

OFFICE OF THE CITY CONTROLLER



**PUBLIC WORKS & ENGINEERING DEPARTMENT
CONTRACT COMPLIANCE AUDIT
BUILDING CONSTRUCTION PROJECTS
FOR THE PERIOD OF MAY 17, 1995
THROUGH JUNE 30, 1998**

Sylvia R. Garcia, City Controller

Judy Gray Johnson, Chief Deputy City Controller

Steve Schoonover, City Auditor



OFFICE OF THE CONTROLLER
CITY OF HOUSTON
TEXAS

SYLVIA R. GARCIA

August 2, 1999

The Honorable Lee P. Brown, Mayor
City of Houston, Texas

SUBJECT: Public Works and Engineering Department
Contract Compliance Audit
Building Construction Projects (Report No. 99-05)

Dear Mayor Brown:

In accordance with the City's contract with Mir•Fox & Rodriguez, P.C. (MFR), MFR has completed a compliance audit of 28 contracts related to construction projects pertaining to four buildings: City Hall, City Hall Annex, Police Department Headquarters at 1200 Travis, and the Public Works and Engineering Department (PW&E) building at 611 Walker. The City of Houston awarded the contracts to various contractors for work that included construction and property management, architectural design, construction renovation and improvements. PW&E's Special Projects Division was responsible for administering the contracts.

The objectives of the audit included determining if: the contractors met the objectives of the contracts and were in compliance with contract terms, PW&E personnel responsible for the administration of the contracts were in compliance with City policies and procedures, and the City's system of internal control pertaining to the contracts was adequate. MFR's report, attached for your review, identified payments for certain items that were unrelated to the scope of services as defined in the contracts, indicated a lack of accountability by City personnel responsible for managing the construction projects, and noted controls relating to the procurement process of materials and services were inadequate.

As you are aware, certain results of the audit were referred to the Office of Inspector General and later to the Harris County District Attorney's Office. A draft copy of the report was provided to Mr. Albert E. Haines, Chief Administrative Officer and Mr. Timothy Oettmeier, Inspector General. The management response indicating actions taken or being taken is appended to the report as Exhibit I.

Mayor Lee P. Brown
August 2, 1999
Contract Compliance Audit

We appreciate the cooperation extended to the MFR auditors by City personnel during the course of the audit.

Respectfully submitted,


Sylvia R. Garcia
City Controller

xc: City Council Members
Albert E. Haines, Chief Administrative Officer
Jorge Cruz-Aedo, Director, Finance and Administration Department
Jerry King, Director, Public Works and Engineering Department
Timothy Oettmeier, Assistant Chief, Office of Inspector General

July 7, 1999

Honorable Sylvia R. Garcia, City Controller
City of Houston
901 Bagby, 8th Floor
Houston, Texas 77002

Dear Controller Garcia:

In connection with the Contract Compliance Audit – Building Construction Projects, we have completed a review of the 28 contracts (the Contracts) listed in Exhibit A that were related to the construction projects pertaining to four buildings: Houston City Hall (City Hall), Houston City Hall Annex (City Hall Annex), Houston Police Department (HPD) Building at 1200 Travis, and the Department of Public Works and Engineering (PW&E) Building at 611 Walker. The City of Houston (City) awarded the contracts to various contractors for construction and property management, architectural design, construction renovation and improvement, asbestos abatement, air monitoring, lab testing and engineering testing services. PW&E's Special Projects Division was responsible for administering the contracts.

The objectives of our review included:

- Determining that the contractors met the objectives of their contract and that they were in compliance with the terms of their contract.
- Determining that PW&E personnel responsible for the administration of the Contracts were in compliance with City policies and procedures.
- Ascertaining that the work performed by contractors was within the scope of the contract approved by the City and that the City's systems of internal control pertaining to the Contracts were adequate.
- Identifying the source of funds used by the City to pay for the services performed under the Contracts being tested and determining the appropriateness of such funding.

The scope of our review was from May 17, 1995 to June 30, 1998 and consisted of the following procedures:

- Located and obtained certain PW&E construction project and contract files related to the Contracts which were referred to the Office of the Inspector General (OIG) and later to the Harris County District Attorney's Office.
- Prepared and maintained an electronic database containing a listing of the files that were received from PW&E and certain vendors.

- Facilitated access to the files by PW&E, OIG and other City personnel.
- Prepared summaries of the contractor's pay estimates and corresponding cash allowances and reconciled them to the amounts recorded in the City's Financial Management System (FMS).
- Identified areas of high risk that related to the Contracts pertaining to the four building projects.
- Gained an understanding of the scope of work performed by the contractor for each contract selected for testing by obtaining and reviewing the selected Contracts, change orders, work change directives (WCDs), proposed modifications and correspondence files.
- Obtained and reviewed the bid tabulation documentation, Requests for Council Action (RCA's), and insurance and bond documentation for adequacy and compliance with the City's policies and procedures.
- Tested the payments made by the City and received the supporting documentation to ensure that the proper funds were charged and that work performed was in compliance with the scope and terms of the contract.
- Reviewed cash allowance source documentation that was maintained by the construction contractors.
- Reviewed supporting documentation at the Southwest Hines Management, Inc. office that pertained to the 1200 Travis Building property and construction management contract.
- Prepared for and consulted with the OIG and the Harris County District Attorney's Office regarding certain transactions that may potentially violate City and/or State of Texas laws.
- Coordinated with PW&E's consulting firm of Greyhawk North America, LLC to reduce potential duplication of effort.

Our procedures were performed through February 26, 1999 and have not been updated since that date.

Major Findings

The major findings, described in detail on the following pages of this report, are as follows:

- The City made payments for certain items that were unrelated to the scope of services as defined in the Contracts.
- There was a lack of accountability by City personnel responsible for managing the construction projects.
- Controls relating to the procurement process of materials and services were inadequate.

Honorable Sylvia R. Garcia, City Controller
July 7, 1999
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Major Recommendations

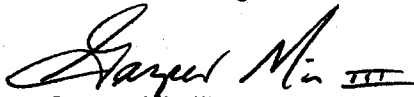
PW&E should review and revise its processes related to the management of construction projects. The review should include the following:

- An evaluation of the purpose and practices relating to cash allowance provisions in construction contracts.
- Development of policies and procedures to define and assign accountability to key personnel related to the construction projects.
- An examination of processes pertaining to procuring certain materials and services related to construction projects.

Mir•Fox & Rodriguez, P.C. is pleased to have assisted you with this project and we appreciate the assistance and cooperation of the Office of the Inspector General, Department of Public Works & Engineering and their contractors.

Very truly yours,

Mir•Fox & Rodriguez, P.C.


Gasper Mir, III
Principal

CITY OF HOUSTON

BUILDING CONSTRUCTION PROJECTS

February 26, 1999

**City of Houston
Building Construction Projects**

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**City of Houston
Building Construction Projects**

Overview of the Four Building Construction Renovation Projects

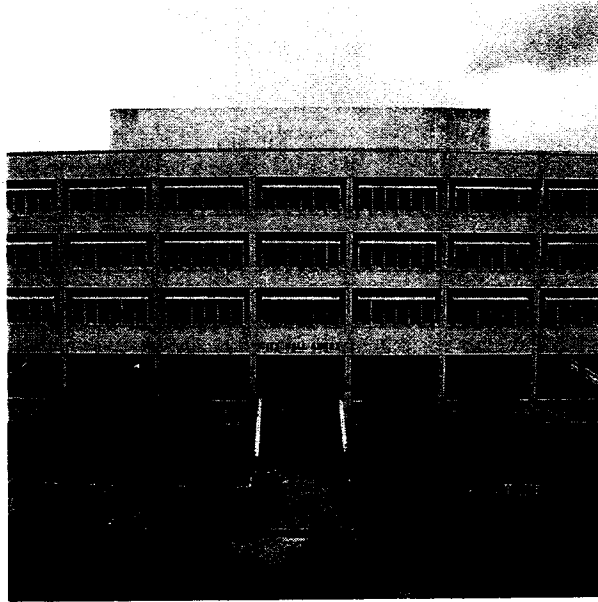
Since May 17, 1995, the City has been in the process of renovating four buildings in the downtown area. The City's PW&E Department was responsible for overseeing the four renovation projects pertaining to City Hall, City Hall Annex, HPD Building and the PW&E Building. The majority of the renovation work was performed under the direction of the Special Projects Division (the Division) which was in the Engineering, Construction, and Real Estate Group (ECRE) of PW&E. We reviewed a total of 28 contracts that were related to these four renovation projects. See Exhibit A for a listing of the Contracts including the description of services and contract amount. Our understanding of the projects is as follows:

**CITY HALL
901 BAGBY**



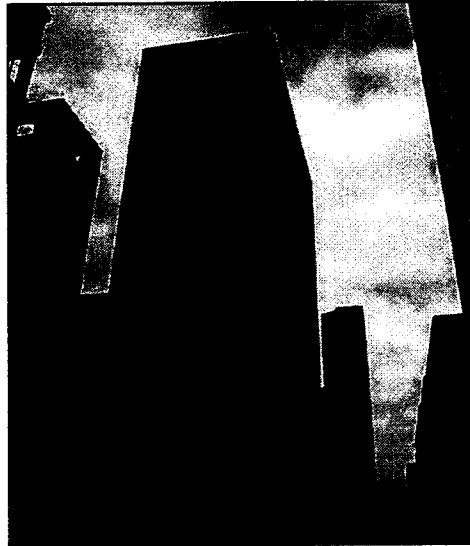
City Hall is located at 901 Bagby Street. City Council approved a Request for Council Action (RCA) on May 17, 1995 for the renovation of City Hall. Renovations began during June 1995. Ray Bailey Architects, Inc. (Ray Bailey) was the architect on the project. The construction was managed by CRSS Constructors, Inc. Mission/Bufete Industrial, Inc. (Mission) and Professional Services Industries, Inc. (PSI) performed the construction and the engineering testing, respectively. Asbestos consulting and asbestos abatement was performed by Kenneth Balk & Associates, Inc. and Certified Abatement System, Inc., respectively. Humphries Construction Corporation (Humphries) performed basement walls and terrace renovations. In addition, construction was delayed a couple of months due to a fire in October 1995. The project was not substantially completed as of February 26, 1999.

**CITY HALL ANNEX
900 BAGBY**



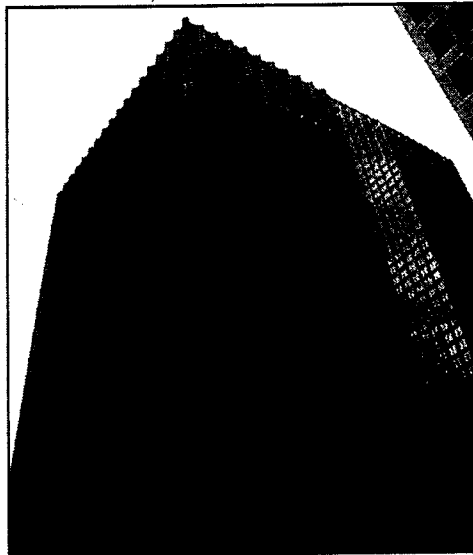
City Hall Annex is located at 900 Bagby Street. City Council approved the RCA for the City Hall Annex Renovation Project on June 26, 1996. Renovations began during July 1996. UBA, Inc. (UBA) and Aster, LLC. performed the construction and the engineering testing, respectively. The project was substantially completed by January 1997. The project was closed on October 21, 1998.

**HOUSTON POLICE DEPARTMENT BUILDING
1200 TRAVIS**



HPD headquarters is located at 1200 Travis and was purchased by the City during October 1994. City Council approved the HPD Renovation Project on June 19, 1996. The development and property management was performed by Southwest Hines Management, Inc. (Hines). Constructors & Associates, Inc. (Constructors) and Hercules Engineering & Testing Services, Inc. (Hercules) were awarded their contracts in July 1996 and they performed the construction and engineering testing, respectively. Asbestos abatement, demolition of the old interior fixtures and corresponding old material disposal was partially performed by American Resources, Inc. during the Spring of 1996. However, the remaining work was completed by Constructors. The project was substantially completed in December 1996. Constructors' contract was not closed as of February 26, 1999.

**PUBLIC WORKS & ENGINEERING BUILDING
611 WALKER**



PW&E headquarters is located at 611 Walker and was acquired by the City during January 1996. City Council approved the 611 Walker Renovation Project on June 25, 1997. Renovations began July 1997. The design and construction management was performed by 3DI International, Inc. Constructors and Jerdon Enterprise, Inc. (Jerdon) were the construction contractors. The engineering testing services were performed by Paradigm Consultants, Inc. and Maximum Technologies, Inc. LVI Environmental Services, Inc. (LVI) performed the asbestos abatement, demolition of the old interior fixtures and the old material disposal. The project was not substantially completed as of February 26, 1999.

CONSTRUCTION CONTRACTS

Introduction

Six of the twenty-eight contracts for the four building projects were for construction services. The following are the contract prices for the construction contracts and their respective cash allowance provisions.

Building Project	Contract Number	Contractor	Contract Amount	Allowance Amount
City Hall Basement and Terraces	C36695	Humphries	\$ 1,788,177	\$ 0
City Hall Renovation	C35405	Mission	7,645,000	456,055
City Hall Annex Public Level Renovations	C36701	UBA	340,000	50,000
1200 Travis HPD	C36706	Constructors	16,884,026	270,000
611 Walker Renovation	C37959	Constructors	35,287,000	6,500,000
611 Walker Tunnel	C37208	Jerdon	2,720,000	121,000

During our review of these construction contracts, we noted significant issues pertaining to cash allowances, project scheduled completion dates and work change directives.

Cash Allowances

Background

Construction contracts awarded by the City generally include a cash allowance provision. The purpose of the cash allowance is to cover the costs of those items that cannot be estimated at the time the contract is approved and authorized.

Cash allowance amounts are included in the construction contract price and are defined within the contract documents. The contracts indicate that the cash allowance can be used for services, utility relocations, permits, or other such capital costs that are related to the specific project. The cash allowance can only be used to cover the actual cost of the item or service. According to the General Conditions of the construction contract, the contractor's overhead can not be included in the cash allowance amount paid by the City.

In addition, the General Conditions of the contract require the contract price to be adjusted by a change order when costs are more or less than the allowance amount authorized. The amount of the change order should represent the difference between actual costs and the amount of the allowance stated in the contract documents.

Cash allowance provisions were not specified in any of the RCAs for the construction contracts with cash allowances. City Council is generally provided only the RCA to review as a basis to approve the construction project. As a result, City Council was not made aware of the specific amount or purpose of the cash allowances that was included in the aggregate amount approved for each construction contract.

The aforementioned RCAs and corresponding contracts were approved by City Council for only the specific construction projects.

During construction, the contractor usually initiates the process for expenditures pertaining to the cash allowance in their contract. When the contractor wants to perform a service utilizing the cash allowance, they will submit a letter requesting authorization to purchase materials, equipment or services to the Project Engineer or City Engineer. After the contractor's request is approved by the Assistant Director of PW&E, the contractor performs the specified service. Upon completion of the services, the contractor submits supporting documentation in their payment requests to the City for reimbursement.

Findings and Recommendation

Findings:

During our review of the five construction contracts that included cash allowance provisions and the related supporting documentation, we noted the following exceptions:

1. The cash allowance amount reimbursed by the City to the contractor was usually the estimated costs included in the authorization requests, not the actual amount paid by the contractor to their suppliers. The City's records did not contain any documentation from the construction contractor to verify the actual amount(s) paid by the construction contractor.

2. Reimbursements to the contractors for the cash allowance amounts were for certain services or items outside the scope of work specified in the construction contract. In addition, it appeared that some of the out of scope items paid through the cash allowance were initiated by the Division's employees instead of the contractor. Although the contract requires that the cash allowance be used for "any items of extra work if approved by the Director of PW&E", there was no provision in either the contract or the RCA that the allowance could be used for items outside the scope of the contract. The following is a summary of the cash allowance transactions that were not within the scope of services of the related contracts for the period of inception to June 30, 1998:

Contractor	Contract Number	Allowance Amount in Contract	Out of Scope Transactions	
			No.	Amount
Mission	C35405	\$ 456,055	2	\$ 66,940
Constructors	C37959	6,500,000	23	93,300
LVI	C36562	698,000	8	82,160
Jerdon	C37208	121,000	5	71,770
Total			38	\$ 314,170

Several of the out of scope transactions pertaining to Constructor's contract C37959 relating to the 611 Walker Project were paid from the Water and Sewer Consolidated Construction Fund number 755 (the Fund). It is our understanding that only improvements to the water and sewer system are paid from the Fund that is financed by City bonds. However, we noted that certain out of scope transactions pertaining to contract C37959 did not relate to the Fund, for example, \$2,588 for the installation of a video monitor for City Council Chambers and \$1,688 for glass tops for furniture in the Mayor's Office.

3. Several payments from three of the five construction contracts with cash allowances had sales tax, overhead and other mark-ups totaling \$4,571 that were included in the amounts paid by the City. These types of expenditures are not allowed to be included in cash allowance reimbursements.

4. The construction contractor's payment documentation that was maintained by PW&E and the payment vouchers maintained by the City Controller's office did not contain adequate documentation to determine the nature and amount of items being reimbursed to the construction contractor through the cash allowance provisions.

Recommendation:

PW&E should review the purpose and practices relating to cash provisions. The RCA that is sent to City Council for approval should clearly indicate the cash allowance amount included in the contract price. All items purchased through the allowance should be done in accordance with the City's procurement policies and procedures. PW&E should also verify that all items approved for reimbursement through the contract's cash allowance are within the scope of services of the project. The contract should also require the contractor to submit actual original invoices prior to being reimbursed by the City. In addition, the payment requests should clearly itemize the invoices paid to date through the allowance and the remaining amount available.

Cash Allowance Overpayment

Background

Contract C36706 between Constructors and the City was for the renovation of the Houston Police Department Building at 1200 Travis. The original contract executed on July 1, 1996 in the amount of \$12,097,000 included a cash allowance provision of \$170,000. A contract amendment was approved by City Council in August 1996 and executed by the Mayor on October 24, 1996 that increased the contract to \$16,884,026 and the total cash allowance provision to \$270,000.

Finding and Recommendation

Finding:

During the duration of the contract, Constructors was only authorized to use \$100,000 of the \$270,000 cash allowance provision. However, Constructors received the entire \$270,000 of the cash allowance provision by erroneously including the remaining \$170,000 in the base contract amount for the payment requests that were made.

Recommendation:

The City should request a \$170,000 refund from Constructors. In addition, to avoid the risk of overpaying construction contractors in the future, PW&E should review and revise its process for preparing payment requests. PW&E should ensure that the cash allowance amounts and base contract amounts recorded on the payment requests are the same amounts as in the approved contract and change orders.

Project Completion Dates

Background

The construction contracts require that the construction contractor complete the project within a specified number of days from project commencement. The date of commencement establishes the date from which the contractor is authorized to work. The date of "Substantial Completion" is the date that the City Engineer certifies that the construction is sufficiently complete and the City can start using the asset. Failure to complete the work within the Contract's specified time may result in the contractor paying the City liquidated damages. The General Conditions of the construction contract state "the amount stipulated shall be paid to the City for each and every calendar day of delay beyond the Contract Time until the Work is substantially complete".

The number of days that were required to complete the project is determined by subtracting the "Commence Date" from the "Substantial Completion Date." The closed date of the contract is not used in this calculation.

Finding and Recommendation

Finding:

Three of the six construction contractors' projects have taken more days to complete than was specified in the contract. However, no liquidated damages have been assessed for delay beyond the contract time. We determined the contract calendar days by the days specified in the contract plus any additional days approved in the change orders. See table below for the contract days used.

Contractor	Contract Number	Commence Date	Substantial Completion Date	Contract Calendar Days	Contract Days Used	(Over) Under	Percentage Completed
Substantially Completed							
Humphries	C36695	07/22/96	02/24/98	244	582	(338)	100%
UBA	C36701	07/22/96	01/17/97	180	179	1	100%
Constructors	C36706	08/13/96	12/18/96	365	127	238	99%
In Progress at June 30, 1998							
Mission	C35405	06/26/95	N/A	601	1100	(499)	86%
Constructors	C37959	07/07/97	N/A	378	358	20	76%
Jerdon	C37208	03/03/97	N/A	438	484	(46)	99%

Recommendation:

PW&E should include as part of each construction contractor's payment request the "contract days used" and the "contract calendar days" to determine if the project is on schedule and if the City is due liquidated damages from the construction contractor. The Construction Manager should use a formal tracking system to monitor the variables mentioned above to ensure that the project remains on schedule. In addition, any delays in the project should be immediately brought to the attention of both the City Engineer and Project Engineer.

Work Change Directives

Background

According to the General Conditions of the contracts, "The City Engineer may, by Work Change Directive, order changes in the "Work" within the general scope of the Contract." Also, according to the contracts, "A Work Change Directive cannot change the Contract Price or the Contract Time. In order for the Directive to adjust the Contract Price or the Contract Time, a Work Change Directive must be incorporated in a subsequent Change Order."

Finding and Recommendation

Finding:

During our review, we noted 25 Work Change Directives totaling \$256,943 that were not processed in accordance with the General Conditions of the three construction contracts. These Work Change Directives required additional costs to be incurred and, accordingly, they should have been incorporated into a change order that would have adjusted the contract price. Because the Work Change Directives were inappropriately reimbursed through the cash allowance amounts, the procedures in the General Conditions of the construction contracts for processing and approving changes in the scope of "Work" and their associated costs were not followed by City personnel.

Recommendation:

PW&E should review and revise their procedures to ensure that their personnel comply with the terms and General Conditions of the construction contracts that they are administering. Special consideration should be given to ensuring that Work Change Directives are incorporated into change orders.

ASBESTOS ABATEMENT CONTRACTS

Background

LVI was awarded contract C36562 by the City on May 20, 1996 to perform asbestos abatement services for the 611 Walker renovation project. The contract price of \$5,096,180 included a cash allowance amount of \$698,000.

Finding and Recommendation

Finding:

The City paid \$56,340 for the following items that were not within the scope of services relating to the cash allowance provision of LVI's asbestos abatement contract:

- City Council chairs - \$33,409
- Computers and printers delivered to 901 Bagby - \$20,122
- Tote bags with a City of Houston logo - \$2,809

These transactions were paid from the Water and Sewer Consolidated Construction Fund that was used to pay for the 611 Walker renovation project.

Recommendation:

PW&E should review the purpose and practices relating to cash allowances in the asbestos abatement contracts. The City should also verify that all items approved for reimbursement through the contract's cash allowance are within the scope of services of the project.

PROPERTY AND CONSTRUCTION MANAGEMENT CONTRACTS

Property Management Operating Account

Background

Hines contracted with the City to perform both property management and construction management services for the renovation of the HPD Building at 1200 Travis. According to their Contract C35315, "the Project Manager shall use the funds in the Account (operating account) to pay the monthly operating costs of the Building". Operating costs include: security, elevator maintenance, expenses associated with the operation of the parking garage, routine office expenses (telephone, supplies, etc.) for the on-site engineer's office, the salary including benefits of the on-site operating engineer, the property management fee and other repair and maintenance costs approved by the Director of PW&E.

Hines deposited the money that they collected from the commercial tenants and the parking garage into the operating account that was maintained by Hines. The terms of the contract indicated that the revenues from the commercial leases and parking fees could be used to pay for the operating costs. To ensure that there were adequate funds in the property management operating account, Hines maintained an encumbrance log that listed all of the expenditure commitments pertaining to the operating account.

According to the Contract, "Upon each Anniversary Date, Project Manager shall pay to the City all interest accrued upon any funds then remaining in the Account, as well as all funds then remaining in the Account that exceed the amount of \$10,000".

Finding and Recommendation

Finding:

Based on the supporting documentation we reviewed in connection with the property management operating account maintained by Hines during the period of March 1995 through May 1998, rental revenue totaling \$1.8 million was received from the two commercial tenants and parking garage at the 1200 Travis location. In our review we noted that Hines paid for various costs that were related to the 1200 Travis Building project but were not operating costs as specified in contract C35315. Costs paid by Hines from the operating account included design and construction costs, fixed asset purchases, relocation expenses, fire damage expenses, asbestos work, and other miscellaneous construction type costs. In addition, an HPD sketch artist was authorized and paid to paint a portrait of the former City of Houston Mayor for \$8,000.

During September 1997, the operating account maintained by Hines had inadequate funds to pay the required operating costs. To replenish the operating account, another contractor, Hercules, was authorized by the City to remit a \$50,000 payment to Hines. The City reimbursed Hercules a total of \$55,000 under their Contract C36701. This \$55,000 included the \$50,000 paid to Hines and a 10% administrative fee of \$5,000 that was in accordance with Hercules' contract.

At the end of 1995 and 1996, Hines had balances of \$381,295 and \$189,400, respectively, in the operating account. Such balances indicate that Hines did not comply with the terms of their City contract by refunding amounts in the operating account in excess of \$10,000 at the end of each period.

Recommendation:

PW&E should review and revise its policies and procedures pertaining to the receipt and use of revenues from commercial tenants and parking garages to ensure that they are in compliance with the applicable City property management contracts. Consideration should be given to having the contracted property manager forward all of the lease revenue directly to the City. The property manager would then be provided an imprest fund for specific building operating expenditures. Each month the property manager would replenish the imprest account by requesting reimbursement for the expenses from the previous month.

PM Realty Contract

Background

PM Realty performed property maintenance services for the PW&E Building at 611 Walker for the period April 1996 through July 1998. PM Realty had also been the property manager for the previous owner of the building.

Finding and Recommendation

Finding:

During the period of April 1996 through July 1998, PM Realty performed services for PW&E without an executed contract with the City. Based on the information that was available, PM Realty was paid a total amount of \$171,484 for their services through other City contracts, including HOK Contract C36003, LVI Contract C36562 and Constructors Contract C37959 during the period April 1996 through December 1997. Inadequate documentation was available to determine how PM Realty was paid from January 1998 through July 1998.

Recommendation:

PW&E should review and revise its contracting procedures to ensure that City contracts are obtained for all property management services. The terms and general conditions of property management services should be clearly documented in a formal contract to ensure that the City's assets are adequately managed and maintained.

ENGINEERING TESTING CONTRACTS

Background

The four building projects included contracts for construction, architectural design, construction management, and engineering testing services. The scope of the engineering testing services contracts included "all subsurface investigations, material control and inspections, mix designs, sampling and testing required as authorized by the Director of PW&E".

Finding and Recommendation

Finding:

The City paid three of the five engineering testing contractors for services performed which were not within the scope of their respective contracts. These services totaled \$337,592 and included services for a project that did not relate to the four buildings as well as for asbestos testing, asbestos abatement, air monitoring and management services. The expenditures identified that were not within the scope of services of the engineering testing contracts are summarized as follows:

Building Project	Engineering Testing Contractor	Out of Scope Expenditures
City Hall	Professional Services, Inc.	\$ 80,413
HPD – 1200 Travis	Hercules Engineering & Testing Services, Inc.	197,273
611 Walker Shell & Core	Paradigm Consultants, Inc.	59,906
	Total	\$ 337,592

Recommendation:

PW&E should review and revise its procedures to ensure that all payments made to engineering testing contractors are for expenditures that were within the scope of their contract.

GENERAL ISSUES

Project Accountability

Background

The general conditions of the construction contracts define the general terms of the contract, identifies the key parties' responsibilities and documents the general rules that govern the agreement. According to the general conditions of the construction contracts, the City Engineer, the Project Engineer and the Contractor are responsible for completing the construction project. Their responsibilities and authority include:

- "The City Engineer will provide administration of the Contract as described in the Contract Documents, and will be the City's representative during construction."
- "The Project Engineer has the right to attend project meetings and visit the site at intervals appropriate to the various stages of construction to observe the progress and quality of the executed Work and to determine in general if the Work is being performed in a manner indicating that the Work, when completed, will be in accordance with the Contract Documents."
- "The Contractor shall supervise, direct, and inspect the Work competently and efficiently, devoting such attention and applying such skills and expertise as necessary to perform the Work in accordance with the Contract Documents."

In addition, according to the general conditions of the construction contract, "a Change Order is an agreement between the City Engineer and Contractor; a Work Change Directive may or may not be agreed to by the Contractor; and an order for a minor change in the Work may be issued by the City Engineer alone."

Finding and Recommendation

Finding:

Although the general conditions of the construction contracts define the responsibilities of the key parties, the construction contracts' provisions did not contain any requirements for the City Engineer to formally report results on a regular basis to responsible senior City officials.

Recommendation:

PW&E should review and revise its policies and procedures pertaining to construction contractors to ensure that accountability and responsibility of personnel related to the project are clearly defined. Consideration should be given to having weekly meetings with the City Engineer, Project Engineer, Construction Manager and the Contractor to discuss the progress of the project and any related issues. The results of the meetings would be the basis for a status report that is forwarded to senior City officials.

Procurement Process

Background

During the performance of a building renovation contract, certain unforeseen unfavorable conditions within the building are occasionally discovered that are outside the scope of the existing construction and other related contracts. These conditions may not be evident to the architect or the contractors at the time the contracts are awarded. Often these unforeseen conditions need to be corrected before the contractors can continue with their required work. In the case of existing contracts, a change order has to be prepared and approved by PW&E's management. Any change order that adjusts the contract price by more than 5% has to be approved by City Council.

Based on our discussions with certain PW&E personnel related to the four building projects we reviewed, it is our understanding that the process for approving change orders and preparing the associated RCA's require significant amounts of time and, therefore, often delays construction projects. These project delays impact the scheduling of the construction contractors, their subcontractors and the deliveries of materials to the site. Such adjustments to the scheduling may also affect the liquidated damages provision of the construction contracts and the ultimate cost of the project to the City.

Finding and Recommendation

Finding:

It is our understanding that to avoid the City's lengthy change order review process and numerous approvals, PW&E significantly increased the cash allowance amounts of the construction contracts in recent years to process construction related items. For example, the Division decided to use drywall construction on the 611 Walker project instead of the VMI panels. The estimated cost of this change in work was \$250,000. The allowance provision of Constructor's Contract C37959 was used to pay for this change in work. In addition, we were told that certain RCAs have been revised numerous times before they are presented to City Council for review and approval.

Recommendation:

PW&E should review and revise the RCAs and change order process as well as the methods of acquiring certain equipment and materials for its building projects to ensure that the authorizations are expedited. Consideration should be given to preparing formal procedures to ensure that authorizations for the RCAs and change orders are processed on a timely basis. The procedures should include a reduced number of approvals.

City of Houston
Contract Compliance Audit – Building Construction Projects
Listing of Contracts Review

Contract Number	Name	Type of Service Provided	Amount of Contract
City Hall			
C29315	Ray Bailey Architects, Inc.	Architectural	\$ 292,900
C29438	Linbeck Construction Corporation	Construction Management	154,500
C31562	PRC Roofing Company, Inc.	Roof Repairs	279,132
C32673	Kenneth Balk & Associates, Inc.	Asbestos Abatement Consultant	25,000
C33835	CRSS Constructors, Inc.	Construction Management	1,121,246
C34842	Certified Abatement System, Inc.	Asbestos Abatement	254,000
C35405	Mission/Bufete Industrial, Inc.	Renovation	7,645,000
C35406	Professional Services Industries, Inc.	Engineering Testing	155,000
C35973	AGH Engineers	Basement Walls & Terraces Renovation	202,900
C36695	Humphries Construction Corporation	Basement Walls & Terraces Repairs	1,788,177
C36696	McBride-Ratcliff & Associates, Inc.	Engineering Testing	30,000
City Hall Annex			
C36701	UBA, Inc.	Renovation	340,000
C36702	Aster LLC	Engineering Testing	5,100
HPD			
C33853	M Arthur Gensler & Associates, Inc.	Space/Facility Analysis	68,000
C34659	Charter Title Company	Building Acquisition	6,750,000
C35199	IRM International, Inc.	Telecommunications Consulting	105,400
C35315	Southwest Hines Management, Inc.	Property Management	2,878,000
C35965	American Resources, Inc.	Asbestos Abatement	3,374,000
C36706	Constructors & Associates, Inc.	Renovation	16,884,026
C36707	Hercules Engineering & Testing, Inc.	Asbestos Abatement Testing	240,000
C38054	Law Engineering, Inc.	Settlement for Asbestos	198,420
611 Walker			
C36003	Hellmuth, Obata, & Kassabaum, Inc.	Property Investigation & Inspection	125,000
C35295	3DI International, Inc.	Design, Construction & Construction Management	3,976,154
C36562	LVI Environmental Services, Inc.	Asbestos Abatement	5,096,180
C37208	Jerdon Enterprises, Inc.	Tunnel Renovation	2,720,000
C37209	Maxim Technologies, Inc.	Tunnel Testing	50,000
C37959	Constructors & Associates, Inc.	Renovation	35,287,000
C37960	Paradigm Consultants, Inc.	Asbestos Testing	500,000
TOTAL			\$ 90,545,135

EXHIBIT 1



CITY OF HOUSTON

Post Office Box 1562 Houston, Texas 77251-1562 713/247-2200
OFFICE OF THE MAYOR

Lee P. Brown, Mayor

CITY COUNCIL MEMBERS: Bruce Tatro Michael J. Varbrough Martha J. Wong Jew Don Boney, Jr. Rob Tadd Ray F. Driscoll Jean Kelley Felix Fraga
John E. Castillo Annise D. Parker Joe Roach Orlando Sanchez Chris Bell Carroll G. Robinson CITY CONTROLLER: Sylvia R. Garcia

Albert E. Haines
Chief Administrative Officer

July 27, 1999

Mr. Gasper Mir
Mir • Fox & Rodriguez, P.C.
One Riverway, Suite 1900
Houston, Texas 77056

Dear Mr. Mir:

This is to provide the management response to the contract compliance audit for the building construction projects. In June 1998, we advised the Mayor that several payments had been made through the construction contracts for the City Hall and 611 Walker renovation projects for work not related to those projects. We also requested that the City Controller audit the construction contracts and other related contracts to determine whether the Public Works and Engineering Department (PW&E) staff administered the projects appropriately, ensuring that all activities were within the scope of the work in the approved contracts. The scope of the audit was subsequently expanded to the City Hall Annex and 1200 Travis projects.

At the same time, we initiated a review of the City's overall building management practices, including organizational structures, maintenance and operating costs and general condition of over ten million square feet of building space under City ownership. Organizational and procedural deficiencies have been addressed although a comprehensive review and revision of existing policies and procedures have been deferred pending the completion of the compliance audit and investigation by the Office of the Inspector General.

The Building Services Department (BSD) was created in April, in part, to address leadership and organizational restructuring. On July 21, 1999, the Mayor appointed Richard Lewis, Deputy Chief Administrative Officer, as Interim Director for the next six months and charged him with implementing the improvement opportunities identified in the February 1999 Building Management Project Report. BSD will review, revise and implement policies which address issues such as project management efficiency and accountability; cost and schedule controls; streamlining procedures; roles and

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Management Response

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RE: Management Response to the Contract Compliance Audit
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responsibilities in facility design and construction; and information distribution to facilitate decision-making.

Cash Allowances

Recommendation: Review the purpose and practices relating to cash provisions.

The Administration agrees with this recommendation. Existing practices will be reviewed, and BSD will implement policies and procedures regarding cash allowances.

Cash Allowance Overpayment

Recommendation: Request a \$170,000 refund from Constructors and Associates. Review and revise payment request preparation process.

The Administration disagrees with the finding, noting an overpayment of \$100,000 rather than \$170,000. The original cash allowance included \$70,000 for permit fees and \$100,000 for miscellaneous expenses. The recommendation has been implemented, in part. City staff discovered the overpayment and reached an agreement with the contractor to deduct the overpayment from future change orders. The overpayment was deducted from Change Order #14, dated May 27, 1999. We recommend the audit team review their detailed findings with the City Task Force assigned to closeout the project to ensure that the amount recovered represents the full amount due the City.

The Administration agrees that cash allowance amounts and base contract amounts need to be accurately recorded on payment requests. However, cash allowances are included in the base contract amounts and deducting the cash allowances to create a new "base" contract amount is not in compliance with the contract documents. Only change orders can revise the base contract amount.

Based on preliminary investigations by PW&E and the Legal Department, PW&E has already instituted a policy that cash allowances can only be revised by change order. Work change directives and allowance authorizations are no longer utilized for cash allowance changes. All change orders are tracked on the contractor estimates. In addition, cash allowance logs will be requested with each contractor estimate.

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Project Completion Dates

Recommendation: Include "contract days used" and the "contract calendar days" as part of each construction contractor's payment request. Use a formal tracking system to monitor project schedule. Immediately bring delays to the attention of the City Engineer and project engineer.

The Administration agrees with this recommendation, and PW&E has already implemented the changes in the contractor's payment request. The project manager/engineer and Assistant Director approve each payment request, and they are aware of the schedule status. The City Engineer is notified when the schedule status involves a dispute between the contractor and the City staff.

BSD will develop and implement procedures requiring that schedules for all projects be developed early. Three teams, each reporting to a BSD Assistant Director, will be responsible for managing the project from design through construction closeout. Project tracking software will be implemented, and the project manager/engineer will monitor progress. Schedule delays will be reported up the chain of command to the Deputy Director for Design and Construction.

Work Change Directives

Recommendation: Review and revise procedures to ensure that personnel comply with the terms and general conditions of the construction contracts they are administering.

The Administration agrees with this recommendation, and BSD will address work change directives procedures in a new policy.

Asbestos Abatement Contracts

Recommendation: Review the purpose and practices relating to cash provisions including verification that items approved for reimbursement are within the scope of services of the project.

The Administration agrees with this recommendation. As noted above, existing practices will be reviewed, and BSD will implement policies and procedures regarding cash allowances. Scope of work issues will be addressed in the new policy.

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Property and Construction Management Contracts

Recommendation: Review and revise policies and procedures pertaining to the receipt and use of revenues from commercial tenants and parking garages to ensure they are in compliance with the applicable property management contracts.

The Administration agrees with the recommendation. BSD will implement a policy regarding receipt and use of revenues from commercial tenants. Additionally, in BSD, the Property Management Division will manage the maintenance of buildings while the Design and Construction Division will manage renovation projects. This separation of responsibilities should prevent the type of irregularities identified in the audit.

Engineering Testing Contracts

Recommendation: Review and revise procedures to ensure that all payments made to engineering testing contractors are for expenditures within the scope of their contracts.

The Administration agrees with this recommendation, and PW&E will address scope of work issues in a new policy.

Project Accountability

Recommendation: Review and revise policies and procedures pertaining to construction contracts to ensure that accountability and responsibilities of project personnel are clearly defined. Consider weekly meetings and status reports.

The Administration agrees with this recommendation in part. BSD will issue directives addressing the level of accountability for project personnel when the Director has finalized the organizational structure for the department. We do not agree with conducting weekly meetings with the City Engineer, project engineer, construction manager and contractor or issuing weekly status reports. Most large projects do not achieve measurable results within one week. Monthly reports would be more beneficial. The Parks to Standard Program, for example, has maintained monthly status reports which are distributed to the owning department and the Facilities Construction Assistant Director. Additionally, regular job meetings are held with the architect, owning department, project manager and contractor. Issues not resolved in these meetings are brought to the attention of senior construction officials or the City Engineer.

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Procurement Process

Recommendation: Review and revise the RCA process, the change order process and the methods for acquiring certain equipment and materials for building projects to ensure that authorizations are expedited.

The Administration agrees with this recommendation, noting that the findings and recommendations deal specifically with the change order process on construction projects. Additional general conditions costs and schedule delays have been incurred due to the lengthiness of the change order process. BSD will examine the change order process, including the legal requirements, for possible improvements.

In summary, we are in agreement with your recommendations for increased accountability among project personnel and a critical review of policies and procedures. We appreciate your validating our preliminary findings and recommendations from last year and for the opportunity to respond to this report. If you have any questions, please contact me at 713-247-2577.

Sincerely,



Albert E. Haines
Chief Administrative Officer

AEH:JSS/afw

Management Response

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