



# CITY OF SAN ANTONIO

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SAN ANTONIO TEXAS 78283-3966

September 4, 2008

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Mayor

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Councilwoman, District 5

**Diane G. Cibrian**  
Councilwoman, District 8

Mayor and Council Members:

SUBJECT: Contract Clauses Audit Report

We are pleased to send you the report on the Audit of Contract Clauses. This audit began in January 2008 and concluded with an exit meeting with department management on July 10, 2008. The City Attorney's response is included in Appendix F, which states agreement with the contract clause enhancements in the report. We would like to commend the City Attorney's Office for their proactive approach in working with City Departments to improve standard contract language.

The Office of the City Auditor is available to discuss this material with you individually at your convenience.

Respectfully submitted,

A handwritten signature in cursive script that reads "Park E. Pearson".

Park E. Pearson, CPA  
Interim City Auditor  
City of San Antonio

Distribution:

Sheryl L. Sculley, City Manager

Michael Bernard, City Attorney

Leticia Vacek, City Clerk

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**CITY OF SAN ANTONIO**  
**OFFICE OF THE CITY AUDITOR**



Audit of Contract Clauses

City Attorney's Office

Project No. AU08-003

September 4, 2008

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## Executive Summary

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We conducted an audit of the City's contract template clauses. We worked closely with the City Attorney's Office (CAO) to determine if

**Current contract template clauses protect the City's interests and provide for liquidated damages as appropriate.**

We determined that current contract clauses protect the City's interests and provide for liquidated damages as appropriate. However, through collaboration with the CAO, we identified enhancements to contracts that will further clarify certain contract clauses and protect the City's interests. A summary of the key enhancements is below.

### *Audit Clause*

1. Include time to resolve a dispute in the time frame allowed for audits.
2. Include examples of contractor records subject to review and audit.
3. Specify which individuals or parties may perform an audit.
4. Specify which business locations are subject to an audit.
5. Include audit clause in any subcontractor, supplier or vendor contracts.
6. Include audit cost recovery language in all revenue contracts and expenditure contracts that are on a cost basis.

### *Changes in Work Clause- Contractor Costs*

1. Actual cost per hour for labor for, and only for, workmen and working foremen directly involved in performing the work,
2. Actual cost of materials necessary to perform the work,
3. Rented equipment costs specifically needed to perform the work, which cannot include contractor-owned equipment,
4. Administrative costs cannot include supervision or field office personnel.

### *Delay Clause*

1. Compensate contractor on an "actual cost" basis, which excludes profit for the contractor and compensation for subcontractors and suppliers.

### *Liquidated Damages Clause*

1. Base the liquidated damages dollar amount on the City's current estimated administrative costs and include estimated lost revenue.

We recognize and commend the proactive approach the CAO is taking to work with City Departments to improve standard contract language.

The City Attorney's Office concurs with the audit report. Their response is in Appendix F, page 14.

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## Background

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The City of San Antonio contracts for many different types of goods and services such as for the construction of buildings, engineering services, and professional and personal services. For purchases greater than \$50,000, the City must utilize the competitive bidding process, unless specifically exempted or required otherwise by state law. The City's bid document also serves as the contract when the contract is awarded.

The City Attorney's Office (CAO) team of approximately 60 lawyers and 40 support staff is available to assist City departments with designing appropriate procurement methods, preparing contracts, and negotiating business transactions. They also review City contracts for form, content, and legal aspects of a business transaction. CAO personnel are currently working closely with City departments to improve the City's contract language.

The City uses certain standard clauses in its contracts. These clauses establish a mutual understanding of roles and responsibilities of both parties to the contract, and act to protect the City's interests. We chose the following four contract clauses for our review:

1. *Audit Clause* – An audit clause allows the City to perform an audit of the Contractor's records to determine if the contractor is abiding by all terms in the contract. All types of City contracts contain an audit clause.
2. *Changes in Work Clause* – Changes in work may be accomplished after the execution of the contract, and without invalidating the contract, by Change Order, Field Work Directive or order for a minor change. These clauses specify the terms for carrying out changes to the original construction plans which were bid on by the contractor.
3. *Delay Clause* – A delay clause also pertains to construction contracts and specifies the terms for dealing with unforeseen delays or interruptions of work caused by the City.
4. *Liquidated Damages Clause* – A liquidated damages clause defines the financial damages to be paid by the contractor and is most commonly used in the event the performance is not substantially completed within the time frame required by the contract.

## **Audit Scope and Methodology**

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The audit scope consisted of selected contract clauses used by the City as of February 5, 2008.

We reviewed commonly used City contract templates and the City of San Antonio Contracting Policy & Process Manual. We interviewed personnel from the City Attorney's Office (CAO) and obtained a legal perspective regarding the appropriateness and applicability of potential contract enhancements. We also interviewed personnel from the Purchasing and Contract Services Department, Capital Improvements Management Services Department and Public Works.

To gain an understanding of best practices in contract language, we obtained and reviewed contract clause information from several government and other sources, such as State of Texas Contract Management Guide, Federal Acquisition Regulation, the Department of Defense, The Institute of Internal Auditors and the State Bar of Texas.

We conducted this audit from January 2008 to June 2008 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate information to provide a reasonable basis for the results based on the audit objectives. We believe that the information obtained provides a reasonable basis for the results based on the audit objectives.

## Audit Results

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Together with the CAO, we reviewed existing contract templates and clauses, and agreed on enhancements to the clauses. Examples of contract templates reviewed include the City's "080 General Conditions for Building Construction", the "060 Supplemental Conditions", and the Concession Agreement template.

### A. Audit Clause

We agreed on the following enhancements to the standard audit clause used in City contracts:

1. Revise the time frame for audits and retention of records to include the extension of time until final resolution of a dispute.
2. Add a section that includes an explanation of the types of contractor records subject to review and audit.
3. Specify which individuals or parties may perform an audit.
4. Specify which business locations are subject to an audit.
5. Require contractors to include the audit clause in any subcontractor, supplier or vendor contracts.
6. Include audit cost recovery language in all revenue contracts and expenditure contracts that are on a cost basis.

Examples of an audit clause and audit cost recovery language can be found in Appendix A.

### B. Changes in Work Clause

We agreed on the following enhancements to the standard changes in work clause used in City contracts. These enhancements clarify the cost basis for items the contractor can include in changes to the work.

1. Actual cost per hour for labor for, and only for, workmen and working foremen directly involved in performing the work,
2. Actual cost of materials necessary to perform the work,
3. Rented equipment costs specifically needed to perform the work, which cannot include contractor-owned equipment,
4. Administrative costs cannot include supervision or field office personnel.

An example of a changes in work clause can be found in Appendix B.

### **C. Delay Clause**

We agreed on the following enhancement to the standard delay clause used in City contracts:

1. Change the method of compensation to the contractor from a "per diem" basis to an "actual cost" basis, which excludes profit for the contractor and compensation for subcontractors and suppliers.

An example of a delay clause can be found in Appendix C.

### **D. Liquidated Damages Clause**

We agreed on the following enhancements to the implementation of the standard liquidated damages clause used in City contracts. The enhancements are for determining liquidated damages dollar amounts, and not contract language.

1. Base the liquidated damages dollar amount on the City's current estimated costs of administering the contract.
2. When applicable, liquidated damages may also include estimated lost revenue due to the contractor not completing the work on time.

An example of a liquidated damages clause can be found in Appendix D.

These contract enhancements serve to further protect the City's interests and reduce potential misinterpretation of contracts in general.

**Note: Agreed upon enhancements in Appendices A-D are underlined.**

## **Appendix A – Examples of Audit Clause and Audit Cost Recovery Language**

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### Audit Clause

The Contractor grants the City, or its designees, the right to audit, examine or inspect, at the City's election, all of the Contractor's records relating to the performance of the Work under the Contract during the term of the contract and retention period herein. The audit, examination or inspection may be performed by a City designee, which may include its internal auditors or an outside representative engaged by the City. The Contractor agrees to retain its records for a minimum of four (4) years following termination of the contract, unless there is an ongoing dispute under the contract, then, such retention period shall extend until final resolution of the dispute. "Contractor's records" include any and all information, materials and data of every kind and character generated as a result of the work under this Contract. Example of Contractor records include but are not limited to billings, books, general ledger, cost ledgers, invoices, production sheets, documents, correspondence, meeting notes, subscriptions, agreements, purchase orders, leases, contracts, commitments, arrangements, notes, daily diaries, reports, drawings, receipts, vouchers, memoranda, time sheets, payroll records, policies, procedures, federal and state tax filings for issue in question, and any and all other agreements, sources of information and matters that may in the City's judgment have any bearing on or pertain to any matters, rights, duties or obligations under or covered by any Contract Documents.

The City agrees that it will exercise the right to audit, examine or inspect only during regular business hours. The Contractor agrees to allow the City's designee access to all of the Contractor's Records, Contractor's facilities, and current or former employees of Contractor, deemed necessary by City or its designee(s), to perform such audit, inspection or examination. Contractor also agrees to provide adequate and appropriate work space necessary to City or its designees to conduct such audits, inspections or examinations.

Contractor must include this audit clause in any subcontractor, supplier or vendor contract.

Audit Cost Recovery Language – Cost Contract

If an audit, inspection or examination discloses overpricing or overcharges of any nature by the Contractor to the City in excess of five percent (5%) of the total contract billings, in addition to making adjustments for the overcharges, the reasonable actual cost of the City's audit shall be reimbursed to the City by the Contractor. Said amount shall be remitted to the City no later than \_\_\_\_\_ days from the date of notice by the City to Contractor of such overcharge.

Audit Cost Recovery Language – Revenue Contract

If an audit inspection or examination discloses that Contractor's Gross Revenue as previously reported for the period audited were understated, Contractor shall immediately pay to the City the additional Percentage Revenue due for the period audited together with interest at the Interest Rate of \_\_\_\_\_ from the date(s) such amount was originally due. Further, if such understatement was in excess of five percent (5%) of Contractor's actual Gross Revenue, the reasonable actual cost of the City's audit shall be reimbursed to the City by the Contractor.

## Appendix B – Example of Changes in Work Clause

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Note: The following changes in work clause is taken from the City's "080 General Conditions for Building Construction" contract template.

### 7. CHANGES IN THE WORK

#### 7.1 GENERAL.

7.1.1 Changes in the Work may be accomplished after the execution of the Contract, and without invalidating the Contract, by Change Order, Field Work Directive or order for a minor change in the Work that does not affect the Contract Time or the Contract Sum, subject to the limitations stated in this Article 7 and elsewhere in the Contract Documents.

7.1.2 A Change Order shall be based upon agreement among the Owner, Contractor and Design Consultant; a Field Work Directive requires agreement by the Owner and Design Consultant and may or may not be agreed to by the Contractor; and an order for a minor change in the Work that does not affect the Contract Time or the Contract Sum may be issued by the Design Consultant alone.

7.1.3 Changes in the Work shall be performed under applicable provisions of the Contract Documents, and the Contractor shall proceed promptly with the changed Work, unless otherwise provided in the Change Order, Field Work Directive or order for a minor change in the Work or in this Article 7.

#### 7.2 CHANGE ORDERS.

7.2.1 A Change Order is a written modification of the Contract prepared by the Design Consultant and signed by the Owner, Contractor and Design Consultant, (and approved by the City Council, if required) which authorizes an addition, deletion, or revision in the Work or an adjustment in the Contract Sum or the Contract Times and is issued on or after the Effective Date of the Agreement.

7.2.2 Methods used in determining adjustments to the Contract Sum may include those listed in Section 7.3.3. The Contractor and Subcontractors shall be entitled to include overhead and profit in any Change Order only as provided by City of San Antonio Standard Specifications for Construction.

7.2.3 Acceptance of a Change Order by the Contractor shall constitute a full accord and satisfaction for any and all claims and costs of any kind, whether direct or indirect, including but not limited to impact, delay or acceleration damages, arising from the subject matter of the Change Order. Each Change

Order shall be specific and final as to prices and extensions of time, with no reservations or other provisions allowing for future additional money or time as a result of the particular changes identified and fully compensated in the change order. The execution of a Change Order by the Contractor shall constitute conclusive evidence of the Contractor's agreement to the ordered changes in the Work. This Contract, as amended, forever releases any claim against the Owner for additional time or compensation for matters relating to or arising out of or resulting from the Work included within or affected by the executed Change Order. This release applies to claims related to the cumulative impact of all Change Orders and to any claim related to the effect of a change on unchanged Work.

### **7.3 FIELD WORK DIRECTIVES**

7.3.1 A Field Work Directive is a written order prepared by the Design consultant, and signed by the Owner and Design Consultant, directing a change in the Work prior to agreement on adjustment, if any, in the Contract Sum or Contract time, or both. The Owner may by Field Work Directive, without invalidating the Contract, order changes in the Work within the general scope of the Contract consisting of additions, deletions or other revisions, with any changes to the Contract Sum and/or the Contract Time to be adjusted according to the terms of this Section 7.3.

7.3.2 A Field Work Directive shall be used in the absence of total agreement on the terms of a Change Order.

7.3.3 If the Field Work Directive provides for an adjustment to the Contract Sum, the adjustment shall be based on one of the following methods:

7.3.3.1 A sum properly itemized and supported by sufficient substantiating data to permit evaluation;

7.3.3.2 unit prices stated in the Contract Documents or subsequently agreed upon;

7.3.3.3 cost to be determined in a manner agreed upon by the parties and a mutually acceptable fixed or percentage fee; or

7.3.3.4 as provided in Section 7.3.6.

7.3.4 Upon receipt of a Field Work Directive, the Contractor shall promptly proceed with the change in the Work involved and advise the Design Consultant of the Contractor's agreement or disagreement with the method, if any, provided in the Field Work Directive for determining the proposed adjustment in the Contract Sum or Contract Time.

7.3.5 A Field Work Directive signed by the Contractor indicates the agreement of the Contractor therewith, including adjustment in Contract Sum and Contract Time or the method for determining them. Such agreement shall be effective immediately and shall be recorded as a Change Order.

7.3.6 If the Contractor does not respond promptly or disagrees with the method for adjustment in the Contract Sum, the method and the adjustment shall be initially determined by the Design Consultant on the basis of reasonable costs and savings attributable to the change, including, in case of an increase in the Contract Sum, a reasonable allowance for overhead and profit. In such case, and also under Section 7.3.3.3, the Contractor shall keep and present, in such form as the Design Consultant may prescribe, an itemized accounting together with appropriate supporting data. Unless otherwise provided in the Contract Documents, costs for the purposes of this Section 7.3.6 shall be limited to the following:

7.3.6.1 Labor: Cost of labor shall be based on the actual cost per hour paid by the Contractor for those workers or crews of workers who will perform the field work directive. Labor hours shall include hours only for those workmen and working foremen directly involved in performing the field work directive. Cost of labor includes social security, old age and unemployment insurance, fringe benefits required by Law, agreement or custom, and workers' compensation insurance;

7.3.6.2 Material: Cost of materials shall reflect the Contractor's actual cost for the purchase of the material needed for the field work directive which includes; costs of materials, supplies and equipment, including cost of transportation, storage installation, maintenance, dismantling and removal, whether incorporated or consumed;

7.3.6.3 Equipment: Rental costs shall reflect costs of equipment specifically needed to perform the field work directive and may consist of; rental costs of machinery and equipment, exclusive of hand tools, including costs of transportation, installation, minor repairs and replacements, dismantling and removal;

7.3.6.4 Expenses incurred in accordance with Contractor's standard personnel policy for travel approved by the Owner in advance;

7.3.6.5 costs of premiums for all bonds and insurance, permit fees, and sales, use or similar taxes related to the field work directive; and

7.3.6.6 Payments made by the Contractor to Subcontractors directly related to the field work directive.

7.3.7 The amount of credit to be allowed by the Contractor to the Owner for a deletion or change which results in a net decrease in the Contract Sum shall be actual net cost of the deleted or change Work, plus the Contractor's allocated percent for profit and overhead as confirmed by the Design Consultant, subject to equitable adjustment recommended by the Design Consultant and approved by the Owner. When both additions and credits covering related Work or substitutions are involved in a change, the allowance for overhead and profit shall be figured on the basis of net increase or decrease, if any, with respect to that change.

7.3.8 Pending final determination of the total cost of a Field Work Directive to the Owner, amounts not in dispute for such changes in the Work shall be included in Applications for Payment accompanied by a Change Order indicating the parties' agreement with part or all of such costs. For any portion of such cost that remains in dispute, the Design Consultant will make an interim determination for purposes of monthly certification for payment for those costs. That determination of cost shall adjust the Contract Sum on the same basis as a Change Order, subject to the right of either party to disagree and assert a claim in accordance with Article 4.

7.3.9 When the Owner and Contractor agree with the determination made by the Design Consultant concerning the adjustments in the Contract Sum and Contract Time, or otherwise reach agreement upon the adjustments, such agreement shall be effective immediately and shall be recorded by preparation and execution of an appropriate Change Order.

## Appendix C – Example of Delay Clause

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Note: The following delay clause is taken from the City's "080 General Conditions for Building Construction" contract template.

### 8.3 DELAYS AND EXTENSIONS OF TIME

8.3.1 Neither the Owner nor the Contractor, except as provided for in this Section 8.3.1, shall be liable to the other party for delay to the Contractor's Work by reason of unreasonably severe weather, fire, act of God, riot, strike, or any other cause beyond the Owner's control. Should any of these factors delay the Work's critical path, as evidenced by a time impact analysis developed by Contractor and verified by the Design Consultants, the Program Manager (if any), and the ODR, Contractor shall receive an extension of the Contract Times equal to the delay if a written claim is made within five work days of the delaying event, and under no circumstances shall the Owner be liable to pay the Contractor any compensation for such delays.

8.3.2 Should the Contractor be delayed by the act, neglect or default of the Owner or the Design Consultants, and should any of these factors delay the Project's critical path, as evidenced by a time impact analysis developed by Contractor and verified by the Design Consultants, the Program Manager (if any) and the ODR, Contractor shall receive an extension of the Contract Times equal to the delay if a written claim is made within twenty one (21) days. In addition, Contractor, upon timely notice to the City and substantiation by the Design Consultants, the Program Manager (if any) and the ODR, shall be compensated for the actual costs incurred by the Contractor, which means amounts determined on the basis of costs incurred (excluding profit) during the delay period, and does not include costs associated for any tier of Subcontractor or Supplier to administer their Work. In no event will Contractor be entitled to home office or other off-site expenses or damages.

8.3.3 Claims relating to time shall be made in accordance with applicable provisions of Section 4.3.

8.3.4 This Contract does not permit the recovery of damages by the Contractor for delay, disruption or acceleration, other than those described above in Section 8.3.2 and as provided under Section 4.3.11(3). Contractor agrees that Contractor shall be fully compensated for all delays solely by an extension of time or as contemplated in Section 8.3.2.

## Appendix D – Liquidated Damages Clause

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For each Calendar Day that any Work is not completed after the expiration of Calendar Days stated in the Invitation for Bids or Invitation for Competitive Sealed Proposals, plus any Extended Calendar Days granted by Owner in accordance with the Contract Documents, the sum as shown in the table below will be deducted from the money due or to become due the Contractor, not as a penalty, but as mutually agreed to liquidated damages and added expense for Owner Contract administration, not otherwise susceptible to exact determination by Owner and Contractor prior to the execution of this Agreement.

<b>Amount of Contract</b>			<b>Liquidated Damages per Day</b>
\$ XXXXXX	or	Over	\$ XXXX
\$ XXXXX	to	\$XXXXX	\$ XXX
\$ XXXX	to	\$ XXXX	\$ XX
\$ XXX	to	\$ XXX	\$ X

## Appendix E

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### Staff Acknowledgement

Barry Lipton, CPA, DABFA, Deputy City Auditor  
Theresa Cameron, CPA, CIA, Audit Manager  
Buddy Vargas, Auditor-in-Charge

## Appendix F

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### **CITY OF SAN ANTONIO**

SAN ANTONIO TEXAS 78283-3966

September 2, 2008

TO: Park E. Pearson, CPA, Interim City Auditor  
FROM: Michael Bernard, City Attorney  
RE: Management's Response for the Audit of Contract Clauses

I have reviewed the Contract Clauses audit report and agree with the contract clause enhancements included therein. The City Attorney's Office appreciates the collaboration with the Office of the City Auditor on this project.

Sincerely,

A handwritten signature in black ink, appearing to read "Michael D. Bernard", written over a horizontal line.

Michael D. Bernard  
City Attorney  
City Attorney's Office