



Management Action Plan: Internal Audit Report - Changes to Select Contract Terms and Conditions

Date: September 19, 2019
To: TTC Audit and Risk Management Committee
From: Head of Audit, Risk and Compliance

Summary

During 2018, as Internal Audit staff (now part of Audit, Risk and Compliance) began to identify potential construction and consultant contracts to review, the following changes to certain TTC contract terms and conditions as implemented by the Contract Documents Committee (CDC) were noted:

- A revised 'Records and Audit' clause in the TTC's master construction contract that has eliminated the TTC's ability to gain access to third party records for purposes of substantiating contractor claims and contract changes under certain conditions (i.e. when settled as lump sum or negotiated amounts).
- The removal of the lump sum contract change valuation methodology and cost break-down framework from the contract document was replaced with a simplified clause that the valuation of contract changes performed under a lump sum basis shall be subject to negotiations between the TTC and the contractor. This leaves the negotiation process susceptible to inconsistencies and abuse.
- The elimination of stipulated maximum mark-ups in consultant contracts, thereby exposing the TTC to excessive consultant fees.

In addition, the TTC CDC is not currently governed by any internal reporting structure and the rationale for final recommended contract language changes was not clearly documented, including the results of benchmarking exercises and industry consultations.

Executive Management has acknowledged its need to ensure appropriate controls and risk mitigation measures are in place to improve TTC's transparency in decision making and ability to control costs. This report outlines Management's Action Plan to address our observations.

Recommendations

It is recommended that the TTC Audit and Risk Management Committee:

1. Receive the report for information.

Financial Summary

The funding implications related to the Report recommendations are included in the approved 2019 Operating Budget. Any additional funding requirements will be requested as part of the 2020 budget submission.

The CFO has reviewed this report and agrees with the financial summary information.

Equity/Accessibility Matters

There are no accessibility or equity impacts associated with this report.

Decision History

The Internal Audit Report: Changes to Select Contract Terms and Conditions (2018 Flexible Work Plan Update) was presented to the February 26, 2019 Audit and Risk Management Committee.

[http://www.ttc.ca/About the TTC/Commission reports and information/Committee meetings/Audit Risk Management/2019/Feb 26/Reports/6 Changes to Select Contract Terms and Conditions 2018 Flexi.pdf](http://www.ttc.ca/About%20the%20TTC/Commission%20reports%20and%20information/Committee%20meetings/Audit%20Risk%20Management/2019/Feb%2026/Reports/6%20Changes%20to%20Select%20Contract%20Terms%20and%20Conditions%202018%20Flexi.pdf)

A copy of the Internal Audit Report: Changes to Select Contract Terms and Conditions (2018 Flexible Audit Plan Update) was forwarded to the TTC Board for information.

A detailed report was issued to Management and provided to the City Auditor General at her request.

Issue Background

Internal Audit staff reviewed the rationale, impact and related risks introduced by the changes made to three construction and consultant contract clauses in 2014-2015:

- Records and Audit (construction contracts)
- Valuation of Changes in the Work (construction contracts)
- All-Inclusive Billing Rate Calculation (consultant contracts)

In addition, the role of the CDC was reviewed in light of the fact that they were responsible for instituting these contract clause changes.

Comments

Internal Audit staff recommended that management revisit the “Records and Audit” and “Valuation of Changes in the Work” clauses to ensure the revisions made are not unduly compromising contractor oversight and value for money. Management is currently working with the law firm of Osler Hoskin & Harcourt LLP to update the TTC’s standard construction contract as a result of the new Construction Act. Management will use this opportunity to update both the “Records and Audit” and “Valuation of Changes in the Work” clauses to address audit concerns and identified risks.

With respect to All-Inclusive Billing Rates, Internal Audit is concerned that the elimination of stipulated maximum mark-ups in consultant contracts exposes the TTC to excessive consultant fees. The need to increase competition when procuring Construction Management professional services was also reported in 2017 as part of Internal Audit’s “Use of Consultants” audit. Management intends to have proponents bid their mark-up rates that would remain fixed for the duration of the contract. Differentiation between mark-up rates to be applied to consultant staff base labour rates when working on-site versus off-site would be made in the submission.

Internal Audit highlighted the need for governance controls to ensure decision making by the CDC is transparent and serves the best interests of the TTC. In order to improve upon oversight and better delineate accountability going forward, responsibility for contract templates and commercial management processes will reside with a Commercial Management function currently being implemented at the TTC. However, as the Commercial Management function is not anticipated to be in place until Q2 2020, the CDC will continue in its current form but all proposed contract clause changes with rationale and holistic risk assessment will now be presented to the TTC Executive for approval, prior to implementation.

Contact

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Signature

Tara Bal
Head of Audit, Risk and Compliance

Attachments

Attachment 1: Management Action Plan: Internal Audit Report - Changes to Select Contract Terms and Conditions

**Management Action Plan (MAP): Internal Audit Report
Changes to Select Contract Terms and Conditions
Accountability – Chief Executive Officer**

Internal Audit (now Audit, Risk and Compliance) Observations

1. **Records and Audit Clause (construction contracts):** To enhance transparency and the protection of public funds, Management should revisit the 'Records and Audit' clause in the TTC's master construction contract and restore the ability for TTC Audit, Risk and Compliance staff to gain access to all books and records deemed necessary to verify contractor estimates, actual costs and valuations of changes in work. Future attempts and requests by contractors to eliminate or erode the ability of the TTC to protect itself by including comprehensive right to audit clauses in its contracts should be viewed with skepticism and approached with caution.
2. **Valuation of Changes in the Work Clause (construction contracts):** To enhance consistency in the negotiation process, and to support the ability to control costs associated with all construction contract changes, cancelled work and claims, Management should revisit the 'Valuation of Changes in the Work' clause in the TTC's master construction contract. The contract should explicitly state the agreed upon contract change valuation methodology, including a cost break-down framework for calculating contractor overhead when contract changes are settled as lump sums, and that the estimates and accepted lump sums are subject to the provision of supporting documentation to the satisfaction of an independent audit.
3. **All-Inclusive Billing Rate Calculations Clause (consultant contracts):** To enhance the ability to control consultant fees, Management should revisit the removal of stipulated maximum mark-up rates from consultant billing rate calculation provisions. Greater competition should be encouraged by requiring consultant firms to bid the mark-up rate to be applied to consultant staff base labour rates when working on-site versus off-site, which would remain fixed for the duration of the contract. Breaches of contract for noncompliance with stated records and audit clauses should be documented as part of performance reviews for consultant firms, and formally taken into consideration when evaluations of new tenders are completed. The risk associated with not imposing punitive measures on those that breach the audit clause should be evaluated as part of commercial management strategies. Where exaggerated mark-up rates and profit margins have been identified through the audit process, the TTC should attempt to re-negotiate with applicable firms more reasonable all-inclusive billing rates and recover excessive amounts already paid.
4. **Contract Document Committee (CDC) Governance:** Oversight controls need to be improved to ensure the decision making by the CDC is transparent and serves the best interests of the TTC. The rationale for final CDC recommended contract language changes should be clearly documented, including the results of benchmarking exercises and researched best practices. Formal approval and final wording should be documented in CDC minutes.

**Management Action Plan (MAP): Internal Audit Report
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Accountability – Chief Executive Officer**

Management Action Plan	
1	<p><u>Construction Contracts:</u></p> <p>(a) Management is currently working with the law firm of Osler Hoskin & Harcourt LLP to update the TTC’s standard construction contract as a result of the new Construction Act. Management will use this opportunity to update both the “Records and Audit” and “Valuation of Changes in the Work” clauses to address audit concerns and identified risks.</p> <p><i>Responsibility: Acting Head of Materials and Procurement (Mike Piemontese) - with support from Legal and Engineering and Construction</i> <i>Target Completion Date: December 2019</i></p>
2	<p><u>Consultant Contracts – Mark-Up Rates:</u></p> <p>(a) Management intends to have proponents bid their mark-up rates that would remain fixed for the duration of the contract. Differentiation between mark-up rates to be applied to consultant staff base labour rates when working on-site versus off-site would be made in the submission.</p> <p><i>Responsibility: Acting Head of Materials and Procurement (Mike Piemontese) - with support from Legal and Engineering and Construction</i> <i>Target Completion Date: December 2019</i></p>
3	<p><u>Contract Documents Committee:</u></p> <p>(a) Responsibility for contract templates and commercial management processes will reside with a Commercial Management function currently being implemented at the TTC and anticipated to be in place by Q2 2020. In the interim, the CDC will continue in its current form but all proposed contract clause changes with rationale and holistic risk assessment will now be presented to the TTC Executive for approval, prior to implementation.</p> <p><i>Responsibility: Acting Head of Materials and Procurement (Mike Piemontese) - with support from Legal and Engineering and Construction</i> <i>Target Completion Date: July 2020</i></p>