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November 5, 2020

AUDITOR’S LETTER

In keeping with generally accepted government auditing standards and Auditor's Office policy, as authorized by city ordinance, the Audit Services Division has a responsibility to monitor and follow up on audit recommendations to ensure city agencies address audit findings through appropriate corrective action and to aid us in planning future audits.

I am pleased to report that, in our follow-up effort for the “Halcyon Construction Inc. On-Call Contract” examination report completed by CliftonLarsonAllen LLP and issued in March 2019, we determined the Department of Transportation & Infrastructure fully implemented all recommendations made in the original examination report.

Since that original examination, the Department of Public Works was renamed the Department of Transportation & Infrastructure. Therefore, in this report, we reference the Department of Transportation & Infrastructure as acting upon the recommendations from the original examination, which referenced the Department of Public Works.

The Highlights page in this report provides background and summary information about the original examination and the completed follow-up effort. Following the Highlights page is a detailed implementation status update for each recommendation.

I would like to express our sincere appreciation to the personnel at the Department of Transportation & Infrastructure who assisted us throughout the examination and the follow-up process. For any questions, please feel free to contact me at 720-913-5000.

Denver Auditor’s Office

Timothy M. O’Brien, CPA
Auditor
Halcyon Construction Inc.  
On-Call Contract  
November 2020

Objective

- To assess the Department of Transportation & Infrastructure’s review of Halcyon Construction Inc.’s selection of subcontractors under its on-call construction services contract with the city and to review the department’s examination of pay applications and change orders.

- To understand the department’s internal controls associated with reviewing and approving pay applications and change orders.

- To review the department’s oversight of Halcyon’s compliance with construction project progress reporting, project budgets, and project closeout processes and procedures.

Background

CliftonLarsonAllen LLP conducted this examination on behalf of the Auditor’s Office.

The audit firm examined the Department of Transportation & Infrastructure’s compliance with city procurement policy, Executive Order 8, and the city’s on-call contract with Halcyon Construction Inc. from May 1, 2015, through April 30, 2018. Specifically, CliftonLarsonAllen LLP looked at subcontractor selections, pay applications, change orders, construction project progress reporting, project budgeting, and project closeouts.

REPORT HIGHLIGHTS

Highlights from Original Audit

Pool of Small Business Enterprise Contractors Should Provide a Competitive Bidding Environment for the City and County of Denver

The Department of Transportation & Infrastructure did not follow its mini-bid process because the department lacked internal controls. Additionally, having a limited number of small business enterprise contractors in the pool for on-call construction services could have restricted competition for the mini-bid process.

No Formal Policy Is In Place regarding Exemptions to the Mini-Bid Process for On-Call Construction Services Projects

A department manual exempted Transportation & Infrastructure from going through the mini-bid process for small work and emergency repairs costing $60,000 or less. However, this manual was not equivalent to a formal policy.

Enhancing Internal Controls over Costing of Projects Will Strengthen Internal Records

Halcyon was not required to provide subcontractor invoices to the Department of Transportation & Infrastructure to support amounts it paid to them. Therefore, CliftonLarsonAllen LLP could not determine whether Halcyon properly classified direct labor, material, and equipment costs. Furthermore, the audit firm identified numerous instances when the amounts Halcyon paid to its subcontractors did not match the invoices Halcyon provided. This resulted in the city being overcharged.

Internal Controls over Project Monitoring and Change Order Process Should Be Enhanced to Improve Oversight of Contractors

The Department of Transportation & Infrastructure could not provide documentation showing it inspected construction work in progress. Substantiating inspections helps ensure construction work is in line with project specifications.

Additionally, the amount of change orders Halcyon had was significantly higher than other small business enterprise on-call contractors. The aggregate dollar amounts on Halcyon’s change orders were between 3% and 301% higher than the original work orders.

✅ 4  
FULLY IMPLEMENTED

⊙⊙⊙ 0  
PARTIALLY IMPLEMENTED

❌ 0  
NOT IMPLEMENTED
Action Since Examination Report
Halcyon Construction Inc. On-Call Contract

4 recommendations proposed in March 2019

By implementing all of the examination recommendations, the department improved controls surrounding the mini-bid process. It took steps to improve that process by working to increase the number of small businesses that can participate. The department also updated on-call construction contract language, and it now tracks information to compare change orders for each project to their original work orders.
**Finding 1 | Pool of Small Business Enterprise Contractors Should Provide a Competitive Bidding Environment for the City and County of Denver**

**Recommendation 1**

We recommend that Public Works enhance the internal controls surrounding the mini-bid process to ensure compliance with policies. This can be accomplished by improving checklists and process flows surrounding the mini-bid process to ensure projects are competitively bid and evidence is retained to show compliance. We also recommend that Public Works consider expanding its pool of SBE contractors to allow for a more competitive environment and opportunities for other contractors to be considered for this work.

**AGENCY ACTION**

**Original target date for completion: 90 days (June 10, 2019)**

In July 2019, the Department of Transportation & Infrastructure created and implemented a new on-call construction policy and procedure. Included within this policy and procedure is a process flow detailing how the mini-bid process should be performed — such as when the mini-bid process can be bypassed and when documentation is required.

To substantiate that this policy and procedure were implemented, we used our professional judgment to sample and review three on-call construction work orders issued to Halcyon after the 90-day target implementation date Transportation & Infrastructure set for this recommendation. We verified that the department is adhering to these new safeguards and that the safeguards are operating as laid out in the on-call construction procedure. We found that for all three projects, Transportation & Infrastructure properly followed the mini-bid process, and it maintained all appropriate supporting documentation to substantiate compliance with the policy and procedure.

The second part of this recommendation called for the Department of Transportation & Infrastructure to consider expanding its pool of small business enterprise contractors to allow for a more competitive environment and more opportunities for other contractors to be considered for on-call work. The department made several efforts to improve its outreach and expand its pool of on-call contractors. Specifically, the department meets on a quarterly basis with contractors to educate them on how they can work with the city on on-call construction projects. On top of this, the department holds monthly meetings with contractors to encourage other small business contractors to become a part of the department's on-call pool.

As a result, we consider this recommendation fully implemented.
Finding 2 | No Formal Policy Is In Place regarding Exemptions to the Mini-Bid Process for On-Call Construction Services Projects

Recommendation 2

We recommend that Public Works follow its policy on the mini-bid process to ensure that the policy is understood and reflected in any employee resource manuals. This can be accomplished further by incorporating policies and process flows into training opportunities for employees and verifying that policies are fully understood by employees to ensure compliance.

AGENCY ACTION

Original target date for completion: 90 days (June 10, 2019)

As discussed in the agency action for Recommendation 1, the Department of Transportation & Infrastructure implemented in July 2019 its new on-call construction procedure that includes the mini-bid process. Additionally, the department now dedicates a section of its employee resource manual to discussing the mini-bid process in detail. New employees are required to read the new on-call construction procedure — including the details on the mini-bid process — and they must undergo training.

To verify whether the department implemented the on-call construction procedure and mini-bid process, we:

- Reviewed agendas for staff meetings where department officials went over this procedure with their employees.
- Reviewed e-mails from management to all department personnel responsible for ensuring the mini-bid process is completed — which asked them to review the new on-call construction procedure and reminded them that the mini-bid process is required.
- Reviewed an orientation schedule for one new hire, showing that they were required to read the resource manual and that they specifically received training on the mini-bid process.

As a result, we consider this recommendation fully implemented.
Finding 3 | Enhancing Internal Controls over Costing of Projects Will Strengthen Internal Records

Recommendation 3

We recommend that Public Works implement a policy requiring all subcontractor invoices to be submitted to Public Works by Halcyon at the time the "Contractor's/Consultant's Certification of Payment" (CCP) forms are submitted for payment processing and go through a detailed review process prior to payment. Detailed invoice support should also be required to be provided by Halcyon for their direct charges to further support amounts being certified for payment. Public Works should enhance its training, process flow, and oversight to address risks associated with potential overcharging by contractors and subcontractors under on-call contracts.

AGENCY ACTION

Original target date for completion: 90 days (June 10, 2019)

The department agreed with Recommendation 3 after the original examination. Department officials at the time said they would evaluate their existing method for receiving and reviewing contractors' certification-of-payment forms, and they said they would develop and document a methodology for verifying payments made by vendors — including Halcyon — to their subcontractors against what is detailed in the subcontracts.

Since then, however, department officials decided that developing a new way to verify payments made to vendors was not the best alternative. Instead, they decided that changing the language in on-call construction contracts would better align with construction industry best practices.

In June 2019, the department signed a new three-year, on-call construction contract with Halcyon Construction Inc. The previous contract that was in place during the original examination required contractors to provide at the time of bid a detailed breakdown of direct costs (e.g., material, labor, and equipment) separately from indirect costs such as sales tax, permit costs, or bond costs. That contract then specified markup percentages that were allowed for direct cost categories. The original examination acknowledged that Halcyon provided the required detailed cost breakdown at the time of bid, but the issue that led to Recommendation 3 was that the Department of Transportation & Infrastructure did not validate when Halcyon submitted payment applications as work progressed.

Such validation by the city was necessary because the contract allowed for markups to be applied to only some cost categories. To ensure Halcyon
marked up costs correctly, Transportation & Infrastructure needed detailed invoices for direct costs to support amounts being certified for payment.

Meanwhile, the new on-call contract that took effect in June 2019 removed the requirement that Halcyon separate direct costs from indirect costs, and it removed the percentages for direct cost markups. Transportation & Infrastructure officials said the revised language better aligned the contract terms with how the construction industry handles lump-sum construction contracts. Officials said that because lump-sum contracts are typically supported by “percentage complete billing,” industry practices do not require a breakdown of direct and indirect costs at the time of billing. “Percentage complete billing” is a process whereby a contractor bills a portion of the agreed-upon lump-sum work order amount that corresponds with the percentage of the scope of work it completed to date. The city relies on inspections to verify the work performed, that the materials used match the project specifications, and that the amount of project billings match the amount of work completed.

Additionally, Transportation & Infrastructure officials said that because Halcyon on-call projects are bid in a competitive mini-bid environment, the city obtains the best value by accepting the lowest bid. A lump-sum contract is bid through a process whereby on-call contractors provide a single lump-sum price at the time of bid followed by a schedule of values to outline the scope of work, and the department then selects the lowest bidder.

Whenever a change order is requested that adjusts the amount of the original lump sum, the contract requires the contractor to provide the city with an updated schedule of values that itemizes cost estimates, so that the city can evaluate the contractor’s change request. Specifically, the contractor must include cost estimates for direct labor, labor burden, direct material, equipment costs, and profit and overhead markup.

As part of our follow-up audit work, we used our professional judgment to select three recent on-call projects, and we verified that the lowest bidder was awarded the project in all three instances.

The Department of Transportation and Infrastructure did not implement the recommendation by creating a policy requiring that subcontractor invoices be submitted. However, we conclude that the risk identified in the original examination has been mitigated, because the department is requiring detailed cost information to be included in the schedule of values at the time a project is bid and whenever a change order is requested, as well as through its performance of on-site project inspections.
Finding 4 | Internal Controls over Project Monitoring and Change Order Process Should Be Enhanced to Improve Oversight of Contractors

Recommendation 4

We recommend that Public Works enhance internal controls surrounding contractor monitoring and change order oversight. This can be accomplished by implementing a standardized checklist around site inspections for on-call construction projects. This can also be accomplished by enhancing the controls surrounding change order approvals by having a detailed process flow or similar documentation to track original work order scope, change order reasoning, and retain evidence of comparison of change orders to work orders. This process flow or similar documentation should be standardized for all projects and include comparisons to RSMeans data available for project managers regarding costing of projects.

AGENCY ACTION

Original target date for completion: 90 days (June 10, 2019)

The first part of Recommendation 4 called on the Department of Transportation & Infrastructure to implement a standardized checklist around site inspections for on-call construction projects. To verify whether the department did this, we used our professional judgment to select two recent Halcyon on-call projects, and we requested the site inspection forms for those projects. Although the department provided us with completed site inspection forms, the forms were not standardized as Recommendation 4 suggested.

Recommendation 4 also noted that Transportation & Infrastructure could improve its contract monitoring by enhancing controls for change order approvals and having a detailed process flow or similar documentation to track the original work order’s scope and the reason for change orders and by retaining evidence that staff compared change orders to the original work orders.

We found Transportation & Infrastructure tracks change order data on the contractor certification-of-payment form, as well as on the change order request form — which contractors must submit to the department anytime they request a change in the scope of work or in the originally agreed-upon cost.

Since the original examination, Transportation & Infrastructure now requires contractors to submit standardized certification-of-payment forms every time an on-call contractor submits a payment application. We obtained the standardized checklist the department uses when processing on-call
contractors’ submitted payment applications to verify whether the certification-of-payment forms are required with all payment requests before the department approves payment.

We used our professional judgment to select two Halcyon projects, for which we obtained the contractor certification-of-payment forms and the change order request forms. We verified that documentation exists to track the original scope of work and the reason for change orders and that information is available to compare change orders with the original work orders.

For both projects, the certification-of-payment forms and the change order request forms included information about the original total for the work order and the total for the change order — allowing staff to track and compare the change order against the original work order. Furthermore, we noted the change order request forms included descriptions that provided a rationale for the requested changes.

Lastly, Recommendation 4 suggested that RSMeans data should be made available to the department’s project managers. We confirmed that department project managers now have access to RSMeans data and can reference the database’s current cost information when reviewing the cost details of on-call contractors’ change order requests.

As a result, we consider this recommendation fully implemented.
Office of the Auditor

The Auditor of the City and County of Denver is independently elected by the citizens of Denver. He is responsible for examining and evaluating the operations of City agencies and contractors for the purpose of ensuring the proper and efficient use of City resources. He also provides other audit services and information to City Council, the Mayor, and the public to improve all aspects of Denver’s government.

The Audit Committee is chaired by the Auditor and consists of seven members. The Audit Committee assists the Auditor in his oversight responsibilities regarding the integrity of the City’s finances and operations, including the reliability of the City’s financial statements. The Audit Committee is structured in a manner that ensures the independent oversight of City operations, thereby enhancing citizen confidence and avoiding any appearance of a conflict of interest.

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We deliver independent, transparent, and professional oversight in order to safeguard and improve the public’s investment in the City of Denver. Our work is performed on behalf of everyone who cares about the City, including its residents, workers, and decision-makers.