



Maricopa County

Internal Audit Department

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June 30, 2006

Don Stapley, Supervisor, Chairman, Board of Supervisors
Fulton Brock, Supervisor, District I
Andrew Kunasek, Supervisor, District III
Max W. Wilson, Supervisor, District IV
Mary Rose Wilcox, Supervisor, District V

As part of the annual audit plan approved by the Board of Supervisors, we reviewed Maricopa County's \$12 million Public Health/Environmental Services facility construction contract. All costs incurred from the start of construction through August 31, 2005 were examined by Jefferson Wells International, an external firm that we engaged to perform this audit.

Jefferson Wells International's examination of contract billings, supporting documentation, and resulting payments concluded that the construction company may have overcharged Maricopa County \$57,031, as of August 31, 2005. The potential overcharges were for various items including medical insurance. Several control weaknesses in the construction contract process were also noted. These include the lack of a definitive contract audit clause, which increases Maricopa County's risk of fraud, waste, and abuse due to the inability to access the construction company's records.

This report contains specific audit findings, our recommendations, and a response to those recommendations by the Facilities Management Department, the office that oversees Maricopa County's vertical construction projects. We reviewed this information with the Facilities Management Director, the construction company, and Project Manager. We appreciate the excellent cooperation provided by management and staff. If you have any questions, or wish to discuss the information presented in this memo, please contact Eve Murillo at 602-506-7245.

Sincerely,

A handwritten signature in cursive script that reads "Ross L. Tate".

Ross L. Tate
County Auditor

C: David Smith, County Manager
Joy Rich, Deputy County Manager

Executive Summary

Contract billing documentation for construction of the new Maricopa County (County) Public Health/Environmental Services facility appears to be in good order. However, we found that the construction company billed, and was reimbursed by the County, \$57,031 for potentially non-allowable procurement and medical insurance costs. The Facilities Management Department (FMD), which oversees vertical (building) construction projects, should make every effort to recover the \$57,031 from the construction company.

Introduction

The County is in the process of expanding several facilities, including the recently constructed Public Health/Environmental Services building located at 1645 E. Roosevelt Street in Phoenix. The construction contract was awarded to Holder Construction Company, LLC (Holder) based in Atlanta (GA) with an office in Phoenix. Holder performed the work under a Guaranteed Maximum Price (GMP) contract for approximately \$11.7 million. Under this type of contract, the pre-construction (design) phase of the contract is a lump sum and the construction phase is GMP, cost reimbursable with a not-to-exceed amount. The contract work was completed in June 2005.

This contract is managed and monitored, for the County, by FMD. We engaged an outside firm, Jefferson Wells International, to conduct a compliance audit of the construction costs associated with this contract.

Scope and Methodology

The objectives of this audit were to:

- Determine if the method used to establish the GMP was contractually valid.
- Determine if the work was performed in accordance with contract specifications.
- Validate payments to subcontractors and verify contractors licensing to ensure payments were made to a legal entity.

The auditors reviewed the three objectives above and found no exceptions. The report addresses the following objectives.

- Verify if the contractor's billings did not exceed actual costs or the GMP not-to-exceed amount.
- Ascertain if project costs including labor, materials, equipment, equipment rentals, disposable tools, and overhead costs represented value received and were justifiably charged to the project.

This audit was performed in accordance with generally accepted government auditing standards.

Audit Test Results

Industry standards state that a contract's general conditions should identify allowable and unallowable costs. We found that contract attachment "Exhibit A", provided by Holder, identified only allowable contract costs and omitted unallowable costs, which may be

unfavorable for the County. Industry standards also recommend that a contract contain a definitive “right to audit” clause. This contract contains a provision that the Construction Manager must preserve records for three years; however, its provision to “afford” access to records by the Owner (County and FMD) and its accountants is weaker than the recommended industry standards.

Contract billing documentation showed that Holder incurred and invoiced costs in accordance with contract terms and conditions. The total actual costs were \$11,527,818. An additional contractor fee of \$563,438 increased this total to \$12,091,256. At the time of our review, FMD had paid \$12,098,691 for the facility construction, an amount \$7,435 above the total contract costs plus the fee.

Holder also charged certain items that did not appear to be billable to the County, according to contract provisions. The \$49,596 of potential overcharges pertain to procurement and medical insurance costs consisting of:

- \$25,860 greater than the not-to-exceed procurement allowance.
- \$21,632 for Blue Cross medical premiums.
- \$2,104 for 215 shirts.

| | |
|--|-------------------|
| Contract Value and Fee Amount Paid to Holder | \$12,098,691 |
| Less: Amount Supported by Actual Cost including Fee | - \$12,091,256 |
| Equals Variance (Contract Value less Actual Cost) | = \$7,435 |
| Plus Overcharges | + \$49,596 |
| Total Amount Due from Vendor (Variance + Overcharges) | = \$57,031 |

We also found that changes were made to the contract regarding the allowance and contingency language. At the time of our review, executed change orders that authorized these changes were not yet available.

Recommendations

FMD should:

- A.** Make every effort to recover the \$57,031 overpaid to Holder.
- B.** Define specific allowable and unallowable cost provisions for inclusion in similar future contract agreements. Agreements may be modified to address other costs such as incentive compensation.
- C.** Incorporate a definitive “right to audit” clause in all future contracts, subject to the County Attorney’s Office review.
- D.** Execute formal change orders whenever a necessary change is made to the contractual amount and/or status of an allowance or contingency.

Department Response



Maricopa County

Facilities Management Department

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Date: June 23, 2006

Subject: Public Health/Environmental Services Construction Contract Audit

We have reviewed the audit report for the Public Health Clinic project prepared by Internal Audit and the audit report prepared by Jefferson Wells in support of the Internal Audit report.

We look forward to the results of any audit, as a review of practices and procedures is essential to continually improving our product. The Facilities Management Department (FMD) desires to always improve. It is with that spirit that we have reviewed the reports.

We believe the audit was very beneficial to the department and assists in improving our processes. A narrative has been attached to this document providing additional information on the issues presented. In response to the audit the Facilities Management Department submits the following response:

Issue #1: Overcharges

Facilities Management was overcharged by the contractor in the amount of \$57,031.

Recommendation A.: FMD should make every effort to recover the \$57,031 overpaid to Holder.

Response: Partially Concur

We agree that if in fact there are overcharges they should be recovered. The audit has correctly pointed out that our contracts require additional specificity as to allowable and non-allowable charges.

FMD is fully committed to recover any costs paid to the general contractor that are not in accordance with our contract documents. It is essential though that prior to any cost recovery we ensure that we have a sound contractual basis for that effort and that our position would be upheld in a court setting.

The audit references industry standards as the criteria we have been measured against. We would appreciate information as to where we may be able to obtain those standards so that we may initiate the improvement of our contracts.

We do not agree, based on the information included within the report and our contract documents that we can recover \$57,031 from the general contractor. We are certain that the variance of \$7,435 referenced as an overpayment is not correct. The auditing team did not

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have the opportunity to review the final change order that provided this information to increase the contract amount.

We do not believe the amount of \$25,860 identified as the amount over the procurement allowance to be recovered is correct. The contract documents clearly identify the process that occurs in this instance and it is the process that was followed.

The amount of \$21,632 identified for Blue Cross medical premiums does require additional research as to what it is actually for. If it is as stated by the audit we will recover the funds. If this amount is a justified expense as claimed by the contractor it is not recoverable. We will pursue further information on this issue.

The amount of \$2,104 identified for shirts also requires some additional research to determine if our contract documents identify this as an allowable or non-allowable cost. It is likely that are documents are silent on the issue and that the audit recommendation for inclusion of specific contract language is correct. This cost may not be recoverable.

Target Completion Date: September 1, 2006

Benefits/Costs: Improved contract documents

Issue #2: The contract documents only contained a section on allowable costs and not one on unallowable costs, which may be unfavorable for the County.

Recommendation B: Define specific allowable and unallowable cost provisions for inclusion in similar future contract agreements. Agreements may be modified to address other costs such as incentive compensation.

Response: Concur – in process. FMD will add contract language identifying allowable and non-allowable costs. It would be very helpful if the audit team could forward the industry standard language that provided the comparative analysis on this issue.

Target Completion Date: October 1, 2006

Benefits/Costs: Improved contract documents

Issue #3: The contract did not include a definitive right to audit clause.

Recommendation C: Incorporate a definitive right to audit clause in all future contracts, subject to the County Attorney's Office review.

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Response: Concur – In Process. FMD will clarify the currently approved County Attorney CMR contract language by changing “afford access” to “shall provide access and cooperate fully in the review of project records” to the clause.

Target Completion Date: September 1, 2006

Benefits/Costs: Improved contract documents

Issue #4: FMD did not execute change orders for changes made to an allowance or contingency item.

Recommendation: Execute formal change orders whenever a necessary change is made to the contractual amount and/or status of an allowance or contingency.

Response: Concur. This is our standard practice and the audit team did not find anything to the contrary.

Target Completion Date: No action required

Benefits/Costs: N/A

Approved By:  _____ 6/23/06
Department Head/Elected Official Date

 _____ 6-23-06
Chief Officer Date

 _____ 6/28/06
County Administrative Officer Date

Auditor's Note: A detailed response addendum submitted by Facilities Management is available upon request.