**CITY AND COUNTY OF SAN FRANCISCO**
**OFFICE OF THE CONTROLLER**

**Ben Rosenfield**
**Controller**

**Todd Rydstrom**
**Deputy Controller**

# MEMORANDUM

TO: Phil Ginsburg
General Manager
Recreation and Park Department

President and Commissioners
Recreation and Park Commission

Mohammed Nuru
Director
Department of Public Works

FROM: Tonia Lediju
Director of City Audits
City Services Auditor Division

DATE: January 17, 2017

SUBJECT: Recreation and Park Department & Department of Public Works: Department Change Order Processes Increased Risk of Disputes and Delayed Contractor Payment for the Joe DiMaggio Playground Improvement Project

## EXECUTIVE SUMMARY

Construction management and project controls at the Department of Public Works (Public Works) of the City and County of San Francisco (City) need some improvement. The Office of the Controller's City Services Auditor Division (CSA) reviewed Change Order Requests and payment applications for the contract between Bauman Landscape and Construction, Inc., (Bauman) and the Recreation and Park Department (Rec and Park) for renovation of the Joe DiMaggio Playground, a construction project managed by Public Works. Public Works accepted, reviewed, and processed Change Order Requests on behalf of Rec and Park for the Joe DiMaggio Playground Improvement Project. The audit found that:

- Public Works and Rec and Park allowed Bauman to complete change order work without first documenting Public Works' review and approval of the scope and cost of the requested change.
- Because of their prolonged change order approval processes, Public Works and Rec and Park delayed a payment to Bauman for more than eight months. These processes increased the risk of disputes and caused a lack of compliance with the city's prompt payment policy.
- Public Works and Rec and Park complied with progress payment requirements.

## BACKGROUND, OBJECTIVES & METHODOLOGY

### Background

Rec and Park. Rec and Park administers 220 neighborhood parks, 179 playgrounds, 671 marina slips, 25 recreation centers, and 4,113 acres of recreational and open spaces. The Recreation and Park Commission oversees the department.

Public Works. Public Works maintains city buildings, streets, and sidewalks, and provides design, construction, and construction management services to other city departments, as it did for Rec and Park in managing the Joe DiMaggio Playground Improvement Project.

Joe DiMaggio Playground Improvement Project: The Joe DiMaggio Playground Improvement Project (DiMaggio Playground Project) is among 27 improvement projects funded by the City's $195 million 2012 Clean and Safe Neighborhood Parks Bond. The bond allocated $5.5 million for the project. In 2014 Rec and Park contracted with Bauman, as the contractor, to construct the project and engaged Public Works as its construction manager. The project included the reorganization and renovation of the children's play area, tennis courts, paved play areas and pathways, access improvements, and landscaping and seating improvements to the open space adjacent to the North Beach Branch Library. The project was completed in November 2015.

Change Order Process. The City prepares and issues a change order after a project contract has taken effect. The change order serves as a record of agreement between the City and the contractor upon a change in the work outlined in the contract. Changes in work can include the amount of an adjustment in the contract sum, the adjustment of contract time, or an amendment to any other contract term or condition. Change orders can be initiated by the City via a Proposed Change Order or by the contractor via a Change Order Request. A change order is formally implemented when the City and contractor agree on the total cost and time of a Proposed Change Order or Change Order Request.

Payment Application Process. Before the City can pay the contractor, the contractor must submit a written request for payment for work completed in accordance with the project contract and approved schedule of values. The City issues payment only if it determines that the work has progressed satisfactorily to the point stated in the application for payment.

### Objectives

The objectives of this audit were, regarding the DiMaggio Playground Project, to:

- Evaluate Rec and Park's construction management, project controls, and oversight of—and Bauman's adherence to—certain cost and other provisions of its contract.
- Assess and evaluate payment applications and contract change order processes.

## Methodology

CSA engaged SF Delaney Consulting to assist with the audit. The scope of the audit included the contract between Rec and Park and Bauman for construction of the DiMaggio Playground Project, all contract change orders, all payments to Bauman, and the policies and procedures of Rec and Park and Public Works in effect during the project.

To conduct the audit, the audit team:

- Reviewed and obtained an understanding of contractual requirements for the general contractor.

- Reviewed and obtained an understanding of Rec and Park and Public Works processes and procedures for review and approval of Change Order Requests and payment applications.

- Interviewed four key Rec and Park and Public Works personnel, including construction management support staff.

- Evaluated a purposeful sample of 8 of 66 approved Change Order Requests representing nearly $897,000 or 84 percent of the dollar value for compliance with contract requirements and Public Works procedures. The sample Change Order Requests ranged from $24,000 to $496,000 and were for various purposes, including asbestos abatement, soil removal, and adding work included in the original bid as modifications to the contract. CSA's testing included assessing:

    - The reasonableness of the cause for the change.
    - Whether proper review, price negotiation, and approval occurred before work commenced.
    - The reasonableness of change order costs and time extensions.
    - Whether supporting documentation meets the requirements of the contract and the department's policies and procedures.

- Evaluated a purposeful sample of four of nine approved payment applications, representing $3,187,841 (or 59 percent of the value of the project's approved progress payments), for compliance with contract requirements and Public Works procedures. CSA's testing included assessing:

    - Reasonableness and accuracy of payment application submittals and approved payments.
    - Compliance of supporting documents with contractual requirements.
    - Whether city staff reviewed applications in accordance with the processes and procedures of Rec and Park and Public Works before approving payment.

CSA conducted this audit in accordance with generally accepted government auditing standards. These standards require planning and performing the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for the findings and conclusions based on the audit objectives. CSA believes that the evidence obtained provides a reasonable basis for the findings and conclusions based on the audit objectives.

## RESULTS

### Finding 1 – Public Works and Rec and Park allowed Bauman to complete change order work without first documenting Public Works' review and approval of the scope and cost of the requested change.

Public Works did not always approve a Change Order Request before Bauman began the requested work. This puts the City at risk of incurring a liability for additional, unneeded work, increased costs, and making delayed payments to the contractor due to financial disputes.

The Joe DiMaggio Playground Improvement Project contract requires Bauman to submit a Change Order Request within five working days of a proposed change. The Change Order Request must reference the related clarification, directive, specification, drawings, and details about the change's cost and schedule, including required materials, equipment, and labor, and any related taxes, insurance, or bonds. Per the contract, Public Works must then review and either approve or reject the Change Order Request within ten working days. These procedures are to ensure that when a contractor proposes changes in the work, the contractor provides the City with its best estimate of the costs and impacts associated with each change so that the City can adequately evaluate each potential change. Changes should only be implemented after Public Works, acting on behalf of Rec and Park, and the contractor agree on the total cost and schedule outlined in the Change Order Request.

Five (63 percent) of the eight change orders tested did not contain documentation of a formal agreement between Public Works and the contractor on the scope and cost of the proposed change. Public Works documents the formal agreement between itself and Bauman through Public Works' review and approval of a Change Order Request, but five of the eight change orders did not contain this document. Each of these changes did have a memorandum documenting Public Works' review of the request as a record of the department's negotiations with Bauman over scope and cost. However, according to the project manager, memorandums are only available to the contractor in Public Works' change order management system during the approval process, which is often after the contractor has performed the work. Consequently, the memorandums do not serve the purpose of documenting, in advance, that both parties agree to the costs and schedule because the contractor cannot review the document before performing the work.

Not documenting the agreement between Public Works and the contractor on the scope of the proposed change before the contractor completes the work increases the risk of misunderstandings and disputes over the final scope and cost of the proposed change and risks

delays in paying the contractor. Although Public Works was the contract manager for the project, Rec and Park was ultimately responsible for ensuring that proper procedures existed.

**Recommendations**

1. The Recreation and Park Department and Department of Public Works should ensure that the standard contract template and change management procedures consistently require a formally documented agreement between the department and contractor on the scope of any proposed change order before the contractor begins the change order work.

2. The Department of Public Works should document agreements with contractors on the scope of any proposed change order work before giving a contractor notice to proceed.

**Finding 2 – Because of its prolonged change order approval processes, Public Works and Rec and Park delayed a payment to Bauman for more than eight months.**

Public Works and Rec and Park delayed paying Bauman $70,399 for more than eight months for two Change Order Requests, negatively impacting the contractor's cash flow. Although Public Works complied with the change order payment provisions, the contract's change order approval procedures unfairly allowed delays, which effectively negated Public Works' timely payment obligation.

The contract requires timely payment on payment applications. Specifically, the contract requires Public Works to endeavor to process and pay undisputed payment applications within 15 business days but no later than 45 business days. Based on this requirement, the contractor could expect the City to issue payment within 45 days of the contractor submitting a request for payment for completed work. Despite this requirement, Public Works did not pay the two Change Order Requests listed in the exhibit below within that period and still had not paid them at the time of the audit's testing on August 9, 2016. According to Public Works, Rec and Park was working on final funding to pay the change order.

**EXHIBIT** **Public Works and Rec and Park Took More Than Eight Months to Approve Two Change Order Requests From Bauman**

| Change Order Request No. | Description of Change | Change Order Number | Time From Direction to Proceed to Approval[b] |
|---|---|---|---|
| 19 | Pier Columns at Columbus Curbs | 8[a] | 279+ days |
| 48 | Remove Additional Asbestos Asphalt Concrete | 8[a] | 225+ days |

Notes:
[a] This change order still had not been approved on August 9, 2016.
[b] Business days

Source: Auditor analysis of documentation prepared by Public Works and interviews with Public Works personnel.

The contract does not allow the contractor to submit a payment application (and, thereby, receive payment) for work performed under a Change Order Request until the City formally approves the change order. Although the contract requires Public Works to review the Change Order Requests within ten working days, it does not specify when the department must approve the requests. Public Works' delay in approving the two requests in the exhibit above effectively negated the contract's timely payment provision.

Although Public Works payments complied with the progress payment requirements, long delays could negatively impact any contractor and may especially discourage small, local contractors from bidding on city projects because they may have less capital to withstand delays in cash flow.

**Recommendation**

3. The Department of Public Works and Recreation and Park Department should better manage and track the timing of Change Order Request work and the change order approval process to ensure timely approvals of changes and timely payments to contractors.

**Finding 3 – Public Work and Rec and Park properly evaluated Bauman's monthly progress payment applications.**

All four of the payment applications sampled were complete, accurate, and complied with the contract. The audit's testing of payment applications also found that Public Works:

- Approved the progress payment applications in a timely manner.
- Reviewed the schedules of values for accuracy and requested any necessary adjustments.
- Verified that insurance coverage was up-to-date.
- Reviewed that the Local Business Enterprise Ordinance compliance forms were included in the submission.
- Used an accounting invoicing checklist to ensure that payment applications met all requirements.

The responses of Rec and Park and Public Works are attached. CSA will work with the departments to follow up on the status of the recommendations in this memorandum. CSA extends its appreciation to departmental staff that assisted with this audit. If you have any questions or concerns, please contact me at (415) 554-5393 or Tonia.Lediju@sfgov.org.

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# ATTACHMENT: DEPARTMENT RESPONSE

Edwin M. Lee, Mayor
Philip A. Ginsburg, General Manager

January 6, 2017

Tonia Lediju, Director of City Audits
City Hall, Room 476
1 Dr. Carlton B. Goodlett Place
San Francisco, CA 94102

Dear Ms. Lediju,

This letter is in response to the draft audit, *Recreation and Park Department & Department of Public Works: Department Change Order Processes Increased Risk of Disputes and Delayed Contractor Payment for the Joe DiMaggio Playground Improvement Project* prepared by the Controller's Office for the Joe DiMaggio Playground Improvement Project. Thank you for the opportunity to review the audit report and provide a response. Our response includes comments from both the Recreation and Park Department and the San Francisco Public Works Building Design and Construction.

Consistent with our mission to create and maintain beautiful parks, RPD is committed to implementing best practices in construction management. Change orders on a project are inevitable, but we do strive to process change orders fairly and responsibly. While we have robust procedures to manage change orders, we appreciate working with your office to both improve them and make sure that they are followed. We also acknowledge that prompt payment is important, especially to smaller contractors with limited cash flow.

We appreciate the recommendations of your office as they will continue to inform our work on capital improvement projects.

Sincerely,

Philip A. Ginsburg
General Manager

CC: Dawn Kamalanathan, RPD Director of Capital & Planning
Cara Ruppert, RPD Project Manager
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For each recommendation, the responsible agency should indicate whether it concurs, does not concur, or partially concurs. If it concurs with the recommendation, it should indicate the expected implementation date and implementation plan. If the responsible agency does not concur or partially concurs, it should provide an explanation and an alternate plan of action to address the identified issue.

# RECOMMENDATIONS AND RESPONSES

| Recommendation | Responsible Agency | Response |
|---|---|---|
| The Recreation and Park Department & Department of Public Works should: | | |
| 1. Ensure that the standard contract template and change management procedures consistently require a formally documented agreement between the department and contractor on the scope of any proposed change order before the contractor begins the change order work. | Recreation and Park Department & Department of Public Works | ☐ Concur ☐ Do Not Concur ☑ Partially Concur<br><br>Auditors found that five proposed change orders (PCO) did not have formally documented scopes of work before the department issued a notice to proceed (NTP). However, four of those five were for force account work. Force account work is appropriate when the "extent of extra work is not easily determined." (See Public Works procedure 11.04.04, Paragraph C; General condition Section 6.07). Staff did follow this procedure. Staff also tracked work progress using tags and existing oversight procedures including documenting work, holding regular progress meetings, and having an Inspector observe the work product. For non-force account work, we concur with the recommendation. |

| Recommendation | Responsible Agency | Response |
|---|---|---|
| 2. Document agreements with contractors on the scope of any proposed change order work before giving a contractor notice to proceed. | Department of Public Works | ☐ Concur ☐ Do Not Concur ☑ Partially Concur<br><br>Generally, prior to NTP, we document agreements with contractors including defining the scope of work of any proposed change order(s). However, when the scope of work is not easily determined or defined, the force account work process is appropriate. (See Public Works procedure 11.04.04, Paragraph C; General condition Section 6.07) |
| 3. Better manage and track the timing of Change Order Request work and the change order approval process to ensure timely approvals of changes and timely payments to contractors. | Recreation and Park Department & Department of Public Works | ☑ Concur ☐ Do Not Concur ☐ Partially Concur<br><br>The Recreation and Park Department and the Department of Public Works strive to be partners with our contractors at all times to ensure timely responses to requests for information, approvals and payments. We will work internally to meet that goal for all future projects. |