City Auditor's Office

21-05 Project Contingency Fee Audit

Report Issued: March 25, 2022

Audit Report No. 21-05

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TO: Mayor Gunter and Council Members

FROM: Andrea R. Russell, City Auditor

DATE: March 25, 2022

SUBJECT: Project Contingency Fee Audit

The City Auditor's Office has completed the audit of project contingency fees. The audit was conducted in conformance with Generally Accepted Government Auditing Standards by the authority granted through City Ordinances 28-02 and 79-10.

We would like to express our sincere appreciation to the Financial Services Department management and staff for the courtesy, cooperation and proactive attitude extended to the team members during the audit. If you have any questions or comments regarding this audit, please contact Andrea Russell at 242-3380.

C: Rob Hernandez, City Manager
Connie Barron, Assistant City Manager
Dolores Menendez, City Attorney
Kimberly Bruns, City Clerk
Mark Mason, Financial Services Director
Audit Committee

TABLE OF CONTENTS

EXECUTIVE SUMMARY 4
BACKGROUND 4
AUDIT OBJECTIVES 4
STATEMENT OF AUDITING STANDARDS 5
FINDINGS AND RECOMMENDATIONS 5
SCOPE AND METHODOLOGY 7
APPENDIX A 8

EXECUTIVE SUMMARY

The City Auditor's Office conducted a performance audit of the project contingency fee process. This audit was completed at the request of Mayor Gunter and was not included in the City Auditor's FY22 approved Audit Plan.

Based on the test work performed and the audit recommendations noted below, we concluded overall that controls are in place for accurate processing of project contingency fees; however, controls over monitoring and policy and procedure documentation for contingency fees need improvement.

For further details on the finding and recommendation, see the Findings and Recommendations section. While we noted controls need improvement in some areas, no material control deficiencies were noted, and contingency amounts appeared to be accurate.

BACKGROUND

City projects may have a contingency fee associated with them. This fee can range from three to 15% based on contract terms which are negotiated between the City and the vendor. The contingency fee is utilized for unforeseen or additional expenditures that can arise during a project, such as scope changes, or changes in specifications. The total amount, project cost plus contingency, is presented as a total project budgeted cost on the consent agenda. Consent agenda items appear on every council meeting for approval for expenditures over $100,000 in accordance with City procurement guidelines. Total budgeted amounts for projects for FY19 through FY21 were more than $72 million. City departments utilize the Procurement Ordinance Section 2-146(g) as the only guidance for processing and handling of contract contingency fees. The responsibility of allocating and monitoring contingency fees resides with the individual departments overseeing the project contracts. At project close out, any unencumbered contingency money is returned to the fund in which the project was expended.

AUDIT OBJECTIVES

- To determine if controls are in place to ensure contingency fees are spent in accordance with City Ordinance, Financial Services policies and procedures, and project specifications.
- To determine if Financial Services monitoring of contract contingency fees is appropriate to ensure the fees are spent in accordance with project guidelines and applicable procedures.

STATEMENT OF AUDITING STANDARDS

We conducted this performance audit in accordance with Generally Accepted Government Auditing Standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

FINDINGS AND RECOMMENDATIONS

FINDING 2021-01 Contingency Fee/Contract Amendment process documentation needs improvement
Rank: High

Condition:
Process documentation
As part of the contingency fee testing, we reviewed invoices in Munis for liquidated contingency amounts. The invoices were selected from purchase orders reviewed for projects with contingency. Based on the report provided by Financial Services, we reviewed 86 invoices from several different departments including Public Works, Utilities and Parks and Recreation/Go Bonds. Any project for any department can have contingency fees associated with the contract and are not limited to the departments included in our testing. We noted all contracts appeared on the consent agenda and received appropriate approval from City Council.

Currently, the only guidance regarding contingency fees is in the Procurement Ordinance which references contract amendments. Amounts for contract amendments are reflected on the consent agenda and purchase order as contingency fees. These fees can range on average from three to 15%. According to Financial Services, expenditure of contingency fees was not previously tracked in JD Edwards (JDE), the financial accounting system in use prior to the implementation of Munis. As part of the change from JDE to Munis, outstanding purchase order amounts had to be carried forward into the new system. We noted during testing, it was difficult to confirm the carry forward balances based on the information available in Munis. In addition, when we tested individual contingency fee liquidated amounts, it was often difficult to determine if amounts were expended in accordance with the Procurement Ordinance Section 2-146(g) because of the inconsistency in how documentation of liquidation of the fees was recorded in Munis.

As shown in the table below for 50% of the sample tested, documentation to support authorization of expenditures was not attached to the invoices as support in Munis; however, the documentation is maintained by the individual departments managing the contracts.

Test Attribute:	Was documentation attached to invoices as support in Munis?	Total	%
	Yes	37	43.0%
	No	43	50.0%
	Unable to determine	6	7.0%
	Total Tested	**86**	**100.0%**

Monitoring of Contingency Fee Balances
In addition to detailed testing of purchase orders and invoices, we reviewed the monitoring process of contingency fee balances. We noted that the individual departments and divisions tested, rely on internal monitoring of contingency fees by utilizing a variety of means including tracking quantities per contract in comparison to quantities utilized on spreadsheets. This monitoring is done as a part of the project and is not specific to contingency fees. Financial Services relies on monitoring performed by individual departments, divisions, and project managers because the process is decentralized. It is important to note that each department or division we met with to discuss their contingency fee monitoring, appear to have effective processes in place to account for accurate tracking.

Criteria:
- Procurement Ordinance Section 2-146 (g) Contract Amendments: At the time of contract approval, the City Council may approve a "contract amendment" amount for funding the cost of potential changes due to unforeseen circumstances. These funds may also be used to enhance the project. The City Manager or designee is authorized to approve and execute change orders within the limits of funds available in the "contract amendment." Change orders that exceed the pre-approved amount require City Council approval.
- Best practices for contract and project administration-monitoring of costs and quantities

Cause:
- Reliance on ordinance to provide guidance
- Lack of detailed procedures from Finance for departments, divisions and project manager that describes in detail the treatment and processing of contingency fees (only documented guidance is the Procurement Ordinance section 2-146(g))
- Inconsistent recording and monitoring of contingency fee amounts

Effect:
- Potential insufficient documentation of project costs
- Potential unauthorized/unapproved use of contingency fee funds
- Potential inaccurate project costs
- Unclear process for expending contingency fees

RECOMMENDATIONS:
2021-01: To ensure accurate and authorized contingency fee expenditures and monitoring, Financial Services should work with individual departments to determine information required by both the individual departments and Financial Services and document the information in

policies and procedures. Detailed procedures should contain what information should be entered into Munis, as well as information that should be monitored at the project level.

Management Response and Corrective Action Plan:
2021-01 Select one of these boxes: ☒ **Agree** ☐ **Partially agree*** ☐ **Disagree***
2021-01 *Management will develop processes and procedures to centralize documentation supporting contingency related change orders to contracts and purchase orders.*
2021-01 **Management Action Plan Coordinator:** *Financial Services Director*
2021-01 **Anticipated Completion Date:** June 30, 2022

SCOPE AND METHODOLOGY

Based on the work performed during the planning and the assessment of risk, the audit covers the project contingency fee process in place from the period of July 1, 2020, to September 30, 2021. Testing was performed using applicable Ordinances and department policies and procedures that were in place during the scope.

We reviewed original transactions for purchase orders and invoices in the Munis system to support objective one. Sample size and selection were based on the CAO Sample Methodology. We tested 100% of the items included on the report provided by Financial Services which resulted in a sample of 92 purchase orders reviewed. For invoice testing conducted, we selected any vendor where it was indicated in Munis that contingency fees were liquidated within our scope. This resulted in a sample of 86 invoices for review. To gain a better understanding of departmental monitoring, we judgmentally selected a sample of departments or divisions to discuss monitoring procedures for objective two. The tests performed support the objectives and the determination of whether controls were in place for contingency fee processing and monitoring. For details of the objectives, see the Audit Objectives Section.

In order to achieve the audit objectives, we used data from the City's financial accounting system, Munis. The information is tested by the external auditors as part of the Annual Comprehensive Financial Report. While we relied on the external auditors' testing, we also conducted additional data reliability and reasonableness testing on the Financial Services reports that were used for sample selection and testing to gain a better understanding of report data.

Unless specifically stated otherwise, based on our selection methods, and testing of transactions and records, we believe that it is reasonable to project our results to the population and ultimately draw our conclusions for testing, findings, and recommendations on those results. Additionally, for proper context, we have presented information concerning the value and/or size of the items selected for testing compared to the overall population and the value and/or size of the exceptions found in comparison to the items selected for testing.

APPENDIX A

Finding Classification
Findings are grouped into one of three classifications: High, Medium or Low. Those findings that are categorized as low are not included in the report but rather are communicated separately to management. Classifications prioritize the findings for management to address and also indicate the level of testing required to determine if a finding's Corrective Action Plan is fully implemented in accordance with recommendations and Management's Response.

High: A finding that is ranked as "High" will have a significant impact on the organization. It is one that *prevents* the achievement of a substantial part of significant goals or objectives, or noncompliance with federal, state or local laws, regulations, statutes or ordinances. Any exposure to loss or financial impact for a High finding is considered *material*. Examples include direct violation of City or Department policy, blatant deviation from established policy and procedure, such as actions taken to circumvent controls in place, material non-compliance with federal, state or local laws, regulations, statutes or ordinances, or an area where significant cost savings could be realized by the Department or the City through more efficient operations.

High findings require immediate management attention and should take management's priority when considering implementation for corrective action.

Medium: A "Medium" finding is one that *hinders* the accomplishment of a significant goal or objective, or non-compliance with federal, state or local laws, regulations, statutes or ordinances, but can't be considered as preventing the accomplishment of the goal or objective or compliance with federal, state or local laws, regulations, statutes or ordinances. Exposure to loss or potential or actual financial impact is *significant but not material* to the Department or City. Examples include lack of monitoring of certain reports, insufficient policies and procedures, procedure in place or lack of procedure that can result in *potential* noncompliance with laws and or regulations.

Medium findings require management attention within a time frame that is agreed upon by the Department and the City Auditor. Priority for implementation of management's corrective action should be considered in light of other High or Low findings.

Low: A "Low" finding is one that warrants communication to management but is one that isn't considered as hindering the accomplishment of a significant goal or objective and isn't causing noncompliance with federal, state or local laws, regulations, statutes or ordinances. Financial impact or risk of loss is minimal to none; however, low findings can *hinder the effectiveness or quality of department operations and thus are communicated to management separately. Low ranked findings are not included in the final audit report.*

The City Auditor's Office will not follow up on the status of Low findings communicated to Management.