
OFFICE OF THE CITY AUDITOR

PERFORMANCE AUDIT OF INSURANCE REQUIREMENTS FOR CITY CONTRACTS

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**July 19, 2002
Report No. 361**

Memorandum



CITY OF DALLAS

July 19, 2002

Honorable Mayor and Members of the City Council
City of Dallas

We have conducted a performance audit of insurance requirements for City contracts.

We found that the Risk Management Division did not have written policies and procedures to ensure that insurance requirements would be determined in an equitable and consistent basis. Additionally, insurance requirements for subcontractors may be excessive because they must maintain coverage identical to the prime contractor's coverage regardless of their level of participation. Related opportunities for improvement are presented in this report.

We appreciate the cooperation of City staff during our examination.

Thomas M. Taylor

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c: Teodoro J. Benavides, City Manager

**PERFORMANCE AUDIT OF INSURANCE REQUIREMENTS
FOR CITY CONTRACTS**

CONTENTS

	<u>PAGE</u>
INTRODUCTION	1
Authorization	1
Scope and Methodology	1
Overall Conclusion	2
Background	2
OPPORTUNITIES FOR IMPROVEMENT	5

INTRODUCTION

Authorization

We have conducted a performance audit of insurance requirements for City contracts. This audit was conducted under the authority of Chapter IX, Section 2 of the Dallas City Charter and in accordance with the Annual Audit Plan approved by the City Council.

Scope and Methodology

Our audit was performed in accordance with generally accepted government auditing standards and, accordingly, included tests of the accounting records and other procedures that we considered necessary in the circumstances. Our audit included construction and professional services contracts active during the period October 1, 2000, to December 31, 2001.

The audit objective was to determine the City's policy for establishing insurance requirements on City contracts and whether such insurance requirements are excessive.

Our scope was City departments actively involved in major construction projects. These departments were selected based on their functionality, frequency of construction activity, and size. Our fieldwork was limited to four departments: Equipment and Building Services, Public Works, Dallas Water Utilities, and Parks and Recreation.

For our audit, we obtained a listing of active contracts during the period October 1, 2000, to December 31, 2001, and we selectively tested documentation relating to twelve contracts: two professional services contracts totaling \$1,795,564 and ten construction contracts totaling \$49,846,912.

To develop an understanding of policies and procedures relating to the determination of insurance requirements, we:

- Reviewed Administrative Directive (AD) 4-5, "Contracting Goods and Services," dated May 10, 1999, and the proposed changes to the AD. (The AD is currently undergoing revision.)
- Reviewed bid procedures for construction contracts.
- Interviewed Risk Management staff, City Attorney's staff, and Procurement/Business Diversity and Development Department staff regarding determination of insurance requirements for City contracts.

INTRODUCTION

- Consulted professional engineers and architects employed by the City.
- Visited departments and held discussions with personnel.
- Reviewed project manuals relating to contracts.
- Accessed information on the Internet for current practices and standards.

Overall Conclusion

The prevailing practice was that departments determined and established insurance requirements. The Risk Management Division did not have written policies and procedures to ensure that insurance requirements would be determined in an equitable and consistent basis. Additionally, insurance requirements for subcontractors may be excessive because they must maintain coverage identical to the prime contractor’s coverage regardless of their level of participation.

Background

The Director of Human Resources administers the risk management program.¹ Risk Management Division’s full-time staffing equivalents of twenty-seven FTEs for the current fiscal year are as follows:

# of FTEs	Title	Description
2	Asst Dir & Client Services	Management and supervision
9	Worker’s Comp – Risk Analysts	Administer claims contract & wage supplementation program
4	Safety – Risk Analysts	Assist City departments with workplace safety
5	Office Assistants	Clerical support
2	Risk Analysts & Office Assistant	Perform risk assessments, obtain & track insurance certificates
2	Return to Work – Risk Analysts	Assist employees with permanent physical job restrictions
1	Insurance – Risk Analyst	Purchase insurance for the City
1	Liability Claims – Risk Analyst	Procure & administer contract with third party claims administration firm
1	Subrogation & Recovery – Risk Analyst	Recover for damages to City property or injury to employees

¹ City Code, Chapter 2, Article VI, Sec 2-62.

INTRODUCTION

The Risk Management Division anticipates a reduction of three FTEs for fiscal year 2002-2003. These reductions will affect the Workers' Compensation and Return to Work programs.

Risk Management's objectives for FY01-02 (per the City's Adopted Budget) are:

- Provide quality Worker's Compensation and Liability claims administration in a responsive, responsible, and respectful manner by decreasing the time to resolve claims and respond to customer inquiries.
- Minimize negative impact of losses to contract related risks by reviewing procurement specifications and applying appropriate risk transfer methods.
- Protect City assets through appropriate risk management techniques including the purchase and maintenance of insurance policies and establishing a self-inspection program.
- Optimize absence management by assisting employees in returning to work by providing training, employment assistance, and alternative options.

It is the responsibility of the Risk Management Division to perform and document a risk assessment on all service and construction contracts greater than \$5,000 and contracts for the purchase of goods that are greater than \$15,000.² It shall be the responsibility of the initiating department to provide the Risk Management Division with a scope of services written in sufficient detail to perform the risk assessment.

The Risk Management Division shall, if insurance is required, develop and make recommendations to determine the types of insurance policies and coverage needed and set limits of insurance.³

Risk Management did not always participate in the initial planning phases of construction projects; thus, its role evolved into a limited one regarding insurance requirements for construction contracts. Risk Management took

² AD 4-5, paragraph 5.4. The pending revisions to AD 4-5 increases the threshold amount to \$25,000 on all service and construction contracts and eliminates reference to contracts for the purchase of goods.

³ AD 4-5, paragraph 8.2.1.

INTRODUCTION

responsibility for developing insurance requirements related to professional contracts and played a passive role of advising on umbrella/excess insurance coverage for construction contracts, based on requests from departments. Certain pending changes to AD 4-5 (if implemented) provide for improved inter-departmental cooperation and an active role for Risk Management to review specifications prior to the bidding process.

In January 2001, the City Council authorized a professional services contract for \$400,000 with the consulting firm of Mason Tillman Associates, Ltd. to perform an Availability and Disparity Study of minority contracting opportunities. This contract was extended to March 31, 2002. The study covered the period October 1, 1997, through September 30, 2000, and included a review and analysis of past and present contracting procedures. The report (dated May 2002) noted in the anecdotal section that minority/women business enterprises expressed a difficulty in obtaining insurance.

OPPORTUNITIES FOR IMPROVEMENT

We identified certain policies, procedures, and practices that can be improved. Our audit was not designed or intended to be a detailed study of every relevant system, procedure, and transaction. Accordingly, the opportunities for improvement presented in this report may not include all areas where improvements may be needed.

1. Risk Management should develop written internal procedures for determining insurance requirements.

There were no written procedures for determining insurance requirements. City departments determined their own insurance requirements for construction contracts, and the Risk Management Office determined insurance requirements for professional services contracts. However, there were no written procedures to identify what standards to use or how to determine the level and types of insurance coverage required to minimize the City's exposure to potential risk.

Lack of written procedures precluded assurance that insurance requirements would be uniformly determined in a fair and consistent basis.

AD 4-5, paragraph 8.1 states that the criteria established by Risk Management will assist the responsible department in identifying the best risk assessment methods based on (1) Avoidance, (2) Prevention, (3) Retention, and (4) Transfer, including insurance.

AD 4-5, paragraph 8.2 states that if insurance is to be required, the Risk Management Division shall develop and make recommendations to set limits of insurance, determine types of insurance policies and coverage needed, and provide insurance attachments to the initiating department.

We recommend that the Director of Human Resources ensure that:

- The Risk Management Division develops written departmental guidelines for identifying the types of insurance and coverage required for all types of contracts. These guidelines should include, at a minimum:
 - Methods for identifying potential risks.
 - Elements of a risk assessment.
 - Instructions on how to perform and document a risk assessment.
 - Basis for determining types of insurance, minimum insurance limits, and coverage required.
 - A checklist to ensure that all requirements are addressed prior to bid advertisement.
 - Other factors that may not be covered by ADs.
- The Risk Management Division accepts a more active role commensurate with the duties and responsibilities delegated to it by City directives. Such a role should include, at a minimum:

OPPORTUNITIES FOR IMPROVEMENT

- Reviewing insurance specifications for all contracts prior to bid advertisement.
- Establishing criteria for identifying and evaluating risk assessment methods.
- Periodically (at least annually) reviewing and updating insurance requirements based on current industry standards.

Management's Response:

Management concurs with and will implement the recommendations outlined. With regard to review of insurance requirements, staff will update insurance requirements when needed to ensure that the insurance required will be, at a minimum, appropriate for the scope of services, adequate to protect the City, and available to contractors/vendors to purchase.

2. City departments determined their own insurance requirements for construction contracts.

Departments relied on insurance standards developed by either the American Institute of Architects (AIA) or the North Texas Council of Governments (NTCOG). The department selected which standards to use based on the nature of the construction project. NTCOG standards were used for horizontal contracts (i.e., streets, bridges, sidewalks, etc.), and the AIA standards were used for vertical contracts (i.e., buildings, roofs, etc.). AIA standards are modified by the City Attorney's Office and incorporated into the contract as Supplementary General Conditions.

Departments did not always comply with existing policies and procedures. Thus, Risk Management's role in construction contracts was limited to monitoring prime contractors' certificates of insurance and assessing umbrella⁴ coverage, but only if requested by the project manager responsible for the construction project.

Failure to comply with policies and procedures precluded assurance that insurance requirements would be uniformly determined in a fair and consistent manner and ensure that the City would be adequately protected against potential risks.

AD 4-5, paragraph 5.4 states, "It shall be the responsibility of the Risk Management Division of the Human Resources Department to perform and document a risk assessment on all service and construction contracts greater than \$5,000 and goods greater than \$15,000. It shall be the responsibility of the initiating department to provide the Risk Management Division a scope of services written in sufficient detail to perform the Risk Assessment."⁵

⁴ Umbrella coverage is excess liability coverage following the form of the primary liability policies.

⁵ The pending revisions to AD 4-5 increase the threshold for services and construction contracts to \$25,000 and levy the responsibility on the Procurement Division to provide Risk Management a copy of the specifications and scope of services.

OPPORTUNITIES FOR IMPROVEMENT

We recommend that the City Manager ensure that City departments comply with AD 4-5, as it pertains to requesting a review of contractually required insurance prior to bidding contracts.

Management's Response:

Management concurs and will work with the City Manager's Office to develop communication to departments directing compliance with AD 4-5.

3. Insurance requirements for subcontractors may be excessive.

The departments used insurance standards that established the required liability insurance coverage based on project type and size. This liability coverage was required of the prime contractor. However, subcontractors were also required to obtain and maintain the same insurance requirements and coverage as the prime contractor, regardless of their level of participation.

The responsibility for subcontractor insurance was levied on the prime contractor per the City's contract. This practice was incorporated as standard language into all contracts.

Requiring subcontractors to maintain identical insurance coverage as the prime contractor may be excessive and could be an obstacle to becoming a subcontractor for City construction contracts. This requirement for identical insurance coverage could result in higher insurance premiums for the subcontractor and may not be proportionate to their level of participation.

Our audit inquiries revealed:

- The City of Euless does not require subcontractors to carry the equivalent insurance coverage as the prime contractor.
- The City of Austin intervenes if it is determined that the prime contractor has established high insurance requirements for the subcontractors.
- The City of Plano requires commercial general liability policy to include coverage for use of contractors and subcontractors.

The standard City contracts state in part:

"Without limiting any of the other obligations or liabilities of the Contractor, the Contractor and each Subcontractor, at their own expense, shall during the term of the Contract, purchase and maintain the hereinafter stipulated minimum insurance with companies duly authorized or approved to do business in the State of Texas and satisfactory to the Owner."

"The Contractor shall obtain and monitor the certificates of insurance from each Subcontractor in order to assure compliance with the insurance requirements."

OPPORTUNITIES FOR IMPROVEMENT

We recommend that the Director of Human Resources instruct the Risk Management Division, in consultation with the City Attorney's Office, to evaluate the City's exposure to risk and consider eliminating or amending the standard contract requirement that subcontractors must maintain identical insurance coverage as the prime contractor.

Management's Response:

Management concurs and will implement the recommendations outlined.

This report is intended to promote the best possible management of public resources. You are welcome to keep this copy if it is useful to you. If you no longer need the report, you are encouraged to return it to:

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