificate, reviewed by the risk manager, noted that it did not meet city requirements. However, there was no follow up to obtain corrections.

There is no city policy specifically stating that certificates of insurance be filed with the city clerk. The most logical place to keep the certificates is in the same location as the originals of the signed contracts.

RECOMMENDATIONS:

- There should be an established procedure to ensure contract language is followed by obtaining a certificate of insurance before the work starts.
- There should be a procedure to require all insurance certificates be reviewed by the risk manager.
- Establish a procedure for obtaining corrections required by the risk manager.
- A policy or procedure should be established for a specific place to file certificates of insurance.

3. BUSINESS LICENSES

The Bremerton Municipal Code requires firms engaged in business activities within the city to obtain a general business license. The various contracts also require the vendor, contractor or consultant to obtain a city business license. There is no established procedure whereby the project manager or other department employee confirms with the Tax and License Division whether the firm actually has a city license. There is also no established procedure for project

managers or others to provide information to the Tax & License Division alerting them the city has entered into a contract with a firm.

Three of the 30 firms included in this review did not have a city license. The Tax & License staff does not have the resources to compare city payments to business license files searching for unlicensed contractors.

RECOMMENDATION:

The city administration should create a simple communication procedure so all affected parties know if a vendor has a city business license if one is required.

4. CONTRACT FORMAT

Some public works projects are funded by state or federal agencies which require the use of their agency forms for contracts. Although some of these forms are poorly written, the city should be properly completing them. Some of the required blanks include information as stating who is employing the contractor, who is furnishing items not mentioned, and a liability clause. There are also two different standard contracts on the state website – one for building construction and one for highway construction.

RECOMMENDATION:

The appropriate forms should be used and care should be taken to properly complete the required contract forms before they are signed.



MEMORANDUM

DATE: September 15, 2014
TO: Gary Nystul, Auditor
FROM: Chal Martin, Director Public Works & Utilities
SUBJECT: Draft Audit Report – Review of Public Works Contracts

Review of Public Works Contracts	
CHANGE ORDERS	<p>Recommendation: Staff should continue to process work change directives or change orders as soon as practical.</p> <p>Status: Engineering staff continues to improve work flow to process change orders in a timely process.</p>
INSURANCE	<p>Recommendation:</p> <ul style="list-style-type: none">• There should be an established procedure to ensure contract language is followed by obtaining a certificate of insurance before the work starts.• There should be a procedure to require all insurance certificates be reviewed by the risk manager• Establish a procedure for obtaining corrections required by the risk manager• A policy or procedure should be established for a specific place to file certificates of insurance <p>Status: Workflow process is under review to ensure certificates of insurance are reviewed by the risk manager and corrections have been met. The Project Assistant will ensure a specific place is determined for the certificates of insurance along with the copy for the project file.</p>

Review of Public Works Contracts	
BUSINESS LICENSES	<p>Recommendation: The city administration should create a simple communication procedure so all affected parties know if a vendor has a city business license if one is required.</p> <p>Status: Project Assistant to verify if business license is needed.</p>
CONTRACT FORMAT	<p>Observations: The appropriate forms should be used and care should be taken to properly complete the required contract forms before they are signed.</p> <p>Status: Managers will review with staff and incorporate into workflow.</p>



Office of Risk Management

Memorandum

To: Gary Nystul, Auditor
From: Thelma Swem, Risk Management Specialist *JWS*
Re: Audit Report related to Review of Public Works Contracts
Date: September 22, 2014

Risk Management provides the following response to the Audit Report related to Review of Public Works Contracts:

The Risk Management Office receives insurance certificates through the mail, through email transmission, through inter-office mail, and during the contract signature routing process. Risk Management reviews every insurance certificate received to attempt to connect it to a contract entered into by the City of Bremerton. In addition to contracts, there are other occurrences which may trigger the need for insurance (i.e., mobile vendors, ambulance services, special events, etc.)

The project manager or other person responsible for ensuring contract completion and compliance for each contract should ensure the insurance certificate is received and reviewed by Risk Management prior to issuing a notice to proceed or otherwise allowing work to begin. That same individual should be tasked with ensuring new certificates are obtained and routed to Risk Management for review upon expiration and renewal of any insurance policy.

Risk Management agrees with the recommendations of the Auditor, however, any policy or procedure should be established as a city-wide contract management policy. This policy should include components related to obtaining and maintaining current insurance certificates and ensuring proper review and approval by Risk Management prior to commencing work as well as other compliance issues related to contract administration.