



Construction Contract Auditing

*Thomas A. Mock, CIA, CCA
Director of Internal Audit
Lake County Schools*





Overview of Session

- Types of Construction Contracts
- Architectural Agreement
- Contract Documents
- Bonds and Insurance Programs
- General Conditions
- Schedule of Values & Payment Applications
- Change Orders, Allowances & Contingences
- Logs, Reports, Schedules
- Subcontractors
- Construction Audit Program



TRENTON – Attorney General Anne Milgram and Criminal Justice Director Gregory A. Paw today announced that the treasurer of a Barrington construction company has been sentenced to prison for submitting fraudulent bonds in connection with three government contracts.

According to Director Paw, Ethan E. Joss, 33, of Sewell, was sentenced on Friday to five years in state prison by Superior Court Judge Thomas A. Brown Jr. in Camden County. Joss pleaded guilty on May 25 to an accusation charging him with three counts of second-degree false contract payment claims and a single count of third-degree theft by deception.

Joss, the former treasurer and part owner of his family's company, EEJ Mechanical Inc. of Barrington, was sentenced to five years in prison on each of the second-degree charges and three years on the third-degree charge, with all of the sentences to run concurrently. He was ordered to pay \$48,000 in restitution to the Haddon Heights Board of Education. He further was ordered to divest himself of all ownership interest in EEJ Mechanical Inc. and to be permanently banned from contracting with the state.

Joss admitted that in February 2006, in order for EEJ Mechanical to obtain a \$1.7 million contract with the Haddon Heights Board of Education to install HVAC systems in three schools, he submitted a fraudulent performance-payment bond to the school board. The theft by deception charge and restitution order relate to the amount that Joss billed the school board for the fraudulent bond under the contract. Joss also admitted he submitted a fraudulent bid bond to the City of Somers Point in November 2005 for a \$587,000 contract for HVAC work at city hall, and submitted a fraudulent bid bond to the Woodbury Heights Board of Education in August 2005 for a \$113,000 contract to replace a boiler at Woodbury Heights Elementary School.

Deputy Attorney General Daniel F. Dryzga and State Investigator Alan Drummond handled the case for the Division of Criminal Justice.

Monday, July 30, 2012

By Bob Hennelly

"The over billing fraud affected city, state and federal public building projects," she said. "If you are a New York City resident, Bovis indirectly swindled you on three different levels. For 10 years the pattern of fraudulent over billing was a standard practice, business as usual."

At the heart of the probe is what prosecutors say is an industry-wide practice known as "8 and 2" in which construction companies fraudulently bill clients for hours not worked by labor foremen.

Bovis would add two hours of overtime pay on top of regular hours for as many as 60 foremen and falsely listed unworked hours as worked, prosecutors said.

Costa Bella Builders' Convicted for WC Fraud

October 22, 2013

Email This

Recommend

Print

24

25

Newsletters

Share

54

2 Comments

Article

The owner of a Northern California construction company and his family members in were convicted of committing workers' compensation insurance premium fraud.

Key Thranow, 59, owner of Costa Bella Builders was convicted of committing workers' compensation insurance premium fraud for his part in failing to report employees to his carrier or to the Employment Development Department.

LAK

g

ectly

audulent

Harris County man sues construction company for alleged fraud

May 21, 2014 4:21 PM
By BEN HART

A building company has been named in a fraud claim after allegedly failing to provide proof of the amount a Harris County man owed for a job.

Cass Shewbart filed a lawsuit May 7 in the Galveston Division of the Southern District of Texas against Stoneray Builders LLC and Tony P. Frederick, citing fraud.

Shewbart claims he came to an agreement with the defendants to build his residence on Pegasus Lane in League City last July.

The suit alleges defendant Frederick wanted to buy all materials and pay for labor himself and then have Shewbart reimburse him for any amounts expended on the project.

According to the brief, Shewbart states he grew suspicious of the invoices that seemed excessive and asked the defendants for their lumber invoices, but they have avoided giving him the invoices.

Shewbart is seeking actual damages, interest, attorney's fees and court costs.

He is being represented by Humble attorney John Papapavlou and Porya Mostaghimi of PM Law Firm PLLC.

Galveston Division of the Southern District of Texas Case No.
14-CV-0512

This is a report on a civil lawsuit filed at the Galveston Division Courthouse. The details in this report come from an original complaint filed by a plaintiff. Please note, a complaint represents an accusation by a private individual, not the government. It is not an indication of guilt, and it only represents one side of the story.





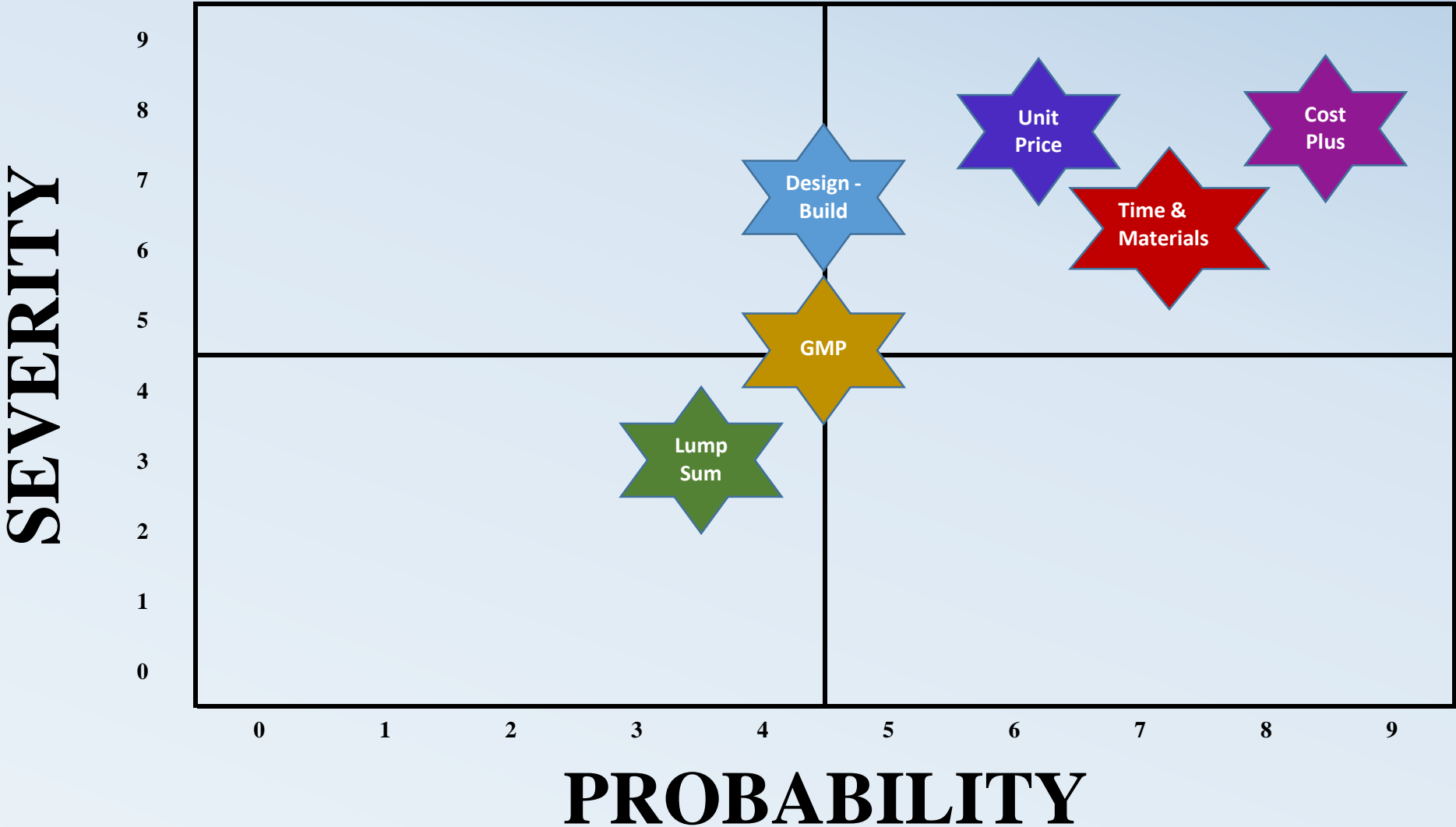
Types of Construction Contracts

- Lump Sum (or Fixed Cost)
- Guaranteed Maximum Price (GMP)
- Time and Material
- Cost Plus
- Unit Price
- Design/Build

Contract Risks for the Owner



| Type of Contract | Explanation |
|--------------------------|------------------------------------|
| Lump Sum | Risk is directly on the contractor |
| Guaranteed Maximum Price | Risk is shared |
| Time and Material | Risk is on the Owner |
| Cost Plus | Risk is on the Owner |
| Unit Price | Risk is on the Owner |
| Design - Build | Segregation of duties issue |





Architectural Agreement

- **Main Components**

- Recitals (outline or scope of work)
- Basic Services (CD, SD, DD, CD)
- Additional Services
- Compensation
- Reimbursable Expenses
- Exhibits

- **Four Phases**

- Concept Design (CD)
- Schematic Design (SD)
- Design Development (DD)
- Construction Documents (CD)



Contract Documents

- Must READ THEM and tab key areas in contract and create an Abstract listing out the key elements with contract language

Abstract Of Key Contract Terms
Lake County Schools
Construction Project
Cypress Ridge Elementary Cafetorium

Auditor: TM
Date:10/12/2018

| # | Key Abstract of Contract | Contract Section | Contract Terms | Amendments |
|----|--|------------------|---|---------------|
| 1 | The Guaranteed Maximum Price (GMP) for the Project | 1st Amendment | The Guaranteed Maximum Price for the Project pursuant to the Agreement is \$4,997,462.67. | 1st Amendment |
| 2 | General Requirements | Attachment A | The General Requirements of the Project are for the amount of \$127,155.37 | |
| 3 | List of Alternates | Section 04 | List of Alternates show the deletion of two items in the contract: Delete Emergency Generator for \$103,621 and Delete Relocation of existing Playground Equipment \$9,108. | |
| 4 | List of Allowances | Section 05 | List of Allowances provides three items: #1 Provide new canopy columns/footings at existing canopy to remain per A001 note, #2 Demolish existing sidewalk, provide new sidewalk and canopy column footing, and #3 Delete all new kitchen equipment and provide an allowance for any new kitchen equipment and to relocate any existing kitchen equipment. | |
| 5 | List of Value Engineering | Section 06 | \$881,666 value engineering changes to contract (see list of value engineering items) | |
| 6 | Construction Manager | Page 2 | Wharton-Smith, Inc. 705 Monroe Road, Sanford, FL 32771 | |
| 7 | Architect-Engineer | Page 3 | GatorSkth Corp | |
| 8 | Construction Manager's Services | Article III | Narrative Reporting Subsystem: Monthly Executive Summary, Monthly Cost Narrative, Monthly Scheduling Narrative, Monthly Accounting Narrative, Monthly Construction Progress Report, Daily Construction Diary and Listing of all changes from the plans and specifications. | |
| 9 | Bond | | In accordance with provision of Section 255.05, Florida Statutes, the CM shall provide to the Owner, a 100% Performance Bond and a 100% Labor & Material Payment Bond each in an amount not less than the GMP, less Pre-Construction Phase Fee. | |
| 10 | Pre-Construction Services | | \$9,936.48 or actual cost, whichever is less | |
| 11 | General Conditions | | \$240,100.85 or the actual cost | |
| 12 | Overhead & Profit Fee for Construction Phase | Article IX | 4% of the Cost of Work, excluding the Pre-Construction Phase fee, Construction Phase General Condition Fee and the Overhead & Profit fee, and the Owner's contingency and the Builder's Risk Insurance and Construction Manager's liability insurance. | |



Bonds and Insurance Programs

- Performance Bond – guarantee by a surety that the work will be performed in the contractor fails to perform.
- Payment Bond – guarantee by a surety that labor and material costs will be paid if the contractor fails to pay.
- Insurance Requirements
 - Workman Compensation
 - Builder's Risk
 - General Commercial Liability
 - Auto Liability
 - Professional Liability
 - Umbrella/Excess Liability



General Conditions

Sets forth many of the rights, responsibilities and relationships of the parties involved or of the contract.

- **Key Terms**

- Cost of the Work
- Schedule of Values
- Contract Sum
- Payment Applications
- Architect's Certificate for Payment
- Change Order Process and Definition
- Allowances & Alternates
- Award of Subcontracts
- Requests for Information (RFI)
- Permit, Fees and Notices
- Extensions of Time
- Superintendent

Schedule of Values & Payment Application



- SOV shows the breakdown of the project by category (plumbing, electrical, concrete, mechanical, etc...)
- PA is construction lingo for the contractor's invoice. Normally issued monthly and are numbered from 1 to _ for the owner to pay for work completed/material stored. The PA shows the total construction price, change orders total, the % of construction completed to date, the amount paid to date, and the amount owed on this PA.
- Must be signed by contractor
- Approved by Architect
- Notarized

Change Orders

- A written instrument prepared by the Architect and signed by the Owner, Contractor & Architect...stating their agreement on changes in the Work, amount of adjustment in the contract sum and the extent of adjustment in time if any. Change Orders should be sequentially numbered and a log should be maintained listing all Change Orders even if not accepted.







Allowances

- Cost of items whose exact character or level of quantity cannot be specified at the time of bidding and therefore cannot be accurately bid. Example could be; carpeting, fountain, signage, landscaping, etc.

Cooper Health
Cancer Center
Audit of Allowances GMP #1

Auditor: TAM
Date: 9/11/2012

| # | TYPE OF ALLOWANCE | ALLOWANCE SOURCE | ALLOWANCE AMOUNT | SOURCE FOR RECONCILIATION | ALLOWANCE AMOUNT | COST OF WORK | AMOUNT CHANGE ORDER | BACK UP SUFFICIENT Y/N |
|------------------|-----------------------|------------------|--------------------|--------------------------------|----------------------|--------------------|---------------------|------------------------|
| 1 | Mock-Up Modifications | GMP #1 Exhibit A | \$3,000.00 | GMP #1 Cost Event #5 | (\$3,000.00) | \$4,602.57 | \$1,602.57 | YES |
| 2 | Fencing | GMP #1 Exhibit A | \$20,000.00 | Cost Event #10 Contingency Log | (\$20,000.00) | \$18,800.00 | (\$1,200.00) | YES |
| 3 | | | \$0.00 | | \$0.00 | \$0.00 | \$0.00 | |
| 4 | | | \$0.00 | | \$0.00 | \$0.00 | \$0.00 | |
| 5 | | | \$0.00 | | \$0.00 | \$0.00 | \$0.00 | |
| Total Allowances | | | <u>\$23,000.00</u> | | <u>(\$23,000.00)</u> | <u>\$23,402.57</u> | <u>\$402.57</u> | |

Construction Contingency



Owner Contingency Log - Eustis Heights Elementary School

| CI # | Description | Date | Origin | Cost Submitted | Date Submitted | Date Approved | Amount Approved | CCR # |
|------|--------------------------------------|------------|-----------|-----------------|----------------|---------------|----------------------|-------|
| | Original Contingency Balance | | | | | | \$ 173,013.00 | |
| 001 | PR 001 - AHU Motoer Starter MOD | 11/15/2013 | PR #1 | \$ (2,189.00) | 12/10/2013 | 1/10/2014 | \$ 2,189.00 | 001 |
| 007 | Elevator Battery Pack | 12/4/2013 | Submittal | \$ 834.00 | 12/10/2013 | 1/13/2014 | \$ (834.00) | 002 |
| 011 | PR 005 - SE Parking Lot | 12/13/2013 | PR 005 | \$ (433,311.91) | 2/6/2014 | 6/19/2014 | \$ 433,311.91 | 012 |
| 018 | RFI #011 - Chiller Yard Nema 3R Eqpt | 1/31/2014 | RFI #011 | \$ 2,098.03 | 2/18/2014 | 3/20/2014 | \$ (2,098.03) | 003 |
| 019 | PR 008 - Freezer Truck Outlet | 2/19/2014 | PR 008 | \$ 2,135.04 | 3/7/2014 | 3/20/2014 | \$ (2,135.04) | 004 |
| 020 | PR 009 - Door Bell | 2/19/2014 | PR 009 | \$ 518.12 | 3/14/2014 | 4/1/2014 | \$ (518.12) | 005 |
| 024 | Secondary Power Pull Box Delete | 2/26/2014 | Site | \$ (1,496.00) | 3/14/2014 | 4/1/2014 | \$ 1,496.00 | 006 |
| 028 | PR 011R2 - Existing Bldg CHW Tie Ins | 4/25/2014 | PR 011R2 | \$ 5,925.52 | 6/12/2014 | 6/30/2014 | \$ (5,925.52) | 014R |
| 030 | PR 013 - Premise Distribution | 5/25/2014 | Owner | \$ 169,193.08 | 5/9/2014 | 5/25/2014 | \$ (169,193.08) | 009 |
| 031 | Gave Valve BMS Delete | | Owner | \$ (433.00) | 9/17/2014 | 9/19/2014 | \$ 433.00 | 017 |
| 033 | General Trades Scope Delete | 5/20/2014 | Owner | \$ (24,540.00) | 5/20/2014 | 6/9/2014 | \$ 24,540.00 | 011 |
| 034 | Footing Dampproofing Credit | 5/22/2014 | Owner | \$ (1,139.16) | 5/21/2014 | 6/30/2014 | \$ 1,139.16 | 015 |
| 037 | ASI #22 - TV Blocking | 5/13/2014 | ASI #22 | \$ 2,178.38 | 6/26/2014 | 8/15/2014 | \$ (2,178.38) | 016 |
| 040 | Service Drive Revisions | 7/22/2014 | RFI #069 | \$ 2,053.73 | 10/1/2014 | 10/2/2014 | \$ (2,053.73) | 018 |
| 041 | ASI #032 - CCTV Ceiling Height | 8/28/2014 | ASI #032 | \$ 701.35 | 10/23/2014 | 12/9/2014 | \$ (701.35) | 019 |
| 042 | PR 015 - CCTV Electrical Adds | 9/2/2014 | PR 015 | \$ 3,778.02 | 10/23/2014 | 12/9/2014 | \$ (3,778.02) | 020 |
| 045 | East Play Lot Fencing Delete | | Owner | \$ (7,200.00) | 12/10/2014 | 12/17/2015 | \$ 7,200.00 | 021 |
| 049 | Menu Board Delete | 12/9/2014 | Owner | \$ (7,943.00) | 1/6/2015 | 1/23/2015 | \$ 7,943.00 | 023 |
| 048 | Projection Screen Changes | | Owner | \$ 2,567.16 | 1/6/2015 | 1/23/2015 | \$ (2,567.16) | 024 |

Owner Contingency Balance

\$ (286,269.64) \$ 459,282.64

Owner Contingency Used \$ (191,982.43)
Credit Back to Owner Contingency \$ 478,252.07

CM Contingency Log - Eustis Heights Elementary School

| CI # | Description | Date | Origin | Cost Submitted | Date Submitted | Date Approved | Amount Approved | CCR # |
|------|-------------------------------------|-----------|----------|----------------|----------------|---------------|----------------------|-------|
| | Original Contingency Balance | | | | | | \$ 273,827.00 | |
| 024 | PR 010 - Interactive TV Rough In | 3/25/2014 | PR 010 | \$ 16,664.61 | 4/10/2014 | 5/16/2014 | \$ (16,664.61) | 008 |
| 016 | RFI #009 - LASS Power | 1/15/2014 | RFI #009 | \$ 2,408.18 | 5/20/2014 | 7/2/2014 | \$ (2,408.18) | 013R |

\$ 19,072.79 \$ 254,754.21

\$ 714,036.85



Alternatives

- Optional aspects of construction or design that include an associated fixed price for bidding purposes. Alternates may delete work from the project, require additional work or change the level of quality specified.
- The Owner may choose whether or not to exercise the alternates as the project progresses, alternates provide the owner with an opportunity to modify the project to ensure that construction costs fall within a fixed budget. Unlike with allowances, the final cost of an alternate is not adjusted.



Logs, Reports, Schedules

- These fall under the area of Controlling the Construction Process. These documents along with the Construction Team assist in organizing, monitoring and controlling the project from beginning to end.
 - Monthly Construction Report
 - Budget vs. Actual Cost Variance & Budget vs. Estimated Final Cost
 - Field Reports (Daily Inspection Reports, Daily Progress, Photographs, Material delivery reports, Sign In/Out Logs, Safety meetings, etc.
 - Request for Information Log, Backcharge Log, Equipment Log, Value Engineering Log, Submittals Log, etc.
 - Schedule showing all key milestones and area completion dates from the beginning of the project until its completion.



Subcontractors

- Contractor shall furnish in writing to the Owner and the Architect the names of subcontractors proposed for each portion of the Work, i.e. the trade subcontractors who will compose the Schedule of Values (SOV) (this is also know as the Buyout).

CONCRETE BID EVALUATION TABULATION

| Bid Package: | BNG | Drawdy | Cocoa | R&R Rebar | Harris Rebar |
|---------------------------------|--------------|--------------|--------------|----------------|----------------|
| USA Concrete | \$733,180.00 | \$713,250.00 | \$887,500.00 | \$45,948.00 | \$36,870.00 |
| Add Porch Covers | \$4,835.00 | \$18,115.00 | \$15,230.00 | No Bid | No Bid |
| Add Southeast Parking Sidewalks | \$43,555.00 | \$37,190.00 | \$42,760.00 | No Bid | No Bid |
| Add Construction Guardrails | \$5,492.00 | \$3,500.00 | \$8,000.00 | No Bid | No Bid |
| Add Soil Treatment | \$5,898.00 | \$5,500.00 | \$7,360.00 | No Bid | No Bid |
| Polishing of Concrete | Included | \$2,500.00 | Included | No Bid | No Bid |
| Bond | Included | \$7,800.55 | Included | No Bid | No Bid |
| | | | | | |
| Total Base Bid | \$792,960.00 | \$787,855.55 | \$887,500.00 | Non-Responsive | Non-Responsive |



Construction Audit Program

- IF the construction project has not begun, a decision can be made: when should the audit begin? Should the audit start right away? Should it wait until the project is 50% complete? Or, should it begin closer to the end of the project? Some audit don't begin until after the project is fully complete?

| AUDIT PROGRAM <i>Construction Audit Cypress Ridge Cafeteria Building</i> | Lake County Schools Construction Project | | | | |
|--|---|-----------|----------|------------|---------|
| | Auditor | Beg. Date | Mid Date | Close Date | WP Ref. |
| A. Interview Owner's and/or Construction Mgmt. | | | | | |
| 1. Ask about outstanding Issues | | | | | |
| 2. Inquire about the potential for any current future or close out issues. | | | | | |
| B. Review minutes from various mtgs. | | | | | |
| C. Review contract documents | | | | | |
| 1. Prepare abstract of key terms & conditions | TM | 4/25/2019 | N/A | N/A | C1.1 |
| 2. Prepare Construction Cost spreadsheet and compare SD to DD Costs | | | | | |
| D. Construction In Process (CIP) - Obtain A/P listings of all payments | | | | | |
| 1. Prepare control schedule | TM | 5/25/2019 | | | F1.1 |
| 2. Select large payment for review | TM | 7/18/2019 | | | F1.1 |
| a. Verify mathematical accuracy of pay app from previous pay app. | TM | 7/18/2019 | | | F1.1 |
| b. Recalculate retention & ensure amount retained agrees with provisions | TM | 7/18/2019 | | | F1.1 |
| c. Recalculate CM fee to agreement and/or % of completion | TM | 7/18/2019 | | | F1.1 |
| d. Recalculate fees, overhead and profit/markups to contract docs. | TM | 7/18/2019 | | | F1.1 |
| e. Ensure architect has issued certificate of payment with each pay app | TM | 7/18/2019 | | | F1.1 |
| f. Sample and review amounts billed by subcontractors | TM | 7/18/2019 | | | F1.1 |
| 3. Test payments from A/P journal to contractor | | | | | |



Other Areas

- Permits, Fees & Notices
- Owner Direct Purchasing (ODP)
- Labor Burden Rates
- Equipment Rental
- Self Performed Work
- Construction Extensions
- Project Close Out
- Punch List

Audit Program



- Interview Q&A
- Construction Contract
- Construction in Process
- Bidding Process
- Payment Applications
- Change Orders
- Subcontractor Agreements
- Contingency
- Allowances
- Architect
- Job Cost Ledger
- Equipment Rental
- Close Out
- Monthly Reports/Meeting Minutes

Questions & Discussion

