Montana Legislative Audit Division

Performance Audit Summary

Highway and Bridge Construction Contract Claims Process
March 2003

Introduction

A performance audit of the contract claims process was requested by the Montana Department of Transportation (MDT) and approved by the Legislative Audit Committee. Contract claims is the term used to refer to the process for handling disputes between contractors and district staff in performance of a construction contract.

Contract claims are a normal part of the highway and bridge construction process to help determine if additional compensation to a contractor is warranted. Contract claims are handled outside the normal process of paying contractors. Therefore, it is important to have a process that is efficient and timely. Department officials requested an audit because they wanted to know:

- How claims impact department and contractor operations?
- If the contract claims process is fair to contractors while still protecting the taxpayer's investment?
- If the department's claims process is efficient and if any changes are needed in the current process?

Contract Claims Are Limited

There are relatively low numbers of contract claims filed and their dollar impact to the department's overall construction program is limited. The department measures total construction costs by tracking payments made to contractors for work performed. One method for assessing the impact claims have on department operations is to compare payments made to contractors to total claims settled for the same time period. The department paid contractors more than $638 million between fiscal years 1999-00 through 2001-02, but claims amounted to less than one-half of one percent of this total. However, even though claims are a small percentage of total payments, contractors were still paid more than $3 million in additional compensation through claim settlements over the last three years.

Claims Can Affect Individual Projects

Claims can have significant financial impacts on individual projects and contractors. This includes the amount of staff time needed to address claim issues. We reviewed all (25) claims for projects that began construction in calendar years 2000 and 2001. Even though claims have limited impact on the costs of the department's overall construction program, they can significantly impact payments to contractors on individual projects. For example, one project we reviewed has a $2.5 million dollar claim pending on a $10.7 million project. This is 23 percent of the contract amount. Contract claims also increase general administrative and indirect costs for both the department and contractors.

Management Information Needed

The department does not have management information that provides for efficient administration of contract claims. The department does not track information such as the total number of claims filed in each district, the reasons claims were filed, the amount of time staff spend dealing with claim issues, and the status of claims being reviewed. Presently, the department relies exclusively on Construction Bureau and district staff memory to obtain data related to claims. Consequently, we identified problems with the accuracy of department information related to claim activity and neither the Construction Bureau nor district staff knew the extent or impact of claim activity on the MDT's construction program.

Documentation Could be Improved

Documentation weaknesses in the department's claims process make it difficult to determine how decisions to settle claims are made and whether the settlements are fair to either the state or contractors. Documentation plays a significant role in favorable and timely negotiation and settlement of claims. ***Therefore, all phases of claim review should be documented and all department decisions supported.***

Coordination Needed

There is limited coordination between the districts, Construction Bureau, and Federal Highway Administration (FHWA) regarding contract claim activity. The Construction Bureau has expertise not available in the districts and is also responsible for ensuring problems on construction projects are handled consistently statewide. Therefore, districts should be immediately notifying the bureau about claim issues. Our review found coordination between the districts and the Construction Bureau on claim issues is limited and inconsistent. Often the Construction

Bureau was not notified and included in claim issues until district staff and contractors had spent months trying to resolve an issue. In some cases the Construction Bureau was not aware of contract claims until they were appealed to the Board of Contract Appeals.

The FHWA determines whether contract claims are sufficiently supported to receive federal funding participation. Early coordination with the FHWA is necessary so it can determine if it will participate in payment of a claim. MDT district construction staff generally has the responsibility to coordinate claim issues with the FHWA. Of the 25 claims we reviewed, districts initiated early coordination with the FHWA on only 3 claims. In several cases, FHWA officials were not aware of claim issues until late in the claim review process. Claim review and settlement decisions were delayed due to limited coordination between districts and the FHWA. ***Insufficient coordination caused consistency and timeliness issues in resolving contract claims.***

How Can Contract Claim Administration be Improved?

There are a number of weaknesses in the department's current system to administer contract claims. ***To help improve its ability to administer contract claims the department should establish a database to compile and analyze management information related to claim activity, train staff regarding claim documentation requirements, and establish a quality control process that includes claim file review to ensure claims are properly documented.***

Contract Claim Evaluation and Settlement

We reviewed the timeliness of the claims process from the date a claim issue was first brought to a district's attention until final resolution. It takes the department approximately 90 to 270 days to process a claim. For the 25 claims we reviewed, the districts took an average of 130 days to review claims. The current claims review process has repetitive steps that contribute to inefficiencies. Specifications currently require contractors to notify districts of claim issues three different times. There is little difference in the information provided during these three steps. Additionally, district staff must respond to each notification and denials were generally for the same reason each time.

Formal negotiations with contractors should begin early in the claims process because the more time that passes the larger the disagreements become and the more difficult it becomes to reach a settlement. We noted any negotiations with contractors tend to occur during the latter stages of the claims process and after districts denied issues at least twice. Since negotiations occur late in the claim process, the effectiveness of the claims process is reduced because an adversarial relationship has generally developed between the district and contractor. ***To improve the timeliness and effectiveness of the claim process, the department should eliminate repetitive steps from the claim process and focus on early negotiations of claim issues with contractors.***

Escrowed Bid Documents

Construction contracts of at least $3 million include a special provision that requires bid documents be placed in escrow within seven days of the bid opening. In the event a contractor files a claim on a project, the special provision allows the department to open and review the escrowed documents and use the information when negotiating the claim. Construction contracts state that if contractors do not submit all bid documentation to be placed in escrow it is considered a "material breech" of the contract and acts as a "final and total waiver" of the claim. We identified instances where all bid documentation was not provided as required, but claims were not denied. There is inconsistent support among department staff on whether placing bid documents in escrow is valuable to the contract claims process. ***The department needs to decide on the value of placing bid documents in escrow. If it determines the value is limited then the requirement should be eliminated. If the department continues the practice, a process should be established to ensure contractors provide all documentation.***

Board of Contract Appeals

The Board of Contract Appeals becomes involved in the claims process when claims are denied at the district level. If contractors disagree with a district's decision to deny a claim, the decision can be appealed to the board. The board reviews the documentation related to the claim and the reason the district denied it. The board can uphold the district's decision or modify the decision in whole or in part.

We did not find evidence the board was making unfair or biased decisions. ***The department's process to use an internal Board of Contract Appeals is working as intended and a change to an alternative approach is not warranted.***

However, our review found the board was not reviewing claims in a timely manner. On average, it takes the board 147 days to review claims that were appealed. The department's specifications establish timelines for other phases of the claim process, but do not require the board to review claims within any specified period of time. ***The department should establish timelines for Board of Contract Appeal reviews in the Standard Specifications for Road and Bridge Construction.***

For a complete copy of the report (02P-11) or for further information contact the Legislative Audit Division at 406-444-3122; e-mail to lad@mt.gov; or check the web site at http://leg.mt.gov/audit.