

**Management’s Response to the Auditor General’s Review of
Management of Construction Contracts – Toronto Water and Sewer Emergency Repair Contracts**

<u>Rec No</u>	<u>Recommendation</u>	Agree (X)	Disagree (X)	<u>Management Comments:</u> <i>(Comments are required only for recommendations where there is disagreement.)</i>	<u>Action Plan/ Time Frame</u>
1.	<p>The General Manager, Toronto Water, in consultation with the Deputy City Manager and Chief Financial Officer and the City Solicitor:</p> <p>(a) evaluate City business continuity and disaster management risks in contracting with a single contract provider for all City water and sewer emergency repairs;</p>	X		<p>Initially, these contracts were structured in two parts (Part A – for new site servicing and Part B – for emergency infrastructure repairs). The contract terms and conditions were in place for all contracts since before amalgamation. Part A expenses are fully recoverable based on permit fees charged to applicants.</p> <p>(a) Although Toronto Water agrees with the recommendation and will review the matter for risks associated with awarding to a single contract provider, it is noted that the risk level is low as the contracts are not standard construction contracts. The contracts are service related and cover hundreds of small repair sites lasting, on average, 1-2 days in duration. A contractor that defaults in this scenario does not impact business continuity and the City is still covered by performance bonds that can be used to engage other contractors.</p> <p>In 2004-05 there were 5 contractors (for 7 contracts) providing both new water and sewer connections and emergency repair services under the same contract terms. All of the contracts were awarded on a tendered low-bid basis in accordance with the City’s Purchasing Policies.</p>	<p>Meet with parties by November 30, 2007 to evaluate risks prior to tendering and considering revising contracts from “emergency response” to “general services to carry out repairs”.</p>

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				<p>In 2006, the tender process was changed to separate the Part A and Part B work. There were 3 contractors (for 4 contracts) providing only new water and sewer connection services. There was 1 contractor (for 2 contracts) providing emergency repair services. All of the contracts were awarded on a tendered low-bid basis in accordance with the City’s Purchasing Policies.</p> <p>In 2007, there are 3 contractors (for 4 contracts) providing only new water and sewer connection services. There are 2 contractors (for 4 contracts) providing emergency repair services. All of the contracts were awarded on a tendered low-bid basis in accordance with the City’s Purchasing Policies.</p> <p>An analysis comparing all contract amounts spent for 2005 and 2006 shows that in aggregate, total expenses remained relatively the same (\$20.89 M vs. \$20.6 M). However, there was a 27.8% decrease in emergency repair costs that can be attributed to separating the original contracts. As the new servicing costs of \$13.4M were recovered by separate fees, there was a savings of \$2.79M in Toronto Water’s 2006 operating budget generated by restructuring the contracts.</p>	

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	(b) evaluate the viability and impact of alternate procurement solutions such as a roster of contractors, or restricting bidding contractors to a limited number of districts; and	X		<p>Toronto Water continually reviews the efficiency and effectiveness of its tendered contracts and is prepared to review the potential risks associated with awarding all emergency repair contracts to one vendor even though they may be the low bidder in a tendering process. The review will require consultation with Purchasing and Materials Management Division (PMMD) and Legal Services to consider impacts to City policies.</p> <p>(b) Toronto Water will review alternate procurement solutions with Legal Services and PMMD to consider any changes that may be required to existing City Purchasing Policies or the Financial Control By-law.</p> <p>It should be noted that considering other options such as a roster of vendors has the potential to reduce the risk faced by the City, but it will not likely produce the lowest cost. Also, restricting or limiting the award of contracts in a competition may lead to other problems such as collusion by Bidders on pricing and bid territories as the chances of winning an award increases for each bidder when restrictions are placed on a competitive tender process.</p>	<p>Meet with parties by November 30, 2007 to evaluate risks prior to tendering and considering revising contracts from “emergency response” to “general services to carry out repairs”.</p>

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	(c) develop appropriate criteria for the standardized use of contractual incentives such as alternative liquidated damages provisions when emergency repairs are delayed and include such criteria in future City water and sewer emergency contracts.		X	<p>(c) The existing contracts have provisions for liquidated damages for not completing the contract in a specified time. However, this is not a standard construction contract so it is very difficult to administer liquidated damages for hundreds of small repair sites.</p> <p>For an alternative liquidated damages provision to be properly administered it will require setting out specific time frames for completion in advance of each type of work to be completed. This is an onerous and operationally costly task to undertake as most of the work is completed on an emergency response basis with usually a limited amount of time to consider detailing a scope of services. The added process will also delay the customer response time to complete the repairs.</p>	
2.	The Deputy City Manager and Chief Financial Officer ensure the tendering process is complied with and a comparative summary of bids is developed and authorized. Copies of key sections including authorization and pricing sections of competitive bids should be retained by the Purchasing and Materials Management Division.	X		PMMD has already implemented this recommendation as the process was changed subsequent to the issuance of the 2004-05 contracts reviewed in this audit. All bid summaries are provided to PMMD by City Divisions and PMMD makes photocopies of all pertinent bid document pricing pages for their records prior to releasing the document to the Division for analysis.	Already Implemented.

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3.	The General Manager, Toronto Water, in consultation with the City Solicitor, review the content of all standard Toronto Water emergency repair contracts in order to ensure that contract provisions are clear, consistent and enforceable.		X	<p>Toronto Water is already using standard construction provisions included in the General Conditions section of the contracts. These have been written and approved by the City Solicitor.</p> <p>The issue with the inconsistencies in language appeared in the special specifications section that is written by technical staff for each project as it is being tendered.</p> <p>As such, these specifications <u>will need</u> to vary for all projects and Legal Services has indicated, in a separate response provided to the Auditor General’s office, that the nature of special conditions or specifications are technical in nature and “do not lend themselves well to standardization of language by Legal”.</p> <p>In the 2003 tender (for the 2004-05 contract years), there was unclear or missing language in some contracts that would better define work between Part A and Part B sections of the contracts. Despite this omission, a review of past contracts (and as noted in the Auditor’s Report) showed that staff administered the contracts in the same manner across the City and in accordance with the intended scope of work.</p>	

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				<p>In the 2005 tender (for the 2006 contract year), a contradictory language error occurred as staff attempted to separate and harmonize contracts for new service installations and emergency repairs for the entire City. The impact of this error was minimal as a review confirmed that staff administered these contracts in a consistent manner across the entire City.</p> <p>As noted previously, there were seven (7) different contracts that provided both new service installation and emergency repair service across the City. These contracts were administered in a decentralized model under 2 separate Directors having a total of 13 Managers and 68 Supervisors reporting to them.</p> <p>The District Operations of Toronto Water has been restructured and now has 1 Director, 9 Managers and 56 Supervisors. From 2003-2007, the restructuring has produced annual reoccurring savings of \$5.2M.</p> <p>Starting in 2005, Toronto Water placed the administration of these contracts under the Manager of the newly formed District Contract Services Unit to provide centralized and harmonized contract management services to the various District Yards.</p>	
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				The Unit is funded to have 53 staff but only had 34 staff in place at the time of the audit. There is now 40 staff and more anticipated as the restructuring of the unionized staff of District Operations continues.	
4.	The General Manager, Toronto Water, review payments to the contractor based on undocumented assumptions and informal agreements and where appropriate such payments be recovered.		X	<p>Toronto Water is prepared to review payments made to the contractor for the 2006 and 2007 contract years as outlined in Recommendation 9 as contained herein. However, we do not agree with this recommendation as the scope is too broad and would not likely lead to any financial benefit to the City.</p> <p>As noted, prior year contracts were structured in two parts (Part A – for new site servicing and Part B – for emergency infrastructure repairs). The contract terms and conditions were in place for all contracts since before amalgamation.</p> <p>Although, some omissions, inconsistency and contradictory terms existed between these contracts, bidders were familiar with and understood the requirements of the two-part contracts. Furthermore, a review confirmed that staff administered these contracts in a consistent manner across the entire City. Therefore, Toronto Water does not agree with reviewing payments for 2004 and 2005 as the</p>	

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				<p>recovery of payments once made under a contract, particularly once a contract is completed, can be difficult, if not impossible.</p> <p>It is regrettable that previous contracts contained some inconsistencies not resolved by a priority clause as the error occurred in the special specifications section of the agreement. Nevertheless, staff considered the impact of the ambiguity and determined to honour the original intent of the tender as any challenge to the document language would have likely been construed against the City in favour of the contractor.</p> <p>Furthermore, Part A unit pricing as provided by the Bidders included certain costs (such as backfill charges, piping and couplings) as the work for new services is carried out at the request of applicants and generally in undisturbed ground conditions and in accordance with plans submitted with applications for new water and sewer service connections.</p> <p>Part B unit pricing did <u>not</u> include certain costs (such as backfill charges, piping and couplings) as quantity estimates are very difficult to predict for emergency work. It is impossible to predict the amount of material (i.e. length of pipe or number of couplings)</p>	

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				<p>needed to affect certain repairs. Also, some deeper excavations require different safety support systems, while in other instances, additional excavation and backfilling is required when ground conditions become saturated with escaping water or sewage.</p> <p>The separate payment for certain materials under emergency repair conditions is understandable and expected.</p>	
5.	The General Manager, Toronto Water, direct staff that any decisions, and in particular, decisions that involve financial commitments for contract terms which appear to be ambiguous, unclear or inconsistent only be made after consultation with the City's Legal Services Division and approval by the senior management. All such consultations and approval be documented.	X		Agreed.	Communication to be issued by the General Manager to all Directors by September 30, 2007.
6.	The General Manager, Toronto Water, review the possibility of including criteria for emergency and non-emergency work in future contracts and obtaining separate rates for emergency and non-emergency work accordingly.		X	Prior year contracts were structured in two parts (Part A – for new site servicing and Part B – for emergency infrastructure repairs). As part of the 2003 tender process, separate rates for emergency and non-emergency work was requested from Bidders as some of the work completed under the previous contracts	

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				<p>could have potentially been non-emergency in nature.</p> <p>For the 2006 contract year, Toronto Water restructured the tender so that new water services and emergency contract services would be provided under separate contracts. This was done so that any water service replacement not deemed to be an emergency could be redirected to the new water service repair contracts while drain replacements not deemed to be in immediate need of repair could be added to a subsequent list for future contract tenders.</p> <p>Toronto Water does not agree with asking for non-emergency pricing under the terms and conditions of an emergency contract. Re-introducing these criteria defeats the purpose of creating separate emergency response contracts. If two separate prices were to be requested, then it would be better to restructure the contract to become a general services contract that provides unit rate pricing and time and material pricing for a specified list of repair work.</p> <p>An analysis of bid rates was carried out for all seven (7) of the 2004 and 2005 Water and Sewer Servicing and Emergency Contracts. A total of 27 bids were received from eight different bidders. The seven</p>	
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				contracts were issued to 5 different bidders. Separate rates were requested in this tender and in the majority of the cases contractors did not bid a premium for emergency service over non-emergency work.	
7.	The General Manager, Toronto Water, ensure that where possible, estimated quantities contained in emergency repair contract tenders are reasonably accurate and are representative of actual quantities required to complete the contract. In addition, The General Manager in consultation with Purchasing and Materials Management, explore other procurement solutions for obtaining emergency repair services independent of fixed quantity estimates.	X		<p>It should be noted that these types of contracts (unlike standard construction contracts) are for dealing with emergencies and on-demand applications. Annual quantities for both services vary from year-to-year and can be very difficult to estimate. Nevertheless, Toronto Water will review with PMMD other procurement solutions that reduce the risk of under estimating quantities.</p> <p>In addition, at the start of 2006, Toronto Water implemented a new tracking procedure. The work was tracked based on the items used under the 2006 contracts. This has provided a better method to estimate contract needs for subsequent years.</p> <p>Furthermore, discussions were held with the District Operations Managers to ensure that the type of work and estimates were more representative of the contracted work required. It is the Operations Managers and Supervisors who first respond to all customer emergency calls and then make a</p>	<p>Partially implemented in January 2006.</p> <p>The remainder to be considered in accordance with Recommendation #1 by November 30, 2007.</p>

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				determination of whether they have the necessary resources to complete the repair. If not, the work is referred to the Manager of District Contract Services for administration and completion under the tendered contracts.	
8.	The General Manager, Toronto Water, take steps to develop policies and procedures for managing emergency repair contracts and ensure staff is appropriately trained.	X		<p>Toronto Water recognized the need to strengthen contract management controls and, in response, realigned the oversight of District Operations from two Directors to one at the end of 2004. In addition, Operations Managers were restructured from 13 to 9 and a single District Contract Services Unit was created in 2005. Staffing levels for the Unit are well below the intended target of 53 people. At the time of the audit there was 34 staff while today there is now 40 staff in place.</p> <p>The structure of the District Contract Services Unit provides for the hiring of a contract administration team to support Contract Supervisors in the preparation, execution and processing of contracts and payments. This team was identified as part of the original initiative but has not yet been formed due to several delays in the restructuring and redeployment process taking place in District Operations.</p>	The Capital Works Procurement Manual and Field Services Manual will be in place by July 1, 2008 .

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				<p>The hiring processes for these positions (as well as other technical support positions) were issued in late 2006 and early 2007. To date only 6 of the 19 vacancies have been permanently filled. As such the policies and procedures for managing construction contracts have not been implemented as staff resources were diverted from this task to address the immediate needs of the public in the delivery of customer service.</p> <p>Toronto Water will be reviewing existing Technical Services Capital Works Procurement Manuals and the proposed Technical Services Field Services Manual to better establish roles, responsibilities and consistency in the management of contracts.</p> <p>These documents, with appropriate amendment, will form the basis for the new policies and procedures used to train Toronto Water staff.</p>	
9.	The General Manager, Toronto Water, review 2006 and 2007 contractor payments for emergency repairs and take steps to determine and recover overpayments made to the contractor identified as part of the review.	X		Toronto Water will review all contractor payments for the 2006 and 2007 emergency repair contracts. The risk to the City is non-existent in this instance as Toronto Water has held back sufficient funds, by way of a set off, under the contracts to recover any outstanding or disputed liabilities including any	Complete review of 2006 and 2007 contract payments with Legal Services and attempt to recover

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				<p>inadvertent payment or mathematical calculation errors that may require adjustment under the contracts.</p> <p>These funds will not be released for payment to the contractor until such time as there is a satisfactory resolution of all outstanding or disputed liabilities. In these circumstances, it is appropriate for Toronto Water to consult with Legal Services, if it is determined that payment errors were in fact made, to investigate the possibility of the potential recovery of the funds paid from the monies currently being held by the City, or any other available recourse.</p>	<p>funds by March 31, 2008.</p>
10.	<p>The General Manager, Toronto Water, develop policies to ensure that:</p> <p>(a) Site Inspector’s Daily Work Reports are prepared independently of contractor invoices and provide relevant details including services provided, calculations and measurements supporting payment; and</p>	X		<p>a) On March 7, 2007, the Manager of District Contract Services met with the Contract Services Supervisors to address several issues, including the appropriate completion of inspector reports and proper handling of contractor invoices. The District Contract Services Unit will undertake a review of all Inspector Daily Reports in an effort to standardize the report into one Daily Work Report.</p>	<p>Instructions were issued March 7, 2007 on the proper procedure for handling Inspectors reports.</p>

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	(b) documentation supporting progress payments is reviewed in detail by supervisory staff.	X		b) On March 7, 2007, the Manager District Contract Services met with the Contract Services Supervisors to address several issues, including the appropriate level of review required for all documentation supporting progress payments.	Instructions were issued March 7, 2007 on the process and requirements for supporting contract payments.
11.	The General Manager, Toronto Water, ensure that extra work is awarded through authorized change directives and that separate inspector reports are used for recording work pertaining to extra work orders.	X		<p>The nature of emergency response work differs significantly from that of planned construction work; as such Change Directives are not always possible. In most cases, decisions for extra work are made in the field by Inspection staff in consultation with Supervisors. As a result, it is not practical to have Change Directives issued for every on-site issue or to deal with unforeseen circumstances.</p> <p>However, Toronto Water agrees that a Change Directive process for work not covered under the existing contract should be implemented. These Change Directives will be administered by use of independent inspector reports. Toronto Water will review the protocols and requirements outlined in the Technical Services' Capital Works Procurement Manual and modify the document to create a</p>	Develop new Change Directive process including Extra Work Record forms and Issue instructions to staff by January 1, 2008.

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				standardized process. Appropriate instructions will be issued to all contract management staff on the new process and proper use of forms.	
12.	The General Manager, Toronto Water, ensure that to the extent possible, all required work be included in the original contract and extra work orders be limited.	X		Beginning in 2006, all contracts have been set up to allow Contract Supervisors to track quantities and better manage future estimates. Several new work items to cover various scenarios were introduced into the 2007 Emergency Contracts. The provision of the new items has significantly reduced the number of extra work events under the 2007 contract.	Already Implemented in January 2006.
13.	The General Manager, Toronto Water, develop a process for the periodic monitoring of contract expenditures and ensure that Purchasing by-law requirements for authorizing over-expenditures are complied with. Appropriate action is taken in circumstances where non compliance of the by law is identified.	X		In addition to the contract monitoring services provided by accounting staff in the Policy, Planning, Finance and Administrative Division (PPFA), Toronto Water is reviewing contract expenditures at regular Supervisor meetings. Toronto Water has amended its policies so that the process for contract re-tendered starts when 80% of the contract value as been expended or the term of the contract is set to expire, whichever occurs first.	Already implemented in January 2007.

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14.	The General Manager, Toronto Water, ensure contractor performance issues are consistently documented and monitored. Significant contractor performance issues that can not be resolved through the regular contract management process should be communicated to Purchasing and Materials Management for consideration in future contract award decisions.	X		Toronto Water will review with PMMD and Legal Services specific documentation requirements to ensure that vendor performance issues are communicated to PMMD in future contract award decisions.	Develop appropriate contractor performance monitoring forms by January 1, 2008.
15.	The General Manager, Toronto Water, expedite the review and assessment of the existing work management systems, including an assessment of the SAP Plant Maintenance Module. Following the selection of a work management system, its implementation should be expedited and the cost benefits of its integration with SAP be evaluated.	X		<p>In March 2006, Toronto Water completed its Technology Blueprint project designed to chart an investment plan for the next seven years. Staff fully recognized the need to review and assess existing Computerized Work Management Systems (CWMS) but delayed proceeding with a review as the City was restructuring its Corporate Information Technology (IT) Division and various governance policies.</p> <p>There are significant opportunities for partnering with other Divisions and Corporate IT in reviewing existing CWMS across the City. A proper integration review should involve full consultation with the City’s new Chief Information Officer (CIO) and other General Managers that extensively use CWMS.</p>	Complete discussions with the CIO, by December 31, 2007 , on a broader Corporate or multi-divisional review of CWMS and SAP integration issues.

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16.	The General Manager, Toronto Water, develop procedures to ensure staff review repair requests to determine if the required work is covered under warranty.	X		Toronto Water will develop a process to track work undertaken by contractors in the Hansen WMS and further develop a process where new work is checked against warranty records before it is issued for repair.	Develop process to track warranty work by March 31, 2008.
17.	The General Manager, Toronto Water Division, develop a process for District Contract Services and Operations & Maintenance staff to meet on a regular basis to discuss project status, and document and assess the priority of ongoing projects for re-assignment of pending projects to in-house staff.	X		Toronto Water will require regular attendance of Contract Services Supervisors at Operation & Maintenance District Supervisor Meetings. The two teams of Supervisors will be required to review on-going business requirements, discuss status of various work sites and reassign projects to in-house staff based on any changes in priorities as determined by staff at that time.	Process to be developed and implemented by December 31, 2007.