



CHICAGO HOUSING AUTHORITY OFFICE OF INSPECTOR GENERAL CHICAGO, IL

OIG Case# 2018-11-0020

Construction Change Orders Follow-Up Audit

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Table of Contents

A.	Executive Summary.....	3
I.	Authority and Role:.....	3
II.	Objectives:	3
III.	Scope:	4
IV.	Approach and Methodology:.....	4
V.	Summary of Results:.....	4
B.	Finding and Recommendations.....	5
I.	Finding: Lack of Documented Policy and Procedure.....	5
II.	Finding: Change Order Process Not in Compliance with CHA’s Procurement Manual	6
III.	Finding: Use of Fire Suppression Allowance.....	6
IV.	Finding: C.O. Committee Roles Are Not Clearly Defined	8
V.	Finding: Proof for Bond Adjustments	9
VI.	Finding: CHA Significant Action Policy is Not Consistently Applied.....	10
VII.	Finding: Cost Analysis is Not Rigorous.....	10

A. Executive Summary

I. Authority and Role:

The authority to perform this audit is pursuant to the Board-approved *Inspector General Charter*, which states that the Office of the Inspector General (OIG) has the authority and duty to audit the administrative programs of the Chicago Housing Authority (CHA). The OIG is tasked with identifying inefficiencies, waste, fraud, abuse, misconduct and mismanagement, as well as promoting economy, efficiency, effectiveness, and integrity in the administration of CHA programs and operations. The role of the OIG is to conduct independent audits of CHA operations and programs and make recommendations for improvement when appropriate. CHA management is responsible for establishing and maintaining measurable processes to ensure that CHA programs operate economically, efficiently, effectively, and with integrity.

Standards

The OIG conducts program audits in accordance with Generally Accepted Government Auditing Standards issued by the Comptroller General of the United States and *The Principles and Standards for Offices of the Inspector General*. Those standards apply to performance audits of government agencies, and require the OIG to plan and perform the audit to provide objective analysis, findings, and conclusions to assist management and those charged with governance and oversight with, among other things, improving program performance and operations, reducing costs, facilitating decision making by parties responsible for overseeing or initiating corrective action, and contributing to public accountability.¹

The OIG believes that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives to identify conditions and/or an environment that results in, or could result in, waste, fraud, abuse, misconduct or mismanagement.

In 2016 the OIG conducted an audit of the construction change order (C.O.) practices by CHA's Capital Construction Department (CCD). Six of the nine findings in the audit were ranked "High Risk," and therefore, demanded prompt action by CHA Management.

II. Objectives:

1. To determine the status of the corrective actions from the original audit recommendations.
2. Review CCD's change order (C.O.) process for compliance with applicable HUD regulations, CHA's Procurement Manual, and CCD's Policies and Procedures.
3. Assess the roles and responsibilities of internal stakeholders such as CCD, Legal Department, and Department of Procurement and Contract (DPC) during the C.O. process.
4. Assess the risk environment and determine whether the existing controls are sufficient to minimize fraud, waste and abuse in C.O. practices.

¹ The U.S. Government Accountability Office, Comptroller General of the U.S. (2018). *Government Auditing Standards* (The Yellow Book). Washington, DC: GAO.

III. Scope:

The initial scope period included CCD's change orders associated with contracts from January 1, 2016 through December 31, 2018. It was modified to January 2017 through December 31, 2018.

IV. Approach and Methodology:

To determine the current status of our previous recommendations, the OIG communicated with management to determine the actual actions taken with regards to the recommendations for improvement.

The following steps were performed:

- Reviewed Audit Status Report submitted by the Chief Construction Officer.
- Identified the status of each recommendation.
- If a recommendation was implemented, the OIG assessed its effectiveness to obtain assurance that risks identified are addressed.
- If a recommendation was partially implemented, the OIG identified what was and what was not implemented and assessed the degree of the residual risk.
- If management chose an alternative action plan, an evaluation was conducted to ensure management actions effectively mitigate the risk identified.
- If a recommendation was not implemented, the OIG asked management to provide an explanation and projected implementation timeline.
- If management stated that the recommendation is no longer applicable, the OIG evaluated the management's assertions and the immediate risks related to the finding.

Interviews were conducted with the Procurement Department, Finance Department, and CCD key personnel.

We reviewed construction data from e-Builder, an online collaboration software use by CHA, CCD, Finance and Procurement Departments, and performed limited testing to verify the implementation of the OIG recommendations for improvement.

The OIG selected construction contracts that were started by the CHA as of the last CCD Change Order Audit issued in 2016.

V. Summary of Results:

The original audit report had nine (9) findings with twenty-two (22) recommendations. Of the 22 recommendations in the original audit report, the OIG determined that 14 were implemented, 2 were no longer applicable, and 6 were not implemented.

During the year 2017 and 2018, CCD started 15 construction contracts² totaling initial cost of \$83,553,649.94. These construction projects had change orders totaling \$6,031,230.35 and averaging 4 change orders per contract (7% of the initial cost). This 7% rate is within the reasonable range according to a study performed by Michigan State University in 2004. Building Solutions, one of the leading real estate development companies in the USA, published in 2015 a change order range of 8% to 14% of the capital construction project costs.

² The construction contracts are actual construction tasks, not construction related activities such as architecture and engineering (AE) or environmental consulting services.

B. Finding and Recommendations

I. Finding: Lack of Documented Policy and Procedure

Risk Level: High

The audit indicated that CCD did not have formally approved policies and procedures for the department. In lieu of a Policies and Procedures Manual, CCD has a flow chart documenting the C.O. process flow.

Recommendation:

- a) Develop a written policies and procedures manual in line with CHA's governing documents.
- b) Train CCD's staff of C.O. policies and procedures.
- c) Have a centralized depository location for construction related documents.

Management Response:

- CCD concurs with all observations and recommendations.
- Partial recommendations were implemented in November 2016.

Current Status: Partially Implemented

CCD implemented recommendation "c" by exclusively using "e-Builder" (an online collaboration software) to review, process and approve C. O's. All relevant documents related to C. O's are located in e-Builder.

The OIG noted recommendations "a" and "b" were not implemented. The current practice is as follows:

1. CCD did not have a written policies and procedures manual. Some CCD staff have developed a "How To" guide for their functions.
2. Potential change orders (PCO) over 10% of the independent cost estimate (ICE) go through a different process.
3. CCD presents C.O.'s in excess of 11% (of the original contract amount) to the Board for approval.

These practices should be incorporated in written policies and procedures.

II. Finding: Change Order Process Not in Compliance with CHA’s Procurement Manual

Risk Level: High

The audit indicated that the C.O. process is not in compliance with CHA’s Procurement Manual requirement.

Article V. Paragraph D. Section (iv) (b) of the CHA’s Procurement Manual stated: *“The change order must be competitively procured or state an acceptable reason why it was not. The User department must: 1. Competitively solicit bids for the value of the deviation; or 2. Document the impracticality of bidding the changed work; or 3. Document the overwhelming value received from the bid of the current contractor so as to obviate the solicitation of additional bids.”*

Currently, CHA is not following the above cited C.O. procedure, including cases where a C.O. is out of the general scope of the contract.

Recommendation:

- a) Establish a procedure to identify tasks that are out of the scope of the original contract and ensure compliance with the CHA Procurement Manual.
- b) The CHA Department of Procurement and Contracts should consider revising Article V. Paragraph D. Section (iv)(b) of the CHA Procurement Manual to reflect best and current practices; or, in the alternative, provide the required documentation stating why the change order will not be competitively procured.

Management Response:

- CCD partially concurs with observation and recommendations.

Current Status: Implemented

III. Finding: Use of Fire Suppression Allowance

Risk Level: High

A. Insufficient Initial Assessment and Testing of Construction Projects in Contract #11120

The audit showed evidence that there may be a lack of comprehensive assessment of the general scope at the initiation of projects.

Recommendation:

- a) Conduct a complete and thorough initial assessment of the project scope, prior to solicitation of general contract work in order to ensure that the scope of service is appropriate.

Management Response:

- CCD concurs with observation and recommendations implemented in November 2016.

Current Status: Implemented

B. Using Fire Suppression Allowance for Unrelated Task in Contract #11121

CCD used the Fire Suppression Allowance for a task unrelated to *The City of Chicago Life Safety and High-Rise Ordinance Fire Code*.

Recommendation:

- a) Funds dedicated for Fire Suppression should not be used as contingency allowances to accomplish a task that does not fall under permissible use of Fire Suppression allowance.
- b) Use Fire Suppression Allowance to meet *The City of Chicago Life Safety and High-Rise Ordinance Fire Code* only.
- c) Change Order Committee should scrutinize all Project-end C.O.'s to ensure contract compliance and proper review and oversight of C.O. costs and allowance usage.

Management Response:

- CCD concurs with observation and recommendations implemented since 2016.

Current Status: Implemented

C. Overhead and Profit Improperly Charged in Contract

The contract #11120 between CHA and Old Veteran Construction (OVC) incorporates the installation of automatic sprinkler equipment (Fire Suppression).

OVC submitted a proposal to CHA for \$3,251,688.27 (out of \$3,500,000) allowed making up the final total cost for the aforementioned installation. The proposal specifically included \$2,388,487.24 for a task that was completed by a sub-contractor. However, at the completion of the work, OVC submitted a certified lien waiver stating that the Fire Suppression work performed by the sub-contractor amounted to \$2,009,395 (a lump sum sub-contract) and the said amount was paid with zero balance. The variance between the \$2,009,395 paid to the sub-contractor and the final cost of \$2,388,487.24 is \$379,092.24 (this included 11% profit and overhead charge). This variance was either unaccounted for or unallocated.

In addition, the audit demonstrated that OVC improperly charged 5% profit on tasks performed by subcontractor in violation of the contract agreement. In the Fire Suppression portion of Contract #11120, it states, "*Should the decision be made to install a fire sprinkler system during the life of the contract issued to the Awardee for this solicitation, the following process will be followed...The Awardee may NOT add profit and overhead to the sub-contractor's proposal.*" The profit charges by G.C. on sub-contractor tasks amounted to \$143,571.02. Of this amount, only \$11,506 profit and overhead on the G.C.'s material and equipment cost is permissible. Therefore, \$132,065.02 is impermissible profit to OVC. The combined total of impermissible profit and overhead (379,092.24 and 132,065.02) charged by OVC is \$511,157.26, which represents 16% of the total cost of the work, \$3,251,688.27.

Recommendation:

- a) Review invoice and other documents submitted by G.C. for payment to ascertain that there are in accordance with contract requirement and there are no labor overcharges.
- b) Review the accuracy of the initial fire allowance amount.
- c) Recover the credit back from OCV for the overcharge.
- d) Review internal process to ensure from reoccurring.

Management Response:

- CCD partially concurs with observation and recommendations.
- Recommendations were expected to be implemented October 31, 2016.

Current Status: Partially Implemented

Recommendation “c” is not implemented. CHA did not recover the credit back from OVC for the \$132,065.02 impermissible profit.

IV. Finding: C.O. Committee Roles Are Not Clearly Defined

Risk Level: Medium

Assessment of current Change Order Committee functions, responsibilities and deliverables identified that some internal stakeholders’ (i.e. CCD, DPC, Legal Department and Budget Department) roles are not clearly defined or understood.

Recommendation:

- a) As part of CCD’s written procedures, clearly define roles, responsibilities and deliverables of all internal stakeholders representing the C.O. committee (See Recommendation 1a).
- b) CCD should work with committee members to agree on how many days in advance they need to review PCO documents prior to the committee meetings.

Management Response:

- CCD disagrees with the observation and recommendations.

Current Status: Partially Implemented

Recommendation “a” is not implemented. CCD did not have a written policies and procedures manual to clearly define roles, responsibilities and deliverables of all internal stakeholders representing the C.O. Committee.

V. Finding: Proof for Bond Adjustments

Risk Level: High

24 CFR Part 85.36 Section (h).2. &.3. states the minimum bonding for construction or facility improvement contracts or subcontracts exceeding the simplified acquisition threshold as:

(2) A performance bond on the part of the contractor for 100 percent of the contract price. A performance bond is one executed in connection with a contract to secure fulfillment of all the contractor's obligations under such contract."

(3) A payment bond on the part of the contractor for 100 percent of the contract price. A payment bond is one executed in connection with a contract to assure payment as required by law of all persons supplying labor and material in the execution of the work provided for in the contract.

Recommendation:

- a) Establish a process to ensure that bonding requirements are met and that bond and insurance documents are included within the C.O. files.
- b) Develop a tracking mechanism to monitor compliance with bonding and insurance requirements.

Management Response:

- CCD partially concurs with the observation and recommendations.

Current Status: Not Implemented

None of the above recommendations were implemented. Currently, there is no tracking mechanism for a General Contractor's performance and payment bond documents. The documents were not accessible within e-Builder and were scattered in the appropriate solicitation and/or contract folders. The performance and payment bond amount also did not reflect 100% of the new contract price, when there was an increase from a change order, as required by the following regulation:

Federal Acquisition Regulation (FAR 28.102.2) states for contracts exceeding \$150,000:

*(1) Performance bonds. Unless the contracting officer determines that a lesser amount is adequate for the protection of the Government, the penal amount of performance bonds must equal- (i) 100 percent of the original contract price; and (ii) **If the contract price increases, an additional amount equal to 100 percent of the increase.***

*(2) Payment bonds. (i) Unless the contracting officer makes a written determination supported by specific findings that a payment bond in this amount is impractical, the amount of the payment bond must equal- (A) 100 percent of the original contract price; and (B) **If the contract price increases, an additional amount equal to 100 percent of the increase.** (ii) **The amount of the payment bond must be no less than the amount of the performance bond.***

VI. Finding: CHA Significant Action Policy is Not Consistently Applied

Risk Level: Medium

CHA has a Significant Actions Policy that states “*Board approval must be obtained prior to CHA incurring liabilities in excess of \$100,000. Modernization activities, change orders, or cumulative change orders in excess of 5% of the contract amount or \$100,000, whichever is greater, must receive Board approval.*”

According to the audit, the Significant Actions Policy was inconsistently applied. Some C.O.’s that were above the significant action threshold, but did not have a contingency amount, were not submitted for board action, as required. At the same time, some C.O.’s that were under the significant action threshold were submitted for board approval, even though approval was not required.

Recommendation:

- a) Establish a process to ensure consistent application of the Significant Action Policy.

Management Response:

- CCD partially concurs with the observation and recommendations.
- We believe that this observation is no longer applicable.

Current Status: No Longer Applicable

VII. Finding: Cost Analysis is Not Rigorous

Risk Level: Medium

The Audit noted certain instances where the independent cost estimate (ICE) and the general contractors’ proposal were not congruent.

Recommendation:

- a) Pursuant to Article V. Paragraph D. Section (iv) (b) of the CHA’s Procurement Manual (“...*The User department must: 1. Competitively solicit bids for the value of the deviation; or 2. Document the impracticality of bidding the changed work; or 3. Document the overwhelming value received from the bid of the current contractor so as to obviate the solicitation of additional bids.*”) CCD should solicit cost deviation of C.O.’s (See Observation II for full language of Article V).
- b) Consider establishing an acceptable percentage deviation of G.C.’s proposal and ICE.

Management Response:

- CCD concurs with the observation and recommendations.
- Corrective steps implemented in 2016.

Current Status: Partially Implemented

The OIG noted recommendation “b” was not implemented. The current acceptable deviation percentage is 10%, but CCD did not have written policies to support this practice.