Internal Audit Report - Contract Compliance Cycle Audit

Department of Environmental Services: MCN Build Inc. - Contract Agreement No. 17-223-RFP

Report Date: July 16, 2019

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TRANSMITTAL LETTER

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July 16, 2019

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Director, Department of Environmental Services

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Pursuant to the contract and related statement of work for Arlington County, Virginia ("the County"), we hereby present the contract compliance cycle audit: Department of Environmental Services ("DES") – MCN Build, Inc. ("MCN") Contract Agreement No. 17-223-RFP. Our report is organized in the following sections:

Executive Summary	This section includes a background summary of the function, the objectives and approach, and a detailed description of the observation(s) noted during this cycle audit. Identified with each observation is the recommended action(s), and management's corrective action plan, including the responsible party and estimated completion date.
Background	This section provides an overview of the function within the process and pertinent operational control points and related compliance requirements.
Objectives and Approach	The cycle audit objectives and focus are expanded upon in this section as well as a review of the various phases of our approach.
Process Maps	This section illustrates process maps, which depict data flow, key control points and any identified gaps.

As described in our objectives and procedures outlined on pages 13 and 14 of this report, the observations noted are based on our analysis of the processes, documents, records and information provided to us by the County. This cycle audit focused on evaluating the soundness of internal control policies to safeguard assets and on reviewing compliance with County policies. We offer no assurances that schemes or fraudulent activities have not been, or are not currently being perpetrated by any person within the areas reviewed.

We would like to thank the staff and all those involved in assisting RSM US LLP with this contract compliance cycle audit.

Respectfully Submitted,

RSM US LLP

RSM US LLP

EXECUTIVE SUMMARY

Background

Contract compliance monitoring is an integral piece of the County's control environment. Contract compliance encompasses all contractual agreements entered into by the County. The focus of this cycle audit was the construction design phase requirements and the related invoicing process. Although certain aspects of the purchasing function are centralized within the Department of Management and Finance ("DMF"), and vendor selection is performed in conjunction with Purchasing (for purchases greater than $5,000), some of the high risk areas like contract compliance and monitoring are the responsibility of the individual departments / divisions / bureaus.

Effective January 1, 2017, the County implemented a *Contract Administration Policy* for all contracts, regardless of their procurement methodology or dollar value. The purpose was to define and implement a standard policy and process for the administration of contracts and define roles and responsibilities for County personnel that monitor and manage contractual relationships.

The MCN Build, Inc. ("MCN") contract that was selected for this cycle audit is primarily managed by the Project Officer in the Facilities, Design and Construction ("FDC") Division. Contract Agreement No. 17-223-RFP is a professional services contract to construct the replacement of the Lubber Run Community Center building, recreation spaces and amenities, and on-site parking structures. The contract was signed for an amount of $39 million. The Guaranteed Maximum Price ("GMP") associated with this contract is comprised by three main components: the total cost of work as defined within initial contract, a construction management fee in the amount of $900,000, and a general conditions fee in the amount of $1,044,030. Related to the GMP, two change orders took place amounting to $468,222. Total dollars spent on the contract during the audit period (July 1, 2018 to March 1, 2019) was $6,554,195 (with ~$327K retainage).

The Lubber Run project utilizes a Construction-Management-At-Risk ("CMAR") delivery method. This is the first CMAR contract the County has utilized, as prior projects have utilized the lump sum contract methodology. The CMAR delivery method offers many benefits over lump sum contracts, and may potentially lower costs, improve performance and provide for more rapid delivery. Successful implementation of this methodology does require a higher level of commitment and effort from County personnel to review invoices and supporting documentation to verify compliance with the contract terms.

Objective and Scope

The scope of this cycle audit encompassed one (1) contract from the Department of Environmental Services: Facilities, Design and Construction Division: Agreement No. 17-223-RFP with MCN Build, Inc. The objective of this internal audit was designed to assess whether the system of internal controls is adequate and appropriate, for effective contract compliance, with selected provisions of the selected contract as it relates to payment and identified terms.

Six pay applications were submitted for payment during the audit period of July 1, 2018 to March 1, 2019. We selected the most recent two pay applications (Pay Application #5 and #6) and respective subcontractor invoices for detailed testing. Additionally, we reviewed the documentation corresponding to the contractual requirements related to each of the contract phases.

Overall Summary / Highlights

The observations identified during our assessment are detailed within the pages that follow. We have assigned relative risk or value factors to each observation identified. Risk ratings are the evaluation of the severity of the concern and the potential impact on the operations of each item. There are many areas of risk to consider in determining the relative risk rating of an observation, including financial, operational, and/or compliance, as well as public perception or 'brand' risk.

Number of Observations by Risk Rating
(See page 15 for rating definitions)

	High	Moderate	Low
Contract Compliance Cycle Audit: DES – MCN Build, Inc	1	2	-

Fieldwork was performed February 2019 through April 2019.

We would like to thank all Arlington County team members who assisted us throughout this cycle audit.

EXECUTIVE SUMMARY (CONTINUED)

Detailed Observations

Observation	1. Pay Application Review
High	Per the MCN Build Inc. Contract Agreement, Section A5.1.1 "Cost of Work" • *"The Cost of Work consists of the following, which shall be reimbursable at cost and without mark-up of any kind:* ○ *Payments made by the Contractor to subcontractor and suppliers, but only in accordance with the subcontractor and supply agreements;* ○ *All amounts due to the Contractor under the terms of the County's written authorization for the Contractor to perform any portion of the Work as self-performed work. If an authorization for the Contractor to engage in self-performed work is not on a fixed-price basis, then, as to that Work, the following costs shall be within the Cost of Work: labor, Incorporated Materials, and Unincorporated Materials".* Per the MCN Build Inc. Contract Agreement, Section 7 "Release of Liens": • *"The County, before making any payment, shall require the Contractor to furnish a complete release of all liens arising out of this Contract... If any lien remains unsatisfied after all payments have been made, the Contractor shall refund to the County all money that the latter may be compelled to pay in discharging such lien. However, the County may make payments in part or in full to the Contractor without requiring the releases or receipts", and the payments so made shall not impair the obligation of any Surety or Sureties on any bond or bonds furnished under this contract".* *Per Title 43, Chapter 1, §43-3 of the Virginia Code:* • *"A. All persons performing labor or furnishing materials of the value of $150 or more, including the reasonable rental or use value of equipment, for the construction, removal, repair or improvement of any building or structure permanently annexed to the freehold, …shall have a lien, if perfected as hereinafter provided, upon such building or structure, and so much land therewith as shall be necessary for the convenient use and enjoyment thereof, and upon such railroad and franchises for the work done and materials furnished, subject to the provisions of § 43-20."* As part of our fieldwork, we reviewed the two most recent pay applications (#5 and #6 as of the time of testing), which were received and paid by the County in January and February, 2019. Based on our testing we noted: • The County Project Officer pay application review does not include a review of the related subcontractor invoices. These invoices are what the subcontractors send to the General Contractor (MCN Build) and help validate the actual costs incurred. Per section A5.1.1 "Cost of Work", Arlington is only responsible for the costs actually incurred by subcontractors. The Project Officer currently reviews a listing of subcontractor costs provided by MCN Build. ○ Related to the two pay applications tested, ~$2.2M of costs were incurred related to fourteen (14) subcontractors. Based on our review of the subcontractor invoices, we determined that MCN Build was charging subcontractors 10% retainage although the County was only paying 5% retainage, as contractually obligated, for each pay application. Therefore, MCN Build was underpaying the subcontractors by withholding an extra 5% of each subcontractor invoice.

EXECUTIVE SUMMARY (CONTINUED)

Detailed Observations (continued)

<table>
<tr><th>Observation</th><th>1. Pay Application Review (continued)</th></tr>
<tr><td></td><td>The County Project Officer does not have a process in place to review Lien Waivers (“Release of Liens”) for completeness. Lien waivers are currently obtained without the subcontractor’s signature since the General Contractor utilizes a system (Textura) to obtain and share documents with subcontractors. There is no evidenced process to validate lien waivers were collected for all subcontractors who completed work at the construction site. As part of fieldwork, we obtained Lien Waivers related to the two pay applications tested and performed a reconciliation to the descriptions of work completed by subcontractors during both periods. We were not able to determine if additional Lien Waivers should have been collected for other subcontractors. Lien Waivers provide reassurance that the County is no longer responsible for the dollar value associated with work completed by subcontractors.
The County Project Officer does not have a process in place to review supporting documentation for “Self-Performed” work completed by MCN Build. i.e. reviewing MCN Build personnel timesheets to ensure work billed was actually incurred.
Insufficient review of subcontractor invoices, Lien Waivers, and “Self-Performed” work supporting documentation increases the County’s financial (including improper payment), legal, and reputational risks related to the Lubber Run Community Center project.</td></tr>
<tr><td>Recommendation</td><td>We recommend that FDC enhance the Project Officer pay application / invoice review process to include:
A review of subcontractor invoices so that the Project Officer validates the accuracy of the pay applications received from the General Contractor for all CMAR / Cost-Plus construction projects. Subcontractor invoices should be retained and uploaded to the County’s Construction Management System (E-Builder).
A Lien Waiver review process so that the Project Officer validates that completed and approved Lien Waivers were received for all subcontractors who performed work on the construction site. Lien Waivers should be signed by the subcontractor or equivalent approval evidence should be provided. Lien Waivers should be retained and uploaded to E-Builder.
A review of General Contractor supporting documentation and prior authorization (as required); Self-Performed” work, as defined by contractual requirements. If the applicable contract requires authorization prior to completion, it should be documented, retained, and uploaded to E-Builder.</td></tr>
</table>

EXECUTIVE SUMMARY (CONTINUED)

Detailed Observations (continued)

Observation	1. Pay Application Review (continued)
Management's Action Plan	**Response:** 1) FD&C management immediately trained all FD&C staff on the proper review of invoices under this unique CMAR contract. The training covered the review steps necessary to ensure invoices are being billed in accordance with contract terms with emphasis on reviewing subcontract invoices and cost of work, waiver of liens, self-performing work and billed fee. In addition, a new invoice review checklist will be developed and attached to pay applications once established. Project managers will be required to complete the checklist and provide as documentation before invoices will be paid for all FD&C capital projects. The checklist will include requirements for uploading all supporting documentation in E-builder 2) The CMAR contractor will provide all sub contract lien waivers as part of each pay application moving forward and the project manager will review for accuracy before approving the invoice. There were lessons learned from this CMAR project as it was one of the County's first experiences with this type of project delivery method. Actions such as requiring partial releases of liens with each payment is not recommended for projects moving forward. 3) Ensuring that payments were made correctly by the County was an issue MCN Build immediately resolved regarding fee retainage and was verified by the Project Manager in the July payment application. This did not result in an over payment overall on the project because retainage is ultimately paid upon project completion. 4) FD&C reviewed supporting documentation and verified there was no self-performing work. FD&C reviews all sub consultant documentation prior to payment. The FD&C staff have been trained on the steps necessary to ensure any self-performing work when incurred, is correctly billed in accordance with contract terms. **Responsible Party:** FD&C Bureau Chief and Program Manager **Target Date:** Training completed. Checklist will be completed by November 30, 2019 and used for all future pay applications.

EXECUTIVE SUMMARY (CONTINUED)

Detailed Observations (continued)

Observation	2. Certificate of Insurance
Medium	Per the MCN Build, Inc. Contract Agreement, Section VII "Insurance Requirements": • *"The Contract with the Contractor will not be executed by the County until the Contractor has obtained, at its own expense, all of the insurance called for hereunder and such insurance has been approved by the County; additionally, the Contractor shall not allow any subcontractor to start work on any subcontract until all insurance required of the subcontractor has been so obtained and approved by the Contractor"* • *"The Contractor shall purchase insurance coverages for the following: Commercial General Liability, Business Automobile Liability, Worker's Compensation, and Asbestos and Lead-Based Paint Abatement Projects.* Based on our testing we noted: • MCN Build's Certificate of Insurance was signed on October 18, 2018, two months after the contract was executed (August 2018), but prior to commencement of work (November 2018). Based on contractual requirements, this Certificate of Insurance should have been obtained prior to contract execution. • MCN Build's Certificate of Insurance did not include coverage for asbestos and lead-based paint abatement projects. Failure to meet insurance requirements can lead the County to various financial, legal, and reputational risks. Having all insurance in place prior to contract execution allows for proper validation that required terms have been met.
Recommendation	We recommend re-emphasizing the Certificate of Insurance review process by the County's Purchasing Office. As applicable, Project Officer's should validate that the Certificate of Insurance aligns with contract requirements. If they do not align, the Project Officer should notify the Purchasing Office to resolve the issue.
Management's Action Plan	**Response:** The certificate of insurance review process was a primary discussion topic at a Purchasing Office staff meeting in September 2019. Additionally, the Purchasing Agent will ensure that all contract templates, the Purchasing Manual, and Purchasing Office staff practices are consistent with one another on the certificate of insurance process. The Purchasing Agent will also reiterate the process to FD&C staff and the CMAR. Expiration Dates on certifications will be included as part of the checklist. **Responsible Party:** County Purchasing Agent **Target Date:** November 2019

EXECUTIVE SUMMARY (CONTINUED)

Detailed Observations (continued)

Observation	3. General Condition Costs and GMP Support
Medium	Per the MCN Build, Inc. Contract Agreement , Section "A5.1.2" "Non Reimbursable Costs":

- *"The Contractor's General Condition costs, including but not limited to, the following shall be included in the General Conditions Fee:*
  - *The Cost of Construction Staff. The term Construction Staff shall mean the Project Executive, project managers and superintendents assigned to the project, administrative staff assigned on full-time basis to the Project site, and professional staff performing scheduling, cost estimating, and accounting services;*
  - *Fringe Benefits associated with Construction Staff'*
  - *Payroll taxes and payroll insurance associated with Construction Staff*
  - *Staff cost associated with obtaining permits and approvals*
  - *Out-of-house consultants*
  - *The field office for the Contractor including but not limited to: (i) trailer purchase and/or rent; (ii) field office installation, relocation and removal; (iii) utility connections and charges during the Construction Services Phase; (iv) furniture; (v) office supplies*
  - *Office equipment including, but not limited to (i) computer hardware and software; (ii) fax machines, (iii) copying machine; (iv) telephone installation, system, and use charges; (v) job radios;*
  - *Local Delivery and overnight delivery costs; and*
  - *First Aid Facility"*

As part of detailed testing, we noted 13 items that were invoiced as "Rough Carpentry" costs, but were actually General Condition costs that are non-reimbursable based on contract terms as the contractor is already compensated for these costs under the General Condition fee. .

Specifically, during our review of supporting documentation for pay application #6, we identified the following items that were inappropriately included (received and paid by the County in February 2019) as "Rough Carpentry":

Item Description	Amount
Clothes (boots, vests, and jackets)	$1,526.72
Kitchen Consumption Items (coffee, sugar, cups, and water)	174.00
Batteries	57.88
Magnifying glass	10.06
Office Materials (sharpies, trash bags, donuts, and traffic cones)	647.67
Total Costs Identified	**$2,416.33**

Pay application #6 included $46,849 of "Rough Carpentry" costs. Therefore, ~5% of "Rough Carpentry" included in pay application #6's was inappropriate. $421,346 in "Rough Carpentry" has been included in pay applications from inception, through pay application #6, and the GMP includes a "Rough Carpentry" budget of $2,390,955.

EXECUTIVE SUMMARY (CONTINUED)

Detailed Observations (continued)

Observation	3. General Condition Costs and GMP Support (continued)
	Note: "Rough Carpentry" supporting documentation was only reviewed for pay application #6. The County may be incurring unnecessary costs by paying for items that should be considered General Condition costs. A General Condition fee is included in the contract to cover miscellaneous costs, such as these.
Recommendation	We recommend the following: • FDC re-emphasize the process of reviewing alignment of the GMP with contract conditions and requirements prior to contract execution. • As part of the Project Officer's pay application review, each pay application should be reviewed for alignment with the GMP document. • The Project Officer review all other pay applications to identify other costs that should have been considered General Condition costs, to identify total reimbursements owed to the County to date.
Management's Action Plan	**Response:** As stated in the management response to Finding No 1, the FD&C staff were immediately trained on the proper review of invoices under this contract including ensuring compliance with unique and special payment provisions (e.g., non-reimbursable costs). MCN Build explained it was a billing oversight on pay application # 6 and has agreed to credit the County. Nevertheless, FD&C staff immediately commenced a review of all supporting documentation for the Rough Carpentry cumulative billing and will promptly work with MCN Build to ensure the County is immediately credited for any overbillings found. Also, the checklist will include steps for testing compliance with any special terms and conditions (e.g., non-reimbursable costs) and performing a detailed review of supporting documentation. **Responsible Party:** FD&C Bureau Chief and Program Manager **Target Date:** October 31, 2019

BACKGROUND, OBJECTIVES AND APPROACH

Background

Overview

Contract compliance encompasses all contractual agreements entered into by the County. Although certain aspects of the purchasing function are centralized within the Department of Management and Finance, and vendor selection is performed in conjunction with Purchasing, some of the high-risk areas like contract administration, compliance and monitoring are the responsibility of the individual departments / divisions / bureaus. These monitoring responsibilities specifically include:

- Understanding the scope of work and terms and conditions of the contract;
- Management of contract billings to avoid cost overruns;
- Validation of complete and satisfactory performance of work through physical walkthroughs and site visits, when appropriate;
- Ensuring timely performance of contracted work;
- Providing updates to the Department Director, Division Chief and Department of Management and Finance related to progress and budget, as necessary;
- Maintaining appropriate documentation, in compliance with the County level document retention policy and respective contract; and
- Review and approval of invoices for payment to the Contractor in line with the payment terms and conditions outlined in the agreement.

Effective January 1, 2017, the County Implemented a *Contract Administration Policy* for all contracts, regardless of their procurement methodology or dollar value. The purpose was to define and implement a standard policy and process for the administration of contracts and define roles and responsibilities for County personnel that monitor and manage contractual relationships. Specifically, the policy establishes Project Officer and Task Officer Responsibilities, defines internal controls surrounding contract payment, quality assurance and recordkeeping, and outlines all applicable regulations to which the contract administration process must adhere.

MCN Build, Inc

The MCN Build, Inc. contract that was selected for this cycle audit is primarily managed by the Project Officer in the Facilities, Design and Construction Division. Contract Agreement No. 17-223 RFP is a professional services contract to provision all Preconstruction and Construction Management services, including labor, materials, supervision, equipment, and other services to raze the existing and construct the new Lubber Run Community Center. The guaranteed maximum price associated with this contract, was for a total amount of $39,168,238 as of August 1, 2018. There have been two change orders related to this contract amounting to $468,222. Arlington County paid six pay applications during the audit period (July 1, 2018 to March 1, 2019); see below for total dollars spent on the contract.

Agreement No. 16-368-RFP					
Contractor	**Contract Title**	**Execution Date**	**Total Dollars Spent on Contract[1]**	**Contract Type**	**County Division**
MCN Build Inc.	Arlington County Agreement 17-223-RFP	August 1, 2018	$6,554,195	Fixed Price	FDC

[1]Total dollars spent since contract execution (August 1, 2018 through March 1, 2019)

BACKGROUND, OBJECTIVES AND APPROACH (CONTINUED)

Background (continued)

CMAR Delivery Method

The Lubber Run Community Center project utilizes a Construction-Management-At-Risk ("CMAR") delivery method. This is the first CMAR project the County has utilized. The CMAR contract is a "Cost Plus Fixed Fee with a Guaranteed Max Price" ("GMP"). Reference Appendix B for definitions of common construction contract types. The CMAR delivery method is a collaborative process and has the ability to limit the County's financial exposure since the CMAR provides a GMP and acts as a consultant throughout most phases of the project. The GMP is calculated by the CMAR utilizing subcontractor bids and must follow the GMP process included in the CMAR contract. In this case the CMAR is MCN Build Inc.

To assess the use of the CMAR delivery method, a contract compliance internal audit was executed and completed related to the architect utilized for the Lubber Run Community Center project on March 20, 2019. The audit encompassed one (1) contract from the Department of Environmental Services: Facilities, Design and Construction Division: Agreement No. 16-368-RFP with VMDO Architects. Contract Agreement No. 16-368-RFP was a professional services contract to develop a design for the replacement of the Lubber Run Community Center building, recreation spaces and amenities, and on-site parking structures. The scope of the internal audit was similar to this audit, but also included "assessing the documentation corresponding to contractual requirements related to each of the six (6) contract phases." The internal audit's related report can be found on the County's website.

Reference "Appendix B – Construction Contract Type Definitions" for descriptions of common construction contracts.

CMAR-Specific Risks:

As described above, the CMAR delivery method can be effective to reduce costs, create efficiencies, and improve effectiveness. The benefits of utilizing a CMAR, also come with certain associated risks when appropriate oversight is not established/maintained, such as overpaying or inappropriately paying for potentially complex areas of the cost of work, including:

- Labor and labor burden;
- Self-performed work and/or related parties;
- Insurance and bonds;
- General conditions/requirements;
- Overhead, profit, fees; and
- Subcontractor costs.

While these risks are associated with a CMAR, the delivery method also provides project officers greater transparency/tools to address these risks and manage the project overall. The CMAR delivery method is a best practice in construction project management.

Roles and Responsibilities

The following departments play key roles in the contract compliance process:

Department of Environmental Services – Facilities, Design & Construction

DES – FDC is responsible for management and oversight of projects and services related to the design and construction of facilities for the County. This is generally accomplished by contracting with professional firms for all design, construction and other services and monitoring the projects until completion. FDC is also responsible for completing all Project Officer functions as outlined in the contract, overall contract compliance, and reviewing and approving vendor invoices for accuracy prior to payment.

BACKGROUND, OBJECTIVES AND APPROACH (CONTINUED)

Background (continued)

Roles and Responsibilities (continued)

Department of Management and Finance

DMF oversees all financial-related County processes. The Purchasing and Accounts Payable divisions are part of DMF and act as support functions for departments managing vendor contracts. Specifically, Purchasing administers the competitive solicitation process for the purchase of goods and services by the County; executes contracts and approves POs for the purchases. Accounts Payable is responsible for processing payments to contractors based on invoices approved by the respective departments.

E-Builder System

DES utilizes a construction program management tool, E-Builder, for functions including, but not limited to: document repository, invoice management, tracking budget vs. actual, tracking project schedules, and automated work flows.

Common Definitions

Some common definitions for construction terminology used throughout this section of the report are as follows:

- *Project Officer* – refers to the County representative responsible for general control, review, and approval of all aspects of the contract, once executed. The Project Officer is appointed by the County's Department of Environmental Services Director or a designee as identified in the contract, who is the primary point of contact for the Contractor in executing the terms of the contract.
- *Contract Amendment/Modification* – refers to an approved additional cost for expanded work outside of the original work plan considered in the development of the contract price. If the cost is deemed necessary and appropriate, an executed contract amendment is established to allow the Contractor to invoice for the additional work.
- *Fixed Price Contract* – refers to a contract with a fixed price to be paid upon completion of work, as defined by the agreement and project timeline. Fixed price contracts are invoiced on a periodic basis with a breakdown of costs by percentage completion of project phases for the applicable period.

Timeline

Below is a timeline of contractual events for the contracted project.

Date	Event Description
August 1, 2018	Arlington County executes Contract Agreement No. 17-223-RFP with MCN Build, Inc.
October 1, 2018	Pay Application for PO 262398 is issued for $1,211,057
October 25, 2018	Pay Application for PO 262398 is issued for $298,251
November 26, 2018	Pay Application for PO 262398 is issued for $687,068
November 26, 2018	Change Order issued to update project schedule extending the substantial completion date to July 1st, 2020
December 20, 2018	Change Order (PO 265387) issued amounting to $468,222 related to roofing, conduit, and garage lifts
December 27, 2018	Pay Application for PO 262398 is issued for $1,469,615
January 25, 2019	Pay Application for PO 262398 is issued for $1,822,279
February 26, 2019	Pay Application for PO 262398 is issued for $738,216.

Background, Objectives and Approach (Continued)

Background (continued)

Timeline (continued)

The two change orders detailed in the table above were executed to update total contract costs and timeline for the following additional work:

- Change Order #1:
  - Update schedule extending the substantial completion date to July 1, 2020
- Change Order #2
  - Furnish and install metal roofing system for additional $350,000
  - Additional services to furnish and install conduit to prep for PV panels by others $40,000
  - Additional services to furnish and install Garage Lift Gates by $43,000
  - Additional amounts related to G/L Insurance, Builders Risk , and P&P Bond by $35,222

The following phases are required as part of the contracted services:

- Preconstruction Phase
  - This phase consist on pre-construction services with the goal of developing an acceptable Guaranteed Maximum Price proposal for the Project.
- Construction Phase
  - This phase awarded through a GMP contract amendment would allow the Contractor to provide all construction management services, including labor, materials, supervision, equipment, and other services necessary to construct the new Lubber Run Community Center on a construction manager at risk basis.

Explicit detailed requirements for each phase are located within Contract Agreement No. 17-223-RFP with MCN Build, Inc. The agreement can be found utilizing the EVA Procurement Portal linked on the County's website.

BACKGROUND, OBJECTIVES AND APPROACH (CONTINUED)

Objectives and Approach

Objectives

Contract compliance encompasses all contractual agreements for the purchase of goods and services including, but not limited to, vendor agreements. Although certain aspects of the purchasing function are centralized within the Department of Management and Finance, some of the high-risk areas like contract administration and monitoring are decentralized to the individual departments.

The scope of this internal audit encompassed one (1) contract with MCN Build, Inc. (Agreement No. 17-223-RFP). The audit period was July 1, 2018 to March 1, 2019.

The objective of this internal audit was designed to assess whether the system of internal controls is adequate and appropriate, for effective contract compliance, with selected provisions of the selected contract as it relates to payment and identified terms.

Six pay applications were submitted for payment during the audit period of July 1, 2018 to March 1, 2019. We selected the last two pay applications (Pay Application #5 and #6) and respective subcontractor invoices for detailed testing. Additionally, we reviewed the documentation corresponding to the contractual requirements related to each of the contract phases.

Approach

Our approach to the audit execution consisted of the following phases:

Understanding and Documentation of the Process

The first phase of this audit consisted primarily of inquiry and walkthroughs, in an effort to obtain understanding of the key personnel, risks, processes, and control relevant to the objectives outlined above. The following was performed as a part of this phase:

- Conducted interviews with the appropriate representatives to discuss the scope and objectives of the audit work, obtain preliminary data, and establish working arrangements;
- Conducted interviews with key personnel to obtain a detailed understanding of the contract compliance process(es);
- Documented flowcharts of the process(es);
- Reviewed the applicable policies and procedures and agreements related to this project;
- Performed walkthrough to gain an understanding of the function and assess the design of internal controls; and
- Developed a risk-based work plan for the evaluation of the design and operating effectiveness of processes and controls, based on the information obtained through our review, inquiry and walkthrough procedures.

Evaluation of the Process and Controls Design and Testing of Operating Effectiveness

The purpose of this phase was to test compliance and internal controls. This phase also consisted of an evaluation of the design and testing of operating effectiveness. Six pay applications were submitted for payment during the audit period of July 1, 2018 to March 1, 2019. We selected the most recent two pay applications (Pay Application #5 and #6) and respective 19 subcontractor invoices for detailed testing. Additionally, we reviewed the documentation corresponding to the contractual requirements related to each of the contract phases including:

- Guaranteed Max Price (GMP) documentation (111 pages) – 28 budget line items;
- Subcontractor Bids documentation (255 pages) corresponding to the GMP documentation;
- Lien Waivers related to Pay Application #5 and #6

BACKGROUND, OBJECTIVES AND APPROACH (CONTINUED)

Objectives and Approach (continued)

Specific procedures performed included:

- Gathered background information on the County's contract compliance and monitoring procedures and any required controls or documentation, including County Board authorization, if necessary;
- Determined whether the selected department/division had related contract compliance procedures outside of County-level procedures;
- Obtained background information on the selected contract, including a copy of the contract, contract administrator information, and detail of expenditures under each contract during our audit period;
- Utilized RSM's CMAR Risk and Control Matrix to identify risks specific to the Lubber Run Community Center project and corresponding testing approach;

Evaluation of the Process and Controls Design and Testing of Operating Effectiveness *(Continued)*

- Tested invoices for the selected contract to determine if the supporting documentation agreed to the payment amount and was mathematically accurate;
- Based on the CMAR delivery-method and contractual requirements, tested CMAR (General Contractor) invoices against sub-contractor invoices to validate that the County was only charged for cost of work;
- Verified that each invoice was charged appropriately against a purchase order as required by the *Contract Administration Policy;*
- Inspected invoices for Project Officer sign-off as required by the *Contract Administration Policy;*
- Determined if payment was made in a timely manner and in accordance with the pricing terms of the contract and the *Contract Administration Policy*, and that payments did not exceed amounts authorized;
- Determined whether goods and services received under the contract were properly verified or monitored prior to payment of the invoice as required by the *Contract Administration Policy*;
- Assessed the adequacy and compliance with select terms of the contract, such as certificate of insurance, right to audit, etc;
- Assessed the overall contract compliance process and controls to determine effectiveness; and
- Assessed the documentation corresponding to contractual requirements related to the construction phase.

Reporting

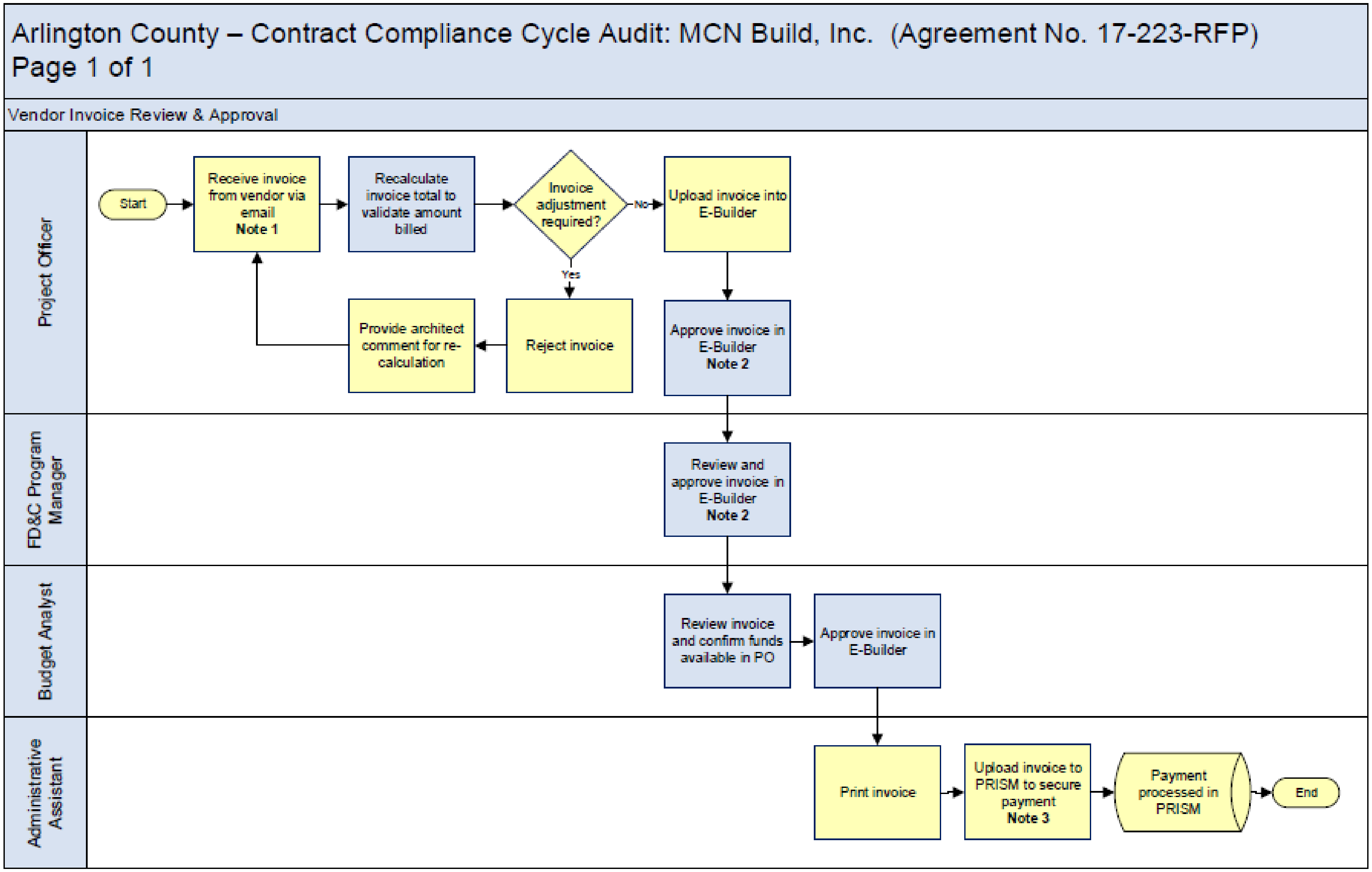
At the conclusion of this audit, we vetted the facts of this cycle audit with DES. The draft report was submitted to DES and DMF for review. An exit meeting was held with DES and DMF to formally review and discuss the draft report and modify accordingly.

BACKGROUND, OBJECTIVES AND APPROACH (CONTINUED)

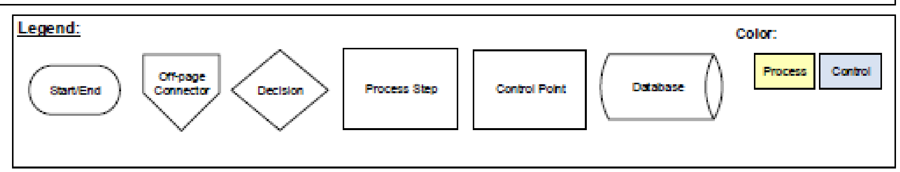
Objectives and Approach (continued)

Observation Risk Rating Definitions	
Rating	**Explanation**
Low	Observation presents a low risk (i.e., impact on financial statements, internal control environment, public perception/brand, or business operations) to the organization for the topic reviewed and/or is of low importance to business success / achievement of goals and internal control structure.
Moderate	Observation presents a moderate risk (i.e., impact on financial statements, internal control environment, public perception/brand, or business operations) to the organization for the topic reviewed and/or is of moderate importance to business success / achievement of goals and improve its internal control structure. Action should be in the near term.
High	Observation presents a high risk (i.e., impact on financial statements, internal control environment, public perception/brand, or business operations) to the organization for the topic reviewed and/or is of high importance to business success / achievement of goals and improve its internal control structure. Action should be taken immediately.

APPENDIX A - PROCESS MAP:



Notes:
1. Vendor invoices include billing related to percentage completion of each design phase as well as travel (mileage) and meal expenses, as approved by the Contract Officer.
2. The workflow within E-Builder automatically sends the invoice to the next reviewer once approved by the previous reviewer.
3. Payments are usually submitted on Monday or Wednesday and are processed the following day.



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