



Lexington-Fayette Urban County Government  
OFFICE OF INTERNAL AUDIT

## **MANAGEMENT ACTION PLAN PROGRESS REPORT**

DATE: July 21, 2014

TO: Jim Gray, Mayor

CC: Sally Hamilton, Chief Administrative Officer  
Glenn Brown, Deputy Chief Administrative Officer  
Aldona Valicenti, Chief Administrative Officer  
William O'Mara, Commissioner of Finance & Administration  
Todd Slatin, Director of Purchasing  
Phyllis Cooper, Director of Accounting  
Susan Straub, Communications Director  
Urban County Council Members  
Internal Audit Board Members

FROM: Bruce Sahli, CIA, CFE, Director of Internal Audit  
Teressa Gipson, CFE, Internal Auditor

RE: Change Order Process Management Action Plan Progress

### **EXECUTIVE SUMMARY**

On August 23, 2013 the Office of Internal Audit issued the Change Order Process Audit Report. The 2013 audit report contained several findings related to non-compliance with CAO Policy 15R, inaccuracies and omissions in PeopleSoft Contract Database, lack of a formal contractor evaluation process, project cost analysis not performed, and project cost status not being consistently reflected in the change orders.

This review is provided for management information only. It is not an audit and no opinion is given regarding controls or procedures. The period of review included procedures and processes occurring during October 1, 2013 through March 31, 2014.

A summary of the findings from the original audit report and a summary of the results of our follow-up are provided in the table below. The original findings, management's original responses, and details of the results of this follow-up are contained in the **ORIGINAL AUDIT RESULTS AND FOLLOW-UP DETAILS** section of this report.

<b>Finding or Risk Observation</b>	<b>Summary of Original Finding</b>	<b>Follow-Up Results</b>
Finding 1 High Priority	CAO Policy #15R Not Consistently Complied With	The CAO notified Directors via email and during a Directors Meeting that CAO Policy 15 and 15R was under review and to comply with the current version. In September 2013, a committee designed to evaluate the Policy concluded that it was adequate and should not be changed. Our testing noted compliance with the Policy in most areas; however, there were still instances of non-compliance in the reporting of the cost percentage effect of change orders.
Finding 2 High Priority	PeopleSoft Contract Database Contains Inaccuracies and Omissions Affecting Purchasing's Ability To Monitor Projects and Change Orders	A PeopleSoft service provider has addressed the issue regarding the ability to add a requisition to an existing PO. We obtained a copy of the Standard Operating Procedures for Change Requests and Change Orders and noted that it was consistent with the previous audits' recommendation, and management represented that the revised SOP had been redistributed to the appropriate Purchasing personnel. We tested some change orders and noted there were still some issues. The Director of Purchasing should work with the Commissioner of Finance & Administration and the CIO to determine if the Project Costing Module can be better utilized.

Finding 3 High Priority	No Formal Contractor Evaluation Process Exists (Repeat Finding From 2005 Audit)	The Division of Central Purchasing researched contractor evaluation programs used by other government entities and found that in most cases there were no formal, organization-wide systems in place. Purchasing represents that implementing a contractor evaluation system would be costly. The Office of Internal Audit reiterates the importance of documenting poor contractor performance and providing a formal evaluation that can be examined by other Divisions considering such a contractor for work.
Finding 4 High Priority	Project Cost Analysis Not Performed (Repeat Finding From 2005 Audit)	The Director of Purchasing maintains that the project manager should track, monitor, and analyze project cost at the Divisional level. We recognize this position has some merit because Purchasing may not have the requisite expertise to properly analyze project costs. We recommend a project cost analysis be performed by the responsible Division's project manager, and that the Division's Director and/or Commissioner review the project cost analysis to increase accountability of project costs.
Finding 5 High Priority	Change Orders Not Consistently Issued to Reflect Changes in Project Cost Status	Purchasing has several versions of the draft regulations they plan to finalize and present to the Council when they return from summer break.

## ORIGINAL AUDIT RESULTS AND FOLLOW-UP DETAILS

### **Original Finding #1: CAO Policy #15R Not Consistently Complied With** **Priority Rating: High**

#### **Condition:**

CAO Policy #15R established a standardized format for contract change orders. In our testing of change order documentation, we found numerous instances where Divisions did not supply all required information to Council as required by this policy, as noted below:

- In 20 out of 26 (77%) instances, a completed “Contract History Form” was not provided as required.
- In 14 out of 26 (54%) instances, supporting documentation for the change order, such as an itemized listing of the additional work to be done by the contractor from either the contractor or LFUCG staff, was not provided as required.
- In 17 out of 26 (or 65%) instances, the percentage change to the total contract amount resulting from the change order was not provided.
- In 6 of 26 (23%) instances, the revised contract amount (with change order) was not submitted as required.
- In 4 of 26 (15%) instances, change orders were not sequentially numbered as required.
- In 5 of 12 (42%) instances, the close out change order was not labeled “final” as required.
- In 8 out of 8 (100%) instances, the cumulative dollar amount of all previous project change orders was not provided as required.

#### **Effect:**

Council may not be receiving enough information to adequately assess the reasons for change orders or in determining whether they are justified.

#### **Recommendation:**

The Office of the CAO should issue a memorandum to all Commissioners and Directors reminding them of the requirements of CAO Policy #15R when submitting change orders to Council for approval. In addition, since CAO Policy #15R was last revised in July 2002, it is also recommended that the Policy be reviewed to determine if its requirements meet the current information and documentation needs of the LFUCG.

**Chief Administrative Officer Response:**

I totally agree and will issue a memo to follow existing policy until we revise it. In the meantime we will form a committee to review the policy in light of your recommendations. I think we will also arrange a short training session after we update the policy. This session will assure that the employees understand the policy and the importance of following it. I agree that it is imperative that Council receive quality information on which to base their decision.

**Follow-Up Detail Results:**

The CAO notified Directors via email and during a Director's Meeting that CAO Policy 15 and 15R was under review but to comply with it in its current state. A committee meeting was held in September 2013 which included individuals who were responsible for the majority of LFUCG's change orders (i.e. Water Quality, Engineering, Building Maintenance, Traffic Engineering, Grants, and Purchasing). The committee concluded that the Change Order Process as outlined in CAO Policy 15 and 15R was adequate and should not be changed.

We tested the nine change orders approved during our review period and noted compliance with the CAO Policy in most of the areas previously audited; however, there were still issues noted with the percentage of change not being added to the Contract Change Order. In 4 of 9 change order contracts (44%) the change order percentage was not included. In these instances, percent of change was not on the format of the form used to communicate the change order activity.

We recommend the current change order reporting format requiring the reporting of percent of change as provided in CAO Policy 15 be consistently used.

**Chief Administrative Officer Response:**

I agree with the recommendation and will reiterate to Directors the importance of this.

**Original Finding #2: PeopleSoft Contract Database Contains Inaccuracies and Omissions Affecting Purchasing's Ability To Monitor Projects and Change Orders**  
**Priority Rating: High**

**Condition:**

The Division of Purchasing maintains purchase order and change order information on any new project which exceeds \$20,000 and requires Council approval by using the contract feature in the PeopleSoft System. All relevant purchase order and change order activity for these projects can be posted and assigned by purchasing staff to the appropriate contract

using this functionality, providing a useful contract database tool to monitor, track, and evaluate projects and change orders. Project managers in other Divisions can find the information provided by this feature useful for similar reasons.

However, our testing noted that financial information provided with this feature was often inaccurate or incomplete. PeopleSoft System processing problems contributing to these exceptions included the inability of data entry personnel to copy change order purchase requisitions to existing contract purchase orders (which would provide a concise contract transaction history viewable on one screen), and problems with change order transactions sometimes being automatically assigned by the system to the wrong contract when the vendor had multiple active contracts. The lack of proper training on this PeopleSoft feature may also have contributed to these exceptions. The results of our testing are noted below:

- In 10 out of 26 (38%) instances, the projects were not set up using the contract feature.
- In 8 out of 26 (31%) instances, the change orders were not properly described in their item description field as change orders, and as a result could not be immediately identified.
- In 9 out of 16 (56%) instances where projects were entered into the PeopleSoft contract feature, the change orders for these projects were not posted or applied correctly.
- In 4 out of 16 (25%) instances where projects were entered into the PeopleSoft contract feature, the data included additional extraneous and irrelevant purchase order information not related to the project and related contract.
- Only 2 of the 16 (13%) instances where projects were entered into the PeopleSoft contract feature were found to be free of data errors, omissions, or discrepancies.
- Only 2 of the 16 (13%) instances where projects were entered into the PeopleSoft contract feature reconciled with the total dollar amounts of original contracts and change orders contained in the Council Clerk's Index Database.

**Effect:**

Due to the errors and omissions, it does not appear the contract feature can be reliably and effectively used by Purchasing and other end users as a financial information resource to monitor Council approved projects and their related contracts and change orders.

**Recommendation:**

The Division of Purchasing should work with the Division of Enterprise Solutions in an attempt to resolve the PeopleSoft contract feature issues and make the information obtained from this resource more reliable and accurate. We also recommend the PeopleSoft

functionality used for these types of projects and their related contracts be evaluated by Purchasing, Enterprise Solutions, and a sample of other users to determine if it is addressing LFUCG's informational needs and business requirements. Once this evaluation is completed, a standard operating procedure (SOP) and any necessary PeopleSoft Job Aids should be developed and communicated to all appropriate personnel who are responsible for entering this information into PeopleSoft. Additional training on the use of this feature should be provided where needed.

In the interim, we recommend the Division of Purchasing conduct a periodic review of a sample of contracts and their related purchase orders and change orders to provide reasonable assurance they have been properly entered into PeopleSoft and assigned to the correct project. Purchasing may consider working with the Division of Enterprise Solutions to develop a query which would facilitate this review and pinpoint problem areas.

**Director of Purchasing Response:**

Purchasing will continue working with Enterprise Solutions to verify that the issue that prevented requisitions from being added to existing purchase orders has been fixed. Adjustments will be made to the existing SOP to ensure that requisitions for change orders are added to the correct original purchase order.

**Commissioner of Finance & Administration Response:**

Commissioner of Finance concurs with the response from Purchasing.

**Follow-Up Detail Results:**

**We obtained documentation from Enterprise Solutions which included notes from the service provider indicating that the issue with adding a requisition to an existing PO had been corrected in PeopleSoft. We also conducted a walkthrough with Enterprise Solutions to verify that the change had been made to PeopleSoft. Additionally, Purchasing management indicated that the Standard Operating Procedures for Change Requests and Change Orders is consistent with the audit recommendation and has been reviewed and redistributed to the appropriate Purchasing personnel. We obtained the SOP's, reviewed them and agreed that they were appropriate.**

**We tested the nine change orders approved during our review period and noted compliance with the CAO Policy in most of the areas previously audited; however, there were still issues noted with the contracts not being set up in the Purchasing Module and the PO line item description not reflecting change order. In 4 of 9 change order contracts (44%) the contracts were not set up using the contract feature in the Purchasing Module. In 2 of 9 (22%) change order**

contracts, the line item description on the purchase order did not reflect it was for a change order.

We spoke with the Director of Purchasing to inquire about contracts not being set up in the PeopleSoft Purchasing Module. The Director of Purchasing stated, "We're typically not setting up contracts for projects, the contract module is really more geared towards price contracts, not capital projects. I think the best way to keep track of the cost is by attaching the change order lines to the original PO rather than have a bunch of individual PO's attached to a contract. The issue with the contract module in PeopleSoft is that if you have multiple contracts for the same vendor it's difficult to decipher which one is which. At one time we had problems attaching requisitions to existing PO's but Enterprise made some changes that have alleviated that problem. The only real problem I see is that once a PO is closed you can't go back, reopen it and attach another line to it but that only happens on rare occasions."

We determined that the Project Costing Module in PeopleSoft will track, monitor and analyze project costs; however, we were informed by Enterprise Solutions that an administrative decision was made to use this Module primarily for grants and bonded projects, and therefore not all projects are included in this Module. We recommend the use of the Project Costing Module be re-evaluated and determine if the comprehensive use of this Module can help alleviate the issues noted with contracts and improve management of all projects. We recommend the Director of Purchasing and the Commissioner of Finance & Administration work with the Chief Information Officer to determine if these issues can be addressed and better utilization of the Project Costing Module can be achieved.

**Director of Purchasing Response:**

Purchasing will confer with the Chief Information Officer to determine the feasibility of using the PeopleSoft Project Costing Module to track construction projects.

**Commissioner of Finance & Administration Response:**

We will investigate the further development of the project module in context with the evaluation of the ERP system and go forward plan.

**Original Finding #3: No Formal Contractor Evaluation Process Exists (Repeat Finding From 2005 Audit)**

**Priority Rating: High**

**Condition:**

No formal organization-wide system is in place to evaluate contractors at the completion of capital projects. After surveying several Divisions on their contractor evaluation processes, each Division appears to have their own methods for reviewing contractor performance and determining whether the contractor has met the Division's expectations for the project.

The LFUCG change order process was last audited by the Office of Internal Audit in 2005. That report identified the need for a consistent organization-wide process for documenting and reviewing contractor performance at the end of a project, and to evaluate the efficiency and effectiveness with which contractors dispensed their assigned responsibilities.

**Effect:**

Without such organization-wide contractor information to refer to, there is a risk that contractors with a history of poor performance may be awarded new projects, particularly by Divisions or Directors having no prior experience with them.

**Recommendation:**

A formal, organization-wide contractor evaluation process should be implemented by the Division of Purchasing with oversight responsibilities for the contractor data it will contain. This process should include a contractor evaluation form with uniform and objective criteria to score each contractor on their project performance. Each Division should be required to complete and submit these forms to the Division of Purchasing upon each project's completion. Information from these documents should be retained by Purchasing and entered into a contractor database. This will enable Purchasing to retrieve information on all contractors who have worked on LFUCG projects and evaluate whether a contractor's performance met LFUCG's and the respective Division's performance standards. This process may also increase objectivity and consistency in the selection of contractors based on measurable performance criteria. If a contractor bidding on a project has a clear history of performing poorly on prior projects, the Division of Purchasing should discuss with the responsible Division the possibility of not selecting such a contractor, even if they are the low bidder.

**Director of Purchasing Response:**

Purchasing will evaluate contractor evaluation processes (including cost and resource requirements) used by other similar sized municipalities to determine implementation feasibility for the LFUCG and make a recommendation to the Commissioner of Finance and Administration by December 31<sup>st</sup>, 2013.

**Commissioner of Finance & Administration Response:**

Commissioner of Finance concurs with the response from Purchasing.

**Follow-Up Detail Results:**

The Division of Central Purchasing researched contractor evaluation programs used by other government entities and stated that in most cases there were no formal, organization-wide systems in place. Purchasing determined that Louisville had a partial vendor or contractor evaluation program, while Cincinnati had nothing in place. Purchasing determined that, in general, entities using a formal, organization-wide system were much larger than the LFUCG (i.e. State of Colorado, Florida State University, Kentucky Transportation Cabinet). Purchasing also determined that many of the entities using an organization-wide system or process were structured to include a capital projects/capital planning group or division to monitor/administer the program, and/or were using a third party software package/database to manage the program.

Based on this preliminary research, the Division of Purchasing represented to us that implementation of a third party vendor evaluation software package/database to manage an evaluation program would cost in excess of \$75,000 annually on the low end, not including implementation fees. The Division of Purchasing also represented to us that development of an internal organization-wide evaluation system using commonly available software (e.g. Access, Excel) would require the addition of a buyer-level resource at an annual cost of \$60,000 to \$70,000 based on current salaries. The Director of Purchasing stated there is open communication between Purchasing and the other Divisions whenever there are issues with contractor performance in order to reduce risk factors.

The Office of Internal Audit recognizes that obtaining and using additional software to implement the recommendation may incur some costs; however, we reiterate that it is important to document poor contractor performance and provide some type of formal evaluation which can be examined by others within the LFUCG that may be considering such a contractor to work for their Division. A possible option to maintaining a contractor database might be attaching contractor performance evaluations to contracts posted in the Purchasing Module and/or the Project Costing Module.

**Director of Purchasing Response:**

Although LFUCG projects do not always go smoothly, it is a rare occurrence that a contractor performs so poorly that we do not wish to use them for future work. In

lieu of a fully developed and costly contractor performance evaluation system, the Division of Central Purchasing recommends that we use and enforce the Disciplinary Action for Failure to Perform section 10.0 of our Procurement Regulations. These regulations give us the ability to identify and discipline contractors who fail to perform per the specifications of our contracts. Per the Regulations, contractors who fail to perform may be placed on probation and/or suspended from bidding on LFUCG work for twelve to twenty-four months. The Division of Central Purchasing believes that this approach will meet the intent of the audit recommendation.

**Commissioner of Finance & Administration Response:**

I concur with the Division of Purchasing response.

**Original Finding #4: Project Cost Analysis Not Performed (Repeat Finding From 2005 Audit)**

**Priority Rating: High**

**Condition:**

The 2005 audit recommended the development of a contract database to identify any possible trends of intentional low bidding and establish a history of change order activity among Divisions, contractors, and types of projects. The Division of Purchasing currently maintains bid files on LFUCG projects for seven years as required by the State Archives and Records Commission. Included in each project file is a bid tabulation sheet which lists all the contractors who bid on the project and the amount they bid. Purchasing also maintains bid history information electronically on the LFUCG Economic Engine database. However, Purchasing does not perform any type of project cost analysis to evaluate whether the vendor awarded the bid subsequently submitted change orders significantly increasing the project cost, or whether such change order activity subsequently exceeded the bids of other vendors not awarded the project.

**Effect:**

Without comparing the actual final costs for a project to the project bids from contractors who were not awarded the project, management is not utilizing important information which could potentially identify unnecessary project cost overruns.

**Recommendation:**

The Division of Purchasing should begin tracking, monitoring, and analyzing total project costs and the effect of related change orders in conjunction with overall project bid history information in order to identify sources of potential project cost overruns. Over time, this analysis could assist in identifying contractors that consistently underbid projects and then

manipulate the change order process to recover the underbid costs and maintain profitability. Cost-conscious and well-managed contractors who consistently come in with low bids and low total costs on projects could also be identified through this analysis.

**Director of Purchasing Response:**

Overall responsibility for a projects success lies with the project manager and it is the recommendation of Purchasing that project cost continue to be tracked, monitored and analyzed at the Divisional level. Purchasing will continue to provide support and bid data from awarded and non-awarded contractors to allow Divisional project managers to include this information in their project cost analysis.

**Commissioner of Finance & Administration Response:**

Commissioner of Finance concurs with the response from Purchasing.

**Follow-Up Detail Results:**

**The Division of Purchasing indicated that they are continuing to provide support and bid data from awarded and non-awarded contractors to allow Divisional project managers to track, monitor, and analyze project cost. The Director of Purchasing maintains that project costs should continue to be tracked, monitored and analyzed at the Divisional level.**

**The Office of Internal Audit recognizes there is some merit to assigning the analysis of final costing to the project manager who sees the finished project and can analyze total project costs which includes all contracts, contract change orders, and how the final costs compares to the initial bid. It is understood that the expertise to accomplish this may not reside in the Division of Purchasing, whereas the project manager should have sufficient knowledge of the project enabling them to determine if any additional costs were based on bidding errors, if significant changes occurred in the design of the project, or if there were significant increases in the product/materials and/or construction costs. We recommend a project cost analysis be performed by the responsible project manager. The project cost analysis should be reviewed by the Director or Commissioner (if the Director is the project manager) responsible for the Division that managed the project in order to increase accountability for project cost management.**

**We also determined that bid sheets are maintained in manual files in Purchasing. This document should be attached to the related contract in the procurement contracts feature of the PeopleSoft Purchasing Module and/or Project Costing Module via the comments screens. This would aid in the manual analysis of the original bid to the total project cost.**

**Director of Purchasing Response:**

Purchasing will confer with the Chief Information Officer to determine the feasibility of using the PeopleSoft Project Costing Module and/or Purchasing Module to logically store bid tabulation sheets.

**Commissioner of Finance & Administration Response:**

We will investigate the further development of the project module in context with the evaluation of the ERP system and go forward plan.

**Chief Administrative Officer Response:**

I agree with the recommendation that a project cost analysis should be performed by the responsible project manager and reviewed by the responsible Director or Commissioner. I will emphasize this through an email.

**Original Finding #5: Change Orders Not Consistently Issued to Reflect Changes in Project Cost Status**

**Priority Rating: High**

**Condition:**

Our testing identified several contract-related purchase orders that had remaining balances because the full amount of the purchase order was not billed by the contractor and/or the full amount of the purchase order was not paid by LFUCG. The projects were then subsequently completed or cancelled and the purchase orders were closed out. According to the LFUCG Division of Purchasing Policies and Procedures Manual regarding change requests to existing purchase orders, “Any change to a purchase order that increases or decreases the contract amount for construction or professional services contracts that have been approved by Council requires a change order to also be approved by the Urban County Council.” Since the remaining balances on these purchase orders effectively represent a reduced contract amount for their respective projects, Purchasing Procedures indicate that related change orders should have been submitted to Purchasing and the Council.

**Effect:**

Council may not have been informed of decreases in the contract amounts as required by the Purchasing Policies and Procedures.

**Recommendation:**

We recommend the Division of Purchasing issue a memorandum to all Departments and Divisions emphasizing the importance of preparing change orders any time contract amounts approved by Council are changed, including reductions in the contract amounts.

The Division of Purchasing may also want to confer with the Department of Law to determine if it is necessary to require Departments and Divisions to issue change orders to reflect projects that were completed under cost due to the efficiency and effectiveness of the work performed.

**Director of Purchasing Response:**

To improve efficiency, Purchasing recommends that an acceptable threshold be established that would allow contracts to be closed under their original amount without requiring Council approval. Purchasing will consult with the Department of Law to determine the feasibility of modifying the procurement regulations to eliminate the change order requirement for completed contracts that close under budget within an established threshold. Purchasing will evaluate the requirement and make a recommendation to the Commissioner of Finance and Administration with regards to the finding by December 31<sup>st</sup>, 2013.

**Commissioner of Finance & Administration Response:**

Commissioner of Finance concurs with the response from Purchasing.

**Follow-Up Detail Results:**

**As part of the planned revision to the Procurement Regulations, the Division of Purchasing intends to modify the current requirement which states that all closed contracts must be returned to Council for approval. The proposed revision will allow for contracts to be closed without Council approval if the final contract amount is at least 90% of the original amount. The Director of Purchasing indicated he had several versions of the draft regulations but was not ready to submit them for review. He stated his plan is to have the revised regulations finalized by the end of July in order to present them to Council when they return from summer break. Since the proposed draft regulations are not ready to release, we did not evaluate them.**

**Director of Purchasing Response:**

**A revision to the Procurement Regulations is still in process and submittal to Council is expected in August or September 2014.**

**Commissioner of Finance & Administration Response:**

**I concur Procurement Regulations need to be updated and the revised Regulations be submitted after coordinating with Department of Law.**