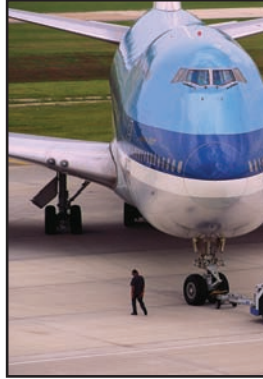


Performance Audit Report

Port of Seattle Construction Management

Report No. 100008



December 20, 2007



Washington State Auditor Brian Sonntag, CGFM

A letter from State Auditor Brian Sonntag

The Port of Seattle is one of the largest and most complex local governments in Washington State. A major share of its budget was spent on construction and capital projects – more than a half-a-billion dollars in each of the past three years. For that reason, we used our performance audit authority under Initiative 900 to take an in-depth look at how the Port manages construction projects.

We are pleased to present the results of that audit, which brings to light serious and pervasive issues in the Port's management of these projects. According to the audit, the Port Commission provided insufficient oversight over contracting practices and the Port did not have adequate systems in place to protect taxpayer dollars from misuse, abuse and misappropriation. To the degree the Port had these systems in place, they were not always followed.

The far-reaching recommendations in this report can steer the Port on a new course toward the accountability and transparency citizens expect and deserve. Among the recommendations:

- Appoint a Chief Procurement Officer. All procurement authority, including contract awards, approval of contract change orders and amendments and other related activities should be re-assigned to the CPO.
- The Port Commission should re-assert its responsibility for Port management. The elected Commissioners should provide stronger oversight of Port operations and take back much of the decision-making responsibility that has been delegated to Port management, particularly as it relates to capital projects.
- Restructure the Port's internal audit function. The individual or individuals in this position should report directly to the Port's Chief Executive and an independent audit committee, not to the Chief Financial Officer.

If followed, these and other recommendations provide the Port of Seattle a genuine opportunity to reduce the Port's vulnerability to loss and to ensure construction projects are completed on time and within projected costs. We hope the Port will use our recommendations in the spirit in which they are offered – as a constructive blueprint for the efficient use of taxpayer dollars.

For this audit, we contracted with two high-caliber

private firms to provide needed specialized expertise. Cotton & Co. is recognized nationally as an expert in management of government construction projects and in forensic auditing. The firm's owner, David Cotton, has helped author national auditing standards. The other firm, CDR Consultants, is frequently called on by the U.S. Court of Federal Claims as an expert witness on issues related to project management, construction claims analysis and construction scheduling.

These firms – through document review and interviews – took a thorough look at Port construction management. We appreciate their professionalism and are fully satisfied that their high quality work is independent, objective and accurate.

This is not the end of our audit work at the Port. Next year, we plan to conduct another performance audit that takes a broader look at Port operations beyond construction management. We also intend to follow up with a review in 2009 to assess the Port's actions in addressing the conditions identified in this audit.

The Port of Seattle is embarking on a new era. It hired a new Chief Executive Officer earlier this year, and most of the issues identified in this audit occurred before his tenure. In addition, two new members were elected to the Port's five-member Commission in November, reflecting citizens' demands for greater accountability.

The new Chief Executive Officer has expressed a commitment to address the issues raised in the audit. We support his vision and recognize the challenges he faces in working with the Commission and Port staff to bring about positive and needed changes.



Brian Sonntag, CGFM
Washington State Auditor

A handwritten signature in black ink, appearing to read "Brian Sonntag". The signature is fluid and stylized, with a large, sweeping "B" and "S".

This audit was conducted under the authority of citizen-approved Initiative 900. We contracted with the private firms of Cotton & Company and CDR Consultants to conduct the audit. Their complete report follows this executive summary.

The firms performed fieldwork between March and October 2007. They identified significant and widespread issues and made 51 recommendations to address those conditions.

The overarching conclusions include:

- The Port lacks sufficient policies and procedures to safeguard public assets from misuse, abuse and fraud. In cases in which controls are in place, they are not always followed.
- The Port Commission has largely delegated decision-making responsibilities for construction projects to Port management and employees. In some cases, vendors control projects and make decisions that should be made by the Port
- Port executive management has withheld information from and sometimes has misinformed the Commission about the terms and progress of construction projects.

These conditions are caused by:

The Port Commission's adoption of Resolution 3181, delegating some of its decision-making authority to Port administration, including some oversight of construction management. The former Chief Executive Officer's broad interpretation of the resolution effectively distanced the Commission from information and oversight authority of capital projects. The audit found no record of the Commission reassessing or questioning whether it was meeting its responsibilities to oversee construction projects.

- Port management does not segregate the duties of procurement and contractor oversight. Port employees routinely award contracts and then oversee the contractors they selected. This creates a conflict of interest because those who work with the contractors may develop working relationships that prevent them from awarding and overseeing contracts with a higher degree of objectivity and diligence.
- Port commissioners have largely ceded the authority to award and manage contracts to low- and mid-level

project managers.

- According to an e-mail to the contracted auditors, the Port maintains it "is not subject to any specific legislative framework governing its procurement practices other than those which govern public works design and construction contracts."
- The Port does not enforce standard construction contract provisions, leading to significant cost and schedule overruns.

These conditions leave the Port's construction management vulnerable to fraud, waste and abuse. For example, Port management authorized a Third Runway contract that cost \$32.7 million more than the Port engineer's original estimate. The contract violated state law, and details of the arrangement were concealed from the Commission.

In addition, a consulting agreement awarded in 1998 increased without competition from \$10 million to more than \$120 million and is being used to augment Port staffing, unnecessarily costing taxpayers \$60.5 million.

To address the conditions, the audit recommends:

- The Port should establish a Chief Procurement Officer (CPO) position, reporting directly to the Port's Chief Executive Officer and responsible for managing and overseeing all procurement-related activity. This individual should have the authority to hire trained and independent procurement staff members to review and approve all procurement-related transactions. All current delegation of authority related to procurement, including contract awards, approval of contract changes and amendments, and related activities should be rescinded and reassigned to the CPO.
- The Port Commission should re-evaluate the delegation of responsibility encompassed in Resolution 3181. Commissioners should develop and issue a new delegation of authority resolution that more clearly defines their intent with respect to construction management and how Port management reports to the Commission and the public concerning construction.
- The Port Commission should designate the internal auditor to report directly to the Port CEO and the Port's audit committee. The internal auditor should

Continued next page

Audit at a glance

not be under the direct supervision or management of or have performance appraisals done by either the Director of Accounting, Internal Audit & Procurement Services or the Chief Financial Officer.

The auditors noted two other issues related to the major findings described above:

- The Port needs to clarify its One Percent for the Arts policy. The Third Runway wall art that cost taxpayers between \$257,000 and \$1 million (the Port could not provide a figure for how much it spent on the project) appears to contradict the policy that art be visible to the general public.
- Port personnel altered audit evidence and impeded access to information. Some were uncooperative during the audit fieldwork.

The six major findings in the report

- Port construction management lacks cost controls and accountability.
- The Port circumvents competition requirements in violation of its own policies and sometimes in

violation of state law.

- Port policies and Port management's interpretations of its policies result in a lack of transparency and thwart Commission oversight of construction management activities.
- Port construction management records are incomplete and disorganized.
- The Port fails to enforce basic contract requirements, resulting in delays, extra costs, and an inability to defend against claims.
- Port construction management is vulnerable to fraud, waste and abuse.

Cost savings

The auditors identified \$97.2 million in unnecessary costs. The Port has the potential to avoid similar costs in the future if it institutes every audit recommendation.

The audit cost \$785,940. The scope limitations presented by the Port prolonged the audit fieldwork and necessitated the Auditor's Office to add \$334,905 to the original contract amount.

Objectives

The objectives of the audit were to:

1. Determine if the Port of Seattle effectively planned, designed and managed its construction projects, including its Third Runway Project, in order to:
 - Minimize all costs associated with its construction projects, including but not limited to engineering, land acquisition, environmental review, permitting and construction.
 - Minimize unnecessary change orders and delays that result in extra costs; and.
2. If not, determine the resulting costs and what can be done to reduce them.

Additionally, Initiative 900 directs the State Auditor's Office to address the following elements:

1. Identification of cost savings.
2. Identification of services that can be reduced or eliminated.

3. Identification of programs or services that can be transferred to the private sector.
4. Analysis of gaps or overlaps in programs or services and recommendations to correct them.
5. Feasibility of pooling the entity's information technology systems.
6. Analysis of the roles and functions of the entity and recommendations to change or eliminate roles or functions.
7. Recommendations for statutory or regulatory changes that may be necessary for the entity to properly carry out its functions.
8. Analysis of the entity's performance data, performance measures and self-assessment systems.
9. Identification of best practices.

The complete text of Initiative 900 is available at www.sao.wa.gov/PerformanceAudit/PDFDocuments/i900.pdf.

The scope of the audit included all construction projects and related consulting agreements active from January 2004 through March 2007. The audit fieldwork began in March 2007 and concluded in October 2007.

This performance audit was conducted in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives except for the effects, if any, of the scope limitations, as explained below.

In planning the audit, we gained an understanding of internal controls that relate to the audit objectives. As part of our survey and testing phases, we determined whether proper internal controls were placed in operation.

Scope limitations

The auditors faced difficulties during their fieldwork, effectively limiting the scope of the audit. Instances occurred in which Port staff delayed responding to and, in some cases, impeded access to information. In other situations, information appeared to have been altered before it was provided to the auditors and the auditors concluded it could not be relied on. Some construction-related records were updated after being requested by auditors, making it difficult to determine how well the records were maintained under normal circumstances. While most Port employees were responsive and cooperative with auditor requests, several staff members were not. These conditions are explained in more detail in Finding 7-A and Appendix A of the report.

Three areas of fieldwork are crucial to achieving the audit's objectives:

- Reviewing construction management records and documents as they are maintained in the normal course of business.
- Accessing construction management information and files, both hard copy and electronically, in an efficient and timely manner.
- Meeting with and interview Port employees and obtain candid answers to questions about construction management.

Each of those activities was blocked or compromised by the Port employees.

Auditing standards allow auditors to request letters from entity employees verifying that the information they provided during the audit is accurate and complete. This is a routine part of audit work, and such a request was made to the Port. After the Port's initial refusal to sign the letters, most were signed and submitted to the auditors, but without complete assurances.

We do not believe the scope limitations presented by the Port undermined the validity of any of the audit findings, conclusions or recommendations. However, conditions noted in the report may be more serious than reported, and there may be additional findings that the audit firm was unable to discover, develop and report.

Government auditing standards state that the report may recognize commendations if they apply to the audit objectives. The auditors asked Port officials to identify noteworthy construction management accomplishments in March 2007. The Port provided the information in July and August 2007, in some cases after auditors had completed field work in certain areas. Because of the delay in receiving the information and the scope limitations described above, auditors did not verify the accuracy of the information. The unaudited information is in Appendix D of the report.

Our audit authority

Washington voters approved Initiative 900 in November 2005, giving the State Auditor's Office the authority to conduct independent performance audits of state and local government entities on behalf of citizens. The purpose of conducting these performance audits is to promote accountability and cost-effective uses of public resources.

The State Auditor's Office engaged Cotton & Company to conduct this performance audit in accordance with Government Auditing Standards. Those standards require that the auditor plan and perform the audit to obtain sufficient, appropriate evidence that provides a reasonable basis for the findings and conclusions based on the audit objectives.

The Port's full response to the audit findings and recommendations are in Appendix E of the report.

Cost savings table

Finding	Description	Cost Savings
1-A	POS Approved Change Orders without Sufficient Evidence of Having Evaluated Proposed Costs	Unquantifiable
1-B	POS's Failure to Timely Process Change Orders and Poor Change Order Documentation Resulted in an Overpayment of \$105,535.50.	\$105,535
1-C	POS Failed to Obtain an \$80,000 Credit When Original Scope Work Was Deleted, and POS Wrongly Issued a 329-Day Time Extension for Work That Was Never Performed.	\$80,000
1-D	POS's Inadequate Review of Change Order Proposals Resulted in Overpayment of Contractor Markups	\$7,202
1-E	POS Altered Contractor Invoices in Order to Pay a Contractor for Work that Exceeded the Amounts Authorized by Law and in Violation of the POS Commission's Delegation of Authority	Unquantifiable
2-A	POS Circumvents Competition Requirements by Awarding Contracts at "Less Competition Required" Levels and then Amending the Contracts to Higher Levels, Splitting Purchases, and Awarding Sequential No Competition Contracts	Unquantifiable
2-B	A Consulting Agreement Awarded in 1993 Grew without Competition from \$950,000 to More than \$30 Million	Unquantifiable
2-C	A Consulting Agreement Awarded in 1998 Grew without Competition from \$10 million to More than \$120 Million and Is Being Used to Augment POS Staffing at Considerable Cost	\$60,483,000
2-D	POS Awarded a \$1.4 Million Consulting Agreement without Evidence of Competition and Awarded a \$2.7 Million Consulting Agreement without Competition.	Unquantifiable
2-E	POS Altered Contractor Invoices in Order to Pay a Contractor for Work that Exceeded the Amounts Authorized Law and in Violation of the POS Commission's Delegation of Authority (This is the same as Finding 1-E)	Unquantifiable
2-F	The Small Works Roster Program Has Resulted in Repeated Awards to the Same Contractors, the Small Works Random Rotation Process Can be Circumvented to Allow Preferred Contractors to be Added to Selection Lists, and the Solicitation Invitation Process Can be Circumvented	Unquantifiable
3-A	A 3rd Runway Procurement Violated Applicable Procurement Laws, and Details of this Unusual Procurement Were Concealed from the POS Commission	\$32,777,042
3-B	POS Management Is Not Providing the POS Commission with Reports on Contract Administration/ Bid Irregularities and Information Related to Professional and Consulting Services as Required by the Commission's Delegation of Authority; and the Authority to Award Consulting Services Contracts Needs to be Clarified	Unquantifiable
3-C	A PSA Agreement and Amendments to that Agreement were Approved in Amounts that Exceeded the Delegated Authority of the POS Managers Involved	Unquantifiable
3-D	A Major 3rd Runway Construction Contract Is being Managed by a Former Employee of the Contractor; and a Consultant Served on a Selection Committee that Awarded a \$5.8 Million Contract to One of His Company's Subcontractors.	Unquantifiable
4-A	POS Project Management Information Systems Data are Incomplete, Out-of-Date, and Inaccurate When Compared to Project Records	Unquantifiable
4-B	POS Requirements for Preparation of Project Notebooks Are Not Enforced, are Inconsistent Between Divisions, and Project Notebooks are Missing, Incomplete, Out of Date, and Not Easily Accessible by Stakeholders	Unquantifiable
4-C	The "Livelihood" Construction Document Management System (CDMS) is Not Being Used Properly	\$864,463
5-A	POS's Failure to Enforce Contract Requirements Contributes to Significant Schedule Overruns and an Inability to Recover a Minimum of \$1,208,000	\$2,910,400
6-A	POS Construction Management is Vulnerable to Fraud, Waste, and Abuse	Unquantifiable
7-A	POS Personnel Altered Audit Evidence, Impeded Access to Information and, In Some Cases, were Uncooperative	Unquantifiable
7-B	The 3rd Runway Wall Art Indicates that POS's One Percent for the Arts Policies Need to Be Clarified	Unquantifiable
7-C	The POS Internal Auditor Lacks Organizational Independence	Unquantifiable
Total cost savings: \$97,227,643		

I-900 Cross-reference

Initiative 900 Elements	Audit Findings
1. Identification of cost savings.	1-A, 1-B, 1-C, 1-D, 1-E, 2-A, 2-B, 2-C, 2-D, 2-E, 3-A, 3-B, 3-C, 3-D, 4-A, 4-B, 4-C, 5-A, 6-A, 7-B, 7-C
2. Identification of services that can be reduced or eliminated.	The audit scope focused on the assessment of construction management practices, which involves tasks that cannot be reduced or eliminated.
3. Identification of programs or services that can be transferred to the private sector.	The audit scope focused on the assessment of construction management practices, which the Port already has outsourced. Opportunities to reduce the cost of outsourcing were identified (See Finding 2-C).
4. Analysis of gaps or overlaps in programs or services and recommendations to correct gaps or overlaps.	1-A, 1-B, 1-C, 1-D, 1-E, 2-B, 2-C, 2-D, 2-E, 5-A
5. Feasibility of pooling information technology systems.	4-A
6. Analysis of the roles and functions at the Port of Seattle and recommendations to change or eliminate roles or functions.	1-A, 1-B, 1-C, 1-D, 1-E, 2-A, 2-B, 2-C, 2-D, 2-E, 3-A, 3-B, 3-C, 3-D, 4-C, 5-A, 6-A, 7-B, 7-C
7. Recommendations for statutory or regulatory changes that may be necessary for the Port of Seattle to properly carry out its functions.	1-A, 1-B, 1-C, 1-D, 1-E, 2-A, 2-B, 2-C, 2-D, 2-E, 3-A, 3-B, 3-C, 3-D, 4-A, 4-B, 4-C, 5-A, 6-A
8. Analysis of the Port of Seattle's performance data, performance measures and self-assessment systems.	5-A
9. Identification of best practices.	1-A, 1-B, 1-C, 1-D, 1-E, 2-A, 2-B, 2-C, 2-D, 2-E, 3-A, 3-B, 3-C, 3-D, 4-A, 4-B, 4-C, 5-A, 6-A, 7-C

Legislative Recommendations

The audit makes several recommendations to the Washington State Legislature. They are abbreviated here; see Appendix C for the full text of the recommendations.

- Clarify the Revised Code of Washington with respect to the competition required in procurements that result in expenditures of public funds and revise the Code section that governs small works roster contract procedures.
- Make a decision whether or not state and local governments should have wide latitude to award sole source contracts for goods and services. Current law gives them wide latitude. If the intent is not to give them wide latitude, revise several laws to reflect that intention.
- Consider revising the law entitled "small works roster contract procedures, limited works process." Remove the phrase "other than a port district" from the law.

After the performance audit

The release of this audit report triggers a series of actions by the Port Commission. The Commission will take the following actions:

- Hold at least one public hearing within 30 days of this report's issuance to receive public testimony on the report. Notices of those hearings are posted with report to the State Auditor's Web site.
- Consider the findings and recommendations contained in this report during the budgeting process.
- Issue an annual report by July 1 detailing the Port's progress in responding to the State Auditor's recommendations. The report must justify any recommendations the Port Commission did not respond to and detail additional corrective measures taken.

Follow-up performance audits of any state or local government entity or program may be conducted when determined necessary by the State Auditor.

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Mission Statement

The State Auditor's Office independently serves the citizens of Washington by promoting accountability, fiscal integrity and openness in state and local government. Working with these governments and with citizens, we strive to ensure the efficient and effective use of public resources.

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**PERFORMANCE AUDIT OF THE
PORT OF SEATTLE'S CONSTRUCTION MANAGEMENT**





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November 27, 2007

The Honorable Brian Sonntag, CGFM
Washington State Auditor
Washington State Auditor's Office
3200 Capitol Boulevard, SW
Olympia, Washington 98504-0031

Dear Mr. Sonntag:

In accordance with the terms of our contract with your office, Cotton & Company LLP and CDR Consultants conducted a performance audit of the Port of Seattle's construction management. The enclosed report provides an audit summary, objectives, scope, scope limitations, methodology, detailed findings, and recommendations.

We appreciate the support provided by you as well as Bonnie Clubb, Chris Cortines, and other members of your staff. Some personnel from the Port of Seattle were very cooperative and helpful during the audit, and we appreciate that assistance.

We are available to meet with you to discuss our audit results in more detail at your convenience.

Very truly yours,

COTTON & COMPANY LLP

A handwritten signature in blue ink, appearing to read "David L. Cotton".

David L. Cotton, CPA, CFE, CGFM
Chairman

CDR CONSULTANTS

A handwritten signature in blue ink, appearing to read "Patti M. Jones".

Patti M. Jones, PMP, PSP
President

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ABBREVIATIONS

AACE	Association for the Advancement of Cost Engineering
ABA	American Bar Association
A/E	Architectural Engineering
AFS	Aircraft Fueling System
AV-PMG	Aviation Project Management Group
CB	Construction Bulletin
CDMS	Construction Document Management System
CDR	Contractor Daily Reports
CEO	Chief Executive Officer
CFO	Chief Financial Officer
CIP	Capital Improvement Program
CM	Construction Manager
CMPU	Central Mechanical Plant Upgrade
CO	Change Order
COSO	Committee of Sponsoring Organizations of the Treadway Commission
CPM	Critical Path Method
CPO	Chief Procurement Officer
DBB	Design-Bid-Build
DOT	Department of Transportation
DRB	Disputes Review Board
EIA	Energy Information Administration
ENR	<i>Engineering News-Record</i>
FAA	Federal Aviation Administration
FAR	Federal Acquisition Regulation
GAGAS	Generally Accepted Government Auditing Standards
GCC	Guaranteed Construction Cost
GC/CM	General Contractor/Construction Manager
IDR	Inspector Daily Reports
JLARC	Joint Legislative Audit and Review Committee
LDs	Liquidated Damages
MIS	Management Information System
MWBE	Minority/Woman-Owned Business Enterprise
NASPO	National Association of State Procurement Officials
NTE	Not to Exceed
NTP	Notice To Proceed
PACT	Port Aviation Cost Trend
PCS	Port Construction Services

PFR	Preliminary Finding and Recommendation
PM	Project Manager
PMG	Project Management Guideline
PMIS	Project Management Information System
PMSC	Program Management Services Consultant
POI	Person of Interest
POS	Port of Seattle
PSA	Professional Services Agreement
PSFS	PeopleSoft Financial System
RCW	Revised Code of Washington
RE	Resident Engineer
REA	Request for Equitable Adjustment
RFQ	Request for Qualifications
SAS	Statement on Auditing Standards
Sea-Tac	Seattle-Tacoma International Airport
SPMG	Seaport Project Management Guideline
SPOTS	Seaport Project Office Tracking System
SOP	Standard Operating Procedure
STEP	South Terminal Expansion Project
STIA	Seattle-Tacoma International Airport
TIA	Time Impact Analysis
WA	Work Authorization
WBE	Woman-Owned Business Enterprise

**PERFORMANCE AUDIT OF THE
PORT OF SEATTLE'S CONSTRUCTION MANAGEMENT**

***COST CONTROL, ACCOUNTABILITY, AND TRANSPARENCY ARE NOT
PORT OF SEATTLE PRIORITIES AND
PORT OF SEATTLE CONSTRUCTION MANAGEMENT IS
VULNERABLE TO FRAUD, WASTE, AND ABUSE***

AUDIT SUMMARY

In accordance with the terms of our contract with the Washington State Auditor's Office, Cotton & Company LLP and CDR Consultants conducted a performance audit of the Port of Seattle's construction management. This audit summary contains the following:

- Port of Seattle Background
- Audit Results
- Summary of Audit Findings
- Summary of Recommendations
- Objectives, Scope, Scope Limitations, and Methodology
- Initiative 900 Elements
- Estimated Cost Savings

We provide details in the second major section of this report titled Detailed Findings and Recommendations.

PORT OF SEATTLE BACKGROUND

The Port of Seattle (POS or Port) is a municipal corporation organized in 1911 through enabling legislation by consent of the voters within the port district. In 1942, King County local governments selected POS to operate the Seattle-Tacoma International Airport (STIA or SeaTac). The Port is a special-purpose government with an elected Commission of five members. POS is legally separate from and fiscally independent of other State or local governments. POS derives its revenues from airline rates and charges, ad-valorem tax levies, passenger facility charges, and federal grants.

POS has four major divisions involved in construction: Aviation, Seaport, Corporate Services, and Economic Development. In terms of capital asset additions, POS reported the following:

Year	Capital Asset Additions*
2006	\$939,733,000
2005	\$765,771,000
2004	\$1,618,178

* Net of depreciation expense and inclusive of construction work in progress.

In terms of capital expenditures, POS reported the following:

Year	Seaport	Aviation	Total
2006	\$159,948,000	\$347,107,000	\$507,055,000
2005	100,012,000	456,898,000	556,910,000
2004	74,383,000	461,001,000	535,384,000
2004-2006	\$334,343,000	\$1,265,006,000	\$1,599,349,000

AUDIT RESULTS

Our overarching conclusions are that:

- **Cost control, accountability, and transparency are not POS construction management priorities, and**
- **POS construction management is vulnerable to fraud, waste, and abuse.**

POS provided a 61-page response to our draft report. The full text of this response is in Appendix E to this report. We have included excerpts from the POS response in our report, added clarifying comments, and made changes to our report, as we deemed appropriate.

SUMMARY OF AUDIT FINDINGS

The following six findings support these two primary conclusions:

Audit Finding 1: POS Construction Management Lacked Cost Controls and Accountability

Our evaluation of specific project records disclosed numerous problems related to lack of thorough reviews and negotiations of change-order proposals, inadequate change order documentation, unsupported time extensions, and inadequate controls over ceiling amounts in contracts. All of these conditions were contrary to established POS policies and procedures and to best practices. Several of these conditions were contrary to State law. Details of individual findings related to this audit finding follow:

Finding	Report Page	Finding Description
1-A	25	POS approved change orders without sufficient evidence of having evaluated proposed costs.
1-B	30	POS's failure to timely process change orders and poor change order documentation resulted in an overpayment of \$105,535.
1-C	36	POS failed to obtain an \$80,000 credit when original scope work was deleted, and POS wrongly issued a 329-day time extension for work that was never performed.
1-D	45	POS performed inadequate reviews of change-order proposals, resulting in overpayment of contractor markups.
1-E	47	POS altered contractor invoices to pay a contractor for work that exceeded the maximum contract amount set by law, thus violating state law and the Commission's delegation of authority.

Audit Finding 2: POS Frequently Circumvented Competition Requirements in Violation of Its Own Policies and Sometimes in Violation of State Law

Washington State law requires (with some exceptions) full and open competition for procurement of “contracts for work” in excess of \$200,000, with contracts to be awarded to the lowest bidders.¹ POS has interpreted this requirement to mean that “contracts for work” pertains only to construction contracts, not consulting or other services contracts *associated* with construction. POS believes that it “is not subject to any specific legislative framework governing its procurement practices” and therefore “enjoys substantial flexibility in how it elects to accomplish the purposes for which it exists under Title 53 of the Revised Code of Washington.”

Thus, POS concluded that it is allowed to award contracts for professional and other consulting services, regardless of magnitude, without competition, with the exception of architectural and engineering (A/E) services.² POS also applied a narrow definition of what constitutes A/E services. Under Washington State law, when procuring A/E services, full and open competition is required, but the procuring agency or municipal government is authorized to enter into price negotiations with the professional services firm deemed most qualified. Procurement policies for consulting services (both A/E and other consulting services) adopted by POS:

- Allow sole source (no competition) contracts of up to \$50,000,
- Require limited competition for contracts between \$50,001 and \$200,000, and
- Require full and open competition for contracts in excess of \$200,000.³

We evaluated numerous POS professional services procurements. POS regularly circumvents competition requirements through a variety of techniques and means. We observed the following:

- Purchases divided into multiple \$50,000 no-competition contracts.
- Contracts awarded for \$50,000 without competition, then amended to higher amounts.
- Contracts awarded for \$50,000 without competition in succession to obtain ongoing services of particular individuals.
- Limited-competition contracts awarded up to \$200,000, then amended to higher amounts.
- Fully-competed contracts awarded and then amended to higher amounts for work outside the scope of original agreements.
- Fully-competed contracts awarded for work to be ordered on a specific task basis and then using the contract to augment POS staffing rather than perform specific tasks.

¹ See RCW 53.08.120, *Contracts for labor and material — Small works roster*.

² See RCW 39.80, *Contracts for architectural and engineering services*.

³ See POS Policy PUR-2, *Consultant Procedures*.

- Follow-on contracts awarded to cover cost overruns on prior contracts.
- Contracts awarded without evidence of competition.
- Sole-source contracts awarded when competition was required.
- Contracts awarded to former Port employees without evidence of competition and in some cases without competition.
- The bidder invitation, advertisement, and selection system manipulated to steer contracts to favored contractors.

Details of individual findings related to this audit finding follow:

Finding	Report Page	Finding Description
2-A	53	POS circumvented competition requirements by awarding contracts at “less competition required” levels and then amending the contracts to higher levels, split purchases, and awarded sequential no-competition contracts.
2-B	69	A consulting agreement awarded in 1993 grew without competition from \$950,000 to more than \$30 million.
2-C	76	A consulting agreement awarded in 1998 grew without competition from \$10 million to more than \$120 million and is being used to augment POS staffing at considerable cost.
2-D	89	POS awarded a \$1.4 million consulting agreement without evidence of competition and awarded a \$2.7 million consulting agreement without competition.
2-E	97	POS altered contractor invoices to pay a contractor for work that exceeded the maximum contract amount set by law, thus violating state law and the Commission’s delegation of authority. (This is the same as finding 1-E.)
2-F	98	POS repeatedly awards Small Works Roster Program contracts to the same few contractors. The Small Works Roster Program’s random contractor rotation process can be circumvented to allow preferred contractors to be added to the Invitation for Bid list. The solicitation invitation process can be circumvented.

Audit Finding 3: POS Policies and POS Management’s Interpretations of These Policies Resulted in a Lack of Transparency and Thwarted Commission Oversight of Construction Management Activities

The POS Commission approved Resolution 3181 in November 1994. This Resolution is the “master policy directive” that established the authority delegated by the Commission to the POS chief executive officer (CEO). Exhibit A to that Resolution is titled *Port of Seattle Commission Policy Directives Administrative Authority of Executive Director and His/Her Designees*. It covers, among other matters, the CEO’s authority (and limits to that authority) to enter into construction and consulting contracts, approve change orders on construction contracts, and amend consulting contracts. It also contains requirements for reporting certain matters to the Commission.

POS established POS Policy EX-2, *Administrative, Monetary, and Contractual Redelegations of Authority from the Chief Executive Officer to Staff*. That policy lists and refers to specific “redelegations of authority” to various POS positions below the CEO level. The purpose for “redelegations of authority” is to establish procurement and construction management authority, and authority limits, for particular POS positions.

In our opinion, Resolution 3181 is unclear. POS management’s interpretation enables management to provide minimal information to the Commission about significant construction management activities and events.

Resolution 3181 contains the following provisions regarding the CEO’s authority to approve contract change orders:

Where contracts for the performance of work have been individually awarded and under which the work is in progress, and changes in plans and/or specifications are necessitated in order to properly accomplish the work, the Executive Director is authorized to execute change orders to the contract provided the following conditions are met:

a. The estimated cost of the changes in plans and/or specifications will not exceed Fifty Thousand Dollars (\$50,000.00) or 15% of the contract price whichever is less. However, when an individual change order issued under any contract shall cause the total cash amount of change orders to that contract to exceed a sum equal to 25% of the original contract amount, such change order shall not be issued without prior Commission approval and no future change orders to said contract may be issued without Commission approval. ...

d. Any time extension for completion of said contract which accompanies said change order does not exceed forty-five (45) days.

POS explained that these provisions applied only to “Individual Work Contract Authorizations,” and that any contract changes or time extensions that POS can associate with a “capital project authorization”⁴ required no further Commission approval or notification unless such a change would exceed total funding approved for the overall capital project. Any contract falling under a “capital project authorization” or that POS can associate with a “capital project authorization” can be awarded or changed by relatively low-level POS personnel, in any amount, unless such an award or change would exceed the total amount of the “capital project authorization.”

We requested that POS provide us with an example of a contract within our audit scope that *would not* fall under a “capital project authorization.” POS was unable to do so.

Based on our audit, we concluded the following:

⁴ Capital project authorizations are, with few exceptions, large multi-year capital programs encompassing numerous construction and consulting contracts. Examples include the 3rd Runway Project (initial budget of \$739,759,818), the South Terminal Expansion Project (initial budget of \$383,809,615), the C-1 Baggage Screening Facility (initial budget of \$198,251,898), and the T-18 North Apron Upgrade (initial budget of \$200,000,000).

- Resolution 3181, as interpreted by POS management, allowed POS management to avoid informing the Commission about significant construction management activities and events.
- POS failed to provide the Commission with information on a basis expressly required by Resolution 3181.
- POS's "redelegations of authority" were, in some cases, interpreted in a way that allowed relatively low-level construction management personnel to approve large contract awards and amendments.

Details of individual findings related to this audit finding follow:

Finding	Report Page	Finding Description
3-A	108	A 3 rd Runway procurement violated applicable procurement laws, and POS concealed details of this unusual procurement from the POS Commission.
3-B	123	POS management did not provide reports on contract administration/bid irregularities and information related to professional and consulting services to the POS Commission, as required by the Commission's delegation of authority. It interpreted Resolution 3181 to permit disclosure of minimal information.
3-C	127	POS managers approved a PSA agreement and amendments to that agreement in amounts that exceeded the delegated authority of these managers.
3-D	133	A former employee of one contractor managed that contractor's major 3 rd Runway construction contract. A POS consultant served on a selection committee that awarded a \$5.8 million contract to one of his company's subcontractors.

Audit Finding 4: POS Construction Management Records were Incomplete and Disorganized

Sound and effective management of numerous and complex construction projects is highly dependent on maintaining accurate, complete, and up-to-date records of project and contract activities. Our audit revealed that POS recordkeeping systems were incomplete and disorganized. Based on our audit, we concluded the following:

- POS's electronic management information systems are missing important project data that are essential for making project cost and schedule decisions. Some information is incomplete or conflicted with hard-copy project records.
- Key project management documents, the Project Notebooks, which are used to obtain Commission budget authorizations and provide key information describing Capital Improvement Projects' (CIP) plans were never updated, could not be located, and did not comply with POS Guidelines.

- An expensive electronic document management system was not used in the manner required by construction contracts. POS, its consultants, and its contractors do not maintain project records in a “real-time” manner, and instead project records are often dumped in batches into Livelink long after the records were created. POS lacks document management procedures creating inconsistencies between projects, and even within single projects.

Details of individual findings related to this audit finding follow:

Finding	Report Page	Finding Description
4-A	138	POS project management information systems data were incomplete, outdated, and inaccurate when compared to project records.
4-B	146	POS requirements for Project Notebooks are not enforced, and requirements are inconsistent between POS divisions. Project Notebooks were missing, incomplete, not updated, and not easily accessible by stakeholders.
4-C	154	POS paid \$864,463 for an electronic construction document management system (“Livelink”), and the contract required POS contractors to use this system on specified projects, but neither POS nor its contractors have used the system as intended.

Audit Finding 5: POS Failed to Enforce Basic Contract Requirements, Resulting in Delays, Extra Costs, and an Inability to Defend Against Claims

POS construction contracts contained standard (best practices) provisions for submitting project baseline schedules and monthly schedule updates. These are essential for assessing liquidated damages for contractor-caused delays and for determining responsibility for contract time extensions. POS’s failure to enforce these provisions prevented it from successfully defending against contractor claims that sought increased costs and extra time to complete projects.

Further details related to this audit finding are in Detailed Findings and Recommendations, Finding 5-A, page 164.

Audit Finding 6: POS Construction Management is Vulnerable to Fraud,⁵ Waste, and Abuse⁶

A combined and overarching effect of Audit Findings 1 through 5, summarized above, is that POS construction management is vulnerable to fraud, waste, and abuse. POS did not employ independent and professional contracting officers to protect the integrity of the procurement process and provide essential segregation of duties. Instead, various engineering, construction management, and project management personnel who work directly with contractors and consultants on a day-to-day basis had the delegated authority to negotiate and award contracts, approve changes to contracts, waive contractual requirements, and settle contract disputes. This resulted in a vulnerability to a wide array of potential fraud schemes that may have occurred and may not have been detected. No controls were in place to deter, prevent, or detect bribery, kickback, illegal gratuity, or bid-rigging schemes. Many of the findings in this report contain indicia of fraud.⁷

The following anomalies noted during our audit could be indicative of fraud:

- On some contracts, change order amounts were consistently the same as the contractor's proposed amounts (see Finding 1-A).
- On some contracts, change orders were approved without evidence of evaluation or negotiation (see Finding 1-A).
- On some contracts, Engineer's Estimates for change orders were unsupported (see Finding 1-B).
- Change orders were approved for amounts substantially higher than Engineer's Estimates on some contracts (see Finding 1-B).
- Change orders were split to remain within delegated approval authority (see Finding 1-B).

⁵ *Fraud is a type of illegal act involving the obtaining of something of value through willful misrepresentation. Whether an act is, in fact, fraud is a determination to be made through the judicial or other adjudicative system and is beyond auditors' professional responsibility. Government Auditing Standards, July 2007 revision, footnote 95, page 138.*

⁶ *Abuse involves behavior that is deficient or improper when compared with behavior that a prudent person would consider reasonable and necessary business practice given the facts and circumstances. Abuse also includes misuse of authority or position for personal financial interests or those of an immediate or close family member or business associate. Abuse does not necessarily involve fraud, violation of laws, regulations, or provisions of a contract or grant agreement. Government Auditing Standards, July 2007 revision, paragraph 4.12.*

⁷ *Indicia of fraud do not necessarily indicate the existence of fraud; rather, each is an indication that fraud may be present. Many times legitimate activity or other reasons may explain the indicia of fraud. Fraud Investigations in Litigation and Dispute Resolution Services, A Nonauthoritative Guide, American Institute of Certified Public Accountants, 1997; 2002.*

- Some summaries of negotiations did not adequately explain negotiation outcomes (see Finding 1-B).
- Contract scope deletions were made without deductions to contract price (see Finding 1-C).
- Contract time extensions were granted without supporting schedule analyses (see Finding 1-C).
- Informal change order negotiations (“tummy rubbing”) were conducted (see Finding 1-C).
- Liquidated damages for contractor-caused delays were not assessed (see Finding 1-C).
- Invoices that exceeded contract amounts were stockpiled and then paid under a newly-awarded, separate contract (see Finding 1-E).
- Project management personnel added preferred bidders to PCS’s randomly-generated small works bid lists to steer contracts to these particular bidders (see Finding 1-E).
- Competition requirements were circumvented by awarding sequential no-competition contracts (purchase-splitting) (see Finding 2-A).
- Competition requirements were circumvented by awarding multiple no-competition contracts (purchase-splitting) (see Finding 2-A).
- Competition requirements were circumvented by awarding no- or limited-competition contracts and amending them above competition thresholds (purchase-splitting) (see Finding 2-A).
- Consultants were given additional work outside the base contract scope via no-competition contract amendments (see Findings 2-B and 2-D).
- Consultant prices were amended without evidence of adequate cost or price negotiations (see Findings 2-B and 2-C).
- POS’s largest consulting contract was awarded based on work to be done on a “work authorization” basis, and then the contract was amended to an “annual level of effort” basis (see Finding 2-C).
- Bases for approving contractor personnel additions to POS’s largest consulting contract were not documented (see Finding 2-C).
- Consultants were authorized to perform work outside contracts’ scopes (see Finding 2-C).

- POS allowed a contractor to maintain “joint” POS-contractor contract files (see Finding 2-C).
- Billing rate increases were approved to match consultant salary increases (see Finding 2-C).
- Consultants were allowed to select other consultants to receive contracts without evidence of POS participation in the selection process (see Finding 2-C).
- Consultant contract mark-ups not stipulated in the contract were paid (see Finding 2-C).
- POS’s largest consultant contract was amended to retroactively allow extra-contractual mark-ups already paid to the contractor rather than enforcing contract terms (see Finding 2-C).
- POS failed to adequately review contractor invoices before payment to assure that only approved personnel were being billed, rates billed agreed with contract rates, and labor categories billed agreed with contract labor categories (see Finding 2-C).
- A \$1.4 million consulting contract was awarded to a former POS employee’s company without evidence of competition (see Finding 2-D).
- A \$2.7 million consulting contract was awarded on a sole-source basis to a former POS employee’s company (see Finding 2-D).
- The Small Works Roster Program has resulted in repeated awards to the same contractors (see Finding 2-F).
- The Small Works Roster Program’s random rotation process can be circumvented to allow preferred contractors to be added to selection lists (see Finding 2-F).
- The Small Works Roster Program’s solicitation invitation process can be circumvented to create an appearance of competition when none exists (see Finding 2-F).
- An Engineer’s Estimate was revised upward by 14 percent (\$13 million) solely because a single, inflated bid was anticipated (see Finding 3-A).
- POS negotiated with a construction contractor prior to contract award (see Finding 3-A).
- A contract was awarded to the sole bidder based on a bid that was more than 35 percent (\$33 million) higher than a fair and reasonable estimate (see Finding 3-A).
- POS created a “cosmetic” deductive change order to conceal from the POS Commission the full extent of an excessive (more than \$33 million higher than estimated) bid it received. (see Finding 3-A).

- POS provided a misleading Commission notification memorandum (see Finding 3-A).
- POS failed to provide required reports to the Commission on contract administration/bid irregularities and professional and consulting services (see Finding 3-B).
- POS personnel approved consulting agreements and amendments to consulting agreements in excess of delegated authority (see Finding 3-C).
- A consultant was allowed to manage his former employer's major construction contract with POS (see Finding 3-D).
- A consultant was allowed to serve on a selection committee resulting in the award of a \$5.8 million contract to a subcontractor of the consultant's company (see Finding 3-D).
- Contractual requirements for use of an expensive construction document management system were not enforced (see Finding 4-C).

In addition, the following other matters noted during the audit (see Findings 7-A and 7-C and Appendices A and B) could also be indicative of fraud:

- Construction management records were altered and updated by POS personnel and POS consultants following identification of projects to be audited (see Finding 7-A).
- Auditor access to construction management information systems was impeded (see Finding 7-A).
- Some POS personnel failed to cooperate with our auditors during interviews (see Finding 7-A).
- POS management interfered with our efforts to obtain routine management representations from key employees, and 13 POS employees did not provide representations that we requested (see Finding 7-A, Appendix A, and Appendix B).
- A senior POS construction management official resigned his POS position and went to work for a POS consulting contractor (see Finding 7-A and Appendix B).
- POS refused to establish an organizationally independent internal audit function (see Finding 7-C).

Further details related to this audit finding are in Detailed Findings and Recommendations, Finding 6-A, page 185.

Other Matters Noted During the Audit

We noted three other matters during the audit that are related to, but do not fall precisely within, the audit findings described above. These matters are as follows:

Finding	Report Page	Finding Description
7-A	195	POS personnel altered audit evidence, impeded access to information, in some cases were uncooperative, and refused to provide management representation letters as requested during the audit.
7-B	207	Management of the 3 rd Runway Wall Art project indicated that POS's one-percent-for-the-arts policies are unclear.
7-C	210	The POS internal auditor lacked organizational independence.

SUMMARY OF RECOMMENDATIONS

Based on our audit, we have two overarching recommendations:

- I. We recommend that POS establish a senior-level Chief Procurement Officer (CPO) position. This official should report directly to the POS CEO and be responsible for managing and overseeing all procurement-related activity. This official should have the authority to hire trained and independent procurement officials who will be charged with reviewing and approving all procurement-related transactions. Current delegations of authority related to procurement—contract awards, approval of contract changes and amendments, and related activities involving expenditure of public funds related to construction and construction management—should be rescinded and re-assigned to the CPO and her or his staff.**
- II. We recommend that the POS Commission re-evaluate the current delegation of authority to the POS CEO (encompassed in Resolution 3181) and develop and issue a new delegation of authority resolution that defines more clearly the Commission's intent with respect to construction management and reporting to the Commission and the public concerning construction activities.**

More specific recommendations are contained in each of the detailed findings in this report. A summary of these specific recommendations is contained in Table I at the end of this Audit Summary.

POS RESPONSE

The full text of POS's responses to these recommendations is included in Appendix E. POS appears to be in agreement with both of these overarching recommendations. With respect to recommendation II, however, POS states that:

... the CEO has asked members of his executive team, led by the General Counsel, to provide him with recommendations for updating, clarifying and strengthening a variety of provisions

in Resolution 3181 within 90 days. ... The CEO then will share these recommendations with the Commission.

AUDITORS' ADDITIONAL COMMENTS

We disagree with POS's planned approach. The Commission should assert its proper leadership and governance role in determining what and how authorities should be delegated to the CEO and his staff rather than waiting for staff recommendations.

OBJECTIVES, SCOPE, SCOPE LIMITATIONS, AND METHODOLOGY

Highlights of our objectives, scope, scope limitations, and methodology are below. Details are provided in Appendix A of this report.

Objectives

The audit's objectives were to:

1. Determine if the Port of Seattle effectively planned, designed, and managed its construction projects, including its 3rd Runway Project, to:
 - Minimize all costs associated with its construction projects, including but not limited to engineering, land acquisition, environmental review, permitting, and construction;
 - Minimize unnecessary change orders and delays that result in extra costs; and
2. If not, determine resulting costs and what can be done to reduce them.

Additionally, Initiative 900 directs the State Auditor's Office to address the following elements:

1. Identification of cost savings.
2. Identification of services that can be reduced or eliminated.
3. Identification of programs or services that can be transferred to the private sector.
4. Analysis of gaps or overlaps in programs or services and recommendations to correct them.
5. Feasibility of pooling the entity's information technology systems.
6. Analysis of the roles and functions of the entity and recommendations to change or eliminate roles or functions.
7. Recommendations for statutory or regulatory changes that may be necessary for the entity to properly carry out its functions.

8. Analysis of the entity's performance data, performance measures, and self-assessment systems.
9. Identification of best practices.

Scope

Except as noted in the Scope Limitations section below and in Appendix A and Appendix B, we conducted this performance audit in accordance with generally accepted government auditing standards.⁸ Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives except for the effects, if any, of scope limitations, as explained below.

The scope of our audit included all construction projects and related consulting agreements active from January 2004 through March 2007.

In planning our audit, we gained an understanding of internal controls that relate to the audit objectives. As part of our survey and testing phases, we determined whether proper internal controls were placed in operation.

Names of contractors, consultants, contractor employees, consultant employees, and POS employees who provided us with information as part of this audit are sensitive and confidential and have been excluded from this report. Alpha placeholders have been used to denote contractors, consultants, contractor employees, consultant employees, and POS employees.

Scope Limitations

As described in more detail in Detailed Finding 7-A, Appendix A, and Appendix B, POS personnel altered construction management records before we accessed them, and our access to POS information systems and other information was delayed and disrupted. Some POS personnel were uncooperative, and some POS employees did not provide management representations related to our audit, as requested.

Our ability to review construction management records and documents as they were maintained in the normal course of business was crucial to achieving our audit objectives. Our ability to access construction management information and files, both hardcopy and electronic, in an efficient and timely manner was also crucial to achieving our audit objectives. Our ability to meet with and interview POS personnel and obtain candid answers to questions about construction management was similarly crucial to achieving our audit objectives. Finally, obtaining requested confirmations from key POS employees regarding explicit and implicit

⁸ GAO-07-731G, *Government Auditing Standards*, United States Government Accountability Office, July 2007 revision.

representations made to us during the audit was crucial to assuring that such representations were accurate and continued to be appropriate.

The nature of these limitations is such that we do not believe that they undermine the baseline validity of any of our audit findings, conclusions, or recommendations. Rather, the nature of these limitations is such that the findings and conclusions may be more serious than reported, and there may be additional findings that we were unable to discover, develop, and report.

Generally accepted government auditing standards state that our report may recognize the positive aspects of the program reviewed if applicable to the audit objectives.⁹ We began asking POS officials to identify noteworthy construction management accomplishments during our survey phase, which began in March 2007. Information on positive accomplishments was provided to us near the end and after fieldwork completion on July 10, August 9, August 13, and August 28. Because of the delay in receiving this information and the scope limitations described above, we did not test or verify the accuracy of this information. This unaudited information is presented in Appendix D to this report.

Methodology

During the survey phase of the audit, we interviewed POS executives, project management personnel, and construction management personnel to obtain an overall understanding of how POS managed its construction programs and projects. We obtained and reviewed policies, procedures, and other documents related to POS construction management. Based on this information, we performed a risk assessment to determine aspects of construction management potentially vulnerable to fraud, waste, or abuse or other potentially problematic aspects of POS construction management.

During the audit phase, based on our risk assessment, we selected samples of specific capital improvement programs and construction projects. For sampled projects, we obtained access to project files and records, reviewed these files and records, and conducted follow-up interviews with project management and construction management personnel.¹⁰

Our sample selection methodology was designed to enable us to examine a cross-section of project types and sizes for which work included design, environmental, right-of-way, procurement, construction, and close-out phases within the three main areas of POS construction management: aviation programs, seaport programs, and POS's Small Works Roster Program, PCS. Following examination of initial samples of projects, we expanded testing by selecting additional projects for examination as we deemed appropriate to further test initial observations and preliminary findings. During both the initial and follow-up sample selection and testing phases of our work, we identified specific attributes to be tested. Due to the nature of POS's recordkeeping as well as the scope limitations described above, we did not test all attributes for all sampled projects.

⁹ *Government Auditing Standards*, July 2007 revision, paragraph A8.02.b.

¹⁰ As noted in the Scope Limitation section of this report, we concluded that project files and records had been altered, and we have unresolved concerns about the reliability of these records. Some POS personnel were uncooperative, and we were unable to carry out some interviews as planned.

As potential problem areas became evident based on our testing, we prepared preliminary findings and recommendations (PFRs) and provided them to POS management for review, analysis, and response. We evaluated POS's responses and modified our findings, recommendations, and conclusions as we deemed appropriate in the circumstances.

Criteria used in assessing POS construction management included Washington State law, POS policies, and best practices. We referred to the *Federal Acquisition Regulation* (FAR) as the source of best practices in several instances. Specific criteria applied are identified in each finding.

INITIATIVE 900 ELEMENTS

Table II, provided at the end of this Audit Summary, displays correlations between our detailed findings and Initiative 900 Elements.

ESTIMATED COST SAVINGS

Table III, at the end of this Audit Summary, displays estimated cost savings associated with each of the detailed findings in this report. Cost savings are difficult to estimate with precision due to the nature of activities and functions audited and our audit approach.

In many cases, our recommendations will undoubtedly yield significant cost savings, but such savings are impossible to estimate with certainty. For example, our recommendations related to Finding 1-A relate to reviewing and negotiating construction contract change orders more carefully. Savings resulting from implementation of a more rigorous review of change order proposals will be substantial, but cannot be estimated with precision. Similarly, it is impossible to determine savings that will result from our recommendations in Finding 6-A related to implementing a rigorous fraud risk prevention and detection program. We think these savings will be substantial. These types of findings are noted with the symbol “‡” in Table III.

In other cases, we identified specific savings associated with a particular finding related to a specific construction or consulting contract, but these savings cannot be easily extrapolated to the universe of construction and consulting contracts due to the nature of our sampling and testing. For example, Finding 2-C focuses on a single consulting agreement and estimates that more than \$60 million would have been saved if POS had expanded its professional staff instead of contracting for these services at fully-loaded commercial rates. Those savings relate to a single contract. We did not attempt to determine the population of other consulting agreements that would have yielded similar cost savings, because such an analysis was beyond the scope of our audit. These types of findings are noted with the symbol “±” in Table III.

Because of the factors discussed above, we believe that the estimated savings displayed in Table III are conservative.

TABLE I
RECOMMENDATIONS FOR POS AND CORRESPONDING FINDINGS

Recommendations	Finding
1. Immediately implement and strengthen control procedures to assure that Engineers' change order estimates are (a) prepared without knowledge of the contractors' proposed amounts, and (b) change order estimates and cost analyses are fully and completely documented. Where cost or price analysis is used to evaluate change order proposals, POS should require full and complete documentation of these reviews, including fully documented supervisory reviews and approvals.	1-A 1-D
2. Undertake a review of all major recent and ongoing projects to identify cases where engineers' estimates and contractors' proposed amounts are consistently the same and, in such cases, undertake a further evaluation of the underlying causes; followed by remedial actions as appropriate.	1-A
3. Revise its SOP Manual to include specific guidelines for proper and accurate change order documentation. POS should provide training to its consultant staff/construction managers to improve the manner in which POS is documenting project change orders.	1-B
4. Develop Standard Operating Procedures (SOPs) that align with industry practices. Current POS SOPs do not provide adequate information regarding change order negotiations.	1-C
5. POS management should take immediate steps to assure that POS rigorously enforces all contractual schedule requirements. Then, when requests for time extensions are made, they can and should be properly evaluated. POS should also provide more oversight of the Change Order process to ensure that estimates are properly created and used.	1-C
6. Immediately cease its informal method of resolving change order differences, and that POS improve its change order documentation requirements to include that details of change order negotiations must be based on discussions of scope/means and methods/pricing differences.	1-C
7. Undertake a review of the change orders negotiated and approved under all contracts to determine if there were other incorrect mark-ups on change orders.	1-D
8. Improve its management information systems to provide more accurate and up-to-date information regarding project and contract expenditures. POS should develop a better means for tracking actual project expenditures against initial estimates to prevent unforeseen cost overruns.	1-E
9. Develop and include in all contracts a "cost limitation" clause that advises contractors that they should not accept work authorizations or perform any work that would result in exceeding the maximum amount of the contract.	1-E
10. Controls should be implemented to prevent specific companies from being added to randomly-generated PCS bid lists by project management personnel.	1-E
11. Evaluate all of its PCS contracts during the past three years to determine other instances where the practice of lapping contractor invoices occurred and take appropriate corrective actions.	1-E
12. Conduct a more detailed investigation of this contract SWV-311608 to determine how and why the preferred electrical contractor was added to the bid list, contact the other bidders on the list to determine if they were aware of the procurement, and initiate follow up actions as appropriate.	1-E
13. Take immediate steps to review and enforce its policies and procedures for awarding PSA contracts and establish controls to ensure that competition requirements are not circumvented.	2-A 2-B 2-D

Recommendations		Finding
14.	Initiate a comprehensive review of all PSAs to determine the full extent to which competition requirements have been circumvented, and take appropriate corrective actions.	2-A 2-B 2-D
15.	Revise PUR-2 to incorporate a limit on the size allowed for amendments to Category 3 and Category C contracts so that a legal review becomes necessary before a contract is allowed to exceed a specified limit. That review should be designed to assure that: <ol style="list-style-type: none"> <i>The project scope of work is not being divided into smaller segments to avoid PUR-2, statutory, or delegation of authority procedures.</i> <i>The increased amended consultant responsibilities are generally related or associated with the project scope utilized in the original consultant selection.</i> 	2-A 2-B
16.	(a) Determine the extent to which costs in violation of Federal grant requirements have been claimed for reimbursement and received from DOT and other Federal agencies, (b) notify applicable Federal grant officers of these violations, and (c) initiate corrective actions prescribed by Federal officials.	2-A 2-B
17.	Undertake a review of all of its professional services agreements to assure that: <ul style="list-style-type: none"> Such agreements comply with State law in terms of being for specific POS requirements rather than being used as supplements of POS staffing, The agreements are being administered in strict conformity with contract provisions and requirements, The contracts contain defined labor category qualifications, and Contract files are complete and maintained by POS employees rather than contractor personnel. 	2-C
18.	Establish a policy whereby, before contracting for consultant services, POS perform a cost analysis to determine if the required work can be more economically performed with POS personnel. (We suggest that POS study and adapt Federal Office of Management and Budget Circular A-76 for this purpose.)	2-C
19.	Add the following procedures to the list of procedures being performed during the invoice approval process for the PMSC contract and other PSA contracts, as appropriate: <ul style="list-style-type: none"> Assure that all personnel being billed have been approved to work on the contracts based on the most recent annual review or work authorization. Assure that labor categories and rates being billed do not exceed the contractually stipulated labor categories and rates. 	2-C
20.	We recommend that PCS develop a means of tracking the award of contracts to ensure that a majority of the work isn't being repeatedly awarded to the same contractors. (Although PCS maintains a substantial amount of statistical information regarding the total percentages of work awarded through the Small Works Roster Program, PCS does not track the <i>distribution</i> of contracts or contract dollars awarded.)	2-F
21.	Small Works Roster Program controls should be established to assure that the random rotation process cannot be circumvented to allow preferred contractors to be added to the selection list.	2-F
22.	We recommend that PCS require contract files to include email and fax confirmations for the advertisements as proof that invitations to bid are actually received by potential bidders. (Presently, no supporting documentation is maintained in procurement files to verify if the listed contractors received the advertisements.)	2-F

Recommendations		Finding
23.	We recommend that PCS create controls in the Small Works Roster Program to ensure that all procurements are advertised (i.e. that solicitations are actually distributed to potential bidders as required).	2-F
24.	We recommend that PCS develop consistent bid evaluation criteria, particularly when the descriptions of work state that “PCS is unable to determine the precise types of work that may be performed under this contract at this time.” (Consistent bid evaluation quantities would make the bid process an equitable one for contractors that have not done prior work for PCS and lack an understanding of the risks associated with each unit price line item.)	2-F
25.	The POS Commission should revise Resolution 3181 to make it clear that, when circumstances requiring reporting under Paragraph V (<i>Contract Administration/Bid Irregularities</i>) occur, POS should provide full and complete information and allow the Commission adequate time for deliberation and decision-making.	3-A 3-B
26.	The POS Commission re-evaluate the policy under which POS management has carte blanche approval and spending authority under project-wide authorizations regardless of project size and, instead, develop more sensible requirements for POS to fully inform the Commission regarding significant or unusual expenditures of public funds.	3-A 3-B 3-C
27.	Begin preparing and providing the semi-annual <i>report summarizing contracts awarded under Resolution 3181, Paragraph V (Contract Administration/Bid Irregularities)</i> as required.	3-A 3-B
28.	When the POS general counsel is asked to provide legal advice, he document the advice provided so that a clear record of his analysis and advice is established and retained.	3-A
29.	Reassign Consultant SK to a position where he has no appearance of a conflict of interest. We also recommend that POS either establish an ethics policy for consultants or revise POS Policy EX-3 to make it clear that POS consultants are expected to adhere to at least the same ethical standards that POS employees are required to follow.	3-D
30.	POS Policy EX-3 should be (a) clarified to make clear that conflicts of interest are not limited solely to situations where there is a direct financial interest and (b) revised to require employees and consultants to recuse themselves from participating in decisions where conflicts of interest exist.	3-D
31.	Develop, implement, and enforce control procedures that include timely updating for the SPOTS, PACT, and PMIS systems with accurate project information until the project is closed out and the project data are archived.	4-A
32.	Develop policies and procedures for ensuring that PSFS data are consistent with data maintained in the other systems.	4-A
33.	SPOTS should be revised to include information regarding change order costs. (Reviewing actual cost data from PSFS does not easily highlight the origin of cost overruns on a project.)	4-A
34.	Enforce contract requirements for project schedule updates so forecasted project completion dates can be accurately recorded in the POS’s project management information systems. We recommend that POS implement a means of tracking current forecasted project completion dates, current change order amounts, original budget amounts, commission funding authorizations, budget transfers in all of its management information systems (SPOTS, PACT/Margen, PMIS).	4-A
35.	Establish a central repository for Project Notebooks within each POS division.	4-B
36.	Develop a check-out and tracking system for the Project Notebooks and utilize it.	4-B

Recommendations		Finding
37.	Require project managers to periodically and on a timely basis update the Project Notebooks with current Construction Trend Logs, Change Order Logs, and Schedule Updates.	4-B
38.	Integrate assessments of Project Notebook completeness and quality into the POS personnel performance evaluation processes.	4-B
39.	If POS continues including the CDMS requirement in its contracts, it should develop a system for monitoring each project's CDMS data updates. This contract requirement, just as any other, should be enforced and controlled. (The current lax approach to maintaining contract documents creates an environment that is prone to cover-ups, intentional omissions, and fraud.)	4-C
40.	Immediately undertake a comprehensive review of its contracts requiring use of Livelink to determine the full extent of contract noncompliance and initiate corrective actions accordingly.	4-C
41.	Take immediate steps to enforce all contract provisions on all ongoing and future contracts, particularly provisions regarding CPM project schedule submission requirements and withholding of contractor payments due to contractor failures to comply with contract requirements. POS should also be more aggressive in timely assessing liquidated damages based on contemporaneous analyses of delay impacts.	5-A
42.	Establish a fraud governance policy that provides for the design and implementation of a comprehensive and coordinated approach to fraud mitigation (deterrence, detection, and prevention).	6-A
43.	Initiate a comprehensive fraud risk assessment focused on its procurement and management of construction and professional services. This assessment should focus on vulnerabilities to fraud under current POS procurement processes and the identification of possible fraud schemes that may be occurring.	6-A
44.	Use the results of the fraud risk assessment to revise its policies and procedures in order to strengthen controls in the areas deemed vulnerable and implement specific control mechanisms designed to deter, prevent, and detect the fraud schemes deemed to be viable.	6-A
45.	Revise and strengthen its policies regarding employee conflicts of interest and establish an organizational code of conduct designed to make all POS employees and consultants aware of their fraud deterrence, prevention, and detection responsibilities. Training on these policies should be mandatory for all existing and new employees and annual update training sessions should be mandatory.	6-A
46.	Establish a fraud hotline through which POS employees, consultants, and contractors can report known or suspected irregularities in the procurement and management of contracts.	6-A
47.	Investigate the findings contained in this report and take prompt disciplinary actions, including the direct involvement of law enforcement agencies, if appropriate. POS should also establish and enforce a comprehensive policy for investigating all future indicia of fraud.	6-A

Recommendations	Finding
<p>48. Re-examine and clarify its policies and guidelines on art expenditures regarding (a) what “accessible and visible to the public” means; (b) how the one-percent determination should be made in cases where major projects consist of portions that are clearly outside the policy’s defined base; and (c) when matters should be referred back to the Commission for discussion in public meetings. The guidelines should also be revised to require budget-versus-actual reporting for each project so that accountability is assured. The guidelines should stipulate that the Art Oversight Committee should document its determination that specific projects comply with all provisions, including the recommended revisions above.</p>	7-B
<p>49. The following actions should be taken with respect to the internal audit function within POS:</p> <ul style="list-style-type: none"> a. The internal auditor should be given a direct reporting line to both the POS CEO and the POS Audit Committee and should not be under the direct supervision or management of or have performance appraisals done by either the Director of Accounting, Internal Audit & Procurement Services or the Chief Financial Officer. b. The internal auditor should not be able to be terminated without the concurrence of the POS Audit Committee. c. The POS Audit Committee should meet at least monthly with the internal audit manager, without the presence of POS management. d. The POS Audit Committee should review, have input into, and approve the internal audit annual work plan. 	7-C

TABLE II
COMPARISON OF INITIATIVE 900 ELEMENTS AND AUDIT FINDINGS

I-900 Element	Audit Findings																						
	1-A	1-B	1-C	1-D	1-E	2-A	2-B	2-C	2-D	2-E	2-F	3-A	3-B	3-C	3-D	4-A	4-B	4-C	5-A	6-A	7-A	7-B	7-C
1. Identification of cost savings.	†	±	±	±	†	†	†	±	†	†	†	±	†	†	†	†	†	±	±	±	†	NA	†
2. Identification of services that can be reduced or eliminated.	The audit scope focused on the assessment of construction management practices, which involves tasks that cannot be reduced or eliminated.																						
3. Identification of programs or services that can be transferred to the private sector.	The audit scope focused on the assessment of construction management practices which POS already has outsourced but opportunities to reduce the cost of outsourcing were identified (See Finding 2-C).																						
4. Analysis of gaps or overlaps in programs or services and recommendations to correct them.	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓								✓				
5. Feasibility of pooling the entity's information technology system.																✓							
6. Analysis of the roles and functions of the Port of Seattle and recommendations to change or eliminate roles or functions.	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓			✓	✓	✓		✓	✓
7. Recommendations for statutory or regulatory changes that may be necessary for the entity to properly carry out its functions.	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓			✓	✓	✓	✓			
8. Analysis of the entity's performance data, performance measures and self-assessment systems.																			✓				
9. Identification of best practices.	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓			✓

Notes:

- † Likely cost savings are associated with this finding, but such savings would be impossible to estimate.
- ± This finding included calculated cost savings.
- ✓ This finding was relevant to the I-900 element.

TABLE III
ESTIMATED COST SAVINGS

Finding	Finding Description	Estimated Cost Savings	Notes
1-A	POS approved change orders without sufficient evidence of having evaluated proposed costs.		‡
1-B	POS's failure to timely process change orders and poor change order documentation resulted in an overpayment of \$105,535.	\$105,535	±
1-C	POS failed to obtain an \$80,000 credit when original scope work was deleted, and POS wrongly issued a 329-day time extension for work that was never performed.	\$80,000	±
1-D	POS performed inadequate reviews of change-order proposals, resulting in overpayment of contractor markups.	\$7,202	±
1-E	POS altered contractor invoices to pay a contractor for work that exceeded the maximum contract amount set by law, thus violating state law and the Commission's delegation of authority.		‡
2-A	POS circumvented competition requirements by awarding contracts at "less competition required" levels and then amending the contracts to higher levels, split purchases, and awarded sequential no-competition contracts.		‡
2-B	A consulting agreement awarded in 1993 grew without competition from \$950,000 to more than \$30 million.		‡
2-C	A consulting agreement awarded in 1998 grew without competition from \$10 million to more than \$120 million and is being used to augment POS staffing at considerable cost.	\$60,483,000	±
2-D	POS awarded a \$1.4 million consulting agreement without evidence of competition and awarded a \$2.7 million consulting agreement without competition.		‡
2-E	POS altered contractor invoices to pay for work that exceeded the maximum contract amount set by law, thus violating state law and the Commission's delegation of authority. (This is the same as finding 1-E.)		‡
2-F	POS repeatedly awards Small Works Roster Program contracts to the same few contractors. The Small Works Roster Program's random contractor rotation process can be circumvented to allow preferred contractors to be added to the Invitation for Bid list. The solicitation invitation process can be circumvented.		‡
3-A	A 3 rd Runway Project procurement violated applicable procurement laws, and POS concealed details of this unusual procurement from the POS Commission.	\$32,777,042	± *
3-B	POS management did not provide reports on contract administration/bid irregularities and information related to professional and consulting services to the POS Commission, as required by the Commission's delegation of authority. It interpreted Resolution 3181 to permit disclosure of minimal information.		‡

Finding	Finding Description	Estimated Cost Savings	Notes
3-C	POS managers approved a PSA agreement and amendments to that agreement in amounts that exceeded the delegated authority of these managers.		‡
3-D	A former employee of one contractor managed that contractor's major 3 rd Runway construction contract. A POS consultant served on a selection committee that awarded a \$5.8 million contract to one of his company's subcontractors.		‡
4-A	POS project management information systems data were incomplete, outdated, and inaccurate when compared to project records.		‡
4-B	POS requirements for Project Notebooks are not enforced, and requirements are inconsistent between POS divisions. Project Notebooks were missing, incomplete, not updated, and not easily accessible by stakeholders.		‡
4-C	POS paid \$864,463 for an electronic construction document management system ("Livelihood"), and the contract required POS contractors to use this system on specified projects, but neither POS nor its contractors have used the system as intended.	\$864,463	▽
5-A	POS repeatedly failed to enforce standard contract provisions that reduce a public owner's risk of project cost and schedule overruns. This Condition limited POS's ability to successfully defend against contractor claims and led to POS's failure to recover \$2,910,400 in liquidated damages.	\$2,910,400	±
6-A	POS construction management is vulnerable to fraud, waste, and abuse.		‡
7-A	POS personnel altered audit evidence, impeded access to information, in some cases were uncooperative, and refused to provide management representation letters as requested during the audit.		‡
7-B	Management of the 3 rd Runway Wall Art project indicated that POS's one-percent-for-the-arts policies are unclear.		‡
7-C	The POS internal auditor lacked organizational independence.		‡
Total Cost Savings Estimate:		\$97,227,643	

Notes:

- ‡ Likely cost savings are associated with this finding, but such savings would be impossible to estimate.
- ± These estimated savings pertain to a single construction contract or consultant agreement, and we did not attempt to extrapolate the estimated savings to the population of all construction contracts or consulting agreements.
- * These are the estimated savings related to the 2006 3rd Runway Embankment Contract. The amount is the difference between the fair and reasonable engineer's estimate (determined prior to POS learning that a single, inflated bid was likely) and the single bid received.
- ▽ This is an estimate of the cost of the CDMS since January 2004.

DETAILED FINDINGS AND RECOMMENDATIONS

Audit Finding 1: POS Construction Management Lacked Cost Controls and Accountability

Finding 1-A: POS approved change orders without sufficient evidence of having evaluated proposed costs.

Background

Pricing and costing of change orders is a vulnerable area for all owners and governments, because once a contractor has been selected through a competitive process, follow-on change orders become sole source procurements, and the contractor has no competitive incentive to price change orders fairly and reasonably. According to POS policies, there are two methods used by POS to assure that change order prices are fair and reasonable: (a) Comparison of the contractor's change order price against an independently-derived Engineer's estimate and (b) cost analysis—a comprehensive review of the elements comprising the contractor's change order estimated cost breakdown. In either case, detailed documentation of the analysis and results should be maintained in POS files.

Condition

During our audit, we noted instances in which Engineer's estimates were consistently the same as the contractor's proposed prices and in which Engineer's estimates were prepared *after* POS had received the contractor's change order proposal.

The C1 Baggage Screening Facility – Shell project (Project # 102337, Task 003) is an illustrative example. That project had 215 change orders totaling \$2,777,552. Of the 215 change orders, the “negotiated” and settled change order amount was identical to the contractor's proposed amount in 186 (86.51%) of the changes. The “negotiated” and settled change order amount was within 1 percent of the contractor's proposed amount in 204 (94.88%) of the changes. A senior POS manager confirmed the following:

If the engineers [sic] estimate method is chooses [sic] it should be made independent of the contractors [sic] proposal but you can't determine this just by looking at the dates of each. The contractor's proposal may come in prior to the engineers [sic] estimate as long as the engineer doesn't refer to it until after he completes his independent estimate.

If the process described above was followed on this project, the fact that in 186 out of 215 cases, the contractor's proposed amount and the independent Engineer's estimate were *exactly* the same would be an extraordinary coincidence. It does not appear that rigorous change order cost evaluations or meaningful change order negotiations took place on this project.

To evaluate this further, we analyzed the supporting documentation for the 40 largest cost-increase change orders (totaling \$2,738,806). We noted the following conditions related to these largest change orders:

- Cost analysis was reportedly used to evaluate the contractor's change order proposed costs on 5 of the 40 change orders. For these 5 change orders, the POS files contained no supporting documentation for the cost analysis.
- For the remaining 35 change orders where an Engineer's estimate was supposedly used to evaluate the proposed cost, the date of the Engineer's estimate was *after* POS had received the contractor's change order proposal in all 35 cases. The Engineer's estimate (prepared after the contractor's change order proposal was received) was identical to the contractor's proposal in 4 of 35 cases. The Engineer's estimate was within 1% of the contractor's proposed amount in 15 of 35 cases. The Engineer's estimate was within 4% of the contractor's proposal in 29 of 35 cases. For none of these 35 change orders was there any supporting documentation detailing the basis for the Engineer's estimate.
- For these 35 change orders negotiated based on an Engineer's estimate, the contractor's *proposed* amount was identical to the *negotiated* change order amount in 31 cases and \$1 different in 3 cases. In the remaining case, the negotiated amount was \$15,580 *higher* (75.84% *higher*) than the contractor's proposed amount.
- On 8 of 40 (20%) change orders, POS did not retain copies of the change order originating documents in the change order files. (Change order numbers 184, 207, 311, 364, 446, 473, 507 and 518.)

In response to a draft of this finding, POS asserted that a “project utilizing an alternative public works contracting methodology – specifically the GC/CM method – does not support” our conclusions, because “the General Contractor/Construction Manager provides the estimates or cost analysis as necessary, negotiates the change orders with the subcontractors and documents the process.” POS also asserted that they “relied on the GC/CM to provide the estimates for Change Order Requests and the Port did a detailed review of these estimates using the “cost analysis” method for the majority of all change order requests.” POS also asserted that:

The GC/CM estimates are prepared and submitted to the Port for review, acceptance or rejection and are of good detail and attached to the Change Order Requests in the Change Order files. The Change Order files and the Change Order Requests will show where many of the initial CORs were rejected and price reduction revisions were requested and received. Some times the rejection of CO pricing was returned to the GC/CM and a revised COR was issue for the reduction. Some of these rejected CORs were retained in the Port CO files, but there are some that were sent back to the GC/CM and are in the GC/CM CO files.

In order to test these assertions that adequate documentation exists, we asked POS to provide us the documentation for a sample of 7 change orders. POS provided us with copies of the documentation. While the documentation was voluminous, we noted the following problems:

- For 6 of the 7 change orders, some of the underlying support for the change order amount was missing or did not match the amounts being claimed.
- The files each contain a “Change Order Reconciliation Checklist” with a list of procedures to be performed in evaluating the change order. It has spaces for “initial & date” for the General Contractor/Construction Manager's (GC/CM) engineer, superintendent, project engineer, cost engineer, and project manager. The GC/CM engineer initialed these forms, but in 7 of the 7 change order files, there was no evidence

of a review by and no initials for the superintendent, project engineer, cost engineer, or project manager.

- None of the files contained any other evidence of a review by POS personnel except for the signatures on the change order approval forms.

Criteria

POS Policy requires the following:

Construction Management Procedure, Change Orders states:

Background Discussion: Change Order (C.O.) process begins once a contract change is identified. The process is initiated by the Resident Engineer. The C.O. can result from an RFI response, user requested scope changes, unforeseen conditions, regulatory agency requirements, or design errors and omissions. **It is essential that C.O.'s accurately describe the change, the reason for change and all necessary back-up information.** It is also critical that C.O.s are executed within the authority delegated by the Port of Seattle Commission. ...

Administrative Controls: Upon execution of the change order by the contractor and Port of Seattle, the change order file is stored in the contract files. **The file must contain at a minimum the following:**

1. The Blue copy of the Change Order with original signatures.
2. A completed Supporting Information Form with original signature
3. A Port of Seattle cost estimate. (Note, if cost analysis is used this is not required.)
4. A copy of the originating document. (This would include the Construction Bulletin and other items such as RFI, letter, e-mail etc).
5. The contractor's original proposal.
6. A summary of negotiations. (This could be a marked up copy of the original proposal, are [sic] revised proposal, or a written comment by the RE accepting the original proposal)
7. All additional information. (At a minimum, this needs to include a copy of the Change Order Log). [Emphasis added]

Best practices for GC/CM contracting indicates that POS's reliance on the GC/CM to negotiate and evaluate change orders is misplaced. The State of Washington Joint Legislative Audit and Review Committee (JLARC) issued *An Assessment of General Contractor/Construction Manager Contracting Procedures* in June 2005. In that report, JLARC states:

... project management on the part of the owner must be as great or more intensive with the GC/CM methods as it is with the DBB method. A GC/CM project involves negotiating a GCC; working through value engineering and constructability reviews; and constantly overseeing on-site construction work. Meeting these project demands requires experienced project management and involvement on the part of the owner.

... case studies ... found that the owner agency's close attention to project and construction management in general, and their day-to-day involvement on the project in particular, was the most critical success factor; no alternative contracting model can substitute for the owner agency's close attention to the project.

While the GC/CM method offers more positive relationships among the parties to a construction project, it does not provide any significant opportunities for owners to abrogate their project management responsibilities.

The lack of experience or project involvement by the owner may have adverse affects on project costs.

Cause

The overarching cause of this condition is the lack of an independent and robust Contract Administration function that would assure that change order proposals receive a rigorous and objective evaluation. Allowing engineers and construction managers the authority to negotiate changes directly with the contractors that they deal with on a day-to-day basis without independent oversight and approval creates inconsistent and lax contract management processes where this type of problem can occur.

Effect or Potential Effect

The failure to follow established and required POS procedures and best practices for evaluating change order proposals may be resulting in millions of dollars of unearned and unjustified monies flowing to contractors. Further, without adequate segregation of duties in the process, the potential exists for a variety of bribery or kickback schemes to be taking place.

Recommendations

This finding supports our overarching recommendations regarding appointment of a Chief Procurement Officer, establishment of an independent contract administration function, and revision of the delegations of authority for approving construction management expenditures. In addition, we recommend the following with respect to this finding:

Recommendation 1: We recommend that POS immediately implement and strengthen control procedures to assure that Engineers' change order estimates are (a) prepared without knowledge of the contractors' proposed amounts, and (b) change order estimates and cost analyses are fully and completely documented. Where cost or price analysis is used to evaluate change order proposals, POS should require full and complete documentation of these reviews, including fully documented supervisory reviews and approvals.

Recommendation 2: We recommend that POS undertake a review of all major recent and ongoing projects to identify cases where engineers' estimates and contractors' proposed amounts are consistently the same and, in such cases, undertake a further evaluation of the underlying causes; followed by remedial actions as appropriate.

POS Response

The full text of the POS response to this finding is in Appendix E. POS disagreed with this finding and stated that:

While the Port could have better documented its independent cost analysis, its files contain detailed documentation supporting the final negotiated price.

The Port's practices are consistent with the recommendations set forth in the Assessment of General Contractor/Construction Manager Contracting Procedures issued by the Washington Joint Legislative Audit and Review Committee ("JLARC") in June 2005.

Auditors' Additional Comments

While change order files sometimes contained considerable documentation, our audit revealed that this documentation did not always support the final negotiated price. As noted in the criteria section, above, we do not agree that POS's practices are consistent with the best practices defined in the June 2005 JLARC report.

Finding 1-B: POS's failure to timely process change orders and poor change order documentation resulted in an overpayment of \$105,535.

Background

The Aircraft Fuel System (AFS) project contract was awarded on May 28, 2004 in the amount of \$33,090,975.00. The project was originally planned to have taken 410 calendar days to achieve substantial completion. The project was completed in 916 calendar days—506 calendar days late.

POS determined during the course of the AFS project that the:

contract documents were not clear about the system commissioning tasks for the fuel system and whose responsibility it fell under – contractor, subcontractor, or owner

and that:

once it was determined that the contractor and subcontractor[s] had neither the appropriate skills, lack of bias and contract compensation for providing overall equipment and system commissioning, the POS commenced with obtaining a qualified representative.

POS executed three force account change orders during the course of the project to pay for the services of a commissioning agent.¹

Change Order Chronology

The October 2004 – Summary of Negotiations, prepared by the CM, states:

The Port proposed splitting the cost of such a Commissioning Agent with the Contractor as such a Commissioning Agent was also of benefit to them. It was agreed to split the cost.

The Summary of Negotiations failed to identify the date that the negotiations took place, who represented the contractor in the negotiations, the details of the cost split, agreed markups, or the basis for the Not To Exceed (NTE) Amount. The Engineer's Estimate Amount of \$100,000 was crossed out and an amount of \$200,000 was hand-written on the document.

A July 11, 2005 Email from the CM stated:

Please turn in a Trend for [agent] cost, our share. Use \$100k.

¹ A commissioning agent provides checkout, setup, acceptance, and operation testing of the completed system to ensure that construction complied with the approved construction drawings and specifications, and was in accordance with the Commissioning Plan developed by the contractor. Commissioning includes a final system acceptance test conducted on the complete operational control system to demonstrate that it functions properly and in accordance with the requirements of the Contract Documents.

A July 11, 2005 – Construction Trend Notice was prepared by the resident engineer (RE). The trend amount shown is \$100,000, and the POS share of costs is identified as 50%.

REASON FOR TREND / REFERENCE DOCUMENTS:	POS and the General Contractor [REDACTED] decided to hire services of [REDACTED] to commission the Aircraft fueling project. POS will be responsible for 50% of the cost and the contractor for the balance.
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The November 5, 2005 – Change Order Log shows an amount pending of \$100,000.

A November 14, 2005 Email from the RE to the construction manager (CM) requested information about the cost split and the amount for markups, if any. The CM stated:

No 6% markup on [Commission Agent's] change order. We pay 75% of his cost.

A November 14, 2005 – Change Order Supporting Document indicated that the change, if approved, will not occur again. The CM noted that he had increased the total amount to \$200,000.

	YES	NO
4 A. HAS ANY WORK BEEN PERFORMED ON THIS CHANGE TO DATE?	X	
B. WILL THIS CHANGE, IF APPROVED:		
1. Occur Again?		X
2. Create any liability for escalation?		X
3. Affect other work not covered by the proposed change order?		X
4. Affect any other present or future contract?		X

The November 29, 2005 – Change Order was signed by POS.

On March 31, 2006 - Four months after CO #52 was executed, and after having doubled the change order amount from the amount of the engineer's estimate, the RE processed and signed CO #64 in the amount of \$49,999 (an amount which is \$1.00 under the signature limit for an RE). The Change Order Supporting Document indicated that the change, if approved will not occur again.

On October 30, 2006 – Seven months after executing CO #64, the RE processed and signed CO #80 in the amount of \$49,999 (again, an amount which is \$1.00 under the signature limit for an RE). The Change Order Supporting Document indicated, once again, that the change, if approved will not occur again.

POS processed the first payment for the commissioning agent on Pay Estimate 17, dated November 30, 2005. The total amount of the invoices for work performed between January and July 2005 was \$105,517.03. POS paid 75% of that amount, \$79,138.00.

In August 2006, POS audited the supporting documentation for CO #52. Of the \$105,517.03, POS's audit revealed \$340.38 in questionable costs, \$175.01 that had been double billed, and \$2,189.95 in costs for which no receipts were submitted. We were unable to determine if the total amount paid by POS to the contractor for the commissioning agent included a reconciliation of the CO 52 audit findings.

The contractor was contacted during the course of our audit to confirm the amount that the contractor paid for its share of the commissioning agent's costs. The contractor confirmed total payments were made to the agent in the amount of \$388,925.15 with POS paying \$299,998.00 of that amount, or 77%.

Finally, the CO documentation gives the reader the impression that POS retained and paid for the commissioning agent because of its concerns that the contractor would not perform the scope of work adequately. The Change Order Supporting Documentation states:

<p>3 CONSEQUENCES IF CHANGE NOT MADE: Experienced Commissioning tasks would be haphazard and not fully documented and performed in time for the schedule use and start-up of the various equipment and systems.</p>

Assuming the contractor's scope of work because POS believed that the contractor was incapable of performing the work to an acceptable standard is not a valid basis for entitlement for additional costs. During our audit, POS project staff explained that the commissioning specification was not "omitted" but that it had been purposely removed from the contract documents in order to try a different approach to commissioning. The change order language is poorly written and fails to objectively and adequately describe the basis for entitlement of this change order.

Conditions

1. There was no supporting information explaining the basis for the POS Engineer's Estimate.
2. The final change order amount was double the engineer's estimated amount and no explanation is provided for that 100% increase.
3. The Summary of Negotiations failed to identify the amount of the cost split. The trend notice indicated that POS's share of the costs would be 50% but the CM authorized 75% to be paid.
4. Change Order splitting occurred. Two additional change orders were prepared and approved by the RE for amounts that could be processed within the RE's signature limit, and *after* each preceding CO had been evaluated as a "NO" for reoccurrence.
5. The CO documentation indicated that POS was to pay 50% but, by the time the change order was processed, over a year had elapsed and the shared cost changed—without justification or explanation—to a 75%/25% split. POS overpaid its share of the costs for the commissioning agent by 25% or \$105,535.50.

Criteria

POS Policy, *Construction Management SOP Manual – SOP 10 – Change Orders*, requires:

Background Discussion: Change Order (C.O.) process begins once a contract change is identified. The process is initiated by the Resident Engineer. The C.O. can result from an RFI response, user requested scope changes, unforeseen conditions, regulatory agency requirements, or design errors and omissions. ***It is essential that C.O.'s accurately describe the change, the reason for change and all necessary back-up information. It is also critical that C.O.s are executed within the authority delegated by the Port of Seattle Commission. [Emphasis added]***

References: Request for Information; Commission Resolution 3181 Delegation of Authority

Administrative Controls: Upon execution of the change order by the contractor and Port of Seattle, the change order file is stored in the contract files. The file must contain at a minimum the following:

1. The Blue copy of the Change Order with original signatures.
2. A completed Supporting Information Form with original signature
3. A Port of Seattle cost estimate. (Note, if cost analysis is used this is not required.)
4. A copy of the originating document. (This would include the Construction Bulletin and other items such as an, RFI, letter, e-mail etc).
5. The contractor's original proposal.
6. A summary of negotiations. (This could be a marked up copy of the original proposal, [a] revised proposal, or a written comment by the RE accepting the original proposal)
7. All additional information. (At a minimum, this needs to include a copy of the Change Order Log).

Cause

The overarching cause of this condition is the lack of an independent and robust Contract Administration function that would assure that change order proposals receive a rigorous and objective evaluation and are well documented. Allowing engineers and construction managers the authority to negotiate changes directly with the contractors that they deal with on a day-to-day basis without independent oversight and approval creates inconsistent and lax contract management processes where this type of problem can occur.

Nearly one year elapsed between when the negotiations took place and when the change order was executed and the first of the invoices was paid. The CM may not have accurately remembered the negotiated amount. The Summary of Negotiations lacked specific details regarding the cost split so the change order documentation was of little help when it came time to pay the invoices that were submitted by the contractor. POS engineering's Construction Management SOP Manual procedures/guidelines provide very little guidance on the type of information that should be addressed in the Summary of Negotiations document.

Effect or Potential Effect

POS paid the contractor \$105,535.50 more than the change order documentation supported.

Recommendations

This finding supports our overarching recommendations regarding appointment of a Chief Procurement Officer, establishment of an independent contract administration function, and revision of the delegations of authority for approving construction management expenditures. In addition, we recommend the following with respect to this finding:

Recommendation 3: We recommend that POS revise its SOP Manual to include specific guidelines for proper and accurate change order documentation. POS should provide training to its consultant staff/construction managers to improve the manner in which POS is documenting project change orders.

POS Response

The full text of the POS response to this finding is in Appendix E. POS stated that:

The change order was not untimely; although the need for the commissioning agent was discussed early in the contract, the change order was not negotiated and signed until the commissioning agent's services were needed and could be accurately defined.

The Port agreed to pay 75% of the cost of the commissioning agent's services after carefully considering the specific tasks performed by the commissioning agent and reviewing the supporting documentation submitted by the contractor. Based on this review, and negotiation with the contractor, the Port concluded that 75% of the commissioning agent's effort was the Port's responsibility. Thus, the Port did not overpay \$105,535.50.

The Performance Auditor's finding is predicated on non-contractual, internal documents such as emails and construction trends in which the need for commissioning agent services was first identified.

Auditors' Additional Comments

The POS response misrepresents the finding and facts pertaining to the change order for the commissioning agent services. This finding identified that POS paid change order costs that exceeded the negotiated amount that was documented in the change order files.

POS's response asserts that the change order was "not untimely." We disagree. The contractor for the aircraft fuel system project confirmed (and invoices substantiate) that the commissioning agent began working on the project in January 2005. POS did not execute the change order until November 2005; over 11 months *after* the commissioning agent began working on the project. The change order was "Force Account" (meaning "time and materials"). As such, costs must be tracked contemporaneous to when the work is performed. The change order should have been executed *prior* to the work starting and prior to incurring costs in January 2005; *not* 11 months after the work commenced.

We disagree with POS that the finding is predicated on "non-contractual, internal documents." POS Policy, Construction Management SOP Manual – SOP 10 – Change Orders, states "*It is essential that C.O.'s accurately describe the change, the reason for change and all necessary back-up information.*" The executed change order document did *not* describe the payment terms (75% vs 50%) between the contractor and POS, and the change order "back-up information" substantiated a negotiated 50/50 split NOT the 77% that POS ultimately paid.

The POS response fails to address the following issues raised in the finding:


- Wrongful practice of change order splitting in order to circumvent the signatory limits established in Resolution 3181.
- Allowing additional work to be performed prior to execution of a change order. In this case time and material work had been performed for 11 months before POS executed the change order.
- Poor change order documentation that failed to substantiate the payment amounts made by POS.
- POS did not confirm if the final costs paid to the commissioning agent were adjusted to account for the questionable, double-billed, and unsubstantiated costs that were found in the time and material supporting documentation.

Finding 1-C: POS failed to obtain an \$80,000 credit when original scope work was deleted, and POS wrongly issued a 329-day time extension for work that was never performed.

Background

POS failed to obtain a credit for original scope work that was deleted from the Aircraft Fueling System (AFS) contract (work project 102400). POS granted the contractor a 329-day time extension to perform original scope work where the means of installation method had been changed; but, that work was never performed. Consequently, the related time extension was unnecessary. POS issued the time extension *after* the contract completion date had passed. POS personnel believed that the contractor's lack of experience with the nature of the work in the AFS contract caused delays on the project but POS never assessed delay days against the contractor nor did POS assess or collect liquidated damages. POS's informal approach to change order negotiations led to a lack of substantiation for the amount paid in Change Order number 84.

POS Deleted Original Scope Work that Was Associated with the Fire Protection System
Construction Bulletin (CB) 109, dated July 24, 2005, deleted work associated with the installation of the foam protection system (tanks 108, 109, 111, and 114):

 Port of Seattle			
Seattle-Tacoma International Airport		AVIATION/ENGINEERING DEPARTMENT	
Construction Bulletin			
DATE:	7/24/2005	CONSTRUCTION BULLETIN:	109
PROJECT TITLE:	2004 Airfield Improvements Contract-1	CONTRACT NUMBER:	MC-0311093
CONTRACTOR:	[REDACTED]	WORK PROJECT:	WP-102400
SUBJECT:	Delete scope of work associated with the Fire Protection System on tanks 108, 109, 111, and 114.	COST TREND:	102400-229
DRAWING REF.:	FP5.01 Detail 6, Detail 3	DESIGN BULLETIN:	N/A
SPEC. REF.:	11300	RFI:	354

The following information/clarification further explains the Scope of Work:

Delete all the remaining scope of work associated with the Fire Protection System at Tanks #108, 109, 111, and 114. Work includes, but is not limited to, installation of above ground piping, fittings, foam chamber, ½" plate brackets at each tank shell course, and tank modifications at foam chamber tank opening, painting and signage.

Contractor shall submit all of purchased material including pipes, Foam Chambers, Foam makers, valves and etc. to the POS inspector on site.

Work on the Fuel Tank #115 remains in contractor's scope of work.

POS's estimate for the credit amount due because original scope work was deleted totaled \$100,000. The contractor estimated the credit at just \$10,000. The construction trend log shows that this CB 109 issue was later "cancelled," so that that significant disagreement regarding the proper credit was not resolved in 2005.

POS Rescinded CB 109 and Reinstated the Work Associated with the Fire Protection System via Change Order #78

Change Order #78 was executed by POS on September 26, 2006. That change order authorized a contract price increase of \$185,000 and a time extension of 329 days. The Contract Completion Date was extended from January 5, 2006 to December 1, 2006.

The scope of work for Change Order #78 stated:

Rescind the previously deleted work (under CB-109) and proceed with installation of the Fire Foam Pipe, Spray Chambers and Brackets at Fuel Tanks 108, 109, 111 and 114. Work to include coordination with Swissport Fueling for tank outages, LOTO, draining, any repairs to interior tank coatings, safety, certified testing and commissioning similar to that performed at Tank 115 doing the same work.

POS initially had determined that the work to perform the Fire Foam Piping, Spray Chambers, and Brackets at Tanks 108, 109, 111, and 114 would be best done by another contractor under a separate contract, and had issued Construction Bulletin 109 to implement that revised approach. CO 78 represented POS's subsequent decision to reinstate the work and have the AFS contractor perform the work under the then-current AFS Contract (work project 102400). The work to install the tanks was originally in the AFS contractor's base contract scope of work, then was deleted by CB 109, and was now being added back into the contract to be performed via a changed method.

POS Wrongly Provided a 329-Day Time Extension for the Work on the Fire Foam Piping Work Because that Work was Never Performed

The AFS contractor's proposal for CO #78 did not request a time extension, but the POS Engineer's Estimate included an estimated time impact of 329 calendar days. The Summary of Negotiations reads:

Since the work is to be done after BOD [beneficial occupancy date] when the tanks are available for shutdown, a time extension of 329 calendar days is required through December 1, 2006.

The change order file does not contain any project schedule evaluation documentation to substantiate how the 329 calendar-day time extension was calculated or determined. The project primarily relied on two week "look ahead schedules" which never depicted the full scope of work in each schedule. POS's decision to require the contractor to comply with the contract requirements regarding schedule update submissions put POS at a severe disadvantage in accurately assessing the amount of time extension, if any, that was warranted at the time CO #78 was being considered. Neither the contractor nor POS performed a schedule analysis to justify giving the contractor 329 days of additional time to perform the CO #78 work. The time extension was given to the AFS contractor because the work on the tanks was going to be done after the beneficial occupancy date. But, this work was never performed by the contractor. POS's "Pay Estimate 28 – Final" substantiates that POS never paid any money for CO 78. Yet,

the time extension which POS granted to the contractor to install the tanks after the beneficial occupancy date was never rescinded by POS.

POS's Summary of Negotiations, dated September 5, 2006, described the settlement of Change Order #78 as follows:

Engineer's Estimate	Contractor's Proposal
Estimated Cost Impact: \$124,966	Proposed Cost Impact: \$218,700
Estimated Time Impact: 329 cal days	Proposed Time Impact:
Prepared By:	
Date Prepared: Aug 2006	Date Received: July 6, 2006
Summary of Negotiations: CB 109 of 7/24/05 originally deleted the Fire Foam system installation on the subject four fuel receipt tanks due to a design problem. The problem was that in order to properly install the brackets supporting the Fire Foam system piping, the tanks had to be drained and the interior coating repaired due to the welding of the brackets to the outside of the tanks. Other installation methods which could be done with the tanks filled were investigated by the AE to no avail, so it was decided to proceed with work via a separate contract as time allowed the tanks to be down for the work. This plan was subsequently changed to do the work as a change order to the current contract rather than go thru the cost of separate plans, specs, and procurement. This was the scope of work of CB 134. Negotiations began in August and continued into September, 2006. The change cost involved both delay in performance of the work as well as additional work to do the tanks one at a time and perform the interior repairs required to each tank. During initial negotiations, the Contractors price was reduced to \$193,408 by adjustment of the Commissioning costs, bracket installation, and prime contractor's mark up. The remaining discussions involved a reestimate of the costs from the fire protection subcontractor, COSCO Fire Protection Inc, which primarily involved delay in their work of over a year. They reduced their net price to perform the work and the Contractor offered to settle the change at \$185,000 which was agreed.	

POS's estimated amount of \$124,966 for CO 78 is based on the calculation shown below which included a credit amount of \$79,434.

TOTAL NOW COST TO DRURY TANKS AND CHANGE ORDER	
TOTAL SUB	\$182,900
GMCC 6%	11,000
GMCC	
FIELD OFFICE	
1 PM x 1 MON	10,000
1 TRUCK x 1 MON	500
	<u>208,400</u>
ORIGINAL GBBV FOR	(79,434)
NET	<u>\$124,966</u>

The POS's credit of \$79,434 for the deleted original scope work never materialized because CO #78 was canceled via CO #84.

The CO #78 estimate (shown above) that was prepared by POS's construction manager (a consultant, not a POS employee) was not calculated in accordance with Contract Section G-09-03.C. The credit portion of the estimate (shown below) fails to include the contractor's costs such as "markup, contingency, overhead and profit." The credit estimate clearly indicates that the costs were for "original labor." The three items of work are subcontractors' work.

DELETE & MARKS

1. MECHANICAL LABOR (GSC)	51,003
2. BRACKET LABOR/PURCHASE	23,375
3. PAINT ^{OUTSIDE} LABOR	9,156
<u>ORIGINAL LABOR</u>	<u>\$79,434</u>

Work that Had Been Deleted via CB 109, Then Reinstated via CO 78, Was Then Deleted—again—via CO #84.

POS executed Change Order #84 on February 21, 2007. Change Order 84 canceled the work described in Change Order #78. Change Order #84 did not include a credit for the deleted original scope of work related to the Fire Foam System at tanks 108, 109, 111, and 114.

Change Order #84 included the following scope of work:

- A. Install temporary power and activate space heater in North Ops ATS enclosure; install space heater, temporary power, and activate space heater in North Ops Emergency Generator Breaker enclosure; **Cancel Change Order #78**
Install Foam System; Cancel Construction Bulletin #131 Install Transfer Pumps (CB-136)
- B. Complete Commissioning of North Ops Emergency Power System including installation and removal of temporary power source

TOTAL ABOVE.....\$59,999.00

POS's January 8, 2007, cost estimate for Change Order 84 was \$50,330.

The contractor submitted a cost proposal for \$70,922 (including markups) on January 17, 2007, for part A of the change and a cost proposal for \$9,285 on January 19, 2007, for part B of the change.

The project records describe the Change Order 84 negotiations as follows:

- POS's Construction Manager (a consultant) emailed the contractor's project manager (PM) on January 18, 2007, indicating that certain portions of the costs were accepted. He wrote, "*Still laughing at the rest... (actually you and SE do have something coming so lets figure that out via tummy rub in lieu of you all documenting what is undocumentable).*" [Emphasis added.]
- The contractor's PM emailed POS at 8:12 AM on January 25th, stating, "*Gee, you're starting to wear me down on this. NOT.*" [Emphasis in original.] The PM offered \$56,000 for part A of the scope change, and \$8,750 for part B of the scope change. Change Order 84 costs included the costs of cancelling Change Order 78, which had included costs for efforts preparing change order cost estimates.
- At 9:13 AM on January 25th, the contractor's PM sent another e-mail: "*Let's see, you countered with 50 for CB 136 and 4.5 for the ATS stuff. Total of 54.5. You're getting closer, but not close enough. Total of 62 for the both of them. Write it up and we're done.*"

The POS's construction manager's email response stated, "*If it starts with a '5' we're there.*" CO #84 was finalized in the amount of \$59,999.

Conditions

1. POS failed to obtain *any* credits from the contractor for the deletion of the original scope of work related to the fire foam piping either via CO #78 or via CO #84.
2. Despite the fact that the contractor's proposal for CO #78 did not request a time extension, POS extended the contract 329 calendar days via CO #78. POS authorized this time extension *after* the *revised* contract completion date had already passed (the original contract completion date had been extended 177 days via CO #55).
3. POS did not withhold liquidated damages for the contractor-caused delay days. POS's construction manager told us:

[The contractor] is a horizontal contractor (dirt work) and not overly sophisticated in terms of project controls systems. This was a new type of work for [the contractor] and they were primarily dependent on their subcontractor, [subcontractor] ([subcontractor] provided the mechanical piping. [subcontractor] had a prior teaming relationship with [contractor]). [Contractor]/[subcontractor] are struggling with understanding how the mechanical system fits together. To date, only four of the 43 total control valves have passed inspection. [Contractor] had been unable to get the fuel hydrants commissioned because valve leaks have been a big issue. The project has also been a challenge from a scheduling perspective. [Contractor] is very good at determining means and methods to get the work done, but they are not so good with project controls paperwork.

4. The work in CO #78 was canceled, thus making a time extension unnecessary, but POS did not rescind the time extension. The CO #78 file does not contain evidence that a "time impact analysis" was prepared to justify the number of days awarded in the time extension. POS acknowledged in our discussions of this project that the contractor had contributed to the delay on the project. Despite this, no calculation of those delays was done by the

contractor, as required by the contract, and POS prepared no supporting information to substantiate giving the contractor 329 days of additional time on the project.

5. POS deleted the CO #78 scope of work associated with the installation of the foam tanks and never sought a credit for those monies. We reviewed COs #85 and #87 (which are “reconciling” change orders). Neither CO #85 nor CO #87 reconcile the credit that POS was due for the deleted scope of work, including markups, contingency, overhead, and profit.
6. POS negotiated (“tummy rubbed”) the final amount of \$59,999 for CO #84 without accounting for the deleted scope of work credits that were due POS.

Criteria

Contract Requirements, Article G-09.01 THE PORT MAY MAKE CHANGES, stipulated the following:

Without invalidating the Contract and without notice to the Contractor’s surety, and at any time during the progress of the Work, the Port may make changes in the Work, which changes included but are not limited to the following:

- A. *increases or decreases in the quantities of Work;*
- B. *deletion or alteration of any portion of the Work;*
- C. *changes in design or specifications; and*
- D. *addition of new Work.*

Article G-09.03.C Changes to Work Other than Unit Price Work, stipulated the following:

2. Deleted Work. If the Port elects to delete all of a portion of the Work, the Engineer shall so advise the Contractor in writing, and the Contract Sum shall be decreased in an amount determined as follows:

- a. The Port and the Contractor will attempt to agree on the amount based upon a proposal submitted by the Contractor or determined by itemizing the elements of Work deleted including all direct costs, markup, contingency, overhead and profit used by the Contractor in preparation of its original Bid, less any costs properly expended to date in connection with the performance of the deleted Work. Upon request of the Engineer, the Contractor shall submit its original bid documents. If the Contractor and the Port cannot agree on the change or the Contractor cannot document the above amount to the satisfaction of the Engineer, the amount allowed for markups, shall be determined in the same manner as if the deleted Work was to be performed on a Force Account basis pursuant to paragraph G-08.06. The Port may then issue a Change Order pursuant to paragraph G-09.04 and the Contractor shall have rights provided in paragraph G-09.06. [Emphasis added]*

The **POS Construction Management Manual: Standard Operating Procedure #10**, requires the following:

Background Discussion: *It is essential that COs accurately describe the change, the reason for change and all necessary back-up information. It is also critical*

that C.O.s are executed within the authority delegated by the Port of Seattle Commission. ...

Cause

The overarching cause of this condition is the lack of an independent and robust Contract Administration function that would assure that change order proposals receive a rigorous and objective evaluation and are well documented. Allowing engineers and construction managers the authority to negotiate changes directly with the contractors that they deal with on a day-to-day basis without independent oversight and approval creates inconsistent and lax contract management processes where this type of problem can occur.

POS's construction manager failed to adequately review the history of CB 109, and although the construction manager negotiated both CO 78 and CO 84, the change order negotiations did not address the fact that the work had been deleted, reinstated and then deleted again. The construction manager's informal style of negotiations led to a failure to properly document change orders which resulted in a failure to pursue a proper credit amount for POS.

POS also failed to enforce the contract requirements for project schedule submissions, so a delay analysis could not be performed. POS's construction manager failed to comply with Contract Section G-09-03.C which required decreases in the Contract Sum due to deletion of work to include amounts for contractor markups, contingency, overhead, and profit.

Effect or Potential Effect

POS overpaid the contractor due to its failure to seek credits for the deletion of original scope work. POS's failure to properly calculate the estimated credit in accordance G-09-03.C of the contract resulted in an incorrect credit amount.

A time extension was granted for 329 days to accommodate the CO #78 work being performed in a sequential manner at the end of the project, but then the work was never performed and POS never rescinded the time extension. POS failed to assess liquidated damages against the contractor for delays it considered to be the contractor's fault.

POS "tummy rubbed" its way to a settlement amount of \$59,999 for CO #84 without accounting for the credit (estimate of \$79,434 from CO 78). The construction manager who negotiated both CO #78 and CO #84 failed to reconcile his work efforts to ensure that POS received a proper credit for the original scope of work that was deleted. The amount paid for CO #84 versus the contractor's proposed change order amount cannot be reconciled and/or substantiated when this type of informal approach is used for change order negotiations.

Recommendations

This finding supports our overarching recommendations regarding appointment of a Chief Procurement Officer, establishment of an independent contract administration function, and revision of the delegations of authority for approving construction management expenditures. In addition, we recommend the following with respect to this finding:

Recommendation 4: We recommend that POS develop Standard Operating Procedures (SOPs) that align with industry practices. Current POS SOPs do not provide adequate information regarding change order negotiations.

Recommendation 5: POS management should take immediate steps to assure that POS rigorously enforces all contractual schedule requirements. Then, when requests for time extensions are made, they can and should be properly evaluated. POS should also provide more oversight of the Change Order process to ensure that estimates are properly created and used.

Recommendation 6: We recommend that POS immediately cease its informal method of resolving change order differences, and that POS improve its change order documentation requirements to include that details of change order negotiations must be based on discussions of scope/means and methods/pricing differences.

POS Response

The full text of the POS response to this finding is in Appendix E. POS agreed that it failed to obtain credits for work that was deleted from the contract and stated:

The Port agrees that it overlooked a credit for certain work deleted from the contract and that some documentation substantiating change orders related to this contract was lacking. However, the amount of the credit to which the Port would have been entitled was less than \$80,000....

The Port is investigating alternatives for recovery of a credit for that portion of the work that was not performed.

POS disagrees that the time extension (for performance of CO 78 work) should have been rescinded and stated:

The Port disagrees that it wrongly issued a time extension for that work. ... The Port was not entitled to rescind the time extension for this work because the contractor remained mobilized on site to undertake the work after the second change order and did, in fact, order materials and perform a portion of the work during this period.

Auditors' Additional Comments

Although, POS agrees that it failed to collect credits it was due, it disagrees that the credit should have been (at least) \$80,000 because “*the contractor performed some of the work and provided all of the materials.*” POS’s position is not supported by the information contained in the change order documentation. The “Summary of Negotiations” described the basis for CO #84 (the final reconciling change order for the foam system tanks) and stated:

Settlement costs address the effort by prime and subcontractors to do the Change Order [78] prior to its cancellation.

The contractor *was* compensated in CO #84 for the portion of (original scope) work it performed under CO 78, prior to the canceling of that change order. Thus, POS *was* entitled to a (minimum) credit in the amount of ~\$80,000. In fact, POS is entitled to a credit *in excess of*

\$80,000 if the contract provisions regarding recovery of contractor markups, contingency, overhead and profit are enforced and correctly applied.

POS's inability to reconcile its own change order documentation to enable it to correctly calculate the change order credit amount is troubling, and it highlights the need for implementation of the audit recommendations regarding:

- Change Order Procedures/Administration
- Change Order Evaluations
- Change Order Negotiations
- Change Order Documentation
- Training

We do not agree with POS's position that the time extension (329 calendar days) was still justified because the contractor "*remained mobilized on the site*" and that "*this mobilization status continued at no cost to the Port.*" POS's position fails to take into account the underlying change order documentation which noted instances of contractor non-performance, deficient performance, and slow performance that drove the contractor's need to remain mobilized on the project. Further, and most importantly, POS had, throughout the project, waived (as it routinely does on its projects) the contractual requirement to submit project schedule updates, so POS was *unable* to assess whether or not the time extension was justified, and it lacks a basis to assert that it "*was not entitled to rescind the time extension.*"

We also disagree that this situation was "*at no cost to the Port.*" POS was entitled to but did not collect liquidated damages (costs) from the contractor due to contractor delays. POS's failure to collect liquidated damages on this project is discussed in detail in Finding 5 of this audit report.

Finding 1-D: POS performed inadequate reviews of change-order proposals, resulting in overpayment of contractor markups.

Background

Some POS construction contracts include standard provisions regarding contractor markups on change orders.

Condition

Change Order #18 on Project # 101998, T-18 N. Apron Upgrade, only received a cursory review prior to being approved. The contractor's proposal was dated July 26, 2006, and sought additional costs of \$65,955.55, inclusive of a 20% markup on subcontractor costs. Two days later, on July 28, 2006, POS approved CO #18 in the amount of \$65,955.55 the exact amount requested by the contractor. POS never took note that the contractor's markup of 20% exceeded the contractually allowed markup of 6%. POS's failure to adequately review the change order resulted in an overpayment in the amount of \$7,202.

In response to a draft of this finding, POS indicated that it had reviewed other change orders under this contract and found two additional errors and was preparing a deductive change order to try to recover the overpaid amounts.

Criteria

POS Contract Provisions, *General Conditions for Construction Contract, G-08.06 Payment for Work Done on a Force Account Basis, 6. Markups*, states that:

b. The Prime Contractor shall also be reimbursed an amount equal to six percent (6%) of the total Subcontractor amount of subparagraph 5 above for all costs associated with the subcontracted work.

Best practices require:

Changes in construction projects are inevitable. No matter how well planned a project may be, there are always a certain number of changes. Each change, whether proposed by the owner or the contractor, requires documentation, negotiation, and an agreement on cost and schedule. The contractor's estimator may provide the cost and schedule projections for the change order proposal, or, as is often the case, the project manager is charged with this task. Here's where the architect or engineer's estimator steps in again to analyze the contractor's change order proposal to decide whether it is "fair and reasonable" within the context of the contract. [Source: RS Means]

Cause

The overarching cause of this condition is the lack of an independent and robust Contract Administration function that would assure that change order proposals receive a rigorous and objective evaluation. Allowing engineers and construction managers the authority to negotiate changes directly with the contractors that they deal with on a day-to-day basis without

independent oversight and approval creates inconsistent and lax contract management processes where this type of problem can occur.

As described in Finding 1-A, POS project personnel are not performing rigorous reviews of contractor change order proposals.

Effect or Potential Effect

According to POS, the contractor was overpaid by \$8,890.54 due to these errors, on just this contract. Other, similar errors may have occurred on other POS contracts.

Recommendations

This finding supports our overarching recommendation regarding appointment of a Chief Procurement Officer, establishment of an independent contract administration function, and revision of the delegations of authority for approving construction management expenditures. In addition, we recommend the following with respect to this finding:

Recommendation 1: We recommend that POS immediately implement and strengthen control procedures to assure that Engineers' change order estimates are (a) prepared without knowledge of the contractors' proposed amounts, and (b) change order estimates and cost analyses are fully and completely documented. Where cost or price analysis is used to evaluate change order proposals, POS should require full and complete documentation of these reviews, including fully documented supervisory reviews and approvals.

Recommendation 7: We recommend that POS undertake a review of the change orders negotiated and approved under all contracts to determine if there were other incorrect mark-ups on change orders.

POS Response

The full text of the POS response to this finding is in Appendix E. POS agreed with this finding and stated that:

The Port readily acknowledges these errors, but does not believe that they reflect an overall lack of rigorous review of contractor change order proposals. Particularly on small change orders such as those involved with these examples, the Port utilizes a cost analysis to determine the validity of the proposed change order amount. While the Port's construction management staff analyzed the direct costs associated with these three change orders, they overlooked the errors in the standard overhead markups.

Auditors' Additional Comments

We disagree with the POS position that these "errors" are not indicative of a lack of care in managing change orders. Although the amounts highlighted in this finding are relatively small, this finding, combined with other findings related to change orders, indicates that POS's internal controls over contract management—especially related to change orders—needs significant improvement.

Finding 1-E: POS altered contractor invoices to pay a contractor for work that exceeded the maximum contract amount set by law, thus violating state law and the Commission's delegation of authority.

Background

Small Works "Electrical Open Order 2004-MES Contract" (SWV-311608) in the amount of \$185,000 was awarded to Contractor AJ. The contract was signed by the contractor on September 30, 2004, and by POS's CEO on October 18, 2004.

The Small Works Roster Program randomly selects seven contractors for bid invitations but PCS project managers have the option to manually select contractors to add anyone else they would like to have bid on a project. Contractors can also "walk-in" to get the bid information. And, PCS project managers also have the option of letting the computer randomly select seven additional contractors.

Condition

Nine contractors were (according to PCS records) on the list of companies invited to bid on SWV-311608. None of the nine contractors was a walk-in. Contractor AJ was manually added to the list by a PCS project manager. PCS files contain the following Abstract of Bids.

PCS Change Order

PRINT CLOSE WINDOW

Abstract of Bids
Project: Electrical Open Order 2004-MES

Contract Number: SWV-311608 **Estimate:** \$185,000.00
Contract Administrator: [REDACTED] **Bid Open Date:** 08/31/2004
Construction Manager: Varies with project **Advertise Begin:** _____

Walk-In	Contractor	Bid Amount	MWBE	Status
	[REDACTED]		M	INVITED TO BID
	[REDACTED]		M	INVITED TO BID
	[REDACTED]			INVITED TO BID
	[REDACTED]			INVITED TO BID
	[REDACTED]			INVITED TO BID
	[REDACTED]			INVITED TO BID
	[REDACTED]		M	INVITED TO BID
	Contractor AJ Inc.	\$185,000.00		AWARDED
<input type="checkbox"/>	[REDACTED]			INVITED TO BID

Total Contractors: 9 **Total MBE:** 3 **Total MWBE:** 0 **Total Walkin:** 0
Low Bidder: Prime Electric, Inc. **License Number:** [REDACTED] **License Exp:** 01/30/2005
Contract Amount: \$185,000.00 **Other Action Recommended:** _____

The only contractor to submit a bid was Contractor AJ, and Contractor AJ was awarded the 2004 MES contract. PCS contract files contained no evidence that the remaining 8 contractors received the invitation to bid. According to PCS, the computerized system automatically sends

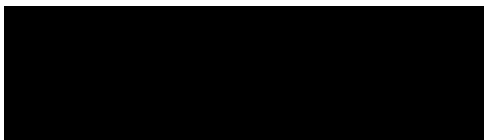
either an email or fax to selected bidders, but no records of this are kept in the procurement files. (Additional information provided by POS in response to our draft findings indicates that POS's electronic systems *may* keep a record of invitations to bid sent by fax, but do not keep a record of invitations to bid sent by email. Additional information provided indicates that 4 of the 9 contractors listed *may* have been sent a fax at 12:22 pm on a Friday requesting bids by 11:00 am the following Tuesday, allowing bidders less than 2 workdays to prepare their bids.)

The bid opening date was August 31, 2004.

Below is a listing of invoices for work that *pre-dated* the date the contract was signed by POS's CEO and *for work actually performed on other contracts*. The invoices below were altered by POS to allocate payments for the invoices to the new contract, SWV-311608. The work per the contractor's invoices was actually performed under the contracts shown in the column entitled "Original Contract Per Invoice."

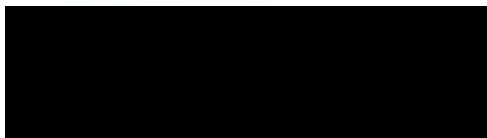
Invoice #	Date	Original Contract Per Invoice	Revised Invoice Billed to Contract	Amount
82145	8/31/2004	SWV-310760	SWV-311608	\$15,023.34
82462	8/31/2004	SWV-310620	SWV-311608	\$9,000.89
82464	8/30/2004	SWV-310620	SWV-311608	\$4,043.81
82465	8/31/2004	SWV-310620	SWV-311608	\$5,160.69
82466	8/31/2004	SWV-310354	SWV-311608	\$5,044.76
82469	8/31/2004	SWV-310354	SWV-311608	\$1,259.77
82470	8/31/2004	SWV-310354	SWV-311608	\$1,500.45
82724	9/27/2004	SWV-310354	SWV-311608	\$12,390.62
82725	9/27/2004	SWV-310354	SWV-311608	\$4,084.27
82726	9/27/2004	SWV-310354	SWV-311608	\$3,142.37
82727	9/27/2004	SWV-310354	SWV-311608	\$445.61
82728	9/27/2004	SWV-310620	SWV-311608	\$14,491.65
TOTAL				\$75,588.23

The above invoices were altered to change the contract numbers and, in some cases, the Work Authorization (WA) numbers that the contractor billed its time under. See the example below.



BILLING ADDRESS:	
PORT OF SEATTLE CONSTRUCTION SERVICES	INVOICE #82470
A [REDACTED]	INVOICE DATE: 8/31/2004
17900 INTERNATIONAL BLVD #420	CLIENT CODE: PORTCO
SEATAC, WA 98188	CUSTOMER REF : 2810
	JOB #03741E
SITE ADDRESS:	
SOUTH SATELLITE GATE S6	
SEATAC AIRPORT	
SEATAC, WA	
WORK DESCRIPTION	
SWV-310354- 311608	
WORK AUTHORIZATION ID #2810- 3679	
PAY APP #3	
PROGRESS BILLING THROUGH 8/8/2004	

As in the case of this invoice example, some of the above-listed invoices included costs for work that was performed before the bid opening date of August 31, 2004. Invoice 82470 (above) was for work performed through August 8, 2004. In the additional example below, the contract number and the WA were revised. The work was performed prior to July 25, 2004, *prior* to the date of the bid opening, and well in advance of the date that the contract was signed by POS and the contractor.



2217
RECEIVED
SEP 01 2004
PORT CONSTRUCTION
SERVICES

BILLING ADDRESS:	
PORT OF SEATTLE CONSTRUCTION SERVICES	INVOICE #82464
[REDACTED]	INVOICE DATE: 8/30/2004
17900 INTERNATIONAL BLVD #420	CLIENT CODE: PORTCO
SEATAC, WA 98188	CUSTOMER REF : 2817
	JOB #03765-C
SITE ADDRESS:	
MES SOUTH SATELLITE	
SEATAC AIRPORT	
SEATAC, WA	
WORK DESCRIPTION	
SWV-310620 311608	
WORK AUTHORIZATION ID #2817 3680	
PAY APP #2	
PROGRESS BILLING THROUGH 7/25/2004	

PCS monitors actual costs compared to the initial Work Request budget, and when necessary (because actual costs exceed the initial budget) a Work Request Revision is prepared. Instead of

preparing Work Request Revisions, these invoices were stockpiled for nearly three months and then paid once the new contract (SWV-311608) was approved.

Criteria

POS Commission Resolution 3181 is a master policy directive that delegates to the POS CEO administrative authority to manage POS. In turn, the POS CEO has redelegated certain administrative authorities to subordinates. Resolution 3181 establishes certain limitations on the authority delegated to the CEO. Among these limitations are limitations on the CEO's authority with respect to the execution of Small Works Roster Program contracts and other contracts. The CEO (and his delegees) may execute such contracts only when statutory procedures are followed and the selection and payment requirements outlined in Resolution 3181 are followed. POS Resolution 3181, IV.B.1., *Small works roster contracts*, provides:

The Executive Director may, without prior Commission approval, execute small works roster contracts where the total estimated contract price does not exceed the amount authorized by RCW 53.08.120, and so long as all statutory procedures are followed and the work is within Authorized Budget Limits. This includes the authority to issue change orders up to the maximum contract amount authorized by RCW 53.08.120.

The maximum amount authorized by RCW 53.08.120 is \$200,000. RCW 53.08.120 requires that:

All such contracts for work, the estimated cost of which exceeds two hundred thousand dollars, shall be let at public bidding upon notice published in a newspaper of general circulation in the district at least thirteen days before the last date upon which bids will be received, calling for sealed bids upon the work, plans and specifications for which shall then be on file in the office of the commission for public inspection.

POS Resolution 3181 does not authorize the CEO or his delegees to make payments to contractors unless all requirements of RCW 53.08.120-135 and all other applicable laws and Port policies have been met (see POS Resolution 3181, V.A.).

Consequently, by paying a contractor monies in excess of the \$200,000 limit without letting “the work at public bidding,” POS violated RCW 53.08.120 as well as Resolution 3181. By making payments to a contractor for work done prior to the award of a contract, POS violated the delegation of authority under Resolution 3181.

Cause

POS personnel failed to discover that WA expenditures exceeded the funds available under the original contracts, thus requiring payment to come from a “new” contract. The process that was described to us was that “work requests are created by PCS and submitted to the project manager for approval of scope, budget and project funding verification.” To the extent that Aviation and Seaport project managers rely on PACT/SPOTS for verification of available project funds, those systems contain inaccurate and outdated information, and the information does not reconcile with the project records or the accounting software in many cases.

Effect or Potential Effect

Costs of \$75,588.23 were paid to the contractor for work that was performed prior to the execution of the contract and for work that was actually performed for other contracts but in excess of contractual and statutory ceilings.

Allowing contractor invoices to overrun existing contract funds placed POS in a position of *needing* to award a follow-on small works contract to the same contractor in order to provide a payment vehicle for the unpaid invoices. This provides an incentive for POS personnel to “steer” new contracts to the old vendor in order to avoid having to disclose that prior contracts were mismanaged.

Recommendations

This finding supports our overarching recommendation regarding appointment of a Chief Procurement Officer, establishment of an independent contract administration function, and revision of the delegations of authority for approving construction management expenditures. In addition, we recommend the following with respect to this finding:

Recommendation 8: We recommend that POS improve its management information systems to provide more accurate and up-to-date information regarding project and contract expenditures. POS should develop a better means for tracking actual project expenditures against initial estimates to prevent unforeseen cost overruns.

Recommendation 9: We recommend that POS develop and include in all contracts a “cost limitation” clause that advises contractors that they should not accept work authorizations or perform any work that would result in exceeding the maximum amount of the contract.

Recommendation 10: We recommend that controls be implemented to prevent specific companies from being added to randomly-generated PCS bid lists by project management personnel.

Recommendation 11: We recommend that POS evaluate all of its PCS contracts during the past three years to determine other instances where the practice of lapping contractor invoices occurred and take appropriate corrective actions.

Recommendation 12: We recommend that POS conduct a more detailed investigation of this contract SWV-311608 to determine how and why the preferred electrical contractor was added to the bid list, contact the other bidders on the list to determine if they were aware of the procurement, and initiate follow up actions as appropriate.

POS Response

The full text of the POS response is provided below. POS agreed with the finding, in part, and stated:

The Port substantially agrees with this finding. Port staff moved invoices for work authorized under one small works contract to another for payment.

But, POS did not agree that actions described in this finding violated Washington law and stated that:

While this conduct violated the Port's internal delegation of authority policy, it did not violate Washington law. The contractor performed the work and was entitled to payment. At the time the work was authorized, Port staff estimated that the cost of the work would be less than the small works contract limit. When the work proved to be more expensive, Port staff should have disclosed the overrun and obtained Commission authorization to amend the small works contract to cover the amounts in excess of the small works contract limit.

Auditors' Additional Comments

The POS response to this finding misrepresents the finding and the facts. POS's explanation that it "moved" invoices from one contract to another infers that only one contract was affected. In fact, POS altered at least 12 invoices to shift costs that had already been incurred on three different open order contracts into the SWV-311608 contract.

POS rationalizes the overruns explaining that "*At the time the work was authorized, Port staff estimated that the cost of the work would be less than the small works contract limit.*" The "work" authorized under an open order contract may include numerous different projects. PCS's explanation would require that cost estimates had been prepared on every project under a Small Works Roster Program contract; the PCS contract files do not contain cost estimates for each project that is authorized under a single open order contract. We believe that the contract cost overruns stem from PCS's inadequate contract administration and oversight of small works contracts and its failure to adequately monitor individual project cost expenditures during the contract period.

POS disagrees that it violated Washington law but admits that it allowed work to be performed "*in excess of the small works contract limit.*" We believe POS violated Washington law when it authorized work to be performed that cost in excess of the contract limit amount (which limit is set at \$200,000 under RCW 53.08.120). And, we believe that POS also violated the law when it intentionally shortened the required RCW stated bid period from 13 days to two days, thereby limiting competition in order to ensure that a particular contractor would likely be the only contractor to bid. POS intentionally steered the award of the SWV-311608 contract to the favored contractor [Contractor AJ] to conceal that it had violated state law contract limits on Contractor AJ's other contracts.

Audit Finding 2: POS Frequently Circumvented Competition Requirements in Violation of Its Own Policies and Sometimes in Violation of State Law

Finding 2-A: POS circumvented competition requirements by awarding contracts at “less competition required” levels and then amending the contracts to higher levels, split purchases, and awarded sequential no-competition contracts.

Background

Washington State law requires (with some exceptions) full and open competition for the procurement of “contracts for work” in excess of \$200,000, with contracts to be awarded to the lowest bidders.² POS has interpreted this requirement to mean that “contracts for work” only pertains to construction contracts, not consulting or other services contracts *associated* with construction. POS believes that it “enjoys substantial flexibility in how it elects to accomplish the purposes for which it exists under Title 53 of the Revised Code of Washington.” Thus POS believes that it is allowed to award contracts for professional and other consulting services, regardless of magnitude, without competition, unless the services are for the procurement of architectural and engineering (A/E) services.³ (POS also applies a very narrow definition of what services are actually A/E services.) Under Washington state law, when procuring A/E services, full and open competition is required, but the procuring agency or municipal government is authorized to enter into price negotiations with the professional services firm deemed most qualified. The procurement policies for consulting services (both A/E and other consulting services) adopted by POS (a) allow sole source (no competition) contracts of up to \$50,000, (b) require limited competition for contracts between \$50,001 and \$200,000, and (c) require full and open competition for contracts in excess of \$200,000.⁴

Our evaluation of numerous professional services procurements revealed that POS regularly circumvents these competition requirements through a variety of techniques and means.

Condition

To evaluate the possibilities of competition avoidance from a global perspective, we performed a Benford’s Law⁵ analysis on PSA award amounts. Benford’s Law is an analytical review procedure designed to identify errors, potential fraud, and other irregularities. The premise of Benford’s Law is that initial digits in a population of normally-occurring numbers display a predictable pattern. Benford’s Law demonstrates that a number in a data set is more likely to begin with a smaller digit (i.e. *1*, *12*, *134*, *1268*, etc) than a larger digit (i.e. *9*, *95*, *978*, *9823*, etc). Anomalies from the predicted norm should be investigated.

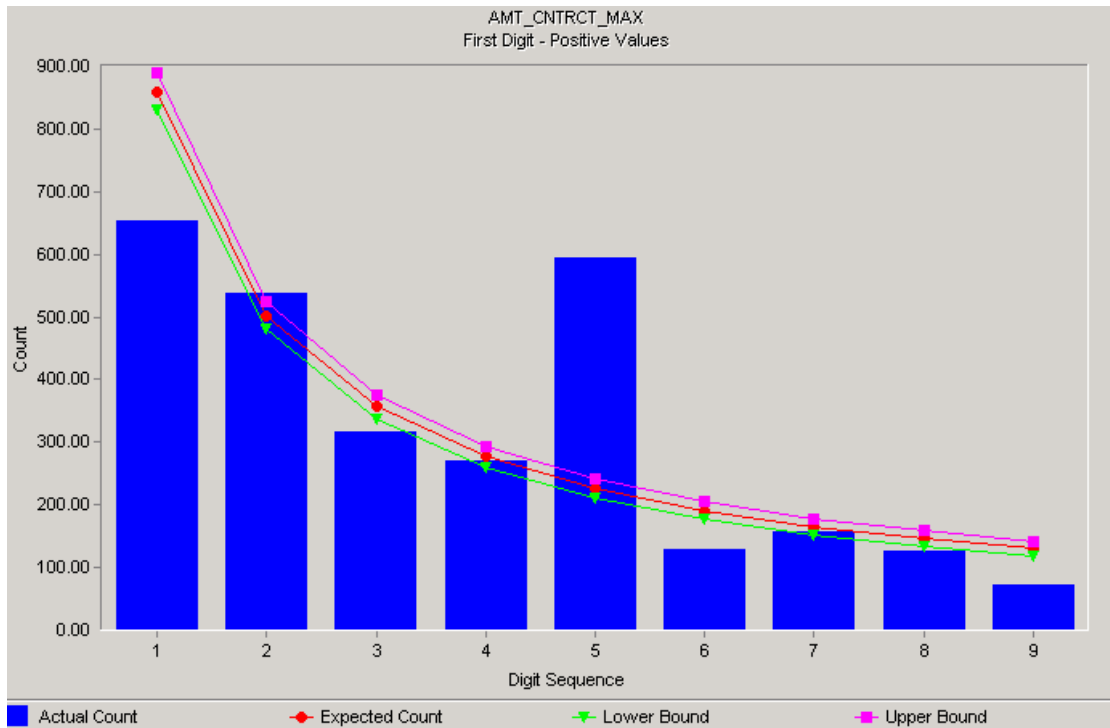
The Benford’s Law curve of PSA award amounts during our audit period is as follows:

² See [RCW 53.08.120](#), *Contracts for labor and material — Small works roster*.

³ See [RCW 39.80](#), *Contracts for architectural and engineering services*.

⁴ See [POS Policy PUR-2](#), *Consultant Procedures*.

⁵ See [Digital Analysis Using Benford’s Law](#), by Mark J. Nigrini.



As this graph demonstrates, POS awards an inordinate number of PSAs with amounts beginning with the digits 2 and 5. This corresponds with awards of \$200,000 and \$50,000, indicating attempts to avoid the greater-competition requirements associated with PSAs of larger amounts. We performed additional testing of specific data in order to verify these analytical results.

In 262 cases we evaluated, according to POS's accounting records, the initial contract was awarded in one competition category, but with amendments,⁶ the contracts moved into a higher competition category:

Condition	No. of PSA	Amend. ≤ \$30,000; allowable per PUR-2	Amend. > \$30,000; Exception Noted
A/1 vs. B/2	228	202	26
A/1 vs. C/3	5	-	5
B/2 vs. C/3	22	10	12
Wrong Category	7	-	7
Grand Total	262	212	50

As noted above, for 50 of 262 of these procurements, amendments elevated the contracts beyond even the amended levels of funding allowed for the competition level under which they were procured. (In some of these instances, it appears that the procurements may have had the correct level of competition, but POS may have recorded the wrong category in its PeopleSoft system.

⁶ PUR-2 allows amendments of no more than \$30,000 above the \$50,000 and \$200,000 limits.

We sought clarification of this possibility, but POS's responses were inconclusive or vague in most cases.)

For 212 of 262 of the procurements noted above, the contracts were *technically* allowable (per PUR-2, paragraph V, which allows amendments of up to \$30,000 above the competition threshold). However, the Port frequently used no-competition procurements, amended them upward by \$30,000; and then awarded new no-competition PSAs to the same contractor. This purchase-splitting process circumvents the spirit and intent of the consultant selection requirements. Several examples follow.

- PV-0310504 was awarded, without competition, to Consulting Company A to obtain the services of Consultant RLG for a 1-year period (9/8/03 – 9/8/04).⁷ It had an initial PSA amount of \$25,000. It was amended upward by \$25,000 on 1/14/04 and then again by \$30,000 on 7/21/04. The total contract amount therefore became \$80,000. Following that, another no-competition PSA (P-00311682) was awarded to Consulting Company A to obtain the services of this same consultant (RLG) for another 1-year period (10/8/04 – 12/31/04). That PSA had an initial amount of \$50,000. It was then amended upward by \$30,000 on 12/7/04, bringing the total contract amount to \$80,000. On 1/10/2005, another no-competition PSA (P-00312071) was awarded for \$50,000 to Consulting Company B. Consulting Company B has the same mailing address as Consulting Company A. The services provided by Consulting Company B were construction support services, with Consultant RLG as the designated project manager. That PSA was amended upward by \$30,000 via amendment No. 1, dated 5/10/2005, bringing the total PSA amount to \$80,000. Another no-competition PSA (P-00312617) was awarded for \$50,000 to Consulting Company C on 7-1-2005. That PSA provided that “[Consultant RLG] will provide inspection construction support services” That PSA was amended upward by \$30,000 on 10/24/2005, bringing the total amount to \$80,000. From September 2003 through December 2005, Consultant RLG (or companies with which he was affiliated) received \$320,000 via four no-competition PSAs. (RLG continues to work as a consultant to POS as an employee or sub-subconsultant of Consulting Company D, a subconsultant under another major consulting contract with Company E.)
- PV-0309614 was awarded, without competition, to obtain the services of Company H for a 1-year period (1/16/03 – 1/16/04). It had an initial PSA amount of \$50,000. It was amended upward by \$29,900 on 4/28/03, bringing the total contract amount to \$79,900. Following that another no-competition PSA (PV-0310918) was awarded to continue the services of this contractor (from 4/7/04 – 8/1/04). That new PSA had an initial amount of \$50,000. It was amended upward by \$29,900 on 5/24/04, bringing the total contract amount to \$79,900. This company received \$159,800 via no-competition PSAs.

⁷ The services of RLG were obtained noncompetitively even earlier (as a subconsultant to Consulting Company F, which was, in turn, a subconsultant to Consulting Company G, the architectural engineering firm on the Aircraft Fueling System project). In Amendment 8 to Company G's A/E PSA (P-00303357), dated October 15, 2002, RLG is listed in the subconsultant section of Company F's rate sheet as “[RLG] (Contract).” RLG's rate is listed as \$75 per hour. RLG's services were continued via Amendments 11 and 12 to the Company G PSA.

- P-00312599 was awarded, without competition, to obtain the services of Consulting Company I for an 18-month period (6/22/05 – 12/31/06). It had an initial PSA amount of \$50,000. It was amended upward by \$30,000 on 1/6/06, bringing the total contract amount to \$80,000. Following that, another no-competition PSA (P-00313552) was awarded to the same contractor for another 18-month period (6/21/06 – 12/31/07). That PSA had an initial PSA amount of \$50,000. It was amended upward by \$30,000 on 2/2/07, bringing the total contract amount to \$80,000. This company received \$160,000 via no-competition PSAs.
- P-00310619 was awarded, without competition, to obtain the services of Consultant RFH for a 14-month period (11/1/03 – 12/31/04). It had an initial PSA amount of \$50,000. It was amended upward by \$30,000 on 7/26/04, bringing the total contract amount to \$80,000. Following that, another no-competition PSA (P-00312043) was awarded to the same contractor to extend the services for another year (1/1/05 – 12/31/05). That PSA had an initial amount of \$30,000. It was amended upward three times: by \$30,000 on 5/9/05; by \$10,000 on 8/3/05; and by \$10,000 on 1/6/06, bringing the total contract amount to \$80,000. This consultant received \$160,000 via no-competition PSAs.
- PV-0309536 was awarded, without competition, to obtain the services of Consulting Company J for a 13-month period (1/1/03 – 1/31/04). It had an initial amount of \$50,000. It was amended upward by \$30,000 on 12/10/03, bringing the total contract amount to \$80,000. Following that, another no-competition PSA (P-00311869) was awarded to the same contractor to extend the services for another year (1/1/04 – 12/31/05). That PSA had an initial amount of \$35,000. It was amended upward twice: by \$30,000 on 8/23/04 and by \$15,000 on 3/1/05, bringing the total contract amount to \$80,000. This consultant received \$160,000 via no-competition PSAs.

POS also awards multiple and overlapping no-competition PSAs to the same vendors. We identified 288 vendors that had two or more Category A/1 (no-competition) PSAs with the Port. In total, there were 1,330 no-competition PSAs awarded to these vendors. In addition, 19 of 288 vendors had ten or more no-competition PSAs with the Port. Each of these 19 vendors had two or more no-competition contracts awarded by the same POS department.

Vendor	PSAs
K	40
L	18
M	13
D	15
N	44
O	17
P	11
Q	20
R	10
S	10
F	16
T	12
U	15
V	44

W	17
X	19
Y	11
Z	20
G	12
19 Vendors	364

We also noted instances in which purchases were split in order to circumvent POS's competition requirements. Examples follow.

- Consulting Company AA received three separate no competition PSAs with the Seaport for disposal of three cranes. Each of these no-competition PSAs had initial contract amounts of \$50,000, and the period of performance was from April 2004 to Dec. 31, 2005 under each of the three contracts.
- During a 24-month period (April 2005 to March 2007), Consulting Company N received 44 Category A (no-competition) PSAs for IT services, with total funding of \$1,178,440.
- During the same 24-month period (April 2005 to March 2007), Consulting Company V received 43 Category A (no competition) PSAs for IT services, with total funding of \$1,530,648.

In addition to these clear-cut examples of no-competition purchase-splitting and sequential no-competition awards, we noted numerous other instances of probable violations of State and POS competition requirements. Examples include the following:

- P-00306927 was awarded, without competition, in an initial amount of \$50,000, but later grew to \$410,051.82. We asked POS for an explanation, and POS stated that this contract was "initially [sic] awarded as a category 1, this was extended due to legal issue...." We asked what the legal issue was and under what authority PUR-2 procedures were ignored. POS stated that "this firm had a [sic] agreement to share in cost savings that were identified due to process they implemented to reduce our waste system. They felt this savings would continue over time and that payments to them would continue (not a one-time realization). The Port disagreed and I recall that we extended their contract for a number of years until the issue was resolved." This explanation does not justify POS's violation of the competition requirements and POS has not cited an authority for this failure to comply with PUR-2.
- P-00307507 was listed in POS accounting records as a Category 1 (no competition) procurement with an awarded amount of \$20,000. Its funding grew to \$298,299.00. We asked POS for an explanation, and POS stated that this was "initially issued as a category 1 due to earthquake assessment see attached commission declaration of emergency commission meeting 03/13/2001." We obtained and reviewed the contract file and noted that this contract was actually awarded on 8-14-01—5 months after the earthquake and resulting emergency declaration by the Commission. The agreement form used was for agreements valued at more than \$50,000. There was no evidence of competition in the file. The contract was amended 14 times thru at least September 2002—19 months after the emergency. Most modifications do not appear to have been emergency-related. For example, a May 2002 task was for "coordination of development of environmental specifications detailing work associated with contaminated soils and ground water" and

"provide Senior Design Engineer staff to facilitate review of the non-[Company U] work associated with the Terminal 5 Earthquake Repairs." We inquired again of POS, and POS revised its explanation to indicate that this was not an emergency procurement after all and provided an advertisement dated July 12, 2001, indicating that the procurement may have been done under PUR-2's category 3. No evidence of the competitive selection process was provided, however. It remains unclear whether this procurement was made in conformity with PUR-2 procedures.

- P-00311760 was awarded using Category A (no competition) procedures, according to PeopleSoft records, with an initial amount of \$50,000. Its funding grew to \$454,950.00. The contract file contained an advertisement dated June 25, 2004, but the contract was awarded 11 months later, on May 20, 2005, and the contract file contained no evidence that a competitive selection process was followed. Following our audit inquiries about this procurement, POS stated that this contract was, in fact, the result of a competitive procurement and stated that "the Port has now prepared a Consultant Selection Process Certificate reflecting this fact."
- PV-0306666 was awarded using Category A (no competition) procedures, according to PeopleSoft records, with an initial amount of \$25,000. Its funding grew to \$1,113,106.00. We asked POS for an explanation, and POS stated that this was "initially issued as a category 1 due to earthquake assessment see attached commission declaration of emergency commission meeting 03/13/2001." Commission Resolution 3181 provides that:

*When any emergency shall require the immediate execution of a contract for work, the Executive Director, pursuant to the procedures of RCW 39.04.020, is authorized to make a finding of the existence of such emergency and execute any contracts necessary to respond to the existing emergency, **provided that the Executive Director shall, at the first Port Commission meeting following the Executive Director's finding of the existence of an emergency, request Port Commission ratification of the finding of emergency and any contracts awarded and/or executed pursuant to that finding.** The Executive Director shall keep the Port Commission informed of the development of the emergency situation and the progress of any contracts executed to remedy the emergency.*
[Emphasis added.]

POS did not request approval of this sole-source \$25,000 contract at the first Port Commission meeting (March 13, 2001) following the executive director's finding of an emergency. POS provided Commission meeting minutes dated May 8, 2001, indicating that a \$150,000 contract with this same contractor was presented for approval in connection with the earthquake. POS has not provided evidence that the Commission was informed (a) of the ultimate size (\$1,113,106.00—44 times its award amount and 7 times the amount of which the Commission was made aware) of this sole source contract, or (b) that this "emergency" contract remained active for 3 years and 7 months beyond the emergency.

- P-00307510 was awarded using Category B (limited competition) procedures, according to PeopleSoft records. The initial award amount was \$75,272.00. Its funding grew to \$5,846,112. The contract file contained no evidence of competition. We asked POS for an explanation, and POS stated that this was actually procured using Category C (full and open competition) procedures. POS provided a copy of an advertisement dated April 28 and April 30, 2001. (Other information POS provided indicated that a consultant served on the selection panel for this procurement. The awardee for P-00307510 was a subcontractor to this consultant's firm under another POS contract. POS has indicated that it has no policy prohibiting such conflict of interest situations.)
- P-00310953 was awarded using Category 2 (limited competition) procedures, according to PeopleSoft records. The initial award amount was \$200,000. Its funding grew to \$600,000—three times the Category 2 limit. The scope of services was to “develop and execute a federal government relations strategy ...; provide general business and governmental consulting; monitor federal legislative and regulatory activity ...; coordinate and attend meetings ...; provide regular and frequent feedback ...; provide office space and logistical support during Washington, DC visits.” We asked POS for an explanation for exceeding the Category 2 ceiling requirement, and POS stated that this was “issued as a 2, Contract executed by CEO, renewed by CEO, copy of Contract available for review.” We followed up and asked POS what the significance was that the “Contract [was] executed by [the] CEO, [and] renewed by [the] CEO.” We also pointed out that although the CEO signed an amendment increasing the contract from \$200,000 to \$400,000, the CEO did not sign the amendment increasing the contract from \$400,000 to \$600,000. We also asked for supporting documentation evidencing that this procurement utilized a competitive selection process. POS's response was “I have no additional information.” POS subsequently stated that:

The procurement of the services for representative legislation is not subject to any purchasing policy or statute. ... Services for representative legislation are commonly referred to as lobbying. These services would have been approved by the Port Commission as part of the annual budget for the Government Relations department.

Following completion of our fieldwork, POS found and provided documentation indicating that this was, after all, a competitive procurement and pointed out that although it was competitive, it did not need to be, because POS policies exempt “representative legislation” from POS-adopted competition requirements.

- P-00311530 was awarded using Category B (limited competition) procedures, according to PeopleSoft records. The initial award amount was \$100,000. Its funding grew to \$1,120,793.00. We asked POS for an explanation, and POS stated that “No, Cat C, documentation provided.” The documentation provided indicated that an entirely different contractor had been selected than the contractor named in PeopleSoft records. We asked POS for an additional explanation, and POS stated that the contractor selected using the competitive process had initially been awarded the contract, but had been

terminated “after a short period of time and [the new contractor] was selected to replace. [The new contractor] as you will note was one of the firms shortlisted in the evaluation process.” Although the new contractor had been one of 6 firms listed on the selection process certificate, POS did not explain why it was selected over the remaining 4 firms, and the 6 firms were not ranked beyond the firm originally selected. POS followed up and provided a “scoring sheet” showing that a third contractor actually had the best score among 6 offerors. Scores for 2 offerors had been altered without contemporaneous explanation resulting in a different outcome. POS stated that:

The Port of Seattle acknowledges that this spreadsheet is less than clear. The numbers reflected on the right reflect the preliminary rankings of the consultants prior to the final meeting of selection panel. At that final meeting, two of the members – based on the discussions of the selection panel – elected to change their individual rankings, but the final, average scores were not recalculated on the spreadsheet. When calculated considering these revisions, the party named in the Consultant Selection Process Certificate and the contractor in fact awarded the work under the referenced contract were tied for the highest score of 2.33.

- P-00302927 was awarded on January 5, 2004, using Category 1 (no competition) procedures, according to PeopleSoft records. The initial award amount was \$100,000. Its funding grew to \$229,500. A second contract, P-00309368, was awarded to the same contractor on February 9, 2004, also using Category 1 (no competition) procedures, according to PeopleSoft records. The initial award amount was \$67,500. Its funding grew to \$230,000.00. We asked POS for explanations. POS initially provided nothing to explain the first procurement, P-00302927. With respect to P-00309368, POS stated that “department extended contract from previous award/selection memo provided.” We asked POS for further clarification about both procurements. POS provided selection memos dated December 22, 2003, and January 26, 2004, indicating that Category 2 (limited competition) procedures may have been followed. It appears, however, that the services were split into two separate procurements in order to avoid PUR-2’s full and open competition requirements. POS later acknowledged that “these contracts do not comply with Port purchasing policy PUR-2.”
- P-00308735 was awarded using Category B (limited competition) procedures, according to PeopleSoft records. The award amount was \$240,000 (\$40,000 above the Category B limit). We asked POS for an explanation, and POS stated that the “the original selection [sic] of [another contractor] was reassigned to several sub-consultants to balance workload” POS has provided no evidence that any competitive process was followed in awarding this \$240,000 contract. In addition, documentation provided by POS in response to our questions about this procurement indicated that POS also awarded another contract, for \$345,000, to another contractor with no evidence of competition. POS later acknowledged that “this contract was not let in strict compliance with Port purchasing policy PUR-2.”

- P-00310481 was awarded using Category A (no competition) procedures, according to PeopleSoft records. The award amount was \$222,186 (\$172,186 above the Category A limit). We asked POS for an explanation, and POS stated that “No Cat C, Ad and Selection Certificate not located which was noted in file. PSA: Category C procedure was followed.” POS also provided a copy of an advertisement dated January 31, 2000. But, according to PeopleSoft records, this contract began more than 3 years later, on March 1, 2003. POS later provided documentation indicating that the procurement had not been based on or associated with the advertisement dated January 31, 2000, but rather the 2003 sole source contract award was based on a 1998 selection process. POS also said that “the procurement of these services for ‘juvenile salmon and inter-tidal habitat evaluation’ is not subject to any requirement of the Revised Code of Washington.”
- P-00311817 was awarded using Category 2 (limited competition) procedures, according to PeopleSoft records. The award amount was \$217,590 (\$17,590 above the Category 2 limit). We asked POS for an explanation, and POS said “see King County Public Art Program Selection Summary.” We asked POS to explain why the King County Public Art Program would justify deviating from the competition requirements of PUR-2. POS stated that “documents provided the process in place for artist selection. This process is consistent with PUR-2 Policy.” POS provided a copy of the Port of Seattle Art Program Guidelines. These guidelines are, in fact, “consistent with PUR-2.” They provide for three levels of competition: “Open Competition,” “Invitational or Limited Competition,” and “Direct Selection.” The Guidelines do not, however, provide for a deviation from PUR-2’s requirements. This procurement required full and open competition, and POS violated PUR-2 in making this award.

Criteria

Washington State Law, RCW 53.08.120, Contracts for labor and material, provides that:

All material required by a port district may be procured in the open market or by contract and all work ordered may be done by contract or day labor. All such contracts for work, the estimated cost of which exceeds two hundred thousand dollars, shall be let at public bidding upon notice published in a newspaper of general circulation in the district at least thirteen days before the last date upon which bids will be received, calling for sealed bids upon the work, plans and specifications for which shall then be on file in the office of the commission for public inspection. The same notice may call for bids on such work or material based upon plans and specifications submitted by the bidder. The competitive bidding requirements for purchases or public works may be waived pursuant to RCW [39.04.280](#) if an exemption contained within that section applies to the purchase or public work.

RCW 39.04.280, Competitive bidding requirements — Exemptions, provides:

... uniform exemptions to competitive bidding requirements utilized by municipalities when awarding contracts for public works and contracts for purchases. The statutes governing a specific type of municipality may also

include other exemptions from competitive bidding requirements. The purpose of this section is to supplement and not to limit the current powers of any municipality to provide exemptions from competitive bidding requirements.

(1) Competitive bidding requirements may be waived by the governing body of the municipality for:

- (a) Purchases that are clearly and legitimately limited to a single source of supply;*
- (b) Purchases involving special facilities or market conditions;*
- (c) Purchases in the event of an emergency;*
- (d) Purchases of insurance or bonds; and*
- (e) Public works in the event of an emergency.*

RCW 39.30.020, *Contracts requiring competitive bidding — Violations by municipal officer — Penalties*, provides that:

In addition to any other remedies or penalties contained in any law, municipal charter, ordinance, resolution or other enactment, any municipal officer by or through whom or under whose supervision, in whole or in part, any contract is made in wilful and intentional violation of any law, municipal charter, ordinance, resolution or other enactment requiring competitive bidding upon such contract shall be held liable to a civil penalty of not less than three hundred dollars and may be held liable, jointly and severally with any other such municipal officer, for all consequential damages to the municipal corporation. If, as a result of a criminal action, the violation is found to have been intentional, the municipal officer shall immediately forfeit his office. For purposes of this section, "municipal officer" shall mean an "officer" or "municipal officer" as those terms are defined in RCW [42.23.020](#)(2).

RCW 39.80.040, *Procurement of architectural and engineering services — Submission of statement of qualifications and performance data — Participation by minority and women-owned firms*, requires that:

In the procurement of architectural and engineering services, the agency shall encourage firms engaged in the lawful practice of their profession to submit annually a statement of qualifications and performance data. The agency shall evaluate current statements of qualifications and performance data on file with the agency, together with those that may be submitted by other firms regarding the proposed project, and shall conduct discussions with one or more firms regarding anticipated concepts and the relative utility of alternative methods of approach for furnishing the required services and then shall select therefrom, based upon criteria established by the agency, the firm deemed to be the most highly qualified to provide the services required for the proposed project. Such agency procedures and guidelines shall include a plan to insure that minority and women-owned firms are afforded the maximum practicable opportunity to compete for and obtain public contracts for services. The level of participation by minority and women-owned firms shall be consistent with their general availability within the professional communities involved.

POS Policy, PUR-2, Consultant Procedures, Paragraph IV., Summary Chart, establishes the following competition requirements for procuring consulting services:

<u>Architectural/Engineering Services</u>		
<u>Category A</u>	<u>Category B</u>	<u>Category C</u>
1) Fee ≤ \$50,000	>\$50,000 Fee ≤ \$200,000	Fee > \$200,000
2) Select Consultant from Files	Select Consultant from Files	Advertisement
3) Interview not Required	Interview 3 Firms	Request for Qualifications (RFQ) Interview Process
4) Short Form Agreement	Standard Agreement	Standard Agreement
<u>Non-Architectural/Engineering Services</u>		
<u>Category 1</u>	<u>Category 2</u>	<u>Category 3</u>
1) Fee ≤ \$50,000	>\$50,000 Fee ≤ \$200,000	Fee > \$200,000
2) Select Any Consultant	Select Three Consultants	Advertisement
3) Interview not Required	Interview	RFQ/Interview Process
4) Short Form Agreement	Standard Agreement	Standard Agreement

Best Practices for procurement of goods and services establish that:

The benefits of competition are well established. Competition saves money for the taxpayer, improves contractor performance, curbs fraud, and promotes accountability for results. –May 31, 2007, memorandum to Chief Acquisition Officers from the Office of Management and Budget.⁸

In addition, the **State of Washington Joint Legislative Audit and Review Committee** stated that:

The primary purpose of the competitive bidding requirement is to prevent fraud, collusion, and favoritism by public officials and to obtain the best work at the most

⁸ [see: http://www.whitehouse.gov/omb/procurement/comp_contracting/competition_memo_053107.pdf]

*reasonable price. The open competitive process satisfies this by making the selection process transparent to the public.*⁹

Federal Regulations

In addition to the above criteria, Federal Regulations apply to 3rd Runway and related facility procurements, as well as other Federal grant programs. POS has received at least \$288 million of United States Department of Transportation grants since 1999 for work related to the 3rd Runway and related facilities. Each grant stipulates that grant funds cannot be used for “any costs determined by the FAA to be ineligible for consideration as to allowability under the provisions of the Act.” POS has received more than \$105 million in Federal program funds from other agencies.

The applicable Federal Regulations for the 3rd Runway grants are Title 49 USC Section 47110, *Allowable Project Costs*, and Title 49 USC Part 18, *Uniform Administrative Requirements for Grants and Cooperative Agreements to State and Local Governments*.¹⁰

49 USC Sec. 47110(b) stipulates that:

A project cost is allowable-- ... if the cost is ... consistent with all applicable statutory and administrative requirements ...

49 USC Part 18, Subpart C, Section 18.36, *Procurement*, stipulates that:

grantees and subgrantees must comply with the following requirements:

(c) *Competition.*

(1) All procurement transactions will be conducted in a manner providing full and open competition consistent with the standards of Sec. 18.36. Some of the situations considered to be restrictive of competition include but are not limited to:

- (iv) Noncompetitive awards to consultants that are on retainer contracts,*
- (vii) Any arbitrary action in the procurement process.*

(3) Grantees will have written selection procedures for procurement transactions. These procedures will ensure that all solicitations:

- (i) Incorporate a clear and accurate description of the technical requirements for the material, product, or service to be procured....*
- (2) Identify all requirements which the offerors must fulfill and all other factors to be used in evaluating bids or proposals.*

(d) *Methods of procurement to be followed*

(3) Procurement by competitive proposals. The technique of competitive proposals is normally conducted with more than one source submitting an offer, and either a fixed-price or cost-reimbursement type contract is awarded. It is generally used when conditions are not appropriate for the use of sealed bids. If this method is used, the following requirements apply:

⁹ See Report 05-9, *An Assessment of General Contractor/Construction Manager Contracting Procedures*, June 22, 2005.

¹⁰ Similar cost allowability requirements and identical administrative requirements are applicable to grants from other Federal agencies.

- (i) Requests for proposals will be publicized and identify all evaluation factors and their relative importance. Any response to publicized requests for proposals shall be honored to the maximum extent practical;*
- (ii) Proposals will be solicited from an adequate number of qualified sources;*
- (iii) Grantees and subgrantees will have a method for conducting technical evaluations of the proposals received and for selecting awardees;*
- (iv) Awards will be made to the responsible firm whose proposal is most advantageous to the program, with price and other factors considered; and*
- (v) Grantees and subgrantees may use competitive proposal procedures for qualifications-based procurement of architectural/engineering (A/E) professional services whereby competitors' qualifications are evaluated and the most qualified competitor is selected, subject to negotiation of fair and reasonable compensation. The method, where price is not used as a selection factor, can only be used in procurement of A/E professional services. It cannot be used to purchase other types of services though A/E firms are a potential source to perform the proposed effort.*
- (4) Procurement by noncompetitive proposals is procurement through solicitation of a proposal from only one source, or after solicitation of a number of sources, competition is determined inadequate.*
 - (i) Procurement by noncompetitive proposals may be used only when the award of a contract is infeasible under small purchase procedures, sealed bids or competitive proposals and one of the following circumstances applies:*
 - (A) The item is available only from a single source;*
 - (B) The public exigency or emergency for the requirement will not permit a delay resulting from competitive solicitation;*
 - (C) The awarding agency authorizes noncompetitive proposals; or*
 - (D) After solicitation of a number of sources, competition is determined inadequate.*
 - (ii) Cost analysis, i.e., verifying the proposed cost data, the projections of the data, and the evaluation of the specific elements of costs and profits, is required.*
 - (iii) Grantees and subgrantees may be required to submit the proposed procurement to the awarding agency for pre-award review in accordance with paragraph (g) of this section.*
- (f) Contract cost and price.***
 - (1) Grantees and subgrantees must perform a cost or price analysis in connection with every procurement action including contract modifications.*

Cause

POS non-construction contracts are not procured or administered using trained and professional contracting personnel responsible for protecting the integrity of the procurement process and assuring that contractual provisions are enforced and adhered to. Instead, PSA contracts are procured and administered by POS project management and engineering personnel who work directly with consultant personnel whose services are being procured.

In addition, PUR-2 contains a loophole that allows POS project and construction management personnel to avoid legal review of amendments when the initial PSA award is in Category 3 or Category C.

We were unable to determine within the scope of this audit if competition requirements are being circumvented in order to avoid the additional time and effort that competition requires, or in order to direct work to favored vendors. The latter cause is a distinct possibility.

Effect or Potential Effect

The circumvention of competition requirements inevitably results in higher costs for services and creates situations where the highest quality and value of services obtained cannot be assured.

The circumvention of competition requirements also conveys a message to the consultant and contractor community that the POS procurement process is not a fair one. This results in even further limitations on the amount of competition POS gets when it procures goods and services.

Because Federal funds are being used for 3rd Runway Project efforts and other projects, POS faces the potential for the disallowance of substantial grant costs and the need to return this money to the Federal government.¹¹

In addition, the manner in which PSAs are being procured allows for significant risk of fraud and abuse. There are no controls in place to prevent a variety of fraud schemes characterized by bribes, kickbacks, and illegal gratuities. Such schemes are very difficult to detect and, therefore, this type of illegal activity may be occurring without POS awareness.

Recommendations

This finding supports our overarching recommendation regarding appointment of a Chief Procurement Officer, establishment of an independent contract administration function, and revision of the delegations of authority for approving construction management expenditures. In addition, we recommend the following with respect to this finding:

Recommendation 13: We recommend that POS take immediate steps to review and enforce its policies and procedures for awarding PSA contracts and establish controls to ensure that competition requirements are not circumvented.

¹¹ POS's Single Audit Report for the year ended December 31, 2004, contained a reportable condition, as follows:
***Condition**—Individuals responsible for preparation and review of claims submitted for reimbursement are not familiar with authoritative literature related to allowable costs and activities for federal awards, such as the OMB Circular No. A-87 and the 49 CFR Part 18. These requirements apply to all awards and grants received from the federal government.*
***Effect**—Lack of knowledge of the regulatory requirements of OMB Circular No. A-87 and the 49 CFR part 18 pose a risk of noncompliance with the grant agreements and failure to receive timely reimbursements from the federal agency.*

Recommendation 14: We recommend that POS initiate a comprehensive review of all PSAs to determine the full extent to which competition requirements have been circumvented, and take appropriate corrective actions.

Recommendation 15: We recommend that POS revise PUR-2 to incorporate a limit on the size allowed for amendments to Category 3 and Category C contracts so that a legal review becomes necessary before a contract is allowed to exceed a specified limit. That review should be designed to assure that:

- 1. The project scope of work is not being divided into smaller segments to avoid PUR-2, statutory, or delegation of authority procedures.*
- 2. The increased amended consultant responsibilities are generally related or associated with the project scope utilized in the original consultant selection.*

Recommendation 16: We recommend that POS (a) determine the extent to which costs in violation of Federal grant requirements have been claimed for reimbursement and received from DOT and other Federal agencies, (b) notify applicable Federal grant officers of these violations, and (c) initiate corrective actions prescribed by Federal officials.

POS Response

The full text of the POS response to this finding is in Appendix E. POS stated that:

The Port acknowledges that there have been instances in which it has violated its own procurement policies. Although many of the specific examples listed reflect inadequate documentation rather than an absence of competition, Port staff has sometimes failed to meet the requirements of its purchasing policies in the manner indicated by the Performance Auditor. ...

The Port does not, however, believe the problems are as prevalent as indicated in the finding. For example, the Performance Auditor relied on raw data from the PeopleSoft Financial System to indicate the level of competition in selecting consultants. PeopleSoft is the Port's financial accounting and project costing information system. The data in this system is not designed to document the level of competition utilized with respect to a particular contract; that information must be obtained from the actual contract files.

Auditors' Additional Comments

We disagree that "many of the specific examples" in this finding merely reflect poor documentation rather than circumvention of competition requirements.

We also disagree that the examples cited in this finding *only* evidence POS failures to follow its own policies rather than violations of State law. POS has argued consistently that the *only* professional services procurements it is *required* to compete are for A/E services. Several of the examples in this finding are procurements of A/E services, including examples where such services were procured without competition.

We also disagree that the possible fact that information in the POS PeopleSoft Financial System is inaccurate means that these problems are not as prevalent as the finding indicates. If the data in the PeopleSoft Financial System are inaccurate as POS asserts, it would possibly mean that these problems are *more* prevalent than the finding indicates.

Finding 2-B: A consulting agreement awarded in 1993 grew without competition from \$950,000 to more than \$30 million.

Background

POS awarded an A/E contract in 1993 and has amended that contract at least 120 times over the past 14 years to include services beyond those included in the original prospectus for the work or in the initial contract. This contract has grown, without competition, from \$950,000 to more than \$30 million.

Condition

A/E Firm F was awarded a contract to perform a “Preliminary Engineering Study for a Third Dependent Runway” on October 1, 1993, fourteen years ago. The original not-to-exceed amount of the contract was \$950,000. Over the past 13 years, POS has amended the contract at least 120 times, increasing its value to \$30,297,468, without competition. The contract remains active.

According to the 1993 prospectus for services (titled *Prospectus for Outside Services for Preliminary Engineering for a Third Dependent Runway at Seattle-Tacoma International Airport*), the contract was to include:

... all required professional services to perform a detailed study and development of conceptual plans for the addition of a third dependent runway at Sea-Tac. The consultant's tasks shall be as follows :

- 1. Research/Review of Port, County, City and State records as required.*
- 2. Development of topographic maps of the current and future airport property.*
- 3. Development of a detailed planning analysis to determine and optimize the third runway location, length, elevation, and the location and geometry of the connecting taxiways, and related facilities.*
- 4 . Development of a detailed preliminary airfield improvement plan detailing the proposed runway, connecting taxiways, and related improvements.*
- 5. Development of a preliminary airport area plan detailing the proposed third runway with related improvements and required relocations within Port property as well as the surrounding area.*
- 6. Preliminary analysis and development of alternatives for sources of fill material within and outside Port property.*
- 7. Perform preliminary geotechnical and hydrological investigation and analysis as required.*
- 8. Analysis of existing Navigational Aids required to be relocated and new Navigational Aids necessary for CAT 111-B capability of the new runway.*
- 9. Development of alternatives for the runway construction including a value engineering analysis.*
- 10. Preliminary analysis of alternatives for attenuation of noise from the proposed runway through the use of berms or barriers.*
- 11. Presentation/Coordination/Review meetings with Port of Seattle staff, FAA, other government agencies, etc., as required.*
- 12. Development of preliminary construction phasing plans.*

13. Development of detailed preliminary cost estimates and project schedules. Following the authorization to proceed of the project the consultant shall complete the work within One Hundred Seventy (170) calendar days.

The Prospectus also stated that *[i]f a project becomes authorized the Port may, at its option, retain the selected consultant to complete further design on the project and other related work.*

The scope of the additional \$29,347,468 in services went well beyond the original scope of work—design, further design, and related work. For example, additional services purchased non-competitively through this contract included the following:

- Amendment 25 (\$735,869): provide **“PM staff to 3rd Runway Project team.”**
- Amendment 29 (\$49,160): **“Relocation of the Weyerhaeuser Facility, hazardous material shed, and decant station, ... Fire training area fill area removal, ... Weyerhaeuser facility access.”**
- Amendment 30 (\$200,000): (there was no scope of work description in the project files for this \$200,000 increase.)
- Amendment 33 (\$1,785,424): “Engineering services for 1999 and 2000 projects, 3rd runway” including **“Task 1: Ongoing program management,” “Task 10: Wall/slope evaluation peer review,” “Task 11: 3rd Runway construction office support,” “Task 13: Assistant embankment project manager,” and “Task 16: Runway project team QA/AC.”**
- Amendment 40 (\$2,304,670): **“On-going program management,”** and “Embankment design phase 4.”
- Amendment 42 (\$39,403): **“Westside office, construction support services.”**
- Amendment 45 (\$2,593,991): **“Ongoing Permit Support and Program Management for a 12 month period beginning in July 2000,” “Provide an Embankment Project Manager to POS's 3rd Runway Team for two year period,” “Provide Construction Technical Support Services for 3rd RW Embankment, Phase 3,” “Provide planning and preparation for embankment construction in the year 2001.”**
- Amendment 46 (\$216,063): **“Provide the services of an Assistant Construction Manager to the Airfield program and related projects of 3rd RW.”**
- Amendment 48.3 (\$141,422): **“Review shop drawings and submittals, answering RFI's, project administration, construction site visits, change order evaluation, and as-built drawing preparation for the Structure and Facility contract.”**
- Amendment 49 (\$374,744): **“Provide two full-time, onsite field inspectors for a one year period.”**

- Amendment 49.1 (\$35,397): “**Extend service of two full-time, onsite field inspectors.**”
- Amendment 49.2 (\$109,352): “**Provide one full-time, on site senior field inspector to the Airfield Program and related projects of the 3rd RW program for the 2003 construction season.**”
- Amendment 49.3 (\$305,745): “**Extend services of one full-time, onsite field inspector for 2004-2005 embankment construction.**”
- Amendment 49.4 (\$204,205): “**Extend services of one full-time, onsite field inspector for 2006 embankment construction.**”
- Amendment 57 (\$229,143): “**Provide service of an assistant CM for 2002/2003 construction seasons.**”
- Amendment 57.1 (\$138,332): “**Provide service of an assistant CM for the 2003 construction season.**”
- Amendment 57.2 (\$15,806): “**Provide service of an assistant CM through 3/19/2004.**”
- Amendments 59.6, 59.7, 59.8, 59.9 (\$342,080): “**Continuing general engineering services and construction support for the 2004-05 Embankment/S154th St Construction Project.**”
- Amendment 59.11 (\$26,059): “**Resolution of Elcon invoices.**”
- Amendment 76 (\$216,960): “**provide the services of a Construction Quality Manager to the 3rd RW Program for the 2007 construction season ...**” [Emphasis added]

In addition to the fact that the majority of services provided under this multi-year and still ongoing contract went well beyond the originally-procured scope of services, there were no records of negotiations or evidence that cost or price analyses were performed for any of the 120 amendments in the amendment or contract administration files.

Criteria

Washington State Law, RCW 39.80.010, *Legislative declaration*, states that:

*The legislature hereby establishes a state policy, to the extent provided in this chapter, that governmental agencies **publicly announce requirements for architectural and engineering services**, and negotiate contracts for architectural and engineering services on the basis of demonstrated competence and qualification for the type of professional services required and at fair and reasonable prices.* [Emphasis added]

RCW 39.80.030, *Agency's requirement for professional services*, states that:

Advance publication. Each agency shall publish in advance that agency's requirement for professional services. The announcement shall state concisely the general scope and nature of the project or work for which the services are required and the address of a representative of the agency who can provide further details. An agency may comply with this section by: (1) Publishing an announcement on each occasion when professional services provided by a consultant are required by the agency; or (2) announcing generally to the public its projected requirements for any category or type of professional services.
[Emphasis added]

In our opinion, the intent of the above provisions is to provide for competition for services on a requirement-specific basis, rather than using the procurement process to supplement POS staffing over a 14-year (or more) period without competition.

POS Policy, PUR-2, Consultant Procedures, requires that:

C. Subsequent to execution of the contract, the contract may be amended above the category fee limit provided:

- 1. The project scope of work is not being divided into smaller segments to avoid PUR-2, statutory, or delegation of authority procedures.*
- 2. The increased amended consultant responsibilities are generally related or associated with the project scope utilized in the original consultant selection.*
- 3. The total amended contract amount is less than \$30,000 above the category fee limit. Amended contract amounts greater than \$30,000 need to be reviewed by the Legal Department for conformity with sentences 1 and 2 above.*

D. No specific amendment authorization requirement is included within PUR-2. Consultant contracts may be amended to the authorized limits, as defined by the current delegation of authority documents (such as Resolution No. 3181, as Amended).

Since this PSA was initially awarded at a level having no “category fee limit,” POS was able to avoid scrutiny by the legal department.

Best Practices for procurement of goods and services establish that:

*The benefits of competition are well established. Competition saves money for the taxpayer, improves contractor performance, curbs fraud, and promotes accountability for results. –May 31, 2007, memorandum to Chief Acquisition Officers from the Office of Management and Budget.*¹²

In addition, the **State of Washington Joint Legislative Audit and Review Committee** stated that:

¹² [see: http://www.whitehouse.gov/omb/procurement/comp_contracting/competition_memo_053107.pdf]

*The primary purpose of the competitive bidding requirement is to prevent fraud, collusion, and favoritism by public officials and to obtain the best work at the most reasonable price. The open competitive process satisfies this by making the selection process transparent to the public.*¹³

Also see **Federal Regulations** in Finding 2-A.

Cause

POS non-construction contracts are not procured or administered using trained and professional contracting personnel responsible for protecting the integrity of the procurement process and assuring that contractual provisions are enforced and adhered to. Instead, the PSA contracts are procured and administered by POS project management and engineering personnel who work directly with consultant personnel and subcontractor personnel.

In addition, as noted above, PUR-2 contains a loophole that allows POS project and construction management personnel to avoid legal review of amendments when the initial PSA award is in Category 3 or Category C.

We were unable to determine within the scope of this audit if competition requirements are being circumvented in order to avoid the additional time and effort that competition requires, or in order to direct work to favored vendors. The latter cause is a distinct possibility.

Effect or Potential Effect

The circumvention of competition requirements inevitably results in higher costs for services and creates situations where the highest quality and value of services obtained cannot be assured.

Because Federal funds are being used for 3rd Runway Project efforts and other projects, POS faces the potential for the disallowance of substantial grant costs and the need to return this money to the Federal government.

In addition, the manner in which PSAs are being procured allows for significant risk of fraud and abuse. There are no controls in place to prevent a variety of fraud schemes characterized by bribes, kickbacks, and illegal gratuities. Such schemes are very difficult to detect and, therefore, this type of illegal activity may be occurring without POS awareness.

Recommendations

This finding supports our overarching recommendation regarding appointment of a Chief Procurement Officer, establishment of an independent contract administration function, and revision of the delegations of authority for approving construction management expenditures. In addition, we recommend the following with respect to this finding:

¹³ See Report 05-9, *An Assessment of General Contractor/Construction Manager Contracting Procedures*, June 22, 2005.

Recommendation 13: We recommend that POS take immediate steps to review and enforce its policies and procedures for awarding PSA contracts and establish controls to ensure that competition requirements are not circumvented.

Recommendation 14: We recommend that POS initiate a comprehensive review of all PSAs to determine the full extent to which competition requirements have been circumvented, and take appropriate corrective actions.

Recommendation 15: We recommend that POS revise PUR-2 to incorporate a limit on the size allowed for amendments to Category 3 and Category C contracts so that a legal review becomes necessary before a contract is allowed to exceed a specified limit. That review should be designed to assure that:

- 1. The project scope of work is not being divided into smaller segments to avoid PUR-2, statutory, or delegation of authority procedures.*
- 2. The increased amended consultant responsibilities are generally related or associated with the project scope utilized in the original consultant selection.*

Recommendation 16: We recommend that POS (a) determine the extent to which costs in violation of Federal grant requirements have been claimed for reimbursement and received from DOT and other Federal agencies, (b) notify applicable Federal grant officers of these violations, and (c) initiate corrective actions prescribed by Federal officials.

POS Response

The full text of the POS response to this finding is in Appendix E. POS disagreed with this finding and stated that:

The Port disagrees with this finding. This consultant was originally selected to provide Third Runway design services through a publicly advertised Request for Qualifications (“RFQ”), to which nine consultant firms, including some of the largest design firms in the country, responded.

POS infers in its response that we think POS should have attempted to “negotiate the complete package of design services at the beginning of the consultant agreement.” POS misstates the basis for our finding by stating that:

The approach suggested by the Performance Auditor would significantly increase risk to and project design costs for the Port. Using a succession of firms to develop project design documents would be highly inefficient and is contrary to best industry practices.

Auditors’ Additional Comments

The POS response to this finding misrepresents the finding and the facts. We do not think POS should have written a contract broad enough to encompass all of the services that were actually performed under this contract. On the contrary, POS could have and should have used the competitively-procured contract for the scope of the *design* services originally advertised. Instead, however, as demonstrated by the list (in the finding above) of *non-design* services

performed by this contractor, POS circumvented competition requirements. In addition, POS did not respond to the final part of the condition noted above: there were no records of negotiations or evidence that cost or price analyses were performed for any of the 120 amendments in the amendment or contract administration files. While it may have been convenient for POS to simply add services to an in-place contract without competition or even cost or price negotiations, this practice is not a prudent means of managing public funds.

Finding 2-C: A consulting agreement awarded in 1998 grew without competition from \$10 million to more than \$120 million and is being used to augment POS staffing at considerable cost.

Background

POS awarded a major “Program Management Services Consultant” (PMSC) contract for A/E services in 1998. From an initial amount of \$3,500,000, this contract has been modified annually, without competition, to a size of more than \$127,000,000 in violation of State law.

Condition

The initial PMSC agreement was for just one year of services, from August 28, 1998, to August 28, 1999. The contract has been amended, without competition, to the present time. Current authorized funding is \$129,020,000. The contract’s scope of services contains the following provisions:

- A. **Scope of Services** – PMSC shall provide Program Management Support Services (“Services”) to assist the Port of Seattle (POS) in implementation of the Capital Improvement Program (CIP) at Seattle-Tacoma International Airport (Sea-Tac). Services shall include a broad range of planning, technical; project and construction management services as requested by the POS and as described in further detail in individual Work Authorizations approved by the POS.
- B. **Authorization of Services** – Services for the Program are separated into various tasks and PMSC shall be authorized to perform individual tasks on specific projects via written authorization (Authorization) from the Aviation Capital Improvement Program Director of the POS. Any such Authorization approved by the POS will set forth in detail the scope of Services, schedule and budget for the work authorized and any other instructions and/or requirements which the POS deems necessary. PMSC shall segregate and accumulate costs on an Authorization basis.

The POS shall notify the PMSC of the Services it requires the PMSC to provide and shall furnish schedules and estimated construction costs for each task if such information is available. Based upon this information, the PMSC shall prepare a Work Authorization for approval by the POS, which sets forth the estimated costs, duration and staff required to perform these Services. Upon POS approval, PMSC shall commence work and perform the Services until the time period specified in the Work Authorization has ended or the approved funding is exhausted. POS may add tasks or Services to this Authorization at any time by an amendment to the Authorization, properly executed by both parties, or by a new Authorization for the additional tasks or Services.

An initial Work Authorization (for mobilization) specified a budget, mobilization services to be provided, and gave the contractor direction to proceed. Following that initial Work Authorization, however, no additional work authorizations conforming to paragraph B, above, were ever issued. No additional authorizations were issued containing detailed scopes of services, schedules, or budgets for the work. POS did not provide the contractor with “schedules and estimated construction costs for each task,” and the contractor did not prepare a Work

Authorization for POS approval setting forth “the estimated costs, duration and staff required to perform these services.” Instead of issuing work authorizations for specific project tasks, POS has issued work authorizations for specific contractor or subcontractor *personnel* to begin their employment at POS under the contract.

Contract amendment number 5, dated December 11, 1999, formally modified the arrangement from the specific task order basis on which it had been procured to an “annual level of effort based upon agreed positions” basis. The contractor and its subcontractors (and sub-subcontractors) simply provide individuals who become part of POS project teams and carry out day-to-day activities side-by-side with, and are indistinguishable from, POS employees. These consultants receive day-to-day direction and oversight by POS employees, rather than performing defined tasks under a scope of services under contractor management. In many cases, these outside consultants manage and supervise POS employees.

The initial hourly rates included in the contract were time-and-materials rates based upon the task order-based scope of services under which consultant personnel were to perform specifically assigned tasks under their own management. Amendment number 5, formally modified the billing rate arrangement from the competitively-procured time-and-materials rate structure to stipulate that “hourly rates will be based upon actual salary times a predetermined and agreed multiplier.” Rates have steadily increased over the years based on this arrangement. (This type of arrangement—direct salaries times a fixed multiplier—is illegal in Federal procurements, because it represents a “cost-plus-percentage-of-cost” arrangement under which the contractor has no incentive to control costs and instead has an incentive to *increase* costs.)

The multiplier applied to each consultant’s direct salary is normally intended to enable the contractor to recover fringe benefits, overhead (space costs and other office overhead), general and administrative expenses (corporate administration, home office overhead, and executive salaries), and profit. The PMSC consultants, however, work in POS space, use POS equipment and supplies, and are managed and directed by POS personnel, rather than contractor executives. As a result, the contractor and its subcontractors are reaping windfalls under this arrangement and POS is paying substantially more than it would need to pay if it had simply hired employees to fill these positions.

Exhibit 2-C-1 is a comparison of the annualized rates of pay being paid to the contractor for contract personnel and comparable POS employee salaries plus fringe benefits. As this demonstrates, POS is paying as much as 216 percent of what it would need to pay for personnel if they had been hired as POS employees.

POS refers to this contract as a Professional Services Agreement (PSA), but it is actually more akin to a prohibited “personal services contract” under Federal Acquisition Regulation (FAR) subpart 37.104. The contractor, subcontractors, and sub-subcontractors simply provide engineers and consultants who work on POS projects under POS direct management and supervision. PMSC personnel are indistinguishable from POS personnel. FAR 37.104¹⁴ provides, in part:

(a) A personal services contract is characterized by the employer-employee relationship it creates between the Government and the contractor’s personnel. The Government is normally required to obtain its employees by direct hire under competitive appointment or other procedures required by the civil service laws. Obtaining personal services by contract, rather than by direct hire, circumvents those laws unless Congress has specifically authorized acquisition of the services by contract.

(b) Agencies shall not award personal services contracts unless specifically authorized by statute (e.g., [5 U.S.C.3109](#)) to do so.

(c)(1) An employer-employee relationship under a service contract occurs when, as a result of (i) the contract’s terms or (ii) the manner of its administration during performance, contractor personnel are subject to the relatively continuous supervision and control of a Government officer or employee.

(2) Each contract arrangement must be judged in the light of its own facts and circumstances, the key question always being: Will the Government exercise relatively continuous supervision and control over the contractor personnel performing the contract....

(d) The following descriptive elements should be used as a guide in assessing whether or not a proposed contract is personal in nature:

(1) Performance on site.

(2) Principal tools and equipment furnished by the Government.

(3) Services are applied directly to the integral effort of agencies or an organizational subpart in furtherance of assigned function or mission.

(4) Comparable services, meeting comparable needs, are performed in the same or similar agencies using civil service personnel.

(5) The need for the type of service provided can reasonably be expected to last beyond 1 year.

(6) The inherent nature of the service, or the manner in which it is provided, reasonably requires directly or indirectly, Government direction or supervision of contractor employees in order to—

¹⁴ We recognize that the FAR is not directly applicable to POS. The same basis for the prohibition on the use of personal services contracts under the FAR, however, is applicable to POS, if only in terms of best practices: *The Government is normally required to obtain its employees by direct hire under competitive appointment or other procedures required by ... laws. Obtaining personal services by contract, rather than by direct hire, circumvents those laws....*

- (i) Adequately protect the Government's interest;*
- (ii) Retain control of the function involved; or*
- (iii) Retain full personal responsibility for the function supported in a duly authorized Federal officer or employee. [Emphasis added.]*

Each of the attributes listed above applies to POS and the PMSC contract arrangement.

We noted other problems with the PMSC contract, including the following:

- The contract contains no labor category definitions stipulating minimum educational accomplishments, required professional qualifications, or years of experience, and so forth. POS and the contractor, subcontractors, and sub-subcontractors simply agree on hourly rates for various labor categories. The contractor and its subcontractors have wide latitude in assigning people to labor categories.
- POS establishes new billing rates each year without requesting cost or pricing data. POS does not seek detailed support for mark-ups (multipliers), has not audited the contractor's or its subcontractors' indirect rates or multipliers, has not requested reports on audits of the contractor or its subcontractors performed by other state or federal agencies, and has not considered the fact that it is paying for substantial amounts of overhead and general and administrative expenses that it is not receiving.
- Although this procurement and the resulting contract were specifically for work on the CIP at SeaTac airport, PMSC contract consultants have frequently worked on non-aviation projects. We found numerous instances where PMSC contract personnel worked on Seaport projects, including instances where POS-approved Work Authorizations *required* them to work on Aviation projects but they actually worked on Seaport projects.
- POS has not maintained complete contract files for the PMSC contract. We asked to see the Work Authorizations that POS approved under the contract. Instead of providing a POS contract administration file or some other complete record of all Work Authorizations, POS referred us to a PMSC employee and indicated that a "decision was made early on to maintain joint files." The contractor employee initially provided 62 work authorizations. When we indicated that the files appeared to be incomplete, the contractor employee found an additional 49 work authorizations several days later. POS has not maintained a complete file of these Work Authorizations and they are not numbered. Hence, POS does not know how many Work Authorizations have been approved, who has been approved to work on the contract or at what rates.
- Consequently, POS has no way of assuring that PMSC invoices contain only charges for approved consultants or that the rates being charged are the rates approved in Work Authorizations.
- Many Work Authorizations simply announce salary increases for PMSC contract consultants already assigned to POS, and POS agrees to simply allow the contractor to

pass through these cost increases to POS by raising the consultant billing rates. These approvals appear automatic. For example:

- Over a 6-month period (from July 31 to December 28, 2000), POS-approved Work Authorizations increased one consultant's billing rate from \$23.47 to \$34.45, an increase of 47%, based on promotions of the employee by the contractor from project assistant, to staff assistant, to construction assistant.
- A July 3, 2000, POS-approved Work Authorization increased another consultant's rate from \$31.74 to \$33.44, a 5.4% increase, based on a hand-written notation "pay raise by employer."
- An August 30, 2000, POS-approved Work Authorization gave a consultant a rate increase from \$28.00 to \$38.47, a 37.4% increase, without an explanation for the increase.

We saw no situations where such requested salary and billing rate increases were denied. A POS manager told us that they do deny some requests for pay and rate increases, but they do not keep any record of these denials.

- We noted instances in which PMSC contract consultants selected other POS consultants for other POS contracts. For example, a PMSC consultant reportedly interviewed candidates over the phone and selected one to perform a design project. We requested documentation of the selection process and we were told:

in response to your request for documents to support the Consultant selection for [name of project], there are no electronic/hardcopy files. The interviews were conducted by [PMSC consultant] over the phone.

Although a POS employee signed the resulting contract, it was clear that the POS employee had no basis for the selection besides the POS consultant's recommendation.

- POS's internal auditor performed an audit of the PMSC contract and issued a report on that audit, dated May 23, 2002. One of the audit findings was as follows:

We noted that a markup of 1.5 percent is applied on costs claimed for other direct costs. Other direct costs involve reimbursements to the Consultants for its employee expenses such as airfare, meals, living allowances, telephone charges, car rentals, lodging, parking etc. No authority and/or criteria were found for this markup.

Per the contract, Consultant is paid based on a time and expense basis in accordance with fees specified in Attachment B – Schedule of Charges.

The contract further states:

*... The Consultant is an independent contractor and payment of **any income, payroll or similar taxes under federal; state or local law shall be the responsibility of the Consultant...***

...All invoicing, home office finances and accounting are included in the rates and will not be direct billed...

*Based on our reading and interpretation of the contract, we conclude that markups on direct costs are not reimbursable under this contract. We **recommend** Port management determine the amount paid under this category and resolve the issue with the Consultant. [Emphasis in original.]*

Instead of determining the unallowable and extra-contractual amount that the PMSC contractor had been improperly paid, POS simply amended the contract to retroactively ratify the unallowable amounts paid and continue allowing the extra mark-ups.

In response to a draft of this finding, POS asserted that:

The [finding] cited that there are no controls in place to review billings. A more in depth review by the auditor would have discovered that there are controls in place for reviewing all charges as follows:

- When a new project is established, the applicable Cost Controls person determines if a new WBS code is required.*
- If it is, the Cost Control person makes a request to the PMSC Contracts Administrator to create a new WBS for the Work Project.*
- This creates the ability (authorization) for appropriate PMSC consultants to charge to the project. (If a request comes from a Project Manager, the PMSC Administrator redirects the request back to Port Cost Controls).*
- When a PMSC consultant fills out their required bi-weekly timesheet, these WBS codes are used to charge their time.*
- Timesheets are routed to all applicable program groups for approval and signature. This generally includes the Program Leader or Project Manager, Cost Controls, and always at least one Port employee signature. The timesheets are submitted to the PMSC Contracts Administrator for processing.*
- The PMSC invoices are received by the Port with a breakdown by the WBS codes allowing the charges to be converted to the Port's Chartfields for processing by Accounts Payable.*

To verify the invoice, the Core Cost Controls take steps and checks to:

- Review the invoice for consistency of WBS usage. If any discrepancies or changes are noticed, detail review of the charges is conducted to determine the correctness of the coding.*
- Verify the appropriate use of the WBS code as it relates to a discipline (project manager, construction manager, etc.) to ensure that the correct department code will be charged.*
- Add new WBS and applicable Port Chartfields to the pay request supplemental coding spreadsheet. An added benefit of this is that the new WBS is checked for validity and correctness. The supplemental coding spreadsheet is submitted to Accounts Payable for processing.*

The Assistant Director does a cursory review of the invoice looking for appropriate use of Chartfields as well prior to approving the payment request. The charges are carried in the Port's PeopleSoft accounting system and appear in Project Detail Reports that the Project Manager can use to review that all charges to his/her project are correct.

The draft finding did *not* state “that there are no controls in place to review billings.” The draft finding stated that “POS does not know how many Work Authorizations have been approved, who has been approved to work on the contract or at what rates. Consequently, POS has no way of assuring that [PMSC] invoices contain only charges for approved consultants or that the rates being charged are the rates approved in Work Authorizations.”

Conspicuously absent from the list of controls over invoice processing that POS provided in response to the draft finding are the following key steps:

- Assure that all personnel being billed have been approved to work on the contract based on mobilization work authorizations.
- Assure that labor categories and rates being billed agree with the contractually stipulated labor categories and rates.
- Assure that rates being billed do not exceed the contractually stipulated labor categories and rates.

POS also asserted that individual Work Authorizations were no longer needed, because:

the Port and [the contractor] have agreed to an annual review and approval of all PMSC employees working on Port projects. This annual review includes all individuals and their billing rates. Each annual approval supersedes all previous approvals. The last annual review was conducted and executed on 1/12/07 as Amendment No. 16 to the [PMSC] contract.

We reviewed the PMSC invoices for December 2006 and February 2007, covered by the 2006 and 2007 “annual reviews.” For the December 2006 invoice, we noted that:

- 2 (of 29) people were billed at rates that exceeded the rates in the contract (excess costs claimed on this invoice for these two people totaled \$1,014).
- 3 people were billed at labor categories that are not included in the contract (excess costs claimed on this invoice for these three people totaled \$25,473).
- 1 person was not included in the 2006 review (excess costs claimed on this invoice for this person totaled \$3,192).

For the February 2007 invoice:

- 4 (of 33) people were billed at rates that exceeded the rates in the contract (excess costs claimed on this invoice for these four people totaled \$4,613).
- 5 people were billed at labor categories that are not included in the contract (excess costs claimed on this invoice for these five people totaled \$60,116).
- 1 person had no work authorization and was not in the 2007 review (excess costs claimed on this invoice for this person totaled \$590).

Criteria

Washington State Law, RCW 39.80.010, *Legislative declaration*, states that:

*The legislature hereby establishes a state policy, to the extent provided in this chapter, that governmental agencies **publicly announce requirements for architectural and engineering services**, and negotiate contracts for architectural and engineering services on the basis of demonstrated competence and qualification for the type of professional services required and at fair and reasonable prices. [Emphasis added]*

RCW 39.80.030, *Agency's requirement for professional services*, states that:

*Advance publication. **Each agency shall publish in advance that agency's requirement for professional services.** The announcement shall state concisely the general scope and nature of the project or work for which the services are **required** and the address of a representative of the agency who can provide further details. An agency may comply with this section by: (1) Publishing an announcement **on each occasion when professional services provided by a consultant are required** by the agency; or (2) announcing generally to the public its projected requirements for any **category or type of professional services**. [Emphasis added]*

In our opinion, the intent of the above provisions is to provide for competition for services on a project specific basis, rather than using the procurement process to supplement POS staffing over a 10-year (or more) period without competition.

POS Policy PUR-2, *Consultant Procedures*, defines “Consultant” as:

***An impartial, objective advisor** who renders professional opinions, findings, judgments and recommendations. A consultant is a licensed independent contractor who **does not have the authority to decide, command, or control the Port's affairs and cannot supervise or manage Port employees.** Such authority is always retained by Port management. **Consultant services are defined as performance of studies, projects or tasks** by professional or technical organizations or individuals from outside the Port. [Emphasis added]*

As noted above, PMSC consultants are not being asked to perform discrete studies, projects, or tasks, have made source selection decisions, and regularly manage and supervise POS employees.

POS Policy EX-10, *Contingent (Contract) Workers*, paragraph D, Independent Contractors, states:

An independent contractor is any individual or vendor who contracts with the Port to perform service in a non-employee status and meets Internal Revenue Service criteria regarding independent contractors.

*Independent contractors are self-employed and **in control of both the results and the method of the work or service. They are hired to provide a pre-defined deliverable for a set fee.***

Independent contractors typically have other clients, a business license, an office, and equipment.

Independent contractors provide their own project management. The Port has oversight but not direct management responsibility for the independent contractor's work. [Emphasis added.]

As noted above, PMSC consultants are not hired to *provide pre-defined deliverables for a set fee* and do not provide their own project management; and *POS retains direct management responsibility* for PMSC consultants' work.

Best Practices

As noted above, FAR 37.104 is intended to prevent a government agency from circumventing established laws governing employment.

POS has a responsibility to assure that public funds are spent only on allowable purposes. Failure to assure that billings are proper for any contract—but especially one of this magnitude—is a breach of this duty.

Cause

POS non-construction contracts are not procured or administered using trained and professional contracting personnel responsible for protecting the integrity of the procurement process and assuring that contractual provisions are enforced and adhered to. Instead, the PSA contracts are procured and administered by POS project management and engineering personnel who work directly with PMSC personnel and PMSC subcontractor personnel.

Effect or Potential Effect

We evaluated a sample of four PMSC contract invoices (covering February-March 2004, August-September 2005, July 2006, and February 2007) to determine the amounts of subconsultant markups by the PMSC contractor (8% on subconsultant labor costs and 1.5% markups on other direct costs and sub-subconsultant labor costs) and the remaining direct salary-costs-plus-multiplier markups. Based on multiplier information contained in POS's contract administration files (multipliers ranged from 2.080 to 2.680 of consultant employee salaries, with an average multiplier of 2.442) we determined an estimated direct salary cost under these four sample invoices. Based on this sample analysis, we estimate that if POS had hired POS employees to perform the work done by PMSC consultants instead of using the PMSC contract mechanism, POS would have saved approximately \$14,555,000 during 2004 through 2006. We

estimate that during the nearly tens years that the contract has been in place, POS would have saved approximately \$60,483,000.

For the two invoices evaluated to test POS's assertion that its review of PMSC invoices was adequate, \$94,998 of invoice labor costs either exceed contract rates, were for labor categories not in the contract, or were for persons who had not been approved to work on the contract. This was 15 percent of the total labor charges on these two invoices.

In addition, the way this contract is being managed allows for significant risk of fraud and abuse. There are no controls in place to prevent a variety of fraud schemes characterized by bribes, kickbacks, and illegal gratuities. Such schemes are very difficult to detect and, therefore, this type of illegal activity may be occurring without POS awareness.

Recommendations

This finding supports our overarching recommendation regarding appointment of a Chief Procurement Officer, establishment of an independent contract administration function, and revision of the delegations of authority for approving construction management expenditures. In addition, we recommend the following with respect to this finding:

Recommendation 17: We recommend that POS undertake a review of all of its professional services agreements to assure that:

- Such agreements comply with State law in terms of being for specific POS requirements rather than being used as supplements of POS staffing,
- The agreements are being administered in strict conformity with contract provisions and requirements,
- The contracts contain defined labor category qualifications, and
- Contract files are complete and maintained by POS employees rather than contractor personnel.

Recommendation 18: We recommend that POS establish a policy whereby, before contracting for consultant services, POS perform a cost analysis to determine if the required work can be more economically performed with POS personnel. (We suggest that POS study and adapt Federal Office of Management and Budget Circular A-76 for this purpose.)

Recommendation 19: We recommend that POS add the following procedures to the list of procedures being performed during the invoice approval process for the PMSC contract and other PSA contracts, as appropriate:

- Assure that all personnel being billed have been approved to work on the contracts based on the most recent annual review or work authorization.
- Assure that labor categories and rates being billed do not exceed the contractually stipulated labor categories and rates.

POS Response

The full text of the POS response to this finding is in Appendix E. POS disagreed with this finding and stated that:

This consulting agreement to augment staff is consistent with best industry practices ...

Airports do not have adequate staff resources to manage huge, limited-term construction programs and as a result, must augment staff with additional resources to carry out the work. This program management approach is consistent with best industry practice, and airports in Atlanta, Baltimore, Washington, DC, Los Angeles, San Diego, and San Francisco have all used similar nationwide competitions to augment their staff over many years. ...

Some of the necessary technical skills were not readily available in the local labor market. ...

If these consultants had instead been hired and laid off, the Port would have (in addition to internal staff costs associated with the hiring and layoffs) incurred costs associated with the layoffs of almost \$3.0 million under Port Policy HR-10 which relates to reductions in force. ...

Some of the disciplines required were very specialized and would not be required beyond a few select projects. ...

For certain specialized skills, the Port's need was long-term but less than fulltime. ...

The PMSC could use the vast resources of each of the many partner firms to scale up more rapidly than the Port could ...

The Port Commission approved this approach in 1998 and has affirmed this decision in public meetings annually since that time.

Over the course of the PMSC agreement, the Aviation Project Management Group added about 30 employees and the Engineering Department added about 40 employees to support the capital program. These hires enabled the Port to significantly reduce the number of consultants required under the PMSC agreement. These efforts saved the Port \$38 million. ...

The method by which the Port compensates the PMSC is also consistent with best industry practices. ...

Auditors' Additional Comments

We agree that owners often use consulting agreements to provide needed expertise for “*limited-term construction*” projects. The situation with this contract, however, is that the contract has *not* been “*limited-term*.” It has been in place without periodic re-competitions or adequate cost and price analysis for nearly 10 years, and POS plans to continue its use indefinitely.

While it might sometimes be prudent and necessary, in the short-term, to obtain some needed technical skills or specialized disciplines through use of a consulting contract, this contract is

being used to provide clerical, accounting, technician, and administrative personnel at very high prices.

POS asserts that layoffs would have cost \$3.0 million if POS employees were used instead of consultants. We think this would have been preferable to the \$60 million of unnecessary costs that we calculate POS incurred by paying fully-loaded commercial rates for consultants instead of adding to its own staff.

We agree that the Commission has approved and re-approved this arrangement on an annual basis since 1998. The Commission should have but did not consider the cost-effectiveness of this long-term arrangement (except in a cursory manner and only in 1999). Following 1999, the Commission simply approved additional funding without considering whether this arrangement was a prudent use of public funds.

POS asserts that by hiring additional professional staff to replace *some* of these consultants, it has saved \$38 million while disagreeing with our conclusion that *more* of these consultants should have been replaced by hiring additional staff.

We disagree that use of the multiplier contracting method is consistent with best practices. As noted in the finding, this form of contracting is illegal in federal procurements, because it provides an incentive for contractors to actually *increase* costs.

POS's response to this finding does not address the following key elements of this finding:

- The contract was procured on a basis totally different than the manner in which it has been carried out. And POS never considered negotiating on-site rates with the consultants once POS decided to use the contract as a "temporary" services arrangement.
- The contract does not define labor category requirements, so the several consulting firms working under the contract have wide latitude in assigning employees to the contract.
- Although the procurement was specifically for work at the airport, the contract has been used for non-airport projects.
- POS has not maintained complete contract files, but instead relies on the contractor to maintain files for work authorizations.
- POS routinely approves increased billing rates when the contractor gives its employees increases in pay.
- Consultant employees select other POS consultants for other POS contracts.
- Consultant employees manage and supervise POS employees.
- The contractor billed for mark-ups not allowed under the competitively-procured contract. When the POS internal auditor questioned this practice, POS simply amended the contract to retroactively allow these unallowable costs.

Consultant Contract Labor Categories		Consultant Rates Annualized (Based on 1,725 Hours per Year) ¹⁵		Comparable POS Labor Categories	Grade	Base Salary Maximum Plus Fringe Benefits	Consultants' Annualized Rate as Percent of POS Salary plus Fringe Benefits	
Program Director, Asst. Program Director		\$326,767		Director, Assistant Director, Aviation CIP	32-34	\$180,664	180.87%	
Project Specialist		\$324,283		Aviation CIP Leader	30	\$149,533	216.86%	
Program Manager/Principal PM/CM		\$289,127	To \$298,395	Capital Construction Project Manager 5	30	\$149,533	193.35%	To 199.55%
Senior PM		\$267,358	To \$286,613	Planning Program Manager, Aviation	29	\$142,356	187.81%	To 201.34%
PM		\$221,801	To \$274,848	Capital Construction Project Manager 4 Manager, Construction Planning & Coordination	28 27	\$135,419 \$128,783	163.79% 190.69%	To 202.96% To 198.18%
Principal Project Engineer		\$245,571	To \$255,218	Capital Construction Project Manager 3	27	\$128,783	181.46%	To 189.03%
Senior Project Engineer		\$233,686	To \$243,436	Capital Construction Project Manager 2	26	\$122,533	172.93%	To 189.05%
Project Engineer		\$211,899	To \$231,654	Capital Services Supervisor	25	\$116,508	152.03%	
Assistant Project Engineer		\$177,123		Capital Construction Project Manager 1	24	\$110,824	141.24%	
Staff Engineer		\$156,527		Program Controls Manager	28	\$135,419	180.98%	
Principal Project Controls Eng/Contract Admin		\$245,088		Project Scheduler Aviation PM	26	\$122,533	164.73%	
Senior Project Controls Eng/Contract Admin		\$201,842		Cost Engineer	24	\$110,824	159.82%	
Project Controls Eng/Contract Admin		\$177,123		Planning Program Manager, Aviation	29	\$142,356	187.80%	To 201.34%
PLA Senior Manager		\$267,341	To \$286,613	Labor Relations Manager	28	\$135,419	154.68%	
PLA Manager		\$209,467		Senior Planner-Aviation	25	\$116,508	152.00%	
PLA Sr. Administrator		\$177,089		Planning Research and Data Analyst/Aviation	23	\$105,344	135.57%	
PLA Administrator		\$14,8213		Senior Design Engineer	27	\$128,783	147.13%	
Designer		\$189,474		Senior Planner-Aviation	25	\$116,508	152.00%	
Staffing Coordinator		\$177,089		Construction Coordinator	22	\$100,162	145.99%	
Project Technician		\$146,228		Aviation PMG Cost Accounting Specialist	18	\$85,896	155.18%	
Project Cost Accountant		\$133,291		Project Technician AV/PMG	17	\$83,129	121.39%	
Project Administrator		\$100,913		Administrative Assistant	18	\$85,896	88.72%	
Administrative Assistant		\$76,211		Staff Assistant 3	11	\$68,903	92.66%	
Clerical		\$63,842						

¹⁵ 1,950 hours per year, minus 3 weeks vacation (112.5 hours), 1 week of sick leave (37.5 hours), and 10 paid holidays (75 hours).

Finding 2-D: POS awarded a \$1.4 million consulting agreement without evidence of competition and awarded a \$2.7 million consulting agreement without competition.

Background

State law requires that A/E services be procured through a competitive process. POS Polices require contracts greater than \$200,000 to be advertised and competed. Despite these clear requirements, POS:

- Competitively awarded a \$1,200,000 A/E contract to Consulting Company D with one scope of work, and then amended that contract, without further competition, expanding the scope of work well beyond the original scope of work and increasing the contract value to \$4,400,000.
- Awarded a \$1.4 million consulting contract to Consulting Company AB (owned by a former POS employee) without evidence of competition.
- Awarded a \$2.7 million contract to Consulting Company AC (owned, in part, by a former POS employee) without competition.

Condition

A summary of the conditions surrounding these three related contracts follows.

The Consulting Company D Contract: The contract with Consulting Company D was specifically for consultant DW to “serve as Construction Manager for the Third Runway Expansion Program at Seattle-Tacoma International Airport.” The scope of work stated that:

The intent of this position is to secure Construction Management services by Mr. [DW] for the Third Runway Expansion program. However, based on workload, he may be asked to work on other projects upon agreement of the consultant and the Port Manager of Construction Services. Such work is considered to be within the existing scope of this contract.”

This latter provision—essentially making the contract scope open-ended—violates the RCW requirement that:

*Each agency shall publish in advance that agency's requirement for professional services. **The announcement shall state concisely the general scope and nature of the project or work for which the services are required...** An agency may comply with this section by: (1) **Publishing an announcement on each occasion when professional services provided by a consultant are required** by the agency; or (2) **announcing generally to the public its projected requirements for any category or type of professional services.** [Emphasis added]*

Under the terms of the June 15, 1998, Consulting Company D contract, POS was to pay a fixed “monthly fee of \$16,667.00 [as compensation for DW’s services] for the duration of the contract up to a maximum limit of \$1,200,000.”

That fixed monthly rate for DW was increased to \$18,667.00 (\$224,004 per year) effective July 1, 2001; and increased to \$19,834.00 (\$238,008 per year) effective July 1, 2003, with a new maximum limit of \$1,700,000.

In November 2003, the contract was amended again, to add “assistant construction management services in the person of [SK] to support the Port’s capital program.” The new fixed “monthly billing rate” was \$43,754 (\$525,048 per year) and the “not-to-exceed total” for the contract was increased to \$4,400,000.

In July 2005, the fixed monthly billing rate was increased to \$45,417 (\$545,004 per year) and the “not-to-exceed total” for the contract was increased to \$4,469,846.

In September 2006, the contract was amended again to “delete the services of [DW]” The not-to-exceed contract limit was reduced to \$3,500,000. Accompanying this August 2006 amendment was a billing rate sheet listing two additional consultants and a new “Admin & Accounting” labor category, previously unmentioned in either the base contract or any amendment. A new “Project Manager” was specified at a rate of \$158.93 per hour (\$330,574 per year, based on a 40-hour work-week). A new “Project Engineer” was specified at a rate of \$143.00 per hour (\$297,440 per year, based on a 40-hour work-week). The rate specified for the new “Admin & Accounting” labor category was \$70.00 per hour (\$145,600 per year, based on a 40-hour work-week).

A January 2, 2007, amendment increased the hourly rates for the Project Manager, Construction Manager, and Project Engineer to \$167.51 per hour (\$348,421 per year, based on a 40-hour work-week); \$154.63 per hour (\$321,630 per year, based on a 40-hour work-week); and \$148.72 per hour (\$309,338 per year, based on a 40-hour work-week) respectively.

The Consulting Company D agreement states that “if for some reason [DW] cannot complete the contract, and the Port desires these services, Consulting Company D] will be given the opportunity to propose a candidate. If the Port accepts the candidate, the contract will continue as though there has been no change.” The contract file contains no documentation indicating that Consulting Company D was given the opportunity to propose a replacement candidate when DW was removed from the contract (to start his own consulting firm, Consulting Company AD) as the contract required.

The Consulting Company AB Contract: KH was a POS employee from 1994 to 1997. He formed his own consulting firm, Consulting Company AB, and in 1999 was awarded a \$1.4 million contract. POS files contain no evidence that this contract was competed, as required by state law and POS policies.

POS policies also require that the POS CEO must approve contracting with former POS employees. POS had no evidence that such approval was obtained.

In 2003, the contract with Consulting Company AB ended when KH went to work for Consulting Company AC, another POS contractor. With Consulting Company AC, KH was a construction manager, working on POS projects.

The Consulting Company AD Contract: As described above, DW had been a consultant, employed by Consulting Company D for about ten years, until the spring of 2006. In May 2006, DW and KH (the former POS employee) contacted the POS assistant director of engineering services and “expressed their desires to form their own company to provide construction management services to the Port and others around the Puget Sound area.”

On July 1, 2006, DW’s and KH’s newly-formed company, Consulting Company AD, was awarded a \$2.7 million consulting contract without competition.

An undated memo in the Consulting Company AD contract file states that the assistant director of engineering services contacted a POS legal counsel about whether it was necessary to “resurrect another [competitive procurement] process” before awarding a contract to Consulting Company AD. That POS legal counsel, in turn, “passed the issue” to the POS chief counsel who, according to the memo, said it would not be necessary to “resurrect another process” before awarding a contract to Consulting Company AD. The memo says that:

... this would be no different had they switched companies and we wanted to maintain their corporate knowledge and amend their contract to reflect their moving to another, for the original selection was for the individual and not for the company they happen to be working for.

This undated memo was signed by the assistant director of engineering services, and the file contains no other documentation confirming the POS chief legal counsel’s opinion.

At a minimum, the history of these three contracts creates an appearance that lucrative contracts are being awarded based on partiality to long-standing acquaintances.

The POS internal auditor noted these questionable practices (as well as other anomalies) associated with these (as well as other) consulting agreements as early as August 2006.¹⁶ As of completion of our audit fieldwork, POS had not undertaken any corrective actions related to these practices.

Criteria

RCW 39.30.020, *Contracts requiring competitive bidding — Violations by municipal officer — Penalties*, provides that:

In addition to any other remedies or penalties contained in any law, municipal charter, ordinance, resolution or other enactment, any municipal officer by or through whom or under whose supervision, in whole or in part, any contract is made in wilful and intentional violation of any law, municipal charter, ordinance, resolution or other enactment requiring competitive bidding upon such contract shall be held liable to a civil penalty of not less than three hundred dollars and may be held liable, jointly and severally with any other such municipal officer, for

¹⁶ See Port of Seattle, Internal Audit, *Consultant Services—Limited PSA Testing*, August 2006.

all consequential damages to the municipal corporation. If, as a result of a criminal action, the violation is found to have been intentional, the municipal officer shall immediately forfeit his office. For purposes of this section, "municipal officer" shall mean an "officer" or "municipal officer" as those terms are defined in RCW [42.23.020](#).

RCW 39.80.030, Agency's requirement for professional services — Advance publication, provides that:

Each agency shall publish in advance that agency's requirement for professional services. The announcement shall state concisely the general scope and nature of the project or work for which the services are required and the address of a representative of the agency who can provide further details. An agency may comply with this section by: (1) Publishing an announcement on each occasion when professional services provided by a consultant are required by the agency; or (2) announcing generally to the public its projected requirements for any category or type of professional services

RCW 39.80.040, Procurement of architectural and engineering services — Submission of statement of qualifications and performance data — Participation by minority and women-owned firms, requires that:

In the procurement of architectural and engineering services, the agency shall encourage firms engaged in the lawful practice of their profession to submit annually a statement of qualifications and performance data. The agency shall evaluate current statements of qualifications and performance data on file with the agency, together with those that may be submitted by other firms regarding the proposed project, and shall conduct discussions with one or more firms regarding anticipated concepts and the relative utility of alternative methods of approach for furnishing the required services and then shall select therefrom, based upon criteria established by the agency, the firm deemed to be the most highly qualified to provide the services required for the proposed project. Such agency procedures and guidelines shall include a plan to insure that minority and women-owned firms are afforded the maximum practicable opportunity to compete for and obtain public contracts for services. The level of participation by minority and women-owned firms shall be consistent with their general availability within the professional communities involved.

RCW 39.80.050, Procurement of architectural and engineering services — Contract negotiations, requires that:

(1) The agency shall negotiate a contract with the most qualified firm for architectural and engineering services at a price which the agency determines is fair and reasonable to the agency. In making its determination, the agency shall take into account the estimated value of the services to be rendered as well as the scope, complexity, and professional nature thereof.

(2) If the agency is unable to negotiate a satisfactory contract with the firm selected at a price the agency determines to be fair and reasonable, negotiations with that firm shall be formally terminated and the agency shall select other firms in accordance with RCW [39.80.040](#) and continue in accordance with this section until an agreement is reached or the process is terminated.

POS Policy PUR2, Consultant Procedures, Paragraph IV., Summary Chart, establishes the following competition requirements for procuring consulting services:

<u>Architectural/Engineering Services</u>		
<u>Category A</u>	<u>Category B</u>	<u>Category C</u>
1) Fee ≤ \$50,000	>\$50,000 Fee ≤ \$200,000	Fee > \$200,000
2) Select Consultant from Files	Select Consultant from Files	Advertisement
3) Interview not Required	Interview 3 Firms	Request for Qualifications (RFQ) Interview Process
4) Short Form Agreement	Standard Agreement	Standard Agreement
<u>Non-Architectural/Engineering Services</u>		
<u>Category 1</u>	<u>Category 2</u>	<u>Category 3</u>
1) Fee ≤ \$50,000	>\$50,000 Fee ≤ \$200,000	Fee > \$200,000
2) Select Any Consultant	Select Three Consultants	Advertisement
3) Interview not Required	Interview	RFQ/Interview Process
4) Short Form Agreement	Standard Agreement	Standard Agreement

POS Policy EX-10, Contingent (Contract) Workers, requires that:

Former Port employees being considered for contract services of any nature will receive very close scrutiny by the Port's Project Manager for the work and by Procurement Services staff. The Chief Executive Officer must approve contracting with former Port employees.

Best Practices for procurement of goods and services establish that:

The benefits of competition are well established. Competition saves money for the taxpayer, improves contractor performance, curbs fraud, and promotes accountability for

results. –May 31, 2007, memorandum to Chief Acquisition Officers from the Office of Management and Budget.¹⁷

In addition, the **State of Washington Joint Legislative Audit and Review Committee** stated that:

*The primary purpose of the competitive bidding requirement is to prevent fraud, collusion, and favoritism by public officials and to obtain the best work at the most reasonable price. The open competitive process satisfies this by making the selection process transparent to the public.*¹⁸

Cause

POS non-construction contracts are not procured or administered using trained and professional contracting personnel responsible for protecting the integrity of the procurement process and assuring that contractual provisions are enforced and adhered to. Instead, the PSA contracts are procured and administered by POS project management and engineering personnel who work directly with consultant personnel.

We could not determine within this audit's scope if competition requirements are being circumvented in order to avoid the additional time and effort that competition requires, or in order to direct work to favored consultants. The latter cause is a distinct possibility.

Effect or Potential Effect

The circumvention of competition requirements inevitably results in higher costs for services and creates situations where the highest quality and value of services obtained cannot be assured.

Further, the steering of contracts to specific, favored individuals discourages other qualified consultants from bidding and proposing on POS requirements.

In addition, the manner in which PSAs are being procured allows for significant risk of fraud and abuse. There are no controls in place to prevent a variety of fraud schemes characterized by bribes, kickbacks, and illegal gratuities. Such schemes are very difficult to detect and, therefore, this type of illegal activity may be occurring without POS awareness.

Recommendations

This finding supports our overarching recommendation regarding appointment of a Chief Procurement Officer, establishment of an independent contract administration function, and revision of the delegations of authority for approving construction management expenditures. In addition, we recommend the following with respect to this finding:

Recommendation 13: We recommend that POS take immediate steps to review and enforce its policies and procedures for awarding PSA contracts and establish controls to ensure that competition requirements are not circumvented.

¹⁷ [see: http://www.whitehouse.gov/omb/procurement/comp_contracting/competition_memo_053107.pdf]

¹⁸ See Report 05-9, *An Assessment of General Contractor/Construction Manager Contracting Procedures*, June 22, 2005.

Recommendation 14: We recommend that POS initiate a comprehensive review of all PSAs to determine the full extent to which competition requirements have been circumvented, and take appropriate corrective actions.

POS Response

POS disagreed with this finding and stated that:

The consultant construction managers to which this finding applies were both selected through competitive processes. While documentation associated with the selection of one of these consultants was lost or destroyed in the course of repeated construction office relocations, the Port substantiated the competition process used for that selection through the statements of people involved and records located outside the official selection files. The processes used for both met the requirements of applicable laws and the Port's procurement policies.

The Performance Auditor asserts that competition did not occur when the individual consultants, who had participated and won competitively bid contracts, changed firms. In this case, the Port had selected specific individuals as the "most highly qualified to provide the services required." As a result, it was appropriate for the work to follow the selected consultant, and the Port managers responsible for these contracts specifically obtained the opinion of the Port's General Counsel that such an approach was consistent with law and Port policy.

Auditors' Additional Comments

In response to a draft of this finding, POS initially asserted that these services were not architectural engineering (A/E) services and that POS was not required to follow the law regarding A/E procurements. POS apparently realized that its own records indicate clearly that Consulting Contract D was procured as an A/E contract, and POS has now developed a new position to try to justify these questionable procurements.

POS asserts that documentation of the competitive procurement of the \$1.4 million contract with a former POS employee (the Consulting Company AB contract) was "lost or destroyed," but that other records were "located outside the official selection files" that showed that this procurement was competitive. We provided a draft of this finding to POS on August 28, 2007. POS did not mention the existence of these other records or "statements" until its December 3, 2007, response to the draft report, and POS has not produced these records or statements.

We disagree that these procurements met the requirements of applicable laws and POS policies. Consultant DW was selected through a competitive process in 1998. Other consultants were added to that contract, without competition, for services not included in the contract scope. Eight years later, consultant DW—after leaving the company that had received the competitive contract—was awarded a sole source \$2.7 million contract. Other consultants have been added to that contract without competition; and *consultant DW no longer works on POS projects under this contract.*

Under the convoluted reasoning set forth in POS's response, any consultant who was selected under a competitively-procured arrangement would be free to start his or her own company and be entitled to multi-million-dollar sole source POS contracts.

POS's response does not address that fact that two of these questionable procurements were with former POS employees. That fact alone warranted extra efforts to comply with the laws and POS policies in order avoid any appearance of favoritism in the contracting process.

Finding 2-E: POS altered contractor invoices to pay for work that exceeded the maximum contract amount set by law, thus violating state law and the Commission's delegation of authority.

This finding is the same as Finding 1-E. Please see Finding 1-E for details.

Finding 2-F: POS repeatedly awards Small Works Roster Program contracts to the same few contractors. The Small Works Roster Program’s random contractor rotation process can be circumvented to allow preferred contractors to be added to the Invitation for Bid list. The solicitation invitation process can be circumvented.

Background

According to PCS’s 2004 Financial Report, PCS issued 18 electrical contracts via the Small Works Roster Program during 2004. There was a total of 23 electrical contractors (6 of which were Minority/Woman-Owned Business Enterprise (MWBE) firms) approved and listed on the 2004 Small Works Roster, but of those 23 contractors *only* four electrical contractors [contractors AJ, AK, AL, and AM] were awarded contracts during 2004. Of the 18 contracts that were awarded, eight contracts were awarded to Contractor AJ for a total of \$1,389,200.00, seven contracts were awarded to Contractor AK (a Woman-Owned Business Enterprise (WBE) firm) for a total of \$1,168,995.00, two contracts were awarded to Contractor AL for a total of \$209,291.00, and one contract was awarded to Contractor AM for \$185,000.00. (See the table below.)

**Small Works Contracts Awarded in 2004 - Electrical Contracts
(Source Data: PCS 2004 Financial Report)**

Contract #	Contract Name	Initial Contract Amounts	Contract Signed Date	Contractor
1 SWV-310895	101/102 C-1 Feeder Project	\$94,200.00	4/20/2004	AJ
2 SW-0310958	Electrical Open Order 2004-04	\$185,000.00	4/29/2004	AJ
3 SW-0310354	S Gate C.U.T.E Electrical Open Order	\$185,000.00	5/6/2004	AJ
4 SW-0310760	Electrical Open Order 2004-01	\$185,000.00	5/10/2004	AJ
5 SW-0311463	Electrical Airport Open Order 2004-06	\$185,000.00	7/21/2004	AJ
6 SW-0311521	Electrical Seaport Open Order 2004-07	\$185,000.00	8/11/2004	AJ
7 SW-0311608	Electrical Open Order MES/CUTE	\$185,000.00	10/18/2004	AJ
8 SW-0311882	Electrical Open Order 2004-10	\$185,000.00	2/17/2005	AJ
TOTAL Contract Amounts for Prime Electric in 2004		\$1,389,200.00		
9 SW-0310893	Electrical Airport Open Order 2004-03	\$185,000.00	4/23/2004	AK
10 SW-0310724	Electrical Seaport Open Order 2004-02	\$185,000.00	5/11/2004	AK
11 SW-0311207	Electrical Airport Open Order 2004-05	\$185,000.00	6/17/2004	AK
12 SW-0311558	Electrical Airport Open Order 2004-08	\$185,000.00	8/23/2004	AK
13 SW-0311612	Electrical Airport Open Order 2004-11	\$185,000.00	9/16/2004	AK
14 SW-0311635	STS Shop Modifications- Electrical	\$58,995.00	10/20/2004	AK
15 SW-0311907	Electrical Open Order 2004-12	\$185,000.00	1/14/2005	AK
TOTAL Contract Amounts for SHJ Electric in 2004		\$1,168,995.00		
16 SWV-310965	Electrical Power Distr for Delta and American	\$60,000.00	4/21/2004	AL
17 SW-0309616	Conc. C Dbl End Switchgear - Electrical	\$149,291.00	4/19/2004	AL
TOTAL Contract Amounts for E. C. Company in 2004		\$209,291.00		
18 SW-0310425	Electrical S. Gates CUTE Open Order	\$185,000.00	5/6/2004	AM
TOTAL Contract Amounts for Veca Electric in 2004		\$185,000.00		
TOTAL Contracts Amount		\$2,952,486.00		

Although, POS is not required to advertise the *results* of the procurement process under the Small Works Roster Program, POS is required by RCW 39.04.155 (c) to establish procedures for “securing telephone, written, or electronic quotations from contractors on the appropriate small works roster to assure that a competitive price is established.” POS can invite quotations from “all appropriate contractors on the appropriate small works roster” or “as an alternative, quotations may be invited from at least five contractors on the appropriate small works roster.”

POS designed its Small Works Roster Program to randomly select seven contractors to receive invitations for bid.

Conditions

POS's Small Works Roster Program results in repeated awards to the same contractors

Between April 20, 2004, and May 10, 2004, (a period of 21 days), PCS awarded four contracts to Contractor AJ. These included three open order contracts for a total of \$555,000 and one contract specific to the C-1 Project for \$94,200, or \$649,200 for all four contracts.

Electrical open order contracts totaling \$2,952,486.00 were awarded during 2004; 47% of the total work was awarded to Contractor AJ, and 40% of the total was awarded to Contractor AK. Of the total \$2.95 million in electrical small works contract, 87% of the work went to two firms, often with multiple awards within less than a month's time. Clearly, PCS is not achieving an equal distribution among the Small Works Roster Program contractors as contemplated in RCW 39.04.155.

Contractor AJ (an electrical contractor whose website indicates it has an annual sales volume of nearly \$40 million) was awarded the largest dollar value of electrical contracts in 2004, so we selected three of their open order contracts for additional testing. We observed that during the course of the following three advertisements (January, July, and December 2004) responses from electrical contracting firms dwindled until the only two firms submitting proposals were the same two firms who had jointly received 87% of the total work awarded during 2004.

SW-0310760: The advertisement for this procurement was posted both on POS's web site and displayed publicly. Twenty one firms are shown to have been sent invitations "to bid" on "Electrical Open Order 2004-01 Contract." The Notice of Intent to Award date was January 29, 2004. Eight contractors were listed as plan holders, with five of the eight contractors submitting proposals to PCS. The PCS evaluation "bid amounts" used to determine the "low bidder" are derived by PCS through the use of a Bid Evaluation Matrix in which estimated hours/dollars are used and each contractor's bid unit prices are inserted to determine the "lowest bidder." Contractor AJ was awarded the contract.

SW-0311521: The advertisement for this procurement was posted on POS's web site and public space at PCS's building, and 21 firms are shown to have been sent invitations to bid "Electrical Seaport Open Order 2004-07 Contract." The Notice of Intent to Award date was July 27, 2004. Four contractors were listed as plan holders, with three of the four contractors submitting proposals to PCS. ALL of the bids that were submitted exceeded the \$200,000 limit for open order contract work. The contract was awarded in the amount of \$185,000 to Contractor AJ.

SW-0311882: The advertisement for this procurement was *not* "Displayed Publicly." Seven firms were *shown* as having been invited to bid. POS could not, however, confirm that any of the bidders listed actually received notification of the bid either via fax or email. The contract file did *not* include documentation verifying that any of the listed contractors received the invitations to submit bids, and POS has been unable to find or produce such documentation. Two of the seven contractors listed were the preferred contractors AJ and AK. The Notice of Intent to Award date was December 10, 2004. The contract was awarded to Contractor AJ.

The Small Works Roster Program's solicitation invitation process can be circumvented.

We tested the Small Works Roster Program to see if procurement documentation could be prepared for an awarded project without actually distributing the invitation for quotation. POS provided us with access rights that allowed us to set up a “demo” project in the Small Works Roster Program. We found that it is possible to navigate through the setting up process for a “demo” project and post it as awarded without actually distributing a solicitation for the procurement. *Our concern regarding the solicitation invitation process under the small works program was generated because of documentation found in the file for SW-0311882, described above.* Of the three small works contracts discussed above, two of the projects indicated that the advertisements were “displayed publicly” and the project status was “Active.” In the case of SW-0311882, however, the project was *not* displayed publicly and the project status was “Awarded.” Below is the contract documentation that we reviewed.

PCS Change Order

PRINT CLOSE WINDOW

Project Information

Electrical Open Order 2004-10

Project Status: AWARDED

Contract Administrator: [REDACTED]
Construction Manager: [REDACTED]

Bid Opening Date: 12/09/2004 11:00 AM
Estimate Amount: \$185,000.00
Award Amount: \$142,584.03
Department Code: PCS
Contract Number: SW-0311882

Contract Accounting Number:
Work Duration: 365 Calendar days
Bid Opening Location: PCS Office - 17900 International Blvd. Suite 420 SeaTac WA 98188

Work Description:
The Contractor shall provide the necessary journey level person(s), supported with all the tools and equipment as necessary, to work with various Port of Seattle persons and/or other contractors on various projects at Sea-Tac International Airport, to provide electrical work as required. Contractor shall be paid agreed upon rates as specified in the project bid proposal. PCS is unable to determine the precise types of work that may be performed under this contract at this time. However, the work will be identified and scheduled with the contractor on a project by project basis.

Pre-Bid Information:
There will be a no pre-bid.

Plan Pick Up Instructions:
The complete bid package can be picked up at the office of Port Construction Services located at 17900 International Blvd., Suite 420 SeaTac, WA 98188. PCS Main Reception hours are 8:00AM - 4:30PM Monday through Friday. The Main Reception telephone number is (206)444-6710.

Restrictions:
PCA: yes OCIP: yes Badging: yes Safety: yes
Display Publicly: NO

Craft codes:
EL - Electrical/General Power

Project Contractors Click company name to change status.

Company	Status
[REDACTED]	INVITED TO BID MWBE: none
[REDACTED]	View Contractor Info -- Check Fax Status INVITED TO BID MWBE: M
[REDACTED]	View Contractor Info -- Check Fax Status INVITED TO BID MWBE: none
[REDACTED]	View Contractor Info -- Check Fax Status INVITED TO BID MWBE: none

PCS Change Order

Contractor AJ

View Contractor Info -- Check Fax Status

AWARDED
Bid: \$142,584.03
MWBE: none

Contractor AK

View Contractor Info -- Check Fax Status

BIDDER
Bid: \$149,588.05
MWBE: W

View Contractor Info -- Check Fax Status

INVITED TO BID
MWBE: W

View Contractor Info -- Check Fax Status

As shown below, we were able to create a “demo” project in the PCS program and designate it as “awarded” and replicate the documentation found in the contract file for SW-0311882. Variations in the printouts shown below are due only to the documents being printed on different printers. The Small Works Roster Program randomly selected seven contractors, and then we manually selected two additional contractors, with Contractor AJ being one of the contractors that was added to the list. Then we changed the status from “Future” to “Awarded;” changed the contractor statuses from “Invited to Bid,” to “Bidder” and “Awarded;” and entered bid and contract amounts. We were able to prepare file documentation that appears as if this “demo” contract proceeded through the proper solicitation invitation process, without ever actually distributing a solicitation to anyone. (After we completed this test we deleted the “demo” project from the project listing.)

Project Information

PRINT CLOSE WINDOW

Demo

Project Status: AWARDED

Contract Administrator: Auditor, (123) 456-7890

Construction Manager: Auditor, (123) 456-7890

Bid Opening Date: 10/01/2007 05:00 PM

Estimate Amount: \$185,000.00

Award Amount: \$150,000.00

Department Code: PCS

Contract Number: SW-9999999

Contract Accounting Number:

Work Duration: 365 calendar days

Bid Opening Location: PCS Office - 17900 International Blvd. Suite 420 SeaTac WA 98188

Work Description:
demo project

Pre-Bid Information:
There will be no pre-bid.

Plan Pick Up Instructions:

The complete bid package can be picked up at the office of Port Construction Services located at 17900 International Blvd., Suite 420 SeaTac, WA 98188. PCS Main Reception hours are 8:00AM - 4:30PM Monday through Friday. The Main Reception telephone number is (206) 444-6710. Bidders can also request a complete bid package by contacting the Contract Administrator.

Restrictions:

PLA: yes OCIP: yes Badging: yes Safety: yes

Display Publicly: no

Craft codes:

EL - Electrical/General Power

Project Contractors

Company

[REDACTED]

[REDACTED] N CO

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

Contractor AJ

[View Contractor Info -- Check Fax Status](#)

[View Contractor Info -- Check Fax Status](#)

[View Contractor Info -- Check Fax Status](#)

[View Contractor Info -- Check Fax Status](#)

[View Contractor Info -- Check Fax Status](#)

[View Contractor Info -- Check Fax Status](#)

[View Contractor Info -- Check Fax Status](#)
Plan set held by
E C Company
(123) 456-7890

[View Contractor Info -- Check Fax Status](#)

[View Contractor Info -- Check Fax Status](#)

Click company name to change status.

Status

INVITED TO BID

MWBE: M

INVITED TO BID

MWBE: W

INVITED TO BID

MWBE:

INVITED TO BID

MWBE:

INVITED TO BID

MWBE:

INVITED TO BID

MWBE:

INVITED TO BID

MWBE:

BIDDER
Bid: \$170,000.00
MWBE: S

AWARDED
Bid: \$150,000.00
MWBE: S

2.10 ADVERTISING A PROJECT

Note: Advertising a project results in bid advertisements being sent (via fax or email) to the contractors selected when you created the project. Therefore, do not execute the advertise function until all project information has been entered and reviewed.

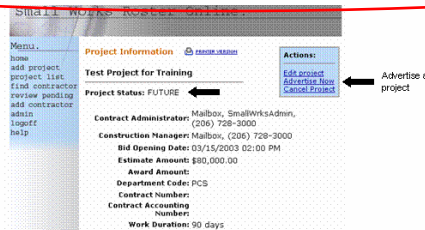
1. If you created the project that you now want to advertise, locate the project in your project list and click on its title.

--- OR ---

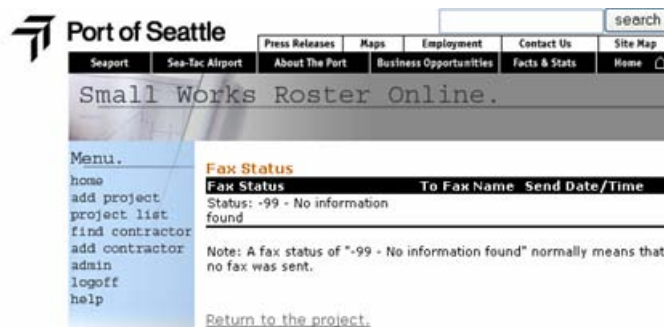
If another CA created the project that you now want to edit, click on the **PROJECT LIST** link on the left-hand navigation menu. The Project List can be sorted by clicking on one of the list headers (**BID NAME**, **STATUS**, or **DEADLINE**). From the list of projects, click on the title of the project that you want to edit.

2. Click on the **ADVERTISE NOW** link in the **ACTIONS** box located in the upper right hand section of the screen.

If this option is not available, make certain that the status of the project you are trying to advertise is **FUTURE**. If the status is anything other than **FUTURE**, you can not advertise the project from this screen.



In response to a draft of this finding, POS provided the “Bid Invitation Delivery Status Summary page” as documentation that the invitation for quotation process had not been circumvented for contract SW-0311882. The information from POS did *not* demonstrate that the contract had been advertised to solicit quotations from the bidders listed. The Small Works Roster Program provides for potential bidders to designate their preference for bid notifications via either email or fax. The Small Works Roster Program’s “Bid Invitation Delivery Status Summary” page only provides evidence of fax transmissions and does not record when, or if, emails are sent. In the case of SW-0311882, five of the seven bidders requested fax notification and two bidders requested email notification. *None* of the bidders were sent faxes (as indicated by the Status 99 – no information found error message), and POS was unable to provide evidence that emails were sent. Below is an example of the supporting documentation that was provided by POS:



We have not asserted that *all* PCS contracts have been rigged. Our purpose in reporting this Detailed Finding (2-F) was to demonstrate how easily the PCS procurement process *can* be rigged.

The Small Works Roster Program lacks essential controls that would prevent the manipulation of contract awards or the “steering” of contracts to favored contractors.

Criteria

State Law, RCW 39.04.155, *Small works roster contract procedures*, states:

*(c) Procedures shall be established for securing telephone, written, or electronic quotations from contractors on the appropriate small works roster to assure that a competitive price is established and to award contracts to the lowest responsible bidder((,)) as defined in RCW (([43.19.1911](#))) [39.04.010](#). **Invitations for quotations shall include an estimate of the scope and nature of the work to be performed as well as materials and equipment to be furnished.** However, detailed plans and specifications need not be included in the invitation. This subsection does not eliminate other requirements for architectural or engineering approvals as to quality and compliance with building codes. **Quotations may be invited from all appropriate contractors on the appropriate small works roster. As an alternative, quotations may be invited from at least five contractors on the appropriate small works roster** who have indicated the capability of performing the kind of work being contracted, in a manner that will equitably distribute the opportunity among the contractors on the appropriate roster. **However, if the estimated cost of the work is from one hundred thousand dollars to two hundred thousand dollars, a state agency or local government, other than a port district, that chooses to solicit bids from less than all the appropriate contractors on the appropriate small works roster must also notify the remaining contractors on the appropriate small works roster that quotations on the work are being sought.** The government has the sole option of determining whether this notice to the remaining contractors is made by: (i) Publishing notice in a legal newspaper in general circulation in the area where the work is to be done; (ii) mailing a notice to these contractors; or (iii) sending a notice to these contractors by facsimile or other electronic means. **For purposes of this subsection (2)(c), "equitably distribute" means that a state agency or local government soliciting bids may not favor certain contractors on the appropriate small works roster over other contractors on the appropriate small works roster who perform similar services.** [Emphasis added.]*

(d) A contract awarded from a small works roster under this section need not be advertised.

(e) Immediately after an award is made, the bid quotations obtained shall be recorded, open to public inspection, and available by telephone inquiry.

RCW 53.08.120, *Contracts for labor and material---Small work roster*, states:

However, a port district may let contracts using the small works roster process under RCW [39.04.155](#) in lieu of calling for sealed bids. Whenever possible, the managing official shall invite at least one proposal from a minority contractor who shall otherwise qualify under this section.

*When awarding such a contract for work, when utilizing proposals from the small works roster, the managing official shall give weight to the contractor submitting the lowest and best proposal, and **whenever it would not violate the public interest, such contracts shall be distributed equally among contractors, including minority contractors, on the small works roster.*** [Emphasis added.]

POS Policy, PCS's *Strategic Direction*, states:

A new model for management for professional services agreements centered around contracts with smaller dollar value with the objective of continuing to provide increased opportunities for small business enterprises. [Emphasis added.]

Cause

PCS's practice of repeatedly awarding the electrical small works contracts to the same two contractors during 2004 may have deterred other small works contractors from attempting to bid the work, realizing that PCS has "favored" certain Small Works Roster Program contractors.

PCS contract administrators could be "steering" awards toward contractors on which overruns of approved contract amounts for prior contracts have occurred in an attempt to cover up poor contract management/oversight.

The Small Works Roster Program lacks the necessary controls to prevent users from circumventing the advertisement (solicitation invitation) process, thus creating the ability to award contracts without advertising the invitation for quotation in accordance with RCW 39.04.155 (c).

POS personnel may be assisting contractors that repeatedly get small works contracts awarded by not advertising/posting the job notifications. We found that it is possible to set up a contract and "award" the contract without ever having sent invitations for quotations to selected contractors.

Effect or Potential Effect

The same few contractors have been receiving POS contracts. Repeatedly awarding contracts to the same contractors can be a deterrent to achieving more robust competition among small works contractors. PCS relies on the Small Works Roster Program to randomly select contractors and PCS receives exception messages only when a contractor does not get an advertisement that has been faxed. However, if an advertisement is not actually sent, then no exception message would be received. Thus, once the advertisement process is circumvented, the opportunity exists for PCS personnel to verbally notify a favored contractor(s). Contract SW-0311882 was the next contract awarded to Contractor AJ after Contract SW-0311608 which was "steered" toward Contractor AJ to cover contract cost overruns (see Finding 2-E). The contract file contains indicia of contract advertisement circumvention.

Recommendations

This finding supports our over-arching recommendation that POS establish an independent Procurement and Contracts Administration unit and revise delegations of authority to transfer authority for procurement and contract administration from project and construction managers to independent, objective, and professional contracting officers. In addition, we recommend the following with respect to this finding:

Recommendation 20: We recommend that PCS develop a means of tracking the award of contracts to ensure that a majority of the work isn't being repeatedly awarded to the same contractors. (Although PCS maintains a substantial amount of statistical information regarding

the total percentages of work awarded through the Small Works Roster Program, PCS does not track the *distribution* of contracts or contract dollars awarded.)

Recommendation 21: We recommend that Small Works Roster Program controls be established to assure that the random rotation process cannot be circumvented to allow preferred contractors to be added to the selection list.

Recommendation 22: We recommend that PCS require contract files to include email and fax confirmations for the advertisements as proof that invitations to bid are actually received by potential bidders. (Presently, no supporting documentation is maintained in procurement files to verify if the listed contractors received the advertisements.)

Recommendation 23: We recommend that PCS create controls in the Small Works Roster Program to ensure that all procurements are advertised (i.e. that solicitations are actually distributed to potential bidders as required).

Recommendation 24: We recommend that PCS develop consistent bid evaluation criteria, particularly when the descriptions of work state that “PCS is unable to determine the precise types of work that may be performed under this contract at this time.” (Consistent bid evaluation quantities would make the bid process an equitable one for contractors that have not done prior work for PCS and lack an understanding of the risks associated with each unit price line item.)

POS Response

The full text of the POS response to this finding is in Appendix E. POS’s response did not agree or disagree with this finding and did not address any of the indicia of fraud identified in our report regarding PCS’s obvious manipulation of the solicitation procedures for small works contract awards. Instead, POS’s response addressed and mischaracterized an earlier draft of this finding, and stated:

Pointing to different language in Section 53.08.120 of the Revised Code of Washington, the Performance Auditor indicates that the Port should have been making contract awards based on criteria other than the low bid, in order to distribute the contracts equally among the contractors on the small works roster. Given the Port’s commitment to competition, long-standing policy has been to award the contract based on the low bid.

...

In response to the Small Works Roster Program rotation recommendation, the Port is currently reviewing the rotation process and making appropriate revisions to eliminate any ability to circumvent contractor rotation in the small works bidding. These revisions will result in greater transparency and may result in increased competition for small works contracting opportunities.

Auditors’ Additional Comments

The draft version of this Finding did *not* recommend that POS make “contract awards based on criteria other than the low bid.” We cited Section 53.08.120 of the Revised Code of Washington

which states “*When awarding such a contract for work, when utilizing proposals from the small works roster, the managing official shall give weight to the contractor submitting the lowest and best proposal, and whenever it would not violate the public interest, such contracts shall be distributed equally among contractors, including minority contractors, on the small works roster*” because POS had consistently awarded the majority of the 2004 electrical open order contracts to the same two contractors. The RCW provides for awarding contracts based on the lowest and best proposal *and* equal distribution of contracts to Small Works Roster Program contractors.

In fact, the contractor who received ~50% of the small works electrical contracts that were awarded during 2004, (a) was a large electrical contractor with gross revenues of \$40+ million per year; (b) is the same contractor to whom POS steered contract SW-0311608 to conceal contract cost overruns (see Finding 1-E); and (c) is the same contractor to whom POS steered contract SW-0311882 when it [POS] manipulated the Small Works Roster Program rotation procedures and avoided advertising the solicitation to other small works roster contractors.

The concern expressed in this finding (that the POS response ignores) is that PCS personnel appear to be manipulating the small works procurement process to steer contracts to a small number of preferred contractors. If POS truly had a “*commitment to competition*,” it would be concerned that its manipulation of the small works contracting process appears to be inhibiting and discouraging competition.

The recommendations in the draft and final versions of this Finding are identical. Our Recommendations focus on correcting POS’s failure to monitor the distribution of small works contracts to achieve a more equal distribution, its manipulation of the roster rotation process, circumvention of solicitation advertisements, and the use of bid evaluation criteria which favor larger contractors who have received repeated awards, all of which combine to limit competition and award of small works contracts to the true “small” and diverse contractor community.

Audit Finding 3: POS Policies and POS Management’s Interpretations of These Policies Resulted in a Lack of Transparency and Thwarted Commission Oversight of Construction Management Activities

Finding 3-A: A 3rd Runway Project procurement violated applicable procurement laws, and POS concealed details of this unusual procurement from the POS Commission.

Background

The history surrounding a major procurement for work on the 3rd Runway Project indicates that:

- POS violated State procurement law by improperly negotiating with the low bidder before contract award, and
- POS personnel failed to fully inform the POS Commission of the unusual circumstances surrounding the procurement, thus precluding the Commission from being able to exercise its statutory responsibilities and authorities.

Condition

Following is a summary of the issues related to the 2006 3rd Runway embankment procurement.

The 3rd Runway 2006 Embankment Contract: 3rd Runway embankment work was divided into two contracts: the “2004/2005 contract” and the “2006 contract.” (According to a POS manager, the reason for dividing the work was that:

...there was a new radar that was being designed and constructed by the FAA. Once commissioned and in service, the [older] existing facility, which was in the footprint of the embankment, could be decommissioned and demolished. The project was delayed and the potential for an impact to the embankment construction schedule was extremely high. As a result the 3-year project was split into two separate contracts.

POS’s Risk Assessment Failed to Identify a Critical Risk: POS conducted a “POS SeaTac 3rd Runway Risk Assessment” in 2003 and issued a report on that assessment on June 20, 2003. That assessment did not identify limited competition for embankment work as a risk. The POS report included a cost estimate for the construction contract cost of the 3rd Runway embankment work (2006 contract). The 2003 cost estimate showed a construction contract cost of \$60,197,465, construction contingency of \$2,283,702, allocable sales tax of \$5,498,343, and an allowance for escalation of \$6,635,000 for total construction contract cost of \$74,614,510.

Two bids were received for the 2004/2005 contract (Construction Company AF and Construction Company AG) and the contract was awarded to Construction Company AF.

POS Suspected Limited Competition Leading to an Inflated Bid: Bids were due for the 2006 embankment contract on December 20, 2005. POS suspected, prior to the bid date, that they would receive only one bid. POS project personnel were concerned about competition and called various potential subcontractors to ask who they were submitting quotes to. POS learned that Construction Company AF (the contractor already performing the 2004-2005 embankment work) was likely going to be the only bidder. POS project personnel affirmed that if POS knew

about the lack of competition, Construction Company AF almost certainly knew this also. POS project personnel were hopeful that another contractor *might* bid. According to a POS manager, another contractor:

...was a plan holder and had prior approved fill material from the 2004-05 Project sufficient to supply the entire 2006 work. [This other contractor] was informally contacted prior to the bid opening date to understand their intention on the project. I believe the response was “we haven’t ruled it out but we have [other work] and really no available trucks for the job..... we are unsure at this time.”

POS Inflated Its Own Engineer’s Estimate in Anticipation of an Inflated Bid: The POS Engineer’s Estimate for the 2006 contract was, initially, “about \$92 million,” or about \$17,385,490 higher than the 2003 risk assessment estimate. A POS manager confirmed that by late 2005, POS’s estimating team was in a very good position to develop an accurate estimate: the work was relatively straight-forward embankment work, and POS had two years of experience with the actual performance of the work during the 2004-2005 contract. Nevertheless, the \$92 million estimate was (shortly before bids were received) raised to \$105,071,395. A POS manager indicated that the:

...major swing, the \$10+ million in the initial estimate, [was] as a result of [the] realization that the bid wasn't going to be competitive.

(There does not appear to have been any additional change to the Engineer's Estimate following the bid opening on December 20, 2005.)

One Bid—Even Higher Than POS had Feared—Was Received for the Work: One bid was received on December 20, 2005: Construction Company AF’s bid for \$124,777,042. This exceeded the *initial* Engineer’s Estimate by 35.63 percent and exceeded the upwardly revised Engineer’s Estimate by 18.75 percent.

POS Project Personnel Posited Possible Reasons for the Inflated Bid: In assessing causes for the higher-than-expected bid, a POS manager suggested that:

...increase[s] in the bid prices from the 2004-05 Contract were likely due to [Construction Company AF] underestimating the cost of some of the work. For instance: 1) Cost of keeping the roads clean ... 2) The cost of diesel fuel ...and 3) The cost of maintaining legal truck loads ...

The POS manager also speculated that:

...the possible reasons the competition was limited were (a) other bidders thought [Construction Company AF] had the job “locked;” (b) [Construction Company AF] had already invested around \$1 million in getting the needed environmental testing of various borrow pits done, and other bidders were unwilling to make

such an investment just to be able to bid; and (c) the construction industry in Western Washington was booming at the time.

There is no indication that POS considered the possibility that the receipt of a single bid that was substantially higher than expected may have been due to a collusive bidding arrangement.

Could the Limited Competition Situation Have Been Avoided?: We asked if POS might have anticipated, as the environmental suits were being decided, that borrow sources might be limited, and if POS considered designating approved borrow sites (and paying for the testing) rather than letting a single contractor gain such a competitive advantage. This would have maintained an equal competitive footing. In response, a POS manager stated that they were:

...not sure [if that would be] a customary approach to embankment work. It is clear the requirements of the Port's permits on this project were far from customary or typical. The procurement of fill material was analyzed and discussed at length. Because of the magnitude of the work, the ongoing certification of the fill sources as the work progresses and the importance of maintaining the gradation and moisture of the material to the construction schedule, the responsibility fill [sic] in its entirety was the contractor's. It was universal opinion that if the Port "provided" the material, we would "own" all the risk. There was over 33 million cubic yards of material tested and submitted as part of the two bids received for the 2004-05 Contract. Approximately 15 million cubic yards from 5 sources was approved at the time of award of the 2004-05 contract. Only about 6 million cubic yards of imported material was required in the documents. These same sources were essentially pre-approved for the 2006 contract. Of the total of initially approved sources, 5 million cubic yards was from a non-[Construction Company AF] source.

The POS Project Team Considered Its Options But Did Not Consult the Commission: A POS manager said that right after the \$124,777,042 bid was received on December 20, 2005, the project team began considering three options that they might take:

(a) award to [Construction Company AF] at the bid price, (b) not award to [Construction Company AF] and re-procure the needed work, and (c) negotiate a deductive change order with the contractor.

Although Prohibited by Washington State Law, POS Decided to Negotiate with Construction Company AF: A POS manager maintained that the POS general counsel told POS that because there was only one bidder, POS could—legally—enter into negotiations with Construction Company AF to try to get them to lower their price. There is no documentation of that legal determination. During our audit, the POS general counsel stated that:

...as far as I know I did not authorize negotiating prior to award and do not believe that would be appropriate.

The POS general counsel later offered:

*The 3rd runway is arguably a matter of public necessity for national and regional transportation reasons, and there were major storm water runoff mitigation requirements if a construction season was missed. ... as I understand it the lone bid was high but I doubt we were in any position to reject and rebid given the consequences of delay and the unlikely prospect of additional bidder participation So, the Port engaged in discussions to determine if the bidder would consider value engineering to lower the cost; my recollection was it related to some sort of fuel cost formula given the rapidly increasing cost of diesel. But at the end of the day, the contract was awarded for the price bid, and c/o was subsequently executed to incorporate what was at best an unenforceable understanding reached preaward. Clearly this was an unusual process applied to an unusual situation. The absence of other bidders eliminates the "level playing field" concern typically associated with preaward discussions with one bidder to the exclusion of others. The prebid understanding seems clearly intended to save money, not enrich the contractor, and was done in the context of significant financial and environmental consequences associated with delay. As a result it seems the intent of the bidding laws was satisfied as there is no apparent corruption or unlawful motive involved. And by awarding as bid, it seems that not only was the spirit but also the letter of the bidding laws satisfied. **So while in hindsight this would seem to be at a minimum an unconventional approach and not one that I am particularly comfortable with, given the practical considerations at hand at the time, I am not so sure based on what I have been told that it was necessarily improper.** [Emphasis added]*

POS's CEO Intervened and Ordered Negotiations to Get Construction Company AF's Price Within 10% of the POS Engineer's Estimate: The POS CEO and the SeaTac Managing Director had a meeting (at "Spencer's for Steaks and Chops") with a Construction Company AF principal on the afternoon of December 23rd. According to the SeaTac Managing Director, this was:

...after the bids were opened and during a period in which we were deliberating on the best way to proceed. Effectively, we were seeking a sense of whether [Construction Company AF] would be open to negotiating a change order that would allow us to share some of the risk associated with what were very dynamic fuel prices. We did not negotiate anything. I do not want to speak for [the former POS CEO] but I think he came away satisfied that [the Construction Company AF principal] and [Construction Company AF] would be reasonable in seeking a negotiated means of sharing the fuel cost risk.

The SeaTac Managing Director later clarified that:

...the meeting of [the former POS CEO], [the Construction Company AF principal], and me was not a negotiations [sic]. Once we determined that it made sense to proceed, the project folks undertook negotiations.

Whether termed “negotiations” or “discussions,” the POS CEO directed 3rd Runway Project personnel to negotiate with Construction Company AF to lower the contract price by \$9.4 million—an amount needed to bring the contract price to within 10% of the revised Engineer’s Estimate. The negotiations, conducted on December 23, 2005, focused on:

1. the anticipated cost of fuel,
2. mobilization/demobilization costs (Construction Company AF’s mobilization/demobilization line item on the 2006 bid was twice what it had in the 2004/2005 contract and 6.2 times higher than the POS Engineer’s Estimate; and Construction Company AF was, essentially, already mobilized), and
3. reductions in [estimated] quantities for fill, debris excavation, and asphalt concrete debris removal, unsuitable excavation, gravel borrow, and geotextile fabric. (For these last three unit price line items, quantities were reduced to zero, but the line items were not eliminated, and the contractor was ultimately paid actual quantities for all six of these line items.)

The \$9,391,604 Reduction Achieved was, in Part, Legitimate, and, in Part, Cosmetic:

Negotiation item (2) (mobilization/demobilization) was, in part, a legitimate change in the contractor’s price. Negotiation item (3), however, was purely cosmetic. On item (3), Construction Company AF would ultimately receive payment for *actual* quantities regardless of *estimated* quantities used in the initial contract price, so the change order was clearly not a meaningful price or scope reduction in that regard.

Negotiation item (1) (fuel costs) is more complicated, but also largely cosmetic. The adjusted price included a reduction of \$4,000,000 based on fuel costs, and that reduction was embedded, in part, in the mobilization/demobilization reduction (\$607,000) and, in part, in a \$0.87 per yard unit price reduction (\$3,393,000) in the common fill line item. The \$4,000,000 fuel cost reduction was founded on the premise that Construction Company AF’s embankment unit price was based on an assumption that fuel would cost \$3.00 per gallon. The POS CEO had (according to a POS manager) asserted that fuel would likely cost only \$2.00 per gallon during the course of the contract (calendar year 2006). The parties agreed that Construction Company AF would lower its bid amount by \$4,000,000 to match the POS \$2.00 per gallon assumption; but that a change order would be processed at the end of the job to compensate Construction Company AF if the actual cost for fuel turned out to be higher than \$2.00 per gallon and less than \$3.00 per gallon. At the time of these negotiations, the price of the fuel in question, No. 2 diesel, was \$2.52 per gallon.

There is No Support for the \$4 Million Price Reduction’s Foundation Premise that Fuel Prices Would Fall: We asked if there was any support for the POS assertion cited as the basis for the fuel cost reduction in Change Order 1 (and written into the subsequent Change Order 8 that gave back the \$4,000,000) that Change Order 1 was based on “the widely held industry projections of an average of \$2.00 per gallon during the life of the 2006 Contract.” There was no support for this important assertion attached to or with the change orders. A POS manager stated:

According to [the POS CEO], there was a Fed economic report in the Fall of 2005 that was projecting falling energy prices with diesel dropping to \$2/gallon

and below during 2006. [The POS CEO] at the time was on the Federal Reserve Bank Board.

We asked the former POS CEO about this Fed economic report and he did not indicate that he was aware of such a report, and indicated that he had not been involved in the details of the negotiations.

We have been unable to locate such a report. According to the United States Energy Information Administration (EIA), the actual price for fuel in December 2005 when this was being negotiated was \$2.52 per gallon. (By February 2006, when POS signed deductive Change Order #1, the price had risen to \$2.59 per gallon. By June 2006, when Construction Company AF signed deductive Change Order #1, the price had risen to \$3.16 per gallon.)

The EIA publishes a monthly *Short-Term Energy Outlook*, that forecasts energy prices for 12 months into the future. The October 12, 2005 *Outlook* projected the retail price of No. 2 diesel fuel to be \$2.58 per gallon in 2006. The November 8, 2005 *Outlook* projected the retail price of No. 2 diesel fuel to be \$2.56 per gallon in 2006. The December 6, 2005 *Outlook* projected the retail price of No. 2 diesel fuel to be \$2.54 per gallon in 2006.

Following receipt of a draft of this finding, a POS manager produced a graph from a September 2005 issue of ENR (*Engineering News-Record*) that predicted fuel prices dropping in the 1st and 2nd quarters of 2006. A December 19, 2005 ENR report, however—available when POS was negotiating with Construction Company AF on December 23, and when the diesel fuel price was \$2.52/gal, included the following paragraph:

Diesel fuel prices also are expected to remain high. This year, diesel fuel prices posted a 59% year-to-year increase, according to the Bureau of Labor Statistics producer price index for October. "Higher fuel prices have led to stiff surcharges for the delivery of materials," says Mary Wallers, president of Sierra West Group, which compiles the Lee Saylor cost index (see p. 28). She says delivery surcharges have been reported between 10 to 25%.

POS Did Not Change Its Engineer's Estimate to Reflect the Reduced Estimated Quantities Negotiated with the Contractor: POS did not adjust its Engineer's Estimate to take into account the reductions in estimated quantities upon which the contract price was supposedly revised. Doing so would have simply maintained the gap between the bid and the Engineer's Estimate and, thus, been contrary to the stated goal of bringing the contractor's price to within 10% of the POS estimate. If the same quantity reduction used in negotiations had been made to the Engineer's Estimate, the Engineer's Estimate would have been \$100,777,995 and the

cosmetically reduced contract price would still have been 114.49% of the corresponding Engineer's Estimate.

In effect, although the negotiated reduction appeared to lower the contract amount by \$9,391,604, in reality it consisted of just \$1,997,104 in legitimate reductions, \$3,394,500 in cosmetic reductions, and the \$4,000,000 reduction contingent upon the unsupported premise that fuel prices would drop from \$2.52 per gallon to below \$2.00 per gallon during the life of the contract.

POS Policies Required Commission Notification: POS policies [Resolution 3181] require that whenever a lowest bid is greater than 10% above the Engineer's Estimate, the Commission must be notified so that they can intervene in the procurement decision if deemed necessary. A POS manager stated that:

The purpose of the [notification] Memo is to indicate that we will proceed – if we do not here [sic] back from Commission within typically 7 – 10 days.

The Commission was notified of the intent to award the contract to Construction Company AF via a memo dated December 27, 2005:

December 27, 2005

TO: Commissioners
M. R. Dinsmore, Chief Executive Officer
Linda Strout, Deputy, Chief Executive Officer
Mark Reis, Managing Director Aviation Division
Craig Watson, General Counsel

FROM: Ray Rowe, Chief Engineer/Director Engineering Services 

SUBJECT: Notification of Intent to Award a Contract to TTI Constructors, LLC, for 3rd Runway - 2006 Embankment Construction/R/W 16L Safety Area Expansion project

1. In accordance with Resolution 3181, we are notifying Commission that we intend to award this contract to the sole successful low bidder, TTI Constructors, LLC.

2. Background:

We received one bid on December 20, 2005 for the above-noted project. The Bidder was TTI Constructors, LLC with a bid of \$124,777,042.50 based upon extrapolation of unit prices and estimated quantities. After requesting the Bidder to validate their bid and to verify the unit prices and estimated quantities, an adjusted amount of \$115,385,438.50 was provided. The Port's estimate of construction cost is \$105,071,395.00.

3. The existing Commission authorization to date is adequate to satisfy this contract award. The Port will proceed with the award process on December 30, 2005, and administer an immediate deductive change order to reflect the adjusted quantity/pricing as described above.

If you have any questions please contact me at 728-3105.

cc: David Soike, Deputy Managing Director Aviation
Bob Riley, Director, Av/CIP
Mike Merritt, Director Commission Services
Michael Mequet, Assistant Director, Construction Services
John Rothnie, Program Leader Airfield
Paul L. Powell Jr., Manager, Contract Services
Scott Kyles, Project Manager
Carol Bestwick, Contract Administrator

We spoke with four of the five Commission members who were serving in December 2005, and none of them remembered seeing this memorandum. The 2nd paragraph is significant in at least three respects:

1. It clearly indicates that POS conducted negotiations prior to award to obtain the \$9,391,604 price reduction.
2. It does not clearly indicate that POS planned to award the contract at a price 18.75% higher than the Engineer's Estimate.
3. It is misleading, at best, in indicating that the "adjusted amount" is based on "requesting the bidder to validate their bid and to verify the unit prices and estimated quantities." The adjusted amount was only tenuously based on "validation" or "verification" of unit prices. The adjusted amount had nothing to do with "validation" or "verification" of estimated quantities.

This memo also makes it clear that the Commission was not informed that the intended award was actually \$32,777,042, or 35.63% higher than the more realistic Engineer's Estimate or that POS had increased the Engineer's Estimate just prior to receipt of bids "as a result of [the] realization that the bid wasn't going to be competitive."

The Contract Was Awarded at the \$124,777,042.50 Bid Price Rather Than the "Adjusted Amount": POS issued a Notice of Intent to Award the contract at the bid price of \$124,777,042.50 on January 3, 2006, four days following the Commission notification.

There Were No Commission Discussions or Deliberations: This unusual procurement was not discussed by the Commission in public session or even in executive session. Bids were received on December 20, 2005, and the award notification was sent to the contractor on January 3, 2006. Commission meetings were held on December 13, 2005 and January 10, 2006.

The Contractor balked at Accepting the "Adjusted Amount" Change Order: Contract Change Order Number 1 was the \$9,391,604 "adjusted amount" deductive change that had supposedly been agreed to with Construction Company AF prior to award. It had an effective date of February 6, 2006, and was signed by POS's Assistant Director, Construction Services, on February 22, 2006. Construction Company AF initially balked at signing the change order, but finally signed it on June 5, 2006, 5 months *after* negotiations and contract award. A POS manager indicated that some persons in Construction Company AF realized that they were under no obligation to agree to the \$9,391,604 deductive change order, but that he was able to convince them that they had shaken hands on the deal in December and Construction Company AF should honor that agreement.

Another consideration in Construction Company AF finally signing the change order nearly six months after it had been negotiated may have been the facts that (a) by June 2006, the cost of diesel fuel had risen to \$3.16 per gallon, making it clear that Construction Company AF would ultimately get the \$4,000,000 fuel-cost reduction back and (b) the knowledge that the estimated quantities reduction was meaningless. A POS manager also stated that:

...the monthly payments, as the work progressed, we overpaid on the fill material quantity by an amount estimated to compensate for the reality that the price of fuel was not headed down. This was in response to the charge that if fuel prices did go up—which they did dramatically—and [Construction Company AF] wasn't compensated until the end of the project, the Port was using [Construction Company AF]'s money that [Construction Company AF] had in their bid at the outset.

The Contractor Ultimately Received the Full \$4,000,000 Fuel Cost Adjustment Back and Was Paid for Actual Quantities: Change Order #8, signed by Construction Company AF on 2/21/07, gave the contractor back the full \$4,000,000 fuel cost reduction. (Although a spreadsheet attached to and supporting the Change Order contains logical flaws, the rise in fuel prices was such that, based on the agreement that had been reached, return of the \$4,000,000 was supported.) As for the estimated quantities reductions, Construction Company AF was paid for actual quantities, as follows:

Line Item	Description	As-Bid Quantities	Change Order #1 Reduced Quantities	Final Quantities Paid
A 8	Asphalt Concrete Debris	200,000	120,000	16,782
A21	Debris Excavation	470,000	400,000	438,473
A22	Unsuitable Excavation	30,000	0	0
A25	Fill Material	4,000,000	3,900,000	4,039,354
A26	Gravel Borrow	30,000	0	0
A28	Geotextile Fabric	10,000	0	12,448

The contractor's bid price was \$124,777,042. Construction Company AF was ultimately paid \$124,765,702 (including non-fuel-cost change orders totaling \$3,092,775).

At Least One POS Manager Was Uncomfortable with this Procurement: Deductive Change Order #1 contains a block for "Approval Initials: [3rd Runway Construction Manager]." This 3rd Runway Construction Manager was a POS consultant, and he refused to initial Change Order #1 and did not initial Change Order #8. According to a POS manager, the 3rd Runway Construction Manager disagreed with the way the contract award and the change order negotiations had been handled. We spoke with the 3rd Runway Construction Manager, and he confirmed his unease with the procurement. He indicated that he had been a Federal contracting officer and he knew that such an award would have been improper under Federal rules and said that he did not know enough about the Revised Code of Washington to enable him to feel comfortable agreeing with the contract award and the subsequent related change orders.

Criteria

Washington Law, RCW 53.08.130 (Notice — Award of contract — Low bidder claiming error) makes clear that POS had two options when this single bid, substantially higher than the Engineer's Estimate, was received: (1) award to the low (or best) bidder, or (2) reject all bids. RCW 53.08.130 states, in part:

At the time and place named the bids shall be publicly opened and read and the commission shall proceed to canvass the bids and, except as otherwise in this section provided, shall let the contract to the lowest responsible bidder upon plans and specifications on file, or to the best bidder submitting his or her own plans and specifications. If, in the opinion of the commission, all bids are unsatisfactory, they may reject all of them and readvertise...

RCW 39.04.015 (Adjustment to bid price — Conditions) lists the limited conditions under which POS would have been able to negotiate an adjustment to the bid price prior to award. It states:

Notwithstanding the provisions of RCW [39.04.010](#), a state contracting authority is authorized to negotiate an adjustment to a bid price, based upon agreed changes to the

contract plans and specifications, with a low responsive bidder under the following conditions:

(1) All bids for a state public works project involving buildings and any associated building utilities and appendants exceed the available funds, as certified by the appropriate fiscal officer;

(2) The apparent low responsive bid does not exceed the available funds by: (a) Five percent on projects valued under one million dollars; (b) the greater of fifty thousand dollars or two and one-half percent for projects valued between one million dollars and five million dollars; or (c) the greater of one hundred twenty-five thousand dollars or one percent for projects valued over five million dollars; and

(3) The negotiated adjustment will bring the bid price within the amount of available funds.

None of these conditions applied to this procurement. Since this project was part of the much larger 3rd Runway CIP and there were sufficient funds in that CIP, “available funds” was not a consideration. The POS legal position appears to be that since the contract was awarded at the bid price, *the spirit but also the letter of the bidding laws [was] satisfied*. POS clearly engaged in “negotiations to adjust the bid price.” The *exact* “adjusted amount” was clearly determined prior to award. The fact that Construction Company AF initially balked at signing the deductive change order that would implement the agreed-upon adjustment indicates the risk that POS assumed by trying to satisfy the *letter of the bidding laws* by awarding the contract at the bid amount rather than the lower “adjusted amount.”

Best Practices

Adjusting the Engineer’s Estimate based on knowledge that there will only be a single bid in an uncompetitive market situation defeats the purpose for preparing an accurate Engineer’s Estimate. As noted in *Guidelines on Preparing Engineer's Estimate, Bid Reviews and Evaluation*, published by the Federal Highway Administration:¹⁹

The critical review of any bid depends on the reliability of the estimate it is being compared to. ... The engineer's estimate should reflect the amount that the contracting agency considers fair and reasonable and is willing to pay for performance of the contemplated work. Under-estimating causes project delay while additional funding has to be arranged to meet the contract costs. On the other hand, over-estimating causes inefficient use of funds that could be used for other projects. In addition, the engineer's estimate serves as the benchmark for analyzing bids and is an essential element in the project approval process.
[Emphasis added]

POS Policies

An accurate and objective Engineer’s Estimate is a critical factor in POS’s own bid evaluation procedures, as described in POS’s Contract Administration Manual [See section 3.2].

¹⁹ <http://www.fhwa.dot.gov/programadmin/contracts/ta508046.cfm>

POS Resolution 3181 establishes the authorities delegated from the Commission to the POS executive director and staff. Paragraph V.B. states that:

In the event that the lowest responsible bid on any contract for work in excess of Two Hundred Thousand Dollars (\$200,000) exceeds the Engineer's estimate by more than ten percent (10%) ... the Port Commission shall be notified prior to award of the contract. ... The Port Commission shall be provided with a report summarizing contracts awarded under this paragraph ... on a semi-annual basis.

Providing the Commission with a notification that is incomplete, misleading, and not inclusive of all pertinent facts and circumstances surrounding a contract administration/bid irregularity circumvents the intent and purpose of POS Resolution 3181. Resolution 3181 indicates that:

The following policy is adopted by the Port Commission for the purpose of establishing the administrative authority of the Executive Director...The Executive Director shall regularly inform and consult with the Commission regarding significant information, and business transactions and policies ...

(We also noted that POS is not providing the semi-annual *report summarizing contracts awarded under Paragraph V.B.* as required.)

Cause

POS does not have an independent procurement and contract administration authority. Instead, procurement responsibilities have been delegated to and subordinated within the engineering department. While a contract services unit exists within the engineering department, that unit serves primarily in a procedural and clerical role rather than as a procurement authority overseeing and safeguarding the integrity of the procurement process. This enables engineers and project managers to circumvent the spirit and intent of established POS policies and State law in order to take actions without regard for safeguards and controls and in circumvention of Commission oversight responsibilities and authority.

Further, under POS policy (Resolution 3181) POS management has carte blanche authority to spend money under “project-wide authorizations.” The 3rd Runway Project was approved by the Commission as a single (initially \$720 million) project. Thus, unless and until POS exceeded that ceiling amount, POS was free to award contracts in excess of estimates, approve change orders of any size, and grant contract time extensions without further Commission approval. Consequently, even if the low bid for this contract had been 300% higher than a fair and reasonable estimate, POS only needed to “notify” the commission that it was awarding the contract.²⁰

Effect or Potential Effect

Because POS failed to anticipate the limited competition for the 2006 embankment contract, POS paid \$32,777,042 more for the work than its own Engineer’s Estimate deemed fair and reasonable. POS’s view that once it found itself in this unfortunate and awkward position, it did its best to resolve the situation in the most expeditious way possible may have merit. Nevertheless, by concealing the full facts and circumstances from the Commission, POS precluded the Commission from carrying out its statutory decision-making responsibilities and authority.

Further, by concealing the full facts and circumstances surrounding this unusual procurement, opportunities for lessons learned were lost. Finally, by circumventing Washington State laws and negotiating with the bidder prior to award, opportunities for waste, abuse, or fraud were created, and there is no assurance that such irregularities did not occur.

Recommendations

This finding supports our overarching recommendations regarding appointment of a Chief Procurement Officer, establishment of an independent contract administration function, and revision of the delegations of authority for approving construction management expenditures. In addition, we recommend the following with respect to this finding:

Recommendation 25: We recommend that the POS Commission revise Resolution 3181 to make it clear that, when circumstances requiring reporting under Paragraph V (*Contract Administration/Bid Irregularities*) occur, POS should provide full and complete information and allow the Commission adequate time for deliberation and decision-making.

Recommendation 26: We recommend that the POS Commission re-evaluate the policy under which POS management has carte blanche approval and spending authority under project-wide authorizations regardless of project size and, instead, develop more sensible requirements for

²⁰ In contrast to this 3rd Runway procurement (where the Commission only needed to be *notified* when the low bid was \$32,777,042 more than the fair and reasonable cost estimate) was a more recent procurement for replacement of a roof at the airport. That project had been authorized by the Commission as a single-contract project with a budget of \$1,148,000. When the low bid for construction came in at \$662,607 more than the Engineer’s Estimate, POS management wanted to go ahead with the award at that price. That price, however, would have exceeded the Commission-approved budget for this single-contract project. Thus, POS had to seek Commission approval to make the award at the higher amount. After deliberating on this matter in public session, the Commission rejected the POS plan to award the contract and ordered POS to develop an alternative plan for the project.

POS to fully inform the Commission regarding significant or unusual expenditures of public funds.

Recommendation 27: We recommend that POS begin preparing and providing the semi-annual report summarizing contracts awarded under Resolution 3181, Paragraph V (*Contract Administration/Bid Irregularities*) as required.

Recommendation 28: We recommend that when the POS general counsel is asked to provide legal advice, he document the advice provided so that a clear record of his analysis and advice is established and retained.²¹

POS Response

The full text of the POS response to this finding is in Appendix E. POS appears to disagree with this finding but the POS response includes contradictory statements:

... the Port Commission was fully informed about the Third Runway Program and its progress throughout the course of the project. ...

The Port acknowledges that its efforts to engage the only bidder in discussions prior to the award of the 2006 embankment contract were ill-advised, but the Port ... complied with all applicable legal requirements. The Port also acknowledges that the memorandum provided to the Commission in connection with this contract could have been clearer.

POS also misleadingly states that:

The Performance Auditor provides no evidence to support the statement that the 2006 embankment contract may have been subject to a “collusive bidding arrangement.” On the contrary, all information available to the Port (and provided to the Performance Auditor) indicates that the single bid obtained for the 2006 embankment contract was due to marketplace forces, not collusion.

Auditors’ Additional Comments

The POS Commission was clearly not fully informed about the unusual circumstances surrounding this major procurement—one of the largest and most important procurements within the Third Runway Program. The memorandum provided to the Commission was more than simply unclear. It was incomplete, misleading, and contained false statements.

²¹ The POS general counsel indicated to us that:

I frequently receive calls from clients seeking guidance. I assume that they are being honest and candid when they report the situation and I try to ask relevant questions to make sure I have the necessary information. I would typically not document a phone call, emails are retained. These are typically short conversations in which I may provide my advice immediately or get back to them after a review - I doubt I would prepare a legal memoranda in these circumstances. Typically I would simply be referring the client to the appropriate Port policy.

We agree that it has not been proven that this contract was the result of collusive bidding. Contrary to POS's response, we did not state that the contract may have been subject to collusive bidding and we have not asserted that collusive bidding occurred. Our finding states that **“[t]here is no indication that POS considered the possibility** that the receipt of a single bid that was substantially higher than expected may have been due to a collusive bidding arrangement.” The POS response further supports this conclusion.

The very nature of collusive bidding makes it difficult to prove. It is inaccurate, however, for POS to assert that “all information available ... indicates that the single bid obtained ... was due to marketplace forces, not collusion.” Information available to POS included the facts that (a) only one bid was anticipated shortly before the bid due date, (b) it was widely known that only one bid was likely, (c) only one bid was received, (d) the single bid received was \$32,777,042 (35.63%) higher than POS's own estimate of a *competitive* price for the work, and (e) another potential contractor *“was a plan holder and had prior approved fill material from the 2004-05 Project sufficient to supply the entire 2006 work.”* POS's continuing willingness to ignore these facts and deny their serious nature further supports our conclusion that POS construction management is vulnerable to fraud, waste, and abuse.

By providing a misleading notification to the Commission and not fully informing the Commission of all relevant facts, POS deprived the Commission from exercising its governance duties and being able to consider the possibilities that public funds were being wasted, or worse.

Finding 3-B: POS management did not provide reports on contract administration/bid irregularities and information related to professional and consulting services to the POS Commission, as required by the Commission’s delegation of authority. It interpreted Resolution 3181 to permit disclosure of minimal information.

Background

As explained in Finding 3-A, POS Commission Resolution 3181 requires POS management to report certain information related to construction contract administration and bid irregularities to the Commission. POS has not been reporting this, as well as other information, to the Commission, as required. The POS policy on authority to award consulting agreements is confusing and not being adhered to as stated.

Condition

POS is not providing the Commission with semi-annual reports summarizing contracts awarded where (a) the lowest responsible bid exceeds the Engineer’s estimate by more than 10%, (b) an award was to other than the lowest responsible bidder, (c) there is a material deviation from the Port’s General Conditions, (d) a bid is the subject of a dispute, or (e) all bids were rejected.

POS also is not providing the Commission with semi-annual reports of professional and consultant services obtained.

POS Resolution 3181 provides the POS CEO authority to enter into contracts with architectural, engineering, environmental and technical testing and inspection firms “so long as the fees for any single project or closely related work do not exceed Two Hundred Thousand Dollars (\$200,000) ...” and “for any such services not ancillary to capital projects included in the Port’s Annually Reviewed Capital Improvement Plan, such fees shall not exceed Fifty Thousand Dollars (\$50,000).”

The Resolution also gives the CEO the authority to “arrange for [professional and consultant services] where the estimated cost of the proposed services does not exceed the amount of One Hundred Thousand Dollars (\$100,000) provided all such arrangements shall be reported to the Port Commission Semi-annually.”

POS routinely awards A/E and other professional services contracts well in excess of these \$50,000, \$100,000, and \$200,000 limits and routinely amends existing A/E and other professional services contracts adding amounts well in excess of these limits.

Criteria

POS Commission Resolution 3181 is the master policy directive defining the administrative authority of the POS Executive Director and his designees. It specifically requires the following semi-annual reports:

Resolution 3181, Exhibit A, paragraph V, *Contract Administration/Bid Irregularities*, requires:

B. In the event that the lowest responsible bid on any contract for work in excess of Two Hundred Thousand Dollars (\$200,000) exceeds the Engineer's estimate by more than ten percent (10%), an award is to be to other than the lowest responsible bidder, there is material deviation from the Port's General Conditions, or a bid is the subject of dispute, the Port Commission shall be notified prior to award of contract. Part Commission approval shall be required for the rejection of all bids. The Port Commission shall be provided with a report summarizing contracts awarded under this paragraph IV.A.3. on a semi-annual basis.

Resolution 3181, Exhibit A, paragraph X, *Professional and Consultant Services*, requires:

Except as provided in Section VI of this Exhibit A, the Executive Director shall be responsible for obtaining professional and consultant services where deemed necessary in carrying out normal Port operations and provided all applicable legal requirements are met. The Executive Director may arrange for such services where the estimated cost of the proposed service does not exceed the amount of One Hundred Thousand Dollars (\$100,000) provided all such arrangements shall be reported to the Port Commission semi-annually.

Resolution 3181, Exhibit A, paragraph VI, *Architectural, Engineering and Technical Services*, requires:

The Executive Director is authorized to contract with qualified architectural, engineering, environmental and technical testing and inspection firms licensed in the State of Washington to provide such services as required for maintenance; preliminary engineering, planning or project scoping; small projects of the Port; or for similar purposes; so long as the fees for any single project or closely related work do not exceed Two Hundred Thousand Dollars (\$200,000) and are within Authorized Budget Limits; provided, however, for any such services not ancillary to capital projects included in the Port's Annually Reviewed Capital Improvement Plan, such fees shall not exceed Fifty Thousand Dollars (\$50,000). Selection and payment for all such services shall follow all required statutory procedures and shall be consistent with normal established fees paid for such services. The Executive Director will endeavor to use a variety of firms (including minority and women business firms) based on the nature of the work and the expertise of the firms.

Cause

POS explained that, in its view, once a capital project receives Commission approval under Resolution 3181, POS has the authority to award and amend A/E and other professional services contracts in any amounts as long as the total budget for the entire capital project is not exceeded. Capital projects, as packaged by POS, often and usually contain multiple construction projects and require numerous A/E and other professional services agreements. Consequently, according to POS's interpretation, the limits set forth in Resolution 3181, Exhibit A, paragraphs VI and X are not applicable if the Commission has granted project-wide approval.

With respect to the semi-annual reporting requirement in Resolution 3181, Exhibit A, paragraph V (*Contract Administration/Bid Irregularities*), a POS manager indicated that he believed that the semi-annual reporting required on the status of all projects is sufficient to meet the paragraph V requirement, even though the semi-annual reporting on projects does not summarize contracts awarded where (a) the lowest responsible bid exceeds the Engineer's estimate by more than 10%, (b) an award was to other than the lowest responsible bidder, (c) there is a material deviation from the Port's General Conditions, (d) a bid is the subject of a dispute, or (e) all bids were rejected. POS also stated that since the matters required to be reported under paragraph V are reported on an individual basis, it believes that the semi-annual reporting is redundant.

With respect to the semi-annual reporting requirement in Resolution 3181, Exhibit A, paragraph X (*Professional and Consultant Services*), POS stated that such a report is prepared, but has not

been transmitted to the Commission, due perhaps to a personnel change. POS informed the Commission during our audit that it planned to begin reporting these arrangements.

Effect or Potential Effect

The Commission is unable to carry out its statutory oversight responsibilities if it is not kept fully informed of contract administration and bid irregularities and professional and consultant services obtained by POS.

As noted elsewhere in this report, we identified significant procurement irregularities related to (1) a major 3rd Runway procurement and (2) professional services agreements that were not fully and completely disclosed to the Commission. Had the required semi-annual reports been provided to the Commission, the Commission would have been in a position to assess its need for further information in order to evaluate POS management performance. Knowledge of these issues would enable the Commission to assess the need for corrective actions and possible revisions to its delegations of authority.

The POS interpretations of Resolution 3181 that the Commission's project-wide authorizations supersede the explicit limitations set forth in Resolution 3181 and also supersede the limits set forth in the POS redelegations of authority for various positions results in relatively low-level POS engineers, project managers, and program managers being able to award multi-million dollar contracts and amend those contracts without Commission scrutiny, knowledge, or oversight.

These anomalies in Resolution 3181 and the POS failure to report as required create situations conducive to fraud, waste, and abuse. A variety of fraud schemes characterized by bribes, kickbacks, or illegal gratuities could be taking place without POS knowledge.

Recommendations

This finding supports our overarching recommendations regarding appointment of a Chief Procurement Officer, establishment of an independent contract administration function, and revision of the delegations of authority for approving construction management expenditures. In addition, we recommend the following with respect to this finding:

Recommendation 25: We recommend that the POS Commission revise Resolution 3181 to make it clear that, when circumstances requiring reporting under Paragraph V (*Contract Administration/Bid Irregularities*) occur, POS should provide full and complete information and allow the Commission adequate time for deliberation and decision-making.

Recommendation 26: We recommend that the POS Commission re-evaluate the policy under which POS management has carte blanche approval and spending authority under project-wide authorizations regardless of project size and, instead, develop more sensible requirements for POS to fully inform the Commission regarding significant or unusual expenditures of public funds.

Recommendation 27: We recommend that POS begin preparing and providing the semi-annual report summarizing contracts awarded under Resolution 3181, Paragraph V (*Contract*

Administration/Bid Irregularities) and the semi-annual report required by Resolution 3181, Paragraph X (*Professional and Consultant Services*) as required.

POS Response

POS stated that:

The Port substantially agrees with this finding. Although the Port has always provided the Port Commission notification of any bid irregularities when they arose, it has not provided the semi-annual reports required by Resolution 3181. These reports, however, would only summarize the same information the Commission previously received when the irregularity arose. Similarly, although the Port has historically provided the Commission with reports of professional and consultant services awarded and has continued to prepare such reports, it appears that the last four reports were not forwarded to the Port Commission. The Port has now remedied these oversights. These inadvertent and isolated examples, however, do not support the Performance Auditor's conclusion that Port staff generally limits transparency or thwarts Commission oversight. The Port will, nonetheless, consider reporting protocols as part of its discussions regarding revisions to Resolution 3181.

Finding 3-C: POS managers approved a PSA agreement and amendments to that agreement in amounts that exceeded the delegated authority of these managers.

Background

As described previously, POS Commission Resolution 3181 sets forth the authority delegated from the POS Commission to the POS CEO. In turn, POS Policy EX-2 (*Administrative, Monetary and Contractual Redelegations of Authority from the Chief Executive Officer To Staff*) sets forth the “limits of authority for conducting regular day-to-day business transactions involving personal materials and finance.” Policy EX-2 refers to “schedules of redelegated authority” for various positions below the CEO. On its face, POS Resolution 3181 appears to indicate that the POS CEO has authority to enter into A/E and other professional services contracts of no more than \$200,000. The various schedules of redelegated authority appear to establish *lower* limits than those specified in Resolution 3181 and Policy EX-2. As interpreted by POS, however, none of these limits applies in cases where a contract is interpreted by POS to be within a larger project-wide authorization approved by the Commission.

The following example is indicative of how the delegation and redelegations of authority are carried out by POS.

Condition

POS contracted with Consulting Company U for the furnishing of professional services for “Terminal 18 Slope Stabilization and Apron Upgrade/Repair” via PSA P-00304886. The original agreement was awarded on January 7, 2000, with a not-to-exceed amount of \$225,244.00. That agreement was signed by “[AGT] for [MGB].” The name “[MGB]” was printed below this signature. AGT was a program manager and MGB was director of cargo and cruise services. Our review of POS Resolution 3181, POS EX-2, and the various delegations and redelegations of authority did not indicate that AGT, a program manager, had the authority to sign a contract of that size. POS Policy EX-2 has no redelegations listed for the “program manager” job title. (In response to a draft of this finding, POS indicated that AGT was actually a project manager.)

It also does not appear that MGB had the authority to sign a contract of this size. The redelegation of authority for the director of cargo and cruise services indicates that MGB had authority to execute professional and consultant services contracts of \$50,000 or less, and authority to execute architectural, engineering and technical services contracts “so long as fees for any single project or closely related work do not exceed \$100,000 and are within Authorized Budget Limits.”

This PSA has had 22 amendments processed since January 2000, and according to POS personnel, two new amendments were being processed during our audit. The contract has grown over the past 7 years from a “not-to-exceed” amount of \$225,244.00 to a total value of at least \$4,388,914.00. Based on the current contract completion date of December 31, 2008, the contract will span a total of nearly eight years. Below is a summary of the amendments in the contract files and the POS personnel who authorized each one:

Amendment #	Amount	Amendment Signed By	Change Order Form Signed By
Initial PSA	\$225,244.00	Program Manager AGT	
1	\$38,763.00	Director MGB	File Copy Unsigned
2	\$459,799.00	Director MGB	Program Manager AGT
3	\$51,498.00	Program Manager AGT	Program Manager AGT
4	\$42,617.00	Program Manager AGT	Program Manager AGT
5	New Rates	Program Manager AGT	Program Manager AGT
6	\$185,750.00	Program Manager AGT	Program Manager AGT
7	\$59,600.00	Program Manager AGT	Program Manager AGT
8	\$1,064,416.00	Program Manager AGT	Program Manager AGT
9	\$8,500.00	Program Manager AGT	Program Manager AGT
10	\$69,676.00	Program Manager AGT	Program Manager AGT
11	\$207,858.00	Program Manager AGT	Program Manager AGT
12	\$84,978.00	Program Manager AGT	Program Manager AGT
13	\$113,535.00	Program Manager AGT	Program Manager AGT
14	\$228,907.00	Program Manager AGT	Program Manager AGT
15	\$120,138.00	Program Manager AGT	Program Manager AGT
16	\$741,752.00	Program Manager AGT	Program Manager AGT
17	\$200,000.00	Project Manager TM	Project Manager TM
18	\$21,950.00	Project Manager JO	Project Manager JO
19	New Rates	File Copy Unsigned	Project Manager TM
20	\$450,000.00	Project Manager TM	Project Manager TM
21	\$11,450.00	Project Manager JO	Project Manager JO
22	\$2,483.00	Project Manager JO	Project Manager JO
	<u>\$4,388,914.00</u>		

As noted above, MGB was director of cargo & cruise services and AGT was a program manager. TM and JO were project managers. Our review of POS Resolution 3181, POS EX-2, and the various delegations and redelegations did not indicate that these individuals had the authority to sign most of these amendments.

As noted above, the redelegation of authority for the director of cargo and cruise services indicates that he had authority to execute professional and consultant services contracts of \$50,000 or less. The redelegation is silent regarding authority for amendments. As noted above, there is no redelegation of authority for the program manager job title. The redelegation of authority for the Project Manager Level III contains redelegations for professional & consultants services that are the same as the authority delegated to the director of cargo and cruise services. That redelegation is likewise silent regarding authority for amendments. Even if the redelegation levels for contracts are applied to the amendments, amendments 17 and 20 (signed by project managers) exceeded the delegated authority.

In response to a draft of this finding, POS asserted that this January 2000 contract was “specifically authorized by the Port Commission in an open public meeting” and that:

...[u]nder a 'project wide authorization,' no further Port Commission action is required to complete the work identified so long as such work can be performed within the budget authorized by the Port Commission.

We asked POS to provide evidence of Commission approval for this particular procurement. POS provided minutes of the Commission meeting on January 14, 1997, and an underlying memorandum dated December 18, 1996. Those minutes and the underlying memorandum, however, indicate that the Commission was only asked to approve and authorize “interim funding for the expansion project through approximately the end of 1997,” and the minutes do not mention work related to “Terminal 18 Slope Stabilization and Apron Upgrade/Repair.” POS has provided no evidence of prior Commission authorization for the January 2000 contract with Consulting Company U.

Criteria

POS Resolution 3181, Exhibit A, *Port of Seattle Commission Specific Policy Directives of Administrative Authority of Executive Director and His/Her Designees*, sets forth the following authority for the CEO:

Paragraph IV, *Capital Projects/Contracts for Performance of Work*, allows:

1. Preliminary Work on Projects Within Authorized Budget Limits:

For projects which are within Authorized Budget Limits, the Executive Director is authorized to conduct project planning; scoping; permitting; and preliminary engineering and environmental testing necessary to the projects (s) without prior Commission approval, so long as the cost of such activities does not exceed Two Hundred Thousand Dollars (\$200,000), and the selection and payment requirements referenced in Section VI are followed.

2. Final Commission Capital Project Authorization:

After preliminary planning, scoping and engineering has been performed, and before funds in excess of Two Hundred Thousand Dollars (\$200,000) are expended on a project, additional Commission approval shall be required. Such additional Commission authorization may also constitute final project authorization if, at the time of request for such further Commission approval, the request includes sufficient information necessary for the Commission to give final project approval, and if the Commission gives final approval. The information in such a request for final approval shall include, but is not limited to: how the project accomplishes established organizational objectives, anticipated community or customer impacts, expected financial return or other appropriate financial analyses, the anticipated schedule for project completion, estimated project costs, (including planning, architectural and engineering, staff, construction contract and project contingency costs) and project funding sources.

Paragraph VI, *Architectural, Engineering and Technical Services*, allows:

The Executive Director is authorized to contract with qualified architectural, engineering, environmental and technical testing and inspection firms licensed in the State of Washington to provide such services as required for maintenance; preliminary engineering, planning or project scoping; small projects of the Port; or for similar purposes; so long as the fees for any single project or closely related work do not exceed Two Hundred Thousand Dollars (\$200,000) and are within Authorized Budget Limits; provided, however, for any such services not ancillary to capital projects included in the Port's Annually Reviewed Capital Improvement Plan, such fees shall not exceed Fifty Thousand Dollars (\$50,000). Selection and payment for all such services shall follow all required statutory procedures and shall be consistent with normal established fees paid for such services. The Executive Director will endeavor to use a variety of firms (including minority and women business firms) based on the nature of the work and the expertise of the firms.

Paragraph X, *Professional and Consultant Services*, allows:

Except as provided in Section VI of this Exhibit A, the Executive Director shall be responsible for obtaining professional and consultant services where deemed necessary in carrying out normal Port operations and provided all applicable legal requirements are met. The Executive Director may arrange for such services where the estimated cost of the proposed service does not exceed the amount of One Hundred Thousand Dollars (\$100,000) provided all such arrangements shall be reported to the Port Commission semi-annually.

POS Policy EX-2, *POS Redelegations of Authority*, delegates to the Director, Cargo and Cruise Services, the following:

1. Preliminary work on projects within Authorized Budget Limits

Authorized to conduct project planning; scoping; permitting; and preliminary engineering and environmental testing necessary to the project(s) without prior Commission approval, so long as the cost of such activities does not exceed \$100,000 and the selection and payment requirements referenced in Section VI, Resolution No. 3181, as Amended, are followed.

2. Final Commission Capital Project Authorization

After preliminary planning, scoping and engineering has been performed, and before funds in excess of \$100,000 are expended on a project, additional Commission approval shall be required. Such Commission action combined with this delegation shall constitute full authorization to take all actions necessary to affect the project.

VI. Architectural, Engineering and Technical Services:

Execute such contracts so long as fees for any single project or closely related work do not exceed \$100,000 and are within Authorized Budget Limits. (See Outside Professional Services Procedure PUR-2.)

(NOTE: Such services not ancillary to capital projects included in the Port's Annually Reviewed Capital Improvement Plan may not exceed \$50,000 and require Chief Executive Officer approval, pursuant to Section VI, Resolution No. 3181, as Amended.)

X. Professional and Consultant Services:

Execute such contracts of \$50,000 or less. (See Outside Professional Services Procedure PUR-2.)

POS Policy EX-2, *POS Redelegations of Authority*, delegates to the position Project Manager Level III, the following:

1. Preliminary Work on Projects within Authorized Budget Limits

Authorized to conduct project planning; scoping; permitting; and preliminary engineering and environmental testing necessary to the project(s) without prior Commission approval, so long as the cost of such activities does not exceed \$100,000 and the selection and payment requirements referenced in Section VI, Resolution No. 3181, as Amended are followed.

VI. Architectural, Engineering and Technical Services:

Authorized to contract with architectural, engineering, environmental and technical testing and inspection firms licensed in the State of Washington to provide such services as required for maintenance; preliminary engineering, planning or project scoping; small projects of the Port; or for similar purposes; so long as the fees for any single project or closely-related work do not exceed \$100,000 and are within Authorized Budget Limits. (See Outside Professional Services Procedure PUR-2.)

X. Professional & Consultant Services:

Execute such contracts of \$50,000 or less (See Outside Professional Services Procedures PUR-2.)

Cause

As noted previously, POS explained that, in its view, once a capital project receives Commission approval under Resolution 3181, POS has the authority to award and amend A/E and other professional services contracts in any amounts as long as the total budget for the entire capital project is not exceeded. Capital projects, as packaged by POS, often and usually contain multiple construction projects and require numerous A/E and other professional services agreements. Consequently, according to POS's interpretation, the limits set forth in Resolution 3181, Exhibit A, paragraphs VI and X are not applicable if the Commission has granted project-wide approval.

In the case of this procurement, POS was not able to provide evidence that this particular work ("Slope Stabilization and Apron Upgrade/Repair") did, in fact, receive Commission approval. Nevertheless, POS asserted that the fact that the Commission had previously approved *some* work related to Terminal 18 gave program managers and project managers the authority to spend \$4,388,914.

In terms of lower-level POS personnel amending this \$225,244 contract to more than \$4 million, POS indicated, in response to a draft of this finding, that it considers each amendment to a contract to be a separate procurement action; so that a project manager was allowed to approve 10 amendments totaling \$391,515 because each amendment was below \$100,000.

Effect or Potential Effect

These POS interpretations render what appear to be spending controls contained within POS Resolution 3181 and the redelegations of authority meaningless when it comes to capital project spending.

Based on these interpretations, relatively low level POS employees can approve and amend contracts in significant amounts without evidence of higher-level knowledge or approval and without informing the Commission. This creates a condition conducive to waste, abuse, and fraud.

Recommendations

This finding supports our overarching recommendations regarding appointment of a Chief Procurement Officer, establishment of an independent contract administration function, and revision of the delegations of authority for approving construction management expenditures. In addition, we recommend the following with respect to this finding:

Recommendation 26: We recommend that the POS Commission re-evaluate the policy under which POS management has carte blanche approval and spending authority under project-wide authorizations regardless of project size and, instead, develop more sensible requirements for POS to fully inform the Commission regarding significant or unusual expenditures of public funds.

POS Response

The full text of the POS response to this finding is in Appendix E. POS disagrees with this finding and states that:

The Port Commission directly or indirectly authorized all of the work performed under this professional services agreement, and Port personnel acted within the scope of their delegated authority when completing that work. ...

...Resolution 3181 is not an absolute limit on the authority of staff. The Port Commission may – and regularly does – delegate authority to staff in excess of the authority provided in Resolution 3181. With respect to capital project delivery, this additional authority may be provided on either an individual contract or project-wide basis. ...

With respect to this particular finding, all of the work at issue related to the Port's Terminal 18 redevelopment and specifically the north apron upgrade. The Port Commission authorized nearly all of that work in five open public meetings....

As such, all actions related to this consultant agreement were proper and consistent with the Port Commission's delegation of authority. Nonetheless, as mentioned previously, the Port will review Resolution 3181 and additional delegations of authority to ensure greater clarity on these matters.

Auditors' Additional Comments

If the POS Commission's understanding and intent is that by approving \$100+ million projects, it is also granting relatively low level POS personnel authority to make contract award and amendment decisions in excess of the limits defined in Resolution 3181, then we recommend that the Commission re-evaluate this intent.

With regard to the example contract described in this finding, POS asserts that the Commission approved this work in a public meeting and identified five meetings where approvals took place: January 14, 1997, February 13, 2001, June 10, 2003, December 14, 2004, and August 8, 2006. This \$225,244 contract was awarded on January 7, 2000, and amended upward to \$817,921 by January 10, 2001. The only meeting identified by POS where approval for this contract and these amendments could have been granted was the January 14, 1997, meeting. The minutes of that Commission meeting, however, indicate that the Commission was only asked to approve and authorize "interim funding for the expansion project through approximately the end of 1997." That authorization for funding through the end of 1997 should not have served as approval for this contract awarded three years later or amendments made four years later.

Finding 3-D: A former employee of one contractor managed that contractor’s major 3rd Runway construction contract. A POS consultant served on a selection committee that awarded a \$5.8 million contract to one of his company’s subcontractors.

Background

In managing millions of dollars of public funds, conflicts of interest—whether in fact or in appearance—should be avoided. We noted instances in which POS outside consultants were placed in situations that created *at least* the appearance of such conflicts of interest. Two examples illustrate this problem.

Condition

Example 1: Consultant SK currently works for Consulting Company D. SK’s current assignment under this consulting arrangement is Construction Manager overseeing the Construction Company AH contract on the 3rd Runway Project. Prior to joining Consulting Company D, SK worked, for 25 years, for Construction Company AH. The Construction Manager is the senior member of the contract management team, according to POS organization charts, overseeing resident engineers and project inspectors. Although SK does not, according to POS, have authority to approve contractor payments and change orders, he routinely signs off on such transactions, recommending their approval. Consequently, he is in a strong position to influence contract management.

Although (according to a POS manager) SK represented that he no longer has a direct financial interest in Construction Company AH, POS has not investigated or verified that assertion, obtained that assertion in writing, or obtained evidence supporting that assertion from SK.

Even if SK divested himself of any direct *financial* interests in Construction Company AH, there would remain the appearance of a conflict of interest in that SK may be inclined to afford favorable treatment to his former employer and former co-workers.

In response to a draft of this finding, POS asserted that “POS has received written assurance from the construction manager’s current employer that no conflict of interest exists.” We asked for a copy of that written assurance. POS provided a copy of the June 1998 contract with Consulting Company D containing a standard clause stating:

CONSULTANT covenants that it presently has no interest and shall not acquire any interest, direct or indirect, which would conflict in any manner or degree with the performance of services required to be performed under this Agreement. CONSULTANT further covenants that in the performance of this Agreement, no person having any such interest shall be employed.

Consulting Company D did not hire SK until late 2003 or early 2004, several years after signing the 1998 contract.

Example 2: Consultant SW works for Consulting Company E and is the “program Director”—the senior manager—for the large PMSC contract. Consulting Companies D and AI are subcontractors on the PMSC contract with POS that Consultant SW manages.

Consultant SW served on the selection committee that decided on the award of a \$5.8 million contract for work related to the South Terminal Expansion Project (STEP). SW's two subcontractors, Consulting Companies D and AI, were two of five offerors being considered for the contract. The contract was awarded to Company AI.

Criteria

POS Policy EX-3, *Ethics Policy for Port Employees*, states that:

An employee shall not knowingly take part in any decision-making, review, selection, or supervisory activities, concerning any contract, property, or other significant matter of any kind, in which the employee or his/her Family has a Financial Interest, or which otherwise creates a conflict of interest.

(Although SK and SW are technically not subject to this policy because they are not POS employees, as noted elsewhere in our findings, they and many other POS consultants act in the same capacity as POS employees.)

Best Practices

The **American Society of Civil Engineers** defines a Conflict of Interest as a situation in which a:

...member uses his or her contacts or position in his or her employment to advance his or her private business, financial interests, or that of family and friends, whether or not at the expense of the Employer.

ASCE further requires that:

All professional and business decisions shall be made in the best interest of the Employer or profession. Conflicts of interest can arise in many situations, some of which may be based simply on perceptions. Playing favorites or engaging in conflicts of interest, whether in practice or just appearance, is contrary to the expectation of fair and ethical treatment to which we are entitled. ASCE members are expected to avoid any relationship, influence, or activity that might be perceived to or actually impair their ability to make objective and fair decisions when performing their jobs. When in doubt, they should share the facts of the situation with their leadership and resolve the conflict.

The **Federal Acquisition Regulation, Part 3, Improper Business Practices and Personal Conflicts of Interest**, states:

*Government business shall be conducted in a manner above reproach and, except as authorized by statute or regulation, with complete impartiality and with preferential treatment for none. Transactions relating to the expenditure of public funds require the highest degree of public trust and an impeccable standard of conduct. **The general rule is to avoid strictly any conflict of interest or even the***

appearance of a conflict of interest in Government-contractor relationships.
While many Federal laws and regulations place restrictions on the actions of Government personnel, their official conduct must, in addition, be such that they would have no reluctance to make a full public disclosure of their actions.
[Emphasis added.]

The **United States Office of Government Ethics, *Ethics & Procurement Integrity***, states that:

Even though you may not have a financial interest that can be affected by a procurement activity or contract, circumstances might arise that could call your impartiality into question. Some examples of when your impartiality could be questioned include the following:

- ***Your duties require you to work on a procurement involving your former employer or clients, your spouse's employer or clients, close relatives, or others with whom you have some kind of business relationship. ...***
- ***You are required to evaluate bids, one of which was submitted by a friend.***

If you encounter any situation where you think your impartiality would reasonably be questioned, you should stop working on that matter, and contact your supervisor and agency ethics official for further advice. [Emphasis added.]

Cause

POS is aware of the appearance of this conflict of interest situation with SK (Example 1, above) but, according to a POS manager, this situation is not a problem, because SK has no signature authority, and there are other fully independent personnel who must approve decisions on the contract. In response to a draft of this finding, POS asserted that it “has reasonably determined that no conflict of interest exists,” based on the assertion that “the construction manager has made clear, he has no ‘Financial Interest’ in his former employer.”

With respect to the SW situation (Example 2, above), POS did not indicate that it had been aware of the appearance of this conflict of interest in having SW participate in the selection one of his company's subcontractors for a \$5.8 million contract. POS stated, however, that SW was “routinely included in major selection panels (such as this one) relevant to the STEP program, for which he was the Program Leader.”

We disagree with the POS interpretation that a conflict of interest only exists in situations where a person has a *financial* interest with respect to the organization he or she is managing. The POS policy specifically states that:

An employee shall not ... take part in any decision-making, review, selection, or supervisory activities, concerning any contract, property, or other significant matter of any kind, ..., which otherwise creates a conflict of interest. [Emphasis added.]

Effect or Potential Effect

SK is in a position to give favorable treatment to his former company by recommending approval of contract changes or by failing to require enforcement of contract provisions.

SW is similarly in a position to affect the award of major contracts to companies with which he or his company have other relationships.

At a minimum, the appearance of these clear conflict of interest situations furthers the negative reputation that POS has among others in the contractor community that some contractors receive favored treatment by POS.

Recommendations

This finding supports our overarching recommendations regarding appointment of a Chief Procurement Officer, establishment of an independent contract administration function, and revision of the delegations of authority for approving construction management expenditures. In addition, we recommend the following with respect to this finding:

Recommendation 29: We recommend that POS reassign Consultant SK to a position where he has no appearance of a conflict of interest. We also recommend that POS either establish an ethics policy for consultants or revise POS Policy EX-3 to make it clear that POS consultants are expected to adhere to at least the same ethical standards that POS employees are required to follow.

Recommendation 30: We recommend that POS Policy EX-3 be (a) clarified to make clear that conflicts of interest are not limited solely to situations where there is a direct financial interest and (b) revised to require employees and consultants to recuse themselves from participating in decisions where conflicts of interest exist.

POS Response

The full text of the POS response to this finding is in Appendix E. POS disagrees with this finding and states that:

The Port has evaluated the circumstances surrounding the two individuals identified by the Performance Auditor and concluded that they do not present ethics problems. In the first example cited by the Performance Auditor, it has been almost four years since the consultant – now employed by a national consulting firm of the highest caliber – was last employed by the contractor now performing work for the Port. That consultant severed all financial ties to his former employer and has repeatedly certified to the Port the absence of any conflict of interest. Likewise, the national consulting firm by whom he is now employed has covenanted conflict-free services. ...

In the second example, the particular consultant was included in the seven person selection panel because of his expertise and responsibilities within the Airport's capital program. The consultant never worked for the firm that the panel selected. Instead, the alleged conflict is based on unrelated contracts between the selected firm and the national consulting firm by whom the consultant is employed. Thus, the consultant not only lacked any financial interest in the selected firm but also lacked any direct connection to the selected firm. ...

Auditors' Additional Comments

At a minimum, the *appearance* of conflicts of interest is clear in both cases. The POS assertion regarding the second example that the consultant does not have any “direct connection” to the selected firm is misleading. Consultant SW is the “Program Director”—*the* most senior manager—for the large PMSC contract. Consulting Companies D and AI are subcontractors on the PMSC contract. Consultant SW approves subcontract actions related to and the invoices for Consulting Companies D and AI under this contract. His participation in the selection of Company AI’s \$5.8 million contract was inappropriate.

Audit Finding 4: POS Construction Management Records were Incomplete and Disorganized

Finding 4-A: POS project management information systems data were incomplete, outdated, and inaccurate when compared to project records.

Background

POS utilizes PeopleSoft accounting software to track project financial transactions. Information from PeopleSoft Financial System (PSFS) can be found through POS Compass MIS. POS personnel generally do not believe that PSFS provides information in a form and format that is useful to the Project Management and Construction Management Groups. Thus, Seaport Division developed the Seaport Project Office Tracking System (SPOTS), and the Aviation Division developed the Port Aviation Cost Trend (PACT) system to meet needs for better project reporting. Port Construction Services (PCS) uses a fourth management information system, Project Management Information System (PMIS). Numerous POS staff complained about the lack of user-friendliness of the PSFS system for project managers and indicated that the accounting software system simply did not meet the needs of the project management/construction management staff: “PeopleSoft provides actual costs but the focus was on the general ledger and not project management.” Nearly every POS project manager indicated that POS could improve its project management systems to make it easier to track key project information.

Condition

We reviewed the POS management information systems for five (5) seaport projects, twenty (20) airport projects, and ten (10) PCS projects.

We tested these 35 projects for several attributes, including:

1. Key Project/Contract Information (SPOTS, PACT, PMIS).
2. Availability of Commission Authorization Funding Information (SPOTS).
3. Project Schedule Information (Plan and Current Project Start and Completion Dates) (SPOTS, PACT).
4. Change Order Information (SPOTS, PACT, PMIS).
5. Construction Trends/Change Order Logs (PACT, SPOTS).
6. Costs to Date/Actual Costs/Invoices (SPOTS, PACT, PMIS) compared to PSFS.
7. Work Authorizations (PMIS).

Summary of Findings

Attribute 1 (Key Project/Contract Information): Information fields in SPOTS/PACT/PMIS for the sample audit projects contained:

- inaccurate information,
- incomplete information,
- discrepancies in the information provided compared to hard copy records;
- and/or discrepancies in the information provided compared to the information shown in PSFS.

The discrepancies in the information did not appear to be the result of being between update cycles with regard to the periodic PSFS downloads (which some of these systems rely on for updating actual cost data). Rather, the discrepancies in the information appeared to be the result of incorrect information being entered by POS staff, or the failure of POS staff to enter the required information. In several cases, information from the project hard copy records conflicted with the information shown in the electronic information systems.

SPOTS: The “Project Details” screens were either incomplete or the information conflicted with information provided in hard copy project records or the PSFS.

PACT: The “Contracts” screen was not set up for some of the projects we reviewed, even though the projects were in the design or construction phases. Aviation’s use of this screen is inconsistent. Some projects were set up and others that we reviewed were not set up. The “Contracts” screen provided general project information about the start and completion dates, etc. Projects on which the “Contracts” screen was setup did not have substantial completion dates recorded or final project completion dates. Final costs have not been reconciled to show the total project costs as of close-out.

PMIS: For several of the projects reviewed there were costs shown in the “retention held” fields, yet the contract expiration date had long since passed. For example, on contract SW-0312098 the retention held was \$8,671.03 but the contract had expired on 2/20/06. The PMIS screen showed the status as “in closing.” The PMIS screen indicated that PCS received the final invoice on 11/8/06, yet the project did not appear to have been closed out and it did not appear that PCS had accepted the work. The PMIS screens appear not to have been updated, and to the extent that the information was correct, then PCS should have been more proactive in closing out its contracts. This contract expired over 1 ½ years ago. Also, some of the information shown in PMIS conflicted with accounting information shown in PSFS.

Attribute 2 (Availability of Commission Authorization Funding Information): Reconciling the CIP funding amount that has been authorized by the commission requires the user to reconcile “Budget Transfer” amounts in and out of projects, and if there is more than one project within a CIP, the task is time-consuming and difficult, requiring multiple source documents such as Semi-Annual Authorization Reports, Commission Memos, etc.

PACT: We searched for the current commission-authorized CIP amount on the “Contracts” screen, in construction trend logs, and in budget transfer screens. The budget transfer logs track money as it is moved incrementally to a work project number. PACT does not provide an ability to reconcile the total project expenditures to date against the project authorization amount. Although this can likely be accomplished, it would require comparisons of funding authorizations and budget transfer amounts shown in PSFS against project expenditures.

SPOTS provides information for total project budgets, but the amounts shown in SPOTS did not, in all cases, reconcile with the information shown in PSFS.

Attribute 3 (Project Schedule Information): Project Schedule Dates (Plan and Current Start and Finish Dates) contained inconsistencies between the information found in 1) project records, 2)

dates listed in POS Contracts, and 3) in a few instances, with information found in PSFS, and information contained in Agreements. We specifically tested for consistency between plan start and finish dates. We took into consideration that PSFS tracks start and finish dates which were used to obtain program/project funding authorization, and that those dates may not be the same as dates shown in PACT and SPOTS. For the most part, information in PACT and SPOTS was either missing or incomplete, and in a few cases there were discrepancies between dates recorded in PACT/SPOTS and the project records (i.e., schedule data, change order logs, etc.). POS does not appear to update the PMIS to reflect current information that is forecasted on project schedules, to the extent that a current project schedule update has been submitted by the contractor and the requirement to do so has not been waived by POS.

Attribute 4: Change order information in PACT was either missing, incomplete, or contained discrepancies. We were unable to find change order amounts and change order cost-to-date information for several of the Seaport projects in the SPOTS system. The SPOTS systems tracks “Critical Issues,” but no costs were shown for each of the critical issues, so there is no ability to forecast the POS’s exposure to potential cost overruns. PSFS tracks actual costs for the PCS projects that had change orders, we found the change order information in PMIS was complete and current for the projects tested.

Attribute 5: Construction trends and change order logs should be included in PACT, but we did not find logs for all Aviation projects in our audit sample. In some cases, the trend logs and change order logs were one in the same. In other cases, PACT trend/change order logs were not up-to-date, and if we had not specifically requested that POS staff provide us with change order logs, we would not have known that the logs in the PACT system were incomplete and not up-to-date or in agreement with the hard copy change order logs. In several of the sample audit projects, the PACT records were severely behind the more current paper records and, in some instances, the PACT method of maintaining change order information appeared to have been abandoned by project personnel. Also, information contained on the POS-provided hard copy change order logs had not been entered into PACT (i.e., change orders were listed on the POS-provided logs but several of the change orders had not been entered into the PACT system, so the total amounts for costs to date was incorrect).

We were unable to locate change order logs in SPOTS. The “Critical Issues” report is supposed to provide comments about potential sources or possible causes of impacts, but the impacts are not quantified in terms of cost impacts in most cases. SPOTS uses red, yellow, and green indicators to heighten Seaport project management’s awareness that a project is in jeopardy of exceeding its planned budget or schedule. The “Critical Issues” comments lacked specifics to ascertain the cost/schedule impacts to the projects. Seaport explained that SPOTS is management’s “dashboard” that is relied upon for key information about its projects. It was described as the single place that a person can go to get pertinent and essential project information. SPOTS is lacking a key component of construction management cost controls – the ability to manage and mitigate cost overruns due to change orders.

Attribute 6: Costs-to-date and actual costs were compared against PSFS data for accuracy. Approximately half of the Seaport and Aviation sample audit projects contained discrepancies in these totals. In several of the PCS sample audit projects, invoices were either missing from the

project files or the invoice amounts shown did not reconcile to the amounts that were entered in the PMIS.

Attribute 7 (PMIS only): PCS project files were reviewed to compare the work authorizations (WA) against the information shown in PMIS. All of the sample audit projects either contained discrepancies between the hard copy records and the PMIS, or hard copies of the WAs were missing from the files so we were unable to validate the amounts shown in PMIS. The discrepancies noted in our review were not due to .01 rounding errors or sales tax. In most instances the discrepancies were due to user input errors.

The following table displays the results of our testing of POS's several project management systems. Red cells indicate discrepancies.

		SEAPORT					AVIATION														PCS																
Capital Improvement Project		C001561	C001698	C001769	C800050	C800063	C101600	C001662	C001760	C001805	C100172				C100526	C102163	C102167	C800034	SW-0312639	SW-0312640	SW-0312107	SW-0312098	SW-0312099	SW-0310760	SW-0311521	SW-0311862	SW-0310935	SW-0311285									
Work Project Number		101613	101998	100112	103089	103112	101975	100893	200086	102400	100370	100724	100873	100956	100994	102013	102341	103215	100880	102337	102637	101547	103468	103477	103512	103364											
ATTRIBUTE TESTED		SPOTS					PACT														PMIS																
1	SPOTS "Project Detail" Screen PACT "Contracts" Screen PMIS "Contract Information" Screen	N	N	N	N	N	Y	N	N	N	N	Y	N	Y	N	Y	Y	N	N	N		N	N	N	N	Y	Y	N	N	Y	N	Y	N				
2	Commission Authorization Amount	Y	Y	N	Y	Y	PACT - Not Available														PMIS - Not Applicable																
3	Schedule (Plan and Current) Dates Project Start and Finish Dates	N	N	N	N	N	Y	N	N	N	N	N	N	N	N	N	N	N	N	N	Design Project - N/A	N	N	N	N	PMIS - Not Applicable											
4	Change Order Information	N	N	Y	N	N	NR	N	NR	N	N	Y	N	NR	Y	Y	Y	Y	N	N		N	NR	NR	NR	NR	Y	NR	Y	NR	Y	Y	Y	Y	NR	Y	
5	PACT/SPOTS - Construction Trends and/or Change Order Logs	N	N	Y	N	N	Y	N	Y	N	Y	Y	N	Y	Y	N	Y	N	N	Y		Y	Y	Y	Y	PMIS - Not Applicable											
6	Costs to Date/Actual Costs/Invoices	Y	N	N	N	N	Y	Y	Y	Y	Y	N	N	N	Y	Y	Y	Y	Y	N		N	Y	Y	N	N	N	N	N	N	Y	Y	N	N	NR	Y	
7	PCS ONLY - Work Authorizations	SPOTS Not Applicable					PACT - Not Applicable														N								N	N	N	N	N	N	N	NR	N
		Y Meets Criteria / No Discrepancies N Missing/Incomplete/Discrepancies NR Not Required																																			

Criteria

POS Policy, Seaport Project Management Guideline, Ver.2 06.08.2005, describes the SPOTS system as follows:

SPOTS is a Microsoft Access database that is a repository for basic information about active projects within the Seaport PMG program. The database allows the SPMG to better plan and track the SPMG portfolio, to evaluate programmatic and project-specific performance, and report progress to upper management. The system supplements the Port's PSFS [PeopleSoft Financial System] and integrates the scope, budget, and schedule, particularly in terms of tracking commitments and trends, allowing for dynamic forecasting of costs and change controls, and linking MS Project schedule data. Reporting from SPOTS is oriented toward SPMG-specific needs. The database is intended for use directly

by PMs and SPMG managers, and is generally administered by the SPMG administrative staff members.

2.1 THE PROJECT CONTROLS DATABASE

The heart of the project controls system for the SPMG is the customized Seaport Project Office Tracking System (SPOTS). The database has six (6) primary characteristics.

SPOTS:

1. integrates cost and schedules on both project-specific and programmatic levels,
2. provides functionality to identify trends as potential/actual changes to the project budget,
3. provides functionality for change controls to record and document changes to scope, schedule and budget,
4. generates monthly reports and program CIP schedules,
5. is independent of other Port cost and finance systems and allows customization to meet PM and Program Manager needs, and
6. is compatible with PM-specific work tasks/tools and accountabilities and is easy to use, providing consistency among projects and managers.

AV-PMG Procedure Manual, C. Accurate Records and Recording of Transactions states:

AV/PMG has responsibility to furnish reliable information on a timely basis. AV/PMG's records must accurately reflect transactions and the disposition of assets. Employees shall not knowingly:

- (1) Make or cause to be made any false, artificial, or misleading entries upon AV/PMG's or the Airport's books or records;*
- (2) Make any entry in AV/PMG's or Airport's records that do not accurately and properly record in accordance with supporting facts or documents, a transaction or disposition of assets, in a timely manner;*
- (3) Make, cause or allow another employee to make any false entries in the records; or establish any disclosed or unrecorded fund or account.*

The key to successful project change management is to know what is changing as early as possible in order to provide intelligent solutions to best meet our customer's expectations. Another reason for managing project change is to ensure we are getting the most benefit out of every dollar we spend. In order to accomplish this it is necessary to conscientiously track changes. It is also desirable to track changes in one place. The Port of Seattle Aviation Project Management Group (AV/PMG) utilizes a cost trend management system. This is an application and database which records information at the project level in order to help manage scope, schedule and budget change at the program level. The key successes of the trend management system are early recognition of changes and timely input of these trends into the system. Although the Project Control teams record and monitor trends, everyone on the project team is obligated to identify changes and initiate trend communications as soon as they become aware of a change that could have either scope, cost and/or schedule impacts. AvPMG team members are required to document changes as soon as they are recognized, and submit trend documentation to Project Controls for action. Once initiated, trends are

*continuously monitored for updates to ensure that forecasts reflect the latest information available.*²²

*The Project Manager maintains a cost trend system for monitoring all costs incurred on the project relative to the established budget. The construction cost trends are created by the CM and R/E to support this activity and to serve as a means of alerting the PM and Port to construction cost growth. In addition to identifying the need for additional construction contingency, the Cost Trend System is also used to notify the PM of additional costs for CM services, when there are delays to the project.*²³

Cause

The reason for the inconsistencies between project data in the hardcopy documentation and SPOTS/PACT could be due to personnel inattention to or lack of concern for the importance of keeping the information systems accurate. It could also differ for concealment purposes (to hide developing schedule or budget problems). No controls appear to exist to assure that these information systems are correct and updated on a regular basis. In fact, senior POS management stated “we do not know where all of the files are kept for each project (electronically or physical locations). We have to research where records may be stored.” Clearly, POS project managers’ acceptance that the electronic management information systems are “inadequate to meet project management needs” denotes a lack of desire to maintain these several systems.

At a more fundamental level, the fact that POS’s primary information system, PSFS, does not meet project management needs, thereby requiring ad hoc and duplicative systems to be developed and maintained invites inaccurate and incomplete recordkeeping.

Effect or Potential Effect

If POS senior management is unaware of budget discrepancies or schedule delays, it can no longer effectively manage projects and staff or initiate timely corrective actions. Inappropriate budget transfers cannot be monitored and controlled if the systems are not regularly updated. Also, the ability for network users to inadvertently change information in the systems is a high risk. There should be data integrity protection measures in place to guard against “accidental” data changing while viewing information in these electronic systems. PMs do not have the ability to easily or quickly view key criteria for assessing project success, namely budget/change order information, and actual vs. planned schedule performance.

Recommendations

This finding supports our overarching recommendation regarding appointment of a Chief Procurement Officer, establishment of an independent contract administration function, and revision of the delegations of authority for approving construction management expenditures. In addition, we recommend the following with respect to this finding:

Recommendation 31: We recommend that POS develop, implement, and enforce control procedures that include timely updating for the SPOTS, PACT, and PMIS systems with accurate project information until the project is closed out and the project data are archived.

²² AvPMG Procedures Manual, page 61.

²³ Construction Management SOP Manual, SOP #17, “Cost Trends”.

Recommendation 32: We recommend that POS develop policies and procedures for ensuring that PSFS data are consistent with data maintained in the other systems.

Recommendation 33: We recommend that SPOTS be revised to include information regarding change order costs. (Reviewing actual cost data from PSFS does not easily highlight the origin of cost overruns on a project.)

Recommendation 34: We recommend that POS enforce contract requirements for project schedule updates so forecasted project completion dates can be accurately recorded in the POS's project management information systems. We recommend that POS implement a means of tracking current forecasted project completion dates, current change order amounts, original budget amounts, commission funding authorizations, budget transfers in *all* of its management information systems (SPOTS, PACT/Margen, PMIS).

POS Response

The full text of the POS response to this finding is in Appendix E. POS's response disagreed with and mischaracterized this finding and its recommendations, and stated that:

Within the environment of its multiple systems, the Port efficiently utilizes them [sic] systems for specific purposes and records data into them once when full and complete information is available. The Port, however, has consciously elected not to use all data fields offered by the applications where unnecessary or duplicative and even sometimes chooses not to apply all tools to particular projects when those tools are determined not to add value or be cost-effective. This may not coincide with the manner in which the Performance Auditor envisions the systems should work; nevertheless, the manner in which the Port's suite of systems operate meets the Port's requirements for effective project management....

The seven "attributes" were particular pieces of information the Performance Auditor believed the systems should reflect. However, in most cases, those information systems are not intended to capture the information tested by the Performance Auditor.

While the Port accepts both the recommendation that a unified system would be preferable and the admonition that timely and accurate updates to these systems are crucial to their effectiveness, these three systems meet the needs of their respective work groups.

Auditors' Additional Comments

We disagree that POS "records data into them [the MIS systems] once [sic] full and complete information is available." Although obtaining and maintaining our access to POS MIS systems was an ongoing challenge throughout the audit (and discussed in more detail in Finding 7-A of this Report), we pursued the use of these systems because we recognized that POS project managers *do* rely on the information (that is supposed to be recorded in those systems) to make key project decisions throughout the course of the project. During the audit field work phase and

after, we used these systems extensively, and as noted in the above Condition section, we found numerous instances on projects when actual information was “full and complete” where that information was *not* recorded in the MIS systems.

POS explains that it “*has consciously elected not to use all data fields ... and even sometimes chooses not to apply all tools to particular projects when those tools are determined not to add value or be cost-effective.*” We found gross inconsistencies in POS’s choosing to use or not use these MIS “tools” on particular projects, and even within single projects. The inconsistencies, errors, and omissions that we found in the MIS systems do not substantiate POS’s assertion that decisions to utilize these MIS systems are based on value added or cost effectiveness.

POS’s assertion that “*in most cases, those information systems are not intended to capture the information tested by the Performance Auditor*” is misleading and inaccurate.

The MIS systems contain data fields to record the specific information that we tested for in this finding. And, in specific instances when an attribute was, in fact, not applicable to one of the MIS systems, we noted that in the above matrix.

POS has misrepresented our recommendations in this finding stating that “*while the Port accepts ... the recommendation that a unified system would be preferable ... these three systems meet the needs of their respective work groups.*” Our recommendations do not mention using a “unified system” or suggest that POS use a “unified system.” We recommended that POS develop policies and procedures to ensure consistent and timely updating of the *current* MIS systems being used, and that “POS implement a means of tracking certain core project information (considered to be standard information for *any* construction project) “in *all* of its management information systems (SPOTS, PACT/MARGen, PMIS).”

Finding 4-B: POS requirements for Project Notebooks are not enforced, and requirements are inconsistent between POS divisions. Project Notebooks were missing, incomplete, not updated, and not easily accessible by stakeholders.

Background

The POS Seaport and Aviation Divisions' Guidelines describe Project Notebooks as "an essential tool" that "conveys critical information" and is used by POS to communicate project information to stakeholders, POS management, and the entire project team. Project Notebooks lay the foundation for effective project delivery and help define, plan, and implement projects.

The Project Notebook, in a preliminary form, is required to be prepared prior to requesting project funding authorization from management and the Commission.

Condition

Of the 14 CIPs (26 sample projects) that were selected for audit, we were able to obtain Project Notebooks for approximately half of the CIPs. We observed the following:

- *None* of the Aviation or Seaport Project Notebooks had been updated since they were initially prepared at the onset of the projects. (Two Project Notebooks were updated, but these notebooks were updated/revised by POS personnel because of their awareness of the ongoing performance audit. POS personnel explained that "the notebooks were out of date so [they] wanted to ensure that we [auditors] had the most current information." We doubt that these two Project Notebooks would have been updated had it not been known that these particular projects were selected for audit.)
- The 3rd Runway Project Notebook was prepared in May 2003. The Project Notebook contained information for several, but not all, of the audit sample projects. We inquired about the missing Notebooks and were told by POS that Project Notebooks were not prepared for all of the 3rd Runway projects. We asked if the Project Notebook had been updated since 2003, particularly in light of the fact that several years had elapsed since the Notebook was prepared, and some of the projects have just recently started construction. POS stated that the May 2003 Project Notebook was the only version that had been prepared. The Project Notebook was out of date and of limited value to the stakeholders.
- In instances when POS has had to seek additional funding authorizations from the Commission for projects that have either exceeded the baseline (planned) project cost and schedule, or the initial authorizations were only for a portion of the project such as the design phase, the Project Notebook baseline cost and schedule information was *not* reviewed or updated. POS explained that the Project Notebooks are not updated because "it would be a duplication of effort with other systems." We reviewed POS management information systems (i.e., PACT, MARGen, and SPOTS) and concluded that updated information such as project schedule updates did not exist in other POS systems. One reason that project schedule updates could not be found for certain projects is because "the Port has consciously elected not to routinely insist on monthly project schedule updates despite contractual language mandating the same."
- There is no indication that the Project Notebooks are ever used again by project personnel after initial creation. The notebooks that we obtained during the audit were not updated

and lacked Commission Memos substantiating additional project funding authorizations that were obtained throughout the course of project execution.

- Project Notebooks are incomplete and lack core project documentation that is required by POS Seaport and Aviation guidelines. There are inconsistencies in the required formats of the Project Notebooks between the Aviation and Seaport Divisions, although some similar elements are required for both divisions' formats.
- The Project Notebooks are supposed to be “accessible when a Project Manager (PM) is not available or project staffing transitions occur.” Throughout the audit we experienced difficulties obtaining the Project Notebooks. For example, we requested the Project Notebook for the T-91 Utility Infrastructure Upgrade Project and were told that its location was unknown. The project was completed in February 2007, prior to the commencement of our fieldwork for the audit. POS personnel then explained that “sections [of the Notebook] are scattered around, as we have many people still using them.” We were ultimately provided with a copy of the Project Notebook. POS had asserted that the current version was the version on the ‘M’ drive per POS’s direction. Below is a comparison of the electronic information we obtained vs. the hardcopy Project Notebook that was ultimately provided.

Hardcopy	Electronic
CIP Project Description	CIP Project Description
Request to Open A New Project	Request to Open A New Project
Project Notebook Cover	Project Notebook Cover
<i>Not Included</i>	Project Assumption
103112 - Project WBS	103112 - Project WBS
POS T-91 Redevelopment Pictures	POS T-91 Redevelopment Pictures
Major Capital Investments - T91	Major Capital Investments - T91
Estimate of Probable Cause	Estimate of Probable Cause
103112 Project Schedule	103112 Project Schedule
Latest P-91 Utility Asset Plan	Latest P-91 Utility Asset Plan
<i>Not Included</i>	Old P-91 Utility Asset Plan
Pier 90/91 Framework Plan 06/01/2005	<i>Not Included</i>
Commission Agenda - March 22, 2005	<i>Not Included</i>
Commission Agenda - November 2, 2005	<i>Not Included</i>

The electronic file titled *Project Assumption.doc* contained only the following statement: “Please see hard copy of notebook. Original file lost.” There was no hardcopy file of *Project Assumption.doc*.

There are no Kepner-Tregoe or risk management assessment documents in the hardcopy or electronic versions of this Project Notebook, and no team meeting notes. The schedules provided in the Project Notebook are outdated.

The hardcopy version of the Estimate of Probable Cost as of December 20, 2004 – the Baseline Estimate – was printed on 06/18/2007.

- POS lacks procedures to ensure continuity for preparation and maintenance of the Project Notebooks when staffing transitions occur. POS staff often didn’t know if a Project

Notebook existed or they were unable to find the Notebook because project personnel changes had occurred. The current project managers often had no idea whether or not a Notebook had ever been prepared, and if one was prepared, they often did not know where it was stored.

- Project managers believe that essential project management information can (usually) be obtained from the electronic project management information systems (PACT/SPOTS). Project Notebooks are not viewed by project managers as ongoing repositories for key project documentation, thus updating efforts are lax. However, the project managers' reliance on the PACT/SPOTS systems does not always yield the same information that should have been stored in the Project Notebook. The PACT/SPOTS systems are out of date and often missing key project information. Locating core project information regarding funding authorizations, planned start and completion dates vs. actual start and completion dates, executed change orders, and change order logs is a significant challenge and requires a good working knowledge of the many electronic and manual filing locations in which documents could or should reside.
- Most often missing from the Notebooks was information regarding Potential Problem and Opportunity Analyses. The 3rd Runway Project performed a Risk Assessment in 2003 but never conducted another session to re-evaluate the issues that were identified as problems or to follow-up on areas of opportunity. POS has performed Kepner-Tregoe risk assessment sessions on a few projects that were experiencing severe project cost and schedule overruns (i.e., C-1 Baggage Handling System project), but the majority of POS projects are executed without a risk assessment being conducted by the project team.
- Information contained in the Project Notebooks (POS's project plan) is not being used by project teams. The Notebook is viewed as a necessary requirement in order to obtain project funding authorization. But, after funding is authorized, the Project Notebooks are abandoned, and in some cases, the project objectives (scope), schedule and budget goals, and assumptions made during the planning phase changed during the project execution phase without regard to the original project concept/scope.

Criteria

POS Policy, Seaport Division – PM Guidelines, requires:

1.1 PURPOSE OF PROJECT NOTEBOOKS

The Project Notebook is an essential tool in documenting and communicating project details to stakeholders, Port of Seattle management, and the entire project team. The Notebook should be accessible when a Project Manager (PM) is not available or project staffing transitions occur. PMs are encouraged to use the planning methodology and tools available in the "Kepner-Tregoe" (KT) process when developing the Project Notebook. Additional templates and tools are referenced within this Guideline. These tools are either required or strongly recommended and will help to provide a consistent format and result.

The Project Notebook is used as a tool to support the process by which projects evolve from the sponsoring Seaport Business Units to the Project Management Group charged with successful project delivery. The Project Notebook conveys critical project information, particularly:

- Project Definition,
- Planning Elements, and
- CIP Authorization.

The PM is responsible for setting up the Project Notebook. A preliminary version of the notebook is **REQUIRED** prior to requesting CIP Authorization(s) from Management and the Commission. This preliminary notebook must, at a minimum, have the project description, preliminary work breakdown structure (WBS), preliminary estimate of probable cost, and preliminary schedule.

Following the CIP authorization, the PM is responsible for project delivery, including project planning, permitting, design, construction, commissioning, and closeout.

Seaport Project Notebooks must contain the following information:

1. Project Description & Objectives
2. Project Assumptions
3. Work Breakdown Structure
4. Resource Requirement & Responsibilities
5. Budget Authorizations
6. Schedule
7. Potential Problem Analysis
8. Asset Plan

Airport Division – Project Design Manual requirements include:

The project notebook is an essential tool in communicating project details to the entire Project Team. It is at hand when a PM may not be available. The most important information in the notebook is an accurate, updated project description. The Project Manager (PM) is responsible for setting up the notebook.

1. Select either electronic or manual (hardcopy) format.
 - For electronic:
 - Go to the AV/PMG homepage. [://ntklry41/Av-Pmg/Indx.htm](http://ntklry41/Av-Pmg/Indx.htm)
 - Select website for your program. V:\Av-PMG/projnotebooks/new-version.doc
 - Set up notebook file using standard tabs for content format (see #2 below).
 - Maintain a hard copy at the PM's desk.
 - For manual:
 - Use large three-ring binder with tab set.
 - Set up notebook using standard tabs for content format (see #2 below).
2. Arrange notebooks with six standard tabs. Tabs other than these are optional:
 - Project Statement
 - Project Objectives
 - Cost Estimate Original and Today
 - Potential Problem Analysis
 - Summary Schedule: Design, Advertise-Bid-Award, NTP, Construction Start-Stop
 - Linkages to Other Projects
3. Within the notebook, the PM must:
 - Define scope, schedule, and budget;
 - Estimate hard and soft costs;
 - Input baseline budget in Parsons Aviation Cost Trend (PACT) system;
 - Input hard and soft cost budgets in PACT;
 - Input project in Master Schedule (predesign, design, construction);
 - Establish the schedule using template; and
 - Identify critical interfaces with other projects.

Best Practices, *The Kepner-Tregoe PM Process Guide* (recommended by POS Seaport division to be used by Project Managers) discusses the importance of developing a project plan. It states:

Definition Phase Summary

The definition phase is the preamble to project planning and implementation. In the definition phase, the true nature and scope of the project becomes clear to senior management, the project team, and the entire organization. This is where commitment is gained and where the organization links its resources to the objectives it is trying to achieve. Four key elements of the project become clear during this phase: purpose, objectives, results and resources.

The ***Project Management Institute (PMI)*** organized project management processes into five groups, one of which groups is the planning process. The project plan, as described in PMI's ***Project Management Book of Knowledge (PMBOK)***, "uses outputs from the planning processes to create a consistent, coherent document that can be used to guide both project execution and project control." PMI further states that the project planning process is "almost always iterated several times."

Project Management Institute Standards Committee, PMBOK, Chapter 4 – Project Integration Management states:

The project plan is used to:

- *Guide project execution.*
- *Document project planning assumptions.*
- *Document project planning decisions made regarding alternatives chosen.*
- *Facilitate communication among stakeholders.*
- *Define key management reviews as to content, extent, and timing.*
- *Provide a baseline for progress measurement and project control.*

The construction industry has widely accepted that risk planning at the onset of a project, and risk assessments during the course of completing the project, are essential to achieving timely project completion within the planned budget. The Project Management Institute includes “risk management” as one of its nine key project management processes.

The **Association for the Advancement of Cost Engineering’s** recent publication of the technical article *Proactive Risk Management* by Minnesh Kalisprasad, CCE, states:

Project risk management has to be integral to all the project phases if it is to be accepted and practiced. It should be given the same attention as one would give the scope, the schedule, the resource loading, and the budgeting aspects of a project.

In order for risk management to work in any organization, it has to be proactive, and not reactive.

Risk management has to become part of the organization culture if it is to work. The support of management in such an endeavor is paramount to any management program’s long-term survival.

Cause

Although Project Notebooks are required in order to obtain funding authorizations, the POS Commissioners are not shown these documents in their entirety. The Project Managers do not regard the Project Notebooks as essential communication tools, so once they have obtained CIP funding from the Commission they lack incentive to maintain the Notebooks. POS management does not enforce its internal guidelines requiring Notebooks to be prepared for all projects or updated so that they contain useful, current information. POS’s decentralized project management approach allows construction managers to make project decisions regarding budget and schedule with very little, if any, involvement from the project managers. POS project managers are often not informed of project issues and thus lack essential information that would be required to keep the Project Notebook updated.

Effect or Potential Effect

The Project Notebook is of little value if it is not regularly updated. The Project Notebook is a necessary management tool throughout the life of the project. Lack of a quickly accessible and completely up-to-date project record creates situations where key decisions may be erroneously

or ineffectively made based on incomplete or outdated information. Further, as personnel changes occur, lack of up-to-date Project Notebooks increases the time needed for new managers to gain control of the projects. To the extent that updating is essential, the Project Notebooks should be monitored to insure that updates are completed in a timely manner, leaving no chances for intentional omissions or blatant cover-ups.

Properly maintained Project Notebooks can be a useful resource from which to gather project “Lessons Learned” within POS. Each Project Notebook, if regularly updated, will provide a history of the project’s funding, schedule for completion of the work, and costs (actual vs. planned). Reviewing past CIP projects’ actual performance versus projected/planned project performance objectives will highlight areas where improved project performance could be achieved. None of these potential construction management benefits is being realized.

Recommendations

This finding supports our overarching recommendation regarding appointment of a Chief Procurement Officer, establishment of an independent contract administration function, and revision of the delegations of authority for approving construction management expenditures. In addition, we recommend the following with respect to this finding:

Recommendation 35: We recommend that POS establish a central repository for Project Notebooks within each POS division.

Recommendation 36: We recommend that POS develop a check-out and tracking system for the Project Notebooks and utilize it.

Recommendation 37: We recommend that POS require project managers to periodically and on a timely basis update the Project Notebooks with current Construction Trend Logs, Change Order Logs, and Schedule Updates.

Recommendation 38: We recommend that POS integrate assessments of Project Notebook completeness and quality into the POS personnel performance evaluation processes.

POS Response

The full text of the POS response to this finding is in Appendix E. POS’s response agreed with this finding but disagreed with one of the recommendations associated with this finding. POS stated that:

The Port agrees some additional attention is required to Project Notebooks. These notebooks capture the initial plan for the successful delivery of a project and set the baseline scope, budget and schedule. Consistent with best industry practices, they are not intended to be updated continuously to reflect the current state of the project.

...Acknowledging a need to focus on consistency in content and quality of project notebooks, the Port has developed an action plan and formed a task group to evaluate and implement the TKW recommendations. That task group is specifically reviewing the Port’s current practices, clarifying notebook criteria and content, and ensuring that notebook quality is included in project managers’ performance reviews.

Auditors' Additional Comments

POS disagreed with our recommendation to require project managers to periodically update the project notebooks. POS stated that:

The Port disagrees with this recommendation because it would be inconsistent with industry best practices. Construction trend logs, change order logs, and schedule updates are more efficiently maintained elsewhere; and including this information in Project Notebooks would be redundant. The earlier independent TKW performance audit noted that the Port's notebook process is consistent with best industry practices. The Port will continue to implement the TKW recommendations to ensure consistent Project Notebook entries.

POS's disagreement contradicts its own "Action Steps" set forth to address its auditor's (TKW) recommendation. POS's Action Steps stated:

*The Port will establish the threshold where project notebooks will be required, when they will be base-lined, **and they must be updated with changes.** [Emphasis added.]*

If POS *were* efficiently maintaining change order and schedule information elsewhere, then it might be possible to place less emphasis on the project notebook, but we did not find that to be the case. In fact, Finding 4-A, above, pointed out that the information in POS's MIS systems is often incomplete, out-of-date, inaccurate, and often did not reconcile with hard copy projects records.

POS misrepresented TKW's Recommendation regarding project notebooks which stated: *We recommend the Port of Seattle focus upon consistency in content, quality, **and updating of project notebooks.***

We disagree with POS's assertion that updating the project notebooks is inconsistent with industry standards, and POS has mischaracterized our recommendation. The project notebook is a "project manual" which is a living document typically required on construction projects and routinely updated as the project plan changes to accommodate specific project needs and circumstances. We did not recommend that the project notebook be "*updated continuously to reflect the current state of the project.*" We recommended *periodic* updates to reflect current change order trends, change order logs, and schedule updates (all of which are the primary project documents that record changes to forecasted costs and schedule completion).

Finding 4-C: POS paid \$864,463 for an electronic construction document management system (“Livelihood”), and the contract required POS contractors to use this system on specified projects, but neither POS nor its contractors have used the system as intended.

Background

The Port intranet describes the Construction Document Management System (CDMS) known as “Livelihood” as:

a web-based document management system that can generate and capture electronic documents, route them to appropriate individuals, file, and then allow for easy retrieval, display, and archiving.

Specifically, the system:

- *Keeps track of all document revisions.*
- *Identifies who made the changes to the documents and what the changes were.*
- *Identifies when a document was viewed or revised.*
- *Electronically files the documents.*
- *Provides search capabilities for easy document retrieval.*

Allows only those individuals who have appropriate permissions to view and/or revise documents.

The CDMS will be used on major Port construction projects to facilitate project collaboration between project team members, such as Port staff, contractors, and design professionals. The Port of Seattle will oversee and maintain the system and will allow login access to team members. Port staff will also provide elementary training to team members regarding the use of the system.

Information Regarding the Use of Livelihood:

Livelihood is a web-based application for storing, sharing, and distributing information. Livelihood is designed to help:

- Organize documents and other work items in a central, permission-controlled location
- Share, find, and keep track of information
- Revise documents and other information in a version-controlled environment
- Manage and simplify business processes by creating and using Workflows
- Communicate news and other information to other members of the organization
- Manage the work of project teams

The Livelihood file structure is set up using a template. POS projects that have been set up in Livelihood are premised on the same basic file structure. The file structure established by POS in the Livelihood file “Project Filing Structure” is typical of the types or categories of project records that are maintained for construction projects. Livelihood also has workflows that are used to transmit documents among various project personnel.

Documents are added to Livelihood by uploading a document that already exists to the system, or by creating a new document to add to the system. When an existing document is added to Livelihood, the user can specify a Name and Description for it, modify its Categories, and choose the location in Livelihood where it is added. When a new document is added to Livelihood, the user

selects a document type, specifies information about the document, and then composes its contents. Document types that can be added are set by a Livelink Administrator, but can include Microsoft Word, Excel, and PowerPoint documents. Once a new document is added, a blank version of the document opens in its associated desktop program where the user can compose its contents. The documents maintained in POS's projects are primarily PDF documents that have been created outside the Livelink system and then uploaded. ***Documents that are “uploaded,” such as PDF documents, are given a “create” date which is shown in the Livelink audit trail.***

Documents are edited in Livelink by starting an edit session. When an edit session starts, the Document is reserved, downloaded to a temporary location on the user's computer, and opened in its associated desktop program. When the user is finished making changes to the document, he or she can choose to save the changes to Livelink as a version to the original document.

Access to added items is controlled by “permissions.” By default, any item that a user adds inherits its permissions from the container in which it is put. For example, if a group has “See Contents” permission on a Folder, members of that group will have permission to see any Document added to that Folder. However, it is possible to modify the permissions of individual items in a Folder. POS modifies permissions at the folder level and at the file level.

Livelink automatically stores and maintains a set of basic information for every item in the system. This information is displayed on a series of tabs on the item's Properties page. Different item types have different Properties tabs. One of the Properties is the Audit tab. In this tab, an audit trail displays a log of events for the item. *Typical audit events include when the item was added (meaning a document that has been uploaded/created as an existing file, or created as a new document from an application within Livelink), moved, opened, or modified; the date of each action; and the user who performed the action.*

Condition

Both contractors and POS project personnel are required by some contracts to use CDMS for “all contract communications, submittals and shop drawings between Port and the Contractor.” However, the CDMS (Livelink) system was not utilized as required by contracts and instead, in many instances, the Livelink system was used as end-of-project document repositories.

Contract Section 01340 states:

DIVISION 1 – GENERAL REQUIREMENTS

Section 01340 - Construction Document Management System

PART 1 – GENERAL

1.01 Description of Work

- A. The Construction Document Management System (CDMS) is a web-based system developed by the Port to manage Contract Documents. The CDMS will be used to generate and capture electronic Contract documents, route them to the appropriate individuals, file them, and then allow for easy retrieval. The CDMS shall be used for all Contract communications, submittals, and shop drawings between the Port and the Contractor.

The matrix below lists five POS projects that were included in our sampled projects for which the contracts (specifically Section 01340) required Livelink to be utilized by the contractors on the project.

Project #	Project Description	Doc Mgmt Syst Req'd	Project Cost	1	2	3	4	5	6
100112	Shilshole Bay Marina Renewal & Replacement Work	Y - LiveLink	\$54,611,222	N	Y	N	Y	N	Y
100724	2006 Embankment - 3rd Runway Construction/RW 16L Safety Area Expansion	Y - LiveLink	\$124,777,042	N	Y	Y	Y	N	Y
102013	Third Runway Project 2004-05 Embankment S. 154th Street Construction	Y - LiveLink	\$192,639,883	Y	Y	Y	Y	Y	Y
102337	C-1 100% Final Baggage Screening Facility	Y - LiveLink	\$111,303,258	N	Y	N	Y	N	Y
102637				N	Y	Y	Y	Y	N
102400	2004 Airfield Improvement Projects - Contract 1	Y - LiveLink	\$33,090,975	N	Y	Y	Y	Y	N

Each Livelink project has a “Filing Cabinet.” We selected the following six key attributes to review for the above listed projects.

1. 301 – Conformed Spec (subfolder Conformed Contract)
 2. 304 – Contract Clarification and Changes (Change Orders)
 3. 305 – Communications (Correspondence)
 4. 305 – Communications (Meeting Minutes)
 5. 308 – Schedules
 6. 314 – Reports (Contractor Daily Reports)
- a. Red indicators in the table above denote empty or incomplete folders.
- b. Yellow indicators denote when folders or files were either incomplete or the documents were “created” (i.e. uploaded) in Livelink significantly after the documents were originally generated by project personnel during execution of the project. And, in some instances documents were “created” in Livelink as a result of POS being informed that the project had been selected for audit. Such situations were noticeable because the document “create” dates coincided with the date that POS was notified that that project was selected for audit. The document “create” dates did not appear to be the result of routine document management maintenance because the document dates (original document date) in these instances preceded the upload (“create”) date by months, and

sometimes more than a year. For example, Project 102400 had 79 documents uploaded (“created”) on May 30, 2007 but the documents were originally generated by project personnel between January and July of 2006.

- c. Green denotes folders in which the documents appeared to be complete and the documents were (generally) “created” contemporaneous to the document origination dates.

Project 100112 (Contract Execution Date: February 4, 2005 for Construction Services. Contract is a General Contractor/Construction Manager (GC/CM) Contract.)

Attribute 1 (Conformed Spec): This folder was completely empty. While some projects at least contained the single-page signed Agreement, this project did not have the even minimum of key contract documents (i.e., Agreement, General Conditions, Supplementary Conditions, Specifications). In response to the draft finding, POS stated that contracts and conformed copies of the specifications are not typically placed in the Livelink system since they are kept separately, both in hard copy format in the contract file and electronically in the Engineering archive site, which was created around the same time as the project filing structure in Livelink. We repeatedly requested POS to provide us with written procedures regarding POS’s implementation and use of Livelink. POS told us that they did not have any procedures or documentation for Livelink. POS’s lack of written procedures regarding the use of Livelink contributes to inconsistency among projects required by contract to use Livelink, and allows project team personnel to improvise various ways to use Livelink, including the setting up of generic folders that POS purportedly doesn’t intend to use.

Attribute 3 (Communications, Correspondence): “Correspondence to Hoffman,” subfolders 2005 and 2006, primarily contained transmittal sheets. There were many instances in which the document dates preceded the Livelink file creation date by several months, thus indicating that project records were not timely “created” in Livelink to allow contemporaneous use by project team personnel. Letters from POS to the contractor on project matters were non-existent. The “Emails” folders for “2004” contained one email, “2005” was empty, “2006” contained two emails, and “2007” was empty.

Attribute 4 (Communications, Meeting Minutes): Documents in the Weekly Construction Meeting Minutes Subfolders “2005” and “2006” generally were “created” in Livelink between two and four months after the documents were initially generated in the project meetings.

Attribute 5 (Schedules): All “Schedules” subfolders and the main folder were empty.

Attribute 6 (Reports): The “Weekly Reports” subfolder “CM Weekly Reports 2005 – 2006” was missing weekly reports, specifically meetings 59 through 72, and 76 through 89; a total of 28 weekly reports.

Project 100724 (Contract Execution Date: January 18, 2006)

Attribute 1 (Conformed Spec): This folder was empty.

Attribute 3 (Communications, Correspondence): This folder was incomplete.

Attribute 5 (Schedules): The folder contained empty subfolders.

Attribute 6 (Reports): This folder was incomplete and documents were “created” in Livelink months after the documents were generated on the project.

This project was the most recent of projects to require utilization of Livelink and it showed the least use of the projects that were included in our sample. In response to our draft finding, POS stated, “Since first implemented in 2004, there have been ongoing, incremental increases in the consistent and uniform use of the Livelink system. At the present time, most contractors on most projects use the Livelink system.” This project did *not* substantiate POS’s assertion.

Project 102337 (Contract Execution Date: May 26, 2004)

Attribute 1 (Conformed Spec): This folder contained (a) the 2-page signed GCCM Agreement dated July 27, 2004, but not “created” in Livelink until December 27, 2004, (b) the subcontract between the prime contractor (GC/CM) and a subcontractor dated October 04, 2004, but not “created” in Livelink until January 4, 2007, and (c) the subcontract for the replacement baggage handling system subcontractor which, dated November 13, 2006, but not “created” in Livelink until January 19, 2007. The project Specifications were not in Livelink. Documents were not “created” in Livelink until several months after the documents were initially generated on the project, and sometimes years after, as was the case with item (b) above.

Attribute 2 (Contract Clarification and Changes): There were five subfolders for “Requests for Information” that contain ~4005 RFIs in the “Change Clarifications and Changes” folder. One of the RFI folders contained 499 items (RFIs 001 through 499). These were not always added to the system on a timely basis. For example, RFI 001, dated June 6, 2004, was “created” in Livelink on April 15, 2005, 10 months after the document was originally prepared during the project. There were other instances when RFIs were not “created” in Livelink in a timely manner.

Attribute 3 (Communications, Correspondence): In the folder “2004 Email[s] to POS” (the email folder example used by POS in response to a draft of this finding) was a file titled “6-17-2004 305.1 102337 – Fuel Hydrant Schedule.” It was dated June 17, 2004, but was not “created” in Livelink until approximately six months later on October 27, 2005. The folder “2005 Emails to POS” is incomplete. During the audit, we requested that the Resident Engineer’s Outlook email files be provided to the audit team because the emails were *not* in the Livelink system, and the emails contained document attachments with essential project information. The Outlook files that we were provided contained approximately 2 gigabytes of information—a significant amount of information that, in many, many instances, had never been “created” or uploaded into the Livelink system. Many of the document attachments included in the email files we received were not in the Livelink system. The Livelink folder “2004 Letter to POS” contained only one document, but the system should have contained all project correspondence that was sent to POS during 2004.

Attribute 4 (Communications, Meeting Minutes): Meeting minutes in the “2005” folder were not “created” in Livelink until April 2006 or later.

Attribute 5 (Schedules): The “Progress” schedules folder contained 71 items. With a few exceptions, progress schedule documents that were originally prepared by project personnel

during 2005 and the first half of 2006 were not “created” in Livelink until June 6, 2006. The subfolder titled “2004 Schedules” contained some additional schedules (though not for the entire year). The schedule documents for 2004 were “created” on June 26, 2007 during our audit of the project.

Attribute 6 (Reports): Daily Reports for September through December 2004 were, in most instances, “created” over one year after the documents were prepared. The folders for 2005 and 2006 had the same issue (i.e., CDRs for July 2006 were recently “created” on August 23, 2007).

Project 102013 – (Contract Execution Date: May 28, 2004)

Attribute 1 (Conformed Spec): The “Conformed Contract” folder was empty. The Contract Specifications were located in a folder titled “Conformed Spec Book,” in a subfolder entitled “Project Manual.”

Attribute 2 (Contract Clarification and Changes): Although, some change orders were prepared and executed during 2004 and 2005, the change orders were not “created” in Livelink until beginning in February 2006. For example, CO #1 was signed on November 23, 2004, but not “created” in Livelink until February 3, 2006.

Attribute 3 (Communications, Correspondence): Nearly all correspondence files included in the “Correspondence – POS” folder were “created” on December 29, 2005, over 1 ½ years *after* the Agreement was signed.

Attribute 4 (Communications, Meeting Minutes): This folder was incomplete.

Attribute 5 (Schedules): This folder was incomplete. Lookahead schedules existed for only the period between September 26, 2004 and November 29, 2004, and the “Progress Schedule” folder was also incomplete and had only one schedule, dated December 14, 2005, in the folder.

Attribute 6 (Reports): The Daily Reports folder for 2004 contained subfolders for August through December 2004, and those files were “created” on December 21, 2005; one year after the documents were generated on the project. Based on the “create” dates shown for documents in the Daily Reports folder for 2005, the daily reports were entered in batches (several weeks worth of daily reports were uploaded -- “created” on the same day). The documents were “created” in Livelink approximately every three or four weeks, and in some instances, longer periods of six or seven weeks would occur between batches.

Project 102400 (Contract Execution Date: May 28, 2004)

Attribute 1 (Conformed Spec): This folder was empty.

Attribute 2 (Contract Clarification and Changes): Folders for individual change order documents were “created” at the onset of the project when the File Structure was established using the project template, so some of the change order folders have “create” dates that align with the initial setup of the project. However, the documents *contained in* the change order folders were, in some instances, not “created” in Livelink until much later in the project. And in other cases, the Change Order folders were not “created” until long after the change order

documentation had been prepared by project personnel. For example, the Change Order #004 folder was “created” on August 2, 2006, nearly two years after the documentation in the folder was originally prepared (the document date was September 24, 2004).

Attribute 4 (Communications, Meeting Minutes): Meeting minutes prepared at the onset of the project took between two and four months to get “created” in Livelink.

Attribute 5 (Schedules): Within the “Schedules” folder there were three subfolders for “Look Aheads” for the years 2004, 2005, and 2006. These files/folders contained three-week Look Ahead schedules. The “Look Aheads 2004” folder was “created” on May 31, 2007. Files were uploaded into these folders on May 31, 2007, three years after the contract execution date, and right after our auditors began reviewing project records. The Livelink folder “Contractor Monthly Schedules” contained only four documents (emails dated 6/21/05, 6/22/05, 8/3/06, and 8/12/06), and although the documents had been prepared by project personnel between June 2005 and August 2006, the documents weren’t “created” in Livelink until May 30, 2007, coincident with our audit.

Attribute 6 (Reports): The files in “Contractor Daily Reports” (CDRs) were incomplete. The subfolders included CDRs for the months of April and June through December 2004, and for 2005 there were some daily reports for the months of January through May, and July through September. There were no Contractor Daily Reports for 2007. A subfolder called “Things that are broken list” contained 79 files that were originally generated on the project between January and July 2006, but the documents weren’t “created” in Livelink until May 30, 2007.

Summary of Findings:

1. Contractors are not maintaining project records contemporaneously in Livelink as required by contracts.
2. POS is wasting an unknown amount of money requesting contractors to bid based on the use of the CDMS/Livelink system and then not requiring contractors to perform the required scope of work related to the system.
3. POS is upsetting the competitive procurement process since contractors who have worked with POS know that costly contractual requirements will not be enforced. Thus, those contractors obtain an unfair competitive advantage over other bidders that base their bids on full contract compliance.
4. In several instances, POS revised its files once it knew that certain projects had been selected for audit. Our ability to review the adequacy and accuracy of the POS document management system was impacted by POS’s actions.

Criteria

Contract Requirements stipulate that:

DIVISION 1 – GENERAL REQUIREMENTS

Section 1340 – Construction Document Management System

PART 1 – GENERAL

1.01 Description of Work

A. The Construction Document Management System (CDMS) is a web-based system developed by the Port to manage Contract Documents. The CDMS will be used to

generate and capture electronic Contract documents [sic], route them to the appropriate individuals, file them, and then allow for easy retrieval. The CDMS shall be used for all Contract communications, submittals, and shop drawings between the Port and the Contractor.”

PART 3 – EXECUTION

3.02 SYSTEM USE

A. System Use

1. The Contractor shall use the Port of Seattle’s Web-based CDMS specified herein for all project communications, including but not limited to submittals, transmittals, requests for information, etc.

*2. **Any information not transmitted via the Construction Document Management System will not be considered official documentation, unless specifically allowed as an exception by the Engineer based on extenuating circumstances.** All information transmitted via the CDMS shall be in electronic format.*

The Port may, from time to time, require hard paper copies of certain documents, including Submittals, Change Orders, and Contracts to be signed by the Contractor. In these cases, the Port will provide the Contractor with hard copies of the signed documents, and will incorporate signed documents into the system for reference purposes. In the event that the Contractor feels a certain document should be maintained in hard-copy form in addition to the electronic form, the Contractor may submit such a request to the Engineer through CDMS. Documents approved for hard copy in this fashion shall be prepared for the Port of Seattle at the sole expense of the Contractor.”

[Emphasis added.]

Cause

The overarching cause of this condition is the lack of an independent and robust Contract Administration function that would assure that important contractual and recordkeeping requirements are adhered to. Allowing engineers and construction managers the authority to waive contractual requirements by contractors that they deal with on a day-to-day basis without independent oversight and approval creates inconsistent and lax contract management processes where this type of problem can occur.

This situation could also be caused by a lack of qualified personnel, or insufficient training of those assigned to update the electronic documents. We asked several times for a training manual or information that would explain the workflows and how they are used but no one at POS was able to find an instruction manual or written procedures or guidelines.

Effect or Potential Effect

The reason for implementing the CDMS at POS was to streamline construction document management and simplify the processing/retrieval of documents within the Port. When documents are not “created” on a timely or complete basis, it is impossible for POS and contractor construction managers to efficiently review construction progress, retrieve the most recent document revisions, and check costs on projects. Relying on incomplete and outdated construction documents can lead to erroneous and costly contract management decisions.

Additionally, the contract states that hard copy documents not entered into the CDMS will not be considered official. This opens the door for the contractor to submit revised versions of hard copy documents as the “official” versions—months after initial hard-copy submissions.

As noted above, POS is damaging the competitive procurement process since contractors who have worked with POS know that costly contractual requirements will not be enforced. Consequently, those contractors obtain an unfair competitive advantage over other bidders that base their bids on an expectation of full contract compliance being required.

POS spent approximately \$1.3 million dollars since June 2001 implementing and maintaining Livelink, and continues to spend approximately \$90,000 per year for annual licenses, upgrades, and maintenance. To the extent that POS fails to require its consultants and contractors to use Livelink as intended and required by contract, POS’s expenditures of \$864,463 since 2004 appear to have been of little added value to the projects.

Recommendations

This finding supports our overarching recommendation regarding appointment of a Chief Procurement Officer, establishment of an independent contract administration function, and revision of the delegations of authority for approving construction management expenditures. In addition, we recommend the following with respect to this finding:

Recommendation 39: We recommend that if POS continues including the CDMS requirement in its contracts, it develop a system for monitoring each project’s CDMS data updates. This contract requirement, just as any other, should be enforced and controlled. (The current lax approach to maintaining contract documents creates an environment that is prone to cover-ups, intentional omissions, and fraud.)

Recommendation 40: We recommend that POS immediately undertake a comprehensive review of its contracts requiring use of Livelink to determine the full extent of contract noncompliance and initiate corrective actions accordingly.

POS Response

The full text of the POS response is provided below. POS’s response conflicts factually with other information that was provided to us by POS regarding Livelink.

The Livelink® system supports the Port’s priority to improve operational efficiencies and to move the Port from a hard-copy paper filing environment to an electronic, paperless filing system. It represents a dramatic shift in the way the Port manages contracts and has required a significant period of time for development, testing, and transition.

The Port does use the Livelink® system properly today. Since first implemented in 2004, there has been ongoing expansion in the consistent and uniform use of Livelink®. The performance audit report only examined the period over which this transition occurred. While it may be true that the system was utilized as an end depository for records during the transition period, the Port has made notable progress toward timely and complete use of Livelink® as intended.

At the present, Livelink® is being utilized on those projects where it is considered cost-effective. On those projects, it is being utilized by most contractors. Current use specifically extends to change orders, correspondence, meeting minutes, submittals, requests for information, and contractor daily reports. The Port will continue to focus on greater consistency and uniformity in its use. However, contracts and conformed copies of the specifications and drawings are not typically placed in the Livelink® system. Instead, the contract agreement is kept separately in hard-copy format in the contract file and electronically in the Engineering archive site.

Auditors' Additional Comments

POS's assertions that it "first implemented Livelink in 2004" and that "the performance audit report only examined the period over which this transition occurred" is inaccurate and conflicts with factual data that POS provided to us during the audit. In reviewing POS's costs spent to date for the Livelink system, we requested historical cost information. POS provided documentation that substantiates that Livelink licenses were initially obtained on October 24, 2001 at a cost of \$192,102.00. POS also reported that between June and November 2001 POS spent \$78,929.00 performing "initial Livelink setup," and between December 2001 and December 2006 a total amount of \$193,842.00 was paid to one of the several consultants that have worked for POS implementing and maintaining the Livelink system. To the present date, POS reported that it has spent a total of ~\$1.3 million dollars implementing and maintaining²⁴ the systems since 2001.

We disagree that the performance audit report examined a period of "transition." POS's documentation indicates that Livelink's initial implementation occurred more than two years prior to the start of our audit period (January 2004 through March 2007).

POS's assertion that "Livelink® is being utilized on those projects where it is considered cost-effective" does not align with the fact that during 2004 through March 2007 POS incurred expenditures on more than 1,300 projects, many of which were very large multi-million dollar complex projects on which Livelink would have been cost effective, if used properly. Instead, the Livelink system lists only 47 projects between 2004 and present.

POS disagreed with our recommendation to undertake a comprehensive review of its contracts requiring the use of Livelink to determine the full extent of contractor noncompliance and initiate corrective actions, stating that it believes that the current use of Livelink® generally meets its requirements." We believe the Condition described above clearly demonstrates otherwise.

²⁴ POS spends approximately \$90,000 per year for Livelink software licenses (not including maintenance and upgrade costs)

Audit Finding 5: POS Failed to Enforce Basic Contract Requirements, Resulting in Delays, Extra Costs, and an Inability to Defend Against Claims

Finding 5-A: POS repeatedly failed to enforce standard contract provisions that reduce a public owner's risk of project cost and schedule overruns. This Condition limited POS's ability to successfully defend against contractor claims and led to POS's failure to recover \$2,910,400 in liquidated damages.

Condition

We examined eight projects (listed below) that were either completed or in the close-out phase. Only one of these projects was completed on time and *all* of the below-listed projects failed to complete within the original contract amount that was awarded for the construction contract.

Division	CIP No.	Project No.	Project Description	Cost Overrun	Schedule Overrun
Aviation	C001662	100893	STEP - Concourse A & Main Terminal	23.5%	13.40%
Aviation	C001805	102400	2004 AFS Contract	13.3%	123.4%
Aviation	C100172	100873	SR 509 Temp Interchange NOTE: POS suspended work due to lack of a NPDES permit	22.7%	277.14%
Aviation	C100172	102013	2004-05 Embankment/S 154th St Contract	4.8%	0%
Aviation	C100526	100860	Central Mechanical Plant Upgrade	21.1%	74.0%
Aviation	C102163	102337	C1 Baggage Screening Facility	28.7%	81.9%
Seaport	C800050	103089	T-91, Pier 91, Carnitech Building	13.9%	46.0%
Seaport	C800063	103112	P-91 Utility Infrastructure Upgrade	19.5%	70.4%

We selected two Seaport and two Aviation projects (highlighted in yellow, above) which we examined in detail to review POS's enforcement of the contract provisions related to:

- Project scheduling requirements
- Withholding of Payment for Contractor failure to comply with contract provisions
- Assessment of liquidated damages (LDs)
- Timely Notice of Changed Conditions
- Approval of Time Extensions

PROJECT: Central Mechanical Plant Upgrade

Background: The Central Mechanical Plant Upgrade (CMPU) Contract was awarded to the contractor on January 18, 2001. This project is part of the Seattle-Tacoma International Airport's Infrastructure Program. The work required under the contract involved the renovation and upgrade of the existing Central Mechanical Plant including the mechanical and related electrical systems, construction of a small office area and the upgrade of the parking electrical distribution system. The initial contract amount was \$6,578,357. The contract was required to be completed 386 calendar days following the effective date of the agreement. The original contract completion date was February 8, 2002.

During construction of the project, POS authorized 22 change orders totaling \$1,389,914. The final contract amount totaled \$7,968,271, a 21.1% project cost overrun per POS's Change Order Log.

The project was delayed 286 calendar days, a 74% schedule overrun. The project was finally declared substantially complete on November 21, 2002.

The contractor submitted a baseline schedule dated March 26, 2001. The baseline schedule was not updated again until September 21, 2001, despite the contract requirement for *monthly* schedule updates to be submitted.

On February 5, 2003, over two months after the project was completed, the electrical subcontractor filed a \$1,617,677 claim against POS for extra work, delay, impacts, and production and efficiency losses. The electrical contractor claim alleged that POS had delayed the project 276 days, of which 104 days of delay were related to the solid copper bus bar issue; the majority of the \$1.6M claim was related to delay costs. The electrical subcontractor also filed claims against its own suppliers for their delays in providing the electrical equipment. Pass-through claims from subcontractors to the general contractor will typically include sub-subcontractor and/or supplier claims, so there was nothing particularly unusual regarding the number of parties to the claim. The certified claim that was submitted by the general contractor totaled \$1,960,757, inclusive of contractor markups. POS denied the claim on the basis that the general contractor and its subcontractor had failed to timely provide the long-lead electrical equipment items needed for the work which POS, and its claims consultant, had assessed as a contributing factor to the delays on the project completion.

POS responded to the claim on August 13, 2003, stating that POS "*believes it is responsible for only \$20K of the claim.*" The POS letter also stated that the contract provided for POS to recover its claim analysis costs, and "*for the Port to assess liquidated damages (L/D) for that portion of time beyond contract completion that is not attributable to the Port's fault and is not concurrent.*"

Of the 286 calendar days of delay, POS was willing to waive only 24 calendar days of liquidated damages. POS indicated that a deductive change order in the amount of \$409,000 would follow for the contractor's execution. POS calculated the deductive amount as follows: POS to pay

\$20,000 for the change from cable bus to solid copper bus, an issue that had been resolved by the project-established Disputes Review Board²⁵; LDs of \$1,400/day times 262 calendar days of contractor-caused delay; and claims analysis costs of \$62,000, for a total of \$409,000. Just prior to the mediation, on January 20, 2004, POS restated its claim damages for an increased amount of \$530,000 due to additional costs incurred by its claims consultant in analyzing the claim.

POS retained a claims consultant to review the certified claim submitted by the contractor. The claims consultant's findings were issued in a report dated December 19, 2003. The report recommended that the *"Port reject [contractor's claim] in its entirety pending submission of a final work product. As presented, [contractor] has failed to establish entitlement or causation for delay allegedly attributable to the Port."*

POS was unable to resolve the claim through its three-tiered dispute resolution procedures and proceeded to mediation on January 26, 2004. The mediation resulted in POS agreeing to pay the contractor a sum of \$310,000.

Audit Findings:

- ***POS failed to enforce project schedule contract requirements:*** Although the contractor submitted a baseline project schedule, following that, POS did not enforce the contract requirements for *monthly* CPM schedule updates. POS told us, "They [contractor] only re-submit them if the project is slipping behind. You'll only see maybe six of them." Although, the general contractor and its subcontractor provided delay analyses, those analyses did *not* use contemporaneous monthly project schedule updates, because the contractor had not prepared project schedule updates on a regular basis during the project as the contract required.
- ***POS failed to withhold progress payments:*** The contract provided for POS to withhold progress payments from the contractor if the contract requirement for submission of monthly project schedule updates was not met. POS ignored this contract provision.
- ***POS failed to enforce the timely notice requirements:*** The contractor failed to provide POS timely notice of its intent to pursue a request for equitable adjustment (REA), but because POS routinely waived contract requirements it was not in a position to assert contractor non-compliance as a defense to change orders and claims.
- ***POS failed to enforce contract requirements regarding submission of time impact analyses:*** The contract required that during the execution of the project if the contractor believed it had been delayed then it was required to submit a time impact analysis. POS failed to enforce this requirement, and by failing to do so POS was at a severe disadvantage in accurately forecasting the risk of its exposure to additional costs/time.

²⁵ A hearing was convened on April 29, 2002 at the Port of Seattle offices in the City of Sea-Tac. The matter was presented to the Disputes Review Board (DRB). The DRB deliberated on the information and testimony presented at and for the hearing. The DRB Summary and Recommendation stated: *"In as much as the Port did not provide clear details of the desired alternate type of conductor, the Port should be responsible for any difference in cost of obtaining copper bus bars versus the cost of obtaining the cable connections the contractor assumed at the time of bid. However since the Contractor elected to order and authorize delivery of the specialized equipment without the required approvals, the Contractor is responsible for any cost differentials for shipping, installation and/or delay."* [Emphasis added]

- ***POS failed to enforce contract requirements regarding liquidated damages (LDs) when the contractor failed to achieve project completion by the contract specified date:*** POS did not assess LDs against the contractor when it failed to complete the project by the contract completion date. POS issued six Notices of Forebearance notifying the contractor that it had not satisfactorily completed the contract in accordance with its terms, but never collected any LDs. In fact, although we requested evidence demonstrating that POS has ever collected LDs from a contractor due to its failure to complete the project per plan, POS provided no evidence that it has *ever* collected LDs on a project.
- ***POS failed to enforce contract requirements regarding the assessment of liquidated damages (LDs) when the contractor failed to achieve interim project completion milestones:*** The contract's Supplementary Conditions included interim project milestones. The contractor did not meet the interim project milestones. POS did not send the first Notice of Forebearance until after the project completion milestone had been missed. POS failed to impose LDs "*for delay after the time of completion of each additional milestone date as defined in Section SC-08.08.*"
- ***POS wrongly issued a time extension to cover the entire delay period being asserted by the contractor:*** The Disputes Review Board (DRB: a three person decision board and triers of fact) had already issued a determination that the contractor was responsible for any delay associated with the bus bar issue. *Nevertheless*, POS approved a time extension in the amount of 286 calendar days even though the contractor and the subcontractor's claims only alleged delay in the amount of 276 calendar days, and of the total amount of time awarded to the contractor, 104 calendar days were for the bus bar issue which the DRB had ruled was the contractor's responsibility.
- ***The change order file lacked supporting documentation and justification for the amount paid:*** Supporting documents that were identified as "The items in bold type have a document in this change order folder" were missing. Specifically, the Commission Approval for final settlement of \$310,000. The POS change order documentation did not adequately explain or support the basis for the amount that POS agreed to pay the contractor as a result of the mediation. Clearly, POS's position had been that the contractor *owed* POS \$409,000 (later increased to \$530,000) and the record of negotiation provided in Change Order # 22 (stated to be the 'Port's portion of the final settlement for all lawsuits and claims between the parties') does not provide adequate information to explain why POS instead *paid* the contractor a total of \$310,000 and authorized a time extension of 286 days, when POS's consultants had asserted that POS was blameless.

POS's failure to enforce several of the contract requirements and its inconsistent contract administration practices (which POS described as "informal partnering") disadvantaged POS in terms of leveraging essential, standard construction contract provisions in order to achieve a more favorable (less costly) settlement.

PROJECT: P-91 Utility Infrastructure Upgrades (Work Order 103112) and T-91 Pier 91 Carnitech Building (Work Order 103089)

Background: The T-91 Utility Infrastructure Upgrade project scope of work included pouring the foundation for the Carnitech Building, work that was precedent work for the T-91 Carnitech Building contract. The contractor was awarded the Utility Infrastructure Upgrade project on March 27, 2006. Notice to proceed was given on May 17, 2006. The original contract value was \$6,586,820. The contract was planned to be complete within 186 calendar days on September 29, 2006. The project was actually completed on February 7, 2007.

POS approved change orders totaling \$1,282,271 (of which \$197,334 was related to a 127 calendar day time extension), a 19.5% cost overrun. POS also approved time extensions totaling 131 calendar days, a 70.4% schedule overrun.

The contractor requested a change order in the amount of \$575,878 and a time extension of 105 work days of compensable time and 22 work days of non-compensable time, a total of 127 work days. The claim value was based on a daily work day rate of \$5,484.55 for 105 work days of delay. The request for time extension included delays that were due to a 28 calendar-day strike by concrete workers (which lasted from August 1 through 28, 2006), inclement weather, and unforeseen site conditions.

identify, quantify, and allocate the incurred delay. The finding of this analysis is that the project has suffered an additional 29 work days of delay for a total delay of 127 work days to Milestone Phase 1. Milestone Phase 2 suffered an additional delay of 33 work days for a total delay of 98 work days. The delays were not caused by [REDACTED] had no ability to mitigate the delays. Based upon the finding [REDACTED] hereby requests a contract modification to extend the contract duration of Milestone Phase 1 to February 14, 2006 by adding 127 work days (183 calendar days) and Milestone Phase 2 to February 19, 2006 by adding 98 work days (143 calendar days).

POS's claims consultant reviewed the time impact requests that were submitted by the contractor and determined that POS was responsible for only 77 work days of delay, of which 50 work days were compensable, and 27 work days were excusable, non-compensable due to weather. Despite the consultant's findings and recommendations, POS approved Change Order #23 on July 3, 2007 in the amount of \$197,334 with a time extension of 127 calendar days (91 work days). Rather than assess LDs against the contractor for the portion of the delay that was attributed to the contractor, POS simply increased the time extension by 20 calendar days (14 work days).

The contract stressed the importance of the project schedule, stating:

*Progress Schedule described here serves as a communication tool between the Port and the Contractor, and the Contractor and its subcontractors. The Contract shall use the schedule to establish a joint understanding of the assumptions regarding the work, and the various constraints and opportunities that are possible within the plan. As the work progresses, **the project team is expected to use the schedule to assess impacts and to formulate the best methods to complete the work on, or ahead of, the contractual completion dates.** [Emphasis added.]*

The contract was specific with regard to the form and content of the Progress Schedule Update.

The bar chart schedule graphic format of the update shall include a dual line entry for each activity; the top bar graph shall indicate original (i.e., Baseline) planned start/finish requirements with the bottom bar graph indicating actual start finish of the activity.
[Emphasis added.]

The contractor's two week look-ahead schedules never showed the contractually-required dual bar entry that was to provide a comparison of the planned vs. actual dates for project work activities.

Audit Findings:

- ***POS failed to enforce project schedule contract requirements:*** POS failed to obtain the monthly schedule updates in a form that was required by the contract (i.e., dual line entry). Instead, the contractor was allowed to submit two week look-ahead schedules that failed to depict comparison bars (planned vs. actual), and the schedule updates did not depict total float (a critical element of the schedule upon which delay impacts would be evaluated). Two-week look-ahead schedules do not provide the owner with an adequate forecasting tool to mitigate delays to the work remaining to be completed. An owner must be able to review the entirety of the scope of work, and the interrelationships between work activities, to assess its options for workarounds and other mitigation efforts in order to proactively guard against delay claims.
- ***POS failed to enforce contract requirements regarding LDs when the contractor failed to achieve project completion by the contract specified date:*** POS did not assess LDs for any portion of the "unexcused delay by contractor" in the amount of \$3,100 per day pursuant to Paragraph G-10.13B of the General Conditions for a total deductive amount of \$43,400 ($\$3,100 * 14$ workdays days).

PROJECT: Carnitech Building (Work Order 103089)

Background: The Carnitech Building project included erection of a steel three-level 20,000 square-foot office space and manufacturing area that totaled approximately 62,000 square feet.

POS and the contractor executed an agreement on August 11, 2006 in the amount of \$5,850,000.00, despite the fact that concrete workers had been on strike for 10 days, and POS knew that the contractor for the precedent work had been delayed (because of the related work orders discussed in the prior section of this report). The foundation was supposed to have been completed by October 3, 2006 but did not get completed (enough for the office portion of the steel building to begin) until December 1, 2006. The contract duration was planned to complete within 198 calendar days on March 1, 2007 (per Addendum 1).

POS issued multiple, partial Notices To Proceed (NTP) to the contractor during the months of November and December, 2006, splitting the start dates for erection of the office portions vs. the manufacturing portions of the steel fabricated building.

POS approved change orders totaling \$810,655, a 13.9% cost overrun, and a time extension for 92 calendar days, a 46% schedule overrun.

The concrete foundation work that was performed by the precedent contractor was planned to start on October 3, 2006, but instead started on December 13, 2006; thereby delaying the Carnitech contractor's start of grid layout activities from October 3, 2006 to December 13, 2006.

POS requested a cost proposal to accelerate the contractor's work to mitigate the delays caused by the precedent contractor's work. The contractor and POS agreed to costs of \$254,132 for Change Order 001 to ensure the project would be completed by April 1, 2007. (Note: Change Order 001 did not revise the project completion date.) The acceleration costs included (additional manhours, site supervision, and equipment allocations). The change order was approved and signed on January 31, 2007. It stated,

Add to the contract all costs associated with the additional crew man hours, site supervisions, and equipment allocations necessary to compensate for accelerated steel erection in the project schedule due to the delayed start of construction and the splitting of activities required as noted in CRX001 dated December 20, 2006.

The project records indicate that the project experienced additional delays due to the contractor's actions, including the lack of a crane being on site, anchor bolts placed incorrectly, and the contractor's failure to timely progress the work, and taking longer than planned to begin erection of the steel after receipt of the unrestricted NTP. POS's letter to the contractor, dated April 12, 2007, states:

The schedule submitted with CRX 001 for the Steel Erection Schedule Acceleration shows the steel erection to be completed by March 13, 2007. As requested, Change Order 001 was issued on February 15, 2007 for \$254,132.00 to cover the costs of acceleration and additional supervision to recover time lost due the delayed start and to meet the schedule shown in CRX001.

The steel has not been installed per the acceleration schedule and other trades are being impacted due to this delay. You are notified that the Port considers this condition unacceptable and is endangering performance of the contract. Per G-04.17.A, the Port is requesting a Recovery Schedule be submitted by April 19, 2007 to demonstrate PCL's proposed plan to make up the lag in scheduled progress and to ensure completion of the work within the Contract Time.

Please note section G-04.17 requires the Contractor to furnish "such manpower, services, materials, facilities and equipment and shall work such hours, including night shifts, overtime operations, Sundays and holidays, as may be necessary to ensure the prosecution and completion of the Work or specified portions thereof within the specified dates of the Contract."

Despite having paid the contractor \$254,132 to accelerate the work, in May 2007 POS approved Change Order No. 009, a no-cost time extension for 92 calendar days, *extending* the project completion from March 1, 2007 to June 1, 2007. Change Order 009 states,

The delay in the start of work placed the contractor in jeopardy of not completing the project by the contract completion date, therefore resulting in liquidated damages although the delay was excusable.

The office portion of the project achieved substantial completion on July 18, 2007 and the manufacturing portion of the project achieved substantial completion on July 27, 2007. The project failed to complete by June 1, 2007. We asked POS the following question and received the answer noted:

Q. Does the Port plan to issue a time extension for the days between June 1, 2007 and substantial completion, or is the Port in negotiations for a time extension to cover the period between the current contract completion date and substantial completion?

A. We are currently waiting for the contractor to submit their Time Impact Analysis and claim to cover this time period.

On June 6, 2007, POS sent the contractor a Notice of Forebearance indicating that the project completion date to June 1, 2007 had not been met, and that it would maintain all “legal existence to the established delivery date of 01 June 2007.”

Although the Baseline Project schedule met the requirements of the contract, POS failed to enforce the contract requirements for Progress Schedule updates. Instead of submitting Progress Schedule updates that were based on the electronic Baseline Schedule (depicting planned vs. actual dates for work activities), the contractor began submitting manual schedules in the form and format below.

		Previous Week							Current Week							Second Week												
		15	16	17	18	19	20	21	22	23	24	25	26	27	28	29	30	31	1	2	3	4	5	6	7	8	9	
ID#	Work Description	M	T	W	T	F	S	S	M	T	W	T	F	S	S	M	T	W	T	F	S	S	M	T	W	T	F	
	Floor Systems 1-2	X	X	X	X	X	X		X	X																		
	Roof Systems 1-2	X	X	X	X	X	X		X	X	X	X	X	X		X	X	X	X	X								
	Wall System 1-2								X	X	X	X	X	X		X	X	X	X	X								
	Plumber Sleeve Decks								X	X	X	X																
	Mechanical Sleeve Decks											X																
	Sprinkler Sleeve Decks																											
	Set West Stairs								X	X		X																
	Rep Pan Decks															X												
	Set up + Parv Decks																X	X	X	X			X	X	X	X		
	Mechanical Framing Layout																	X	X	X			X	X	X	X		
	Steel Stud Framing																		X				X	X	X	X		
	East Stair											X														X	X	X
	Steel Erection 2-9																							X	X	X	X	X

POS was limited to seeing only near-term work and was at a disadvantage in adequately assessing delays to the entirety of the remaining work to be completed.

POS paid the contractor acceleration costs in the amount of \$254,132 to ensure a timely as-planned contract completion date, but when the contractor failed to meet that date, POS granted the contractor a 92-day time extension.

POS asserts that the acceleration change order and the time extension change order are unrelated, and that “additional (excusable) delays” associated with the building foundations necessitated the acceleration change order and that the time extension change order was necessary because the project start had been delayed 92 calendar days. Project events do not support POS’s assertion.

The acceleration change order (CO #001) was signed on February 15, 2007. It clearly stated:

Add to the contract all costs associated with the additional crew man hours, site supervision, and equipment allocations necessary to compensate for accelerated steel erection in the

project schedule due to the delayed start of construction and the splitting of activities required as noted in CRX001 dated December 20, 2006. [Emphasis added.]

CO #001 included the standard language regarding the adjustment constituting “complete and final settlement” in regards to Contract Sum and Contract Time.

CO #009 for the 92-day time extension was negotiated on April 4, 2007, *after* the acceleration change order. CO #009 clearly stated”

This extension adjusts the schedule to allow for excusable contract delays. The extension is caused by obtaining the Carnitech Building permit late as well as late delivery of building foundation and slab on grade associated with Utility Infrastructure Upgrade (WO 103112). The late foundation and slab delivery was caused by a 30 day concrete strike, concrete delivery problems after the strike, and being pushed into inclement weather after the strike.”

CO 009 provided the contractor a time extension *after* CO 001 had already provided “complete and final settlement” for the delays at the start of construction (i.e., the 92-day delayed start). Further, to the extent that POS had paid the contractor any monies against the acceleration change order, POS received *no benefit* from the acceleration costs that it paid.

Audit Findings:

- ***POS failed to enforce project schedule contract requirements:*** POS failed to require the contractor to prepare schedule updates based on the work activities that had been shown in the Baseline Schedule, and the two week look-ahead schedules were created manually. The manual schedules do not have work activity interrelationships, do not provide a comparison of the actual vs. plan dates for work activities, and do not show total float values. As such, when the contractor requested a time extension, POS had no ability to evaluate the critical path of the project to quantify the delay impacts. The contract required analysis of the delays as follows:

C. In the event that the Contractor requests a Contract time extension, the time impacts to critical path activities in the current accepted Progress Schedule shall be clearly shown. Extensions of time will be granted only to the extent that such changes or delays cause the time for the changed activity and related activities to exceed the total float along the affected path of activities at the time of the Port of Seattle directive to proceed with the change or the actual commencement of the delay included in the TIA.

- ***POS failed to withhold progress payments:*** POS never withheld the Contractor’s payments due to its failure to comply with the contract requirements regarding the schedule update submissions.
- ***POS failed to enforce the timely notice requirements:*** Although POS had paid acceleration costs to achieve a timely completion, the contractor failed to complete the project by the planned completion date. The contractor did not provide the detailed breakdown for its delay request within 30 days of the occurrence of the delaying event, which, by contract, would preclude the contractor from asserting a request for time extension. However, POS proceeded to evaluate the contractor’s request for time rather than deem that the contractor had waived its rights to a request for time extension.

- *POS wrongly gave the contractor a time extension (CO 009) for delays to the start of the project, matters that had already been deemed “complete[ly] and final[ly] settle[d]” in CO 001.*

PROJECT: Airfield Improvements Project (Work Order 102400)

Background: The Airfield Improvements Project included the Aircraft Fueling System (AFS) project. Work Order 102400 was Contract 1 of a two-contract procurement. The scope of work for AFS Contract 1 included completion and commissioning of the new aircraft fuel hydrant system at SeaTac International Airport. Specific elements included modifications and improvements to the existing fuel farm facility, refurbishment of three existing fuel tanks, construction of a new Operations Building, modifications to the existing Operations Building, construction of a new Disaster Containment System, a new Fire Protection System, construction of ~7,000 linear feet of aircraft fuel piping and 30 fuel hydrant pits, and removal and replacement of 20,000 square yards of cement pavement.

POS issued the Notice To Proceed (NTP) to the contractor on June 16, 2004. The original contract amount was \$33,090,975. The contract was planned to be completed within 410 calendar days, on July 12, 2005. The project achieved substantial completion on November 21, 2006.

POS approved change orders totaling \$4,392,445.35, a 13.3% cost overrun. POS also approved time extensions on the contract totaling 506 calendar days, a 123.4% schedule overrun.

The contract provisions required the contractor to submit a baseline “bar chart” followed by monthly schedule updates. The bar chart activities were required to be logically tied together and the schedules were to be prepared using Primavera Project Planner (version 3.1). The Baseline Project Schedule was required to be resource loaded “to show material production rates and manhours required to complete the work,” and *all* contract milestones were to be shown in the baseline schedules. The milestones were the basis on which LDs would be assessed if the contractor missed the milestones. The Supplementary Conditions, 07.01 “CONTRACT TIME,” listed 14 milestones that were required to be met. Liquidated Damages due to the contractor missing a milestone were to be assessed at a rate of \$5,000/day, and if the contractor missed the substantial completion date, then LDs in the amount of \$1,500/day were to be assessed.

During execution of the project, the schedule updates were not consistently provided on a monthly basis. The contractor’s scheduler left the project, so the contractor simply stopped preparing schedule updates using the required Primavera scheduling software. POS waived the contract requirements for monthly schedule updates and allowed the contractor to submit three week look-ahead schedules. Monthly schedule updates would have depicted the entirety of the work remaining to be completed. The three week look-ahead schedules showed only the near term work and did not show the balance of the remaining work that needed to be completed on the project. The look-ahead schedules were initially produced using Microsoft Excel (which is *not* considered to be a scheduling program), and later in the project, the contractor began using Microsoft Project.

After the contractor made a few attempts to submit a contractually compliant baseline schedule, POS finally approved the Baseline Schedule “as noted” on December 1, 2004.

The contractor’s first monthly Progress Schedule update was submitted to POS on February 16, 2005, over two months *after* the approval date of the Baseline Schedule. The Schedule Update was finally “Approved as Noted,” more than three months later, on May 16, 2005.

POS and the contractor negotiated Change Order #55 which granted the contractor a 177-day time extension for delays due to the pipe rack failure (determined by POS to be an owner-design error). POS’s schedule analysis wasn’t based on either the Baseline Schedule or the contemporaneous Progress Schedule Updates, and the analysis was poorly documented. The contractor was required to prepare a “Time Impact Analysis” in accordance with Division 1 General Requirements, Section 01324, Part 1.09, but did not submit a Time Impact Analysis. POS waived the contract requirements for obtaining monthly schedule updates, so POS lacked the tools and information needed to quantify the delay impacts and to determine whether the delays were caused by the contractor or POS.

The contractor was also responsible for providing two week look-ahead schedules to POS for the duration of the project. The Look-ahead schedules were to have been based off of the current Progress Schedule. The contractor never met this requirement. None of the two week look-ahead schedules were based off of an approved Progress Schedule. From the beginning of the project through June 2005, the contractor submitted primitive bar charts that appear to have been created in Microsoft Excel. The contract required the contractor to prepare the Progress Schedules using Primavera Project Planner, a sophisticated scheduling program that logically links work activities together to depict the interrelationships among various elements of the work. From June 2005 onward, the look-ahead schedules were generated with Microsoft Project, but they were still not based off of an approved Progress Schedule.

Audit Findings:

- ***POS failed to enforce project schedule contract requirements:*** POS’s failure to obtain contract compliant schedules throughout execution of the project prevented POS from conducting a thorough assessment of contractor-caused delays. POS failed to enforce Progress Schedule requirements related to:
 - Submission of the Baseline Schedule
 - Submission of Schedule Updates
 - Submission of Time Impact Analysis
 - Form and content of the Progress Schedules
- ***POS failed to withhold progress payments:*** POS never withheld any portion of the contractor’s progress payments due to its repeated failures to comply with contract requirements.

Additional Information Requested Regarding POS’s Assessment of Liquidated Damages:

Given the audit findings related to the above four projects, we concluded that POS does NOT assess LDs when contractors fail to complete projects by the contract completion dates. POS personnel had asserted to us that LDs had been assessed on “some projects.” Thus, on July 11, 2007, we requested “a list of all contracts during 2004-present where liquidated damages have

been assessed.” To date, POS has indicated that no seaport projects have had liquidated damages assessed but they identified two aviation projects where liquidated damages may have been assessed.

In response to our July 11 request, on July 27, 2007, POS provided a binder labeled “Liquidation Damages Information Engineering Department STS/TNT Group.” This binder contained 14 dividers, each referencing a project number. Of the 14 projects that were identified in the binder, six projects did not have any information provided other than a single page that indicated “No Liquidated Damages,” and the remaining eight projects included unsigned (all but one) change orders. Only one project of the 14 projects provided appears that it may have had a partial amount of LDs assessed. On August 14, 2007, we requested copies of the signed change orders and the “change order supporting documents” because the information provided by POS appeared to indicate that LDs are *not* assessed when contractors fail, due to their own actions, to complete projects on time. POS has not provided any additional information.

The table below summarizes the information that POS provided. Given an extensive review of the above four projects, we concluded that POS does *not* enforce contract provisions regarding the assessment of LDs. Based on the information provided by POS (shown below), change orders authorizing time extensions do not indicate that POS “may have assessed LDs.” As summarized in the Comments column of the table below, the assessment of LDs was only mentioned in one out of the 14 projects that were identified by POS.

LIQUIDATED DAMAGES: RECONCILIATION OF POS PROVIDED INFORMATION (Source: Binder "Liquidated Damages Information - Engineering Department STS/TNT Group rec'd 7/27/07)							
Tabs	Contract No.	Work Order No.	Project Description	Change Order #	Contract Time Extended	Change Order Value	Comments
1	304857	100598	STS Refurbishment/Replacement N. Esplanade/N. Main Stn Renovation	53	63	\$695,000	No discussion of LDs Assessment in Change Order
2	311719	100636	Police Department Office Consolidation Project	15	0	-\$35,800	8 calendar days LDs assessed
			Police Department Office Consolidation Project	16	0	-\$31,325	7 calendar days LDs assessed
			Police Department Office Consolidation Project	17	0	-\$31,325	7 calendar days LDs assessed
			Police Department Office Consolidation Project	18	0	-\$40,275	9 calendar days LDs assessed
			Police Department Office Consolidation Project	40	0	\$75,000	Extended Field Office OH Settlement
3	304662	100783	STS Replacement Project				"No Liquidated Damages"
4	311634	100947	Main Terminal HVAC Air Handler System Upgrade				"No Liquidated Damages"
5	307867	100950	Concourse B, C, D HVAC Upgrades	5	16	\$11,449	No discussion of LDs Assessment in Change Order
			Concourse B, C, D HVAC Upgrades	6	23	\$43,132	No discussion of LDs Assessment in Change Order
			Concourse B, C, D HVAC Upgrades	24	21	\$43,132	No discussion of LDs Assessment in Change Order
6	308523	100997	STS Transit Stations Renovations Project	25	30	\$15,663	No discussion of LDs Assessment in Change Order
7	0309878A		PCL Construction - Tunnel Ventilation System (TVS)				"No Liquidated Damages"
8	307496	101031	Concourse D Pedestrian Bridge Site Improvements	3	73	\$0	Resident Engineer assessed the delay to be POS responsibility - this change order is a time extension
9	311550	101182	Sea-Tac Restroom Enhancement Project	14	45	\$0	Change order is a time extension No discussion of LDs
10	310606	101725	North and South Satellite Plumbing Project				"No Liquidated Damages"
11	310817	101973	Grease Interceptors, Concourses B, C & D				"No Liquidated Damages"
12	309948	102125	South Satellite Roof Replacement	2	14	\$0	Change order is a time extension due to poor weather
			South Satellite Roof Replacement	4	21	\$0	Change Order states, "The time extension is needed to give the contractor time to complete the work."
13	310928	102337	C1 100% Final Baggage Screening Facility (Task 6)	54	0	\$0	LDs were to be assessed in future change order-no LDs were assessed
			C1 100% Final Baggage Screening Facility (Task 4)	164	0	-\$168,541	This change order reconciles COs 53 and 83 which were issued as "not-to-exceed" pending final costs
			C1 100% Final Baggage Screening Facility (Task 9)	307	0	\$0	This change order reconciles CO 55 which was issued as "not-to-exceed" pending final costs
			C1 100% Final Baggage Screening Facility (Task 3a, 4, and 9)	458	796	\$0	This change order references a change in the amount of LDs that POS will be entitled to if milestones dates 16 and 20 are missed
			C1 100% Final Baggage Screening Facility (Task 3a and 9)	476	0	\$34,602,766	This change order is for the cost to replace the conveyor baggage handling system subcontractor
14	Not Listed	102795	STS Transformer Renewal/Replacement				"No Liquidated Damages"

Instead of assessing LDs, POS routinely authorizes time extensions to contractually amend original contract completion dates to match the actual completion dates. POS does so because they fail to obtain contract compliant schedule updates during the course of the project, thus POS lacks the necessary tool to quantify contractor delays or to segregate POS-caused delays from contractor-caused delays.

Criteria

POS Standard Contract Provisions

POS uses the following standard contract provisions in its construction contracts (General Conditions). These provisions (modified as needed on a contract-by-contract basis) set forth the roles, rights, and responsibilities between the contractor and POS. Supplementary Conditions provide project-specific requirements, so these criteria differ from project to project. Information in the Supplementary Conditions pertaining to LDs and the amounts to be assessed, and contract milestones/substantial completion/project completion dates varies by project.

General Conditions G-04.31 “NOTICE OF EVENTS,” stipulates that:

- A. *Notice. The intent of this clause is to ensure that the Port receives notice of an Event prior to the Contractor incurring alleged additional time and/or cost. If an Event occurs for which the Contractor believes an equitable adjustment in time or money is or will be due, the Contractor shall give the Port immediate oral notice of the Event followed by **written notice within seven (7) days of such Event**, which notice in all Events must be given and the Engineer’s direction received prior to performing the work. Such notice must identify in detail the basis for the claim.*
- B. *Detailed Breakdown. **Within 30 calendar days of the Event** (without regard to when notice (if any) of the Event was provided), **the Contractor shall provide the Port with a written breakdown of all of the elements and sub elements of the claim detailing the increase in the Contract time or Contract Sum being sought**, in accordance with G-09.06D.*
- C. *If the Contractor fails to satisfy the requirements of this paragraph, the Contractor shall be deemed to have waived all rights to assert any claim against the Port arising from, or related to the Event. [Emphasis added.]*

General Conditions G-04.16 “PROGRESS SCHEDULE,” states:

- A. *The Contractor shall prepare and submit to the Engineer a progress schedule in the form specified and within the time specified. Should the Contractor fail to provide and maintain a satisfactory schedule the Port will invoke its rights set forth in Article G-10.10.*
- B. *The Contractor shall not less than monthly update, revise and keep current the progress schedule pursuant to the specified requirements. Failure to comply with this paragraph will result in withholding of additional funds from payment due.*

General Conditions G-10.10 “PORT’S RIGHT TO WITHHOLD PAYMENT,” states:

The Port has the right to withhold payment otherwise due the Contractor if and so long as the Contractor does not meet any of its obligations under this Contract. The Engineer will notify the Contractor of the reasons for any amounts withheld and the remedy required.

General Conditions G-09.05 “CHANGED CONDITIONS AND CLAIMS INCLUDING REQUESTS FOR EQUITABLE ADJUSTMENT,” states:

- A. The Contractor shall notify the engineer promptly orally and in writing in accordance with G-04.31 of: ... (c) other alleged contract conditions for which an equitable adjustment in cost or time is desired. If such notice is not given prior to the condition ... the Contractor will be deemed to have waived any claim for extra compensation or extension of the Contract Time on account of any additional or different work (including labor, material and equipment). ...*
- C. If the Engineer determines that the Contractor’s request does not warrant an equitable adjustment in the Contract Sum and/or Contract Time, the Contractor shall diligently pursue the Work in accordance with the Engineer’s direction while retaining the right to protest the Engineer’s decision in accordance with paragraph G-09.06.*

General Conditions G-09.06 D.7 “PROCEDURE FOR PROTEST BY THE CONTRACTOR,” states that:

*... the Contractor shall provide the Port with the following details: ...
If an adjustment in the Contract Time is sought, the specific days and dates for which it is sought; the specific reasons Contractor believes an extension in the Contract Time should be granted; and Contractor’s analysis of its Progress Schedule to demonstrate the reason for the extension in Contract Time (time impact analysis).*

CMPU Supplementary Conditions SC-10.13 “DAMAGES FOR UNEXCUSED DELAYS BY THE CONTRACTOR, Part E – LIQUIDATED DAMAGES, states:

Pursuant to the requirements of Paragraph G-10.13B of the GENERAL CONDITIONS, the Liquidated Damages for the entire project shall be [Cost per day is project-specific].

The damages stipulated above are to be deducted as Liquidated Damages from any monies due or coming due to the Contractor.

Liquidated damages as indicated shall also be imposed for delay after the time of completion of each additional milestone date as defined in Section SC-08.08. [Emphasis added]

Carnitech Supplementary Conditions SC-10.13 “DAMAGES FOR UNEXCUSED DELAYS BY THE CONTRACTOR, Part E – LIQUIDATED DAMAGES,” states:

Pursuant to the requirements of Paragraph G-10.13B of the GENERAL CONDITIONS, the Liquidated Damages for the entire project shall be

Three Thousand One Hundred Dollars (\$3,100) per day.

The damages stipulated above are to be deducted as Liquidated Damages from any monies due or coming die the Contractor.

Liquidated damages as indicated shall be imposed for delay up to the time of Substantial Completion as defined in Document 0700, G-08.08.”

Best Practices:

Time Impact Analysis (TIA)– The Association for the Advancement of Cost Engineering (AACE), *International Recommended Practice No. 52R-06 – Time Impact Analysis – As Applied in Construction*, states:

The TIA procedure is performed while a project is on-going, and thus has a ‘forward-looking’ or a ‘prospective analysis’ perspective in near-real time.

The longer the period between the delay and the approval of the TIA, the less useful and valid the TIA becomes. Because time is the issue being negotiated, the value obtained from a timely resolution of this contract adjustment is greatly diminished by delay in preparation and/approval of the TIA.

TIA assumes that the most recently accepted schedule update, just prior to the actual delay, correctly displays the project status and logical sequence of work involved on the project at the time of the delay.

Maintaining a set of timely, accepted, schedule updates is very important to the TIA success.

Progress Schedules: Timely project schedule update submissions improve an owner’s ability to mitigate delay impacts and the owner’s ability to accurately quantify the amount of delays and associated costs, thereby reducing the likelihood that an owner might over-compensate a contractor for delay simply because the project has inadequate project schedule documentation.

In fact, POS’s own claims consultant’s report addressed the importance of the contemporaneous schedule update process. The report cited the following from the Wiley Law Publications *Construction Scheduling, Preparation, Liability and Claims*, written by Jon M. Wickwire, Thomas J. Driscoll, Stephen B. Hurlbut, Section 9.15, page 230, which states,

The clear weight of authority (case authority, contract clauses, and agency manuals) since 1974 has been to give credence to the dynamic nature of the CPM process and require that the determination of delays affecting the critical path, as well as the quantum of such delays, should be developed contemporaneously as the project history unfolds, using the updating process as the point of reference.

Liquidated Damages: Make Liquidated Damages Work, Clark R. McCormick, PE, 2003 *AACE International Transactions, CDR.15, AACE International, Morgantown, WV, 2003*, states:

This brings us to an important rule under enforceability: take a proactive role in enforcing your liquidated damages rights under the contract. ... As part of the contractor’s bid, they have included in their cost the risk of being assessed LDs and ensuring the work is completed by the time(s) stipulated in the contract. In reality, the owner has bought the right to assess liquidated damages and in no way should feel guilty about assessing them. ... The owner has to let the contractor know in no uncertain terms that there are ramifications and costs associated with not completing the work on time. By acquiescing and finding a way not to assess them, the owner has tipped its hand contractually, and the contractor will adjust accordingly when deciding to employ additional resources to the work force in order to make a completion date.

Partnering

Public agencies have been using “partnering” on construction projects since the 1990s and, although the process is sometimes voluntary, it is structured and formal, and most importantly, partnering does not result in waiving or changing the contract requirements. As can be seen in the examples provided below, these public agencies have defined processes and written guidelines for staff on the implementation of partnering on construction projects.

Ohio Department of Transportation, *ODOT Partnering Handbook*, states that:

*Partnering is the process of creating a cooperative and mutually beneficial team out of potential adversaries on a construction project. **Partnering is voluntary and does not replace contractual agreements.** Rather, it enables these agreements to be executed successfully because the trust, respect, open communications and appropriate systems are in place and agreed to by all.*

Why is it important?

Time is money in a construction project. Effective partnering reduces delays, avoids misunderstandings and creates positive relationships that encourage people to achieve common goals. By solving problems ahead of time, it removes system bottlenecks that can derail a project. And it removes the inclination to sue. People rarely sue people they like and respect.

How does it work?

Partnering begins before construction starts. The first session is a workshop to set common goals, agree to standards, communications strategies, dispute resolution practices and problem-solving mechanisms. During this session, team members learn how to be an effective team and sign a partnering agreement that reflects how they will work together. Throughout the life of the contract, there are partnering meetings at regular intervals to ensure that the agreement continues to guide behavior. Other forms of communication and forums for problem solving, designed at the initial session, are implemented during the contract period. Wrap-up and celebration occurs when the job is completed on time and within (or under) budget.

California Department of Transportation (Caltrans) states that:

The State will promote the formation of a "Partnering" relationship with the contractor in order to effectively complete the contract to the benefit of both parties. The purpose of this relationship will be to maintain cooperative communication and mutually resolve conflicts at the lowest possible management level.

The Contractor may request the formation of such a "Partnering" relationship by submitting a request in writing to the Engineer after approval of the contract. If the Contractor's request for "Partnering" is approved by the Engineer, scheduling of a "Partnering" workshop, selecting the "Partnering" facilitator and workshop site, and other administrative details shall be as agreed to by both parties.

The establishment of a "Partnering" relationship will not change or modify the terms and conditions of the contract and will not relieve either party of the legal requirements of the contract. [Emphasis added.]

Bay Area Rapid Transit District (BART) states that:

SC8.1.1 District Partnering Policy. It is the policy of the District to encourage the Contractor to enter into a "Partnering" arrangement with the District as describe below. The Contractor is not obligated to enter into a Partnering arrangement with the District. There will be no penalties of any kind imposed on the Contractor if it elects not to participate in a Partnering arrangement.

Partnering consists of a voluntary effort by the District, the GEC, and the Contractor to develop joint goals and to establish a cooperative atmosphere regarding execution of the construction project. To initiate the Partnering arrangement, the parties will conduct an open discussion prior to the start of the job at a meeting arranged through a Professional Facilitator. It is expected that, at the conclusion of the initial discussion, the parties will express a consensus regarding among other things, the respective goals in completing the Contract. Thereafter, the parties will continue discussions as necessary and will conduct periodic joint evaluations of performance throughout the life of the Contract. It is expected that the parties will use the services of a Professional Facilitator not only at the initial discussion but, if needed, to assist in later discussions.

SC8.1.2 Partnering Goals. The Goals of Partnering are as follows:

- 1) For the Contractor, the GEC, and the District to work as partners;*
- 2) To avoid confrontation and litigation among the parties;*
- 3) To reach a mutual understanding on how the construction project is to be conducted; and*
- 4) To establish an atmosphere of trust and communication.*

*SC8.1.4 Contract Rights. **The Partnering arrangement will not alter either the District's or the Contractor's legal rights and obligations under the Contract.*** [Emphasis added.]

Arizona Department of Transportation (ADOT), states that:

104.01 (A) Voluntary Partnering: The Arizona Department of Transportation intends to encourage the foundation of a cohesive partnership with the contractor and its principal subcontractors. This partnership will be structured to draw on the strengths of each organization to identify and achieve reciprocal goals. The objectives are effective and efficient contract performance and completion within budget, on schedule, and in accordance with plans and Specifications.

This partnership will be bilateral in makeup, and participation will be totally voluntary. To implement this partner initiative within 30 days of notice to award and prior to the preconstruction conference, the contractor's on-site project manager and ADOT's Construction Supervisor will meet and plan a partnering development seminar/team building workshop. At this planning session arrangements will be made to determine attendees at the workshop, agenda of the workshop, duration, and location. Persons required to be in attendance will be the ADOT Construction Supervisor and key project personnel; the

contractor's on-site project manager and key project supervision personnel of both the prime and principal subcontractors. The project design engineers and key local government personnel will also be invited to attend as necessary. The contractors and ADOT will also be required to have Regional/District and Corporate/State level managers on the project team. Follow-up workshops will be held periodically throughout the duration of the contract as agreed by the contractor and Arizona Department of Transportation.

The establishment of a partnership charter on a project will not change the legal relationship of the parties to the contract nor relieve either party from any of the terms of the contract. [Emphasis added.]

Washington Department of Transportation states that:

*The successful bidder will have the opportunity to enter into a cooperative partnership agreement with the State for the contract. The objective of this agreement is the effective completion of the work, on time and to the standard of quality that will be a source of pride to both the State and the Contractor. **The "Partnering" agreement will not affect the terms of the contract.** It is intended only to establish an environment of cooperation between the parties.* [Emphasis added.]

Cause

We concluded that these costly contract failures were due to the lack of an independent and robust Contract Administration function that would assure that contractors comply with basic contract requirements. Allowing engineers and construction managers the authority to waive contract requirements and negotiate changes without independent oversight creates inconsistent and lax contract management. Some POS personnel indicated to us that they feared that if they enforced contract provisions, contractors would no longer want to bid on POS work because POS would be viewed as too tough or difficult to work for.

Effect or Potential Effect

The lack of project schedule updates resulted in POS's inability to adequately defend itself against the contractor's claims and undoubtedly contributed to the significant schedule overruns on these and other projects.

On the CMPU Contract, neither POS nor its claims consultant was able to adequately review or critique the schedule analysis that had been submitted by the contractor's claims consultant. The lack of schedule updates also prevented POS from evaluating impacts to the critical path until *after* the project was complete. Had the project CPM schedule updates been submitted during the course of the project as contractually required, POS would have been able to mitigate the delay before it accrued to 286 days. POS failed to prevail in mediation in its assertion that the 286 calendar days were due to the contractor's and subcontractor's actions, and instead POS awarded the contractor a 286 calendar day time extension. POS was forced from a position in which it believed the contractor owed POS \$530,000 to a position wherein POS paid the contractor \$310,000. Thus, failure to enforce basic contract provisions cost POS \$840,000 and resulted in late contract completion.

On the AFS Contract, POS was unable to accurately quantify the amount of contractor-caused delay on the project because schedule updates were not submitted and the project relied on two week look-ahead schedules. Completion of this project was delayed by 506 days. Because POS did not and could not reasonably calculate the contract delays, there is no ability to know if POS would have been entitled to assess LDs. POS failed to collect LDs for milestones that were missed. The North Satellite milestone was missed by 110 days resulting in non-collection of \$385,000. The Perimeter Road milestone was missed by 21 days resulting in non-collection of \$73,500. POS possibly could have assessed LDs in the full amount of 506 days of delay or for LDs which based on \$1,500/day would amount of \$1,447,500.

On the Carnitech Building Contract, POS paid ~\$254,000 to achieve a timely contract completion. The contractor failed to finish the project by the contract completion date. POS should have assessed LDs. Failure to enforce the contract provisions cost POS \$285,200 (92 days times \$3,100/day).

On the T-91 Utility Infrastructure Upgrade Contract, POS did not assess liquidated damages (LDs) for any portion of the “unexcused delay by contractor” in the amount of \$3,100 per day pursuant to Paragraph G-10.13B of the General Conditions for a total deductive amount of \$83,700 (\$3,100 times 27 days).

Recommendations

This finding supports our overarching recommendation regarding appointment of a Chief Procurement Officer, establishment of an independent contract administration function, and revision of the delegations of authority for approving construction management expenditures. In addition, we recommend the following with respect to this finding:

Recommendation 41: We recommend that POS take immediate steps to enforce all contract provisions on all ongoing and future contracts, particularly provisions regarding CPM project schedule submission requirements and withholding of contractor payments due to contractor failures to comply with contract requirements. POS should also be more aggressive in timely assessing liquidated damages based on contemporaneous analyses of delay impacts.

POS Response

The full text of the POS response to this finding is in Appendix E. POS disagreed with the facts that we set forth in the Condition section of this Finding and mischaracterized the key issues raised in this Finding. POS stated that:

This finding does not reflect a realistic understanding of the manner in which legal claims are made and settled in contract disputes. The Port always asserts its right to collect liquidated damages from the contractor for missed schedule updates, missed milestones, or delayed beneficial use of the facilities or systems. However, where delays result from causes attributable to both the Port and the contractor, the Port is not entitled to collect liquidated damages from the contractor. In all of the projects reviewed by the Performance Auditor, the contractor had submitted a claim for additional time and money associated with delays arising from technical details or operational needs alleged to be the responsibility of the Port.

POS's disagreed with our recommendation to take immediate steps to enforce all contract provisions on all ongoing and future contracts, and to be more aggressive in timely assessing LDs based on contemporaneous analyses of delay impacts. POS stated:

The Port disagrees with the facts supporting this recommendation and believes that its enforcement of contract terms in the cases cited was appropriate under the circumstances. Nonetheless, the Port will review whether opportunities exist to enhance its enforcement of contract schedules, evaluation of time extension requests, and contemporaneous assessment of liquidated damages.

Auditors' Additional Comments

POS infers that we asserted that it should collect liquidated damages when a project is delayed solely as a result of POS actions/inactions or when delays are concurrently caused by both the contractor and POS. We did not assert that POS should collect LDs in those circumstances. We asserted that in instances of contractor-caused delays POS should *not* simply reserve its rights, but that it should begin withholding LDs from the point of the missed milestone or substantial/beneficial occupancy date. Article G-10.13 – *Damages for Unexcused Delays by the Contractor* of the General Conditions and POS's Supplementary Conditions clearly explain the assessment of LDs. *POS simply does not enforce these contract provisions.*

Collecting LDs is ultimately dependent on any owner's ability to substantiate/prove that the delays were caused by the contractor. The standard way to do this is to conduct schedule analyses that are based on the contemporaneous project schedule monthly updates. POS waives the contract requirements for schedule updates and does not require contractors to submit these important deliverables. Schedule updates enable the owner to monitor project progress, forecast the completion of remaining work, and assist in mitigating the impacts of delay and defining corrective actions. POS explained that:

While the Port does not always demand monthly updates to the baseline schedule when construction progress substantially adheres to plan, it does require updates whenever events materially affect – either positively or negatively – the time for project delivery.

For instance, the Airfield Fuel System project completed 506 days late, representing a 123% schedule overrun compared to the planned completion date. The project delays were apparent from early in the project but POS failed to require schedules that complied with the contract requirements, information that would have enabled POS to accurately quantify the portion of the delay attributable to contractor performance issues vs. owner issues. But, POS did not require the contractor to submit contract compliant schedule updates at the point when events on the project had clearly begun to threaten the project's completion.

POS asserts that *all* of the projects reviewed incurred delays due to “technical details or operational needs.” We disagree and believe that the Conditions discussed above describe instances of contractor non-performance, poor performance, and slow performance. These performance issues were not thoroughly evaluated because POS lacked the required information to conduct meaningful analyses.

POS asserted that:

*While the Port **has not often** collected liquidated damages, it does assert its right to collect such damages.*

POS provided *no* evidence that it had *ever* collected LDs on any projects during the period of 2004 through March 2007.

Finally, in a prior draft response to this finding, POS asserted that it employed “partnering” concepts on its projects, inferring that its repeated failure to enforce contract provisions was consistent with industry practices. Best practices noted in the above Criteria section do not support the POS perception regarding “partnering.”

The illustrative projects discussed in this Finding highlight the fact that POS’s construction management practices do not require the enforcement of POS’s (and industry best practices’) standard contract provisions. POS’s management of construction contracts does not demonstrate that POS is concerned about preventing project cost and schedule overruns through the use of risk avoidance techniques such as proper contract administration and oversight.

Audit Finding 6: POS Construction Management is Vulnerable to Fraud,²⁶ Waste, and Abuse²⁷

Finding 6-A: POS construction management is vulnerable to fraud, waste, and abuse.

Background

A combined and overarching effect of the detailed findings in this report is that POS construction management is vulnerable to fraud, waste, and abuse. POS does not employ independent and professional contracting officers to protect the integrity of the procurement process and provide essential segregation of duties. Instead, various engineering, construction management, and project management personnel who work directly with contractors and consultants on a day-to-day basis have the delegated authority to negotiate and award contracts, approve changes to contracts, waive contractual requirements, and settle contract disputes. This results in a vulnerability to a wide array of potential fraud to occur and not be detected. No controls are in place to deter, prevent, or detect bribery, kickback, illegal gratuity, or bid-rigging schemes. Many of the findings in this report contain indicia of fraud.²⁸

Condition

The following anomalies noted during our audit could be indicative of fraud:

- On some contracts, change order amounts were consistently the same as the contractor's proposed amounts (see Finding 1-A).
- On some contracts, change orders were approved without evidence of evaluation or negotiation (see Finding 1-A).
- There were unsupported Engineer's Estimates for change orders on some contracts (see Finding 1-B).
- Change orders were approved for amounts substantially higher than Engineer's Estimates on some contracts (see Finding 1-B).
- Change orders were split to remain within delegated approval authority (see Finding 1-B).
- Some summaries of Negotiations do not adequately explain the negotiation outcomes (see Finding 1-B).

²⁶ *Fraud is a type of illegal act involving the obtaining of something of value through willful misrepresentation. Whether an act is, in fact, fraud is a determination to be made through the judicial or other adjudicative system and is beyond auditors' professional responsibility. Government Auditing Standards, July 2007 revision, footnote 95, page 138.*

²⁷ *Abuse involves behavior that is deficient or improper when compared with behavior that a prudent person would consider reasonable and necessary business practice given the facts and circumstances. Abuse also includes misuse of authority or position for personal financial interests or those of an immediate or close family member or business associate. Abuse does not necessarily involve fraud, violation of laws, regulations, or provisions of a contract or grant agreement. Government Auditing Standards, July 2007 revision, paragraph 4.12.*

²⁸ *Indicia of fraud do not necessarily indicate the existence of fraud; rather, each is an indication that fraud may be present. Many times legitimate activity or other reasons may explain the indicia of fraud. Fraud Investigations in Litigation and Dispute Resolution Services, A Nonauthoritative Guide, American Institute of Certified Public Accountants, 1997; 2002.*

- There were deletions of contract scope without deductions to the contract price (see Finding 1-C).
- Contract time extensions were granted without supporting schedule analyses (see Finding 1-C).
- Informal change order negotiations (“tummy rubbing”) were conducted (see Finding 1-C).
- Liquidated damages for contractor-caused delays were not assessed (see Finding 1-C).
- Invoices that exceeded contract amounts were stockpiled and then paid under a newly-awarded different contract (see Finding 1-E).
- Project management personnel added preferred bidders to PCS’s randomly-generated small works bid lists in order to steer contracts to these particular bidders. (see Finding 1-E).
- Competition requirements were circumvented by awarding sequential no-competition contracts (purchase-splitting) (see Finding 2-A).
- Competition requirements were circumvented by awarding multiple no-competition contracts (purchase-splitting) (see Finding 2-A).
- Competition requirements were circumvented by awarding no- or limited-competition contracts and amending them above competition thresholds (purchase-splitting) (see Finding 2-A).
- Consultants were given additional work outside the base contract scope via no-competition contract amendments (see Finding 2-B, 2-D).
- Consultant prices were amended without evidence of adequate cost or price negotiations (see Findings 2-B, 2-C).
- A major consulting contract was awarded based on work to be done on a “work authorization” basis and then the contract was amended to an “annual level of effort” basis (see Finding 2-C).
- The bases for approving the addition of contractor personnel to a major consulting contract were not documented (see Finding 2-C).
- Consultants were authorized to perform work outside the contract scope (see Finding 2-C).
- POS allowed a contractor to maintain “joint” POS-contractor contract files (see Finding 2-C).
- Billing rate increases were approved to match consultant salary increases (see Finding 2-C).
- Consultants were allowed to select other consultants to receive contracts without evidence of POS participation in the selection process (see Finding 2-C).
- Consultant contract mark-ups were paid that were not stipulated in the contract (see Finding 2-C).
- A major consultant contract was amended to retroactively allow extra-contractual mark-ups already paid to the contractor rather than enforcing contract terms (see Finding 2-C).
- POS failed to adequately review contractor invoices before payment to assure that only approved personnel were being billed, that rates being billed agreed with contract rates, and that labor categories being billed agreed with the contract’s labor categories (see Finding 2-C).
- A \$1.4 million consulting contract was awarded to a former POS employee’s company without evidence of competition (see Finding 2-D).

- A \$2.7 million consulting contract was awarded on a sole source basis to a former POS employee's company (see Finding 2-D).
- The Small Works Roster Program has resulted in repeated awards to the same contractors (see Finding 2-F).
- The Small Works Roster Program's random rotation process can be circumvented to allow preferred contractors to be added to selection lists (see Finding 2-F).
- The Small Works Roster Program's solicitation invitation process can be circumvented (see Finding 2-F).
- An Engineer's Estimate was revised upward by 14 percent (\$13 million) solely because a single, inflated bid was anticipated (see Finding 3-A).
- POS negotiated with a construction contractor prior to contract award (see Finding 3-A).
- A contract was awarded to the sole bidder based on a bid that was more than 35 percent (\$33 million) higher than a fair and reasonable estimate (see Finding 3-A).
- POS created a "cosmetic" deductive change order to conceal the full extent of the excessive bid received from the POS Commission (see Finding 3-A).
- POS provided a misleading Commission notification memorandum (see Finding 3-A).
- POS has failed to provide required reports to the Commission on contract administration/bid irregularities and professional and consulting services (see Finding 3-B).
- POS personnel approved consulting agreements and amendments to consulting agreements in excess of delegated authority (see Finding 3-C).
- A consultant has been allowed to manage his former employer's major construction contract with POS (see Finding 3-D).
- A consultant was allowed to serve on a selection committee resulting in the award of a \$5.8 million contract to a subcontractor of the consultant's company (see Finding 3-D).
- Contractual requirements for use of an expensive construction document management system are not being enforced (see Finding 4-C).

In addition, the following other matters noted during the audit (see Findings 7-A and 7-C) could also be indicative of fraud:

- Construction management records were altered and updated following identification of projects to be audited (see Finding 7-A).
- Auditor access to construction management information systems was impeded (see Finding 7-A).
- Some POS personnel failed to cooperate with our auditors during interviews (see Finding 7-A).
- POS management interfered with our efforts to obtain routine management representations from key employees and 13 POS employees did not provide representations that we requested (see Finding 7-A, Appendix A, and Appendix B).
- POS has refused to establish an organizationally independent internal audit function (see Finding 7-C).

Criteria

Best Practices Related to Segregation of Duties and Conflicts of Interest

The Committee of Sponsoring Organizations (COSO) of the Treadway Commission issued the most widely accepted framework on proper internal control²⁹ policies and procedures. This COSO Framework establishes five interrelated components: Control Environment, Risk Assessment, Control Activities, Information and Communication, and Monitoring. Segregation of duties is one of the most fundamental control activities:

*Control activities are the policies and procedures that help ensure management directives are carried out. They help ensure that necessary actions are taken to address risks to achievement of the entity's objectives. Control activities occur throughout the organization, at all levels and in all functions. They include a range of activities as diverse as approvals, authorizations, verifications, reconciliations, reviews of operating performance, security of assets and **segregation of duties**. [Emphasis added.]*

The **United States Government Accountability Office, *Standards for Internal Control in the Federal Government***, explains that:

Key duties and responsibilities need to be divided or segregated among different people to reduce the risk of error or fraud. This should include separating the responsibilities for authorizing transactions, processing and recording them, reviewing the transactions, and handling any related assets. No one individual should control all key aspects of a transaction or event.

The ***Federal Acquisition Regulation, Part 3, Improper Business Practices and Personal Conflicts of Interest***, states:

*Government business shall be conducted in a manner above reproach and, except as authorized by statute or regulation, with complete impartiality and with preferential treatment for none. Transactions relating to the expenditure of public funds require the highest degree of public trust and an impeccable standard of conduct. **The general rule is to avoid strictly any conflict of interest or even the appearance of a conflict of interest in Government-contractor relationships.** While many Federal laws and regulations place restrictions on the actions of Government personnel, their official conduct must, in addition, be such that they would have no reluctance to make a full public disclosure of their actions. [Emphasis added.]*

²⁹ Internal control is broadly defined as a process, effected by an entity's board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories:

- Effectiveness and efficiency of operations.
- Reliability of financial reporting.
- Compliance with applicable laws and regulations.

[*Internal Control-Integrated Framework*, Committee of Sponsoring Organizations (COSO) of the Treadway Commission, September 1992.]

The **United States Office of Government Ethics, *Ethics & Procurement Integrity***, states that:

Even though you may not have a financial interest that can be affected by a procurement activity or contract, circumstances might arise that could call your impartiality into question. Some examples of when your impartiality could be questioned include the following:

- *Your duties require you to work on a procurement involving your former employer or clients, your spouse's employer or clients, close relatives, or others with whom you have some kind of business relationship. ...*
- *You are required to evaluate bids, one of which was submitted by a friend.*

If you encounter any situation where you think your impartiality would reasonably be questioned, you should stop working on that matter, and contact your supervisor and agency ethics official for further advice.

Best Practices Related to Acquisition Systems and Management

The **United States Government Accountability Office**³⁰ explains that:

The objective of a public procurement system is to deliver on a timely basis the best value product or service to the customer, while maintaining the public's trust and fulfilling public policy goals. The federal government achieves this through guiding principles established in the FAR. NASPO [National Association of State Procurement Officials] and the ABA [American Bar Association] model procurement code have also established key guiding principles and practices that are generally accepted and should be incorporated into an effective procurement system. In addition, our work has identified best practices and other accepted elements that are essential for an efficient and accountable acquisition function.

Key characteristics of a successful procurement system include:

- ***Transparency***—Comprehensive procurement law with clear and written policies and procedures that are understood by all sources.
- ***Accountability***—Clear lines of procurement responsibility, authority, and oversight. State and local governments recommend the CPO [Chief Procurement Officer] have full-time, sole, and direct responsibility for the procurement program.
- ***Integrity***—Public confidence earned by avoiding any conflict of interest, maintaining impartiality, avoiding preferential treatment for any group or individual, and dealing fairly and in good faith with all parties.
- ***Competition***—Specifications that do not favor a single source and solicitations widely publicized to benefit from the efficiencies of the commercial marketplace.
- ***Organizational Alignment and Leadership***—Appropriate placement of the acquisition function in the organization to cut across traditional organizational boundaries with stakeholders having clearly defined roles and responsibilities.

³⁰ GAO-07-159, *District of Columbia Procurement System Needs Major Reform*, January 2007

For state and local governments to operate effectively, recommended practice is central leadership in the executive branch.

- *Human capital management—Competent workforce responsive to mission requirements, with continued review and training to improve individual and system performance.*
- *Knowledge and information management—Technologies and tools that help managers and staff make well-informed acquisitions decisions.* [Emphasis added.]

Best Practices Related to Fraud Deterrence, Prevention, and Detection

The Auditing Standards Board, Statement on Auditing Standards (SAS) Number 99, *Consideration of Fraud in a Financial Statement Audit*, identifies the following fraud risk factors:

Inadequate internal control over assets may increase the susceptibility of misappropriation of those assets. For example, misappropriation of assets may occur because there is the following:

- *Inadequate segregation of duties or independent checks*
- *Inadequate management oversight of employees responsible for assets, for example, inadequate supervision or monitoring of remote locations*
- *Inadequate system of authorization and approval of transactions (for example, in purchasing) ...*
- *Disregard for the need for monitoring or reducing risks related to misappropriations of assets*
- *Disregard for internal control over misappropriation of assets by overriding existing controls or by failing to correct known internal control deficiencies* [Emphasis added.]

SAS 99 also states that:

*Some organizations have significantly lower levels of misappropriation of assets and are less susceptible to fraudulent financial reporting than other organizations because these organizations take proactive steps to prevent or deter fraud. **It is only those organizations that seriously consider fraud risks and take proactive steps to create the right kind of climate to reduce its occurrence that have success in preventing fraud.** ...*

Management is responsible for designing and implementing systems and procedures for the prevention and detection of fraud and, along with the board of directors, for ensuring a culture and environment that promotes honesty and ethical behavior. ...

Misappropriation of assets, though often not material to the financial statements, can nonetheless result in substantial losses to an entity if a dishonest employee has the incentive and opportunity to commit fraud. ...

The risk of corruption may be reduced by closely monitoring the entity's procurement process. ...

An entity's audit committee also should ensure that senior management (in particular, the CEO) implements appropriate fraud deterrence and prevention measures to better protect investors, employees, and other stakeholders. ...

As part of its oversight responsibilities, the audit committee should encourage management to provide a mechanism for employees to report concerns about unethical behavior, actual or suspected fraud, or violations of the entity's code of conduct or ethics policy. [Emphasis added.]

Cause

POS has indicated that it:

*...is **not** subject to any specific legislative framework governing its procurement practices other than those which govern public works design and construction contracts. In all other areas -- specifically including the retention of professional services not governed by Chapter 39.80 of the Revised Code of Washington -- the Port of Seattle enjoys substantial flexibility in how it elects to accomplish the purposes for which it exists under Title 53 of the Revised Code of Washington. [Emphasis in original.]*

POS is also of the view that even though it has established specific policies related to procurement requiring competition, it does not need to follow those policies. POS asserted that:

*The Performance Auditor appears to be laboring under the misapprehension that the Port of Seattle is subject to general laws relating to its procurement practices. However, except with respect to public works contracts, the Port of Seattle – as a port district governed by Title 53 of the Revised Code of Washington – is not subject to any general laws governing its procurement practices. The Port of Seattle enjoys substantial flexibility in how it elects to accomplish the purposes for which it exists under Title 53. While designed to ensure compliance with the very limited number of statutes governing its procurement practices, **the Port's procurement policies are voluntarily instituted and may, except when effecting the requirement of one of those limited number of statutes, be waived.** [Emphasis added.]*

Even when POS chooses to follow its own policies related to procurement, those policies provide broad authority for sole source contracting.

Effect or Potential Effect

The anomalies listed above are each indicators of potential fraud, such as bribery, kickback, illegal gratuity, or bid-rigging schemes. The nature of such schemes is such that they would be very difficult to detect by POS. POS's lack of segregation of duties related to procurement transactions, the widespread delegations and re-delegations of authority to award and amend

contracts, the POS interpretation of Resolution 3181, and the POS view that it “is not subject to any specific legislative framework governing its procurement practices” create a situation that is highly susceptible to these and other fraudulent activities. As a result, and in view of the amount POS spends on construction and construction-related activities, potentially millions of dollars of public funds may have been and could continue to be misappropriated.

The failure by POS to delegate procurement authority to only independent and trained procurement officials not only undermines transparency, accountability, and competition but also increases the risk of preferential treatment for certain vendors and ultimately drives up costs.

The POS views that (1) it is not subject to any state laws requiring competition for non-construction and non-A/E services and (b) it can waive its own policies requiring competition further erode the integrity of the procurement process.

Recommendations

This finding supports our overarching recommendation regarding appointment of a Chief Procurement Officer, establishment of an independent contract administration function, and revision of the delegations of authority for approving construction management expenditures. In addition, we recommend the following with respect to this finding.³¹

Recommendation 42: We recommend that POS establish a fraud governance policy that provides for the design and implementation of a comprehensive and coordinated approach to fraud mitigation (deterrence, detection, and prevention).

Recommendation 43: We recommend that POS initiate a comprehensive fraud risk assessment focused on its procurement and management of construction and professional services. This assessment should focus on vulnerabilities to fraud under current POS procurement processes and the identification of possible fraud schemes that may be occurring.

Recommendation 44: We recommend that POS use the results of the fraud risk assessment to revise its policies and procedures in order to strengthen controls in the areas deemed vulnerable and implement specific control mechanisms designed to deter, prevent, and detect the fraud schemes deemed to be viable.

Recommendation 45: We recommend that POS revise and strengthen its policies regarding employee conflicts of interest and establish an organizational code of conduct designed to make all POS employees and consultants aware of their fraud deterrence, prevention, and detection responsibilities. Training on these policies should be mandatory for all existing and new employees and annual update training sessions should be mandatory.

Recommendation 46: We recommend that POS establish a fraud hotline through which POS employees, consultants, and contractors can report known or suspected irregularities in the procurement and management of contracts.

³¹ The Institute of Internal Auditors, the Association of Certified Fraud Examiners, and the American Institute of CPAs will soon publish a comprehensive document titled *Managing the Business Risk of Fraud: A Practical Guide* that contains more detailed information regarding these recommendations.

Recommendation 47: We recommend that POS investigate the findings contained in this report and take prompt disciplinary actions, including the direct involvement of law enforcement agencies, if appropriate. POS should also establish and enforce a comprehensive policy for investigating all future indicia of fraud.

POS Response

The full text of the POS response to this finding is in Appendix E. POS's response did not agree or disagree with this finding and did not address any of the indicia of fraud identified in our report or the lack of prevention and detection controls highlighted by our report. Instead, POS recited a number of broad control elements that it purports to have in place and stated that:

The Port notes that the Performance Auditor did not find actual cases of fraud during his investigation. As to the finding of vulnerability, the Port takes the risk of fraud seriously and has zero tolerance for acts of fraud. ...

Auditors' Additional Comments

We agree that we did not find conclusive proof of fraud during this performance audit. Our performance audit was not an "investigation," however. It would be extremely unusual for an audit to disclose conclusive proof of fraud. Fraud can only be proven if a perpetrator confesses or if a judicial or other adjudicative system makes such a determination following a trial or hearing, usually preceded by a detailed and often lengthy investigation focused on specific allegations.

An auditor's responsibilities are limited to (a) finding material misstatements or omissions of information, whether caused by error or fraud, and (b) identifying fraud risk factors. An auditor is not responsible for determining *whether* such misstatements or omissions were *caused* by error or fraud. An audit depends on voluntary cooperation by the entity being audited. When misstatements, omissions, or other anomalies are discovered by auditors, investigatory and law enforcement capabilities must be employed in order to determine if fraud has occurred—especially when the audited entity refuses to cooperate with the auditors in evaluating the underlying causes of misstatements, omissions, or other anomalies.

SAS 99, *Consideration of Fraud in a Financial Statement Audit*, expressly states:

*Fraud is a broad legal concept and **auditors do not make legal determinations of whether fraud has occurred.** Rather, the auditor's interest specifically relates to acts that result in a material misstatement of the financial statements. The primary factor that distinguishes fraud from error is whether the underlying action that results in the misstatement of the financial statements is intentional or unintentional.* [AU §316.05] [Emphasis added.]

Government Auditing Standards reiterate this limitation:

Whether an act is, in fact, fraud is a determination to be made through the judicial or other adjudicative system and is beyond auditors' professional responsibility. [Paragraph 7.30] [Emphasis added.]

POS's dismissal of this finding based on the fact that no conclusive cases of fraud have yet been proven is indicative of POS's weak control environment and poor tone at the top with respect to fraud prevention and detection, cost control, accountability, and transparency. This finding lists 46 anomalous situations that represent evidence that fraud may have occurred. POS has not expressed a clear commitment to investigate these situations to determine if fraud has occurred. Instead, POS indicates that "it believes the ... assessments and interpretations of events are inaccurate or incomplete" or that it has already concluded that most of these situations are simply errors.

This audit disclosed numerous conditions that are fraud risk factors—or *indicators*—that fraud may have occurred. SAS 99, *Consideration of Fraud in a Financial Statement Audit*, defines a fraud risk factor as follows:

...events or conditions that indicate incentives/pressures to perpetrate fraud, opportunities to carry out the fraud, or attitudes/rationalizations to justify a fraudulent action. Such events or conditions are referred to as "fraud risk factors." Fraud risk factors do not necessarily indicate the existence of fraud; however, they often are present in circumstances where fraud exists."

POS has few controls in place to prevent a variety of fraud schemes and even fewer controls in place to detect such fraud schemes. If POS had proper duties segregation and other safeguards related to procurement and construction management, conditions such as these would be significantly less risky and public funds would be less vulnerable to fraud, waste, and abuse.

Other Matters Noted During the Audit

We noted three other matters during the audit that are related to, but do not fall precisely within, the audit findings described above. These matters are as follows:

Finding 7-A: POS personnel altered audit evidence, impeded access to information, in some cases were uncooperative, and refused to provide management representation letters as requested during the audit.

Background

Our ability to review construction management documents as they are maintained in the normal course of business was crucial to our ability to achieve the audit's objectives. Our ability to access construction management information and files, both hard copy and electronic, in an efficient and timely manner was also crucial to our ability to achieve the audit's objectives. Our ability to meet with and interview POS personnel and obtain candid answers to questions about construction management was similarly crucial to our ability to achieve the audit's objectives. Finally, obtaining requested confirmations from key POS employees regarding explicit and implicit representations made to us during the audit was crucial to assuring that such representations were accurate and continued to be appropriate. Our efforts were impeded in all four of these areas.

Conditions

POS Personnel Altered Construction Management Records: Our audit approach entailed first gaining an overall understanding of POS's construction management processes and procedures and then examining specific project files and records to assess POS's compliance with its own policies and procedures as well as best practices. We identified an initial sample of 4 projects to be examined, informed POS of these projects on Friday afternoon, May 25, 2007, and indicated that we would begin examining project records on Tuesday, May 29, 2007 (Monday, May 28, 2007, was a holiday.) On Friday, May 25, 2007, a short time after receiving that information, a senior POS manager requested more time to assemble project records. We explained that we did not want project records to be assembled or changed in any way, and that we wanted to examine files and records as they are normally kept.

On (at least) three of these first four projects we selected for audit, POS personnel reorganized, revised, added, and perhaps deleted information in project files between the time the files were requested and the time the files were made available to us. We noted numerous incidents of file alteration. Several examples follow.

Incident 1. Livelink³² is an important construction management recordkeeping system used by POS. On project A, the Livelink system indicated that contractor daily reports (CDR) (within the period January through March 2007) were loaded into Livelink at 1:29 pm on Tuesday, May 29. The most recent *prior* CDRs for this project had been added to Livelink on January 13, 2006, more than 16 months earlier. Inquiries about the May 29 additions disclosed that Person of Interest (POI) A had been instructed by POI B to add these files via an email sent at 4:55 pm on Friday, May 25, 2007.

Incident 2. Also on project A, Livelink showed that the contract's baseline schedule was added to Livelink at 11:07 am on Wednesday, May 30, 2007. (That schedule had been submitted and approved by POS more than two years earlier.) At 6:23 am on Thursday, May 31, 2007, a folder for "Look Aheads 2004" was added to Livelink. At 9:02 am on Wednesday, May 30, 2007, a folder called "KT Sessions" containing 1 file was added to Livelink. At 11:44 am on Thursday, May 31, 2007, a folder called "Construction Bulletins" containing 131 files was added to Livelink. Further inquiries about these additions disclosed that POI A had been instructed by POI C to add these files on or about May 29 or May 30, 2007. In addition, a folder was created titled "Things that are Broken list." In that folder, 79 items were added ("created") on May 30, 2007 at 8:31 AM. The 79 files are contemporaneous documents that were generated by the project between 1/3/06 through 7/24/06. Inspector Daily Reports (IDRs) for the period of 09/01/06 through 05/10/07 were added to Livelink on 5/29/07 between 1:41 and 1:45 PM. Construction Manager Weekly Reports covering July 2004 through July 2006 were added to Livelink on 5/20/07 at 2:08 PM (71 total files were added).

Incident 3. Also on project A, handwritten minutes recording a meeting with a contractor, undated (we think the meeting was on May 30, 2007 based on attachments to the minutes), state the following:

[POI Q] was notified that their contractor daily reports were not up to date and there is an audit going on. Reminded [him/her] to have their daily reports turned in thru [POI R] (mostly for [] forces).

Incident 4. While seeking further information about the reasons for the above three incidents, POI B explained that the project was being closed out (substantial completion on Project A was actually achieved in 2006.), and POI B was simply "organizing" the change order files. It became clear that POI B was referring to hard copy files and was seemingly unaware that we had, until then, only been concerned with unusual Livelink additions. POI B's admission that

³² Livelink is a "web-based enterprise knowledge management software" used by POS to manage some of its projects. According to the software vendor, "Livelink is a product ... that has been customized ... to specifically support project team's responsibilities and processes for managing complex engineering, development, and construction projects. Livelink ... is the primary tool being used to manage project tasks associated with the modernization and renovation projects at Sea-Tac." According to POS's Engineering Quality Manager, "[Livelink is] a remarkable, totally flexible system. With [the vendor's] customizations, we can continue to use the same documents and forms that we've always used without disrupting our processes. This, in turn, reduces costs and saves us time and space. Electronic files can be easily submitted into the system and tracked, and a complete audit trail can be maintained for each document. Contracts, change orders, RFIs, drawing specifications-virtually everything in paper form can be submitted into the system."

hard copy files were also being “organized” indicated that efforts had been taken to improve the condition of hardcopy POS records as well as electronic records.

Incident 5. On project B, POI G brought our auditor the project’s Project Notebook on Tuesday May 29, 2007. The Notebook was disorganized and in disarray. Loose pages were tucked into the binder pocket(s). POI G apparently sensed our auditor’s surprise at the condition of the Notebook. POI G took the Notebook back. POI G returned the Notebook approximately 15 minutes later. It was neat, organized, with tabbed dividers and no longer contained any loose papers. We did not have the disorganized Notebook long enough to determine if the organized Notebook contained the same information, just with better organization, or if information had been deleted, added, or revised. Two weeks later, POI G brought us an entirely new Project Notebook for this project, explaining that this was the “final Notebook” and the one provided earlier had been a “working Project Notebook.” This “final” version had substantially more information in it than the two earlier versions.

Incident 6. On project C, our auditor asked POI J for the project’s Project Notebook on Tuesday, May 29, 2007, and was told that it was in Portland, Oregon, and was being FedExed back to POS. POI J provided our auditor with a CD of Project Notebook files on Tuesday, May 29, 2007. The next day, Wednesday, May 30, 2007, POI J provided our auditor with a second “more complete” CD containing the files from the first CD plus additional files. Later on Wednesday, May 30, 2007, our auditor went to POI J’s desk and noted her/him reviewing the Project Notebook that had “just arrived” while she/he was “in a meeting.” When our auditor finally received the Notebook on May 30, it contained two documents with “printed on” dates of “5/30/07.”

Incident 7. On Project B, 69 contractor weekly reports (covering all of 2006 and 2007, to date) were loaded onto Livelink at 9:40 am on Tuesday, May 29, 2007, by POI K. The most recent previous uploads of weekly reports for this project had been 11 months earlier. POI K initially insisted that the timing of the updated Livelink information was “pure coincidence” and had nothing to do with the audit. POI K later produced an email from POI K to POI N sent at 9:21am on May 29, 2007. The email said:

Would you please go into Livelink Explorer and move the weekly CM Reports from the N drive into Livelink? We are working on the audit and need to get them in there right away.

Incident 8. On Project B, POI N uploaded to Livelink on May 31, 2007: (a) a contractor’s certified payroll affirmations for April through December 2005 and January and February 2006; (b) two weekly certificates of no work performance from September 2006; and (c) certified payrolls from June and July 2005 and statements of compliance from June 2005.

In our follow-up evaluations of these incidents, some POS personnel provided contradictory information and explanations. For example, in explaining incidents 1, 2, and 3, POI A and POI C insisted that the timing of the Livelink uploads was “pure coincidence” and had “absolutely nothing” to do with the audit. POI F (POI A’s and POI C’s superior), however, admitted to us that she/he had, in fact, directed her/his staff to put things into Livelink “to facilitate the audit.”

Our further evaluation of these incidents led to the discovery that several “expense projects” had been established by POS to record work being done specifically related to our audit. These included the following:

<u>Project</u>	<u>Title</u>	<u>Description</u>	<u>Budget</u>
103488	3RW Performance Audit - 2006 Activities	<i>This work project is to capture all costs pertaining to a Performance Audit to be performed in 2007. This work project is for the budget year 2006.</i>	\$10,000.00
103525	SAO Performance Audit Activities	<i>State Auditor's Office Performance Audit for 2007</i>	\$100,000.00
103540	3RW Performance Audit - 2007 Activities	<i>This work project is to capture all costs pertaining to a Performance Audit to be performed in 2007. This work project is for the budget year 2007.</i>	\$200,000.00

We believe that these projects were used, in part, to assemble, revise, and organize construction management documents and records in advance of our audit.

In response to a draft of this finding, POS “acknowledge[d] that in several of the incidents cited, staff apparently uploaded documents into LiveLink in order to ensure that backlogged filing was up to date.” POS also acknowledged prior to the start of the audit that “Airport PMG staff did, in fact, spend time in 2006 and early 2007 making copies and assembling Third Runway construction contracts and documents, which were stored in multiple locations, in order to prepare for the audit.” POS indicated that it was not aware that we did not want construction management records altered.

POS Personnel Impeded Access to Information: Obtaining full access to POS information systems and files was delayed for months. We originally requested identification of “recordkeeping and data file locations and organization related to construction projects” at the audit’s entrance conference on March 20, 2007. Audit phase fieldwork began in mid-May. We reported delays in gaining access to information in our bi-weekly status reports to POS dated May 18, 2007, June 1, 2007, June 15, 2007, and June 29, 2007. We finally obtained access to all projects on Livelink on June 21, 2007, more than 5 weeks after audit fieldwork had begun (but access was later rescinded before completion of our audit). Initial access to most of POS’s network drives was finally obtained on or about June 27, 2007 (but access was later rescinded before completion of our fieldwork). We never obtained access to some of the POS network drives that we were told we had been provided access to. We learned of a new web-based repository of information on July 12, 2007, and were granted limited access on July 16, 2007. Throughout audit fieldwork we experienced numerous difficulties accessing systems for which we had been told permissions had been granted. This happened frequently with both the SPOTS and PACT systems. (We did not experience any access problems with the PCS PMIS system.)

In response to a draft of this finding, POS “acknowledge[d] that in some cases delays occurred,” but that this “resulted from a lack of clarity regarding what was wanted or expected.” POS asserted that it “believes that it used its best efforts to provide information to facilitate the audit on a timely basis and rejects the allegation that staff at any time impeded access to information,” and provided 4 examples of cases in which access was provided on a timely basis.

Access to most repositories of information was clearly impeded and delayed for significant amounts of time. A determination regarding whether this was deliberate or not is beyond the scope of our audit.

Some POS Personnel were Uncooperative: Many POS personnel were cooperative, helpful, forthcoming, and candid in answering our questions and responding to our requests for information. In several cases, however, some POS personnel were not. In two cases, POS personnel declined to be interviewed unless other POS personnel were present at the interviews. In one instance, a POS person being interviewed was evasive, belligerent, rude, and unprofessional, and the interview had to be halted.

Following a July 5, 2007, POS “forum” held to discuss the audit (attended by numerous POS construction management personnel and an SAO manager) POS personnel informed us that no further interviews would be granted unless at least two POS personnel were present at the interviews. We attempted two interviews of project personnel after that event. At both of these interviews, a superior to the project person being interviewed insisted on being present. He interfered with the interviews in both instances by answering some of our questions before the interviewee was able to respond and by “correcting” some of the interviewees’ answers. We concluded that further interviews of project personnel would not be reliable or valuable under those circumstances.

In responding to written requests for information, most POS personnel were cooperative and provided prompt answers to our questions and requests. In some instances, however, POS personnel took an inordinate amount of time to respond to relatively straightforward questions or provided incomplete or non-responsive information. In some instances, POS personnel simply did not respond to our questions or requests for information.

In response to a draft of this finding, POS stated that “the Port directed employees to cooperate fully with the performance audit” but that the “conduct and tone of the Performance Auditor created anxiety and discomfort among many Port staff.”

We believe that the conduct and tone we used in the conduct of interviews was appropriate.

Some POS Personnel Refused to Provide Management Representation Letters as Requested: As described in Appendices A and B of this report, we conducted more than 100 interviews and requested affirmations (in the form of management representation letters) from 23 key POS employees. POS management intercepted these letters, held them all for more than 47 days, and then modified at least 10 of these representation letters before sending them to the employees from whom representations had been requested. POS initially refused to allow any employees to provide these representation letters to us, then selected some individuals who would provide representations, and finally re-wrote the representation letters before sending them to the balance of the employees. No representation letters were provided by one POS employee. 12 additional POS employees provided some representations but refused to provide all representations. Appendix B contains a list of the representations not provided. In order to gain an understanding of the reasons for this non-cooperation, we asked POS to provide us with

copies all relevant emails, memoranda, and correspondence directing employees to either not respond to our request or to modify the requested representations. The POS General Counsel refused to provide this information, asserting that it was privileged.

Criteria

Washington State Law, RCW 43.09.470, *Comprehensive performance audits—scope—reports*, states that:

No legislative body, officeholder, or employee may impede or restrict the authority or the actions of the state auditor to conduct independent, comprehensive performance audits.

The state auditor is authorized to issue subpoenas to governmental entities for required documents, memos, and budgets to conduct the performance audits.

These performance audits shall be conducted in accordance with the United States [Government Accountability] office government auditing standards.

Government Auditing Standards states that:

Auditors should determine the overall sufficiency and appropriateness of evidence to provide a reasonable basis for the findings and conclusions, within the context of the audit objectives. Professional judgments about the sufficiency and appropriateness of evidence are closely interrelated, as auditors interpret the results of audit testing and evaluate whether the nature and extent of the evidence obtained is sufficient and appropriate. Auditors should perform and document an overall assessment of the collective evidence used to support findings and conclusions, including the results of any specific assessments conducted to conclude on the validity and reliability of specific evidence. (Paragraph 7.68)

Evidence is not sufficient or not appropriate when (1) using the evidence carries an unacceptably high risk that it could lead to an incorrect or improper conclusion, (2) the evidence has significant limitations, given the audit objectives and intended use of the evidence, or (3) the evidence does not provide an adequate basis for addressing the audit objectives or supporting the findings and conclusions. Auditors should not use such evidence as support for findings and conclusions. (Paragraph 7.70 (b))

d. Testimonial evidence obtained under conditions in which persons may speak freely is generally more reliable than evidence obtained under circumstances in which the persons may be intimidated.

e. Testimonial evidence obtained from an individual who is not biased and has direct knowledge about the area is generally more reliable than testimonial evidence obtained from an individual who is biased or has indirect or partial knowledge about the area.

f. Evidence obtained from a knowledgeable, credible, and unbiased third party is generally more reliable than evidence from management of the audited entity or others who have a direct interest in the audited entity. (Paragraphs 7.60 (d, e, f))

Testimonial evidence may be useful in interpreting or corroborating documentary or physical information. Auditors should evaluate the objectivity, credibility, and reliability of the testimonial evidence. Documentary evidence may be used to help verify, support, or challenge testimonial evidence. (Paragraph 7.61)

When the auditors identify limitations or uncertainties in evidence that is significant to the audit findings and conclusions, they should apply additional procedures, as appropriate. Such procedures include

- a. seeking independent, corroborating evidence from other sources;*
- b. redefining the audit objectives or limiting the audit scope to eliminate the need to use the evidence;*
- c. presenting the findings and conclusions so that the supporting evidence is sufficient and appropriate and describing in the report the limitations or uncertainties with the validity or reliability of the evidence, if such disclosure is necessary to avoid misleading the report users about the findings or conclusions, or*
- d. determining whether to report the limitations or uncertainties as a finding, including any related, significant internal control deficiencies. (Paragraph 7.71)*

Auditors should also report any significant constraints imposed on the audit approach by information limitations or scope impairments, including denials of access to certain records or individuals. (Paragraph 8.11)

Auditors should describe in their report limitations or uncertainties with the reliability or validity of evidence if (1) the evidence is significant to the findings and conclusions within the context of the audit objectives, and (2) such disclosure is necessary to avoid misleading the report users about the findings and conclusions. ... Auditors should describe the limitations or uncertainties regarding evidence in conjunction with the findings and conclusions, in addition to describing those limitations or uncertainties as part of the objectives, scope and methodology. Additionally, this description provides report users with a clear understanding regarding how much responsibility the auditors are taking for the information. (Paragraph 8.15)

Cause

With respect to POS's altering of project records, we concluded that, in some instances, such alterations were made due to a failure to understand the importance of allowing us to assess how records were maintained in the normal course of construction management activities. In other instances, however, we concluded that the alterations were deliberately intended to make project records appear to be better organized and more complete than they actually were.

With respect to delays in gaining access to POS information systems and data, we could not determine if these delays were deliberate attempts to impede our audit or if they were due to the fact that POS lacks a standard recordkeeping requirement followed by all personnel. We concluded that the possibility exists that delays in gaining access to records were related to POS attempts to alter records before we were able to see them.

With respect to non-cooperation by some POS personnel, we concluded that some of these incidents were deliberate attempts to impede our audit.

With respect to POS's interference in our efforts to obtain management representation letters from selected POS employees, we were unable to determine the reason for this interference. The interference appears to have been coordinated by the POS General Counsel. We asked the POS CEO if he was aware of the events surrounding our attempts to obtain these representations. On November 19, 2007, he stated that "There may have been some misunderstandings about what and when but as far as I'm aware, you have what you have requested.... I am not an attorney and therefore rely on the POS attorney on legal matters. In this matter, I have found no reason to ignore or contradict legal advice that I have received from the POS attorney."

In response to a draft of this finding, POS stated that "the Port believes that the incidents described in PFR-1 do not reflect deliberate attempts to impede the audit."

While we do not believe that *all* of the incidents described in this finding were deliberate, we concluded that some of them were. Regardless of the motivations behind these incidents, however, they all limited the scope of our work.

Effect or Potential Effect

Each of these situations represents an audit scope limitation.

With respect to the alteration of project records, we were unable to make an accurate assessment of the care, consistency, and quality with which construction management records were actually being maintained. As reported elsewhere, we found significant problems with the quality, completeness, and organization of project records, both hard-copy and electronic. Due to this scope limitation, we concluded that the quality, completeness, and organization of project records may be worse than was apparent to us. While some of the alterations of electronic records were apparent due to the audit trails evident in some electronic records, the extent of the alterations made to hard-copy and other electronic records could not be determined.

With respect to delays in gaining access to records, we cannot conclude that the records were in the same condition once we gained access to them as they would have been in had we been able to gain immediate or more timely access to those records.

With respect to the non-cooperation by some POS personnel, we were unable to make complete assessments of certain matters pertaining to the specific projects we selected for evaluation, because we were unsure of the veracity and completeness of information provided to us.

With respect to our inability to obtain requested management representations, we were unable to conclude that information provided to us during the audit was complete and accurate when provided and continued to remain complete and accurate through conclusion of the audit.

The combined effects of all four of these scope limitations were that (a) our audit fieldwork took longer to perform, (b) our audit was more costly, (c) we were unable to evaluate as many

projects as we had originally planned or as would have been the case had these limitations not existed, and (d) we were unable to rely on the accuracy, veracity, or continuing appropriateness of explicit and implicit representations made to us during the audit.

The nature of these limitations is such that we do not believe that they undermine the baseline validity of any of our audit findings and conclusions. Rather, the nature of these limitations is such that our findings and conclusions may actually be more serious than reported, and there may be additional findings that we were unable to discover, develop, and report.

Recommendations

We have no reportable recommendations related to this finding.

POS Response

The full text of the POS response to this finding is in Appendix E. POS disagreed with this finding and stated that:

The stated desire to “review construction management documents as they are maintained in the normal course of business” was not communicated to the Port by the Performance Auditor at the entrance conference or at any time until after the listed incidents occurred. The Port has extensive history with audits of various types, and normal practice is to assemble, organize, and compile information and documents to facilitate review by the auditors. ... The Port did not ask employees to refrain from organizing information, since it was not aware that this was desired.

The conduct noted in “Incident 5” was actually approved by one of the Performance Auditor’s field staff.

... the Port readily admits that it deployed staff to assemble and copy records related to the Third Runway Project before the Performance Auditor arrived, it did so in an effort to expedite and facilitate the performance audit. The Port’s efforts were consistent with its past practice in connection with both financial and performance audits.

... The Port believes that any delays that occurred resulted from a lack of clear communication regarding the Performance Auditor’s desires and the time required to clarify requests and provide access to multiple information systems and data repositories. Once the Port determined what was desired, system access was consistently provided in a responsive and timely manner, and the Port has substantial documentation demonstrating its efforts to clarify what was required and the high priority placed on resolving access issues. Other than noting that delays occurred, the Performance Auditor has provided no evidence to support the claim that the Port impeded access to information.

... the Port used its best efforts to cooperate with the audit and to respond fully to all questions and requests within a reasonable time frame ...

Auditors' Additional Comments

We agree that we did not ask POS not to alter its construction management records prior to our audit. We think a request that audit evidence not be altered would have been extraordinary and we have never done so on any audit. Had we known, however, that this is POS's "normal practice," we would have done so. POS's admission that their "*normal practice is to assemble, organize, and compile information and documents*" comprising audit evidence prior to auditors accessing this evidence raises questions about the conclusions other auditors have reached.

The conduct noted in Incident 5 was *not* approved by our auditor. In fact, our auditor was sufficiently alarmed at this incident that she immediately reported the matter to one of the audit team's principals (who was not in Seattle at the time), and the audit team principal phoned the POS manager and asked him to return the notebook.

The amount of effort expended on the POS expense projects prior to the commencement of our audit indicates that more than just assembling and copying records was likely taking place. According to POS records, POS expended more than \$50,000 on these expense projects prior to the beginning of our audit. This work was being done by senior POS managers and senior managers of POS consulting contractors. If only "assembling and copying" was being done, this work could have been done by clerical or administrative personnel. Based on the copied records that were given to us, this assembling and copying should not have cost \$50,000.

Regarding the POS assertion that our access to information and data was delayed due to "*a lack of clear communication regarding the Performance Auditor's desires*," we disagree. We asked POS for "Descriptions of recordkeeping and data file locations and organization related to construction projects" at the March 20, 2007, entrance conference. POS never provided this descriptive and summary information to us. We learned about various repositories of information and data on a gradual and piecemeal basis. Regarding the POS assertion that "*the Performance Auditor has provided no evidence to support the claim that the Port impeded access to information*," we have extensive documentation of the ongoing delays that occurred. In addition, we reported these delays to POS on a regular basis over the course of the first three months of audit fieldwork. The testing phase of the audit began in early May. Our status report to POS as of May 18, 2007, under "Potential Obstacles Encountered," reported that:

The delays in obtaining access to on-line POS information inhibited the orderly completion of the survey phase of the audit. We have worked around these obstacles so far. Now that the audit phase has begun, any continuing data access problems will impede progress.

Our status report to POS as of June 1, 2007, under "Potential Obstacles Encountered," reported that:

We received access to LiveLink for two of the four projects currently being audited. It is unclear if LiveLink is used for Seaport projects, but if so, we are requesting access for those projects or perhaps general access to all projects.

Our status report to POS as of June 15, 2007, under “Potential Obstacles Encountered,” reported that:

We continue to experience problems obtaining unfettered access to POS’s CIP project records.

Our status report to POS as of June 29, 2007, under “Potential Obstacles Encountered,” reported that:

Obtaining full access to POS information systems and files was delayed.

Our status report to POS as of July 13, 2007, under “Potential Obstacles Encountered,” reported that:

Obtaining full access to POS information systems and files was delayed, as previously reported. We learned of a new repository of information on July 12, but have not been granted access to most of this information and cannot assess the extent to which it contains information relevant to our audit objectives and scope.

Our status report to POS as of July 27, 2007, under “Potential Obstacles Encountered,” reported that:

Obtaining full access to POS information systems and files was delayed. We originally requested access to “recordkeeping and data file locations and organization related to construction projects” at the entrance conference on March 19 [sic], 2007. We reported delays in gaining access to information in our status reports dated May 18, 2007, June 1, 2007, June 15, 2007, and June 29, 2007. We finally obtained access to all projects on LiveLink on June 21, 2007. Access to network drives was finally obtained on or about June 27, 2007. We learned of a new repository of information on July 12, 2007, and were granted limited access on July 16, 2007.

Regarding the POS assertion that “the Port used its best efforts to cooperate with the audit,” Appendix B to this report recounts just one example of non-cooperation by POS. There are numerous similar examples.

The scope limitation related to POS’s interference with our efforts to obtain management representation letters was not in the draft report to which POS responded, but we had extensive discussions of these problems with POS, as Appendix B indicates. We asked the POS CEO if he supported this interference. In an email dated November 19, 2007, he stated:

I am not an attorney and therefore rely on the POS attorney on legal matters. In this matter, I have found no reason to ignore or contradict legal advice that I have received from the POS attorney.

In an email to SAO, dated November 15, 2007, the POS Commission President stated:

I fully support our general counsel in his effort to properly scrub the language of the proposed representation letters so that it is more in line with standard best practices practice in the legal world.

Our request for management representation letters was routine, should have been responded to promptly, and was completely in line with auditing standards.

Finding 7-B: Management of the 3rd Runway Wall Art project indicated that POS’s one-percent-for-the-arts policies are unclear.

Background

In November 2000, the POS Commission directed that one percent of the construction budget for publicly visible and accessible capital projects be earmarked for art. On the 3rd Runway Project, POS spent an undetermined amount of money on retaining wall art that has limited visibility to the public.

Condition

During a tour of the 3rd Runway Project, we noted that the west and north retaining walls have artwork on them. We noted that the surrounding areas are predominately wooded areas so that the artwork is only visible to the public to a limited extent. (Artwork on the north wall is visible to a greater extent than the artwork on the west wall.)

We asked a POS manager how much the artwork cost and were told that it cost \$1 million dollars. We obtained additional documentation regarding the artwork decision-making process and learned that the budget for the artwork was \$257,000. We followed up with the POS manager and asked why the artwork had cost substantially more than had been budgeted. The manager told us that the \$1 million amount was “an estimate.” Since the retaining walls and the artwork are complete, we asked for information regarding the actual cost and were told that POS does not know the actual cost, because “we don’t want to know.” The manager explained that the 3rd Runway project team knew they needed to spend roughly \$1 million on art. They were afraid that if the fact that it only cost \$257,000 were known, they would need to “pony up” additional money to the airport, so they’ve always used the \$1 million estimate and no one had ever questioned it. The manager further explained that the Port’s public relations people had been able to use the artwork to try to “sell” the 3rd Runway to the public. The POS manager’s recollection was that the issue of how much the artwork would cost was not discussed in the public meetings, nor was there any recollection of the cost issue being discussed in an open Commission meeting.

Criteria

POS Policy, *Art Guidelines for PMG*, section 7.11, includes the following procedure:

*Determine if a project is visible or accessible to the public at the project planning and definition phase. All projects **shall have** 1% of the construction budget allocated for art. **Exceptions are major infrastructure projects and/or the major infrastructure portions of large projects. Examples include airfield paving, inner-line baggage system, fuel hydrant system, or electrical duct-bank projects.** [emphasis added.]*

POS Policy, *Port of Seattle Art Program Guidelines*, Final Version, approved October, 2000, states that:

*1% of the construction cost of publicly accessible capital projects **will be allocated for art.*** [emphasis added.]

Government Auditing Standards defines abuse as:

...behavior that is deficient or improper when compared with behavior that a prudent person would consider reasonable and necessary business practice given the facts and circumstances.

Cause

POS's guidelines for its art initiative do not (a) define clearly when projects are visible or accessible to the public; (b) require that a cost-benefit analysis be performed in cases where a project has limited accessibility or visibility to the public; or (c) define clearly the base for computing the one-percent requirement. Further, due to the concern that more funds will be taken from a project, an incentive exists to avoid cost accountability and transparency.

Effect or Potential Effect

Because of the vague wording on when or how the art policy should be applied, it is not clear that a prudent person would consider the expenditure of \$257,000 (or \$1 million) on this limited-visibility art project to be a reasonable expenditure of public funds. Depending on the policy's interpretation, either no money on artwork should have been expended (since the 3rd Runway Project can be viewed as one of the defined exceptions to the policy, or because it is not clear that this artwork rises to the accessible and visible threshold) or a larger amount should have been expended (based on a determination that some larger portion of the project's \$720 million budget was not part of the infrastructure exception).

Some sense of the prudence of such an expenditure may have been gained had the proposed expenditure been discussed at a public Commission meeting.

The fact that the true cost of the project is purposely not known indicates that POS personnel decided to avoid accountability and transparency regarding this significant expenditure of stakeholder funds and hide the true nature of these issues from the Commission, the public, and other POS stakeholders.

Recommendations

Recommendation 48: We recommend that POS re-examine and clarify its policies and guidelines on art expenditures regarding (a) what "accessible and visible to the public" means; (b) how the one-percent determination should be made in cases where major projects consist of portions that are clearly outside the policy's defined base; and (c) when matters should be referred back to the Commission for discussion in public meetings. The guidelines should also be revised to require budget-versus-actual reporting for each project so that accountability is assured. The guidelines should stipulate that the Art Oversight Committee should document its determination that specific projects comply with all provisions, including the recommended revisions above.

POS Response

The full text of the POS response to this finding is in Appendix E. POS disagreed with this finding and stated that:

While the Performance Auditor questions the value of the investment, this public art project was important to the surrounding communities. Given the large size of the mechanically stabilized earth walls on the north and west sides of the Third Runway, the City of SeaTac specifically sought such artwork as one mitigation measure from the effects of the Third Runway. Consequently, the Port involved the City of SeaTac throughout the process, and even provided a briefing to the full City Council shortly before approaching the Port Commission for final approval of the artwork design and budget.

Auditors' Additional Comments

We do not necessarily “question[] the value of the investment.” Indeed, since POS has no idea what the amount invested was, there is not a clear basis for questioning that value. We think the policy needs to be clarified and that accountability over the costs involved with this policy needs to be established. Stakeholders were, according to POS, told what the *budget* for the artwork was, but they were not told what the *actual* cost was and POS made no efforts to determine what those actual costs were or to control those costs.

Finding 7-C: The POS internal auditor lacked organizational independence.

Background

In 2002, POS established and began staffing an internal audit organization. This internal audit unit reports to the Director of Accounting, Internal Audit & Procurement Services, who, in turn, reports to the Chief Financial Officer.

In June, 2006, the POS Commission established an Audit Committee.

Condition

No direct reporting line from the POS internal auditor to either the POS Chief Executive Officer or the POS Audit Committee exists. The majority of the internal audit unit's work to date has focused on compliance with revenue-generating arrangements (aviation and seaport concessions and landing fees) and various other non-construction areas.

Until September 2007, the internal auditor had never had a meeting with the POS Audit Committee. To date, the internal auditor has never had a meeting with the Audit Committee without her POS management superiors present. When we interviewed one of the two members of the Audit Committee in May 2007, he did not know who the internal auditor was.

In a limited scope review of some professional services agreements conducted in 2006, the internal auditor identified some of the same problems related to these agreements that our audit uncovered. The Audit Committee was not informed of these problems until September 2007.

As noted in Finding 2-C, in 2002, POS's internal auditor performed an audit of a major consulting contract. One of the audit findings was that the contractor was claiming and being paid a percentage markup on certain costs that was not allowed under the terms of the contract. Instead of determining the unallowable and extra-contractual amount that the PMSC contractor had been improperly paid and recovering that amount, POS simply amended the contract to retroactively ratify the unallowable amounts paid and continue allowing the extra mark-ups. Neither the Commission nor the subsequently established Audit Committee were informed of this anomaly and the POS response.

Criteria

Government Auditing Standards, contain the following provisions with respect to organizational independence for internal audit functions:

Under GAGAS, a government internal audit function can be presumed to be free from organizational impairments to independence for reporting internally if the head of the audit organization meets all of the following criteria:

- a. is accountable to the head or deputy head of the government entity or to those charged with governance;*
- b. reports the audit results both to the head or deputy head of the government entity and to those charged with governance;*
- c. is located organizationally outside the staff or line management function of the unit under audit;*

- d. has access to those charged with governance; and*
- e. is sufficiently removed from political pressures to conduct audits and report findings, opinions, and conclusions objectively without fear of political reprisal. (Paragraph 3.16)*

The internal audit organization should report regularly to those charged with governance. (Paragraph 3.17)

The internal audit organization should document the conditions that allow it to be considered free of organizational impairments to independence for internal reporting and provide the documentation to those performing quality control monitoring and to the external peer reviewers to determine whether all the necessary safeguards have been met. (Paragraph 3.19) [Emphasis added.]

The **Auditing Standards Board, Statement on Auditing Standards Number 99, Consideration of Fraud in a Financial Statement Audit**, states that:

The internal auditors should have an independent reporting line directly to the audit committee, to enable them to express any concerns about management's commitment to appropriate internal controls or to report suspicions or allegations of fraud involving senior management. [Emphasis added.]

As noted above, the internal auditor is accountable to the Director of Accounting, Internal Audit & Procurement Services, who, in turn, reports to the Chief Financial Officer, and is not directly accountable to the CEO or deputy CEO and is not located organizationally outside staff or line management functions. Until our performance audit commenced, the internal auditor did not have unlimited access to those charged with governance and had not met with the Audit Committee.

Institute of Internal Auditors, International Standards for the Professional Practice of Internal Auditing, require:

The chief audit executive should report to a level within the organization that allows the internal audit activity to fulfill its responsibilities. ...

The internal audit activity should be free from interference in determining the scope of internal auditing, performing work, and communicating results.

The chief audit executive should report periodically to the board and senior management on the internal audit activity's purpose, authority, responsibility, and performance relative to its plan. [Emphasis added.]

Best practices related to internal auditing and corporate governance include the following:

Organizational Governance: Guidance for Internal Auditors; Institute of Internal Auditors Position Paper, July 2006:

*By providing assurance on the risk management, control, and governance processes within an organization, **internal auditing is one of the key cornerstones of effective organizational governance.***

In an organization, management and the board establish and monitor companywide systems for effective governance. Internal auditors can support and improve these actions. In addition, although internal auditors should remain independent, they may participate in the establishment of governance processes. By providing assurance on the organization's risk management, control, and governance processes, internal auditing becomes a key cornerstone for effective organizational governance.

Internal auditors may operate most effectively for the board as an agent of the board who provide independent, objective information and evaluation. The board would then own internal auditing, fostering a mutually supportive internal audit-board relationship. To gain a complete understanding of the organization's operations, it is essential that the board consider the internal auditor's work. For instance, internal auditors can inform the board on matters such as culture, tone, ethics, transparency, and internal interactions. In addition, contemporary internal auditing is based on the organization's framework for identifying, responding to, and managing the different strategic, operational, financial, and compliance risks facing the organization. As a result, internal auditors can provide objective assurance on the effectiveness of the framework as a whole, including management's monitoring and assurance activities, and on management of individual key risks.

*Organizational governance is a broad concept. A **partial list of principles often included in defining effective governance processes are:***

...

9. Ensure effective interaction among the board, management, external and internal auditors, and any other assurance providers.

...

13. Effectively use internal auditors, ensuring the adequacy of their independence, resources, scope of activities, and effectiveness of operations.

[Emphasis added.]

The Role of Auditing in Public Sector Governance; The Institute of Internal Auditors, November 2006:

An effective public sector audit activity strengthens governance by materially increasing citizens' ability to hold their government accountable. Auditors perform an especially important function in those

*aspects of governance that are crucial in the public sector for promoting credibility, equity, and appropriate behavior of government officials, while reducing the risk of public corruption. Therefore, it is crucial that government audit activities are configured appropriately and have a broad mandate to achieve these objectives. The audit activity must be empowered to act with integrity and produce reliable services, although the specific means by which auditors achieve these goals vary. **At a minimum, government audit activities need:***

- ***Organizational independence. Organizational independence allows the audit activity to conduct work without interference by the entity under audit. The audit activity should have sufficient independence from those it is required to audit so that it can both conduct its work without interference and be seen to be able to do so. Coupled with objectivity, organizational independence contributes to accuracy of the auditors' work and the ability to rely on the results and report. ...***

The reporting line of the auditor is tied to the function's independence, which is the most fundamental element of an effective and credible government audit activity. Because the government auditor's role is to provide unbiased and accurate information on the use and results of public resources, auditors must be able to conduct and report on their work without interference or the appearance of interference.

Independence is achieved when the audit activity reports outside the hierarchy of the organization and activities under audit and when auditors are free to conduct their work without interference, restrictions, or pressures from the organization being audited. Such interference can occur if the audited entity limits access to records or employees, controls budget or staffing for engagements, or has authority to overrule or modify audit reports.

The American Institute of CPAs, *Management Override of Internal Control: The Achilles' Heel of Fraud Prevention*, states that:

First and foremost, the internal audit department should understand that its responsibilities are primarily to the audit committee. A strong internal audit function may also include audit committee oversight of the internal audit group's budget approval process and its policies regarding hiring, evaluation, training, and termination of internal audit staff. Terminating or transferring high level internal audit personnel should be ultimately determined by the audit committee.

Executive sessions with the head of the internal audit function at every audit committee meeting provide the audit committee a unique opportunity to engage in candid discussions with him or her about the

possible risk of management override of internal controls and any indications of improper conduct by senior management.

The audit committee, by understanding and assisting in developing the internal auditors' annual audit plan, will influence the internal auditors' agenda by directing the plan's emphasis to areas of particular interest to the audit committee. These areas might include fraud risks—particularly matters that surfaced during the brainstorming session—and controls over judgments and estimates and key information processes. A properly directed internal audit staff can serve as the “eyes and ears” of the audit committee. Specific inquiries might include the following:

- 1. What fraud risks are being monitored by the internal audit team on a periodic or regular basis? How does internal audit address the continuous auditing of these critical risks?... [Emphasis added.]*

Cause

POS cited three main reasons for disagreeing with our draft finding and recommendations:

- 1. ... most standards related to public and private sector audit committees require or prescribe that at least one member have sufficient financial and auditing expertise to effectively discharge the committee's duties. ... while the Port currently benefits by having an audit committee that meets these criteria, with an elected commission this could be a concern since such financial expertise could not be assured in the future.*
- 2. ... potential conflicts could arise with audits conducted on Port tenants or vendors who are active in Commission election campaigns.*
- 3. ... since the internal audit function is viewed as a valuable resource by Port managers in proactively reviewing their internal practices, risks and controls ... staff might be reluctant to seek such assistance if internal audit were outside of management's domain.*

Effect or Potential Effect

As noted above, the POS Commission and Audit Committee have not been fully informed or informed on a timely basis regarding the internal auditor's findings. The Commission was not informed of a significant internal audit finding resulting from a 2002 audit of a consulting agreement. Although the internal auditor had, in 2006, raised and reported several concerns (including some of the findings in this performance audit report) related to professional services agreements, neither the Commission nor the Audit Committee was informed of these matters until September 2007. All of these issues should have been reported to the Commission and the Audit Committee as soon as they were developed by the internal auditor. If the internal auditor had a direct reporting line to the Commission or the Audit Committee, they would have been.

Because the POS internal audit function is not autonomous (and lacks full staffing³³), at least one of POS's external auditors³⁴ did not rely on the internal auditor's work. This resulted in more costly external audits. SAS No. 65, *The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements*, requires that before an external auditor can rely on the work of an internal auditor (and thereby reduce its own testing based on that reliance) the external auditor must assess the competence and objectivity of internal audit. When assessing the internal auditor's objectivity the auditor should obtain information about such factors as:

The organizational status of the internal auditor responsible for the internal audit function, including—

— Whether the internal auditor reports to an officer of sufficient status to ensure broad audit coverage and adequate consideration of, and action on, the findings and recommendations of the internal auditors.

— Whether the internal auditor has direct access and reports regularly to those charged with governance.

— Whether those charged with governance oversee employment decisions related to the internal auditor.

To the extent the internal audit function is autonomous, external audit costs can be reduced.

One of the firms that audited the Port's financial statements and OMB Circular A-133 reporting during the period of our audit scope noted that they would "not rely on the internal audit function of the Port of Seattle The Port employs an individual who has the title of internal auditor, but the Port does not have a fully staffed, autonomous internal audit department." Those external auditors also concluded that "the internal audit department is ineffective or nonexistent" because the POS internal auditor did "not report, or have unrestricted access to the audit committee or board of directors;" and "internal audit staffing levels [did] not appear to be adequate." Those auditors also noted that they discussed with the POS internal auditor that "it may also be beneficial to implement an internal audit group that focuses solely on construction projects due to the large dollar values that go through the large projects."

Recommendations

Recommendation 49: We recommend that the following actions be taken with respect to the internal audit function within POS:

- a. The internal auditor should be given a direct reporting line to both the POS CEO and the POS Audit Committee and should not be under the direct supervision or management of or have performance appraisals done by either the Director of Accounting, Internal Audit & Procurement Services or the Chief Financial Officer.

³³ The auditors noted that "although one individual is not able to provide the detailed assurance of an entire department, they have built a starting point to which they plan to develop" and "the long term plan is to increase the presence at all Port locations."

³⁴ Two different firms audited POS financial statements and OMB Circular A-133 reporting during the period of our audit scope.

- b. The internal auditor should not be able to be terminated without the concurrence of the POS Audit Committee.
- c. The POS Audit Committee should meet at least monthly with the internal audit manager, without the presence of POS management.
- d. The POS Audit Committee should review, have input into, and approve the internal audit annual work plan.

POS Response

The full text of the POS response to this finding is in Appendix E. POS appears to now be in agreement with this finding and recommendations, but questions our evidence. POS states:

The Port firmly believes that organizational independence is the cornerstone of an effective internal auditing function. ... the Port ... generally concurs with the Performance Auditor's recommendation to more closely align with U.S. Government Accountability Office "Yellow Book" standards. The evidence giving rise to that recommendation, however, is inaccurate and should be clarified.

... standards related to internal auditing define "organizational independence" as being free from interference in the conduct of the auditor's work. The Performance Auditor has not provided any actual evidence of interference in the internal auditor's work ... Some of the items cited occurred even before the Audit Committee was formed in the latter half of 2006.

The Performance Auditor states that Port management disagreed with this finding and recommendation, which is not accurate. The Port disagreed with an earlier draft of the finding, which differed in the condition, cause, effect and recommendation compared to the finding presented here.

... the Port takes strong exception to the Performance Auditor's inclusion of quotes attributed to the Port's external auditors that not only appear to be inaccurate but also impugn the integrity and professionalism of the Port's internal auditor. ... the Port's external auditors informed the Port in a letter dated November 8, 2007, that not only had they not made these statements, they did not agree with them. ...

Since the Port's external auditor did not make these statements, the Performance Auditor should clarify where these quotes came from or retract them.

Auditors' Additional Comments

While we are pleased that POS now agrees with this finding and its recommendations, the POS response to this finding is misleading in several respects.

"Being free from interference" in conducting their work is only one aspect of the organizational independence of internal auditors. Internal auditors must also:

- a. [be] accountable to the head or deputy head of the government entity or to those charged with governance;

- b. report[] audit results both to the head or deputy head of the government entity and to those charged with governance;*
- c. [be] located organizationally outside the staff or line management function of the unit under audit;*
- d. [have] access to those charged with governance; ...[Government Auditing Standards, paragraph 3.16.]*

We agree that some of the items cited in this finding took place before the formation of POS's Audit Committee. They should have been reported to the *Commission*, however, and would have been reported to the Commission if the internal auditor was organizationally independent. Instead, POS management concealed these important findings from the Commission.

With respect to POS's assertion that we are incorrect in stating that POS disagreed with an earlier draft of this finding (because that earlier draft was different than the later draft), the initial draft provided to POS on June 21, 2007, was not materially different than the current finding. The June 21 draft finding stated that:

POS has recently established and begun staffing an internal audit organization. This internal audit unit reports to the Director of Accounting, Internal Audit & Procurement Services, who, in turn, reports to the Chief Financial Officer. No direct reporting line to either the POS Chief Executive Officer or the POS Audit Committee exists. ...

Organizationally positioned within the CFO chain of command, the internal audit unit lacks organizational independence. ...

We recommend that the POS internal audit group be organizationally realigned to report directly to the Commission's Audit Committee and have its annual work plans approved and managed by the Audit Committee. ...

POS's response to that draft finding asserted that:

...we disagree with Cotton & Company's recommendation that the internal audit function report directly to the Commission Audit Committee. We believe that Cotton & Company's assessment is based on factual misstatements, unproven assertions, lack of due diligence and a limited understanding of the Port's organizational structure.

POS's response asserts that our "evidence giving rise to [our] recommendation" that the internal audit unit be made organizationally independent and that the quotes included in this finding are "inaccurate and should be clarified" or we should "retract them." POS knows the source of our evidence and of these quotes. POS is aware that it contracted with two different external audit organizations during the period within the scope of our audit and that these quotes were taken directly from one firm's audit working papers. We had extensive discussions with that audit organization and these quotes accurately reflect what their working papers contain.

APPENDIXES

PERFORMANCE AUDIT OF THE PORT OF SEATTLE'S CONSTRUCTION MANAGEMENT

APPENDIX A
OBJECTIVES, SCOPE, SCOPE LIMITATIONS, AND METHODOLOGY

APPENDIX A

OBJECTIVES, SCOPE, SCOPE LIMITATIONS, AND METHODOLOGY

OBJECTIVES

Audit objectives were to:

1. Determine if the Port of Seattle effectively planned, designed and managed its construction projects, including its 3rd Runway Project, in order to:
 - Minimize all costs associated with its construction projects, including but not limited to engineering, land acquisition, environmental review, permitting and construction;
 - Minimize unnecessary change orders and delays that result in extra costs; and
2. If not, determine the resulting costs and what can be done to reduce them.

Additionally, Initiative 900 directs the State Auditor's Office to address the following elements:

1. Identification of cost savings.
2. Identification of services that can be reduced or eliminated.
3. Identification of programs or services that can be transferred to the private sector.
4. Analysis of gaps or overlaps in programs or services and recommendations to correct them.
5. Feasibility of pooling the entity's information technology systems.
6. Analysis of the roles and functions of the entity and recommendations to change or eliminate roles or functions.
7. Recommendations for statutory or regulatory changes that may be necessary for the entity to properly carry out its functions.
8. Analysis of the entity's performance data, performance measures and self-assessment systems.
9. Identification of best practices.

SCOPE

Except as noted in the Scope Limitations section below, we conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives except for the effects, if any, of the scope limitations, as explained below.

The scope of our audit included all construction projects and related consulting agreements active from January 2004 through March 2007.

In planning our audit, we gained an understanding of internal controls that relate to the audit objectives. As part of our survey and testing phases, we determined whether proper internal controls were placed in operation.

Names of contractors and consultants, and contractor employees, consultant employees, and POS employees who provided us with information as part of this audit are sensitive and confidential and have been excluded from this report in order to protect these entities and persons from

disclosure pursuant to State law and POS policy.¹ Alpha placeholders have been used to denote contractors, consultants, contractor employees, consultant employees, and POS employees.

SCOPE LIMITATIONS

As described in more detail in Finding 7-A, POS personnel altered construction management records prior to the time we accessed them, our access to POS information systems and other information was delayed and disrupted, and some POS personnel were uncooperative. In addition, POS management interfered with our efforts to obtain management representation letters from key POS employees and some POS employees did not provide management representations related to our audit as requested.

Our ability to review construction management records and documents as they are maintained in the normal course of business was crucial to our ability to achieve the audit's objectives. Our ability to access construction management information and files, both hard copy and electronic, in an efficient and timely manner was also crucial to our ability to achieve the audit's objectives. Our ability to meet with and interview POS personnel and obtain candid answers to questions about construction management was similarly crucial to our ability to achieve the audit's objectives. Finally, obtaining requested confirmations from key POS employees regarding explicit and implicit representations made to us during the audit was crucial to assuring that such representations were accurate and continued to be appropriate.

With respect to the alteration of project records, we were unable to make an accurate assessment of the care, consistency, and quality with which construction management records were actually being maintained. As the findings in this report indicate, we found significant problems with the quality, completeness, and organization of project records, both hard-copy and electronic. Due to this scope limitation, we concluded that the quality, completeness, and organization of project records may be worse than was apparent to us. While some of the alterations of electronic records were apparent due to the audit trails evident in some electronic records, the extent of the alterations made to hard-copy and other electronic records could not be determined.

With respect to delays and disruption in gaining access to records and information systems, we cannot conclude that the records were in the same condition once we gained access to them as they would have been in had we been able to gain immediate or more timely access to those records.

With respect to the non-cooperation by some POS personnel, we were unable to make complete assessments of certain matters pertaining to the specific projects we selected for examination, because we were unsure of the veracity and completeness of information provided to us.

¹ RCW 42.41.030, *Right to report improper governmental action — Policies and procedures*, requires that the identity of a reporting employee shall be kept confidential to the extent possible under law, unless the employee authorizes the disclosure of his or her identity in writing. POS Policy EX-13, *Reporting of Improper Governmental Action*, requires that [e]xcept as necessary to facilitate investigation and to the extent allowed by law, any person within the Port receiving information about an Improper Governmental Action under this policy shall keep all information received confidential, as well as (1) the identity of any Employee reporting such information (unless the reporting employee expressly waives confidentiality), ...

Obtaining written representations from management at the conclusion of an audit is a routine audit procedure, required in all financial audits and optional in performance audits.² During our audit, we conducted more than 100 interviews with various POS personnel. We identified 23 key POS personnel from whom we requested representations. The representation letters we requested from these POS employees were modeled after the “Illustrative Management Representation Letter” in SAS 85, tailored to our performance audit objectives,³ and modified (in some cases) on an individual basis to seek specific confirmation of assertions from those individuals.

Of 23 POS employees from whom representations were requested, representations were provided as requested from 10 POS employees, no representations were provided by 1 POS employee, and 12 POS employees provided some, but not all, of the requested representations. Appendix B to this report contains (a) the generic text of the representations requested, (b) a chronology of our efforts to obtain these routine communications and POS management’s actions in response to this audit procedure, and (c) the specific representations that were not provided to us.

The following POS personnel did not provide some or all of the representations requested:⁴

- Director Aviation CIP, Aviation Project Management Group
- Managing Director, Seaport, Seaport Administration
- General Counsel
- Manager, Seaport Project Management
- Deputy Managing Director, Aviation Development and Finance
- Corporate Budget Manager, Finance & Budget⁵
- Assistant Director AV/CIP, Aviation Project Management Group
- Aviation CIP Program Leader, Aviation Project Management Group
- Internal Audit Manager
- General Manager, Port Construction Services
- Managing Director, Aviation Division

² Per **Statement on Auditing Standards (SAS) Number 85, Management Representations**:

Written representations from management ordinarily confirm representations explicitly or implicitly given to the auditor, indicate and document the continuing appropriateness of such representations, and reduce the possibility of misunderstanding concerning the matters that are the subject of the representations.

³ **SAS 85** states that:

The representation letter ordinarily should be tailored to include additional appropriate representations from management relating to matters specific to the entity's business or industry.

⁴ Per **SAS 85**,

Management's refusal to furnish written representations constitutes a limitation on the scope of the audit sufficient to preclude an unqualified opinion and is ordinarily sufficient to cause an auditor to disclaim an opinion or withdraw from the engagement. However, based on the nature of the representations not obtained or the circumstances of the refusal, the auditor may conclude that a qualified opinion is appropriate. Further, the auditor should consider the effects of the refusal on his or her ability to rely on other management representations.

⁵ This individual was the focal point for all communications between our audit team and POS personnel. All PFRs were sent through this person and this person sent us all POS responses to PFRs.

- Assistant Director, Engineering/Construction Management, Project Management Group⁶
- Chief Engineer/Director of Engineering Services

The combined effect of all four of these scope limitations is that (a) our audit fieldwork took longer to perform than planned, (b) our audit was more costly than planned, (c) we were unable to evaluate as many projects as we had originally planned or as would have been the case had these limitations not existed, and (d) we were unable to rely on the accuracy, veracity, or continuing appropriateness of explicit and implicit representations made to us during the audit.

The nature of these limitations is such that we do not believe that they undermine the baseline validity of any of our audit findings, conclusions, or recommendations. Rather, the nature of these limitations is such that the findings and conclusions may actually be more serious than reported, and there may be additional findings that we were unable to discover, develop, and report.

Generally accepted government auditing standards state that our report may recognize the positive aspects of the program reviewed if applicable to the audit objectives.⁷ We began asking POS officials to identify noteworthy construction management accomplishments during our survey phase, which began in March 2007. Information on positive accomplishments was provided to us near the end and after the completion of our audit fieldwork on July 10, August 9, August 13, and August 28. Because of (a) the delay in receiving this information and (b) the scope limitations described above, we did not test or verify the accuracy of this information. This unaudited information is presented in Appendix D to this report.

METHODOLOGY

During the survey phase of the audit, we interviewed POS executives, project management personnel, and construction management personnel in order to obtain an overall understanding of how POS manages its construction programs and projects. We obtained and reviewed policies, procedures, and other documents related to POS construction management. Based on this information, we performed a risk assessment to determine aspects of construction management potentially vulnerable to fraud, waste, or abuse or other potentially problematic aspects of POS construction management.

During the audit phase, based on our risk assessment, we selected samples of specific capital improvement programs and construction projects. For sampled projects, we obtained access to

⁶ This was the senior POS official in charge of all POS construction management. The POS General Counsel stated that this person left POS employment before we sent our request for his representations on September 20, 2007. We requested supporting documents to substantiate this assertion. POS provided information on November 29, 2007, indicating that this employee ceased working at POS on or about September 10, 2007, but will continue on the POS payroll until May 7, 2008. POS has not adequately explained why no letter has been provided by this employee, but it appears that POS never provided our letter to this person and asked him to respond.

⁷ *Government Auditing Standards*, July 2007 revision, paragraph A8.02.b.

project files and records, reviewed these files and records, and conducted follow-up interviews with project management and construction management personnel.⁸

Our sample selection methodology was designed to enable us to examine a cross-section of project types and sizes for which work included design, environmental, right-of-way, procurement, construction, and close-out phases within the three main areas of POS construction: aviation programs, seaport programs, and POS's small works program (known as Port Construction Services (PCS)). Following examination of initial samples of projects, we expanded testing by selecting additional projects for examination as we deemed appropriate in order to further test initial observations and findings. During both the initial and follow-up sample selection and testing phases of our work, we identified specific attributes to be tested. Due to the nature of POS's recordkeeping as well as the scope limitations described above, we did not test all attributes for all sampled projects.

POS identified a total of 1,288 active construction projects within our audit scope,⁹ as follows:

Expense Projects	
Seaport	\$75,882,835.37
Aviation	48,646,146.73
Corporate Services	286,500.00
Economic Development	336,348.24
	\$125,151,830.34
Asset Projects	
Seaport	\$698,794,046.29
Aviation	3,061,703,909.41
Corporate Services	310,000.00
Economic Development	13,338,838.31
	\$3,774,146,794.01

Our audit focus was on the universe of \$3.774 billion in asset projects. From the list of asset projects, we selected 14 Capital Improvement Programs (CIP) which included a total of 26

⁸ As noted in the Scope Limitation section of this report, we concluded that project files and records had been altered, and we have unresolved concerns about the reliability of these records. Some POS personnel were uncooperative and we were unable to carry out some interviews as planned.

⁹ The listing provided by POS included projects that had been highlighted by POS with the notation, "The highlighted projects indicate "Active" Major Construction projects in Seaport and Airport that have construction spending within the audit scope (1/1/04 through 3/20/07)." There were 109 projects highlighted by POS. Of the 109 purportedly "active" projects, 82 projects are aviation asset projects, and 27 projects are seaport asset projects. The 82 aviation projects have a total original budget amount of \$1,692,525,184 and the 27 seaport projects total \$345,131,218. The total budgeted amount of the 109 projects is \$2,037,656,403. Although all of the projects we sampled were included on the POS-provided list, some of the projects we sampled were not highlighted by POS as having accounting transactions. Our evaluation disclosed that some projects not highlighted by POS did, in fact, have accounting transactions occurring during the period being audited.

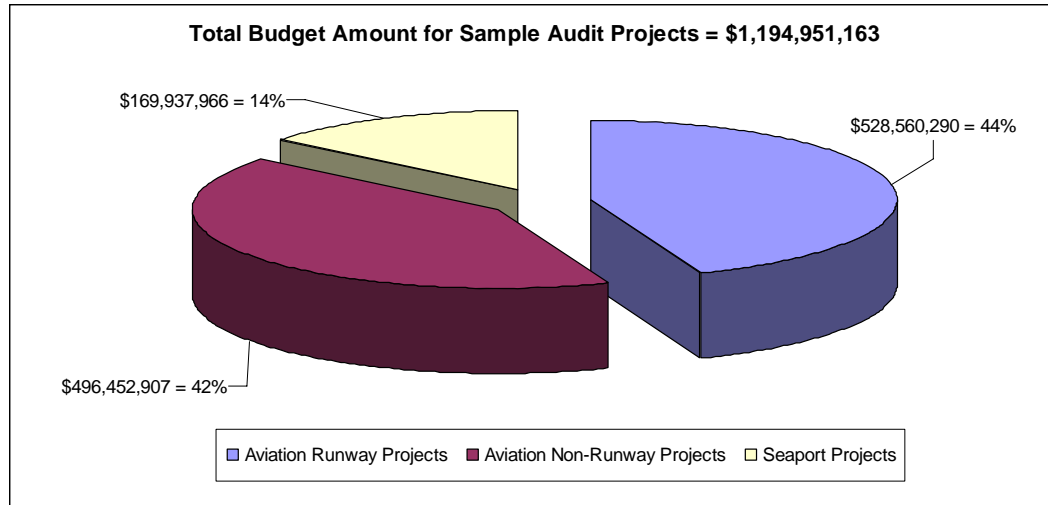
projects: 21 aviation projects and 5 seaport projects. Of the 21 aviation projects, 8 projects are 3rd Runway projects (CIP C100172).

Aviation and Seaport Project Samples

Our sample of aviation projects represents 33% of the total budget amount for all aviation asset projects. Our sample of seaport projects represents 24% of the total budget amount for all seaport asset projects. The listing below displays the projects included in our sample:

CIP No.	Project No.	Project Description	PSFS Budget Amount
101600	101809	Conc A Airline Relocation - Design	\$1,723,000
101600	101975	Conc A Airline Relocation - Construction	\$16,162,000
C001662	100893	STEP; Concourse A & Main Terminal	\$302,224,200
C001760	200086	AIP 96 SeaTac Industrial Park 4 & 5	\$10,000,000
C001805	102400	2004 AFS Contract	\$48,938,530
C100526	100860	Central Mechanical Plant Upgrade	\$16,750,000
C102163	102337	C1 Baggage Screening Fac. - SHELL	\$54,967,517
C102163	102637	C1 Baggage Screening Fac. - BHS	\$57,322,626
C102167	101547	Rental Car Schematic Design	\$10,839,917
C102167	103468	RCF Bus Maint Facility Design	\$58,000
C102167	103477	Art for Rental Car Facility	\$8,700,000
C102167	103512	Rental Car Facility Design	\$32,500
C800034	103364	Contract 2B: Doug Fox parking	\$842,000
		<i>Subtotal Non-Runway Projects</i>	<i>\$528,560,290</i>
C100172	100370	3rd Runway NavAids	\$16,750,000
C100172	100724	2006 Embankment Construction	\$131,284,539
C100172	100873	SR 509 Temp Interchange	\$5,066,356
C100172	100956	2001-2004 Embankment	\$5,545,000
C100172	100994	AFLD Lighting Vault Dsgn&Const	\$14,912,411
C100172	102013	2004-05 Embankment/S 154th St Contract	\$230,000,000
C100172	102341	3rd RW/TW Design & Construction	\$70,039,556
C100172	103215	Safety Area 16C Expansion	\$22,855,045
		<i>Subtotal Runway Projects</i>	<i>\$496,452,907</i>
		Aviation Subtotal	\$1,025,013,197
C001561	101613	T-46 Apron Strengthening & Electrical Upgrade	\$52,760,730
C001698	101998	T-18 North Apron Upgrade	\$52,033,000
C001769	100112	Main Marina Docks (Dock Replacements)	\$44,100,236
C800050	103089	T-91, Pier 91, Carnitech Building	\$10,111,000
C800063	103112	P-91 Utility Infrastructure Upgrade	\$10,933,000
		Seaport Subtotal	\$169,937,966
		TOTAL	\$1,194,951,163

The following chart displays the breakdown of sampled projects by POS area of construction:



Port Construction Services Sample Projects

PCS's Financial Reports for 2004, 2005, and 2006 list small works contracts awarded each year.

	Small Works Contract	PSAs
2004	\$8,292,000	\$3,488,000
2005	\$9,666,000	\$3,470,000
2006	\$7,496,000	\$3,228,000
Totals	\$25,454,000	\$10,186,000

We initially selected 10 sample contracts. Our testing of the initial 10 contracts led us to select an additional 11 small works contracts and five PSAs.

The listing below identifies the contracts included in our sample:

Small Works			PSAs		
	Contract	Initial Contract Amount			Initial Contract Amount
1	SW-0312839	\$185,000	1	P-00310431	\$200,000
2	SW-0312840	185,000	2	P-00311605	50,000
3	SW-0312107	185,000	3	P-00311933	200,000
4	SW-0312098	100,000	4	P-00312018	30,000
5	SW-0312099	185,000	5	P-00312018 CO1	20,000
6	SW-0310760	185,000	6	P-00313317	200,000
7	SW-0311521	185,000	Total		<u>\$700,000</u>
8	SW-0311882	185,000			
9	SWV-310935	100,000			
10	SW-0311285	<u>185,000</u>			
	Subtotal	<u>\$1,680,000</u>			
11	SWV-311608	\$185,000			
12	SWV-311463	185,000			
13	SW-0310893	185,000			
14	SW-0310724	185,000			
15	SW-0311207	185,000			
16	SW-0311558	185,000			
17	SW-0311612	185,000			
18	SW-0311907	185,000			
19	SWV-310895	94,200			
20	SW-0310958	185,000			
21	SW-0310354	<u>185,000</u>			
	Subtotal	<u>\$1,944,200</u>			
Total Small Works					
Contracts		<u>\$3,624,200</u>			
Total Small Works and					
PSAs		<u>\$4,324,200</u>			

Our sample of small works contracts represents 14% of the total small works payments made in 2004, 2005, and 2006. Our sample of professional services agreements represents 7% of the total professional services payments made in 2004, 2005, and 2006.

As potential problem areas became evident based on our testing of aviation, seaport, and PCS projects, we prepared “preliminary findings and recommendations” (PFRs) and provided them to POS management for review, analysis, and response. We evaluated POS’s responses and modified our findings, recommendations, and conclusions as we deemed appropriate in the circumstances.

Criteria used in assessing POS construction management included Washington State law, POS policies, and best practices. We referred to the Federal Acquisition Regulation (FAR) as the source of best practices in several instances. Specific criteria applied are identified in each finding.

APPENDIX B
MANAGEMENT REPRESENTATIONS REQUESTED,
CHRONOLOGY OF EFFORTS TO OBTAIN REPRESENTATIONS, AND
REPRESENTATIONS NOT PROVIDED

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MANAGEMENT REPRESENTATIONS REQUESTED,
CHRONOLOGY OF EFFORTS TO OBTAIN REPRESENTATIONS, AND
REPRESENTATIONS NOT PROVIDED

This appendix contains (a) the generic text of the management representations requested, (b) a chronology of our efforts to obtain these routine communications and POS management's actions in response to this audit procedure, and (c) the specific representations that were not provided to us.

GENERIC TEXT OF REPRESENTATIONS REQUESTED

The following basic management representation letter (modeled after the "Illustrative Management Representation Letter" in SAS 85) was requested from 23 key POS personnel.

October 15, 2007

*Cotton & Company LLP
635 Slaters Lane, 4th Floor
Alexandria, Virginia 22314*

I am providing this letter in connection with your yellow book performance audit of the Port of Seattle's construction management from 2004 to 2007 for the purpose of determining if the Port of Seattle effectively planned, designed and managed its construction projects, including its 3rd Runway Project, in order to (1) minimize all costs associated with its construction projects, including but not limited to engineering, land acquisition, environmental review, permitting and construction, and (2) minimized unnecessary change orders and delays that result in extra costs.

Certain representations in this letter are described as being limited to matters that are material. Items are considered material, regardless of size, if they involve an omission or misstatement of information that, in the light of surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would be changed or influenced by the omission or misstatement.

I confirm, to the best of my knowledge and belief, as of October 15, 2007, the following representations made to you during your audit.

- 1. We have made available to you all—
 - a. Financial and other records and data related to construction projects within the scope of your audit.*
 - b. Construction and construction management records and data related to construction projects within the scope of your audit.**
- 2. There have been no communications from Federal, State, or local regulatory agencies concerning noncompliance with or deficiencies in financial or programmatic reporting practices related to the Port of Seattle's construction management or construction-related grants or contracts.*

3. *There are no material construction transactions that have not been properly recorded in the accounting records, construction records, or construction management records.*
4. *I acknowledge my responsibility for the design, implementation, and maintenance of programs and controls to deter, prevent, and detect fraud.*
5. *I have no knowledge of any fraud or suspected fraud affecting the Port of Seattle's construction contracts, grants, projects, programs, or any other aspect of construction management or capital improvement involving—*
 - a. *Management,*
 - b. *Employees who have roles in construction, construction management, or construction accounting,*
 - c. *Contractors or contractor employees,*
 - d. *Consultants or consultant employees, or*
 - e. *Others where the fraud could have a material effect on POS's financial statements, construction management, construction projects or programs, or capital improvement programs.*
6. *I have no knowledge of any allegations of fraud or suspected fraud affecting the Port of Seattle's construction management, construction contracts, grants, projects or programs, or capital improvement projects or programs received in oral, written, electronic or other communications from employees, former employees, contractors, contractor employees, bidders, bidder employees, potential bidders, potential bidder employees, consultants, consultant employees, or others.*
7. *The following have been properly recorded or disclosed in accounting records, financial statements, and construction management records:*
 - a. *Related-party transactions, including contract awards, change orders, asset sales, asset purchases, loans, transfers, leasing arrangements, or amounts receivable from or payable to related parties.*
 - b. *Guarantees, whether written or oral, under which the Port is contingently liable.*
8. *There have been no and are no—*
 - a. *Violations or possible violations of laws, regulations, or contract or grant requirements whose effects should be considered for disclosure in the financial statements, or as a basis for recording a loss contingency, or reporting to Federal, State, or local funding or law enforcement authorities.*
 - b. *Unasserted claims or assessments that our lawyers (internal or external) have advised us are probable of assertion.*
 - c. *Other material liabilities or gain or loss contingencies.*
9. *The Port has complied with all aspects of contract and grant agreements that would have a material effect on the contracts or grants in the event of noncompliance.*

10. *The Port has explained to you all circumstances surrounding the Port's altering, revising, modifying, updating, or deleting construction and construction management hard copy, electronic or other records and Port information systems; and has provided you with copies of all correspondence and communications to, from, or among Port management, employees, contractors, or consultants related to those matters.*
11. *I have no knowledge of any deliberate attempts by any Port personnel, contractor personnel, or consultant personnel to impede or delay your audit by altering records or denying or delaying your audit team's access to records or information systems or records.*
12. *I have reviewed the Preliminary Findings and Recommendations (PFRs) issued as part of your audit as well as the Port's responses to those PFRs; the Port's responses represented the then-current and complete position of the Port with respect to each PFR; and the Port did not withhold any information from you with respect to any PFR or any PFR response.*
13. [Additional representations were added to some letters to affirm certain representations specific to particular individuals.]

To the best of my knowledge and belief, no events have occurred subsequent to the completion of your audit fieldwork and through the date of this letter that would require adjustment to any of the representations in this letter or disclosure to you of additional matters within the scope of your audit.

[Please Add Correct Title]

CHRONOLOGY OF OUR EFFORTS TO OBTAIN THE REPRESENTATION LETTERS AND POS MANAGEMENT'S ACTIONS IN RESPONSE TO THIS AUDIT PROCEDURE

- On September 20, 2007, we provided (via email) two POS employees with management representation letters to be signed and returned to us by October 15, 2007. Also on September 20, 2007, we delivered (also via email) to the POS Corporate Budget Manager, Finance & Budget (the POS's designated point of contact for audit communications) 21 additional letters and requested that he "distribute [them] to the person identified in each letter's file name, ask them each to review the letter, have it printed on POS letterhead, sign it, and return it to us."
- We subsequently learned that instead of distributing the letters as we had requested, the letters were sent to the POS legal department.
- On October 10, 2007, the POS General Counsel informed us that POS "retained outside counsel to review the letters and provide the Port with some guidance."
- On October 26, 2007, POS informed us that POS had declined "to execute any of the management representation letters in the form" we had presented and "cannot execute the letters in their current form."
- We responded to the General Counsel on October 29, via email, (a) requesting that POS reconsider the decision to not cooperate in providing the requested representations, (b) clarifying the purpose, routine nature, and intent of the request for representations, and (c) addressing each of the General Counsel's arguments asserted as support for the POS decision to not allow POS personnel to provide the requested representations.
- On November 6, 2007, the POS General Counsel sent us a letter indicating that POS would select certain individuals who would provide us with representation letters. We subsequently learned that it was not until on or about November 6, 2007—47 days after our request to have the letters distributed—that *some* of the letters were finally distributed to selected POS personnel by the POS General Counsel.
- We responded to the POS General Counsel's November 6, 2007, letter on that same date and explained that "independent auditors cannot allow (without disclosing the scope limitations) auditees to dictate what audit procedures will be employed, to whom the auditors may have access, or from whom the auditors may seek or obtain information."
- On November 7, 2007, we received representation letters from 10 POS employees. Two employees provided the requested representations. Eight POS employees had modified the requested representations and failed to affirm certain representations. One POS employee followed up two days later with a revised letter that we concluded met the intent of our request. We followed up with the remaining 7 employees seeking clarification of their intent to either provide or not provide the requested representations. One employee responded in a manner that enabled us to conclude that the intent of our request had been met. Six of 10 employees who provided letters on November 7, 2007,

did not provide all of the requested representations and did not explain their reasons for withholding these representations.

- On November 8, 2007, we asked (via email) the POS General Counsel three questions: (1) When were the draft representation letters circulated to POS employees? (2) Were they circulated to all employees from whom we requested representations or just to personnel POS decided upon? (3) If they were circulated to all of the employees from whom we requested letters, did POS direct any employees not to respond?
- The POS General Counsel sent us a letter on November 12, 2007, indicating that that *POS* (not individual employees) would revise the letters and provide the balance of the letters that had been requested.
- On November 14, 2007, we asked POS to provide us with copies of all relevant emails, memoranda, and correspondence directing employees to either not respond to our request or to modify the requested representations. The POS General Counsel refused to provide this information, asserting that it was privileged.
- On November 15, 2007, we received 9 additional letters. These each appear to have been revised in a consistent manner, indicating that the revisions were a coordinated effort rather than individually arrived-at changes by each person.
- Two additional representation letters were also sent to us on November 16, 2007. These appear to have been revised consistent with the ones sent on November 15, 2007.
- On November 27, 2007, we received another representation letter. This letter was revised in a manner consistent with the letters received on November 15 and 16, indicating that the revisions were made by the POS General Counsel rather than by the person who signed the letter. It omitted one of the requested representations.

MANAGEMENT REPRESENTATIONS REQUESTED BUT NOT PROVIDED

Following is a list of the representations that were not provided to us.¹⁰

The **Director Aviation CIP, Aviation Project Management Group**, did not affirm that to the best of his knowledge and belief:

- *I have reviewed the Preliminary Findings and Recommendations (PFRs) issued as part of your audit as well as the Port's responses to those PFRs; the Port's responses represented the then-current and complete position of the Port with respect to each PFR; and the Port did not withhold any information from you with respect to any PFR or any PFR response.*

The **Managing Director, Seaport, Seaport Administration**, did not affirm that to the best of his knowledge and belief:

- *I have reviewed the Preliminary Findings and Recommendations (PFRs) issued as part of your audit as well as the Port's responses to those PFRs; the Port's responses represented the then-current and complete position of the Port with respect to each PFR; and the Port did not withhold any information from you with respect to any PFR or any PFR response.*

The **POS General Counsel** did not affirm to the best of his knowledge and belief that:

- *There are no material construction transactions that have not been properly recorded in the accounting records, construction records, or construction management records.*
- *The following have been properly recorded or disclosed in accounting records, financial statements, and construction management records:*
 - a. *Related-party transactions, including contract awards, change orders, asset sales, asset purchases, loans, transfers, leasing arrangements, or amounts receivable from or payable to related parties.*
 - b. *Guarantees, whether written or oral, under which the Port is contingently liable.*
- *The Port has explained to you all circumstances surrounding the Port's altering, revising, modifying, updating, or deleting construction and construction management hard copy, electronic or other records and Port information systems; and has provided you with copies of all correspondence and communications to, from, or among Port management, employees, contractors, or consultants related to those matters.*

The **Manager, Seaport Project Management**, did not affirm that to the best of his knowledge and belief that:

- *I have reviewed the Preliminary Findings and Recommendations (PFRs) issued as part of your audit as well as the Port's responses to those PFRs; the Port's responses*

¹⁰ Per SAS 85:

Management's refusal to furnish written representations constitutes a limitation on the scope of the audit sufficient to preclude an unqualified opinion and is ordinarily sufficient to cause an auditor to disclaim an opinion or withdraw from the engagement. However, based on the nature of the representations not obtained or the circumstances of the refusal, the auditor may conclude that a qualified opinion is appropriate. Further, the auditor should consider the effects of the refusal on his or her ability to rely on other management representations.

represented the then-current and complete position of the Port with respect to each PFR; and the Port did not withhold any information from you with respect to any PFR or any PFR response.

The **Deputy Managing Director, Aviation Development and Finance**, did not affirm, to the best of his knowledge and belief, that:

- *There have been no communications from Federal, State, or local regulatory agencies concerning noncompliance with or deficiencies in financial or programmatic reporting practices related to the Port of Seattle's construction management or construction-related grants or contracts.*
- *There are no material construction transactions that have not been properly recorded in the accounting records, construction records, or construction management records.*
- *I acknowledge my responsibility for the design, implementation, and maintenance of programs and controls to deter, prevent, and detect fraud.*
- *The following have been properly recorded or disclosed in accounting records, financial statements, and construction management records:*
 - a. *Related-party transactions, including contract awards, change orders, asset sales, asset purchases, loans, transfers, leasing arrangements, or amounts receivable from or payable to related parties.*
 - b. *Guarantees, whether written or oral, under which the Port is contingently liable.*
- *There have been no and are no—*
 - a. *Violations or possible violations of laws, regulations, or contract or grant requirements whose effects should be considered for disclosure in the financial statements, or as a basis for recording a loss contingency, or reporting to Federal, State, or local funding or law enforcement authorities.*
 - b. *Unasserted claims or assessments that our lawyers (internal or external) have advised us are probable of assertion.*
 - c. *Other material liabilities or gain or loss contingencies.*
- *The Port has complied with all aspects of contract and grant agreements that would have a material effect on the contracts or grants in the event of noncompliance.*
- *The Port has explained to you all circumstances surrounding the Port's altering, revising, modifying, updating, or deleting construction and construction management hard copy, electronic or other records and Port information systems; and has provided you with copies of all correspondence and communications to, from, or among Port management, employees, contractors, or consultants related to those matters.*
- *I have no knowledge of any deliberate attempts by any Port personnel, contractor personnel, or consultant personnel to impede or delay your audit by altering records or denying or delaying your audit team's access to records or information systems or records.*
- *I have reviewed the Preliminary Findings and Recommendations (PFRs) issued as part of your audit as well as the Port's responses to those PFRs; the Port's responses represented the then-current and complete position of the Port with respect to each PFR; and the Port did not withhold any information from you with respect to any PFR or any PFR response.*

The **Corporate Budget Manager, Finance & Budget**,¹¹ did not affirm that to the best of his knowledge and belief:

- *I have reviewed the Preliminary Findings and Recommendations (PFRs) issued as part of your audit as well as the Port's responses to those PFRs; the Port's responses represented the then-current and complete position of the Port with respect to each PFR; and the Port did not withhold any information from you with respect to any PFR or any PFR response.*

The **Assistant Director AV/CIP, Aviation Project Management Group**, did not affirm that to the best of her knowledge and belief:

- *There have been no communications from Federal, State, or local regulatory agencies concerning noncompliance with or deficiencies in financial or programmatic reporting practices related to the Port of Seattle's construction management or construction-related grants or contracts.*
- *There are no material construction transactions that have not been properly recorded in the accounting records, construction records, or construction management records.*
- *I acknowledge my responsibility for the design, implementation, and maintenance of programs and controls to deter, prevent, and detect fraud.*
- *The following have been properly recorded or disclosed in accounting records, financial statements, and construction management records:*
 - a. *Related-party transactions, including contract awards, change orders, asset sales, asset purchases, loans, transfers, leasing arrangements, or amounts receivable from or payable to related parties.*
 - b. *Guarantees, whether written or oral, under which the Port is contingently liable.*
- *There have been no and are no—*
 - a. *Violations or possible violations of laws, regulations, or contract or grant requirements whose effects should be considered for disclosure in the financial statements, or as a basis for recording a loss contingency, or reporting to Federal, State, or local funding or law enforcement authorities.*
 - b. *Unasserted claims or assessments that our lawyers (internal or external) have advised us are probable of assertion.*
 - c. *Other material liabilities or gain or loss contingencies.*
- *The Port has complied with all aspects of contract and grant agreements that would have a material effect on the contracts or grants in the event of noncompliance.*
- *The Port has explained to you all circumstances surrounding the Port's altering, revising, modifying, updating, or deleting construction and construction management hard copy, electronic or other records and Port information systems; and has provided you with copies of all correspondence and communications to, from, or among Port management, employees, contractors, or consultants related to those matters.*
- *I have no knowledge of any deliberate attempts by any Port personnel, contractor personnel, or consultant personnel to impede or delay your audit by altering records or denying or delaying your audit team's access to records or information systems or records.*

¹¹ This individual was the POS-designated focal point for communications between our audit team and POS personnel. All PFRs were sent through this person and this person sent us all of the POS responses to PFRs.

The **Aviation CIP Program Leader, Aviation Project Management Group**, did not affirm that to the best of his knowledge and belief:

- *There have been no communications from Federal, State, or local regulatory agencies concerning noncompliance with or deficiencies in financial or programmatic reporting practices related to the Port of Seattle's construction management or construction-related grants or contracts.*
- *There are no material construction transactions that have not been properly recorded in the accounting records, construction records, or construction management records.*
- *I acknowledge my responsibility for the design, implementation, and maintenance of programs and controls to deter, prevent, and detect fraud.*
- *The following have been properly recorded or disclosed in accounting records, financial statements, and construction management records:*
 - a. *Related-party transactions, including contract awards, change orders, asset sales, asset purchases, loans, transfers, leasing arrangements, or amounts receivable from or payable to related parties.*
 - b. *Guarantees, whether written or oral, under which the Port is contingently liable.*
- a. *There have been no and are no—*
 - a. *Violations or possible violations of laws, regulations, or contract or grant requirements whose effects should be considered for disclosure in the financial statements, or as a basis for recording a loss contingency, or reporting to Federal, State, or local funding or law enforcement authorities.*
 - b. *Unasserted claims or assessments that our lawyers (internal or external) have advised us are probable of assertion.*
 - c. *Other material liabilities or gain or loss contingencies.*
- *The Port has complied with all aspects of contract and grant agreements that would have a material effect on the contracts or grants in the event of noncompliance.*
- *The Port has explained to you all circumstances surrounding the Port's altering, revising, modifying, updating, or deleting construction and construction management hard copy, electronic or other records and Port information systems; and has provided you with copies of all correspondence and communications to, from, or among Port management, employees, contractors, or consultants related to those matters.*
- *I have no knowledge of any deliberate attempts by any Port personnel, contractor personnel, or consultant personnel to impede or delay your audit by altering records or denying or delaying your audit team's access to records or information systems or records.*
- *I have reviewed the Preliminary Findings and Recommendations (PFRs) issued as part of your audit as well as the Port's responses to those PFRs; the Port's responses represented the then-current and complete position of the Port with respect to each PFR; and the Port did not withhold any information from you with respect to any PFR or any PFR response.*

The **Internal Audit Manager** did not affirm that to the best of her knowledge and belief:

- *I have reviewed the Preliminary Findings and Recommendations (PFRs) issued as part of your audit as well as the Port's responses to those PFRs; the Port's responses represented the then-current and complete position of the Port with respect to each PFR; and the Port did not withhold any information from you with respect to any PFR or any PFR response.*

The **General Manager, Port Construction Services**, did not affirm that to the best of his knowledge and belief:

- *I have reviewed the Preliminary Findings and Recommendations (PFRs) issued as part of your audit as well as the Port's responses to those PFRs; the Port's responses represented the then-current and complete position of the Port with respect to each PFR; and the Port did not withhold any information from you with respect to any PFR or any PFR response.*

The **Managing Director, Aviation Division**, did not affirm, to the best of his knowledge and belief, that:

- *We have made available to you all—*
 - a. *Financial and other records and data related to construction projects within the scope of your audit.*
 - b. *Construction and construction management records and data related to construction projects within the scope of your audit.*
- *There have been no communications from Federal, State, or local regulatory agencies concerning noncompliance with or deficiencies in financial or programmatic reporting practices related to the Port of Seattle's construction management or construction-related grants or contracts.*
- *There are no material construction transactions that have not been properly recorded in the accounting records, construction records, or construction management records.*
- *The following have been properly recorded or disclosed in accounting records, financial statements, and construction management records:*
 - a. *Related-party transactions, including contract awards, change orders, asset sales, asset purchases, loans, transfers, leasing arrangements, or amounts receivable from or payable to related parties.*
 - b. *Guarantees, whether written or oral, under which the Port is contingently liable.*
- *The Port has complied with all aspects of contract and grant agreements that would have a material effect on the contracts or grants in the event of noncompliance.*
- *The Port has explained to you all circumstances surrounding the Port's altering, revising, modifying, updating, or deleting construction and construction management hard copy, electronic or other records and Port information systems; and has provided you with copies of all correspondence and communications to, from, or among Port management, employees, contractors, or consultants related to those matters.*

The **Assistant Director, Engineering/Construction Management, Project Management Group**, did not provide any of the requested representations.¹²

The **Chief Engineer/Director of Engineering Services** did not affirm, to the best of his knowledge and belief, that:

- *There have been no communications from Federal, State, or local regulatory agencies concerning noncompliance with or deficiencies in financial or programmatic reporting practices related to the Port of Seattle's construction management or construction-related grants or contracts.*
- *The following have been properly recorded or disclosed in accounting records, financial statements, and construction management records:*
 - a. *Related-party transactions, including contract awards, change orders, asset sales, asset purchases, loans, transfers, leasing arrangements, or amounts receivable from or payable to related parties.*
 - b. *Guarantees, whether written or oral, under which the Port is contingently liable.*
- *There have been no and are no—*
 - a. *Violations or possible violations of laws, regulations, or contract or grant requirements whose effects should be considered for disclosure in the financial statements, or as a basis for recording a loss contingency, or reporting to Federal, State, or local funding or law enforcement authorities.*
 - b. *Unasserted claims or assessments that our lawyers (internal or external) have advised us are probable of assertion.*
 - c. *Other material liabilities or gain or loss contingencies.*

¹² This was the senior POS official in charge of all POS construction management. The POS General Counsel stated that this person left POS employment before we sent our request for his representations on September 20, 2007. We requested supporting documents to substantiate this assertion. POS provided information on November 29, 2007, indicating that this employee ceased working at POS on or about September 10, 2007, but will continue on the POS payroll until May 7, 2008. POS has not adequately explained why no letter has been provided by this employee, but it appears that POS never provided our letter to this person and asked him to respond.

APPENDIX C
RECOMMENDATIONS FOR THE WASHINGTON STATE LEGISLATURE

APPENDIX C

RECOMMENDATIONS FOR THE WASHINGTON STATE LEGISLATURE

RECOMMENDATION

We recommend that the Washington State Legislature clarify the Revised Code of Washington (RCW) with respect to competition required in procurements that result in expenditures of public funds and revise the RCW section governing small works roster contract procedures.

With respect to competition requirements in general, if it has been the intent of the Legislature that state and municipal governments should **not** have wide latitude to award sole source contracts for goods and services, then we recommend that the Legislature:

- Revise RCW 53.08.120, *Contracts for labor and material*, to make clear that its competition requirements apply to consulting and other services (except for contracts for A/E services, which are governed by the modified competition requirements in RCW 39.80).
- Revise RCW 39.04.190, *Purchase contract process—Other than formal sealed bidding*, to make it clear that port district purchases of consulting and other services (except for contracts for A/E services, which are governed by the modified competition requirements in RCW 39.80) are *not* exempt from that section’s requirements “to assure that a competitive price is established and for awarding the contracts for the purchase of any materials, equipment, supplies, or services to the lowest responsible bidder.”
- Revise RCW 39.30.020, *Contracts requiring competitive bidding — Violations by municipal officer — Penalties*, to make clear that it applies to the procurement of consulting and other services (including A/E services).
- Revise RCW Chapter 39.04, *Public works*, section 39.04.010, *Definitions*, to make clear that the definition of “public work” includes consulting and other services (including A/E services) that are related to construction, alteration, repair, or improvements executed at the cost of the state or of any municipality.
- Revise RCW 53.12.270, *Delegation of powers to managing official or port district*, to make clear that employees of port districts may **not** waive established Port policies related to competition in the procurement of goods and services without notifying or seeking the approval of the elected commission.

Alternatively, if it **has** been the intent of the Legislature that state and municipal governments should have wide latitude to award sole-source contracts for goods and services, then we recommend that the Legislature reevaluate that position and enact new (or clarify existing) statutes requiring competition for the procurement of goods and services—including consulting and other services (including A/E services).

We also recommend that the Legislature consider revising RCW 39.04.155, *Small works roster contract procedures — Limited public works process*. Paragraph (c) of RCW 39.04.155 provides, in part, that:

*... if the estimated cost of the work is from one hundred thousand dollars to two hundred thousand dollars, a state agency or local government, **other than a port district**, that chooses to solicit bids from less than all the appropriate contractors on the appropriate small works roster must also notify the remaining contractors on the appropriate small works roster that quotations on the work are being sought.*

We recommend that the Legislature remove the phrase “*other than a port district*” from paragraph (c).

BACKGROUND

Cotton & Company’s audit of POS construction management revealed that POS regularly circumvents competition requirements through a variety of techniques and means. We observed the following practices:

- Splitting of purchases into multiple \$50,000 contracts.
- Awarding \$50,000 contracts and then amending the contracts to higher amounts.
- Awarding successive \$50,000 contracts to obtain the ongoing services of particular individuals.
- Awarding limited competition contracts of up to \$200,000 and then amending the contracts to higher amounts.
- Awarding fully-competed contracts and then amending them to higher amounts for work outside the scope of the original agreements.
- Awarding fully competed contracts calling for work to be ordered on a specific task basis and then using the contract to augment POS staffing.
- Awarding follow-on contracts to cover cost overruns on prior contracts.
- Awarding contracts on a sole-source basis when competition was required.
- Awarding a \$1.4 million consulting contract to obtain the services of a former POS employee without evidence of competition.

- Awarding a \$2.7 million consulting contract without competition.
- Manipulating the bidder selection system to steer contracts to favored contractors.

The above practices violated POS's own procurement policies. We concluded that, in several instances, that they also violated Washington State law.

POS disagreed that these practices violated State law and asserted the position that, because State law does not require competition for non-A/E professional services, POS had the latitude to waive its own procurement policies. POS asserted that POS:

*is **not** subject to any specific legislative framework governing its procurement practices other than those which govern public works design and construction contracts. In all other areas -- specifically including the retention of professional services not governed by Chapter 39.80 of the Revised Code of Washington -- the Port of Seattle enjoys substantial flexibility in how it elects to accomplish the purposes for which it exists under Title 53 of the Revised Code of Washington.*
[Emphasis in original.]

When we explained that we thought that Washington State law requires competition for the procurement of all goods and services (with some exceptions), POS further asserted that:

*The Performance Auditor appears to be laboring under the misapprehension that the Port of Seattle is subject to general laws relating to its procurement practices. However, except with respect to public works contracts, the Port of Seattle – as a port district governed by Title 53 of the Revised Code of Washington – is not subject to any general laws governing its procurement practices. **The Port of Seattle enjoys substantial flexibility in how it elects to accomplish the purposes for which it exists under Title 53.** While designed to ensure compliance with the very limited number of statutes governing its procurement practices, **the Port's procurement policies are voluntarily instituted and may, except when effecting the requirement of one of those limited number of statutes, be waived.***
[Emphasis added.]

Our audit also revealed that POS personnel manipulated the small works roster procurement process to create the appearance of competition for services while steering contracts to favored vendors. Imposing on the Port the same requirement imposed on other agencies and governments to “*notify the remaining contractors on the appropriate small works roster that quotations on the work are being sought*” would serve as a strong control mechanism to prevent bid-rigging schemes.

Criteria

In addition to the RCW sections cited in the recommendation above, best practices dictate that competition for the purchases of goods and services results in lower cost.

*The benefits of competition are well established. Competition saves money for the taxpayer, improves contractor performance, curbs fraud, and promotes accountability for results. –May 31, 2007, memorandum to Chief Acquisition Officers from the Office of Management and Budget.*¹³

In addition, the **State of Washington Joint Legislative Audit and Review Committee** stated that:

*The primary purpose of the competitive bidding requirement is to prevent fraud, collusion, and favoritism by public officials and to obtain the best work at the most reasonable price. The open competitive process satisfies this by making the selection process transparent to the public.*¹⁴

Although Federal regulations are not applicable to *all* POS procurements, they *are* applicable to many of them, because POS receives substantial amounts of money via Federal grants. Federal regulations governing procurement can also be considered to constitute best practices. **49 USC Part 18, Subpart C, Section 18.36, Procurement**, stipulates that:

(1) All procurement transactions will be conducted in a manner providing full and open competition consistent with the standards of Sec. 18.36. Some of the situations considered to be restrictive of competition include but are not limited to: ...

- (iv) Noncompetitive awards to consultants that are on retainer contracts, ...*
- (vii) Any arbitrary action in the procurement process. ...*

(3) Grantees will have written selection procedures for procurement transactions. These procedures will ensure that all solicitations:

- (i) Incorporate a clear and accurate description of the technical requirements for the material, product, or service to be procured....*

(2) Identify all requirements which the offerors must fulfill and all other factors to be used in evaluating bids or proposals. ...

(d) Methods of procurement to be followed:

(3) Procurement by competitive proposals. The technique of competitive proposals is normally conducted with more than one source submitting an offer, and either a fixed-price or cost-reimbursement type contract is awarded. It is generally used when conditions are not appropriate for the use of sealed bids. If this method is used, the following requirements apply:

¹³ [see: http://www.whitehouse.gov/omb/procurement/comp_contracting/competition_memo_053107.pdf]

¹⁴ See Report 05-9, *An Assessment of General Contractor/Construction Manager Contracting Procedures*, June 22, 2005.

(i) Requests for proposals will be publicized and identify all evaluation factors and their relative importance. Any response to publicized requests for proposals shall be honored to the maximum extent practical;
(ii) Proposals will be solicited from an adequate number of qualified sources;
(iii) Grantees and subgrantees will have a method for conducting technical evaluations of the proposals received and for selecting awardees;
(iv) Awards will be made to the responsible firm whose proposal is most advantageous to the program, with price and other factors considered; and
(v) Grantees and subgrantees may use competitive proposal procedures for qualifications-based procurement of architectural/engineering (A/E) professional services whereby competitors' qualifications are evaluated and the most qualified competitor is selected, subject to negotiation of fair and reasonable compensation. The method, where price is not used as a selection factor, can only be used in procurement of A/E professional services. It cannot be used to purchase other types of services though A/E firms are a potential source to perform the proposed effort.

EFFECT

Although we consider the POS interpretation of the RCW to be incorrect, if that interpretation prevails and gains recognition among other municipal governments, including port districts, those governments will be free to engage in procurement practices that invite “*fraud, collusion, and favoritism.*”

APPENDIX D
NOTEWORTHY PORT OF SEATTLE ACCOMPLISHMENTS (UNAUDITED)

UNAUDITED INFORMATION

APPENDIX D

NOTEWORTHY PORT OF SEATTLE ACCOMPLISHMENTS (UNAUDITED)

AUDITOR'S NOTE: We asked POS personnel to provide us with information on noteworthy accomplishments¹⁵ during our survey phase (March 20 through May 14, 2007). Information was provided on July 10, August 9, August 13, and August 28. The information was submitted to us too late during the audit to enable us to verify its accuracy. Accordingly, the information in this appendix has not been audited, verified, tested, or confirmed.

Information reported by POS follows.

Third Runway Project

Following are highlights associated with the Third Runway Project during the 2004, 2005 and 2006 construction seasons:

Trucks made more than 539,000 trips and traveled more than 29 million miles hauling fill to the embankment for the runway with no major accidents. Workers built three mechanically stabilized earth walls to retain the embankment. The west wall, at about 130 feet, considered the tallest in North America. In related work crews:

- Relocated a section of roadway and creek to accommodate the third runway's north safety area;
- Successful road, embankment and wall construction immediately adjacent to sensitive areas (wetlands and creek corridor) over a 2 year period, with no long term impacts beyond allowed work zones.
- Expanded the safety area, and built retaining wall for the easternmost runway;
- Constructed seven storm water ponds and four treatment centers; and
- Successful treatment of over 600 million gallons of construction stormwater to 5NTU's or less = strictest standard ever achieved in Washington State.

During environmental mitigation activities workers:

- Removed about 400 houses, other structures and urban debris;
- Created/enhanced 85 in-basin wetland acres;
- Created 68 acres of new wetland habitat along the Green River in Auburn;
- Relocated/rebuilt 1,000 linear feet of channelized creek;
- Built a new 100-year flood plain in a former farming area, next to the new creek channel; and
- Restored and enhanced 6,500 linear feet of creek.

Other environmental accomplishments:

- Successfully completed runway approvals in the face of well funded opposition and in a decade that saw few successful runway approvals at US airports.
- Negotiated mitigation package that met competing and contradictory regulatory requirements for wetland and stormwater mitigation along with wildlife hazard control at airports.

¹⁵ Government Auditing Standards (paragraph A8.02.b.) provide: *The report may recognize the positive aspects of the program reviewed if applicable to the audit objectives. Inclusion of positive program aspects may lead to improved performance by other government organizations that read the report.*

UNAUDITED INFORMATION

- New environmental training film for all contractors and Port employees, now a permanent part of employee and contractor required initial training prior to working on Port construction sites.

Employment opportunities—The percentage of minority and female workers in the project work force during 2004-2005 was the highest for any FAA-funded Port of Seattle construction project, according to Port Contract Compliance records. Minority workers were 18.5 percent of the total work force and nearly 10 percent were female. During the 2006 construction, about 12 percent were minority and 13 percent were female.

Public relations—Staff responded to more than 600 construction hotline calls during 2004-2006. This translated into one call for every 48,333 truck miles and one call for every 898 truck trips. There were about 100 tours, at least 60 briefings about the project, more than 70 media stories and 13 newsletters. The Port paid 54 claims for windshield damage associated with the trucks and the contractor paid 58.

Contract administration—There were no claims against the Port by the contractor. Change orders were 2.4% of the total value of bid amounts for 2004 through 2006. Actual cost of total work performed on the Third Runway Project from 2004 through 2006 was 1.5% over the total bid value, adjusted for actual quantities of work performed and change orders.

Recognitions— John Rothnie, the POS airfield program manager in charge of the third runway project, was chosen by the editors of Engineering News- Record as one of their top 25 newsmakers of the year 2006. His innovations and achievements were recognized for serving the best interests of the construction industry. Engineering News-Record is one of the top publications in the nation providing business and technical news about the construction industry. It has a readership of more than 257,000.

Parsons Contract for Project Management Support

- Over 19% of total cost to date has supported Small Business, Minority, Women Business Enterprises

Engineering Department

1. Implemented the E-Business on line bidding system.
2. Implemented the master record drawing system improvements.
3. Implemented the LiveLink construction document management system.
4. Participated in the development of the Small Business matrix for evaluation of small business opportunities and barriers.
5. Initiated the Port of Seattle GIS Enterprise system in conjunction with ICT and Engineering Survey.
6. Updated the manuals for Construction Safety, Construction Management, and Contract Services.

UNAUDITED INFORMATION

7. Provided steady improvement with the construction safety lagging indicators and outperformed the State of Washington and the National indicators.
8. Initiated and provided a report on overheads of the major capital groups, i.e. Aviation Project Management, Seaport Project Management, and Engineering.
9. Developed a data tracking system for comparison of major construction bids and the Engineer's Estimate.
10. Successfully implemented the construction of the CIP's during these years and provided other Engineering services in design, surveying, contracting and support services.

Port Construction Services Accomplishments from 2004 through 2006

Small works on-line web applications

A project of importance to speed communications, manage information, strengthen partnerships and improve public awareness was the work PCS did with the Port of Seattle e-business team regarding the Small Works Online Web applications. Through this website, PCS can update the self-service vendor roster and Port database, and send bid invitations to qualified small works contractors. This system includes a password protected business-management tool that allows active contractors to monitor personal bidding activity, verify invoice payment schedules, and receive automatic updates for bidding information. Benefits for the Port are a reduction in the number of phone calls to Port staff, increased number of bidders and this greater competition for work has resulted in lower bids for Port projects.

Customer satisfaction culture

As a "service group," PCS exists to provide construction and construction management services to its customers located in the two (2) operating divisions. Since PCS's customers have options available to complete their project work other than PCS, there is a need to better understand what our customers truly want from PCS. Several years ago, PCS conducted a survey which was undertaken to develop strategies and processes to improve PCS's level of service. That survey was designed and conducted with the understanding that "perceptions are reality," and with a customer base that does have choices other than PCS to get the work completed. During 2006 a representative of PCS, using the original survey questions and initial survey results as a baseline, met with over 30 of our customers to determine if PCS was meeting their needs and again asking what we could do better to meet their expectations. This information is being used to support PCS' leadership team in the development of strategies and process improvements that will enable PCS to maintain a high level of customer service and "Be a High-Performance Organization."

Safety Position

As a result of our efforts to foster continuous improvement with our safety program, and to achieve the Port's objective of zero accidents, injuries, or citations contained in Commission Resolution 3213, PCS fully implemented a safety technician position in 2005. Having a person responsible to this effort enabled PCS to place a greater emphasis on pre-project safety planning and to incorporate the mitigation of the safety hazards, inherent in the nature of our work, into the project work plan. Another essential element in the implementation of this position was to have a greater focus on site specific conditions and to perform safety inspections on our construction sites. The

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impact of this position and our continued focus on safety improvements was that, with over 100,000 man hours of work, our occupational injury rate (per 100 workers) was reduced from 10.6 in 2004 to 5.13 in 2006. In addition, we were able to lower our costs from \$1.44 per man hour worked in 2004 to \$0.84 per man hour in 2006. During 2006, our Safety Technician completed the required training to become a Certified OSHA Trainer.

Total work performed by PCS

During 2004, PCS performed work on approximately 216 projects and managed \$18.2m in spending which was 3% more than the \$17.6m in 2003. While total work through the Regulated Materials Management Program decreased by 24% from \$5.4m in 2003 to \$4.1m in 2004, capital work increased by 15% from \$12.2m in 2003 to \$14.1m in 2004.

During 2005, PCS performed work on approximately 343 projects and managed \$22.7m in spending which was 20% more than the \$18.2m in 2004. While total work through the Regulated Materials Management Program decreased by 4% from \$4.1m in 2004 to \$3.9m in 2005, capital work increased by 25% from \$14.1m in 2004 to \$18.8m in 2005.

During 2006, PCS performed work on approximately 249 projects and managed \$17.1m in spending which was 25% less than the \$22.7m in 2005. While total work through the Regulated Materials Management Program decreased by 12.8% from \$3.9m in 2005 to \$3.4m in 2006, capital work decreased by 37% from \$18.8m in 2005 to \$13.7m in 2006.

Community outreach

One of the initial objectives for the creation of PCS was to “provide additional opportunities for small and disadvantaged firms to perform work for the Port of Seattle.” This process begins with an opportunity to communicate the vision, goals and opportunities to internal as well as external constituencies. During the past 3 years, PCS participated in Regional Contracting Forums, Contractor/Consultant workshops, and Diversity Business Symposiums, which focused on identifying procurement opportunities with state, local and Port entities. During these events, PCS staff made short presentations, participated in panel discussions, distributed materials and were available to provide information to the attendees throughout the daylong events. During 2005, PCS was made a member on the Advisory Board for the Contractor Competitiveness and Development Center, which is sponsored by the City of Seattle and the Urban League.

During 2004, PCS generated approximately \$8.3m in payments to small works contractors, of which \$1.5m (18%) went to minority-owned, woman-owned, or small business enterprises. In addition, PCS generated approximately \$3.4m in professional service fees, of which \$835k (25%) went to minority-owned, woman-owned, or small business enterprises.

During 2005, PCS generated approximately \$9.6m in payments to small works contractors, of which \$3.3m (25%) went to minority-owned, woman-owned, or small business enterprises. In addition, PCS generated approximately \$3.4m in professional service fees, of which \$794k (23%) went to minority-owned, woman-owned, or small business enterprises.

During 2006, PCS generated approximately \$7.5m in payments to small works contractors, of which \$1.8m (24%) went to minority-owned, woman-owned, or small

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business enterprises. In addition, PCS generated approximately \$3.2m in professional service fees, of which \$1.2m (34%) went to minority-owned, woman-owned, or small business enterprises.

Over the past 11 years, PCS has generated in excess of \$74m in payments to small works contractors of which \$23.1m (31%) went to minority-owned, woman-owned or small business enterprises. In addition, PCS generated approximately \$40.6m in professional service fees, of which \$6.9m (17%) went to minority-owned, woman-owned, or small business enterprises.

Seaport Accomplishments 2004 - 2006

Database

The Seaport Project Management Group (SPMG) has recently developed the Seaport Project Office Tracking System (SPOTS) an Access database system designed to provide comprehensive project controls for Seaport capital construction projects. The database tracks changes in project costs, schedules, and critical issues and provides trend forecasting tools for project managers.

Construction Projects

In 2004, the Seaport spent \$64.3m on major capital construction projects. Notable accomplishments in 2004 included the following:

- Terminal 46 Redevelopment – expanded Hanjin terminal to 88 acres, added 3 new PPM cranes, upgraded apron and fendering system, made significant yard improvements, and replaced existing buildings. Project was constructed with aggressive schedule in fully operating container terminal. Additional challenges to overcome included unexpected costs for disposal of contaminated soils and other non-discretionary scope changes.
- Terminal 91 Berths 1/3/5/7 Reconstruction – rebuild of existing apron and fendering system to support fishing fleet, barge operations and other marine cargo uses.
- Terminal 30 Cruise Development – worked under very aggressive schedule and extremely tight budget to complete project in time for a successful first year of cruise activity at Terminal 30. The T30 Cruise terminal was completed "cradle to grave" in approximately one year as a result of close cooperation between multiple federal agencies as well as state and local governments that controlled permitting. The project was completed within allocated budgets and has successfully supported a growing cruise industry in Seattle for several years.
- Fishermen's Terminal South Wall Reconstruction – replaced heavily deteriorated seawall in fully operating fishing terminal/marina within close proximity and with minimal disruptions to commercial business, retail, and restaurant activities.
- Fishermen's Terminal Docks 3 & 4 Reconstruction - replaced existing timber docks to support large fishing vessels with minimal disruption to operations in active fishing terminal.

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In 2005, Seaport spent \$87.6m on major capital construction projects. Notable accomplishments in 2005 included the following:

- Terminal 25 – expanded Matson terminal and constructed in approximately one year.
- Security Grants - organized & administered four (4) rounds of security grants for POS, Tacoma and Everett totaling over \$18m in federal funds and completing 33 projects to enhance security.
- Security Standards - helped coordinate the development of the national and international standards for container cargo security.
- Security Demonstration Projects - completed a \$27.5 million demonstration program with 9 demonstration projects.

In 2006, Seaport spent \$102.9m on major capital construction projects. Notable accomplishments in 2006 included the following:

- East Waterway and T18 Berth Dredging - The Port and the U.S. Army Corps of Engineers are conducting a joint dredging project for the first 3,000 feet (914 meters) of the East Waterway of the Duwamish River. The project will help make several more of the Port's container berths deep enough to accommodate the next generation of container ships, some of which can carry 6,000 TEUs (20 ft equivalent unit containers). This will help create additional jobs on the waterfront and throughout the region.
- Terminal 91 Berths C & D Reconstruction - Completion of new concrete apron replacing deteriorated timber apron.
- Shilshole Bay Marina Renewal and Replacement – reconstruction of existing large recreational marina and upland facilities. Construction challenges included working in and around a fully operational marina and several landside businesses, including 300 liveaboard residents. Construction management approach included tight parking constraints, vibration/noise control, frequent customer communications, and carefully orchestrated boat relocations to minimize impacts. Project is scheduled for completion in 2008.
- Fishermen's Terminal Docks 5-10 – replacement of deteriorating timber docks with concrete floats in fully operational fishing terminal with active landside businesses. Project is scheduled for completion in 2008.
- Terminal 91 Carnitech Building – constructed a pre-engineered steel building and utility upgrades to support the new building and up to five additional structures on the pier. Environmental improvements including removal and disposal of contaminated soils and clean up and removal of old fuel lines. Creosote soaked wood pilings and pier decks were removed and replaced with concrete piles and decking, making the piers stronger and more durable. The project also improved the marine environment by removing creosote from the water. The project will support 100 to 130 direct and indirect jobs with an estimated payroll of \$11 million annually. State and local tax revenues generated by the project are estimated at \$1.1 million per year.

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- Terminal 18 North Apron Reconstruction - completed Phase A & B on time. Electrical substation upgraded to activate new SSA purchased 100' gauge cranes. Completed dredging and underwater sheetpile wall installation. Completed Kinder Morgan fender system replacement.
- Radiation Portal Monitors – large x-ray equipment installed at all international container terminals. We have completed four individual radiation portal monitoring set up's to date. Two at T5, one for rail and one non-rail. In addition, we have completed the installation of RPM's at T18 and T46. These installations were performed per Homeland Security specifications and were completed within budget and on schedule. The Port facilitated the design and construction activities of the three truck screening facilities and T18, T46, and T5. The Port performed the design and the government's contractor Battelle completed the construction of the T5 rail RPM. All facilities have been operational for some time and have proved to have minimal impact to tenant operations.

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Photographs Related to the 3rd Runway Project



Bridge before



Bridge after



Near bridge after



S. 154th St bridge before



154th AFTER

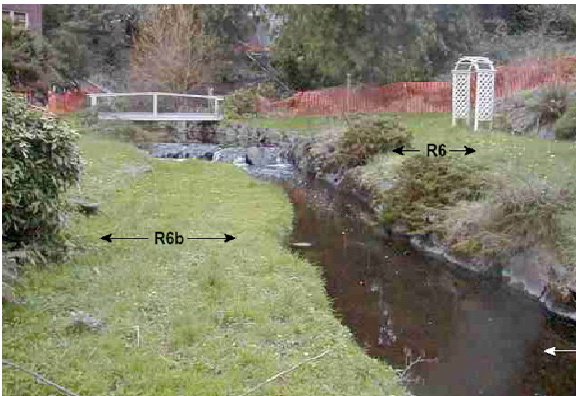
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Pre relocation



Relocated creek



Near 8th Ave before



8th Ave AFTER

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S. 160th before



Miller Creek S. 160th before



S. 160th AFTER

**PORT OF SEATTLE
RESPONSE TO THE
PERFORMANCE AUDIT OF THE PORT OF SEATTLE'S
CONSTRUCTION MANAGEMENT**



**RESPONSE TO THE
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PORT OF SEATTLE RESPONSE TO THE PERFORMANCE AUDIT

Executive Summary

This Performance Audit conducted under the authority of the Washington State Auditor's Office is intended to evaluate government performance, to increase credibility of government services, and to ensure government performance is monitored for efficiency and effectiveness.

The Port of Seattle embraces these goals and welcomes the opportunity to make improvements in its policies and procedures to better serve the public good. In this spirit, the Port is committed to performing to the highest standards and to addressing the issues raised by this audit.

Overview of Response to Findings

The Port is committed to accountability, cost control, and open government. We take the stewardship of taxpayer and customer resources seriously. We also recognize that the Port must have public and customer confidence to operate effectively and remain a viable business.

This performance audit raises a number of serious issues and makes recommendations about how the Port of Seattle conducts its business. The Port agrees that there is a clear need to improve some of our systems and procedures as part of our ongoing commitment to the highest performance standards. We acknowledge this throughout our response and agree with the majority of the audit's recommendations. In direct response to the two overarching recommendations, the CEO has established review teams to recommend options for establishing a central procurement office and to recommend appropriate changes to Resolution 3181. As part of the performance audit process, it is also essential that the Port point out areas where the Performance Auditor has reached conclusions with which we disagree, or made recommendations that will not necessarily improve our performance.

Given the Port's commitment to accountability, cost control, and open government, as well as the detailed nature of this performance audit, the Port is undertaking an in-depth assessment of every issue and recommendation raised in this report and a thorough examination of where policies and procedures should be improved. This assessment is in addition to a Port-sponsored performance audit conducted by the auditing firm Talbot, Korvola & Warwick LLP ("TKW") earlier this year.

As to the issue of fraud, it is important to note that no instance of fraud was found by either auditor. Nonetheless, the Port has zero tolerance for fraud should it ever be found. In following up on the recommendations of this performance audit, the Port also will work to increase its vigilance against the risk of fraud.

While the Port takes pride in its strong record of compliance as evidenced by numerous outside audits, including those conducted by the Washington State Auditor's Office, the Port recognizes that this performance audit raises instances in which the Port's own policies and procedures were not followed. These policies and procedures are not effective unless followed, and the Port is committed to making improvements to ensure consistent compliance and best practices are met.

The Port's response to this performance audit represents one part of a larger effort to ensure the Port of Seattle has the culture and best practices in place to effectively and efficiently manage our operations, and to guard against the potential of fraud, waste, and abuse.

Summary of Response to Major Findings and Recommendations

First, Port staff acknowledges that during the course of its \$4+ billion capital program over the past decade, some errors have occurred in contracting and construction management processes and procedures. The Port agrees with many of the recommendations offered in this audit, and some related improvements already are underway as the result of a Port-sponsored performance audit by TKW, conducted from December 2006 through March 2007.

From this, the Port already has begun a 37-point action plan to improve its cost and schedule risk management, estimating practices, and project controls. Specific efforts include revisions of its Standard Operating Procedure Manual, as well as review of change orders, trend logs, and efforts to ensure fair competition for contracts and professional service agreements.

Second, the Port also acknowledges the necessity for more consistent and complete documentation, and the need for better discipline in following all Port policies. This includes more detailed statements of work, enhanced procedures to mitigate risk from non-compliance, and added review of consultant agreement scope and duration prior to execution of amendments.

Third, with regard to federal grant funding and related contracts, the Port places a high priority on compliance with all applicable Washington state laws, as well as federal laws and regulations. This compliance has been regularly examined and validated by outside auditors on behalf of the relevant federal agencies.

Fourth, the Port is committed to ensuring that sound internal controls exist in all of its business practices. No controls can provide absolute assurance against fraud, but recurring audits have affirmed that effective internal controls exist at the Port to provide

reasonable assurance against fraud, waste, and abuse. This performance audit found no fraud.

Nonetheless, the Port takes fraud-risk seriously, has zero tolerance for fraud and, if found, will notify law enforcement where appropriate. Further, the Port will implement a fraud hotline and will assess its construction management activities to identify additional safeguards against fraud, waste, and abuse.

Lastly, all Port staff respects the role and authority of the Port Commission, whose members serve on behalf of the people of King County. Where the Port Commission delegates its authority, the Port staff strives to follow the Commissioners' policy decisions and works to keep Commissioners fully informed. The Commission and the Port CEO will review this delegation of authority in an effort to increase the transparency and accountability of Port staff's actions.

General Context

The Port of Seattle is a regional catalyst for trade, transportation and tourism that generates tens of thousands jobs, billions of dollars in business and tax revenues, and serves as a vital link to the global economy. As a municipal corporation, the Port operates in a business environment that demands it to be successful, nimble, accountable and responsive to the needs of both customers and taxpayers.

In this environment, the Port is required to undertake massive public works projects such as the expansion and upgrading of Seattle-Tacoma International Airport, and major redevelopments along the Seattle waterfront. As with other major public infrastructure improvements, these kinds of projects must be undertaken and completed in a highly regulated environment and are often subject to numerous construction, environmental, and operational constraints, as well as outside legal challenges, that can dramatically impact schedule and cost. These facilities operate 24 hours per day, 365 days a year and all construction must accommodate these operational realities.

Many capital projects are undertaken directly on behalf of Port customers with significant costs and other consequences to Port business activity if deadlines are not met. Ultimately, the Port has a strong record of successfully delivering large capital projects and has completed over \$4 billion worth of construction projects during the past decade.

Conclusion

This performance audit is an opportunity for the Port to enhance its effectiveness in safeguarding public resources, and meeting the needs and expectations of both taxpayers and customers. As part of our commitment to the highest performance standards and continuous improvement at the Port of Seattle, we will review our operations, study practices of other state and local agencies, and carefully consider the recommendations of this performance audit to develop the best practices for capital project delivery.

Response to Overarching Recommendation 1

Performance Auditor Recommendation:

[The Port] should establish a senior-level Chief Procurement Officer (CPO) position. This official should report directly to the [Port] CEO and be responsible for managing and overseeing all procurement-related activity. This official should have the authority to hire trained and independent procurement officials who will be charged with reviewing and approving all procurement-related transactions. Current delegations of authority related to procurement – contract awards, approval of contract changes and amendments, and related activities involving expenditure of public funds related to construction and construction management – should be rescinded and re-assigned to the CPO and her or his staff.

Port of Seattle Response:

The Port agrees this recommendation has merit. A team is in place, and work is already underway to identify and evaluate procurement models in other organizations that engage in major construction projects. With the help of an outside facilitator experienced in capital project delivery, the team is reviewing and analyzing several options for mission, role, personnel, reporting location, and structure of a Chief Procurement Office (or similar functional unit) over the next several weeks. The Port's CEO has asked the team to provide him with an outline of options and a preferred recommendation within 90 days. A necessary period of implementation planning will follow, but the CEO anticipates that the new unit or department can be operational by June 1, 2008. The working team includes representatives from the Port's executive, legal, project management, engineering, and purchasing staffs.

Response to Overarching Recommendation 2

Performance Auditor Recommendation:

The [Port] Commission should re-evaluate the current delegation of authority to the [Port] CEO (encompassed in Resolution 3181) and develop and issue a new delegation of authority resolution that more clearly defines the Commission's intent with respect to construction management and reporting to the Commission and the public concerning construction activities.

Port of Seattle Response:

Resolution 3181 is the structural framework underlying the relationship between the Port Commission and the CEO. Resolution 3181 was adopted in 1994. It has remained substantially unchanged for the past 13 years. However, only one of the five Commissioners who voted on and signed Resolution 3181 remains in office. A change of CEO occurred earlier this year. Given these circumstances, it is appropriate that the Commission and the CEO review the provisions of this bedrock document. Ultimately, the Commission, in conversation with the CEO, will strike the balance between policy direction and implementation, as well as other matters concerning the scope of the CEO's authority. To advance that effort, the CEO has asked members of his executive team, led by the General Counsel, to provide him with recommendations for updating, clarifying and strengthening a variety of provisions in Resolution 3181 within 90 days. The CEO has directed the team to give specific attention to the results of this performance audit and the 49 resulting recommendations. In particular, the team is charged with providing specific recommendations for process improvements and enhanced checks and balances for project-wide contracting authority, as well as increased public visibility and Commission participation for larger construction projects. The CEO then will share these recommendations with the Commission.

Preliminary Action Plan

The Port is establishing a Preliminary Action Plan to ensure that the recommendations of the Washington State Auditor's Office and the Performance Auditor are addressed.

The categories below stem from the performance audit's two overarching recommendations and the 49 detailed recommendations. Specific responses to each of the overarching recommendations and all of the detailed recommendations are set forth in the larger response.

The Port intends that all recommendations will be fully addressed by the end of 2008. Several have been implemented already, and many more are under review.

Overarching Recommendation 1: Implement Centralized Procurement

Summary of Response Action: Staff Review of Options and Best Practices, with Recommendations to CEO by March 15, 2008

Actions Currently Underway:

- Hired Outside Facilitator for General Review of Procurement Office Options
- Internal Team formed to make Detailed Recommendations to CEO by March 15, 2008

Overarching Recommendation 2: Revise Resolution 3181 – Capital Delivery and Contract Provisions

Summary of Response Action: Staff Policy Review with Recommendations to CEO for Presentation to Commission by March 15, 2008

Actions Currently Underway:

- Internal Team Formed to Review Relevant Provisions of Resolution 3181 and make Detailed Recommendations to CEO by March 15, 2008

Other Major Actions Implemented or Underway:

- Establishing Publicly Accessible Fraud Hotline
- Revising Ethics Policy for Employees Including Addition of Fraud Provisions
- Continuing Work on TKW Audit Action Plan and Augmenting with Recommendations from SAO Performance Audit
- Continuing Work on internal Professional Services Agreement Audit Action Items and Augmenting with Recommendations from SAO Performance Audit

- Preparing Semi-Annual Reports to Port Commission on Bid Irregularities
- Delivering Semi-Annual Report to Port Commission on Professional Services and other Agreements
- Implementing Revisions to Invoice Processing under PMSC Agreement
- Reviewing Change Orders on T-18 North Apron Contract and Preparing Deductive Change Orders as appropriate

Additional Audit Items for Review and Action:

Internal Process and Documentation Improvements to be Made or Evaluated:

- Project Scheduling Requirements Enforcement
- Change Order Process Improvements
- Change Order File Documentation
- Small Works Process Improvements
- Small Works Advertisements/Solicitations Documentation
- Small Works Roster Program Review
- Professional Services Agreements Improvements
- Consolidation Opportunities for Contract Management Information Systems
- SPOTS MIS Data Updates/Improvements
- LiveLink® Utilization Improvements
- Comprehensive Fraud Risk Assessment and Implementation of Additional Risk Control Measures
- Project Notebook Documentation and Procedures

Additional Policy Issues to be Reviewed:

- Management/Reporting Placement of Port Internal Audit Function
- Additional Fraud/Risk Control Policy Updates/Improvements
- Review “1% for Arts” Policy

Response to Major Finding 1

Major Finding 1: POS Construction Management Lacks Cost Controls and Accountability.

The Port agrees that accurate data and strong project controls are keys to maintaining appropriate oversight and management of large capital programs. In order to meet schedule, cost, quality, and other important objectives of the Port's capital program, the Port recognizes that it must uniformly apply sound management techniques for the planning, design, and construction of projects, all the way from inception to completion and closeout.

The Port has designed its capital project delivery system to ensure appropriate oversight, accountability, and controls. For example, the Port intentionally separated the process of project definition and design from that of project construction to promote independence and discipline. Similarly, Port practices are designed to proactively identify and respond to issues that may result in change orders. When they occur, the Port requires detailed analysis and multiple approvals for change orders. For the largest change orders, this includes notification of the Port Commission.

The Port acknowledges that some errors occurred during the implementation of its \$4+ billion capital programs. As detailed below, the Port accepts responsibility for \$8,890.50 of errors identified by the Performance Auditor on one contract and a portion of the \$80,000 error identified on another. While the Port believes these errors were isolated and not systemic, the Port is working to reduce such errors. Continuous performance assessment and measurement are vital to increasing efficiency and effectiveness and ensuring system integrity.

In that spirit, the Port previously commissioned a performance audit by Talbot, Korvola & Warwick LLP ("TKW") to review the Port's capital project delivery system.¹ TKW undertook this review from December 2006 through March 2007 and released its final report in May 2007. As a result of the TKW performance audit, the Port already was in the process of implementing a 37-point action plan to strengthen management of cost and schedule risk, estimating practices, and project controls in its capital program at the time this performance audit began.

¹ TKW is a respected Northwest firm with strong experience in performance audits. They have been hired by the Washington State Auditor's Office to conduct performance audits on other public agencies, including Sound Transit. The TKW report is entitled *Limited Scope Performance Audit: Capital Project Delivery Costs [and] Small and Disadvantaged Business Enterprise Opportunities within the Port's Capital Improvement Program* and was released in May 2007.

Response to Detailed Findings

Finding 1-A: POS Approved Change Orders without Sufficient Evidence of Having Evaluated Proposed Costs.

The Port evaluates all change order proposals submitted to it, and its files reflect detailed documentation supporting the prices to which the Port agrees. The example cited in this finding involved work utilizing the General Contractor/Construction Manager (“GC/CM”) alternative public works contracting methodology authorized by Washington law. That approach employs different procedures than the majority of Port construction contracts. The GC/CM agrees to a maximum construction cost, is at risk for cost overruns and thus conducts the primary analysis and negotiation of change order proposals from its subcontractors. As a result, that negotiation is better reflected in the GC/CM’s files than the Port’s files. The value of change orders is determined through an iterative process with the GC/CM, subcontractors, and the Port, and the GC/CM then forwards the negotiated amount and detailed supporting documentation to the Port’s Resident Engineer, who performs a final cost analysis. Only on the most significant change orders does the Port perform an independent estimate. This process is consistent with industry best practices and similar to that utilized by other Washington public entities.

The Performance Auditor notes that in 186 out of 215 cases he surveyed, the GC/CM’s and the engineer’s cost estimate were identical. This is the result of a collaborative process developed and honed by the Port and GC/CM at the beginning of the project. It is not indicative of a lack of review or analysis regarding these change orders. On the contrary, while the Port’s files reflect only the GC/CM’s final cost estimate, the GC/CM’s files reflect revision of that cost estimate based on negotiations with, and direction from, the Port’s construction management staff.²

The Port provided substantial oversight to ensure that the GC/CM contractor conformed to Port standard operating procedures in the preparation of its estimates. Early in the project, the Port and the GC/CM spent considerable time reviewing and developing the basis for change order pricing consistent with the contract specifications and the Port’s procedures manual.³ Once the Port and the GC/CM agreed to a protocol, the Port was able to efficiently perform a cost analysis on proposed changes. As noted, the Port relied

² The Port asked the GC/CM to pull its files related to two randomly selected change orders referenced in the performance audit report. One of those two files reflected that the Port’s Resident Engineer rejected certain proposed markups and reduced the estimate from \$52,574 to \$49,599. That file also reflects an almost \$16,000 reduction of the change order proposal originally submitted by the subcontractor.

³ For example, the pricing specifically included the following requirements:

- 1) Equipment pricing would be based on the Blue Book and the AGC agreement;
- 2) Materials (and specifically electrical materials) were based on Tracer minus 30%;
- 3) Electrical labor would not be based on NECA but would be based on estimated crew manpower using the labor composite rates negotiated on the Port’s earlier C61 project; and
- 4) Markups would be as set forth in the general conditions matrix, and many items requested such as small tools, management time, and bonding were included in the markups.

on independent estimates only when changes were large or particularly difficult. While the Port could have better documented its independent cost analysis, its files contain detailed documentation supporting the final negotiated price.

The Port's practices are consistent with the recommendations set forth in the *Assessment of General Contractor/Construction Manager Contracting Procedures* issued by the Washington Joint Legislative Audit and Review Committee ("JLARC") in June 2005. Nothing in that JLARC assessment suggests that an owner should completely duplicate the GC/CM's efforts on change order estimates in order to ensure proper construction management oversight. The Port remains actively involved in project and construction management on all GC/CM projects, and the Port's change order files are well documented with evidence of Port oversight. They contain voluminous documentation supporting the change and include a clear attestation that the GC/CM's change order estimate was thoroughly reviewed.

Finding 1-B: POS's Failure to Timely Process Change Orders and Poor Change Order Documentation Resulted in an Overpayment of \$105,535.50.

The change order highlighted by the Performance Auditor represents a negotiated agreement for services by a commissioning agent retained to test the aircraft fueling system and ensure that it was performing properly. This work was undertaken on behalf of the Port, the fueling system contractor and the airline consortium that ultimately funds, owns and operates the fuel system. The change order was not untimely; although the need for the commissioning agent was discussed early in the contract, the change order was not negotiated and signed until the commissioning agent's services were needed and could be accurately defined.

The need for expert commissioning agent services on this project was particularly acute. This major project was the last piece of a \$79 million program to construct and begin operation of a fuel system that serves 73 gates and 96 aircraft parking positions at the Seattle-Tacoma International Airport. At the completion of the project, each of these 155 locations would be served by fuel hydrants, and the need for fuel trucks on the airfield would be eliminated. It was necessary to retain an experienced commissioning agent to ensure final system safety and efficiency. The tolerances associated with this project were extremely tight given the serious consequences of any leaks or system failure.

The Port agreed to pay 75% of the cost of the commissioning agent's services after carefully considering the specific tasks performed by the commissioning agent and reviewing the supporting documentation submitted by the contractor. Based on this review, and negotiation with the contractor, the Port concluded that 75% of the commissioning agent's effort was the Port's responsibility. Thus, the Port did not overpay \$105,535.50. In fact, the Port typically pays for 100% of the costs for commissioning. It was only as a result of proactive, early analysis that the Port recognized that a portion of the services would benefit, and thus should be paid by, the contractor. The Performance Auditor's finding is predicated on non-contractual, internal documents such as emails and construction trends in which the need for commissioning

agent services was first identified. These preliminary documents do not govern the Port's financial obligations; the contract change orders do.

Finding 1-C: POS Failed to Obtain an \$80,000 Credit When Original Scope Work Was Deleted, and POS Wrongly Issued a 329-Day Time Extension for Work That Was Never Performed.

The Port agrees that it overlooked a credit for certain work deleted from the contract and that some documentation substantiating change orders related to this contract was lacking. However, the amount of the credit to which the Port would have been entitled was less than \$80,000. The contractor performed some of the work and provided all of the materials included within the original scope of work valued at that amount. The Port disagrees that it wrongly issued a time extension for that work.

The issue raised in this finding relates to the installation of a fire protection system for the large fuel tanks located at the south end of the Airport. The work required close coordination between the Port, the contractor and the airline consortium that operates the fuel farm. Early in the project, the parties determined that the prescribed method for installation of the fire protection system would be unsafe because the work would be performed on fuel-filled tanks. As a result, the Port deleted this installation through a change order and obtained an approximately \$80,000 credit from the contractor. In the meantime, the Port's designer attempted to identify installation alternatives.

From that effort, the parties agreed that the work could be performed on empty fuel tanks if a protocol for cleaning, inspection and repair inside the fuel tanks also was observed. However, due to constant operational demands, the fuel tanks could not be emptied and turned over to the contractor. Instead, the parties agreed that a phased work rotation over nearly 12 months would be required.

As a result, a second change order was executed to rescind the deletion of the original installation. This second change order also added the additional cleaning, inspection, and repair, and a time extension to do the work.

Ultimately, the airline consortium was not able to make the tanks available due to its operational demands. As a result, the Port executed a third change order again deleting the original installation, as well as the cleaning, inspection and repair required by the second change order. However, in deleting that work, the Port did not recapture any credit for the work deleted by the first change order but added back by the second. The credit to which the Port was entitled, though, was less than the full \$80,000 reflected in the first change order. Following the execution of the second change order, the contractor did perform a portion of the work and delivered to the Port all of the materials required to complete the work.

The Port was not entitled to rescind the time extension for this work because the contractor remained mobilized on site to undertake the work after the second change order and did, in fact, order materials and perform a portion of the work during this

period. This mobilization status continued at no cost to the Port until this work was again deleted in the third and final change order.

This background information does not excuse the fact that the Port overlooked a credit for the deleted portion of the work. However, it does explain the context in which this situation occurred and establishes the contractor's entitlement to the time extension despite the ultimate cancellation of the work. The Port is investigating alternatives for recovery of a credit for that portion of the work that was not performed.

Finding 1-D: POS's Inadequate Review of Change Order Proposals Resulted in Overpayment of Contractor Markups.

The Port agrees that it overlooked contractor markups in excess of the proscribed amounts on three change orders – two of which the Port discovered based on the Performance Auditor's draft finding. As a result, the Port has issued a deductive change order to recover from the contractor the \$8,890.50 that was overpaid on these three change orders.

The Port readily acknowledges these errors, but does not believe that they reflect an overall lack of rigorous review of contractor change order proposals. Particularly on small change orders such as those involved with these examples, the Port utilizes a cost analysis to determine the validity of the proposed change order amount. While the Port's construction management staff analyzed the direct costs associated with these three change orders, they overlooked the errors in the standard overhead markups.

Finding 1-E: POS Altered Contractor Invoices in Order to Pay a Contractor for Work that Exceeded the Amounts Authorized by Law and in Violation of the Commission's Delegation of Authority.

The Port substantially agrees with this finding. Port staff moved invoices for work authorized under one small works contract to another for payment. While this conduct violated the Port's internal delegation of authority policy, it did not violate Washington law. The contractor performed the work and was entitled to payment. At the time the work was authorized, Port staff estimated that the cost of the work would be less than the small works contract limit. When the work proved to be more expensive, Port staff should have disclosed the overrun and obtained Commission authorization to amend the small works contract to cover the amounts in excess of the small works contract limit.

Response to Recommendations

Performance Auditor's Recommendation	Port Response to Recommendation
<p>1. We recommend that [the Port] immediately implement and strengthen control procedures to assure that Engineers' change order estimates are (a) prepared without knowledge of the contractors' proposed amounts, and (b) change order estimates and cost analyses are fully and completely documented. Where cost or price analysis is used to evaluate change order proposals, [the Port] should require full and complete documentation of these reviews, including fully documented supervisory reviews and approvals.</p>	<p>The Port will review its change order control procedures and will implement changes where warranted to ensure alignment with industry best practices. The Port has already begun, and will continue, to make improvements as part of the 37-point action plan from the TKW performance audit, and it will incorporate the Performance Auditor's additional recommendations into that action plan as appropriate. The Port agrees that independent estimates, cost analysis and secondary reviews of contractor change order proposals are vital to transparency and accountability and will ensure that these estimates and reviews are well-documented in the files.</p>
<p>2. We recommend that [the Port] undertake a review of all major recent and ongoing projects to identify cases where engineers' estimates and contractors' proposed amounts are consistently the same and, in such cases, undertake a further evaluation of the underlying causes; followed by remedial actions as appropriate.</p>	<p>The Port has begun a review of change orders and trend logs to identify similarities between Port estimated costs and contractor proposed amounts. The Port will take remedial action as appropriate and also apply the process improvements described above in Recommendation 1.</p>
<p>3. We recommend that [the Port] revise its SOP Manual to include specific guidelines for proper and accurate change order documentation. [The Port] should provide training to its consultant staff/construction managers to improve the manner in which [the Port] is documenting project change orders.</p>	<p>The Port has begun revising its construction Standard Operating Procedures Manual as part of its TKW performance audit action plan. Specifically, this revision will include more guidelines for change order negotiations and documentation. Port staff will receive necessary training to support these new guidelines.</p>
<p>4. We recommend that [the Port] develop Standard Operating Procedures (SOPs) that align with industry practices. Current [Port] SOPs do not provide adequate</p>	<p>As noted in the Port's response to Recommendation 3, the Port has begun revisions to its procedures manual to better conform to industry best practices.</p>

information regarding change order negotiations.	
5. [Port] management should take immediate steps to assure that [the Port] rigorously enforces all contractual schedule requirements. Then, when requests for time extensions are made, they can and should be properly evaluated. [The Port] should also provide more oversight of the Change Order process to ensure that estimates are properly created and used.	The Port will review its practices of contract schedule enforcement and the evaluation of time extension requests to identify where further improvements can be made. The Port will pay specific attention to the practices of other state and local agencies with respect to scheduling and enforcement when conducting this review.
6. We recommend that [the Port] immediately cease its informal method of resolving change order differences, and that [the Port] improve its change order documentation requirements to include that details of change order negotiations must be based on discussions of scope/means and methods/pricing differences.	The Port concurs that change order negotiations should be based on all relevant factors, including formal schedule, scope, means, methods, pricing, and operational considerations. Improvements to standard procedures that are underway will emphasize change order documentation training, including a focus on the above factors.
7. We recommend that [the Port] undertake a review of the change orders negotiated and approved under all contracts to determine if there were other incorrect mark-ups on change orders.	The Port will undertake additional review of change orders using procedures consistent with accepted auditing standards to determine whether other incorrect mark-ups on change orders exist.
8. We recommend that [the Port] improve its management information systems to provide more accurate and up-to-date information regarding project and contract expenditures. [The Port] should develop a better means for tracking actual project expenditures against initial estimates to prevent unforeseen cost overruns.	The Port will review its management information systems to ensure that information available to project managers is accurate and up-to-date, and will make improvements as necessary. The Port will conduct a systematic review of the small works program to improve timely tracking of actual project costs on contracts. There will be an emphasis on providing safeguards to preclude work authorizations from exceeding the contract amount.
9. We recommend that [the Port] develop and include in all contracts a “cost limitation” clause that advises contractors that they should not accept work authorizations or perform any work that would result in exceeding the maximum amount of the contract.	The Port will strengthen the language limiting the contract to the stated amount and ensure that this revised standard is consistently included in all contracts.

<p>10. We recommend that controls be implemented to prevent specific companies from being added to randomly-generated [Port Construction Services] bid lists by project management personnel.</p>	<p>The Port disagrees with this recommendation. Except to advance important societal objectives like those reflected in the Port's small business contracting initiative, the Port does not believe that it is in its best interest to preclude interested bidders from competing for Port contracts.</p>
<p>11. We recommend that [the Port] evaluate all of its [Port Construction Services] contracts during the past three years to determine other instances where the practice of lapping contractor invoices occurred and take appropriate corrective actions.</p>	<p>The Port will undertake an internal audit of Port Construction Services contracts to determine whether additional lapping of contractor invoices occurred. The Port will take corrective action as warranted.</p>
<p>12. We recommend that [the Port] conduct a more detailed investigation of this contract SWV-311608 to determine how and why the preferred electrical contractor was added to the bid list, contact the other bidders on the list to determine if they were aware of the procurement, and initiate follow up actions as appropriate.</p>	<p>The Port will review this contract and take action as appropriate.</p>

Response to Major Finding 2

Major Finding 2: POS Frequently Circumvents Competition Requirements in Violation of Its Own Policies and Sometimes in Violation of State Law.

The Port agrees that fair competition for its contract opportunities is vital. Competition saves money for the taxpayer, improves contractor performance, curbs fraud, and promotes accountability for results. Washington state policy strongly favors competition, and the Port has adopted procurement policies that share this value. The Port also strictly complies with the requirements of Washington law.

Evidencing its commitment to competition, the Port publicly advertised all 57 major construction contracts (totaling almost \$850 million) and solicited quotations through Port Construction Services for all 217 small works construction contracts (totaling \$26.4 million) during the 2004 - 2006 period subject to this performance audit. During the same period, the Port also subjected 918 consultant agreements (totaling \$645 million) to public competition. The Port also publicly solicited proposals for a large variety of opportunities to operate concessions and businesses at its facilities. During this time, those opportunities included major food, beverage, and service concessions at the Airport, car rental concessions at the Airport, and a new, full-service restaurant to be constructed at Shilshole Bay Marina.

The Port acknowledges a need for more consistent and complete documentation in the Port's competitive selection process for consultant agreements. At the request of Port management, an internal audit was conducted on Port practices for consultant agreements.⁴ The report from this audit was published in August 2007, identified a number of instances where Port policies were not adhered to, and recommended areas for improvement, including better documentation and enhanced oversight. In its response, management established a corrective action plan that includes:

- Requirements for more detailed statements of work;
- Added review of consultant agreement scope and duration prior to execution of amendments; and
- Enhanced procedures to mitigate risk from non-compliance.

The Port believes that this renewed focus on consultant agreements will strengthen compliance, further accountability, and conform to industry best practices.

⁴ This audit is distinct from the independent performance audit conducted by TKW. The internal audit was conducted by the Port's own internal auditor – a former employee of the Washington State Auditor's Office who received the SAO Employee of the Year award and whose experience includes six years as a Regional Audit Manager – and her staff.

During the course of this performance audit, there has been some confusion regarding the procurement laws that apply to Port districts (as opposed to other public entities) and the particular application of those laws. While the Performance Auditor states that the Port violated certain statutes, the Port – based on the advice of its legal counsel – believes that it has complied with the relevant statutes.⁵ The issues raised in this finding relate primarily to the Port inconsistently following its own policies relating to the procurement of professional services. These policies exceed statutory requirements in many respects. The Port believes that the high priority it places on compliance is well-documented through numerous outside audits conducted by the Washington State Auditor’s Office and federal grant auditors. However, the Port welcomes further conversation with the Washington State Auditor’s Office to better clarify these matters.

Response to Detailed Findings

Finding 2-A: POS Circumvents Competition Requirements by Awarding Contracts at “Less Competition Required” Levels and then Amending the Contracts to Higher Levels, Splitting Purchases, and Awarding Sequential No Competition Contracts.

The Port acknowledges that there have been instances in which it has violated its own procurement policies. Although many of the specific examples listed reflect inadequate documentation rather than an absence of competition, Port staff has sometimes failed to meet the requirements of its purchasing policies in the manner indicated by the Performance Auditor. The Port earlier identified these problems through its internal audit program and is already implementing a corrective action plan to ensure its procurement policies are followed consistently.

The Port does not, however, believe the problems are as prevalent as indicated in the finding. For example, the Performance Auditor relied on raw data from the PeopleSoft Financial System to indicate the level of competition in selecting consultants. PeopleSoft is the Port’s financial accounting and project costing information system. The data in this system is not designed to document the level of competition utilized with respect to a particular contract; that information must be obtained from the actual contract files. By way of example, the Performance Auditor makes determinations about one agreement (P-00307510) based only on the initial contract amount. However, the contract file for that agreement contains evidence of open, public competition.

Similarly, a large number of agreements with a particular firm for less than \$50,000 does not evidence an intent to avoid procurement policies. For example, the Performance

⁵ The Port’s position is supported in materials published by the Washington State Auditor’s Office. See Washington State Auditor’s Office, *Competitive Bid Laws*, p. 24 (September 20, 2005) [available at <http://www.sao.wa.gov/LocalGovernment/BidLawGuidance/BLGuidance-2005.pdf>]. While the Port has adopted comprehensive purchasing policies that require competitive procurements in most situations, the Port is statutorily required to bid public works projects and contracts for architectural and engineering services. It is not – like most other public entities – required to bid other services and may generally procure materials, supplies and equipment in the open market.

Auditor notes that the Port executed 77 contracts for less than \$50,000 with two firms during a two-year period. However, those two firms provide professional services in the area of information technology, and each agreement was for a separate, discrete scope of services. Moreover, even though not required, in most instances the Information and Communications Technology department obtained at least three proposals for each agreement.

Finding 2-B: A Consulting Agreement Awarded in 1993 Grew without Competition from \$950,000 to More than \$30 Million.

The Port disagrees with this finding. This consultant was originally selected to provide Third Runway design services through a publicly advertised Request for Qualifications (“RFQ”), to which nine consultant firms, including some of the largest design firms in the country, responded. The Port’s intent, which was transparent to all proposers, was to select a consultant that would provide design services for the entire project over many years. However, due to ongoing litigation over the project and uncertainty regarding the schedule, the Port’s RFQ made clear to the consultant community that any additional design work was not guaranteed. Although focusing on issues of preliminary design, the RFQ communicated to the consultant community that the competition extended to complete design services⁶ and specifically targeted experience with, and ability to manage, the design of major runway projects.

Best industry practice on a project like the Third Runway recommends against attempts to negotiate the complete package of design services at the beginning of the consultant agreement. On complex, multi-year capital projects like the Third Runway (especially ones subject to repeated, ongoing litigation), it would be impossible to do so. Instead, best industry practice – as followed by the Port – is to negotiate services for successive tasks as the project progresses.⁷ The approach suggested by the Performance Auditor

⁶ The Request for Qualifications stated on page one:

Because construction of the project has not been authorized by the Port Commission, no level of work beyond the initial study and preliminary scoping is guaranteed. If a project becomes authorized the Port may, at its option, retain the selected consultant to complete further design on the project and other related work.

The Port later reiterated that a “subsequent contract for further design may be awarded to the selected consultant” and made clear that work related to the Third Runway design could also “be assigned to the selected consultant at the option of the Port.”

⁷ For example, the Washington State Department of Transportation specifically states:

In the case of projects covering two or more distinct phases, when the cost for the second phase depends on decisions reached during the first phase, the agreement should cover only the first phase. ***The agreement for preliminary engineering should state that the consultant may be considered for subsequent phases provided this option was identified in the advertised solicitation.*** The consultant’s engagement to complete subsequent phases depends upon the consultant’s satisfactory performance on prior work and upon negotiation of an agreement for the subsequent phase(s).

WSDOT, *Local Agency Guidelines*, p. 31-3 (October 2007) [emphasis added]. In addition, the American Society of Civil Engineers holds: “it is usually best for the client to select a consultant who can support the project from conception through design, construction, and project startup. This continuity... adds to the success of the project.” American Society of Civil Engineers, *How to Work Effectively With Consulting Engineers: Getting the Best Project at the Right Price*, p. 5 (rev. ed. 2003).

would significantly increase risk to and project design costs for the Port. Using a succession of firms to develop project design documents would be highly inefficient and is contrary to best industry practices.

Finding 2-C: A Consulting Agreement Awarded in 1998 Grew without Competition from \$10 million to More than \$120 Million and Is Being Used to Augment POS Staffing at Considerable Cost.

This consulting agreement to augment staff is consistent with best industry practices and was competitively awarded by the Port. The Port specifically sought to minimize cost throughout the course of this agreement, but cost is only one factor among many relevant to the effective management of the large, complex capital program at the Airport.

Developing and managing projects in a major airport is extremely complex as a result of the 24-hour, 365-day operation of the Airport, and as a result of the specialized and technical nature of the work involved in meeting the needs of aircraft operations, passenger service, subway and baggage systems, and passenger security. These types of large airport projects must be sequenced and phased and as a result, each can require many years before construction is complete.

Airports do not have adequate staff resources to manage huge, limited-term construction programs and as a result, must augment staff with additional resources to carry out the work. This program management approach is consistent with best industry practice,⁸ and airports in Atlanta, Baltimore, Washington, DC, Los Angeles, San Diego, and San Francisco have all used similar nationwide competitions to augment their staff over many years. The applicability of this common and successful industry practice was extensively researched by Port staff and adopted for use in connection with the Airport's capital improvement program.

The Port consciously chose to use an open, national competition for this contract. In 1998, the Port publicly advertised for a Program Management Support Consultant ("PMSC") to augment Port staff over the coming decade to help manage over 120 large multi-year projects at the Airport. The Port assured a competitive and transparent process by noting the long duration of the contract in both the public advertisement and in public

⁸ For example, the American Society of Civil Engineers states:

One approach commonly used is called *program management*. Under program management, clients recognize that they do not have the expertise to pull together all of the elements required to complete a project. The client retains a program manager to perform specialized tasks necessary to develop or construct a specific project. Moreover, the client may retain a program manager to develop, define, and oversee the program; prepare budgetary estimates of program costs; prepare program schedules; evaluate and select members of the program team; and provide periodic program status reports. In other cases, the program manager's staff interacts with – and serves as an extension of – the client's staff throughout the life of the program.

American Society of Civil Engineers, *How to Work Effectively With Consulting Engineers: Getting the Best Project at the Right Price*, at p. 4.

Port Commission authorizations. Four major national firms responded to the advertisement and participated in the competitive process.

The winning firm incorporated many separate subconsultants within its team to ensure that the work could be performed by both local and specialty consultants. It was determined that the first year of the PMSC contract work would involve assessing the many projects to determine the extent of the work ahead while beginning the staff augmentation process with key individuals.

In 1988, the Port's Aviation Project Management staff consisted of 20 employees. That staff did not have expertise in a large number of areas needed to manage the projects included in the Aviation Capital Improvement Program. By contrast, at the peak of the Program in 2003, there were a total of 154 people working within the Aviation Project Management Group. In order to support this steep growth curve, the Port made the decision to utilize the PMSC because:

- Some of the necessary technical skills were not readily available in the local labor market. For example, the Port was required to look nationally to find experienced project management staff for its subway and access control systems.
- The Port did not believe it could attract sufficient qualified personnel within Port pay ranges. For example, the Port sought to hire one of the first consultants retained for the Airport projects, but he was unwilling to work within the salary range offered by the Port. More recently, the Port has advertised for cost control managers for five months but has been unable to attract any interest within the salary range offered. The first candidate requested a salary larger than that of the Director of the Aviation Capital Improvement Program.
- The Port wanted to avoid the need for repeated hiring and layoffs to match the varying needs of the program over time. For example, in the period following September 11, 2001, the Airport suffered a serious decline in business. As the Port elected to defer projects, it was able to rapidly scale back its consultant staff to match the reduced demands. In addition, over 220 consultants under the PMSC contract were retained for less than 18 months. If these consultants had instead been hired and laid off, the Port would have (in addition to internal staff costs associated with the hiring and layoffs) incurred costs associated with the layoffs of almost \$3.0 million under Port Policy HR-10 which relates to reductions in force.
- Some of the disciplines required were very specialized and would not be required beyond a few select projects. For example, the needs for expertise in the area of design and construction of fiber optic backbones, design and construction of aircraft fueling systems, and standards for terminal architectural finishes were limited in duration.
- For certain specialized skills, the Port's need was long-term but less than full-time. For example, the Manager of the Port's Project Labor Agreement for the Airport's Capital Improvement Program is nationally recognized and spends only a portion of his time managing the Airport's Project Labor Agreement. The

remainder of his time is utilized by other owners on other large capital projects around the nation.

- The PMSC could use the vast resources of each of the many partner firms to scale up more rapidly than the Port could in order to meet project deadlines. The PMSC and its pool of both local and national consultants have literally thousands of employees that could be rapidly deployed to the meet the emergent needs of the Airport's capital program. In contrast, the Port's standard hiring practice – from the first identification of the need to actually having the employee on board – regularly runs 8 – 12 weeks or longer.

The Port Commission approved this approach in 1998 and has affirmed this decision in public meetings annually since that time.

Recognizing the additional costs associated with the long-term use of consultants, the Port proactively looked for opportunities to develop its internal project management and engineering staff capabilities, and the Port Commission directly supported this goal by authorizing new hires when the benefit could be demonstrated. The Port sought to hire, develop and retain employees that would be required over the entire course of the capital construction program and beyond.⁹ This included both junior and senior project managers as well as engineering employees in the area of survey, safety, construction management, and contract administration. Over the course of the PMSC agreement, the Aviation Project Management Group added about 30 employees and the Engineering Department added about 40 employees to support the capital program. These hires enabled the Port to significantly reduce the number of consultants required under the PMSC agreement. These efforts saved the Port \$38 million.¹⁰

The method by which the Port compensates the PMSC is also consistent with best industry practices. The Municipal Research and Services Center¹¹ states that “salary cost times a multiplier” is “a frequently used method for compensation for professional services” that is particularly suitable to work – like that performed by the Port's Program Management Services Consultant – “in which the scope of services is not well

⁹ It is worth noting that the use of PMSC consultants as part of an integrated project management staff also provided training opportunities within the Port that otherwise would not have been available. Port employees with less experience were able to work alongside seasoned experts with national experience.

¹⁰ This total is calculated as follows: The Port uses an average hourly rate associated with PMSC consultants of \$95.00 per hour and an average burdened rate associated with its employees of one-third less (i.e. \$63.33 per hour). The resultant difference in hourly rates is multiplied by the number of hours per year the difference would be paid (i.e. 1725), the number of employees (i.e. 70) and the number of years (i.e. 10 – 1998 through 2007) for a total estimated savings of \$38,241,525.

¹¹ The Municipal Research and Services Center (“MRSC”) is a non-profit, independent organization created in 1969 to continue programs established in 1934 under the Bureau of Governmental Research at the University of Washington and whose mission is “working together for excellence in local government through professional consultation, research and information services.” By contract, the MRSC staffs and provides all services to the Municipal Research Council, a state agency that provides a comprehensive research and services program for the 281 cities and towns and 39 counties of Washington State. The MRSC is funded entirely by municipal entities in Washington.

defined.”¹² In addition, the Port negotiates those rates every year, specifically considering both market rates for similar services and the performance of individual consultants.

In closing, the Port acknowledges the minor inconsistencies in terminology identified by the Performance Auditor in PMSC invoices and has taken corrective action.

Finding 2-D: POS Awarded a \$1.4 Million Consulting Agreement without Evidence of Competition and Awarded a \$2.7 Million Consulting Agreement without Competition.

The consultant construction managers to which this finding applies were both selected through competitive processes. While documentation associated with the selection of one of these consultants was lost or destroyed in the course of repeated construction office relocations, the Port substantiated the competition process used for that selection through the statements of people involved and records located outside the official selection files. The processes used for both met the requirements of applicable laws and the Port’s procurement policies.

The Performance Auditor asserts that competition did not occur when the individual consultants, who had participated and won competitively bid contracts, changed firms. In this case, the Port had selected specific individuals as the “most highly qualified to provide the services required.”¹³ As a result, it was appropriate for the work to follow the selected consultant, and the Port managers responsible for these contracts specifically obtained the opinion of the Port’s General Counsel that such an approach was consistent with law and Port policy.

Finding 2-E: POS Altered Contractor Invoices in Order to Pay a Contractor for Work that Exceeded the Amounts Authorized by Law and in Violation of the Commission’s Delegation of Authority.

The Port substantially agrees with this finding. Port staff moved invoices for work authorized under one small works contract to another for payment. While this conduct violated the Port’s internal delegation of authority policy, it did not violate Washington law. The contractor performed the work and was entitled to payment. At the time the work was authorized, Port staff estimated that the cost of the work would be less than the small works contract limit. When the work proved to be more expensive, Port staff should have disclosed the overrun and obtained Commission authorization to amend the small works contract to cover the amounts in excess of the small works contract limit.

¹² Municipal Research and Services Center, *Contracting for Professional Services in Washington*, pp. 16-17 (April 1994) [available at <http://www.mrsc.org/Publications/cpserv.pdf>].

¹³ See RCW 39.80.040; Port Policy PUR 2 (“most qualified”).

Finding 2-F: The Small Works Roster Program Has Resulted in Repeated Awards to the Same Contractors. The Small Works Random Rotation Process Can be Circumvented to Allow Preferred Contractors to be Added to Selection Lists. The Solicitation Invitation Process Can be Circumvented.

The Port has awarded all of its small works contracts to contractors that have submitted the low, responsive bid. This is consistent with Section 39.04.155 of the Revised Code of Washington, which governs the small works bidding process for all public entities. Pointing to different language in Section 53.08.120 of the Revised Code of Washington, the Performance Auditor indicates that the Port should have been making contract awards based on criteria other than the low bid, in order to distribute the contracts equally among the contractors on the small works roster. Given the Port's commitment to competition, long-standing policy has been to award the contract based on the low bid. The Port will look carefully at the suggestion that it distribute contracts among firms on the small works roster. This appears to link to the Port's small business contracting initiative, which was also examined as part of the TKW performance audit.¹⁴ While the Port has been very successful at involving small, women's and minority business enterprises in its small works contracting process through its current approach – in fact almost 24% of small works contract dollars went to small, women's or minority business enterprises during 2004 – 2006¹⁵ – this an area where the Port hopes to further improve.

In response to the Small Works Roster Program rotation recommendation, the Port is currently reviewing the rotation process and making appropriate revisions to eliminate any ability to circumvent contractor rotation in the small works bidding. These revisions will result in greater transparency and may result in increased competition for small works contracting opportunities.

Response to Recommendations

Accountability and controls are vital in any organization to ensure policies and procedures are followed. The Port shares the belief that its employees must consistently follow procedures. In that spirit, the Port has already constructed an action plan in response to earlier findings of its own internal auditor and will augment that plan as necessary to incorporate validated recommendations of the Performance Auditor.

Performance Auditor's Recommendations	Port Response to Recommendation
13. We recommend that [the Port] take immediate steps to review and enforce its policies and procedures for awarding and	This recommendation is consistent with the action plan from the Port's internal audit. The Port will review and enforce its

¹⁴ The TKW performance audit is discussed in more detail above in footnote 1 and the associated text.

¹⁵ Of the \$26,375,672 of small works contracts awarded by Port Construction Services during that three year period, \$1,050,090 went to small business enterprises, \$2,436,317 went to minority business enterprises, and \$2,793,995 went to women's business enterprises.

amending [professional services agreement] contracts and establish controls to ensure that competition requirements are not circumvented.	procedures for awarding professional services agreements and strengthen controls to ensure compliance with Port procurement policies.
14. We recommend that [the Port] initiate a comprehensive review of all [professional services agreements] to determine the full extent to which competition requirements have been circumvented, and take appropriate corrective actions.	The Port will undertake additional review of professional services agreements using procedures consistent with accepted auditing standards to evaluate whether other instances of non-compliance exist and will take corrective action as warranted.
15. We recommend that [the Port] revise [Purchasing Policy] PUR-2 to incorporate a limit on the size allowed for amendments to Category 3 and Category C contracts so that a legal review becomes necessary before a contract is allowed to exceed a specified limit. That review should be designed to assure that: <ul style="list-style-type: none"> 1. The project scope of work is not being divided into smaller segments to avoid PUR-2, statutory, or delegation of authority procedures. 2. The increased amended consultant responsibilities are generally related or associated with the project scope utilized in the original consultant selection. 	The Port agrees that large professional service agreements should have additional controls to ensure amendments are consistent with original scope and prevent inappropriate contract segmentation. The Port will evaluate what kind of controls are most effective.
16. We recommend that [the Port] (a) determine the extent to which costs in violation of Federal grant requirements have been claimed for reimbursement and received from DOT and other Federal agencies, (b) notify applicable Federal grant officers of these violations, and (c) initiate corrective actions prescribed by Federal officials.	The Port has been subject to extensive external audits with respect to both its financial statements and federal grant compliance by public accounting firms (who themselves are subject to regular review by the federal government). These audits, which include rigorous internal controls testing of major risk areas, have not identified any material compliance or accountability concerns involving federal grants. While this performance audit did not identify any violations of federal grant requirements, if, in the course of investigating and following up on these findings and recommendations, the Port discovers any federal grant violations it will take prompt and appropriate action,

	including notification to applicable agencies.
<p>17. We recommend that [the Port] undertake a review of all of its professional services agreements to assure that:</p> <ul style="list-style-type: none"> ➤ Such agreements comply with State law in terms of being for specific [Port] requirements rather than being used as supplements of [Port] staffing, ➤ The agreements are being administered in strict conformity with contract provisions and requirements, ➤ The contracts contain defined labor category qualifications, and ➤ Contract files are complete and maintained by [Port] employees rather than contractor personnel. 	<p>The Port will undertake additional review of professional service agreements using procedures consistent with accepted auditing standards to ensure compliance with applicable statutes and Port policy. The Port will also ensure that agreements are administered in conformance with contract provisions and requirements and contain all relevant rates. The Port will also ensure that contract files are complete, but separate supporting files will hold the qualification information (degrees, experience, etc.) related to labor category rates.</p>
<p>18. We recommend that [the Port] establish a policy whereby, before contracting for consultant services, [the Port] perform a cost analysis to determine if the required work can be more economically performed with [Port] personnel. (We suggest that [the Port] study and adapt Federal Office of Management and Budget Circular A-76 for this purpose.)</p>	<p>The Port will take this recommendation into consideration in reviewing its existing consultant policies and procedures, given that cost is not the only factor used in considering the use of consultants. The Port will note its reasoning for retaining outside consultants within the set of documentation files that support actual future agreements. For example, documentation will include whether the consultant has been hired as a result of having special expertise not found among the Port staff, or hired because existing Port staff do not have enough available time to perform the work, etc. For full-time consultant assignments longer than twelve months, the documentation will consider the potential benefits or risks of hiring a new Port staff member to perform the work. The Port will also review OMB Circular A-76 for applicability.</p>
<p>19. We recommend that [the Port] add the following procedures to the list of procedures being performed during the invoice approval process for the PMSC contract and other [professional services agreements], as appropriate:</p> <ol style="list-style-type: none"> 1) Assure that all personnel being 	<p>The Port agrees and has implemented the recommendation.</p>

<p>billed have been approved to work on the contracts based on the most recent annual review or work authorization.</p> <p>2) Assure that labor categories and rates being billed do not exceed the contractually stipulated labor categories and rates.</p>	
<p>20. We recommend that [Port Construction Services] develop a means of tracking the award of contracts to ensure that a majority of the work isn't being repeatedly awarded to the same contractors.</p>	<p>Port Construction Services does track contract awards and has information available on the distribution of both contracts and the contract dollars awarded. The Port notes that the current distribution is based entirely on award to the responsible bidder submitting the lowest price. Nonetheless, the Port will evaluate the distribution of Small Works Roster Program awards and will also look carefully at the suggestion to distribute Port contracts on a basis other than low bid. In fact, this appears to tie to the Port's small business contracting initiative. However, since this change raises a major policy issue, it will require careful consideration by and discussion with the Port Commission and local stakeholders.</p>
<p>21. We recommend that Small Works Roster program controls be established to assure that the random rotation process cannot be circumvented to allow preferred contractors to be added to the selection list.</p>	<p>The Port disagrees with this recommendation. Except to advance important societal objectives like those reflected in the Port's small business contracting initiative, the Port does not believe that it is in its best interest to preclude interested bidders from competing for Port contracts. The Port is, however, currently reviewing the rotation process and making appropriate revisions to eliminate any ability to otherwise circumvent that process.</p>
<p>22. We recommend that [Port Construction Services] require contract files to include email and fax confirmations for the advertisements as proof that invitations to bid are actually received by potential bidders.</p>	<p>Although currently complying with all legal requirements related to the advertisement of small works contract opportunities, Port Construction Services agrees with this recommendation and will improve its documentation associated with advertisements and bid notice</p>

	communications. Port Construction Services intends to integrate this documentation into the Small Works Roster Program.
23. We recommend that [Port Construction Services] create controls in the Small Works Roster Program to ensure that all procurements are advertised (i.e. that solicitations are actually distributed to potential bidders as required).	See response to Recommendation 22.
24. We recommend that [Port Construction Services] develop consistent bid evaluation criteria, particularly when the descriptions of work state that “[Port Construction Services] is unable to determine the precise types of work that may be performed under this contract at this time.”	The Port will review and evaluate its process regarding open order contracts and make changes as appropriate to ensure fair competition among all potential bidders.

Response to Major Finding 3

Major Finding 3: POS Policies and POS Management’s Interpretations of Its Policies Result in a Lack of Transparency and Thwart Commission Oversight of Construction Management Activities.

Transparency, accountability and oversight are essential in a public organization such as the Port. By law, all of the powers of the Port reside with the Port Commission. The Port Commission is elected by, and answerable to, the citizens of King County. While the Port Commission is empowered to delegate some of its authority and duties to staff, it must establish “guidelines and procedures” for staff to follow.¹⁶ It is these “guidelines and procedures” that ensure the actions of staff are visible to, consistent with the intentions of, and ultimately subject to review and revision by the Port Commission. Port staff clearly understands this dynamic and honors its responsibility to both obtain authority and direction from the Commission and adhere to the Commission’s charted course.

The “master policy directive” by which the Commission has delegated its authority and responsibility to staff is Resolution 3181.¹⁷ Resolution 3181 has existed substantially in its present form for 13 years and grants the Port’s Chief Executive Officer certain powers and duties, establishes limits on the Chief Executive Officer’s authority, and requires regular reporting to the Port Commission to ensure transparency and oversight. The historical record relevant to the Port’s capital programs does not support the assertion that Port staff has thwarted the Port Commission’s direction and oversight; on the contrary, that record demonstrates a strong history of compliance with the Port Commission’s protocols.

All major capital projects must be authorized by the Port Commission. Port staff briefs the Port Commission on these projects through both “policy and staff briefings” and formal requests for project approval¹⁸. Consistent with the size and complexity of the Port’s capital programs, this occurs with great frequency. In fact, during the past 12 months, capital projects accounted for 38% of the policy and staff briefings and 52% of the action items presented to the Port Commission. Focusing on a specific project, Port staff publicly briefed the Port Commission on the Third Runway Program 21 separate times.¹⁹ This included four policy and staff briefings and 17 separate requests for project approval and formal action.

¹⁶ See RCW 53.12.270.

¹⁷ The Chief Executive Officer has, as allowed by Resolution 3181, redelegated some of the authority granted by the Port Commission. These redelegations are captured in Port Policy EX-2.

¹⁸ In “policy and staff briefings,” no formal action by the Port Commission is requested. Instead, those briefing’s are an opportunity to review the accomplishments and challenges of particular projects or programs.

¹⁹ This number specifically does not include the multitude of private Port Commission briefings during executive session. Given the long history of litigation related to the Third Runway, the Port Commission

Beyond the examples noted above, the Commission exercises substantial additional review and oversight over the capital program. First, the Port Commission annually reviews and approves the Port's long-term capital budget as part of the budgeting process. This process includes presentations on the planned and ongoing capital expenditures, workshops related to those expenditures, and approval of an annual capital budget.²⁰ Second, Port staff – consistent with Commission direction – also provides formal updates on all project-wide authorizations in February and July of each year. A specific focus of these updates is discussion of those projects that have encountered budget, schedule, or scope changes since the last briefing. Third, the Aviation Project Management Group has, since 1999, also presented periodic progress reports on the Airport's Capital Improvement Program.²¹ Fourth, upon request of the Commission, Seaport staff has provided updates related to the Terminal 30/91 program at every regular public meeting for the past year.

The Commission also has online access to detailed capital project financial data through the Port's intranet. This information allows users to categorize and review all project costs. This financial data is supplemented by monthly cost reporting. For example, the Commission receives a monthly report related to the Aviation capital program that includes both narrative and quantitative data capturing monthly capital expenditures and costs-to-date for every project within the program. The Commission is also notified of all change orders over the amount of \$500,000 as they occur, and this notification was provided five times in the past 12 months.

Although questioned by the Performance Auditor, authority for project-wide authorizations was specifically granted by the Port Commission at the advent of the Port's large capital construction programs to allow the Port Commissioners to focus on policy issues, rather than day-to-day administrative activities. Prior to the adoption of project-wide authorizations, the Port Commission was required to approve each successive and often small step within each project. Foreseeing exponential growth in the number of projects due to the planned capital programs at the Airport and Seaport, the Port Commission elected to authorize the approval of specifically defined projects – not just individual contracts. So long as the project could be accomplished within the proscribed scope, schedule and budget, the Commission's approval extended to all work reasonably necessary. This approach was intentional on the part of the Port Commission and has been applied by the Port with great success for the past 13 years. For example, Port staff briefed the Port Commission earlier this year on the results of Phase 1 of the Aviation Capital Improvement Program and reported savings of \$37 million on the \$1.6 billion budget for the non-Third Runway Projects and \$50 million on the \$1.1 billion budget for the Third Runway Project.

was also provided regular, recurring updates regarding that litigation during executive session over the period.

²⁰ Port staff also provides the Port Commission with progress reviews against that budget each quarter throughout the year.

²¹ In October 2007, that briefing focused on the process for project authorization; the process for scoping, design, and cost estimating; the process for change order approval; and a discussion of the current \$87 million savings in all projects in Phase 1 of the Aviation Capital Improvement Program.

Port management carries out the policies of the Port Commission in a manner consistent with both the Commission's direction and intention. Port management also fosters appropriate review and oversight of its actions by the Port Commission. Looking forward, the Port's Chief Executive Officer will nonetheless engage his executive management team and the legal department to review the Commission's policies and seek ways in which the Port can further increase transparency and oversight. The Chief Executive Officer will then refer recommendations to the Port Commission for consideration and formal adoption.

Response to Detailed Findings

Finding 3-A: A 3rd Runway Procurement Violated Applicable Procurement Laws, and Details of this Unusual Procurement Were Concealed from the POS Commission.

Port staff met all of the requirements imposed by the Port Commission to ensure appropriate oversight and accountability with respect to the Third Runway Program. That major public infrastructure project was supported with careful analysis at every stage and pursued in a manner consistent with best industry practice and professional standards. Resolution 3181 was designed with these values in mind, and as outlined above, the Port Commission was fully informed about the Third Runway Program and its progress throughout the course of the project.

Unfortunately, as a result of construction market conditions prevailing at the time of bid, the Port received only one bid for the Third Runway 2006 embankment project. The Port acknowledges that its efforts to engage the only bidder in discussions prior to the award of the 2006 embankment contract were ill-advised, but the Port did so to further the public interest and ultimately complied with all applicable legal requirements. The Port also acknowledges that the memorandum provided to the Commission in connection with this contract could have been clearer. Although the memo was provided to the Commission specifically because the bid exceeded the Engineer's Estimate by more than ten percent, Port staff should have provided greater detail regarding the circumstances surrounding that bid.

Ultimately, all of the Port's efforts were motivated by a desire to protect the public interest and save money for our airline customers and the traveling public. As a result of its discussions with the contractor both before and after the execution of the contract, the Port was able to execute a change order that, in fact, saved the Port money on costs associated with mobilization/demobilization and further created the potential for savings in connection with variations in fuel prices. The Port calculates the total realized savings at \$2.1 million.

As indicated above, the \$1.1 billion Third Runway Program was undertaken with all due diligence, in a manner consistent with best industry practices, and with full Commission oversight. With respect to other aspects of the Third Runway Program that the

Performance Auditor questions but does not tie to his formal finding, the Port offers the following:

- The risk assessment associated with the Third Runway Program did recognize the potential for a lack of competition. Page 25 of the “Final Report, POS Sea-Tac 3rd Runway Risk Assessment” lists “lack of bidding competition (e.g., re paving).” Although the example provided relates to paving (and not the embankment), the noted risk applied to all components of the bidding. The recognition of this risk is also reflected in the Port’s efforts to create competition for the Third Runway Program generally. Indeed, one reason for separating the two embankment contracts was to decrease the overall contract size, thus increasing the number of contractors that would be able to bid.
- The “Engineer’s Estimate” – which is prepared as required by Washington law before proceeding with the public advertisement of a public works project – is distinct from the multiplicity of estimates that may otherwise be prepared during the development of a project at varying stages of design, with varying levels of supporting information. The \$80,888,000 estimate referenced by the Performance Auditor as the “initial” estimate was only a preliminary cost analysis. It was prepared in 2003. It did not have the benefit of a completed design, was stated in 2003 dollars, and did not account for inflation to the mid-point of construction. It also did not take into account market conditions prevailing at the actual time of bid in late 2005 – two and a half years later. The actual “Engineer’s Estimate” – which admittedly was significantly more – did not suffer from those deficiencies.
- The Performance Auditor provides no evidence to support the statement that the 2006 embankment contract may have been subject to a “collusive bidding arrangement.” On the contrary, all information available to the Port (and provided to the Performance Auditor) indicates that the single bid obtained for the 2006 embankment contract was due to marketplace forces, not collusion.
- The Port’s decision to require contractors to identify proposed fill sources was well-reasoned and reasonable. It was infeasible for the Port to do the environmental testing and certification for the many potential material sources in the region. Instead, the Port chose to let the owners of those resources and the marketplace determine the fill sources. The Port concluded that the large number of fill sources in the region would ensure active price competition. The Port worked actively to ensure that all of the pit operators and contractors in the region were aware of the Third Runway Program and its demand for imported fill material. As a hedge to this approach, the Port further considered the use of its own undeveloped properties in the vicinity of the Airport for fill material.

Finding 3-B: POS Management Is Not Providing the POS Commission with Reports on Contract Administration/Bid Irregularities and Information Related to Professional and Consulting Services as Required by the Commission's Delegation of Authority; and the Authority to Award Consulting Services Contracts Needs to be Clarified.

The Port substantially agrees with this finding. Although the Port has always provided the Port Commission notification of any bid irregularities when they arose, it has not provided the semi-annual reports required by Resolution 3181. These reports, however, would only summarize the same information the Commission previously received when the irregularity arose. Similarly, although the Port has historically provided the Commission with reports of professional and consultant services awarded and has continued to prepare such reports, it appears that the last four reports were not forwarded to the Port Commission. The Port has now remedied these oversights. These inadvertent and isolated examples, however, do not support the Performance Auditor's conclusion that Port staff generally limits transparency or thwarts Commission oversight. The Port will, nonetheless, consider reporting protocols as part of its discussions regarding revisions to Resolution 3181.

Finding 3-C: A PSA Agreement and Amendments to that Agreement were Approved in Amounts that Exceeded the Delegated Authority of the POS Managers Involved.

The Port Commission directly or indirectly authorized all of the work performed under this professional services agreement, and Port personnel acted within the scope of their delegated authority when completing that work.

Resolution 3181 represents the primary delegation of authority from the Port Commission to Port staff. As set forth in the preamble, Resolution 3181 is intended to vest responsibility and authority for regular day-to-day business transactions in the Port's Chief Executive Officer. However, Resolution 3181 is not an absolute limit on the authority of staff. The Port Commission may – and regularly does – delegate authority to staff in excess of the authority provided in Resolution 3181. With respect to capital project delivery, this additional authority may be provided on either an individual contract or project-wide basis.

Under a project-wide authorization, the Port Commission grants Port staff the authority to complete a specifically identified scope of work within a defined schedule and for a maximum dollar amount. The Port Commission delegates this authority to specific members of Port staff who are identified by title. This authority is separate from, and in addition to, the authority provided by Resolution 3181. Under a project-wide authorization, no further Port Commission action is required to complete the work identified so long as such work can be performed within the authorized scope, schedule, and budget.

With respect to this particular finding, all of the work at issue related to the Port's Terminal 18 redevelopment and specifically the north apron upgrade. The Port Commission authorized nearly all of that work in five open public meetings.²² In those five meetings, the Port Commission granted specific members of Port staff project-wide authority to complete the work. That delegation of authority specifically included the ability to contract for the "outside professional services" provided under the agreement at issue, and the specific staff persons to whom the Commission delegated its authority – or, in two cases, their direct supervisors – executed the original agreement and each amendment.

As such, all actions related to this consultant agreement were proper and consistent with the Port Commission's delegation of authority. Nonetheless, as mentioned previously, the Port will review Resolution 3181 and additional delegations of authority to ensure greater clarity on these matters.

Finding 3-D: A Major 3rd Runway Construction Contract Is being Managed by a Former Employee of the Contractor; and a Consultant Served on a Selection Committee that Awarded a \$5.8 Million Contract to One of His Company's Subcontractors.

Integrity and transparency are essential in the award and administration of public contracts. As a result, the Port has adopted an Ethics Policy for its employees and demands conflict-free services from its consultants by contract. The Port adopted its Ethics Policy more than 16 years ago and has revised it at least four times since then. The Ethics Policy parallels the ethics policy for Washington state employees, as adopted by the Washington State Legislature.²³ The Ethics Policy addresses the acceptance of gifts, potential misuse of position and conflicts of interest. Conflicts of interest are recognized to extend beyond purely financial ones and specifically include family relationships, gifts, and any other circumstance that may conflict with job-related duties. The Port's Ethics Policy includes an independent Ethics Board from which employees may obtain advice about particular conduct. The Ethics Board is also empowered to investigate complaints filed by anyone related to alleged ethics violations of Port employees.

The Port has evaluated the circumstances surrounding the two individuals identified by the Performance Auditor and concluded that they do not present ethics problems. In the first example cited by the Performance Auditor, it has been almost four years since the consultant – now employed by a national consulting firm of the highest caliber – was last

²² Specifically, the public meetings relevant to the particular consultant contract occurred on January 14, 1997, February 13, 2001, June 10, 2003, December 14, 2004, and August 8, 2006. The last, small portion of work performed under this agreement was undertaken under – and in strict accordance with – the small capital project authority granted by the Port Commission in Resolution 3181. As such, this small portion was not approved in a public meeting. With respect to that portion of the work, persons to whom authority was redelegated under Port Policy EX-2 authorized the small capital work projects and approved the amendments related thereto.

²³ See RW 42.52.

employed by the contractor now performing work for the Port.²⁴ That consultant severed all financial ties to his former employer and has repeatedly certified to the Port the absence of any conflict of interest. Likewise, the national consulting firm by whom he is now employed has covenanted conflict-free services. As measured against both the Port Ethics Policy and the ethics policy applicable to state employees, this consultant does not have a conflict of interest that would limit his work for the Port. Even still, the Port limits the authority of this consultant – as it does all consultants. Port employees are required to approve all contract decisions to ensure that they are always made in the Port’s best interests.

In the second example, the particular consultant was included in the seven person selection panel because of his expertise and responsibilities within the Airport’s capital program. The consultant never worked for the firm that the panel selected. Instead, the alleged conflict is based on unrelated contracts between the selected firm and the national consulting firm by whom the consultant is employed. Thus, the consultant not only lacked any financial interest in the selected firm but also lacked any direct connection to the selected firm. Again, as measured against the Port Ethics Policy and the ethics policy applicable to state employees, there is no conflict of interest.

Response to Recommendations

Performance Auditor’s Recommendation	Port Response to Recommendation
25. We recommend that the [Port] Commission revise Resolution 3181 to make it clear that, when circumstances requiring reporting under Paragraph V (Contract Administration/Bid Irregularities) occur, [the Port] should provide full and complete information and allow the Commission adequate time for deliberation and decision-making.	Port staff currently notifies the Port Commission of all bid irregularities and provides a window of time within which the Port Commission can consider and provide input on those irregularities. Nonetheless, Port staff will look for and recommend ways in which it can increase transparency and oversight by the Port Commission in connection with bid irregularities. The Chief Executive Officer will review these recommendations with the Port Commission for approval and formal adoption.
26. We recommend that the [Port] Commission re-evaluate the policy under which [Port] management has carte blanche approval and spending authority under project-wide authorizations regardless of project size and, instead, develop more sensible requirements for [the Port] to fully	In connection with project-wide authorizations, the Port Commission currently identifies the specific staff vested with authority to act and places bounds on that authority. Nonetheless, Port staff will review the practice of project-wide authorizations and recommend additional

²⁴ That contractor obtained its contract with the Port through competitive bidding. There is no suggestion that the consultant had any effect or influence on this outcome.

inform the Commission regarding significant or unusual expenditures of public funds.	notifications and/or limitations to ensure adequate oversight by the Port Commission. The Chief Executive Officer will review these recommendations with the Port Commission for approval and formal adoption.
27. We recommend that [the Port] begin preparing and providing the semi-annual report summarizing contracts awarded under Resolution 3181, Paragraph V (Contract Administration/Bid Irregularities) as required.	The Port agrees and has already implemented this recommendation.
28. We recommend that when the [Port] general counsel is asked to provide legal advice, he document the advice provided so that a clear record of his analysis and advice is established and retained.	The Port agrees that legal advice provided in connection with significant contracting decisions should be reflected in writing. While the degree of formality associated with those records will vary depending on the needs and circumstances, the fact of review should be captured.
29. We recommend that [the Port] reassign Consultant SK to a position where he has no conflict of interest. We also recommend that [the Port] either establish an ethics policy for consultants or revise [Port] Policy EX-3 to make it clear that [Port] consultants are expected to adhere to at least the same ethical standards that [Port] employees are required to follow.	The Port has fully reviewed the circumstances surrounding Consultant SK and finds no conflict of interest. As a result, there is no need to reassign Consultant SK. Existing consultant contracts include a prohibition on conflicts of interest. Nonetheless, the Port agrees that it should adopt an additional clear policy statement reflecting the ethical standards to which it expects its consultants to adhere and will, in consultation with relevant industry groups, develop such a policy statement.
30. We recommend that [Port] Policy EX-3 be (a) clarified to make clear that conflicts of interest are not limited solely to situations where there is a direct financial interest and (b) revised to require employees and consultants to recuse themselves from participating in decisions where conflicts of interest exist.	The Port's Ethics Policy currently recognizes and prohibits conflicts beyond those that are strictly financial. A review of the Port's Ethics Policy for employees is currently underway. As part of this review, the Port will ensure the policy is consistent with both government and industry best practices and will implement revisions as appropriate.

Response to Major Finding 4

Major Finding 4: POS Construction Management Records are Incomplete and Disorganized.

Accurate and up-to-date records are a key element of sound decision making within the Port's capital program, and the Port agrees that continuous improvement in the area of record keeping is important. The audit finding highlights two different concerns. The first relates to the lack of an integrated data system. The second focuses on record keeping practices.

The Port developed its project and construction management information systems to meet well-defined needs of the Port's Aviation Project Management, Seaport Project Management, and Port Construction Services groups. However, the needs of those three groups are all unique. Although each requires a large quantity of data – such as cost trending, construction scheduling, and project cost and general ledger accounting – to be captured from multiple sources, the delivery environment for each is different, and the scale of projects ranges from large to medium to small.

The Port has previously pursued a standardized solution for its project management information systems, but the Port was unable to secure a one-size-fits-all solution. The current PeopleSoft Financial System is a Port-wide financial accounting and general ledger system not suitable to fulfill this purpose. As a result, the Port currently maintains three separate information systems specifically designed to address the differing needs of each of its project management groups.

Reflecting the Port's commitment to continuing improvement in this area, the Port commissioned the independent performance audit from TKW.²⁵ From this TKW performance audit, an action plan is underway to evaluate the Port's options for greater integration of our Information and Communications Technology systems, with the goal of a single Port-wide information system for project and construction management data. The Port is seeking recommendations from IT industry leaders to determine whether better products now exist to meet the Port's varied needs.

As to the issue of the ongoing and consistent maintenance of the Port's electronic records and the project notebooks, the Port agrees that some additional attention is required. Project notebooks were a specific focus of the TKW performance audit. In response to that audit, the Port has developed an action plan to ensure that it maintains focus on consistency in content and quality of project notebooks. Following that plan, the Port already has a task group evaluating the Port's current practices, clarifying notebook criteria and content, and ensuring that notebook quality is included in project managers' performance reviews.

²⁵ The TKW performance audit is discussed in more detail above in footnote 1 and the associated text.

Response to Detailed Findings

Finding 4-A: POS Project Management Information Systems Data are Incomplete, Out-of-Date, and Inaccurate When Compared to Project Records.

Within the environment of its multiple systems, the Port efficiently utilizes them systems for specific purposes and records data into them once when full and complete information is available. The Port, however, has consciously elected not to use all data fields offered by the applications where unnecessary or duplicative and even sometimes chooses not to apply all tools to particular projects when those tools are determined not to add value or be cost-effective. This may not coincide with the manner in which the Performance Auditor envisions the systems should work; nevertheless, the manner in which the Port's suite of systems operate meets the Port's requirements for effective project management.

For example, the Performance Auditor elected to test three of the Port's information systems against seven specific "attributes." Those three systems were the SPOTS system used by the Seaport Project Management Group, the PACT system used by the Aviation Project Management Group, and the PMIS system utilized by Port Construction Services. The seven "attributes" were particular pieces of information the Performance Auditor believed the systems should reflect. However, in most cases, those information systems are not intended to capture the information tested by the Performance Auditor.

In order to clarify how those three systems are designed to function, the Port has provided the chart below. That chart – through green shading – shows the seven instances in which the Port's information systems were actually designed to capture the information tested by the Performance Auditor. In three of those seven instances, the data contained in the systems substantially met the Performance Auditor's expectations. In the remaining four, the data did not always match the Performance Auditor's expectations, but the Port believes that any inconsistencies were attributable to either time lags between updates of the particular system²⁶ or the manner in which the data is reflected in the system.²⁷ In all other instances, the systems either are not designed to capture the information tested by the Performance Auditor or are structured to capture that information in a different way that is more useful to the particular work group. The former is reflected through black and gray shading, and the latter is indicated through yellow shading. However, the fact that a particular system does not capture certain information does not mean the information is not tracked by the Port. On the contrary, necessary information is always captured – either within other systems or the Port's hard-copy records.

²⁶ For example, the cost-to-date information reflected in the SPOTS system is manually imported from the Port's PeopleSoft financial accounting and project costing software system. This information is generally updated only monthly.

²⁷ This particular point applies only to Port Construction Services. Port Construction Services is regularly required to revise and reconcile invoices in order to correctly account for items such as sales tax and retainage prior to payment. These adjustments are required by law and will necessarily generate inconsistencies between the hard-copy invoice and the information in PMIS.

<i>Attribute</i>	<i>SPOT System</i>	<i>PACT System</i>	<i>PMIS</i>
Attribute 1 Contract Information	System Not Intended to Track This Information	System Not Intended to Track This Information	Tracks Appropriately ²⁸
Attribute 2 Commission Authorization	System Tracks Inconsistency Due to Time Lag in Data Import	System Not Intended to Track This Information—MARGEN System Tracks	Performance Auditor Acknowledges the Attribute Is Not Applicable
Attribute 3 Schedule	System Tracks Inconsistency Due to Time Lag in Data Import	System Not Intended to Track This Information—MARGEN System Tracks	Performance Auditor Acknowledges the Attribute Is Not Applicable
Attribute 4 Change Order Amount	System Tracks Different Information Qualitative Trends	System Tracks Different Information Predictive Trends by ROM	Tracks Appropriately
Attribute 5 Change Order Logs	System Tracks Different Information Qualitative Trends	System Tracks Different Information Predictive Trends by ROM	Performance Auditor Acknowledges the Attribute Is Not Applicable
Attribute 6 Costs-to-Date	System Tracks Inconsistency Due to Time Lag in Data Import	System Not Intended to Track This Information—MARGEN System Tracks	System Tracks Inconsistency Due to Invoice Reconciliation
Attribute 7 Work Authorizations	Performance Auditor Acknowledges the Attribute Is Not Applicable	Performance Auditor Acknowledges the Attribute Is Not Applicable	Tracks Appropriately ²⁹

While the Port accepts both the recommendation that a unified system would be preferable and the admonition that timely and accurate updates to these systems are crucial to their effectiveness, these three systems meet the needs of their respective work groups.

Finding 4-B: POS Requirements for Preparation of Project Notebooks Are Not Enforced and Are Inconsistent Between Divisions. Project Notebooks are Missing, Incomplete, Out of Date, and Not Easily Accessible by Stakeholders.

The Port agrees some additional attention is required to Project Notebooks. These notebooks capture the initial plan for the successful delivery of a project and set the baseline scope, budget and schedule. Consistent with best industry practices, they are not intended to be updated continuously to reflect the current state of the project.

As noted above, project notebooks were a specific focus of the performance audit that the Port hired TKW to perform. Acknowledging a need to focus on consistency in content and quality of project notebooks, the Port has developed an action plan and formed a task group to evaluate and implement the TKW recommendations. That task group is specifically reviewing the Port's current practices, clarifying notebook criteria and

²⁸ The Performance Auditor identifies certain issues associated with release of retainage and contract closeout. However, the delays associated with release of retainage are attributable to the contractor's failure to satisfy certain requirements imposed by law.

²⁹ Although the Performance Auditor identifies inconsistencies, all work authorizations are generated in PMIS. Thus, PMIS is the source data for work authorizations.

content, and ensuring that notebook quality is included in project managers' performance reviews.

Finding 4-C: The "Livelink" Construction Document Management System (CDMS) is Not Being Used Properly

The Livelink[®] system supports the Port's priority to improve operational efficiencies and to move the Port from a hard-copy paper filing environment to an electronic, paperless filing system.³⁰ It represents a dramatic shift in the way the Port manages contracts and has required a significant period of time for development, testing, and transition.

The Port does use the Livelink[®] system properly today. Since first implemented in 2004, there has been ongoing expansion in the consistent and uniform use of Livelink[®]. The performance audit report only examined the period over which this transition occurred. While it may be true that the system was utilized as an end depository for records during the transition period, the Port has made notable progress toward timely and complete use of Livelink[®] as intended.

At the present, Livelink[®] is being utilized on those projects where it is considered cost-effective.³¹ On those projects, it is being utilized by most contractors. Current use specifically extends to change orders, correspondence, meeting minutes, submittals, requests for information, and contractor daily reports. The Port will continue to focus on greater consistency and uniformity in its use. However, contracts and conformed copies of the specifications and drawings are not typically placed in the Livelink[®] system. Instead, the contract agreement is kept separately in hard-copy format in the contract file and electronically in the Engineering archive site.

Response to Recommendations

Performance Auditor's Recommendation	Port Response to Recommendation
31. We recommend that [the Port] develop, implement, and enforce control procedures that include timely updating for the SPOTS, PACT, and PMIS systems with accurate project information until the project is closed out and the project data	The Port agrees that timely and accurate updates of its management information systems are vital and will evaluate opportunities for additional improvement to its practices with respect to the use of the SPOTS, PACT and PMIS systems. As an

³⁰ Livelink[®] is a leading collaboration and knowledge management software product licensed by the Port and used in construction contract management for on-line information storage as well as business process and workflow automation. Livelink[®] is a registered trademark of the Open Text Corporation. The Port's Livelink[®] system is sometimes referred to as the Construction Document Management System (or CDMS).

³¹ It is worth a minor note that the Livelink[®] system is used slightly differently in connection with construction contracts procured under the General Contractor/Construction Manager model than with the more traditional Design-Bid-Build approach, but those variations flow from differences in the procurement methodologies involved.

are archived.	example of this commitment, the Seaport Project Management group recently staffed a Project Controls office to ensure timely and accurate updates of SPOTS.
32. We recommend that [the Port] develop policies and procedures for ensuring that [PeopleSoft Financial System] data are consistent with data maintained in the other systems.	The Port disagrees with this recommendation. PeopleSoft Financial System is the Port's general ledger and project costing software. PeopleSoft is not a project management tool. PeopleSoft is the definitive source for data on all Port financial transactions.
33. We recommend that SPOTS be revised to include information regarding change order costs.	Currently, change order costs for Seaport contracts are accurately tracked outside of SPOTS. The Port will assess whether the benefit of upgrading SPOTS to include this information offsets the costs associated with doing so and make upgrades as appropriate.
34. We recommend that [the Port] enforce contract requirements for project schedule updates so forecasted project completion dates can be accurately recorded in the [Port's] project management information systems. We recommend that [the Port] implement a means of tracking current forecasted project completion dates, current change order amounts, original budget amounts, commission funding authorizations, budget transfers in <i>all</i> of its management information systems (SPOTS, PACT/Margen, PMIS).	The Port continues to look for integrated software solutions to meet its project management needs and, until one is sourced, will be proactive in making improvements to its current information systems. Currently, detailed project schedules are maintained outside of SPOTS, PACT and PMIS. The Port will assess whether the benefit of upgrading these systems to include detailed schedule information offsets the costs associated with doing so and make upgrades as appropriate.
35. We recommend that [the Port] establish a central repository for Project Notebooks within each [Port] division.	The Port agrees and intends to establish a central repository within each division for Project Notebooks.
36. We recommend that [the Port] develop a check-out and tracking system for the Project Notebooks and utilize it.	The Port agrees and intends to establish an appropriate check-out and tracking system for Project Notebooks.
37. We recommend that [the Port] require project managers to periodically and on a timely basis update the Project Notebooks with current Construction Trend Logs, Change Order Logs, and Schedule Updates.	The Port disagrees with this recommendation because it would be inconsistent with industry best practices. Construction trend logs, change order logs, and schedule updates are more efficiently maintained elsewhere; and including this

	<p>information in Project Notebooks would be redundant. The earlier independent TKW performance audit noted that the Port's notebook process is consistent with best industry practices. The Port will continue to implement the TKW recommendations to ensure consistent Project Notebook entries.</p>
<p>38. We recommend that [the Port] integrate assessments of Project Notebook completeness and quality into the [Port] personnel performance evaluation processes.</p>	<p>The Port agrees that accountability of its personnel is important and will include assessments of Project Notebooks in connection with the Port's Performance Review, Evaluation and Planning process.</p>
<p>39. We recommend that if [the Port] continues including the [Construction Document Management System] requirement in its contracts, it develop a system for monitoring each project's [Construction Document Management System] data updates. This contract requirement, just as any other, should be enforced and controlled.</p>	<p>Livelink® – the Port's Construction Document Management System – enhances efficiency and transparency in connection with construction contract management. The Port agrees that timely, consistent use of Livelink® is important on contracts where it is employed and will, consistent with the recommendation, take steps to ensure and monitor its usage.</p>
<p>40. We recommend that [the Port] immediately undertake a comprehensive review of its contracts requiring use of Livelink to determine the full extent of contract noncompliance and initiate corrective actions accordingly.</p>	<p>The Port disagrees with this recommendation since it believes that the current use of Livelink® generally meets its requirements. Nonetheless, the Port is developing a procedures manual with its document control specialists to enhance Livelink® utilization consistent with Port requirements in connection with each active contract and will initiate corrective action as required.</p>

Response to Major Finding 5

Major Finding 5: POS Fails to Enforce Basic Contract Requirements, Resulting in Delays, Extra Costs, and an Inability to Defend Against Claims.

The Port proactively manages all of its construction contracts to maximize the likelihood of success. It is the Port's practice to:

- Have high quality plans and specifications;
- Pay on time;
- Treat contractors fairly; and
- Use a tiered process for conflict resolution, including a Dispute Resolution Board or Independent Technical Representative on selected large projects.

The TKW performance audit previously conducted on the Port's capital project delivery process recognized that "these practices have helped attract bidders, even during the current competitive construction market where bidders have many opportunities."³²

The Port acknowledges that consistent attention to project scheduling is necessary for successful project delivery.³³ As a result, the Port includes scheduling requirements in all of its major construction contracts, and the Performance Auditor validates that these requirements are consistent with best industry practice. These requirements begin with a baseline progress schedule and require subsequent schedule updates. To ensure timely project delivery, the Port:

- Establishes a baseline schedule with a matching schedule of values – prior to full notice to proceed and first progress payment.
- Requires progress update schedules and/or recovery schedules whenever certain conditions and/or events threaten critical or milestone dates.
- Obtains monthly updates of progress for each activity on the schedule of values for the progress payments.
- Requires three-week look-ahead schedules and reviews these in weekly progress meetings.
- Records the start and completion dates in the daily reports for critical or milestone activities.

While the Port does not always demand monthly updates to the baseline schedule when construction progress substantially adheres to plan, it does require updates whenever events materially affect – either positively or negatively – the time for project delivery.

³² The TKW performance audit is discussed in more detail above in footnote 1 and the associated text. The quoted language appears on page 62 of the TKW report.

³³ The failure to do so may, in fact, result in delays, extra costs and an inability to defend against claims. As discussed in the Port's response to Detailed Finding 5-A, the Port does not believe that occurred here.

Response to Detailed Findings

Finding 5-A: POS's Failure to Enforce Contract Requirements Contributes to Significant Schedule Overruns and an Inability to Recover a Minimum of \$1,208,900.

This finding does not reflect a realistic understanding of the manner in which legal claims are made and settled in contract disputes.³⁴ The Port always asserts its right to collect liquidated damages from the contractor for missed schedule updates, missed milestones, or delayed beneficial use of the facilities or systems. However, where delays result from causes attributable to both the Port and the contractor, the Port is not entitled to collect liquidated damages from the contractor.³⁵ In all of the projects reviewed by the Performance Auditor, the contractor had submitted a claim for additional time and money associated with delays arising from technical details or operational needs alleged to be the responsibility of the Port.

Project: Central Mechanical Plant Upgrade

The Port faced a \$2+ million claim in connection with this contract. This claim was subject to complex litigation involving six separate parties, plus the Port's design consultant, who was not a party to the litigation but intimately involved throughout the dispute.³⁶ While the Port certainly believed and asserted that it was not responsible for the delays on this project and should be entitled to collect liquidated damages,³⁷ that issue was to be resolved by a jury – not unilaterally by the Port. Other parties to the litigation advanced opposing viewpoints, and there was clear risk that those viewpoints might have been adopted by the jury in that litigation. Consequently, the Port used its claim for liquidated damages to secure a favorable settlement of this lawsuit.

The Port believes that the ultimate outcome in the litigation surrounding the Central Mechanical Plant Upgrade project – while involving a payment to the contractor and a time extension – was a positive outcome. The settlement was based on a careful risk analysis undertaken by the Port prior to and during the course of a full day mediation

³⁴ In addition, the finding frames cost increases and schedule extensions as, respectively, “cost overruns” and “schedule overruns.” However, cost increases and schedule extensions do not evidence Port mismanagement. For example, on the Central Mechanical Plant contract (discussed in more detail below), the changes to contract amount and schedule legitimately flowed from differing site conditions, issues with construction phasing in a complex operating environment, scope changes, design issues, and claims resolution. The Port's construction management processes are designed to address these inevitable issues; the issues do not result from the processes themselves.

³⁵ Nor is the contractor entitled to any additional compensation from the Port for this concurrent delay.

³⁶ The Performance Auditor asserts that this number of parties is not unusual because of subcontractor and supplier pass-through claims. However, the sub-tier claims in this case were not simple pass-through claims. The electrical subcontractor contended that errors by the electrical distributor and suppliers were a root cause of project delay and associated damages. In addition, the electrical subcontractor even included claims for alleged violation of the civil rights laws.

³⁷ For example, the Port did assert that the contractor's claim was untimely, inadequately supported, and unjustified. The Port also affirmatively asserted its right to collect liquidated damages. Indeed, that is the primary basis for the \$530,000 claim asserted by the Port that the Performance Auditor acknowledges.

session before a highly respected mediator selected by all parties. The Port Commission was briefed and approved the settlement. While attorney-client privileged documents may not have been included in the documentation supporting the final change order in the project file, the documents justifying the change order (as noted in the change order) were in fact included in the file.

Project: T-91/P91 Utility Infrastructure Upgrades

Public policy in the State of Washington strongly favors settlement of disputes.³⁸ Consistent with that public policy, the Port prefers to resolve disputes fairly and amicably where possible. Although masked with peripheral details, this finding challenges that approach. The contractor documented a request for a 127 work day extension of the time to complete the work. The Port believed that an extension of 77 work days was justified. To resolve this difference, the Port and contractor agreed to settle for a 91 work day extension. The additional 14 work days granted by the Port were a compromise. The Port made a business decision that it was better to resolve the dispute than continue to argue the matter through its contractual dispute resolution processes and face increased costs. The Port stands by the negotiated decision.

Project: Carnitech Building

On this project, the Port extended the project completion date by 92 days to account for an equal delay to the project commencement date. That delay was not the fault of the project contractor, and the construction contract entitled the contractor to this extension of time. In order to address other delays to the project associated with the completion of the building foundation that occurred after project commencement, the Port also directed the contractor to accelerate construction in order to maintain a contract completion date necessary to meet operational needs. While the Port did not execute the change order granting the extension associated with the delay in commencement until after the change order directing the acceleration, the two change orders addressed differing causes for delay in this project. The change order directing acceleration was not intended to address the start-date delay, and it would have been in bad faith for the Port to assert this.

When the project contractor failed to meet certain interim deadlines associated with the change order that directed acceleration of the construction, the Port stopped paying against that change order. In addition, the Port has reserved its right to both collect the amounts paid for the acceleration and assess liquidated damages against the contractor for project delays. However, the contractor has asserted that it is entitled to an extension of time and has submitted a time impact analysis to support that claim. While the documentation supporting that claim was not submitted within the timeframes required by the contract, the Port specifically granted the contractor an extension of time in which to submit the documentation so that the parties would remain focused on completing the

³⁸ The Washington State Supreme Court has stated that the law “strongly favors” settlement and that it is the express public policy of this state to favor settlement. *See, e.g., City of Seattle v. Blume*, 134 Wash.2d 243, 258 (1997).

project. The Port is currently reviewing that documentation and expects to conclude the matter soon.

Project: Airfield Improvements Project

This finding relates primarily to Change Order 55, in which the Port granted the contractor a 177-day time extension. That change order was precipitated by the failure of the pipe rack, which is a major component of the Airfield Fueling System. The Port – not the contractor – was responsible for the consequences of this failure. However, prior to the failure of this component, the contractor had suffered delays for which it was responsible. These multiple causes of delay were all factored into the time extension contained in Change Order 55.

Although the Port did not insist on monthly project schedule updates, the Port did require updates when there were material changes in the schedule and also utilized all of the other tools outlined above to track progress against the project schedule. With those tools and the information they provided, the Port was able to conduct a thorough assessment of the contractor-caused delays up to the point of the pipe rack failure. In fact, the Port had been specifically tracking contractor-caused delays prior to that time. The file for Change Order 55 reflects the delays for which the Port did, and did not, accept responsibility. When negotiating that change order, the Port’s analysis specifically included “time to complete” schedules that were prepared by both the contractor and the Port for the express purpose of defining the delays for which the contractor was responsible prior to the pipe rack failure.

General Comments Regarding Liquidated Damages

While the Port has not often collected liquidated damages, it does assert its right to collect such damages. The Port’s facilities operate around-the-clock. This results in a complex construction environment that tends to generate frequent schedule impacts. These impacts often lead to claims associated with inefficiency and delay. Liquidated damages may generally be recovered only in instances where the Port is faultless.

Response to Recommendation

Performance Auditor’s Recommendation	Port Response to Recommendation
41. We recommend that [the Port] take immediate steps to enforce all contract provisions on all ongoing and future contracts, particularly provisions regarding [Critical Path Method] project schedule submission requirements and withholding of contractor payments due to contractor failures to comply with contract	The Port disagrees with the facts supporting this recommendation and believes that its enforcement of contract terms in the cases cited was appropriate under the circumstances. Nonetheless, the Port will review whether opportunities exist to enhance its enforcement of contract schedules, evaluation of time extension

requirements. [The Port] should also be more aggressive in timely assessing liquidated damages based on contemporaneous analyses of delay impacts.	requests, and contemporaneous assessment of liquidated damages. The Port will also evaluate the practices of other state and local agencies with respect to scheduling and enforcement. When appropriate, the Port will continue to withhold contractor payments consistent with contract documents and state law.
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Response to Major Finding 6

Major Finding 6 and Detailed Finding 6-A: POS Construction Management is Vulnerable to Fraud, Waste and Abuse.

The Port notes that the Performance Auditor did not find actual cases of fraud during his investigation. As to the finding of vulnerability, the Port takes the risk of fraud seriously and has zero tolerance for acts of fraud. If the Port discovers fraud of any kind in the course of investigating and following up on the findings and recommendations of this report, it will take immediate action – including notification of law enforcement where appropriate.

The Port makes it a high priority to ensure that sound internal controls exist in all of its business processes. This specifically includes controls to detect irregularities that may be indications of fraud, waste, or abuse. Consistent with audit industry standards and best practices, those controls are designed to provide reasonable assurance that such irregularities will be detected.

A portion of current Port best-practice controls follows:

- *Tone at the Top* – The Port Commission and senior leadership team model strong ethical principles for Port employees. A core value of the organization is zero tolerance for fraud, and any suspected fraud or losses are deliberately investigated. Emphasizing this commitment, the Port has steadily expanded the Internal Audit function over the past several years, and specifically hired a Certified Fraud Examiner. In addition, the Port Commission established a Commission Audit Committee in 2006 to ensure solid governance and oversight at the policy level.
- *Risk Assessment and Mitigation* – The Port has significantly invested in risk assessment and mitigation by expanding internal audits of Port operations. Also, the Port has proactively created a Financial Controls Analysis Team, focused on Sarbanes-Oxley Act Section 404 reviews of all key business processes consistent with the recommendation of the Committee of Sponsoring Organizations of the Treadway Commission. Emphasis will be placed on covering all risk areas, inclusive of construction and professional service agreements.
- *Code of Ethics* – The Port has a written code of ethics that has, with periodic updates, been in place for over 16 years. That code is consistent with that imposed by the Washington State Legislature on state employees. The Port provides a copy of and reviews this Ethics Policy with all employees at its new employee orientations. The Commission recently revised this code by adopting Resolution 3583. In addition, Section 2 of Resolution 3583 sets out the role of an independent Ethics Board tasked, in part, with the investigation of alleged

violations of the Port's ethics protocols. This Board is accessible to Port Commissioners, Port employees and any member of the public.

- *Policies and Procedures* – As a supplement to the requirements of state law, the Port has adopted a wide variety of policies and procedures that extend to the following areas: ethics, procurement, accounting, employment, leasing, and records retention. These policies and procedures are complemented with a comprehensive training program conducted by subject matter experts.
- *Human Capital Management* – Hiring qualified candidates, providing training to ensure competencies, and evaluating work performance are integral to ensuring quality and accountability in the Port's work force. These commitments, along with the other areas of internal control on which the Port focuses, also contribute to mitigating the potential risks raised in this finding. The Port has adopted detailed practices and procedures to ensure that it hires the most qualified candidates, has a comprehensive program for skills and knowledge development, and utilizes an annual performance evaluation and planning process for salaried employees. In addition, nearly all Airport employees are subjected to detailed criminal record checks in order to work at the Airport.

To provide outside review of these controls against waste, fraud, and abuse, the Port is subject to annual scrutiny by both the Washington State Auditor's Office for public accountability, and by certified public accounting firms for financial and grant compliance. These reviews are conducted in accordance with American Institute of Certified Public Accountants' audit standards, Government Auditing Standards as issued by the U.S. Government Accountability Office, and protocols called for by the Sarbanes-Oxley Act of 2002, all of which mandate the consideration of fraud.³⁹

Response to Recommendations

Performance Auditor's Recommendation	Port Response to Recommendation
42. We recommend that [the Port] establish a fraud governance policy that provides for the design and implementation of a comprehensive and coordinated approach to fraud mitigation (deterrence, detection, and prevention).	The Port agrees that it should have a fraud governance policy. The Port will research best practices in fraud governance among other state and local governments and will implement policy enhancements as necessary. If appropriate, the Port will integrate this new policy with its Ethics Policy, which the Port is currently

³⁹ These standards include American Institute of Certified Public Accountants, *Statement on Auditing Standards No. 99: Consideration of Fraud in a Financial Statement Audit* (October 2002); U.S. Government Accountability Office, *Government Auditing Standards* (July 2007); Committee of Sponsoring Organizations of the Treadway Commission, *Enterprise Risk Management – Integrated Framework* (September 2004); and the Sarbanes-Oxley Act of 2002.

	revising. In addition, the Port will, as part of its annual compliance and financial audits, continue to review its controls to deter, detect, and prevent fraud and will implement additional controls as appropriate.
43. We recommend that [the Port] initiate a comprehensive fraud risk assessment focused on its procurement and management of construction and professional services. This assessment should focus on vulnerabilities to fraud under current [Port] procurement processes and the identification of possible fraud schemes that may be occurring.	The Port agrees and will undertake a comprehensive fraud assessment using its internal audit and Financial Controls Analysis teams.
44. We recommend that [the Port] use the results of the fraud risk assessment to revise its policies and procedures in order strengthen controls in the areas deem [sic] vulnerable and implement specific control mechanisms designed to deter, prevent, and detect the fraud schemes deemed to be viable.	Based on the outcome of the fraud risk assessment, the Port will revise its policies and procedures and implement all necessary training to ensure that employees both understand their obligations with respect to fraud, and adhere to the Port's protocols regarding fraud.
45. We recommend that [the Port] revise and strengthen its policies regarding employee conflicts of interest and establish an organizational code of conduct designed to make all [Port] employees and consultants aware of their fraud deterrence, prevention, and detection responsibilities. Training on these policies should be mandatory for all existing and new employees and annual update training sessions should be mandatory.	The Port's Ethics Policy broadly addresses conflicts of interest, but the Port will nonetheless look at that issue as it proceeds with revisions to that Policy. As noted above in response to Recommendation 42, the Port agrees that it should also have a fraud governance policy and intends to develop one consistent with best governmental practices. The Port will also implement communication and training protocols related to these policies as appropriate.
46. We recommend that [the Port] establish a fraud hotline through which [Port] employees, consultants, and contractors can report known or suspected irregularities in the procurement and management of contracts.	The Port agrees and will implement a fraud hotline as soon as practicable for use by its employees, contractors, and members of the public.
47. We recommend that [the Port] investigate the findings contained in this report and take prompt disciplinary and	As mentioned previously, the conditions supporting this finding recast other findings described by the Performance Auditor

<p>punitive actions, including the direct involvement of appropriate law enforcement agencies. [The Port] should also establish and enforce a comprehensive policy for investigating all future indicia of fraud.</p>	<p>elsewhere in this report. The Port has fully responded to each of these detailed findings, noting where it believes the Performance Auditor's assessments and interpretations of events are inaccurate or incomplete, and openly acknowledging instances where errors have been made, policies have been occasionally circumvented, and opportunities for improvement exist. While the Port believes that it is not vulnerable to fraud to the degree suggested by the Performance Auditor, it nonetheless takes such risk seriously and has zero tolerance for fraud. If, in the course of investigating and following up on the findings and recommendations of this report, the Port discovers fraud of any kind it will take immediate action, including notification of law enforcement where appropriate.</p>
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Response to Other Matters Noted During the Audit

The performance audit report does not include a seventh major finding but instead includes three separate and unrelated detailed findings. The Port addresses each of those detailed findings below.

Response to Detailed Findings

Finding 7-A: POS Personnel Altered Audit Evidence, Impeded Access to Information and, In Some Cases, Were Uncooperative.

At the beginning of this performance audit, Port senior management communicated that all employees should, in the spirit of full disclosure, cooperate completely with the auditors and provide all information requested on a timely basis. The Port strongly disagrees with this finding and believes that most of the “condition” described here resulted from a lack of clarity and understanding regarding the initial expectations and requirements of the Performance Auditor. The stated desire to “review construction management documents as they are maintained in the normal course of business” was not communicated to the Port by the Performance Auditor at the entrance conference or at any time until after the listed incidents occurred. The Port has extensive history with audits of various types, and normal practice is to assemble, organize, and compile information and documents to facilitate review by the auditors. In fact, the Port had done so in connection with the recent performance audit on construction management conducted by TKW, with TKW’s full knowledge and consent. The Port did not ask employees to refrain from organizing information, since it was not aware that this was desired. As soon as it became aware that this was a concern, senior management immediately directed all staff involved in the audit to refrain from organizing information in any manner.

The Port notes that its ability to respond to the specific claims laid out in this finding is impaired since the Performance Auditor declined to specify any of the names or projects referenced in the reported incidents. Based on the information the Port has been able to obtain through its own investigation, it has not found any evidence that staff altered or impeded access to information, or were generally uncooperative.

Altering Audit Evidence

As cited by the Performance Auditor, the Port acknowledges that in some cases staff uploaded electronic documents that already existed elsewhere (email, network drives, etc.) into LiveLink® in order to catch up on backlogged filing.⁴⁰ However, the Port has not found, nor has it been provided with, any evidence that construction records were improperly altered or revised.

⁴⁰ Livelink® is discussed in more detail above in footnote 30 and the associated text.

The conduct noted in “Incident 5” was actually approved by one of the Performance Auditor’s field staff. In that case, the Port’s project manager initially brought the project notebook to the field staff in the “disorganized” condition in which it was maintained. The project manager obtained explicit permission from the Performance Auditor’s staff to organize the notebook to make it more convenient to review.

“Incident 6” similarly illustrates Port staff’s efforts to be helpful. The notebook for this project was unavailable because it was still in the possession of TKW following the earlier performance audit commissioned by the Port. Seeking to provide a timely response, the project manager provided a CD with the files contained in the project notebook plus some additional materials requested by the Performance Auditor, which were incomplete since they couldn’t all be immediately located. The project manager provided a revised disk the following day with the remaining materials. When the Project Manual was finally returned from TKW, the project manager substituted two pages to ensure the information in the project notebook was up-to-date. The project manager intentionally included “printed on” dates directly on those two documents so that the substitution would be apparent and that the Performance Auditor would understand that these new documents were the current versions.

Expense Projects

Before the performance audit began, the Port believed that it would be useful to know the amount of time Port staff spent on the performance audit. To capture the value of that effort, the Port established several expense projects within its PeopleSoft financial accounting software system. Within the PeopleSoft system, expense projects are simply tools used to record the costs associated with the Port’s efforts. These expense projects were designed to capture the costs incurred by the Port with respect to the performance audit, whether before, during, or after the time the Performance Auditor was present at the Port.

While the Port readily admits that it deployed staff to assemble and copy records related to the Third Runway Project before the Performance Auditor arrived, it did so in an effort to expedite and facilitate the performance audit. The Port’s efforts were consistent with its past practice in connection with both financial and performance audits. The Port was not informed, and did not know, that the Performance Auditor did not want information assembled or organized in this way.

Impeding Access to Information

The Port used its best efforts to provide information to facilitate the audit on a timely basis and disagrees that it impeded access to information. Port senior management clearly and consistently directed staff to provide all information requested by the Performance Auditor. The Port believes that any delays that occurred resulted from a lack of clear communication regarding the Performance Auditor’s desires and the time required to clarify requests and provide access to multiple information systems and data

repositories. Once the Port determined what was desired, system access was consistently provided in a responsive and timely manner, and the Port has substantial documentation demonstrating its efforts to clarify what was required and the high priority placed on resolving access issues. Other than noting that delays occurred, the Performance Auditor has provided no evidence to support the claim that the Port impeded access to information.

Cooperation of Port Personnel

Senior Port management directed all employees to cooperate fully with the performance audit. The Port appreciates the Performance Auditor's acknowledgement that most Port employees were "cooperative, helpful, forthcoming, and candid." The Port regrets the one instance claimed where a staff person may have been evasive and rude – such behavior is not sanctioned or condoned in any way – but since the Performance Auditor has refused to identify the individual or provide other specifics, the Port was unable to intervene or address the issue. The Port believes that the few other incidents pertaining to additional attendees at interviews resulted either from a misunderstanding of audit protocols or reluctance on the part of some employees to be interviewed alone due to widely held perceptions that interviews were being conducted in a confrontational and intimidating manner. In one case, a Port employee submitted a formal complaint regarding what was viewed as disrespectful and unprofessional behavior on the part of the Performance Auditor, and the Port appreciates that the Washington State Auditor's Office is reviewing this complaint.

Overall the Port used its best efforts to cooperate with the audit and to respond fully to all questions and requests within a reasonable time frame, noting that staff is also engaged full time in running the day to day operations of the Port. The Port also notes that important lessons have been learned that will allow for improved management of future audits, particularly with respect to better clarifying initial expectations and enhancing overall communication between the auditor and staff. The Port strongly recommends that in future performance audits conducted by the Washington State Auditor's Office on public agencies, specific expectations of the audited organization be clearly set forth in advance of the audit.

Finding 7-B: The 3rd Runway Wall Art Indicates that POS's One Percent for the Arts Policies Need to Be Clarified.

The Port's Art Program was first instituted by the Port Commission in 1969. In October 2000, the Port developed detailed guidelines for the program and those guidelines were accepted by the Port Commission on November 15, 2000. The Port Commission was most recently briefed on the Art Program in September 2007. Under the current program, the Port Commission President, or another Commissioner appointed by the President, serves on the committee that oversees the Art Program, and all decisions of that committee are subject to approval by the full Port Commission.⁴¹

⁴¹ See Port of Seattle Art Program Guidelines (Final Version, October 2000).

Consistent with these policies, the Port Commission specifically approved the artwork incorporated into the mechanically stabilized earth walls constructed as part of the Third Runway Program. The Port Commission granted this approval in a public meeting on May 22, 2001, and the process was open and transparent as to all details of the wall art. Specifically, the request from Port staff included a description of the process by which the artist was selected, a rendering of the artwork concept, a map defining the artwork location, and a clear indication that the budget for the artwork was \$257,000. In short, the Port Commission openly approved all aspects of the Third Runway wall art.

While the Performance Auditor questions the value of the investment, this public art project was important to the surrounding communities. Given the large size of the mechanically stabilized earth walls on the north and west sides of the Third Runway, the City of SeaTac specifically sought such artwork as one mitigation measure from the effects of the Third Runway. Consequently, the Port involved the City of SeaTac throughout the process, and even provided a briefing to the full City Council shortly before approaching the Port Commission for final approval of the artwork design and budget.

Finding 7-C: The POS Internal Audit Function Lacks Organizational Independence.

The Port firmly believes that organizational independence is the cornerstone of an effective internal auditing function. While the Port notes that there is no single reporting structure for internal audit (even among the various standards the Performance Auditor cites), it generally concurs with the Performance Auditor's recommendation to more closely align with U.S. Government Accountability Office "Yellow Book" standards. The evidence giving rise to that recommendation, however, is inaccurate and should be clarified.

As the Performance Auditor cites in multiple references, standards related to internal auditing define "organizational independence" as being free from interference in the conduct of the auditor's work. The Performance Auditor has not provided any actual evidence of interference in the internal auditor's work; rather, the Performance Auditor makes several observations that essentially reflect the fact that the role of both internal audit and the Commission Audit Committee are still developing and evolving at the Port. Some of the items cited occurred even before the Audit Committee was formed in the latter half of 2006. All Port internal audits conducted to date have been free of interference of any kind, which could easily be substantiated by independent review.

The Performance Auditor states that Port management disagreed with this finding and recommendation, which is not accurate. The Port disagreed with an earlier draft of the finding, which differed in the condition, cause, effect and recommendation compared to the finding presented here.

Finally, the Port takes strong exception to the Performance Auditor's inclusion of quotes attributed to the Port's external auditors that not only appear to be inaccurate but also

impugn the integrity and professionalism of the Port's internal auditor. The Port's internal auditor is highly experienced and consistently maintains the highest standards of integrity and professionalism. Her experience includes 17 years with the Washington State Auditor's Office, including six years as a Regional Audit Manager, and she has received the SAO Employee of the Year award. Upon reviewing quotes attributed to them, the Port's external auditors informed the Port in a letter dated November 8, 2007, that not only had they not made these statements, they did not agree with them. Regarding the comment that the internal auditor does not appear to have an objective attitude, partner in charge of the Port audit wrote:

This comment was not made by me or anyone at [the firm]. In fact, I disagree with this characterization. I have been acquainted with the Director of Internal Audit since she was a manager at the SAO and have always found her to be professional, objective and competent.

The Port's external auditor also flatly denied an unwillingness to rely on the internal auditor's work because of any perceived "lack of organizational independence of the [Port's] internal audit unit," and disagreed with the quote asserting that the Port's internal audit reporting relationship evidenced a lack of organizational independence:

[W]e did not provide this comment to the performance auditor. Organizational independence does not have to be achieved solely by a direct reporting line to the board or audit committee. Professional standards and industry guidance define 'organizational independence' as allowing the audit activity to be conducted without interference by the entity under audit.

Since the Port's external auditor did not make these statements, the Performance Auditor should clarify where these quotes came from or retract them. Further, the Port questions why the Performance Auditor failed to seek the opinion of the external auditor regarding the independence of the Port's internal audit function, which opinion would have contradicted information used to support this finding. At a minimum the Performance Auditor should disclose this fact in the finding to ensure factual accuracy.

Response to Recommendations

Performance Auditor's Recommendation	Port Response to Recommendation
48. We recommend that [the Port] re-examine and clarify its policies and guidelines on art expenditures regarding (a) what "accessible and visible to the public" means; (b) how the 1-percent determination should be made in cases where major projects consist of portions that are clearly outside the policy's defined base; and (c) when matters should be referred back to the Commission for discussion in public	The Port's Art Program has always been subject to oversight and final approval by the Port Commission (including the case cited by the Performance Auditor), thus assuring that the program is open and transparent and that the public interest is served by the Program. Nonetheless, the Port will examine its policy in light of these recommendations.

<p>meetings. The guidelines should also be revised to require budget-versus-actual reporting for each project so that accountability is assured. The guidelines should stipulate that the Art Oversight Committee should document its determination that specific projects comply with all provisions, including the recommended revisions above.</p>	
<p>49. We recommend that the following actions be taken with respect to the internal audit function within [the Port]:</p> <ul style="list-style-type: none"> • The internal auditor should be given a direct reporting line to both the [Port] CEO and the [Port] Audit Committee and should not be under the direct supervision or management of or have performance appraisals done by either the Director of Accounting, Internal Audit & Procurement Services or the Chief Financial Officer. • The internal auditor should not be able to be terminated without the concurrence of the [Port] Audit Committee. • The [Port] Audit Committee should meet at least monthly with the internal audit manager, without the presence of [Port] management. • The [Port] Audit Committee should review, have input into, and approve the internal audit annual work plan. 	<p>The Port generally agrees with this recommendation. It notes, however, that while it concurs that the Audit Committee should be able to meet with the internal audit manager without management present, the specific timing will be developed in collaboration with the Audit Committee.</p>

Appendix A

RESPONSE TO RECOMMENDATIONS OF THE LEGISLATURE

During the course of this audit, there has – given the large number of procurement laws in this state that apply to a variety of municipal entities – been some confusion regarding those procurement laws that apply to Port districts. Recognizing this, the Port of Seattle has already engaged the Washington State Auditor’s Office in discussions about the current laws and believes a common understanding can be found. If necessary, both the Washington Public Ports Association and the Washington State Attorney General’s Office may also be engaged in these discussions. The Port of Seattle offers this appendix in an attempt to explain this complicated topic and is sincerely committed to working to further clarify these issues as needed.

The Port of Seattle is a public port district existing under, and defined by, Washington law. As such, the Washington State Legislature has plenary power to shape the affairs conducted by the Port of Seattle and the way they are conducted. The Legislature’s current policy choices for public port districts are reflected primarily in Title 53 of the Revised Code of Washington.

The Performance Auditor maintains that the Port violated certain state statutes which guide procurement and competition. The Port, based on the advice of its legal counsel, believes that it has complied with the relevant statutes.¹ Guided by the Port’s understanding, the issues raised in this finding relate primarily to the Port inconsistently following its own policies for the procurement of professional services. These Port policies exceed the requirements of Washington state law in many respects.

Given the confusion, the Performance Auditor asks the Legislature to clarify or revise the laws that guide procurement by state and municipal governments. If the Legislature is inclined to revisit its policy choices on procurement, the Port respectfully notes this policy discussion should involve more than just the Port of Seattle and other port districts. The laws related to port districts are akin to those governing a variety of other public entities.

¹ See Washington State Auditor’s Office, *Competitive Bid Laws*, p. 24 (September 20, 2005) [available at <http://www.sao.wa.gov/LocalGovernment/BidLawGuidance/BLGuidance-2005.pdf>]. While the Port has adopted comprehensive purchasing policies that require competitive procurements in most situations, the Port is statutorily required to bid public works projects and contracts for architectural and engineering services. It is not – like most other public entities – required to bid other services and may generally procure materials, supplies and equipment in the open market.

The Washington State Legislature has – over the history of statehood – authorized more than 80 different types of municipal entities.² These entities range from general purpose governments, such as cities and counties, to special purpose entities, such as fire protection districts or irrigation districts. They include school districts, transportation districts, convention centers and stadiums. Each is governed by specific provisions within the Washington State Constitution or Revised Code of Washington.

While it is certainly true that there is a strong public policy in Washington State in favor of competition, competitive bidding is not universally required in Washington.³ For example, state law does not generally require most municipal entities to competitively procure services other than architectural and engineering services.⁴ State law also frequently allows the purchase of materials, supplies and equipment without the formal necessity of competitive bidding.⁵ Competitive bidding is only universally required in connection with public works contracts and the procurement of architectural and engineering services.⁶

Port districts fall squarely within this mix. All public works projects must be publicly bid.⁷ Port districts must also competitively procure architectural and engineering services.⁸ However, they are – like most public entities – not subject to a general requirement to bid for other services. Port districts may also procure materials, supplies and equipment in the open market.⁹

Nonetheless, the Port of Seattle has – furthering the public policy in favor of competitive bidding – adopted purchasing policies that apply broadly to the procurement of materials,

² Municipal Research and Services Center, *Special Purpose Districts in Washington*, p. 1 (August 2003) [available at <http://www.mrsc.org/Publications/spd.pdf>]. At the end of 2002, the municipal entities within the State of Washington numbered over 2,000. *Ibid.*, at p. 8.

³ See, e.g., Washington State Auditor's Office, *Competitive Bid Laws*, at p. 5. The Washington State Auditor's Office has specifically stated that "a local government does not have to construct public works or make purchases by competitively bid contracts unless constitutional, statutory or charter provisions require it." *Ibid.*

⁴ Municipal Research and Services Center, *Contracting for Professional Services in Washington State*, p. 5 (April 1994) [available at <http://www.mrsc.org/Publications/cpserv.pdf>] (municipalities "may negotiate for professional services other than those covered by Ch. 39.80 RCW."); Washington State Auditor's Office, *Competitive Bid Laws*, at p. 5; see also Municipal Research and Services Center, *Bidding Book for Washington Counties*, pp. 3-4 (March 2007) [available at <http://www.mrsc.org/Publications/cbb07.pdf>] (noting counties must also bid for collection agency services and the official county newspaper); Municipal Research and Services Center, *Bidding Book for Washington Cities and Towns*, p. 12 (September 2006) [available at <http://www.mrsc.org/Publications/06biddingbook.pdf>].

⁵ For example, first class cities are not generally required to bid for materials, supplies and equipment. See *Bidding Book for Washington Cities and Towns*, at p. 12. School districts do not need to competitively procure materials equipment and supplies less than \$40,000. See RCW 28A.335.190. Water districts, public utility districts and irrigation districts need not competitively procure materials, equipment and supplies less than \$10,000. See RCW 57.08.050; RCW 54.04.070; RCW 87.03.435.

⁶ See RCW 39.04.010 *et seq.*; RCW 39.80.010 *et. seq.*

⁷ RCW 53.08.120; RCW 39.04.010.

⁸ RCW 39.80.010 *et. seq.*

⁹ RCW 53.08.120; see also Washington State Auditor's Office, *Competitive Bid Laws*, at p. 24 ("The port district is only required to competitively purchase materials if it purchases them [under a public works contract] rather than on the open market.")

supplies, equipment and services.¹⁰ This practice is no different than that undertaken, for example, by many first class cities in their charters.¹¹ While the Port of Seattle intends to impose additional accountability and oversight of its procurement practices, the Port of Seattle has been subject to compliance audits by the Washington State Auditor's Office annually without material findings related to its existing procurement practices.

Again, the Port offers this data to help provide context to the laws, procedures and practices related to procurement by state and municipal governments in the State of Washington. The Port of Seattle is committed to the principles of fair and open competition. The Port stands ready to work together with other stakeholders to ensure that the procurement practices of Washington State are clear, effective and fair.

¹⁰ Washington State Auditor's Office, *Competitive Bid Laws*, at p. 5 ("A local government does not have to construct public works or make purchases by competitively bid contracts unless constitutional, statutory or charter provisions require it. However, in Washington, there is a strong public policy in favor of competitive bidding. A local government is not prohibited from enacting an ordinance requiring competitive bidding in the absence of other legal mandates to do so.")

¹¹ See, e.g., Charter of the City of Seattle, Article VII; Seattle Municipal Code, Chapters 20.50 and 20.60.

Appendix B

SELECTED DOCUMENTS TO BE MADE AVAILABLE ON THE PORT'S WEBSITE

The Port of Seattle intends to make a wide variety of the documents and materials referenced in this Response to the Performance Audit available on its website, www.portseattle.org. These documents and materials will include:

- Resolution 3181
- Ethics Policy EX-3
- The Port's purchasing policies, including Policy PUR-2
- Talbot, Korvola & Warwick LLP performance audit report and the Port's associated 37-point action plan
- The Port's internal audit report related to professional services agreements and the Port's associated action plan
- Port of Seattle Art Program Guidelines (Final Version, October 2000)
- Minutes of the May 22, 2001 Port Commission meeting