



ARLINGTON
VIRGINIA

Internal Audit Report - Contract Compliance Cycle Audit

Department of Environmental Services:
Arden Company LLC - Contract Number-16-234-ITB

Report Date: May 31, 2017

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TRANSMITTAL LETTER



May 31, 2017

Mr. Greg Emanuel
Director, Department of Environmental Services

Ms. Maria Meredith
Deputy Director, Department of Management and Finance

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Pursuant to the contract and related statement of work for Arlington County, Virginia ("the County"), we hereby present the Contract Compliance Cycle Audit: Department of Environmental Services ("DES") – Ardent Company LLC. Our report is organized in the following sections:

Executive Summary	This section includes a background summary of the function, the objectives and approach. There were no observations noted during this cycle audit.
Background	This section provides an overview of the function within the process and pertinent operational control points and related compliance requirements.
Objectives and Approach	The cycle audit objectives and focus are expanded upon in this section as well as a review of the various phases of our approach.
Process Maps	This section illustrates process maps, which identifies data flow, key control points and any identified gaps.

As described in our objectives and procedures outlined on pages 6 and 7 of this report, the observations noted are based on our analysis of the processes, documents, records and information provided to us by the County. This cycle audit focused on evaluating the soundness of internal control policies to safeguard assets and on reviewing compliance with County policies. We offer no assurances that schemes or fraudulent activities have not been, or are not currently being perpetrated by any person within the areas reviewed.

We would like to thank the staff and all those involved in assisting RSM US LLP in connection with this Contract Compliance Cycle Audit.

Respectfully Submitted,

RSM US LLP

RSM US LLP

EXECUTIVE SUMMARY

Background

Contract compliance monitoring is an integral piece of the County’s control environment. Contract compliance encompasses all contractual agreements entered into by the County. The focus of this cycle audit was vendor agreements. Although certain aspects of the purchasing function are centralized within the Department of Management and Finance (“DMF”), and vendor selection is performed in conjunction with Purchasing (for purchases greater than \$5,000), many of the high risk areas like contract compliance and monitoring are the responsibility of the individual departments / divisions / bureaus.

Effective January 1, 2017, the County implemented a Contract Administration Policy for all contracts, regardless of their procurement methodology or dollar value. The purpose was to define and implement a standard policy and process for the administration of contracts and define roles and responsibilities for County personnel that monitor and manage contractual relationships.

Contract Selection

The Ardent Company LLC contract 16-234-ITB is a unit price contract for the labor, materials, and equipment for the construction of storm sewer, sanitary sewer, watermain, and other associated work along the N. Sycamore St, 24th St N. and N. Rockingham Street for a total contract amount of \$2,255,200. Per the contract, the anticipated completion date is 365 days from the commencement date of July 27, 2016, which is subject to extension upon identification of unforeseen work to be addressed via a formal change order(s). The County makes monthly progress payments to the Contractor based on documented field measurements of actual quantities installed during the preceding month. In making any progress payments, five percent (5%) of the amount of the estimate upon which the progress payment is based is retained by the County until final completion and acceptance of all work covered by the contract.

Fieldwork was performed April 2017 through May 2017

Objective and Scope

The scope of this cycle audit encompassed one contract from the Department of Environmental Services; contract number 16-234-ITB with Ardent Company LLC. Although the County issued a specific Contract Administration Policy effective January 1, 2017, the audit period was January 1, 2016 to April 1, 2017. For transactions from January 1, 2016 to December 31, 2016, testing was limited to substantive procedures as it related to invoice accuracy, invoice compliance with contract terms, payment timeliness and verification of goods and services. For transactions January 1, 2017 to April 1, 2017, procedures also included department compliance with aspects of the County issued contract compliance policies and procedures.

The objective of this cycle audit was to assess whether the system of internal controls is adequate and appropriate, for effective contract compliance, with selected provisions of the contract as it relates to payment.

Five invoices were submitted for payment since the contract award on July 27, 2016. All five invoices were included in our detailed testing.

Overall Summary / Highlights

No observations were identified during our assessment, and therefore no relative risk or value factors were assigned. Risk ratings are the evaluation of the severity of the concern and the potential impact on the operations of each item. There are many areas of risk to consider in determining the relative risk rating of an observation, including financial, operational, and/or compliance, as well as public perception or ‘brand’ risk.

Number of Observations by Risk Rating

(See Appendix A for rating definitions)

	High	Moderate	Low
Contract Compliance Cycle Audit – DES – Ardent Company LLC	-	-	-

We would like to thank all Arlington County team members who assisted us throughout this review.

EXECUTIVE SUMMARY (CONTINUED)

Detailed Observations

We identified no observations during walkthrough and transactional testing within the scope of this cycle audit.

BACKGROUND, OBJECTIVES AND APPROACH

Background

Overview

Contract compliance encompasses all contractual agreements entered into by the County. Although certain aspects of the purchasing function are centralized within the Department of Management and Finance, and vendor selection is performed in conjunction with Purchasing, many of the high risk areas like contract administration, compliance and monitoring are the responsibility of the individual departments/divisions/bureaus. These monitoring responsibilities specifically include:

- Understanding the Scope of Work and Terms and Conditions of the contract;
- Management of contract billings to avoid cost overruns;
- Validation of complete and satisfactory performance of work through physical walkthroughs and site visits, when appropriate;
- Ensuring timely performance of contracted work;
- Providing updates to the Department Director, Division Chief and Department of Management and Finance related to progress and budget, as necessary;
- Maintaining appropriate documentation, in compliance with the County level document retention policy and respective contract; and
- Review and approval of invoices for payment to the Contractor in line with the payment terms and conditions outlined in the agreement.

Effective January 1, 2017, the County Implemented a Contract Administration Policy for all contracts, regardless of their procurement methodology or dollar value. The purpose was to define and implement a standard policy and process for the administration of contracts and define roles and responsibilities for County personnel that monitor and manage contractual relationships. Specifically, the policy establishes Project Officer and Task Officer responsibilities, defines internal controls surrounding contract payment, quality assurance and recordkeeping, and outlines all applicable regulations to which the contract administration process must adhere.

Ardent Company LLC

The Ardent Company LLC contract 16-234-ITB is a unit price contract for the labor, materials, and equipment for the construction of storm sewer, sanitary sewer, watermain, and other associated work along the N. Sycamore St, 24th St N. and N. Rockingham Street (the "Project") for a total contract amount of \$2,255,200. Per the contract, the anticipated completion date is 365 days from the commencement date of July 27, 2016, which is subject to extension upon identification of unforeseen work to be addressed via a formal change order(s). The County makes monthly progress payments to the Contractor based on documented field measurements of actual quantities installed during the preceding month.

Contract 16-234-ITB

Contractor	Contract Title	Contract Amount	Execution Date	Dollars Spent*	Contract Type	County Division
Ardent Company LLC	N Sycamore St Storm, Sewer, Watermain Construction	\$2,255,200	July 27, 2016	\$611,667.95	Unit Price	DES

*as of 4/11/17

Roles and Responsibilities

The following departments play key roles in the contract compliance process:

Department of Environmental Services ("DES")

DES is responsible for providing project management and oversight services during all phases of the project, from pre-construction and design to inspection and close-out. DES has contracted an inspector to provide assistance with the monitoring of the project until completion. DES is also responsible for completing all Project Officer functions as outlined in the contract, overall contract compliance, and reviewing and approving vendor invoices for accuracy prior to payment.

BACKGROUND, OBJECTIVES AND APPROACH (CONTINUED)

Background (continued)

Department of Management and Finance (“DMF”)

DMF oversees all of the processes and recordkeeping of the County’s financial transactions. The Purchasing and Accounts Payable divisions are part of DMF and act as support functions for departments managing vendor contracts. Specifically, Purchasing administers the competitive bid process and processes requests for procurement of services and goods by executing purchase orders for approved amounts. Accounts Payable is responsible for processing payments to contractors based on invoices approved by the respective departments.

Common Definitions

Some common definitions for construction terminology used throughout this section of the report are as follows:

- *Contract Owner/Project Officer* – refers to the County representative responsible for general control, review, and approval of all aspects of the contract, once executed. The Project Officer is appointed by the County’s Department of Environmental Services Director or a designee as identified in the contract, who is the primary point of contact for the Contractor in executing the terms of the contract.
- *Contingency* – refers to funds included in a budget to allow for defraying the expense of unforeseen circumstances in a construction project.
- *Payment Application (“Pay App”)* – the invoice submitted by the Contractor for payment, including a detailed schedule of values to support the current billing total, including prior payments and additional costs due to change orders.
- *Change Order* – refers to an approved additional cost for unforeseen work outside of the original work plan considered in the development of the contract price. If the cost is deemed necessary and appropriate, an executed change order is established to allow the Contractor to invoice for the additional work.
- *Retainage* – refers to funds withheld from a construction contract until completion of the project, or some other agreed upon date. The amounts are held back to provide the Project Officer and the County with assurances for the quality of the work performed.
- *Unit Price* – a construction contract in which the County pays an agreed upon price for each completed unit of work.

Timeline

Below is a timeline of major events for the project.

Date	Event Description	Purchase Order Amount
July 16, 2016	Arlington County Board approves the award of contract 16-234-ITB between the County and Ardent Company LLC	\$2,255,200
July 27, 2016	Contract executed	-
<i>No change orders or PO modifications executed to date (as of our walkthrough on April 12, 2017)</i>		-
July 27, 2017	Contract expires	-
Total	Initial Purchase order and any executed change orders	\$2,255,200

BACKGROUND, OBJECTIVES AND APPROACH (CONTINUED)

Objectives and Approach

Objectives

Contract compliance encompasses all contractual agreements including, but not limited to, vendor agreements. Although certain aspects of the purchasing function are centralized within the Department of Management and Finance, many of the high risk areas like contract administration and monitoring are decentralized to the individual departments.

The scope of this cycle audit encompassed one (1) contract from the Department of Environmental Services; contract number 16-234-ITB with Ardent Company LLC. Although the County issued a specific Contract Administration Policy effective January 1, 2017, the audit period was January 1, 2016 to April 1, 2017. For transactions from January 1, 2016 to December 31, 2016, testing was limited to substantive procedures as it related to invoice accuracy, invoice compliance with contract terms, payment timeliness and verification of goods and services. For transactions January 1, 2017 to April 1, 2017, procedures also included department compliance with aspects of the County issued Contract Administration Policy.

The objective of this cycle audit was designed to assess whether the system of internal controls is adequate and appropriate, for effective contract compliance, with selected provisions of the contract as it relates to payment.

Approach

Our approach to the audit execution consisted of the following phases:

Understanding and Documentation of the Process

During the first phase, we performed the following:

- Conducted entrance conferences with representatives from DES and DMF to discuss the scope and objectives of the cycle audit, obtain preliminary data, and establish working arrangements;
- Obtained copies of financial reports and other documentation deemed necessary and appropriate to gain an understanding of the existing control environment;
- Reviewed the County's Contract Administration Policy related to this cycle audit;
- Conducted interviews with responsible personnel from the selected department/division to obtain an understanding of the unique aspects of the process in order to perform the walkthroughs and our testing; and
- Developed flowcharts of the process(es), which are included in this report.

BACKGROUND, OBJECTIVES AND APPROACH (CONTINUED)

Objectives and Approach (continued)

Evaluation of the Process and Controls Design and Testing of Operating Effectiveness

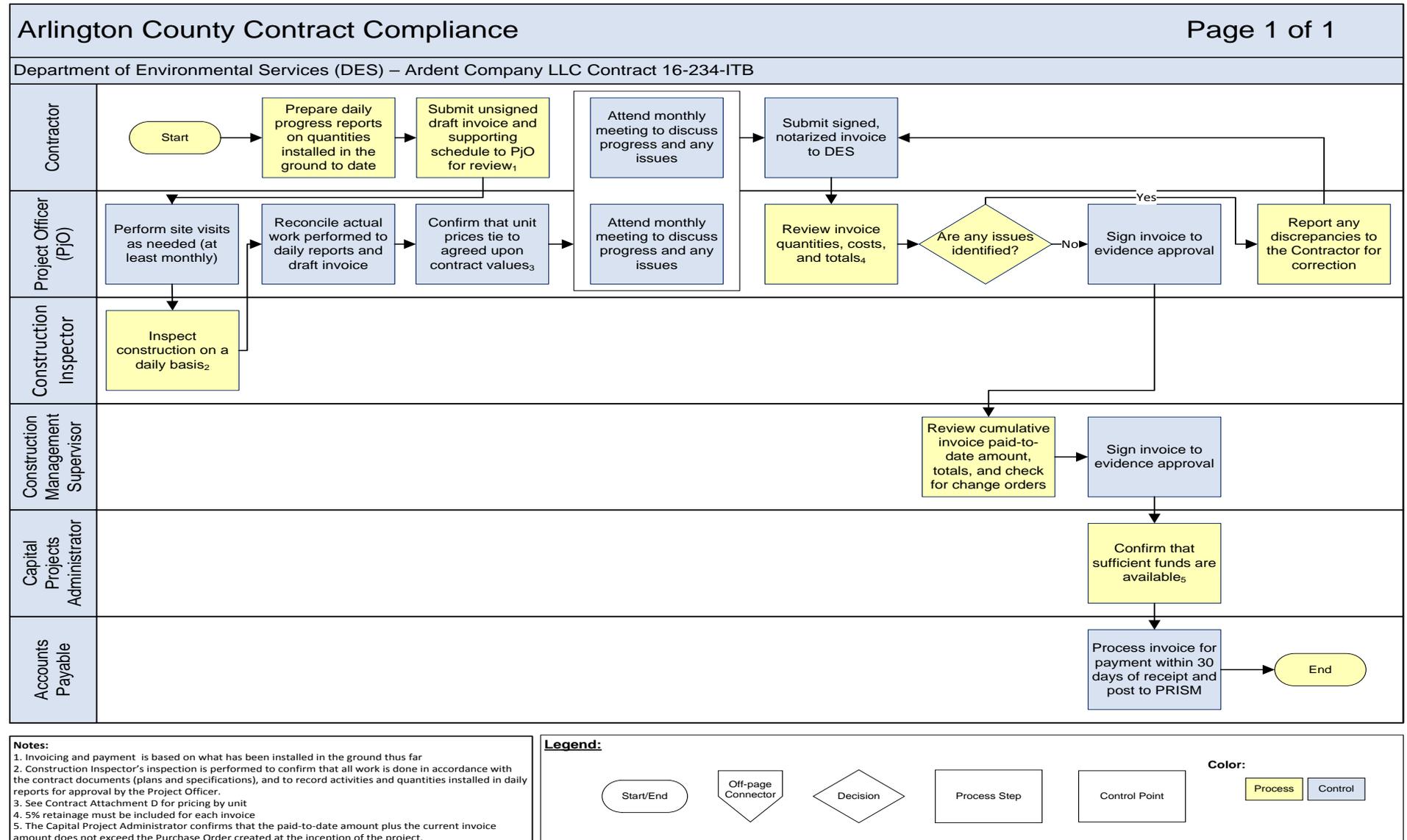
The process and control evaluation phase of this engagement consisted of an evaluation of the design and testing of operating effectiveness. We performed walkthroughs and detailed testing of transactions of all five invoices that have been submitted for payment since the execution of this contract. Specific procedures performed included:

- Gathered background information on the County's contract compliance and monitoring procedures and any required controls or documentation, including County Board authorization, if necessary;
- Determined whether the selected department/division had related contract compliance procedures outside of County-level procedures;
- Obtained background information on the selected contract, including contract copy, contract administrator information, and detail of expenditures under each contract during our audit period;
- Tested invoices for the selected contract to determine if the supporting documentation agreed to the payment amount;
- Verified that each invoice was charged appropriately against a Purchase Order as required by the County Contract Administration Policy;
- Inspected invoices to confirm that unit costs per invoice supporting documentation tied to the agreed upon contract unit prices;
- Determined mathematical accuracy of invoices based on unit costs and retainage calculated;
- Inspected invoices for Project Officer sign-off as required by the County Contract Administration Policy;
- Determined if payment was made in a timely manner and in accordance with the pricing terms of the contract and the County Contract Administration Policy, and that payments did not exceed amounts authorized;
- Determined whether goods and services received under the contract was properly verified or monitored prior to payment of the invoice as required by the Contract Administration Policy; and
- Assessed the overall contract compliance process and controls to determine effectiveness.

Reporting

At the conclusion of this audit, we vetted the facts of this cycle audit with DES. The draft report was submitted to DES and DMF for review. An exit meeting was held with DES and DMF to formally review and discuss the draft report and modify accordingly.

PROCESS MAP:



APPENDIX A – RATING DEFINITIONS

Observation Risk Rating Definitions	
Rating	Explanation
Low	Observation presents a low risk (i.e., impact on financial statements, internal control environment, public perception/brand, or business operations) to the organization for the topic reviewed and/or is of low importance to business success / achievement of goals and internal control structure.
Moderate	Observation presents a moderate risk (i.e., impact on financial statements, internal control environment, public perception/brand, or business operations) to the organization for the topic reviewed and/or is of moderate importance to business success / achievement of goals and improve its internal control structure. Action should be in the near term.
High	Observation presents a high risk (i.e., impact on financial statements, internal control environment, public perception/brand, or business operations) to the organization for the topic reviewed and/or is of high importance to business success / achievement of goals and improve its internal control structure. Action should be taken immediately.



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