

CITY OF HOUSTON

Annise D. Parker
City Controller

Steve Schoonover
City Auditor



PUBLIC WORKS AND ENGINEERING DEPARTMENT LONG-TERM CONTRACTOR RELATIONSHIPS PERFORMANCE AUDIT



Report No. 2010-11



OFFICE OF THE CITY CONTROLLER
CITY OF HOUSTON
TEXAS

ANNISE D. PARKER

December 16, 2009

The Honorable Bill White, Mayor
City of Houston, Texas

SUBJECT: Public Works and Engineering Department - Long-Term Contractor Relationships
Performance Audit - Report No. 2010-11

Dear Mayor White:

In accordance with the City's contract with MFR, P.C. (MFR), MFR has completed a Performance Audit of the Public Works and Engineering Department's (PWE) Long-Term Contractor Relationships. The original objectives of the audit were to:

- Determine to what extent the use of long-term (greater than seven years) contractor relations had benefited the City.
- Determine to what extent such relationships (greater than seven years) were in compliance with the applicable procurement laws.
- Review the cost-benefit of such long-term contractor usage and the appropriateness of their continued selection.

The report, attached for your review, concluded that for specialized construction services PWE demonstrated concerns with the qualifications of the vendor and the vendor's ability to perform the scope of work, which benefited the City. Also, MFR was able to determine that PWE was acquiring services in the most economical manner. However, MFR did note two issues of an operational nature that was brought to the attention of management.

MFR had a limitation in scope pertaining to compliance with the applicable procurement laws as the City maintains the bid documentation for two years in accordance with the Texas State Library & Archives Commission requirements. Therefore, MFR had inadequate information to conclude on whether the City was in compliance with applicable procurement laws and continued vendor selection for long-term contracts.

The observations and recommendations identified during the audit are included in the body of the report. Draft copies of the matters contained in the report were provided to Department officials. The Views of Responsible Officials as to actions being taken are appended to the report as Exhibit C.

Page 2

We commend Department management for their timely efforts to take action to remedy the deficiencies identified by MFR. We also appreciate the cooperation extended to the MFR engagement team by Department personnel during the course of the audit.

Respectfully submitted,

A handwritten signature in black ink that reads "Annise D. Parker". The signature is written in a cursive style with a large initial "A".

Annise D. Parker
City Controller

xc: City Council Members
Anthony Hall, Chief Administrative Officer
Michael Moore, Chief of Staff, Mayor's Office
Michael Marcotte, Director, Public Works and Engineering Department
Alfred Moran, Director, Administration and Regulatory Affairs Department
Michelle Mitchell, Director, Finance Department



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December 9, 2009

Controller Annise D. Parker
Office of the City Controller
City of Houston
901 Bagby, 8th Floor
Houston, TX 77002

Re: Public Works and Engineering Department
Long-Term Contractor Relationships Performance Audit

Dear Controller Parker:

MFR, P.C. (MFR) has completed the City of Houston's (the City) Long-Term Contractor Relationships Performance Audit of the Public Works and Engineering Department (PWE). This audit was outlined in our engagement letter dated December 3, 2008 under Contract No. 56546, approved by City Council Ordinance No. 2004-1296.

The original objectives of our audit were to:

- Determine to what extent the use of long-term (greater than seven years) contractor relations had benefited the City.
- Determine to what extent such relationships (greater than seven years) were in compliance with the applicable procurement laws.
- Review the cost-benefit of such long-term contractor usage and the appropriateness of their continued selection.

In accordance with our engagement letter dated December 3, 2008, the scope of our audit includes any currently active long term contracts that are greater than seven years old as of September 30, 2008, either initiated by or on behalf of PWE (sole participant/spending authority).

Our detailed test procedures for the attached performance report were performed through October 23, 2009. We accomplished the objectives except for those related to compliance with applicable procurement laws and the appropriateness of continued vendor selection. These limitations occurred due to the fact that the City maintains the bid documentation for only two years in accordance with the Texas State Library & Archives Commission requirements. Our observations included in the attached report are the only matters that came to our attention based on the procedures performed.

Because of inherent limitation in controls, errors or fraud may occur and not be detected. Furthermore, the projection of any conclusions, based on our findings, to future periods is subject to the risk that the validity of such conclusions may be altered because of changes made to the system of controls, the failure to make needed changes to the system of controls, or deterioration in the degree of effectiveness of the controls.

The attached report is intended solely for the information and use of the PWE as well as the Office of the City Controller, and is not intended to be used for any other purpose.

MFR is pleased to have been given the opportunity to work on this engagement and we appreciate the cooperation received from your office and the PWE.

Very truly yours,

MFR, P.C.

A handwritten signature in black ink that reads "J. David Ahola". The signature is written in a cursive style with a large, stylized initial "J".

J. David Ahola
Principal, Internal Audit

JDA/ea



**PUBLIC WORKS AND ENGINEERING
LONG-TERM CONTRACTOR RELATIONSHIPS
PERFORMANCE AUDIT**

INDEX

| | Page |
|---|------|
| EXECUTIVE SUMMARY | |
| Background | 1 |
| Objectives and Scope | 1 |
| Overall Conclusion and Assessment | 2 |
| OBSERVATIONS AND RECOMMENDATIONS | |
| Detailed Background | 4 |
| Audit Methodology | 4 |
| Observations and Recommendations | |
| 1. Inaccurate SAP Contract Data | 5 |
| 2. Insufficient Documentation to Support Contract Amendment | 7 |
| Exhibit A – Sample of SAP Contracts Greater Than Seven Years Old as of September 30, 2008 | 9 |
| Exhibit B – Selected Contracts with Inaccurate Dates in SAP | 11 |
| Exhibit C – Views of Responsible Officials | 13 |





**PUBLIC WORKS AND ENGINEERING
LONG-TERM CONTRACTOR RELATIONSHIPS
PERFORMANCE AUDIT**

EXECUTIVE SUMMARY

Background

On September 28, 2007 MFR completed the preliminary survey of the City-Wide Long-Term Contractor Relationships Performance Audit Phase One (Phase One).

For Phase Two, the detailed fieldwork stage, MFR selected three City departments for further analysis: the Houston Fire Department (HFD), the Public Works and Engineering Department (PWE), and the Houston Airport System (HAS). This report on PWE is one of three reports issued to the City as a result of the further analysis of the selected departments in Phase Two of the audit.

Objectives and Scope

The original objectives of the audit were as follows:

- Determine to what extent the use of long-term (greater than seven years) contractor relations had benefited the City.
- Determine to what extent such relationships (greater than seven years) were in compliance with the applicable procurement laws.
- Review the cost-benefit of such long-term contractor usage and the appropriateness of their continued selection.

MFR had a limitation in scope pertaining to compliance with the applicable procurement laws as the City maintains the bid documentation for two years in accordance with the Texas State Library & Archives Commission requirements. This also prohibited MFR from determining the appropriateness of the vendor continued selection.

The scope of the audit was any currently active long-term contract that was greater than seven years old as of September 30, 2008, either initiated by or on behalf of PWE (sole participant/spending authority).



Overall Conclusion and Assessment

For specialized construction services, we noted that PWE demonstrated concerns with the qualifications of the vendor and the vendor's ability to perform the scope of work, which benefited the City. However, for the selected sample of contracts, MFR had inadequate information to conclude on whether the City was in compliance with applicable procurement laws and continued vendor selection. Since a formal cost study analysis was not available for review, MFR performed alternative procedures including inquiries and review of contract documentation. As a result of performing these procedures, MFR was able to determine that PWE was acquiring the services in the most economical manner.

MFR noted two issues of an operational nature that were brought to the attention of PWE Management during fieldwork and are as follows:

- Seven of fourteen contract start and end dates recorded in the SAP system were not consistent with the respective executed contracts. Inaccurate contract start and end dates in SAP may put PWE at risk of making erroneous payments if these contracts have remaining balances and are completed and/or expired.
- No evidence was provided to support the decision to extend the term of the contract with the vendor Severn Trent Environmental Services Inc. from five to eight years, which also included an increase of 15% to the basic service rate. Severn Trent Environmental Services Inc. was the lowest bidder when the City awarded the original contract a year earlier.



OBSERVATIONS AND RECOMMENDATIONS



Detailed Background

During Phase One of the audit, MFR obtained an electronic download of the contract data from the City's Advantage Financial Management System (AFMS). MFR identified in excess of 1,100 contracts for the entire City that were in effect for over seven years. For Phase Two of the audit, MFR obtained electronic downloads of contract data from SAP as well as a manual list of the contract data prepared by PWE. MFR reconciled the AFMS contract data download, SAP electronic contract download and the manual list of contract data provided by PWE. Through the reconciliation process, MFR identified 75 PWE contracts totaling \$590,264,095.

MFR judgmentally selected an original sample of 14 long-term contracts totaling \$540,646,419 from the population of 75 contracts. See "Exhibit A" for a listing of the contracts in the sample.

Audit Methodology

MFR performed the planning phase of the PWE long-term contractor relationships performance audit in conjunction with the HFD and the HAS long-term contractor relationships performance audits. As part of the planning phase, MFR gained an understanding of the contract data conversion process from AFMS to SAP.

To accomplish the scope and objectives of this performance audit, the MFR audit team performed the following audit procedures:

- Prepared for and conducted an entrance conference with department management responsible for administering long-term contracts.
- Conducted interviews and performed a walk through to assess operating effectiveness of management controls, and performance of related long-term contracts.
- Identified, documented, and assessed the department's processes to monitor long-term contracts.
- Researched and reviewed applicable procurement laws, policies, and procedures and determined whether the City was in compliance with the regulations.
- Verified the completeness and accuracy of the list of long-term contracts that were identified during Phase I and reconciled the significant differences.
- Reviewed the specific tasks being performed by the contractors and determined through interviews and the review of documentation, the reasons for their continued use by the City rather than utilizing City employees or other contractors.
- Determined if the original scope of contracted work had been expanded.
- Assessed, on a test basis, the level of compliance by the contractor with the scope, objectives, and contract terms by reviewing a sample of contracts and corresponding sample of support invoices.
- Performed cost benefit analysis for the selected contracts to determine whether the City was acquiring goods/services in the most economical manner.
- Obtained available market information of the costs of the services provided by the selected contract.
- Determined whether contractors identified were delinquent in payment of the City's property taxes by reviewing the tax records at the Harris County Appraisal District website.

The following exceptions were noted when MFR performed the procedures above.

OBSERVATIONS AND RECOMMENDATIONS

1. INACCURATE SAP CONTRACT DATA

Observations

During our sample selection process of long term contracts, MFR relied on the contract end date information in SAP. Based on subsequent testing, MFR identified seven of the fourteen contracts selected that had contract start and end dates which did not agree between the executed contracts and the SAP system information. No documentation was provided to support the contract date discrepancies between the two. See Exhibit "B" for a detail listing of exceptions related to the contracts tested. The underlying contract documentation identified these as contracts with less than a seven year term, which was outside of our original scope and, as a result, MFR did not perform any additional tests on these seven contracts.

According to the executed contracts, the construction projects did not have firm completion dates; however the contracts for professional services did. The business process at PWE allows setting construction contract end dates in SAP in accordance with the approximate construction project completion dates rather than actual contract end dates.

In our testing we noted the following:

Construction:

- The contract with the vendor Texas Sterling Construction was countersigned on September 2, 2008 with the substantial completion within 730 Days. The contract has three one-year options to renew. No evidence was provided to support the SAP contract end date of September 2, 2016;
- The certificate of the substantial completion for the contract with the vendor Reliance Construction Svcs LP was signed on July 21, 2008. No evidence was provided to support the SAP contract end date of December 13, 2015;
- The SAP record of the contract with the vendor Boyer Inc. corresponds with the settlement agreement signed on April 23, 2009. No evidence was provided to support the SAP contract end date of June 23, 2015;
- The certificate of completion for the contract with the vendor Underground Technologies Inc. was signed on January 28, 2009. No evidence was provided to support the SAP contract end date of June 9, 2009.

Professional Services:

- The contract with the vendor Malcolm Pirnie, Inc for engineering services had an end date of May 14, 1993; however, the contract was converted to SAP with the end date December 31, 2008. There was no evidence to conclude that the contract was appropriately closed and related funds in the amount of \$35,489 were released to the originating fund.



The contract with the vendor Lockwood, Andrews & Newnam, Inc. was a three year term contract for construction management and inspection services. Under the contract terms, work orders for the vendor services could be issued up to the contract end date November 11, 2009. In SAP the contract end date was November 30, 2015.

- The contract with the vendor Gartek Technologies, Inc. for migration of the integrated land management system to a UNIX operating system had the end date of May 23, 2009. PWE was in the process of renewing the contract for one more year. The executed contract end date was changed in SAP to October 31, 2020 by a Houston Fire Department employee on May 9, 2007.

According to PWE management, changes to the contract data in SAP are initially made by a PWE employee. The changes become effective and approved in the SAP system only after they are released by an employee in the City Controller's Office.

Inaccurate contract start and end dates in SAP may put PWE at risk of making erroneous payments if these contracts have remaining balances and are completed and/or expired.

Recommendations

MFR recommends that PWE:

- Establish written policies and procedures to close contracts that terminate or expire. The policies and procedures should require the contract to be closed in SAP and any unspent funds be transferred to the appropriate fund.
- Coordinate with the ERP Group to implement contract change management controls in SAP including contract data change authorization procedures and restriction of access to change contract data to authorized employees only.
- Coordinate with the ERP Group to modify the contract information structure in SAP to accommodate contract end dates that agree with the executed contract documentation.
- Review the contract start and end dates to ensure they are accurately recorded in SAP
- Review expired contracts for remaining balances and transfer unspent monies back to the appropriate fund(s).



2. INSUFFICIENT DOCUMENTATION TO SUPPORT CONTRACT AMENDMENT

Observation

The term of an original five year City contract with Severn Trent Environmental Services Inc., started on February 18, 2002 and was extended for three additional years during April of the second year of the original contract term. MFR was not able to obtain sufficient documentation to support the decision to amend the contract term.

The contractor was selected as the lowest bidder for the original contract. However as part of the amendment to the contract the annual cost of basic services was increased by 15% without changing the scope of services. The total cost of basic services for the original five year term of the contract was \$8,929,364 or \$1,785,873 annually. Total cost of basic services for the extended three year term is \$6,198,282 or \$2,066,094 annually.

MFR has provided details of this observation to PWE management responsible for the contract for further review and follow-up.

Recommendation

MFR recommends that PWE should:

- Review the contract amendment process, including approvals, and retain sufficient documentation to justify modifications to terms and/or conditions without rebidding.



EXHIBIT A

**Sample of SAP Contracts Greater Than Seven Years Old
as of September 30, 2008**



EXHIBIT A

Sample of SAP Contracts Greater Than Seven Years Old
as of September 30, 2008

| SAP Outlined Agreement Number | Contractor Name | Contract Start Date ¹ | Contract End Date ² | Contract Amount ³ |
|-------------------------------|--------------------------------|----------------------------------|--------------------------------|------------------------------|
| 4600000398 | Coastal Water Authority | 06/28/1968 | 06/30/2035 | \$500,000,000 |
| 4600000407 | Malcolm Pirnie Inc | 05/14/1990 | 12/31/2008 | \$176,593 |
| 4600000436 | Coastal Water Authority | 11/19/1995 | 11/30/2010 | \$6,990,058 |
| 4600000609 | Severn Trent Environmental Inc | 02/18/2002 | 02/18/2010 | \$13,616,237 |
| 4600004261 | Gartek Technologies Inc | 05/10/2007 | 10/31/2020 | \$306,766 |
| 4600008671 | 800 Dowling LP | 03/20/2008 | 03/20/2016 | \$1,600,000 |
| 4600007379 | Lockwood Andrews & Newnam Inc | 11/01/2006 | 11/30/2015 | \$ 2,874,011 |
| 4600008919 | Texas Sterling Construction | 09/02/2008 | 09/02/2016 | \$3,255,000 |
| 4600005782 | Claunch & Miller Inc | 05/04/2005 | 01/07/2016 | \$1,974,976 |
| 4600007510 | Reliance Construction Svcs LP | 12/13/2006 | 12/13/2015 | \$2,005,113 |
| 4600005897 | Black & Veatch Corp | 06/04/2001 | 12/01/2015 | \$2,404,026 |
| 4600004779 | Boyer Inc | 10/02/2000 | 06/23/2015 | \$428,798 |
| 4600004618 | Underground Technologies Inc | 11/24/2003 | 11/13/2012 | \$227,489 |
| 4600006111 | Camp Dresser & Mckee Inc | 11/13/1999 | 12/01/2010 | \$4,787,352 |
| | TOTAL | | | \$540,646,419 |

¹ Contract Start Date recorded in SAP as of May, 2009

² Contract End Date recorded in SAP as of May, 2009

³ Contract Amount recorded in SAP as of May, 2009



EXHIBIT B

Selected Contracts with Inaccurate Dates in SAP



EXHIBIT B

Selected Contracts with Inaccurate Dates in SAP

| SAP Outline Agreement Number | Contractor | Contract End Date Exceptions | |
|------------------------------|-------------------------------|------------------------------|-------------------------|
| | | Executed Contract | SAP |
| 4600008919 | Texas Sterling Construction | Undefined | 09/02/2016 |
| 4600007510 | Reliance Construction Svcs Lp | Undefined | 12/13/2015 |
| 4600004779 | Boyer Inc. | Undefined | 8/23/2015 |
| 4600004618 | Underground Technologies Inc. | Undefined | 06/09/2009 ⁴ |
| 4600000407 | Malcolm Pirnie Inc. | 5/14/1993 | 12/31/2008 |
| 4600007379 | Lockwood, Andrews & Newnam | 11/01/2009 | 11/30/2015 |
| 4600004261 | Gartek Technologies Inc. | 5/23/2009 | 10/31/2020 |

⁴ The contract date was changed in SAP subsequent to the contract population extraction in May, 2009.



EXHIBIT C

Views of Responsible Officials



EXHIBIT C



CITY OF HOUSTON
Department of Public Works &
Engineering

Interoffice

Correspondence

To: Annise Parker
City Controller

From: Michael Marcotte, P.E., D.WRE, BCEE
Director

Date: December 8, 2009

**Subject: LONG-TERM CONTRACTOR
RELATIONSHIPS PERFORMANCE
AUDIT**

Our response to the Long-Term Contractor Relationships Performance Audit performed by MFR, P.C. follows. We appreciate the recommendations made by the auditors:

Finding I – Inaccurate SAP Contract Data

Recommendation:

1. Establish written policies and procedures to close contracts that terminate or expire. The policies and procedures should require the contract to be closed in SAP and any unspent funds be transferred to the appropriate fund.
2. Coordinate with the ERP Group to implement contract change management controls in SAP including contract data change authorization procedures and restriction of access to change contract data to authorized employees only.
3. Coordinate with the ERP Group to modify the contract information structure in SAP to accommodate contract end dates that agree with the executed contract documentation.
4. Review the contract start and end dates to ensure they are accurately recorded in SAP.
5. Review expired contracts for remaining balances and transfer unspent monies back to the appropriate fund(s).

Response:

Written policies and procedures are in place to set up the Contract in the accounting system according to the business process and work flow defined in SAP. Four of the seven contracts are construction contracts that required several years to complete the construction work and close out process. Although the contract document may provide an 'estimated work days' to complete the project, a specific 'contract expiration date' is not specified. The 'contract date' mentioned in the audit report appeared to be obtained from the 'Outline Agreement' screen of SAP that was for 'validity' purpose only of the 'start' and 'end' dates, and it was not meant to be the exact 'contract' terms. Specific financial terms are set up in the underlying Project Release Order (PRO) according to the budgeted amount approved by the RCA/Ordinance. For 'Design' or 'Project Management' Contracts, there will be multiple PROs for each specific project if the same contractor is awarded, then the 'validity end' date will be modified to include the newer project estimate period. Both OA and PRO and any of the changes / modifications will need to be approved and released by the Controller's Office. When the project is completed and 'accepted' (approved by Council), a specific 'completion' date will be entered in the 'text' field and remaining funds will be returned to the fund according to the applicable policy.

**Views of Responsible
Officials**

EXHIBIT C

We do agree that specific contract start and end date for the Service Contracts are more justified (generally the contracts may not be long term). Resource Management Division Financial Management Branch will consult the ERP Team regarding any workable improvements.

Finding II – Insufficient Documentation to Support Contract Amendment

Recommendation:

Review the contract amendment process, including approvals, and retain sufficient documentation to justify modifications to terms and/or conditions without rebidding.

Response:

We agree that files must be retained in accordance with the Texas State Library & Archives Commission requirements. File documents on hand included the required official documents such as bids, contracts, amendments, and RCA's but we agree that certain administrative documents with a retention period of only 2+ years were no longer available for the auditors review.



Michael Marcotte, P.E., D.WRE, BCEE
Director

MSM:GO:db

cc: aynette Chan, Chief of Staff
Susan Bandy, Deputy Director
David Guernsey, Assistant Director
Godwin Okoro, Deputy Assistant Director
Elaine Benson, Administrative Manager

**Views of Responsible
Officials**