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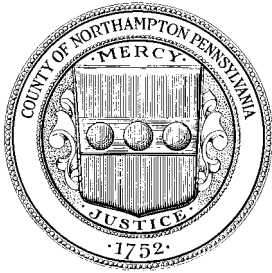
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Audit Report

**CONSTRUCTION
MANAGEMENT
CONTRACT REVIEW**

As of April 2006

**Office of the Controller
County of Northampton
Pennsylvania**



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August 4, 2006

Members of the Northampton County Council
John Stoffa, County Executive
County of Northampton, Pennsylvania

We have completed an audit of Construction Management Contracts as of April 2006.

The Executive Summary on page 1 summarizes the audit results and identifies opportunities for improvement, while the Audit Results section provides a detailed explanation.

We acknowledge the cooperation and assistance we received from the County Administration and the construction management firms of Alvin H. Butz, Inc. and Keating Building Corporation. Their help was essential to the performance of this audit.

Our report was discussed with management at our exit conference on August 17, 2006. Management's response is included in Exhibit 2 of the report.

Very truly yours,

John T. Schimmel, P.A.
County Controller

Kathleen A. Kuzma, CPA
Lead Auditor

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EXECUTIVE SUMMARY - OPPORTUNITIES FOR IMPROVEMENT

The following is a summary of the content of the enclosed report. See report references noted below for full detail.

Section A – 1996 Contract with Alvin H. Butz, Inc.

1. The County would avoid potential questions and confusion if contracts would be more specific in their language about the scope of work to be performed. Contracts should be written with language that details the specific projects to be covered. (Section A-1, page 4)
2. To ensure that all contracts follow County policy, the Administrative Code should be strictly adhered to. (Section A-2, page 5)
3. The County would avoid potential questions and confusion if contracts were written with unambiguous wording with regard to the fees charged and costs involved for the services to be provided. (Section A-3, page 6)

Section B – Review of Invoices from Construction Managers

1. Improving on the review process for invoices and backup documentation and comparing charges to the terms of the contract would lessen the likelihood that questionable or unauthorized charges occurred. All records should be centralized and maintained for the duration of the project for ease of managing and reviewing activity of the project. (Section B-1, page 7)

Section C – Best Practices

1. For future contracts of this nature, the County would benefit by using resources made available by organizations such as the CMAA and by consulting with neighboring counties to gain a better understanding of current market practices. (Section C, page 9)
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INTRODUCTION

Northampton County's 2001 Bond Issue provided funding for various projects. Among these projects were the following:

- Courthouse Expansion for the construction of a new court facility, which would be approximately 100,000 gross sq. ft. and include courtrooms, hearing rooms, public spaces and judicial offices for an estimated cost of \$42 million.
- County Prison Expansion for the construction of an addition to the existing Prison, including approximately 350 beds, administrative offices, secure entrance for inmates, staff and visitors for an estimated cost of \$22.8 million.

The County has used the services of construction management firms to oversee these and other major construction projects. In 1996, the County entered into a contract with Alvin H. Butz, Inc. (Butz) to manage various construction projects at the County. The scope of this contract included miscellaneous countywide projects in an effort to develop a facility master plan to study the long-term facility requirements of the County court system. In 2001, the County decided to continue with Butz for the Courthouse Expansion project. No addendum to the original contract was prepared that covered the Courthouse Expansion project. (However, there was an addendum to add the Domestic Relations Building project.) The County also entered into a contract with Keating Building Corporation (Keating) in 2002 to manage the Prison Expansion project.

The role of a construction management firm can be vital to the success of a major construction project. A construction manager acts as a high level manager who coordinates the different aspects of a project, mediates between the owner, contractors and suppliers, and oversees the entire process from inception through design to completion. A construction manager also works to ensure that the project is feasible from a physical standpoint as well as a budgetary one.

PURPOSE AND SCOPE

County Administration requested that our office review the construction management contracts for the Courthouse Expansion and Prison Expansion projects. Our purpose was to determine:

- If the Butz contract, as originally written in 1996, applies to the current Courthouse Expansion project,
- The propriety and accuracy of invoices submitted to the County for payment of the projects, and
- To offer comments and observations on the construction management industry.

We reviewed costs from the inception of each project through April 2006.

METHODOLOGY

Our methodology included:

- Interviewing various County Officials and personnel from the construction management firms.
- Reviewing the contracts and applicable addendums for the projects.
- Reviewing the applicable sections of the Administrative Code.
- Consulting with our Solicitor on various matters relative to the contracts.
- Testing expenditures related to the invoices for each project submitted by the construction managers.

This audit was conducted in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States.

AUDIT RESULTS

Section A – 1996 Contract with Alvin H. Butz, Inc.

1. Scope per the 1996 Contract

OBSERVATION

The 1996 contract with Butz does not include construction management services with regard to the current Courthouse Expansion project. Further, continuing with Butz as the construction manager of the Courthouse Expansion project was in violation of the Administrative Code in effect at that time. (See Section A-2, page 5.)

Contract #96-211 was executed between the County of Northampton and Butz as of August 29, 1996. The scope of the project specifically included:

- Disposition of Easton City Hall and related properties
- Americans with Disabilities Act upgrades for all County facilities
- Existing Court and Administrative facilities renovations
- New heating plant for the Government Center and Prison
- Possible additional Administrative facilities
- Juvenile Detention and Probation facility renovation and expansion
- Gracedale improvements – roofing, toilet facilities, HVAC and laundry equipment
- Halon system conversion
- HVAC refrigerant conversion

The contract states: “Northampton County is relying on a project management team to most effectively utilize the funds available for this Project within the two-year (1996) bond issue arbitrage limits” and “While it may be possible that the entire Improvement and Modernization Project cannot be completed within the \$10 million bond issue limit, the County would like the opportunity to review several alternative project solutions and parameters to ensure that priorities are addressed, economies are achieved, and the bond proceeds have maximum impact”.

There has been some debate over whether or not the 1996 contract with Butz encompasses the Courthouse Expansion project. Our opinion, as stated above, is supported by the opinion of our Solicitor, David J. Ceraul, Esq., that the 1996 contract with Butz does not cover the Courthouse Construction/Expansion project and that an amendment or replacement to the original contract would have been appropriate to clarify scope and set forth compensation. See the attached Exhibit 1 for more detail.

RECOMMENDATION

The contract was poorly written with respect to the scope of work. Contracts should be worded more carefully with regard to the work to be performed. In this instance, the specific project to be managed by the construction manager should have been delineated in a contract.

MANAGEMENT'S RESPONSE

Victor Mazziotti, Director of Fiscal Affairs – See Exhibit 2.

2. Adherence to the Administrative Code

OBSERVATION

The assignment of Butz as the construction manager for the Courthouse Expansion is in violation of the Administrative Code as it existed prior to the 2004 Revisions. The pertinent sections of the Code are as follows:

- **Professional Services, Section 13.07** – “Contracts for professional services shall be acquired by issuing Requests for Proposals”.
- **Professional Services, Section 13.07 b (2)** – “At least twenty (20) days before the County Executive obligates the County to the proposed terms of any prospective contract, the County Executive shall provide written notification of the proposed terms of the prospective contract to County Council of the contract if the contract consideration exceeds \$100,000”.
- **Contract Modification and Termination, Section 13.06 a** – “Total contract modifications in the form of change orders shall be limited to increases not exceeding 10 percent of the original total contract. Increases in excess of 10 percent of the original contract shall be in accordance with the source selection procedures established by this Code”.

There was no evidence that Request for Proposals were sought for the Courthouse Expansion. There was also no evidence of Council notification for either a modification to the 1996 contract or for the total potential construction management fees to be earned by Butz for the Courthouse Expansion project.

RECOMMENDATION

County policies and procedures were not followed with regard to the 1996 Butz contract. All County rules and regulations should be adhered to with regard to contracts. Specifically, the requirements of the Administrative Code must be followed when entering into contracts.

MANAGEMENT'S RESPONSE

Victor Mazziotti, Director of Fiscal Affairs – See Exhibit 2.

3. Compensation per the 1996 Contract

OBSERVATION

As stated earlier, we believe that the 1996 Butz contract is not applicable to the current Courthouse Expansion project. The County, however, has operated under the assumption that the contract is applicable and has used the specifications of this contract to compensate Butz throughout the term of the project. Therefore, for the purposes of this audit, we used these specifications as criteria for measuring compliance and adequate performance. In doing so, we noted that the fee structure agreed to in the contract is somewhat ambiguous. Although a fee of 4% times the actual amount of all construction contracts required to complete the work is stated in the contract, it is unclear whether this fee includes other reimbursable costs, such as personnel and some general expenses. This opinion is supported by our Solicitor, David J. Ceraul, Esq.

As of our audit date, the following had been paid to Butz:

- Cumulative construction management fee of \$1,135,440
- General condition expenses of \$2,430,568

General condition or reimbursable expenses include the following:

- Expense of transportation, out-of-town travel, long-distance communications and fees paid for securing approval of authorities
- Expense of reproductions, postage, express deliveries, electronic facsimile transmissions and handling of drawing, specifications and other documents
- If authorized in advance by the owner, expense of overtime work requiring higher wages
- Expense of additional insurance coverage or limits requested by the owner in excess of that normally carried by the construction manager.

Our Solicitor comments "Attorney Zito has correctly opined that contract is not clear enough to determine whether Northampton County is obligated to pay this additional compensation. Pending a formal legal opinion by the Northampton County Solicitor's Office, it is impossible to determine if the 4% fee includes supervisory personnel costs. The ambiguity within the four corners of the contract appears to indicate the personnel costs should be covered under the fee, no specific language to this effect is contained in the contract". See the attached Exhibit 1 for more detail.

RECOMMENDATION

The contract was poorly written with regard to fees and costs that were to be billed to the County. Contracts should be carefully worded and the items to be invoiced to the County should have been spelled out in unambiguous language.

MANAGEMENT'S RESPONSE

Victor Mazziotti, Director of Fiscal Affairs – See Exhibit 2.

Section B – Review of Invoices from Construction Managers

1. Authorization of Payment

OBSERVATION

As a result of our review of invoices, we noted instances where we were not able to find evidence of supervisory review and authorization for payment. If this supervisory review and authorization was in fact lacking, it could explain some of the anomalies we discovered with the invoices selected for testing.

A sample of invoices was selected from all expenditures paid to Butz and Keating for the construction management services. Invoices were reviewed to ensure that proper documentation was attached and that they were calculated accurately and were within the guidelines of billable items per the contracts. Invoices were also reviewed for proof of supervisory review by a County official authorizing payment.

While the copies of invoices we were given to review did bear the signature of the Director of Public Works from time to time, a signature was not consistently present on all invoices. Also, we could find no proof that the invoices were reconciled to backup documentation. Reconciling schedules were not present to ensure that the construction management firms correctly accounted for cumulative totals billed and previously paid.

Some anomalies we noted with the invoices include:

- Monthly invoices from Butz included charges for insurance costs.
- Supervision rates were not included in the 1996 Butz contract and no written agreement could be located that approved these rates and subsequent increases.
- Rate increases occasionally occurred more than once annually on Butz's supervision rates.
- Keating invoices revealed that the billing of the construction management fee was not based on the percentage-of-completion of the project.
- Keating had included on several occasions the billing of the construction management fee in the total construction costs. This overstates the construction costs, which in turn overstates the actual construction management fee.
- Reimbursable charges billed to the County from the Architect through the Keating invoices included a markup of 5%.
- Both firms hired consultants to assist with scheduling of the project.
- Both firms entered into related-party transactions for the leasing of equipment and autos.

RECOMMENDATION

The manner in which the records were maintained within County departments made it difficult to determine if the proper supervisory review and authorization for payment was present. Procedures should be implemented to handle large projects of this nature to ensure that the proper review and authorization is performed and records are maintained in a central location.

MANAGEMENT'S RESPONSE

Victor Mazziotti, Director of Fiscal Affairs – See Exhibit 2.

Section C – Best Practices

Research was performed to determine if there were industry standards with regard to contracting for construction management services.

An organization called Construction Management Association of America (CMAA) (<http://cmaanet.org>) was consulted. The CMAA is a national industry association that “promotes professionalism and excellence in the management of the construction process.” It was founded in 1982 in response to an increasing need for owners to manage their projects. It is the only organization in North America dedicated exclusively to the interests of professional construction management/program management. It currently has a membership of 25 regional chapters and 3,000 individuals, firms, and agencies throughout the country. This was an excellent source of information. The website covered various owner-resource topics such as what is construction management, what does a construction manager do, and finding a construction manager.

This organization published “An Owner’s Guide to Construction Management – Assuring Project Success Under Any Delivery Method”, which is an excellent resource for anyone considering contracting with a construction manager. It details several methods of payment that are recognized as commonly used in the compensation of firms for professional construction management services.

- Salary times multiplier plus direct expenses
- Billing rates
- Cost plus fixed fee

A form of compensation that is ***not recommended*** by this organization because it is arbitrary and not related to the effort that may be required is:

- Fee as a Percent of Construction Cost.

Our research also indicated that the PA Procurement Manual ***prohibits*** “cost-plus-a-percentage-of-cost” contracts. Acceptable contracting methods are as follows:

- Firm, fixed-price contracts
 - Established-price types
 - Time and materials contract
 - Labor-hour contract
 - Unit price contract
 - No-fee contract
- Cost-reimbursement contracts
 - Cost-sharing contract
 - Cost-plus-incentive-fee contract
 - Cost-plus-a-fixed-fee contract
- Performance based contracts

RECOMMENDATION

The fees charged by the construction management firms do not follow the prescribed methods of payment under the PA Procurement Code or the CMAA.

The County should consider consulting organizations in this field or counties in the immediate area who have had experiences of this nature for the current acceptable methods for handling these types of contracts.

MANAGEMENT'S RESPONSE

Victor Mazziotti, Director of Fiscal Affairs – See Exhibit 2.

Section D – EXHIBITS

Exhibit 1 – David J. Ceraul, Esquire, County Controller Solicitor



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DAVID J. CERAUL
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**Re: Construction Management Contract
Review Audit**

Dear Kathy:

Per your request, I have reviewed the AIA contract between the County of Northampton and Alvin H. Butz, Inc. identified as Contract No. 96-211. Based upon my review of this standard form contract, it is my opinion this document does not specifically cover the current Courthouse construction/expansion work. Further, I concur with Attorney Zito's opinion, as contained in his Memo to County Council dated February 13, 2006, that, when considering the construction of contracts, the departure point is to determine whether or not the terms of the agreement are clear and unambiguous, such as at the contracting parties can be determined from the four corners of said contract. Glen Distributors Corporation vs. Carlyle Plastics, Inc., 297 F.3d 294 (2002). Using the standard, 4% fee that Butz is currently charging, is not clearly addressed in the original contract, or the Addendum thereto. Attorney Zito has correctly opined that contract is not clear enough to determine whether Northampton County is obligated to pay this additional compensation. Pending a formal legal opinion by the Northampton County Solicitor's Office, is it impossible to determine if the 4% fee includes supervisory personnel costs. The ambiguity within the four corners of the contract appears to indicate the personnel costs should be covered under the fee, no specific language to this effect is contained in the contract.

On a related note, the Keating contract (No. 01-138) is unambiguous, and a determination as to the precise fees due and owing to Keating is determinable. Pursuant to the contract, Keating's fee is 1.35% of the construction costs. No clear calculation can be made as to the Butz contract especially in light of some of the standard language contained in the AIA standard form agreement which provisions are clearly set forth in Mr. Morganelli's letter to Councilman Angle dated November 30, 2005, on page 4 thereof.


Ms. Kathy Kuzma, CPA, Lead Auditor
Page 2
May 9, 2006

In conclusion, I do not believe that the 1996 contract, as originally drafted, applies to the current Courthouse expansion project, without additional information. It is my further opinion, that amendment to the original contract, or a replacement thereof, would be appropriate to not only clarify the scope of the services rendered, but also to clearly set forth the compensation to be paid to Alvin H. Butz company.

As you know, I will be out-of-town from May 15th through the 21st, 2006, celebrating my wedding anniversary. If you require any additional clarification, or additional research upon my return, please advise.

Thank you.

Very truly yours,



DAVID J. CERAUL

DJC/jap

Exhibit 2 – Management’s Response, Victor Mazziotti, Director of Fiscal Affairs

Construction Management Contract Review
Office of the Controller Audit
Management Response
October 5, 2006

Section A – 1996 Contract with Alvin H. Butz, Inc.

We agree with the recommendations.

1. The contract should have been more specific in language and content.
2. It appears that the contract does not adhere to the requirements of the Administrative Code.
3. A more carefully worded contract should have been developed.

Section B – Review of Invoices from Construction Managers

1. The new Public Works Director, Steve Desalva, the primary approver of construction invoices, has been made aware of the concerns expressed in this audit. He will seek additional supporting information when invoices are submitted and he will monitor construction work more closely.
2. All project records are maintained in Public Works and all financial records are maintained in Fiscal Affairs.

Section C – Best Practices

1. We believe that all future construction management contracts should be bid and that the current form – fee as a percent of construction cost and reimbursement for expenses – should not be a permitted method.

The County Executive and the Director of Fiscal Affairs have meet with a number of managers from Alvin H. Butz, Inc., including Lee Butz, CEO and Greg Butz, President, over the past few weeks. Communications between the County and the Butz company is greatly improved and we believe that the project is now on track for an efficient and effective conclusion. The availability of the new Public Works Director will further improve this situation.

The county will continue to review the Alvin H. Butz construction management invoices and we will continue to seek the most advantageous possible billing.