

*Internal Audit Report*

**DEPARTMENT OF COUNTY ADMINISTRATION  
OFFICE OF PURCHASING  
CHANGE ORDERS AUDIT  
APRIL 2015**

*Office of the County Auditor*





## OFFICE OF THE COUNTY AUDITOR

Craig Glendenning, CPA  
County Auditor

April 2015

The Honorable Members of the County Council  
The Honorable Allan Kittleman, County Executive

Pursuant to Section 212 of the Howard County Charter and Council Resolution 22-1985, we have conducted an audit of the County's change order process. The body of our report presents our findings and recommendations.

Our audit disclosed that written policies are out of date and do not include current procedures resulting from the introduction of the County's automated financial system. We also found that the Office of Purchasing did not follow certain requirements for the processing of significant change orders. We found that one employee who did not require access had the ability to create change orders. We also found that the change orders tested were valid and appropriate; however, some documentation was not included in the files.

Our findings have been reviewed with the Chief Administrative Officer and we have included the Administration's responses. We wish to express our gratitude to the Office of Purchasing for the cooperation and assistance extended to us during the course of this engagement.

Craig Glendenning, CPA  
County Auditor

## **EXECUTIVE SUMMARY**

We conducted a performance audit of the change order process. The objectives of our audit were to:

1. Determine if the Office of Purchasing (Office) developed and implemented effective internal controls for the processing of change orders.
2. Determine if change orders processed are valid and appropriate.

### **Conclusions**

For our first objective, we found that policies and procedures have been established outlining the requirements necessary for processing change orders. However, we determined the following:

- Written policies are out of date and do not include current procedures resulting from the introduction of the County's automated financial system (SAP).
- The Office did not follow certain requirements for the processing of significant change orders including obtaining certification of the availability of funds by the Director of Finance as required by the County Code. The Office did not obtain supplemental agreements for change orders relating to capital projects as required by its policies.
- One employee had the ability to create change orders in SAP but did not require such access to perform his job duties.

We found that there is proper segregation of duties in the process of entering and approving change orders in SAP.

With regards to our second objective, we found that all of the change orders tested were valid and appropriate. However, we found the following:

- Our test of 60 change orders processed in fiscal years 2013 and 2014 found that the Office either did not retain supporting documentation or the change order file for 8 change orders tested.
- The Annual Report prepared by the Office contained errors and omissions related to change orders.

## **BACKGROUND**

Section 4.102 of the Howard County Code defines a contract modification as any written alteration in the price or any other provision of an existing contract whether initiated unilaterally by the County or by mutual action of the parties to the contract. It includes change orders, contract amendments and supplemental agreements. According to Section 4.118 of the Howard County Code, every contract modification, change order, or adjustment relating to contracts for services, supplies or construction projects shall be subject to the prior written approval of the County Purchasing Agent. If the modification, change order, or adjustment increases the contract price by 15 percent or more of the contract award amount, the County Purchasing Agent cannot execute the modification unless the following conditions are met:

- The Purchasing Office has a written plan that sets forth internal control procedures;
- Certification by the Director of Finance that sufficient funds are available;
- The Purchasing Office files with the County Auditor the contract in which the price has been increased along with written justification supporting the need for the modification, change or adjustment; and
- The Purchasing Office retains for audit purposes documents relating to the modification, change or adjustment.

The Office of Purchasing's (Office) Purchasing Manual defines a change order as a written or electronic document issued to vendors by the Office formalizing all additions, deletions, and/or changes made to a purchase transaction. According the Office's 2014 Annual Report, the Office processed 6,751 contract modifications including 1,833 change orders.

## FINDINGS AND RECOMMENDATIONS

### **Finding 1**

**The Office did not ensure compliance with certain requirements for significant change orders.**

As previously noted, the Code requires that for changes increasing the contract price by 15 percent or more the Office must, among other requirements, obtain certification from the Director of Finance that sufficient funds are available to fund the increase. Our test of 20 change orders processed in fiscal years 2013 and 2014 that met the 15 percent criteria disclosed that there was no documented certification for any of the items tested. The Office believes these certifications are no longer necessary because of controls within SAP (that is, the system will not process the change if adequate funds are not available).

The Office's purchasing manual requires that change orders for capital projects that increase the original amount of the purchase order by 15% or more include a supplemental agreement reflecting the adjustment in contract terms. Of the 20 change orders tested, 7 required a supplemental agreement (that is, the change order related to a capital project). Our test disclosed that no supplemental agreement was prepared for any of the 7 change orders. The other 13 change orders tested did not relate to a capital project.

*We recommend that the Office ensure that:*

- a. the Director of Finance certify that sufficient funds are available as required by the County Code, and*
- b. supplemental agreements are prepared for change orders related to capital projects as required by the purchasing manual.*

### *Administration's Response*

The Administration concurs with the first finding related to the Director of Finance not presently certifying the availability of funds for changes increasing the contract price by 15 percent or more. The Office will work with the Department of Finance to better define what constitutes "fund certification" for the purposes of meeting this requirement in the County Code, and may revise the County Code to clarify what fund certification means.

The Administration concurs with the second finding related to requirement that capital projects that increase the original amount of the purchase order by 15 percent or more include a supplement agreement. The Office will work with the Department of Public Works to determine the appropriate format for supplemental agreements. We will determine whether or not this document is necessary, and if it is not necessary, the purchasing manual will be revised to remove this requirement.

**Finding 2****The Office of Purchasing's files did not always contain documentation to support change orders.**

Our test of 60 change orders processed by the Office in fiscal years 2013 and 2014 found that the Office did not always have adequate documentation to support the change. As detailed in Table 1 below, we found documentation issues for 8 of the 60 change orders tested.

<b>Table 1 Test of Change Orders</b>			
<b>Fiscal Year</b>	<b>Total Tested</b>	<b>No Supporting Documentation In Office</b>	<b>No Exceptions</b>
2013	30	5	25
2014	30	3	27
<b>Total</b>	<b>60</b>	<b>8</b>	<b>52</b>

For the eight change orders that did not have supporting documentation in the Office, we subsequently obtained documentation from the requesting unit. We used this documentation to determine the validity of the change orders, and we found that all eight change orders were valid.

*We recommend that the Office retain all required documentation supporting change orders.*

*Administration's Response*

The Administration concurs with this finding and will implement the recommendation.

**Finding 3****The purchasing manual has not been updated in over five years and does not include all relevant processes and procedures.**

Section 4.104 of the Howard County Code requires the County Purchasing Agent to revise the purchasing manual at least once every five years, and submit it, with the approval of the County Executive, to the County Council for its approval by resolution. The current Purchasing Manual has an effective date of April 9, 2008. In addition to the purchasing manual, the Office maintains an internal policies and procedures manual. Both manuals were written prior to the County's conversion to its current automated financial system (SAP) that includes a procurement module. As a result, these documents do not detail the current practices and requirements of the Office for processing, reviewing and approving changes to contracts.

*We recommend that the Office revise its written manuals to reflect the current practices and policies for processing, reviewing and approving changes to contracts. We also recommend that the Office submit the revised purchasing manual to the County Executive and County Council for approval as required by the County Code.*

*Administration's Response*

The Administration concurs with this finding and will implement the recommendation.

**Finding 4**  
**The Office's Annual Report of contract changes contained errors and omissions.**

Section 4.103 of the Howard County Code requires that the County Purchasing Agent submit to the County Executive and the County Council an annual report of the work of the purchasing office. The Office uses SAP to compile certain information reported in the Annual Report each year.

The Office's Annual Report of contract changes contained errors and omissions. For example:

- Our test of 20 change orders processed in fiscal year 2014 found that the change order amounts for 2 change orders did not agree to the amounts reported in the Annual Report.
- Of 17 change orders totaling \$6.6 million reported to the County Auditor (required because the change increased the contract price by 15 percent or more) in fiscal year 2014, 9 change orders totaling \$1.8 million were not included in the Annual Report. The Office could not readily determine the cause of these omissions. In addition, for 4 other change orders, the amount reported in the Annual Report did not agree with the change order document.

Similar errors and omissions were noted in our review of fiscal year 2013 change orders.

*We recommend the Office ensure that all change orders are accurately compiled and reported in the Annual Report.*

*Administration's Response*

The Administration concurs with this finding and will implement the recommendation.

**Finding 5****Contract change information reported in the Annual Report is of questionable value.**

The Annual Report prepared by the Office, as noted in Finding 4, contains data on contract modifications, change orders and price adjustments. However, we question the value of the information provided in the Annual Report. The report contains over 6,700 modifications, change orders and price adjustments processed in fiscal year 2014. Our analysis of the report disclosed that almost 5,500 of these changes (or 81 percent) had no monetary impact on the related contract or purchase order. Rather, these changes involved non-financial components (such as changes in quantities to be ordered, vendor addresses, etc.) In addition, the report provides no information or context on the changes made to contracts and purchase orders; rather it simply lists each one.

*We recommend that the Office determine if there is a need to include contract modifications, change orders and price adjustments in its Annual Report. If such information is deemed valuable, we recommend that the Annual Report be modified to only include changes that meet specified criteria (such as those over a predetermined dollar value or percentage change).*

*Administration's Response*

The Administration concurs with this finding and will implement the recommendation.

**Finding 6****One employee could create change orders but did not require this ability.**

Our review of 15 users who could process change orders in SAP disclosed that one user did not require this capability to perform his routine job duties. This user had not worked for the Office since July 2014. When advised of this access, the Office took the necessary action to delete this employee's access.

*We recommend that the Office periodically review a listing of SAP users assigned profiles that allow them to create or approve change orders to ensure that access is assigned only to those users who require such access to perform their job duties.*

*Administration's Response*

The Administration concurs with this finding and will implement the recommendation.

### **Additional Comments**

Our testing of change orders and related documentation included a determination as to whether the change was valid (for example, the change modified the contract scope and was not covered under the original contract terms). For the 60 change orders tested in fiscal years 2013 and 2014, we determined that all of the changes were valid and appropriate.

The Office had established adequate internal controls over the review and approval of change orders in SAP. Our review and testing disclosed that only two supervisory staff within the Office had the capability to approve change orders in SAP. In addition, the same individual could not create and approve the same change order even if the employee had such capabilities.

## **AUDIT SCOPE, OBJECTIVES AND METHODOLOGY**

We conducted a performance audit of the change order process in the Office of Purchasing. We reviewed change orders issued during fiscal years 2013 and 2014.

We conducted our audit in accordance with generally accepted government auditing standards prescribed by the Comptroller General of the United States. Those standards require us to plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence we obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

The objectives of our audit were to:

1. Determine if the Office of Purchasing (Office) developed and implemented effective internal controls for the processing of change orders.
2. Determine if change orders processed are valid and appropriate.

To accomplish our objectives, we met with personnel at the County's Office of Purchasing to document the internal controls and procedures over processing of change orders. We tested compliance with established internal controls and procedures by reviewing supporting documentation for change orders. We also reviewed data from the County's automated financial system. We performed various tests of the relevant data and determined that it was sufficiently reliable for the purposes the data was used for during the audit.

Because of inherent limitations in internal control, errors or fraud may nevertheless occur and not be detected. Also, projections of any evaluation of internal control to future periods are subject to the risk that conditions may change or compliance with policies and procedures may deteriorate.

We conducted our field work from June 2014 to December 2014. The County's responses to our findings and recommendation are included in this report.

**AUDIT TEAM**

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