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SEPTEMBER 29, 2016

TO: BOARD OF DIRECTORS

THROUGH: PHILLIP A. WASHINGTON
CHIEF EXECUTIVE OFFICER

PAW

FROM: DIANA ESTRADA
CHIEF AUDITOR

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**SUBJECT: CONTRACTOR'S PRE-AWARD CONTRACT PROPOSALS AND
CHANGE ORDERS – POSITIONS AND HOURS**

ISSUE

In response to the Board's request, we are reporting back on how Management Audit Services (MAS) ensures that contractor's proposed hours are reasonable and job category/positions are non-duplicative. In addition, the Board requested an assessment on whether or not MAS should have staff member(s) with technical expertise to review contractor's proposed hours and job category/positions.

DISCUSSION:

Management Audit Services provides objective independent assurance services to assist in the contracting process. The services we provide to the Vendor/Contract Management department include audit support for contractual pre-award negotiations, contract change orders, incurred costs, contract close outs and compliance, (e.g. Buy America Act, U.S. Employment Plan, etc.). In support of pre-award negotiations, we provide the Contract Administrators with audit reports on audited direct labor rates, overhead rates, and other direct costs. These reports are used by Contract Administrators to develop their cost analysis of new contract awards and change orders of \$700,000 or more. For construction change order proposals, MAS audits those over \$1 million in value.

For incurred cost audits, we evaluate and report on the contractors' claimed costs including the hours worked for the positions. However, in auditing the proposed costs yet to be incurred, as is the case for contract pre-award and

proposed change orders, our evaluation is limited to the proposed rates (e.g. direct labor rates, overhead rates, general and administrative rates, and other direct costs). The results of our audit, together with other collective information (e.g. scope of work, independent cost estimates, technical evaluation, etc.) are used by the Contract Administrators when making their final determination of a fair and reasonable price for contract award and contract changes. The Contract Administrators conduct a price/cost analysis in determining a fair and reasonable price for each contract award and contract changes. These analyses consider the required level of effort (hours and positions) necessary to fulfill the scope of work. The Contract Administrators make this determination by having access to and relying on the following information:

New contract award:

1. Statement/Scope of Work included in the Request for Proposal (RFP)
2. Independent Cost Estimates - provided by the Cost Estimating Department, or Project Management Teams or Consultants. These estimates are based on an interpretation of the scope of work in the RFP and on a technical evaluation that has been completed before the receipt of proposals for the RFP. Each Independent Cost Estimate is developed based on an independent assessment of the number of hours needed for each position/job category that is deemed necessary to fulfill the Scope of Work in the RFP.
3. Technical Evaluation – The project manager, staff engineers, inspectors, and consultants by virtue of their technical expertise and experience are best suited to perform an evaluation of the required level of effort to fulfill the scope of work in the RFP, including the means and methods, and other factors needed for the execution of the work.
4. Audit results for costs and rates including recommendations – provided by Management Audit Services using the Cost Principles based on Federal Acquisition Regulation Part 31.
5. Competing Price Proposals from the other contractors for non-Architectural and Engineering procurements.

Contract Modification/Change Order

1. Statement/Scope of Work and Change Clause included in the existing contract
2. Independent Cost Estimates - provided by the Cost Estimating Department, or Project Management Teams or Consultants. These estimates are based on an interpretation of each change's scope of work, merit determination findings and on a technical evaluation that has been completed before the receipt of a proposal for the change.
3. Technical Evaluation – provided by Program/Project Management Team including but not limited to engineering, construction management, resident engineers or quality management. The project manager, staff engineers, consultants and inspectors work side by side with the Contractor's Project Management and field crews to assure the proper execution of the work. The project manager's close oversight of these

activities provides Metro with the ability to assess whether new work proposed is defined in the contract's baseline or is new change order work. The project manager and staff, by virtue of their technical expertise, experience and day to day oversight of the work are best suited to perform an evaluation of the proposed change order work, the means and methods used by contractor's crews and any factors that can affect the efficiency of their performance and execution of the work. These technical evaluations contain the assessment of contractor's proposed hours and the total level of effort by category and position.

4. Merit Determination – Contract Administrators in consultation with technical advisers determine whether the proposed change has merit and not previously included in the base contract or previous contract modifications. County Counsel is also consulted for all proposed construction change orders greater than \$100,000.
5. Audit results for costs and rates including recommendations – provided by Management Audit Services using the cost principles based on Federal Acquisition Regulation Part 31.
6. Cost element proposals for change from the contractor.

By having access to the collective information listed above, the Contract Administrators are able to detect the gaps between the contractor's proposal and Metro's recommended level of effort for contractors. Based on the significance of the overlaps or gaps in scope/services or staffing identified, Contract Administrators determine the need for further fact finding meetings among the various parties including Metro's Cost Estimating, Metro's Program Management and/or Project Management, and the Contractors. These meetings are held to determine the reasons for the gaps or overlaps and to achieve common understanding of the Statement/Scope of Work and the required level of effort to fulfill the scope.

Assessment Results - whether MAS should have staff with technical expertise to review contractor's proposed hours and job category/positions.

The agency's current process enables the Project Managers and Contract Administrators to make use of the best available and collective information to evaluate contractor's proposals. We are not recommending the addition of MAS staff with technical expertise to review contractor's proposed hours and job category/positions. This action would be cost and time prohibitive and would duplicate Metro's existing technical staff and would likely be ineffective. Metro receives varying contractor proposals that would require MAS to hire staff with varying levels of knowledge and expertise in multiple disciplines (e.g. design, architecture, engineering, environmental, structural, etc.). Additionally, technical staff that are not included on the project and do not have access to the daily project activities and conditions would require much more effort to gain adequate knowledge to produce technical evaluations comparable to those provided by Metro's Project/Program Management Team.

There is a more cost effective alternative strategy to provide the Board assurance that contractor's proposed costs and schedules are appropriate. That is, MAS can perform audits to determine whether the system of internal controls over the preparation of key information relied upon by Contract Administrators is adequate and effective. Key information includes the Statement of Work, Technical Evaluations, and Independent Cost Estimates. We can report on whether the various key information were prepared in compliance with the departmental procedures, adequately supported, and whether the responsible unit was adequately staffed by qualified personnel. Additionally, we can periodically conduct audits of Vendor/Contract Management's process for evaluating contractor's proposal to determine whether the internal controls over the process is adequately designed and functioning as intended.

NEXT STEPS

MAS will integrate the audits of the internal controls over the contract pre-negotiation process and the process used in developing key information relied upon by Contract Administrators in the FY17 Audit Plan.