

STATE AUDITOR'S OFFICE PERFORMANCE AUDIT



Seattle Public Schools Construction Management

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WASHINGTON
BRIAN SONNTAG
STATE AUDITOR

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EXECUTIVE SUMMARY

Why we did this audit

In 1995, Seattle Public Schools began a capital construction program to modernize and expand the capacity of school buildings and other facilities, many of which were more than 50 years old. Since then, the District has used \$1.2 billion in property tax revenue to finance more than 40 projects through the Building Excellence Program (BEX).

BEX has been funded in three phases. The first phase, projected to cost \$330 million, ended in 2005. The second and third phases are projected to cost \$900 million and the District expects to complete them in 2011.

We audited the District's management of portions of the second and third phases of BEX construction, focusing on seven construction projects and 15 contracts from July 1, 2005, through June 30, 2008. We audited the program because of its large scale, cost and the potential for cost overruns. The District built many BEX projects during a period of rapid escalation in the cost of construction materials, which affected the District's planning and decision-making.

We designed the audit to address the following question:

- Did Seattle Public Schools establish and follow sound processes to effectively manage BEX construction projects?

We conducted the audit under the authority of the state's performance audit law, which was approved as Initiative 900 by Washington voters in 2005. The initiative was designed to promote government accountability and the cost-effective use of public resources. We performed the audit in accordance with generally accepted government auditing standards as prescribed by the U.S. Government Accountability Office.

Audit results

Seattle Public Schools developed policies and procedures to manage the BEX program. The procedures generally were well designed and included most of the leading practices of the construction industry.

However, the District did not always follow its policies and procedures, which increased the risk of cost increases and time delays. For example, BEX staff sometimes bypassed change order approvals; change orders were not adequately justified and supported; and the District overpaid some invoices. In addition, we found instances of overcharges and incomplete record-keeping. We also identified opportunities for the District to strengthen policies and procedures.

It is difficult to determine the precise impact of these weaknesses on the overall cost and timeliness of the BEX program. The inherent difficulty of renovating old and historically significant buildings and rapid inflation during the construction period also affected the District's ability to keep the projects on time and within budget. However, we believe the failure to fully comply with internal processes to control and manage the construction effort negatively affected BEX costs and results.

Recommendations

The District changed several of its construction management procedures during the audit to address some of the weaknesses we identified, although we were not able to evaluate the effectiveness of the new practices. We recommend additional improvements:

- **To address gaps in current policies and procedures,** we recommend the School Board or Superintendent adopt policies and procedures to strengthen the District's contract management; to ensure the District obtains the best price for contracted services; regularly assess contractors' performance; and ensure minority- and women-owned businesses have the maximum practical opportunity to compete for District contracts.
- **To improve contract development and approval practices,** we recommend the Superintendent provide the School Board with fully negotiated contracts that contain complete information about the scope of work and provide timely updates about major project changes and cost increases.
- **To strengthen project management,** we recommend District staff closely monitor contract modifications, change orders and contractor billings. Also, District personnel should reject any contract modifications or change orders that appear to have been split into smaller amounts to avoid management or School Board scrutiny.
- **To improve communication and accountability,** we recommend BEX program managers require the construction manager to include actual costs of ongoing projects versus budgeted amounts for major contracts, and that they more strictly enforce contract terms governing contract modifications, change orders, contractor charges and documentation.

What's next?

The state performance audit law requires the School Board, as the District's legislative body, to conduct at least one public hearing within 30 days of this report's release to consider the audit findings and to receive comments from the public.

The Board must consider the results of this audit in connection with its spending practices and must report by July 1 of each year on its implementation of the audit recommendations. State law also requires the District to justify recommendations not implemented and to report any other corrective action taken in response to the audit.

While the law provides no penalties for audited entities that do not follow performance audit recommendations, the State Auditor will ask the School District to report on the status of the audit recommendations by July 2011. The State Auditor's Office also may conduct follow-up performance audits.

INTRODUCTION

Audit overview

In 1995, Seattle Public Schools began a capital construction program to modernize and expand the capacity of its school buildings and other facilities, many of which were more than 50 years old. Since then, the District has used \$1.2 billion in property tax revenue to finance more than 40 projects through its Building Excellence Program (BEX). Most of those construction projects involved new school construction or major renovations.

The District projected the first phase of BEX construction would cost more than \$300 million. This phase ended in 2005. The next two phases, with projected spending of about \$900 million, were in progress at the time of the audit. The District expects to complete them in 2011.

We audited portions of the second and third phases of BEX construction projects because of the cost and scale of the program and the potential for cost overruns. We focused on management of contracts and contractors, contract changes and communications with interested parties. We designed the audit to determine:

- Did Seattle Public Schools establish and follow sound processes to effectively manage BEX construction projects?

Audit scope

This audit covers portions of the District's management of BEX II and BEX III projects from July 1, 2005 through June 30, 2008. To assess whether the District's executive management, facilities management and BEX construction management followed best practices and District policies and procedures in managing the projects, we selected seven projects to review. We selected 15 contracts related to those projects—at least two per project. Altogether, we audited \$38.3 million of \$280.9 million the District spent on the seven projects as of June 30, 2008. More than 62 percent of the activities we audited were contract modifications and change orders.

The projects and contracts we selected were based primarily on specific transactions—contract modifications and change orders—that appeared to be most likely to result in cost overruns or costs in excess of initial budget. Therefore, we cannot project the results of our audit to all District construction projects. The contracts within each project that we reviewed are summarized below:

Exhibit 1 Construction Projects Audited Dollars in millions					
School	Project	District- Adjusted Budget⁴	Budget as of 12/1/105	Contracts Audited³	Transaction Dates Audited
Roosevelt High School ²	Historic renovation of 1922 and 1928 buildings, demolition and rebuilding of gym and cafeteria. New construction of performing arts center. Original levy estimate ¹ : \$75.6 million in BEX II.	\$89.4	\$94.0	Architectural \$7.1 Construction \$66.5	March 2005 – July 2006
Cleveland High School	Historic renovation of 1927 building, demolition and rebuilding of gym. New construction of a commons. Original levy estimate ¹ : \$48.5 million in BEX II.	\$60.4	\$68.3	Construction \$54.3	July 2005 – July 2008
Garfield High School ²	Historic renovation of 1923 and 1929 buildings with, new constructed additions. Original levy estimate ¹ : \$60.9 million in BEX II.	\$78.8	\$108.9	Architectural \$6.7 Construction \$89.1	June 2003 – July 2008
South Lake High School ²	New construction. Original levy estimate not included in BEX levy.	\$14.5	\$14.5	Architectural \$1.2	March 2006 – July 2008
Hamilton Intl. Middle School	Historic renovation of 1927 building and new construction of a gym. Original levy estimate ¹ : \$18.4 million in BEX II, \$75.5 million in BEX III.	\$79.0	\$72.3	Architectural \$5.5	July 2006 – September 2008
Nathan Hale High School	Renovation of existing building with new additions. Original levy estimate ¹ : \$8 million in BEX II, \$77.6 million in BEX III.	\$83.5	\$85.6	Architectural \$6.1	July 2007 – June 2008
Denny / Chief Sealth	Remodeled existing building and constructed a new building. Original levy estimate ¹ : \$125 million in BEX III.	\$134.6	\$149.0	Architectural \$8.2	October 2007 – August 2008

Source: Seattle Public Schools.

Notes:

1. Original levy estimates were preliminary projections and did not include \$80.2 million in contingency funding, escalation, costs for educational specifications or anticipated earnings from investment of bond money. These costs were assigned across all projects.
2. Completed for occupancy when audit began.
3. The contract amounts as of June 30, 2008.
4. District management stated it revised BEX II project budgets to these amounts to reflect cost escalations occurring during 2004-2006 that were not considered in the original project cost estimates. These escalations were not subject to audit.
5. District management provided project budgets as of December 1, 2010. These were not subject to audit.

We also examined two other contracts as part of the audit:

- A \$19.2 million contract with a construction manager to oversee the day-to-day operations of the BEX construction program.
- A \$1.9 million contract for interior design and furnishings.

Transactions from both projects were charged to multiple BEX construction projects and are included in the amounts shown above.

We examined the following transaction types related to the projects and contracts:

Exhibit 2		
Costs Associated with Transactions Audited		
Description	BEX II Amount	BEX III* Amount
Interim architectural services	\$342,000	\$150,000
Contract modifications	\$9.2 million	\$2.1 million
Change orders	\$12.4 million	N/A
Contractor Invoices	\$5.3 million	\$734,000
Contractor estimates	\$7.9 million	N/A
Total	\$35.2 million	\$3 million
Source: Seattle Public Schools Construction Records.		
Notes: *BEX III projects had just started and had limited activity during the audit period.		

To assess whether Seattle Public Schools had adopted an adequate system for managing these construction projects, we compared leading best practices for construction project management with applicable contract terms and conditions and with the policies, procedures and other practices the District indicated it used to manage the projects.

To assess whether the District followed its policies and procedures and effectively managed the projects, we reviewed documents and management processes the District used to solicit, select and award contracts to vendors; contract provisions and scope of work; contract modifications and change orders approved by the District; requests for payment, and invoices and other supporting evidence. We also hired consultants with expertise in all phases of construction and construction project management to help us perform the audit and review the documentation provided.

More detail on our audit methodology is in **Appendix B** and leading practices are in **Appendix D**.

Audit in accordance with government auditing standards

We conducted this performance audit under the authority of state law (RCW 43.09.470), approved as Initiative 900 by Washington voters in 2005, and in accordance with the generally accepted government auditing standards prescribed by the U.S. Government Accountability Office. 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.

The District was not able to provide all the documents and records we requested during the course of the audit work. While the District stated it was withholding some records due to attorney client privilege, it was not able to provide all documents requested or provided them months after the initial request. Although these actions reduced the number of documents we reviewed and our ability to determine the appropriateness of some expenditures, we believe the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. However, this report discusses project documentation as an audit issue because the completeness of and lack of documentation affected District management's ability to make informed decisions regarding the BEX projects.

We also experienced a number of difficulties in completing the audit on a timely basis. Delays were caused by the slow delivery of requested information and records, significant time to review and assess the audit evidence provided by our audit consultant, and the extensive technical review of audit findings with District representatives, subject matter experts, and legal counsel.

Government auditing standards require that we disclose any impairments to independence or the appearance of such impairments in our audit report, and how they affected or could have affected the audit results. In February 2009, the State Attorney General's Office received a letter from a law firm representing one of the District's contracted construction management firm representatives, written in response to preliminary findings we provided to the District. The letter asserted the audit was not being conducted in accordance with generally accepted government auditing standards, lacked evidence supporting the preliminary findings, and lacked an understanding of the program. The letter threatened to file a lawsuit against the State Auditor's Office.

In our opinion, the audit results are based on our objective assessment of sufficient and appropriate evidence that provides a reasonable basis for our findings and conclusions, based on our audit objectives. The final report reflects our consideration of the District's response to the preliminary findings and additional evidence we obtained as we completed the fieldwork.

We have communicated less significant issues to Board members and management. We do not believe the significance of those issues warrants their inclusion in the audit report.

BACKGROUND AND LEADING PRACTICES

Background on Seattle Public Schools construction

The District serves approximately 45,000 students and operates 12 high schools, nine middle schools, 51 elementary schools, 10 kindergarten-through-eighth-grade schools and seven alternative schools and special programs. An elected, seven-member Board of Directors governs the District, sets policies and priorities, and manages resources. The Board appoints the superintendent, who manages day-to-day operations. Operating and capital funds spent during the audit period is shown below.

Exhibit 3		
District Operations and Capital Expenditures		
Dollars in millions		
Fiscal year ending August 31	Operating expenditures	Capital* Expenditures
2006	\$ 419	\$ 128
2007	\$ 461	\$ 129
2008	\$ 480	\$ 144

Source: *Seattle Public Schools Annual Financial Reports*
Note: * Includes capital outlay from general fund operating expenditures.

BEX capital projects and management system

Building Excellence Program. Voters in the School District authorized the Building Excellence (BEX) Program in 1995 and approved the second and third phases in 2001 and 2007. Voters approved the funds to replace or renovate aging school buildings and other District buildings, and to modernize technology and infrastructure, such as plumbing and heating/cooling systems. BEX III funding also supports athletic field replacement and renovation. The BEX program includes the District's largest and most complex projects.

Voters approved tax levies that provided the District with \$1.2 billion to fund its BEX I, II and III programs, as summarized in **Exhibit 4**. A separate Buildings Technology and Academics Levy pays for nearly \$30 million in costs annually. These costs were not included in this audit.

Exhibit 4					
Building Excellence Program Activity by Levy					
Dollars in millions					
Construction Phase	Levy amount	Levy approved	Estimated completion date	Number of projects	Expenditures as of 8/31/10
BEX I	\$ 330	1995	2005	19	\$ 384
BEX II	\$ 398	2001	2010	17	\$ 435
BEX III *	\$ 490	2007	2011	7	\$ 330
Total	\$1.2 billion			43	\$1.2 billion
<i>Source: Seattle Public Schools website and accounting records.</i>					
<i>Notes: * BEX III projects had just started and had limited activity during the audit period.</i>					

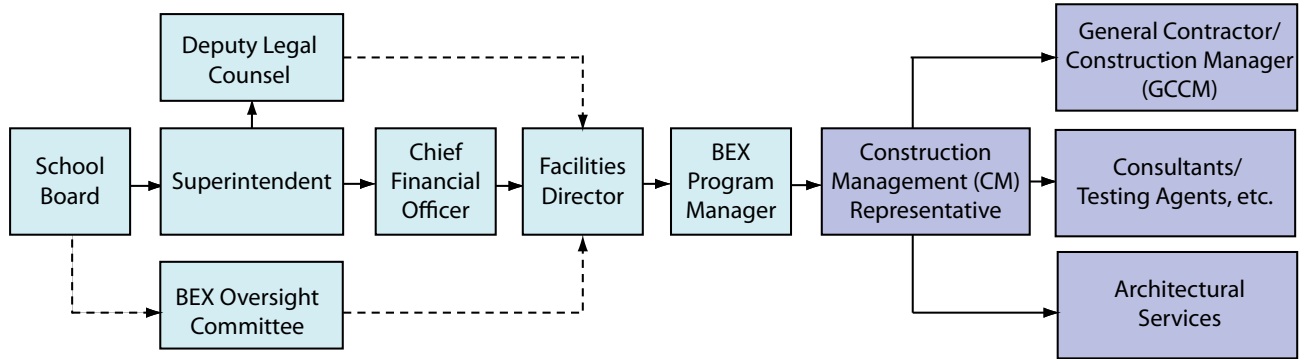
As the table shows, by the end of August 2010, the BEX I and BEX II projects had exceeded original cost estimates. Several factors contributed to the increases. For example, during the audit period—2005 to 2008—material and labor costs increased dramatically. In addition, a significant number of projects were renovations and therefore were more likely than new construction to experience unforeseen conditions that resulted in project delays and additional costs.

The District’s facilities department employees manage and monitor BEX projects internally. The staff includes a BEX program manager, several engineers and three to four support staff. The District contracted with private construction management firms to manage day-to-day operations of BEX construction. These firms work with architects, general contractors and consultants for the design and construction of each school project.

Roles and responsibilities

The following table details the roles and responsibilities of District management staff, facilities staff, the construction manager, and the architects and other contractors/consultants during the audit period.

Exhibit 5 Construction Approval Authority



District Management/Oversight Responsibilities
<p>School Board: Approves contracts, change orders, and contract modifications costing more than \$250,000 (individually and cumulatively).</p> <ul style="list-style-type: none"> Establishes policy and has oversight responsibility for District operations, including construction.
<p>BEX Oversight Committee:</p> <ul style="list-style-type: none"> Established as a requirement of the BEX I levy to monitor implementation of the BEX Program and issue recommendations to the Board.
<p>Deputy Legal Counsel:</p> <ul style="list-style-type: none"> Prepares standard contract forms. Manage negotiation of major contractor claims.
<p>Superintendent: Can approve contracts, change orders, and modifications of up to \$250,000.</p> <ul style="list-style-type: none"> Signs and executes contracts and manages school operations as directed by the Board.
<p>Chief Financial Officer: Can approve contracts, change orders, and modifications of up to \$150,000.</p> <ul style="list-style-type: none"> Oversees accounting function, and establishes budget authority for all construction-related charges, change orders and contract modifications.
<p>Facilities Director: Can approve contracts, change orders, and modifications of up to \$50,000 (\$150,000 after August 2006).</p> <ul style="list-style-type: none"> Oversees Contracting Services and the BEX Program.

Consultant Responsibilities
<p>Construction Management (CM) Representative: Can approve contract, change orders and modifications up to \$10,000 (\$25,000 in emergencies).</p> <ul style="list-style-type: none"> Private firm hired as representative of the District in day-to-day management of BEX projects. Advises BEX program manager. Monitors contractors and work performed on BEX projects. Reviews & negotiates plan specifications, contract modifications, change orders, and contractor invoices. Reports status of projects and of each contract to BEX program manager.
<p>Architectural Services:</p> <ul style="list-style-type: none"> Private firm selected by School Board based on assessment of qualifications and proficiency to design school projects. Drafts project design documents. Develops and recommend changes to the design. Completes construction documents. Provides independent cost estimates of additional work for evaluation of proposals.
<p>General Contractor/Construction Manager (GCCM):</p> <ul style="list-style-type: none"> District hired private firms that serve as independent contractors to supervise and direct the construction. Responsible for delivery of the project consistent with the architect's design. Develops, solicits, and selects subcontractors to perform all tasks necessary to complete the project. Submits change order proposal to the construction management representative for review.

Leading practices for construction management

Good project management is critical to effectively plan, execute, monitor, complete and evaluate construction projects. Good project management should reduce the risk of unnecessary cost increases and increase the likelihood of projects being completed on budget and on time. As a result, numerous industry and government guidelines identify best practices for project management—both in general and specifically related to construction management.

The literature and guidelines we reviewed indicated that, for projects of this size, scope and complexity, the most important practices include hiring a qualified construction manager to oversee contractors’ work, monitoring change requests and schedules, tracking budgets, controlling costs and monitoring project risks.

To help identify leading construction management practices for this audit, we reviewed various project management guides—referenced in **Appendix C**—and hired a consultant experienced in integrated construction budget, scope, schedule, and project management. The key phases of a project management process—and a few highlights of the best practices associated with each phase—are summarized on the next page. More detail on these best practices is presented in **Appendix D**.

Exhibit 6	
Global Project Management Leading Practices	
Process	Sample Leading Practices
1. Develop Project Charter	<ul style="list-style-type: none"> • Establish standardized guidelines. • Assign project manager and authority level. • Provide information on communication process.
2. Preliminary Project Scope Statement	<ul style="list-style-type: none"> • Develop requirements for services needed and requirements for approvals. • Set project schedule for completion.
3. Project Management Plan	<ul style="list-style-type: none"> • Select a project management team. • Establish clearly defined performance standards for contractors, identify how performance will be evaluated and assign staff for monitoring performance. • Decide how project changes will be monitored and controlled. • Develop provisions for communication requirements with interest groups.
4. Direct and Manage Project Execution	<ul style="list-style-type: none"> • Manage the project team, train staff. • Obtain bids from contractors, negotiate contracts. • Manage risks, adopt approved changes. • Collect project information, report costs.
5. Monitor and Control Work	<ul style="list-style-type: none"> • Assign a contract manager to monitor the project. • Compare actual project performance to the project plan. • Identify needs for corrective or preventative actions. • Track budgets and compare invoices and charges to contract terms and conditions. • Maintain accurate and timely information and documentation.
6. Integrated Change Control	<ul style="list-style-type: none"> • Ensure only approved changes are implemented. • Control and update project scope, cost, budget, schedule and quality requirements based on approved changes. • Document complete impact of requested changes.
7. Close Project Process	<ul style="list-style-type: none"> • Verify and document project completion. • Collect project records. • Gather lessons learned from the project. • Update all records and archive for future use.
<p>Source: <i>Project Management Institute, A Guide to the Project Management Body of Knowledge, 2004 Third Edition.</i></p>	

AUDIT RESULTS

Objective: Did Seattle Public Schools establish and follow sound processes to effectively manage BEX projects?

Seattle Public Schools developed sound policies and procedures for guiding the management of the multiyear Building Excellence Program. Overall, those policies and procedures addressed most of the leading practices of the construction industry. However, we found several gaps that, if addressed, could improve the District's policies and procedures and provide greater assurance that construction projects will be adequately managed and monitored.

We also found the District did not always comply with its established policies and procedures or provide effective management and oversight. For example, for the seven school construction projects and 15 contracts we reviewed, the District did not always follow vendor selection rules; its employees bypassed some required approvals; and change orders were not always adequately justified and supported. In addition, we found overcharges, inadequate controls over project scope, and disorganized and incomplete record-keeping.

It is difficult to determine the effect of procedural gaps and noncompliance on the overall cost and timeliness of the BEX program. Significant cost increases in the construction market during the audit period and the challenge of renovating old school buildings under an ambitious completion schedule undoubtedly had some effect on the District's ability to complete projects within its budget. We also believe weaknesses in the plan and implementation of construction management policies and procedures increased the risk of unnecessary costs.

Exhibit 7 identifies more than \$1.2 million in costs that were inadequately supported or that contained overcharges, or might have been reduced or avoided through better project management. These costs are discussed in the sections that follow.

In addition, we identified a lost opportunity to reduce costs by \$1.2 million for additional work in a contract when the District did not solicit competition for the increased scope of work.

Exhibit 7 Costs in Question	
Description	Amount
Contract modification without sufficient justification	\$ 334,000
Unsupported costs	\$ 353,100
Overcharges	\$ 93,900
Costs that could have been reduced or avoided through better management	\$ 454,000
Total	\$ 1,235,000
<i>Source: Items B–D.</i>	

Issue: Overall, Seattle Public Schools adopted appropriate construction management practices that addressed most leading best practices, but it could make improvements in several areas.

In general, we found the District's processes and procedures for managing the BEX construction projects were well designed and addressed most of the leading best practices. Some noteworthy examples are:

- Hiring a construction manager with experience handling large, complex projects. Given that the District did not have employees qualified to manage construction projects of this size and duration, this was one of the most important steps the District took. Among other things, the construction manager was charged with managing and supervising all contracts, observing the daily progress of construction projects; helping the District review, analyze, and process change orders and claims; comparing invoices and charges to contract terms and conditions, and helping the District in negotiations, administrative proceedings and litigation or dispute resolutions with contractors. In addition, the construction manager was responsible for preparing daily reports on issues and developments as they arose, weekly reports summarizing the work performed, and monthly reports on project budget and schedule status. The construction manager had developed an extensive manual of project management policies and procedures. Although the School Board did not formally adopt these procedures, District officials cited them as being "good business practices" that were widely used.
- Establishing standard guidelines for managing projects that addressed financial controls, roles and responsibilities of District employees and the construction manager—including work authorization authority and change order review and approval.
- Establishing guidelines related to project records management, project reporting and communication.
- Using standard contracts that provided a scope of work and requirements for submission, review and approval of contract modifications, including incentive awards, and provisions for corrective action in contracts with general construction contract managers.
- Establishing evaluation and selection procedures for architect/engineer proposals and review committees to monitor and provide input on projects.

We found the District could improve its policies and procedures in the following areas:

- The District did not formally adopt the Building Excellence II Program Procedure Manual the construction manager prepared for these projects. Formally adopting those policies and procedures promotes accountability and would provide greater assurance that the construction manager would consistently follow them.

- School Board policies and procedures lacked several provisions regarding maximizing opportunities for minority and women-owned businesses to compete for public contracts¹.
- Contracts with the construction manager and architects/engineers lacked a requirement for formal performance evaluations and performance measures. During audit fieldwork, District and BEX managers told us they thought formal evaluations were not necessary because BEX project managers met weekly with the construction management firm. These meetings were not documented. Assessing the performance of the construction management firm should be an integral component of an ongoing, District-wide assessment of construction management performance.

Such provisions help ensure that contractors have a clear understanding of what they are expected to accomplish and what actions will be taken if they do not meet those expectations.

- Policies and procedures were silent in regard to timeliness of communication from District employees to the School Board and completeness of contracts submitted for approval. Without timely and complete information, the Board's ability to make informed decisions can be impaired.
- The District did not have a formal process to document "lessons learned" and plans to improve future activities. Such processes are important to help identify what problems occurred, why they occurred, and how to prevent them in the future.

The District addressed many of these gaps when it revised its policies and procedures in September 2008. See District actions to address preliminary audit findings later in this section for more detail of the changes the District made.

These issues are addressed in **recommendations 1, 2 and 3**.

¹ RCW 39.80.040

Issue: The District did not consistently follow its established policies and procedures and best practices on the projects and contracts we reviewed.

Although the District's construction management policies were generally well-designed, they were not consistently followed. We categorized these inconsistencies:

- A. BEX program management did not consistently follow review and approval policies.
- B. BEX program management approved a change order and scope revision without justification sufficient to verify additional work performed.
- C. BEX program management approved contractor charges without support adequate to verify costs.
- D. The District incurred costs that could have been avoided or reduced.
- E. The District did not always maximize use of the bidding process to purchase services.
- F. BEX program management did not always follow provisions of contracts requiring written notice.
- G. Facilities project documentation was scattered and some documentation was not available.

These issues are addressed in **recommendations 4 and 6 through 10**.

A. Review and approval policies were not consistently followed.

As elected officials, school board members ultimately are responsible for ensuring districts' education programs are effectively managed, including the construction and management of facilities. As described in the Background and Leading Practices section, District policies delegate responsibilities among the School Board and District managers and employees, and include thresholds for Board and/or Superintendent approval of contracts, modifications and change orders. In addition, contracts for construction management, architect and engineering services, and general contractor/construction manager (GCCM) firms include provisions for District and/or its representatives' oversight. We found contract modifications and change orders were not always approved at the appropriate level of responsibility in accordance with established policies and procedures, and that complete contracts were not always provided to the School Board for approval.

BEX program management did not always obtain School Board approval for contract modifications, as required. According to School Board policies in effect at the time of the audit, Board approval for changes to existing contracts was not required if they were less than \$250,000 each or if the sum of all changes was less than \$250,000. District and BEX management approved 52 contract modifications totaling almost \$4 million on the five architectural services contracts we reviewed. The School Board approved two modifications of more than \$250,000 each but did not approve the 31 contract modifications that were presented to the District after their cumulative total exceeded \$250,000 on a project. Those modifications ranged from \$2,988 to \$233,640.

In response to these issues, District management acknowledged that such actions were not consistent with School Board policy in effect at the time, and stated the actions were taken because seeking Board approval of smaller actions was not considered an effective use of the Board's time. In September 2008, the Board adopted procedures that require Board approval for individual changes that exceed \$250,000.

In August 2006, the Director of Facilities amended policies to increase thresholds for his approval from \$25,000 to \$50,000 to more than \$100,000 and the BEX Program Manager's from \$25,000 to between \$20,000 and \$100,000 to expedite change-order processing. The change the Facilities Director adopted affected only the review requirements of Facilities and BEX management and did not affect the Board's review threshold. It is not clear whether the Director of Facilities had the authority to change Board policy or if the Board delegated authority to the Superintendent prior to late 2008.

Facilities and BEX program management entered into three interim architectural services contracts without required Board approval. District policies required Board approval of all professional services contracts. Facilities, BEX and District executive management signed interim architectural services contracts before obtaining Board approval of the selection of the architectural firm for projects:

- South Lake High School - \$80,000
- Hamilton International Middle School - \$212,346
- Nathan Hale High School - \$150,000

Facilities and BEX management told us they used interim contracts to get project planning and design work started as quickly as possible to mitigate the effect of cost escalations that occurred during the audit period.

BEX program management approved contract modifications and change orders that had been split into amounts that fell under the threshold for executive management or School Board approval. Those thresholds were \$250,000 for Board approval and \$100,000—after August 2006—for the BEX program manager's approval. Examples of the split invoices that BEX program management approved included:

- Roosevelt High School's heating, ventilation and air conditioning system: A contract modification for \$297,000 was split into two modifications in the amounts of \$233,618 and \$63,769, respectively. An e-mail exchange between the construction management firm and the architect stated: "Here is an alternate way the mechanical redesign can be broken out so that the costs do not exceed the \$250K signature limit." The e-mail indicated the District's Executive Facilities Director was in agreement with the split. It is not clear who initiated splitting the modification.
- Garfield High School project: We identified 10 groups of change orders totaling \$1.9 million. Each group had been divided into two or more change orders that were dated within a couple of days of each other, or represented a single work effort, i.e. floor demolition. The 10 groups of change orders, ranging from \$108,800 to \$530,000, were split into 24 smaller change orders ranging from \$28,500 to \$240,000. Only one was

approved by someone other than the BEX Program Manager. Had these change orders not been separated into smaller amounts, the Facilities Director and, for one group, the approval of the District Chief Financial Officer, Superintendent and Board would have been required.

- Interior design and furnishings professional services contract for BEX II projects: a \$256,600 contract modification for "additional move management services" was split into three smaller modifications for \$95,400, \$50,700, and \$110,500. The Director of Finance approved the first two; the Superintendent approved the third.

Facilities and BEX management submitted incomplete architectural contracts to the Board for its approval.

- The architect contract that Facilities and BEX management sent to the Board for Denny/Sealth was incomplete. The contract did not include \$378,000 for "other basic services" that are part the "all services except additional services" that make up the contract's fixed price. Facilities and BEX management approved six contract modifications adding the costs for these services that should have been included in the fixed-price contract the Board approved. In the District's response to the preliminary finding, it stated costs related to "other basic services" were negotiated separately and the approach for seeking Board approval for an incomplete contract was not appropriate: "Either the entire contract should have been negotiated prior to presenting it to the School Board, or the Board should have been fully informed of the excluded elements."
- Facilities and BEX management sent the \$5.7 million Nathan Hale architect contract to the Board before fully negotiating the architects' fees. Instead, management used estimates because the architectural firm did not have sufficient time to prepare a detailed fee proposal. The documents submitted to the Board did not identify the fact the fees were not finalized. Nearly three months after the Board approved the contract, a modification was issued increasing additional services and reimbursable costs by \$930,000 and reducing basic services by \$978,338 for a net reduction of \$48,338.
- The Nathan Hale, Denny/Sealth and South Lake architectural contracts omitted required lists of approved subcontractors and their hourly rates. The list is necessary to establish pricing for contractor modifications or change orders.

Facilities and BEX management did not inform the School Board of two large project cost increases until it was too late for the Board to consider and act on them.

- BEX management did not inform the School Board of \$1.7 million in additional work to excavate bedrock from the Cleveland High School project until eight months after BEX management was notified by the GCCM and after the District spent \$954,395 on the effort.
- Similarly, BEX management did not notify the Board of the nearly \$2 million in additional costs for the Roosevelt heating and air conditioning system until four months after the construction manager notified BEX management.

B. BEX program management employees approved a change order for scope revision without sufficient justification.

We found one instance in which BEX program management approved payment to contractors for work that was included in the original fixed price, but due to a lack of documentation, we could not determine whether the work added to the original scope of work.

Exhibit 8		
Contract modification without sufficient justification		
Project	Description	Amount
Hamilton Middle School	Contract modification to increase the fee to an architect without evidence of change in scope of work or additional effort.	\$334,000
<i>Source: Seattle Public Schools construction records.</i>		

BEX program management performed the review and was responsible for ensuring the charges were adequately supported and reviewed.

C. BEX program management approved charges without adequate supporting documentation.

We identified instances in which BEX program management, and in some cases higher levels of District management, approved contract modifications and change orders and invoiced charges that did not include sufficient documentation to show the charges were appropriate. We were unable to determine the validity of the following costs:

Exhibit 9		
Unsupported costs		
Project	Description	Amount
Hamilton Middle School	Contractor charges for reimbursable costs and “time spent” labor costs	\$125,300
Garfield High School	Incentive fees awarded to a contractor	\$100,000
Cleveland High School	Additional costs charged by a contractor for rock excavation	\$116,700
Cleveland High School	Contractor charges for removal of excavated material	\$11,100
Total		\$353,100
<i>Source: Seattle Public Schools construction records.</i>		

Although BEX program management performed the initial review with the construction management firm, the District was responsible for ensuring these charges were adequately supported and reviewed as part of the authorization process.

D. BEX management incurred costs that could have been avoided or reduced.

Overcharges: We identified overcharges the construction management firm and BEX program management approved that the District did not need to pay:

Exhibit 10 Overcharges		
Project	Description	Amount
Garfield, South Lake and Hamilton High Schools	Labor rates and mark-up charges were exceeded those in the contracts	\$3,800
Cleveland High School	Excavation hauling was charged more than once	\$23,500
Cleveland High School	Additional bedrock removal costs that should have been included as part of the final settlement agreement	\$5,300
Garfield High School	An incentive payment to the GCCM overstated because of a math error	\$5,000
Roosevelt High School	Payment toward a contractor’s claim settlement in excess of the agreed \$5.6 million	\$55,000
Interior Design and Furnishings Contract (multiple projects)	Mileage and parking charges that were unallowable under the terms of the contract	\$1,300
Total		\$93,900
<i>Source: Seattle Public Schools construction records.</i>		

Costs that could have been reduced or avoided

Facilities management employees requested a redesign of the Roosevelt HVAC system after the architectural drawings were complete. Although they selected a redesign that could have saved them money, BEX employees subsequently amended project plans without requesting complete estimates of the additional costs. Contractors provided an estimate of the additional costs to BEX employees approximately four months after agreeing on the conceptual redesign. BEX management attempted to revert to the original plans, but it was too late, so it approved the redesign at an increased cost of more than \$1.8 million. The \$1.8 million included a settlement for a GCCM’s claim for \$454,000 because of schedule delays caused by the redesign.

E. The District did not always maximize the bidding process to purchase services.

We identified issues in two areas. First, BEX management expanded its \$759,000 interior design and furnishings professional services contract by approving 19 contract modifications totaling \$1.2 million, including \$1 million for services not included in the scope of the original contract. Although it is standard practice to expand project scope, the magnitude of the additional work suggests the District may have gotten a lower price for the work if it had put the additional work out to bid.

Second, BEX management did not consistently follow District procurement policies when selecting architectural/engineering (A/E) firms. Because the District received only two proposals on the Nathan Hale project and three proposals on South Lake, BEX employees were not able to provide the five or six proposals to the A/E selection committee that District policy required. With no policy to guide them when the number of proposals was below policy requirements, BEX staff decided to proceed with only two proposals rather than re-advertise the contract. We were not able to determine the reasons for this decision because the District had limited documentation of its A/E procurement decisions.

F. BEX II program management did not always follow contract provisions requiring written notices.

The District's architectural and engineering contracts contain requirements for the District—or the construction manager acting as the District's representative—to provide written authorizations to the architect to proceed with additional services or changes in services. In response, the architect is required to submit written notice of costs or expected additional compensation to the District or construction manager. We noted the absence of required written notices in the following:

- **Garfield High School Project:** Five contract modifications totaling \$919,042
- **Denny Middle School Project:** One contract modification for \$144,264
- **Hamilton Middle School Project:** Five contract modifications totaling \$493,543

Failure to follow contract terms and conditions may impair the District's ability to hold contractors accountable.

G. Some BEX construction project records were received late, and documentation was not available.

During the audit, we requested documents and other information supporting District decisions and transactions. District facilities employees were unable to provide all requested documents in a complete and timely manner. For example, on April 26, 2009, the District responded to 23 requests for documents and other information that dated back to October 8, 2008. On May 11, 2009, another 24 responses were sent, some also dating back to requests made in October 2008.

We could not always determine whether the inability to supply documents was because the documents did not exist or because they could not be located. Project documents were not stored consistently, and some were in multiple locations.

The District's construction management firm was responsible for maintaining the project documents and files. However, BEX program management did not have direct access to the construction management representative's project documents or cost-tracking systems where project records and information were stored. Employees had to request the documents they needed.

In addition, the District's contract with its construction management firm

required contract-level information to be reported monthly, but these reports did not include enough detailed project information to support effective monitoring. The monthly reports included data on original budgets, budget transfers, approved contract modifications and charges to date. However, the reports were totaled at the project level and did not provide detail at the contract level.

Management needs comprehensive, timely information for effective decision-making, financial management and proper oversight of consultants, contractors and subcontractors. This information also provides the public assurances that BEX funding is effectively spent. The absence of complete documentation and records increased the District’s risk for higher costs and project delays. The District’s lack of documentation is an underlying issue noted throughout this report.

Factors contributing to noncompliance with policies and procedures

Based on our conversations with District managers, we identified the following factors that may have contributed to the failure to fully comply with established policies and procedures for managing the BEX construction projects. Specifically, District management pointed to the effect of construction cost inflation during the early years of the BEX program, tight deadlines to complete projects in time for the start of the school year, and reliance on the construction management consultant.

- **Construction inflation and ambitious construction schedules**

District management stated construction industry costs were rapidly increasing when the projects we audited were under construction. They stated because it was difficult to know when construction inflation would return to normal, they believed it was more cost-effective to make purchases earlier rather than later. In addition, District officials stated that in some cases, it had no alternative locations to hold classes if the work was not completed on time.

For these reasons, District officials stated they took a number of actions to expedite the projects that were under way—including accelerating schedules and removing incentives for everything but meeting project deadlines. They cited market conditions and tight deadlines as the primary reasons they had not always obtained School Board approval when required and had decided not to rebid projects when they had not received the minimum number of bids or when the scope of work was significantly expanded.

- **Challenges associated with renovating old, historical buildings**

The District’s buildings are relatively old, and many of them are subject to the City of Seattle’s historic preservation regulations. With land for new construction in short supply and prohibitively expensive in Seattle and the District’s interest in preserving existing structures, a significant number of the BEX II and BEX III projects are renovations. The renovation and remodel of historical buildings present unique challenges not experienced in new construction, including greater risk of unforeseen conditions, cost overruns and project delays.

- **Over-reliance on construction management firm**

District officials also stated they placed reliance on the construction manager. By contract, the construction manager was responsible for maintaining documentation, tracking projects, reviewing contract modifications and change orders, and approving invoices. District officials stated BEX project management regularly reviewed the work of the construction management firm but did not conduct regular formal performance assessments to ensure it was adhering to the terms of the contract and effectively handling its responsibilities. However, neither the BEX program manager nor the facilities manager documented those reviews.

In many cases, it was difficult for us to determine the effects of District practices on project costs. Market forces during the audit period make it difficult to evaluate the precise reasons for cost overruns and to distinguish between additional costs resulting from weaknesses in District management and cost increases over which the District had no control. Likewise, we could not determine whether the cost overruns resulting from expediting projects were less than the increased costs that would have occurred because of construction inflation.

Nevertheless, we believe weaknesses in the design and implementation of construction management policies and procedures increases the risk that construction project costs will not be adequately controlled. We identified a number of instances in which the failure to apply established policies contributed to overcharges, missed opportunities to control costs, and inadequate support for contract modifications and submitted charges.

District actions to address preliminary audit findings

We communicated our preliminary findings in these areas to District management during audit fieldwork, beginning in early 2009. In November 2010, staff told us the District was developing a plan to modify policies, clarify procedures and prepare staff training, and had taken these steps to address weaknesses. Staff stated the District:

- Would formally adopt the Building Excellence II Program Procedure Manual as administrative procedures and would include a lessons-learned section.
- Would consider performance measures and evaluations as part of the BEX IV contracts for construction management and architectural services.
- Had partially addressed timeliness and completeness of contracts in its 2008 procedures. Those procedures require corrective action for individuals failing to inform management in a timely manner that work is proceeding. A new Superintendent Procedure would address completeness of contract content submitted to the Board.
- Developed and conducted a mandatory "lessons learned" training session in July 2010 for staff involved in the BEX school construction projects. Those lessons resulted from the preliminary findings.

- The 2008 procedure revisions reinforced expectations and clarified responsibilities for following District policies and procedures on:
 - Documenting change negotiations and the purpose for project changes.
 - Required levels of change approval.
- It is in the process of developing a Project Delivery Manual, which is intended to:
 - Standardize and coordinate daily activities and responsibilities.
 - Establish consistency of procedures.
 - Clarify areas of responsibilities.
 - Define lines of communication between various parties during the project.

We could not evaluate the effectiveness of those changes and therefore are unable to judge whether they address the issues we found.

RECOMMENDATIONS

Gaps in current policies and procedures

To help ensure that Seattle Public Schools' policies and procedures address leading best practices for construction management, we recommend the School Board or District Superintendent:

1. Adopt the Building Excellence II Program Procedure Manual as formal procedures that all staff and contractors for the BEX projects are expected to follow.
2. Require that minority and women-owned businesses receive the maximum practical opportunity to compete for public contracts, as required by state law (RCW 39.80.040) for architectural and engineering contracts.
3. Include in contracts for construction managers and architects/engineers requirements for conducting periodic performance assessments based on specific measures.
4. To ensure the District obtains the best price for added services, BEX policies should identify a threshold for competitively soliciting proposals when the additional services would significantly expand a project's scope.

Contract development, negotiations and approvals

5. We recommend for current and future school construction projects, that the District Superintendent provide the School Board:
 - Fully negotiated contracts for their review and approval, including complete information regarding the work to be performed.
 - Timely communication of major project changes and cost increases.
 - All contract modifications and change orders the School Board is required to review under Board policy.

Project management and oversight

6. We recommend the BEX Program Manager review contract modifications and change orders to prevent them from being split into amounts that avoid executive management or School Board review and approval. The Program Manager should deny approval when it appears modifications or changes were split to avoid management or School Board scrutiny.
7. The BEX Program Manager should sufficiently review charges related to contract modifications and change orders to ensure that they are not approved without sufficient documentation supporting those charges.
8. BEX program management and the construction manager should review and monitor contractor billings to ensure:
 - Work that was included in an original fixed-price contract or in a settlement agreement is not paid for again as part of a contract modification or change order.
 - Invoices are not paid without sufficient documentation.

Information and accountability

To help ensure District management has the comprehensive, timely information it needs for effective decision-making, financial management, and proper oversight of consultants and subcontractors, and to be able to demonstrate that BEX funding has been appropriately spent, we recommend the BEX program management:

9. Require the construction manager to include status of scheduled project completion and actual versus budgeted costs for major contracts in monthly reports.
10. Hold contractors to the agreed terms and conditions of contracts. Specifically:
 - Require all architectural and engineering contractors to provide written notice, within required time frames, if additional compensation is expected due to changes in services or additional services.
 - Require the construction manager to thoroughly document contract modifications, change orders and contractor charges.
 - Maintain complete project records with well-defined systems to enable ready access, including but not limited to support for project invoices and payment records.

SEATTLE PUBLIC SCHOOLS RESPONSE



January 25, 2010

Brian Sonntag, State Auditor
Washington State Auditor's Office
Sunset Building
3200 Capitol Boulevard
PO Box 40031
Olympia, WA 98504-0031

Dear Mr. Sonntag:

Thank you for the opportunity to provide this response to the Performance Audit of the Seattle School District's Building Excellence Program. In the spirit of Initiative 900, the District recognizes its responsibility to serve as responsible stewards of public funds, in particular to use prudent management practices to ensure that the investment of over \$1 billion of levy funds is effectively managed.

We agree with the conclusion of the report that the District developed sound policies and procedures for guiding the management of the multi-year Building Excellence Program, which incorporated leading practices of the construction industry.

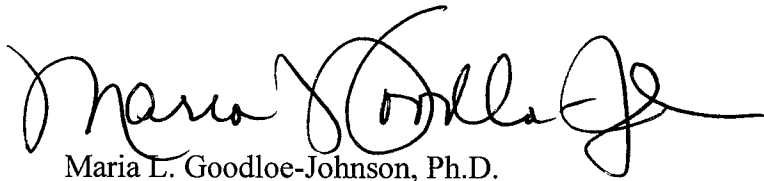
The audit covers activities through June 2008. Since then, the District has taken actions to improve the Program and will continue to do so. These actions address each of the areas noted by the audit. The report correctly acknowledges that the District implemented significant procedural changes even prior to receiving any preliminary findings from the audit, and we appreciate this recognition. The District has already made further revisions to address the audit findings and provided comprehensive training to all involved personnel. We will provide additional training to all involved personnel to assure these changes are fully implemented.

The District is proud of the success of the Building Excellence Program. This report confirms that the Program is effectively managed and that we have been responsible stewards of the public trust.

We appreciate the opportunity to work with your staff. The report has pointed to several areas of the Building Excellence Program where we can improve and we are using the recommendations to guide these actions. We appreciate the value that your audit team has provided and the collaborative, transparent and cordial approach they have used. This approach has allowed ongoing, open and professional interactions between the District and your staff.

Our detailed responses and comments are attached.

Sincerely,

A handwritten signature in black ink, appearing to read "Maria L. Goodloe-Johnson". The signature is fluid and cursive, with a long horizontal flourish extending to the right.

Maria L. Goodloe-Johnson, Ph.D.
Superintendent

Attachment

cc: School Board, w/attachment
Building Excellence Oversight Committee, w/attachment

Detailed Responses and Comments

Background

The Building Excellence Program began in 1995 with the passage of a levy to construct and remodel nearly 20 buildings throughout Seattle. With the continuation of the Program by voter approved levies in 2001 and again in 2007, the District has built, renovated or constructed additions to over 40 schools. Expenditures have totaled over \$1.2 billion.

The audit reviewed expenditures on seven projects, totaling over \$280 million during the audit period, with detailed review of \$38 million in costs, primarily change orders and contract modifications.

As the audit report describes in detail, the Program adopted appropriate practices, was well-designed and addressed most leading best practices. At program inception in 1995, the District retained a professional construction manager (CM) with experience handling large, complex programs. The CM manages the day to day activities of the projects, following an extensive manual of project management policies and procedures. As further described in the audit report, standard guidelines were established for managing projects and records management; reporting and communications standards were established; and selection procedures were established for architect/engineer contracts and standard provisions were included in contracts, including provisions for correction of poor performance. Superintendent-approved procedures have been established for approval of contracts, change orders and modifications.

An independent oversight committee was established by the Board to advise it on the conduct of the Program. This independent committee of construction professionals from other school districts, the University of Washington and the private sector, was appointed by the School Board and has provided oversight for the Program since it began in 1995. One member of the School Board is designated to serve as an ex officio member of the committee.

This structure was continued in 2001 through the decision to retain a construction management firm for the Building Excellence II Program. A complete review of this approach was undertaken in 2005, which concluded that this approach remained the proper approach for the program.

In 2007, the Building Excellence III levy program was approved by the voters, and the District again selected a construction management firm to provide most of the construction and project management services for the Program.

The audit covers events through June 2008 and does not cover actions after that date. As acknowledged by the audit report, the District has undertaken vigorous, ongoing efforts to upgrade its practices, both as part of its general practices and in specific response to the audit.

In September 2008, prior to the audit, the School Board approved revision of its contracting policies and directed the Superintendent to establish comprehensive procedures for award and modification of contracts. The resulting procedures addressed all types of contracts, not just

those for construction and architectural services, and provided direction for selection, award processes, approvals and other matters.

In 2009, following delivery of some of the preliminary findings by the auditor, the District conducted training of all Building Excellence staff and the construction manager to address the concerns raised by the findings. Procedures and forms for approval of contract change orders and modifications were revised to address the preliminary findings.

In the spring of 2010, the District began a comprehensive effort to prepare a construction procedures manual for all District projects. This manual incorporates the provisions of the Building Excellence manual described above and addresses the entire capital project process, from initial planning to construction closeout.

In July 2010, after the auditor notified the District that all preliminary findings had been provided, the District conducted training for all Building Excellence staff, accounting and contracting staff and the construction manager, to address all of the preliminary findings.

In December 2010, following receipt of initial drafts of the audit report, the Superintendent adopted revisions to the 2008 procedures, which addressed the proposed audit findings. More training will take place in early 2011.

In addition, the audit and the District's response will be presented to the Building Excellence Oversight Committee for their review and comment.

Specific Comments

Executive Summary

The District is pleased that SAO has found the District developed policies and procedures in the last 15 years of the Building Excellence Program which are well-designed and included most of the leading practices of the construction industry.

The summary also states that the District did not always follow its policies and procedures. We concur as to most of the instances noted in the body of the report.

The District will continue to assess and improve the Program wherever possible. As acknowledged in the body of the report, SAO acknowledges that SAO reviewed actions *prior to June 2008 only* and that it has not reviewed events since then, including our comprehensive changes to contracting procedures in fall 2008. As SAO has notified SPS of preliminary findings, we have taken aggressive action to correct any problems found. These include numerous procedural changes in 2009 and again in 2010, and comprehensive training of all staff and consultants. These changes address substantially all of the findings by SAO.

Several recommendations are made. We respond below to each of the 10 specific recommendations.

The School Board (through the Audit and Finance Committee) will oversee, guide and direct the Superintendent as appropriate to respond to the audit, including implementation of necessary changes.

Audit Results

Chapter 2 of the report states that the audit was designed to answer the question: Did the District establish and follow sound processes to effectively management BEX construction projects? The report answers this question in the affirmative.

The report identifies the most important practice for construction programs as the hiring of a qualified construction manager to oversee the work, monitoring change requests and schedules, tracking budgets, controlling costs and monitoring project risks. See page 12. The report declares (on pages 3 and 15) that the District's processes were well designed, citing as noteworthy examples the hiring of a construction manager with experience handling large, complex projects, establishing standard guidelines for management projects to address financial controls, work authorization authority and change order review and approval, establishing guidelines for records management, reporting and communications and use of standard contracts with requirements for processing contract modifications. We agree.

The report recommends several changes to its procedures to improve practices, including (a) formal adoption of the Program Procedure Manual, (b) additional guidance on selection of architects, (c) periodic formal evaluations of architects and the construction management firm, (d) procedures for communication of significant actions to the School Board, and (e) a formal lessons learned program.

For item (a) the District Facilities Department will adopt an improved manual when it is completed in 2011. With respect to item (b), the Superintendent Procedures adopted following the 2008 School Board's direction addressed selection procedures, providing additional direction, eliminating some requirements and clarifying others. These Procedures were further revised in 2010 to include more detailed requirements for the selection of architects and engineers. For item (c) see our response to Recommendation 3 below. For item (d) the District will adopt clarifying instructions as part of the Superintendent Procedures, requiring staff to notify the School Board of significant cost changes.

With respect to item (e), the District conducted a lessons learned evaluation in 2007 at the conclusion of most BEX II levy activities. It continues to incorporate improvements to its practices based on developments as they occur. The district will include provisions for a formal "lessons learned" section in the Construction Program Manual when it is adopted.

The report notes that the District did not consistently follow established procedures, identifying several areas:

A. *The report notes that Board policies for review and approval of contracts were not always approved at the appropriate level of responsibility.*

Most of the incidents noted relate to a requirement that whenever the cumulative total of changes on a contract exceeds \$250,000, the Board must approve all additional changes. As acknowledged in the report, this would have required School Board approval of modifications as small as less than \$3,000. In the context of construction contracts of from \$10 million to \$70 million and changes from 5% to 15% of those amounts, this requirement, if followed, effectively would have required School Board to meet daily to approve changes in order to keep projects on schedule. In September, 2008 the School Board changed this requirement to provide that only if an individual modification exceeded the \$250,000 threshold would School Board approval be required.

The report notes that under School Board policy in effect during the audit, in August 2006 the Director of Facilities changed approval authorities for the Building Excellence Program Manager in a manner inconsistent with the Board policy in effect at that time. The District agrees with this finding. Since adoption of the new School Board policy on contracting in September 2008, approval authorities have been set by the Superintendent through formally adopted procedures, which include a matrix of each type of contract action showing which officials must review and/or approve such actions.

The report notes that Board approval is required for all architecture contracts, and that interim contracts were signed for three projects prior to formal Board approval. The amounts of the interim contracts ranged from \$80,000 to \$212,346, and were executed in order to enable the District to accelerate the Building Excellence III program in 2007, to reduce escalation costs for those projects. In each case the School Board subsequently approved the architecture contract for the entire project. The requirement to approve all architecture contracts, regardless of amount, was dropped in the 2008 Board policy changes and the Superintendent Procedures implementing those changes.

The report notes that Building Excellence Program Management approved contract modifications and changes which had been split into smaller amounts that fell under the threshold for senior management or School Board approval. The District concurs with this finding. When these actions were brought to the District's attention early in 2009, new procedures and approval forms were immediately put into place to assure that such splitting of modifications and changes could not occur. Appropriate disciplinary action was taken with respect to involved staff. All Building Excellence staff and consultants were trained on the new procedures. Since that time, responsible project managers and Building Excellence Program Management are required to certify for each change order that such splitting has not occurred. Both legal review and senior Facilities department review now includes assessment to identify whether splitting has occurred.

The report notes that incomplete architectural contracts were submitted to the School Board. The District concurs with this finding. Either the entire contract should have been negotiated prior to presenting it to the School Board, or the Board should have been fully informed of the excluded elements. The 2010 revisions to the Superintendent Procedures prohibit such action and address

requirements for submitting contracts for Board action, including a requirement that contracts submitted to the Board must be complete, with any exceptions described.

The report notes that the Nathan Hale architect contract was sent to the Board before pricing was completed. This approach was used as part of the overall effort to accelerate the Building Excellence III project schedule, in order to reduce escalation costs. When pricing was completed several months later, the contract amount was reduced by \$48,000. While we concur that the School Board should have been informed of the fact that not all prices were fully established, delaying submittal of the contract for several months until negotiations were complete would have meant a delay to the project, possibly for a full year. At escalation rates of between 4% and 8% annually, this would have increased the project construction costs by several million dollars.

The report notes that three architecture contracts did not include required attachments setting approved subcontractors and hourly rates. The District concurs with this finding.

The report notes that in two instances staff did not inform the Board of significant increases to construction contracts until several months after the estimated amount of the increases was known. The project budgets anticipate cost increases to the initial contract amount, and include contingency amounts. Normally the School Board is not notified of cost increases within these contingency amounts. The District agrees that where anticipated increases will exceed the available project contingency, the School Board should be informed. The Superintendent Procedures will be modified to include such a requirement.

B. Approval of a modification to an AE contract without documentation:

The District concurs with the report's conclusion that in one instance BEX program management staff approved an increase of \$334,000 to an AE contract without supporting documentation to establish that the costs were for additional services and not for services within the original contract scope. We do not agree with the use of the term "instances," as only one such event is identified.

C. Approval of modifications to contracts without adequate supporting documentation.

The District concurs that the contract files for the items identified (totaling \$353,100) lacked adequate documentation to support the costs charged, except for charges of \$34,633 for the architectural model, computer rendering and schematic design brochure at Hamilton. These latter items were agreed upon during negotiations to be payable as lump sum items. Payment was not made until delivery of the services, and no additional documentation was necessary for these items.

D. Approval of \$93,000 in overcharges on six contracts.

The District concurs with the report on these items.

The report in this section also notes one instance where early decision making with respect to the Roosevelt HVAC system changes could have allowed the District to avoid paying delay charges.

The District concurs that earlier decision making could have avoided much of the \$454,000 in delay charges associated with those changes.

E. Bidding of added work

The report identifies three contracts: one for interior design and furnishings procurement and two architect contracts.

With respect to the interior furnishings procurement contract, the District agrees that substantial services were added to the contract that were beyond the scope of the contract, and that under good contracting practices the added services should have been competed. However, the suggestion that lower prices would have been obtained is speculative. The original contract was put out to competition and only one firm responded. Rather than simply awarding the contract to that firm, the District readvertised the contract, and was successful in getting a second firm to respond. The initial responder was still deemed the superior proposer. No other firms provide these services in the Seattle area.

There is no dispute that the District received the added services at the rates bid under the original competitively awarded contract. Thus it is unlikely that competition for the added work would have any meaningful impact on price.

With respect to (b), the District agrees that compliance with the specific requirements of the Board policy in effect at that time was not possible, because less than the minimum number of firms submitted proposals. As stated in the audit report, the Board policy did not provide any guidance as to what to do in those circumstances. The staff decided to proceed based on the proposals received, but did not document the file as to reason for the decision not to readvertise. The 2008 changes to procedures eliminated the requirement for a minimum number of proposals.

F. Lack of written authorization to architects to proceed on added work prior to completing pricing, or lack of written notice by the architect, in several instances.

The District agrees that in the instances noted the architects did not provide timely formal notice and/or the construction manager did not provide advance written authorization under the architects' contracts for increases in cost, as required by applicable contracts. However, in each case the added services paid for were actually required for the project and were paid at fair rates, i.e., there was no loss of funds due to the failure to comply with procedural requirements.

G. The report states that the District was unable to provide all requested documents in a complete and timely manner.

The report states that the District was unable to provide all requested documents in a complete and timely manner. The District does not agree.

The audit report does not describe what documents were not provided. This conclusion was never presented in any preliminary finding, with the usual accompanying detailed information,

and thus the District is unable to respond in depth to the statements in the report. We offer the following discussion of the Building Excellence project records system.

The District has a comprehensive system for maintaining project records. The records consist of both construction and accounting records. The District maintains its own accounting records, as well as hard copies of contracts, modifications and change orders and design documents. The other project records, such as requests for information, project correspondence, reports, and other materials, are maintained by the construction management firm in computerized form, available to project personnel. This system, SharePoint, is an acknowledged leading tool in the construction industry for effective project management. In addition, the construction management firm maintained a financial database for management of costs and budgets for the Program.

SAO and its consultants made a total of over 250 different requests for documents. Many of these were for financial reports that are not normally required for management of the program, and thus would require special searches on the construction manager's computerized financial cost system. SPS offered to provide the audit consultant training in how to use the system, from which all project documents were available.

The audit consultant¹ maintained a log of documents requested, which totaled over 250 requests. The log shows the District provided many documents in response to requests, but was often unable to satisfy the consultant. The District repeatedly requested a bi-weekly meeting or conference call to review the status of requests, but the audit consultant declined.

The audit consultant's log acknowledges that, of 230 requests made prior to March 21, 2009 all but 40 were completed. SAO's original consultant stopped work shortly thereafter and the District did not provide any responses after that date. Many of the uncompleted requests were submitted just before the original SAO consultant stopped work, and SAO notified the District that it did not need to respond to the remaining outstanding requests from that period.

Prior to stopping work at the request of SAO, the District had responded to all but 11 of the 230 items. Of the 11 items the audit consultant considered uncompleted, one was for "a description of record keeping," which clearly was provided before the audit even began. In addition, the requests included documents that were not part of the project records. The audit consultant made a total of five different requests for labor reports on the construction management firm, even though the contract was a lump sum contract. Nonetheless, these records were eventually provided for both the CM firm and its major subcontractor. Thus, at most only 5 of the 230 requests for project records were not addressed.

We believe these factors demonstrate that an effective document system exists and is in use for the BEX program, and that the District was able to provide complete and timely responses.

The report also notes that Building Excellence program management did not have direct access to project files and documents, but had to request them from the construction management firm. As

¹ SAO employed two consulting firms to assist in the audit. All references to "audit consultant" are to the original firm.

stated in our responses to SAO to preliminary audit findings, the District retained the construction management firm to provide substantially all of the project management services related to the program, i.e., through 2007, the only District employees working full time on the Program were the program manager, one administrative assistant and limited accounting staff. Essentially the construction management firm served as the staff for the Building Excellence Program. As a senior management official, it is to be expected that the Building Excellence Program Manager would not have, or need, direct access to documents, but would rely on the construction management firm to provide them to him.

The report states that the construction management firm did not provide enough information in monthly reports to provide effective monitoring. The District does not agree. The monthly reports are not intended for the use of the District's program manager. They are intended for the use of more senior officials above the program manager, and the Building Excellence Oversight Committee. The format of those reports was initially set and specifically tailored for their use, in meetings held by the Oversight Committee in 1997 and 1998. The decision was made by the Oversight Committee as to what best served their needs. In addition, the District provides detailed monthly project cost reports and change order reports on each project to both the Oversight Committee and the School Board Operations Committee.

In addition, the District's program manager works on a daily basis with the construction management firm, providing real time monitoring of activities. He meets with the construction management firm weekly, in an all day meeting, to review and make decisions on the projects. The outcomes of these meetings are documented in updated action item lists for each project, which are maintained by the District's program manager. In addition, a planning meeting between the CM and the District's Executive Director of Facilities occurs weekly.

For the reasons stated above, the District does not agree that documentation was lacking. This conclusion was not supported by any detailed findings and there is no indication that any decisions were adversely affected by lack of documents.

Factors contributing to noncompliance with policies and procedures

The report lists a number of factors that contributed to non-compliance with policies and procedures. The report states that the District listed construction inflation, tight deadlines, historic renovations and reliance on the construction management consultant.

The District agrees that construction escalation contributes to cost increases. When the BEX II levy was passed in 2001, construction escalation was projected to be about 4% annually. Starting in November 2003, the escalation increased dramatically, reaching double digits for several years, due to shortages in steel and other commodities. It did not return to historic levels for several years, and by late 2008, construction prices had doubled from late 2003.

As a result, when the BEX III levy passed in 2007, the District decided to accelerate the program, compressing a six year schedule into four years, by starting all of the BEX III projects immediately. The effort to start the levy project quickly led to early selection of architects and

contributed to the use of interim contracts and seeking approval before negotiations were complete for such contracts.

With respect to schedule constraints, this is the single most critical element of nearly all school projects. If the building is not ready for use when classes start in September, the difficulties of moving staff and students during the school year can mean several months or an entire year of use is lost. As a result, the District makes the project schedule a primary focus and takes every reasonable step to complete projects on time.

This is further complicated by the need to move students out of their existing schools into a limited number of interim sites. The Lincoln site was used during construction of both Roosevelt (2004-2006) and Garfield (2006-2008). The Boren site was used while Cleveland was built (2005-2007) then housed the South Lake students while their school was built. If the 24 month long Roosevelt project had been even two months late, it would have meant that the Garfield project could not begin, resulting in delay costs in the millions of dollars. At Cleveland, the problem was even worse. The rapid rise in construction costs in early 2005 (to over 12% annually) resulted in a dispute with the contractor over who should bear those costs. The dispute was not resolved until December 2005, which forced the construction schedule to be compressed into just 20 months.

Where unforeseen events occur that require changes to the work, even a short delay to obtain necessary management and School Board approvals can jeopardize timely completion of the project. Suspending work while approvals are obtained delays the schedule and dramatically increases costs to the contractor. These constraints contributed to the splitting of change orders, delegations of authority from senior management to more junior individuals and failure to seek required School Board approval of actions.

Nonetheless, even though these causes are real, they do not justify any failure to follow proper procedures. The District has taken steps to streamline the processes to address these issues, while maintaining transparency and accountability.

The report describes how the decision to remodel historic structures rather than demolish and rebuild new schools “presents unique challenges, including greater risk of unforeseen conditions, cost overruns and schedule delays”. We concur with that statement.

The report asserts that the District over-relied on the construction management firm, but does not provide any supporting information as to the basis for this conclusion. This subject was not the subject of any preliminary finding, thus the District is not aware of what facts led SAO to this conclusion.

We disagree with the audit report on this point. Because the District has not had a prior opportunity to provide a response to this conclusion we provide the following information:

As the report points out, the District followed leading construction best practices, including the “most important” one of hiring a firm that is experienced in management of complex projects. As was discussed in the 2005 evaluation of the District’s program management practices, this

decision was prompted by several factors. The salaries commanded by experienced project managers are significantly higher than the District is able to offer. When performance problems are experienced with staff, the ability to change individuals without waiting is critical to keeping projects on schedule and has been utilized as necessary. The availability of an experienced pool of talent to draw upon to fill short term needs, without going through an extended hiring process typical of public agencies, is critical to success of the program. The use of consultants instead of employees allows quick decisions and changes. Further, the effective management of a multi-project program requires particular skill sets, such as cost estimating and schedule analysis, that may be needed on only a part time basis and thus cannot be filled through hiring full time additional employees. Finally, as a program ramps up and then draws to a close, the number of individuals and skills needed will change; the use of outside consultants allows the District to match expenditures to needs in a manner that is not possible through hiring regular employees.

The resulting approach has been to employ construction management firms to provide the bulk of the services needed for the Building Excellence Program. The District has employed a senior program manager to run the program, and augmented its own accounting department, but the remainder of the project management personnel comes primarily from a construction management firm and other consultants.

The decision to rely on a construction management firm avoids all of these problems. Since the initial decision in 1995, it has been reaffirmed by the School Board four times, in 1997 (Lincoln renovation), 2001 (BEX II, phase I), 2005 (BEX II phase II) and 2007 (BEX III), by the decision in each case to award substantial contracts to construction management firms.

Contrary to the audit report statement on page 23, this organizational structure has not resulted in overreliance on the construction management firm. We do not agree with the statement in the audit report that the District did not review the work of the construction management firm. The District program manager's entire job was, and remains, to supervise the construction manager. As noted previously, he holds weekly meetings with the senior officials of the construction management firm to plan activities. He conducts all day meetings weekly with the project managers with direct day-to-day responsibility over the projects. He has literally daily contact with the project managers, frequently visiting the project sites.

This approach is used by many other school districts in Washington, including Spokane, Tacoma, Lake Washington and others.

The audit report acknowledges that it is difficult to assess the impacts of individual factors upon costs. The report then states, without any supporting analysis, or indeed any reference to reliance on use of a construction manager, that the items listed, including reliance on a construction manager, can increase the risk that construction costs will not be adequately controlled. We do not agree that use of a construction manager has such an effect.

Given the support of its own consultants and the report's recognition as a "noteworthy example" of best practices the hiring of a construction management firm, we do not understand the audit report's conclusion on this point.

For these reasons, the District disagrees with the conclusion that it relies too heavily on use of a construction manager.

District actions to address preliminary audit findings

The audit report acknowledges that since the audit period ended in over two years ago in mid-2008, the District has taken a number of steps to improve its contracting practices which address weaknesses noted in the audit, and that the audit report does not reflect any analysis of these changes.

The most important of these was the adoption of new comprehensive contracting procedures, through policy changes by the School Board in September, 2008 and subsequent execution of Superintendent Procedures. These actions were taken as part of the District's overall efforts to improve its business practices, not in response to the audit. They were issued prior to the release by SAO of any preliminary audit findings.

In response to the preliminary audit findings, the District has taken a number of actions, as described in the audit report, to improve procedures and train staff and consultants. When SAO provided additional recommendations in November 2010, the District responded by modifying the Superintendent Procedures in December 2010. Additional training will be conducted in early 2011.

Recommendations

The audit report includes 10 recommendations:

1. *Formally adopt the BEX Procedure Manual:*

The manual has been in use since it was created during the BEX I construction program. Formal adoption of the manual would not have any significant effect on District practices, as the District and CM already follows the manual.

During 2010 the District began assembling a Construction Procedures Manual for all capital programs, which goes into far more detail on the entire construction process, from initial levy planning through construction closeout. At this point, the Construction Procedures Manual runs to nearly 2000 pages, and will be put into use for all District projects sometime in 2011.

2. *Revise procedures to assure minority and women-owned businesses receive the maximum practical opportunity compete for AE contracts*

This was done in the December 2010 revisions to the Superintendent Procedures. See Superintendent's Procedure G 45.03 SP, paragraph I.B., page 1.

3. *Include provisions in AE and CM contracts (a) to measure performance and (b) apply corrective actions and (c) for periodic formal performance evaluations.*

Both the AE contracts and the BEX CM contract contain specific requirements for the respective firms to follow. Corrective actions are specified in the contracts, in the form of requirements to re-perform the services and/or to pay resulting damages for failure to meet the professional standards imposed on the firms. These contracts and the requirements for compliance are typical of those used in the industry.

With respect to the recommendation for periodic formal performance evaluations, the authority cited by the audit report is the National School Auditors Association "Best Practices in Contracting for Construction Services". That document does not recommend periodic performance evaluations. Rather, it recommends evaluations at the completion of contracts for use in making future selection decisions. See "Best Practices," page 6. The District already uses such information as part of its regular selection criteria for both architects and construction management firms.

We also note that the BEX II Construction Management contract included a requirement for a formal evaluation, which was done and resulted in formal Board action in 2005 to extend the contract. Because the BEX III program was shorter in duration, this feature was not included in that contract.

For BEX II and III, the AE and CM contracts have already been let and are nearly complete, i.e., construction of the last BEX III project is expected to be complete in late 2011. The recommendation to formalize evaluations at the conclusion of contracts will be considered as part of the planning for BEX IV levy, which will be submitted to the voters in 2013.

4. *The District should identify a threshold for competitively soliciting proposals where additional services would significantly expand a project's scope of work.*

The District concurs that consideration should be given to separately bidding additional services which are beyond the scope of the original contract. The District does not agree that rebidding contracts in the middle of a project is a wise course of action.

The District does not agree that establishing a threshold is appropriate. The audit identifies a single incident where rebidding should have been considered. The decision whether to add work to an existing contract or compete the added services depends a great deal on the specific facts and circumstances and requires consideration of multiple factors and the exercise of professional judgment. The Superintendent Procedures adopted in response to the 2008 policy changes by the School Board include a provision requiring notice to senior management when the value of a contract increases by more than 25 percent.

5. *Provide the School Board (a) fully negotiated contracts, and (b) timely communication and submission of major project changes and cost increases requiring Board approval.*

With respect to (a), Superintendent Procedure G 45.08 SP, page 2, (adopted December 15, 2010) provides that contracts shall be complete, with any exceptions noted. Such exceptions must be disclosed in the formal Memorandum to the School Board. The procedure also discusses interim contracts, and provides that such contracts shall be for a small amount for

services over a short period of time. Approvals are specified, and the approving authority must be informed of the interim nature of the contract.

With respect to (b), Superintendent Procedure G45.08 SP sets out the requirements for the contents of memoranda submitted to the School Board for approval. Superintendent Procedure G 45.01 SP provides that work and services cannot begin until final contract approval is secured. This procedure applies to both change orders and modifications. Attachments 5, 6 and 7 to that procedure provide requirements for staff who allow such actions to occur, including an "Unauthorized Procurement Ratification Request" form that must be signed by the individual responsible for violating the requirement and approved by the Chief Financial Operating Officer. As noted above, the Superintendent Procedures will be modified to provide that the School Board will be informed whenever the expected amount of a construction contract will exceed the available project contingency.

6. *The BEX program manager should review contract modifications to identify patterns of splitting them to fall under approval thresholds*

The District was informed through preliminary audit findings in early 2009 of several incidents of splitting of change orders to avoid requirements for senior management and/or School Board approval. Immediate actions were taken to adopt requirements for project managers to certify in writing that change actions were not split. Training was conducted for all Building Excellence staff and consultants. The Building Excellence Program Manager, the Facilities Director and District legal counsel include this factor as part of their regular review and approval of change orders.

7. *Assure modifications and change orders have sufficient documentation to support the changes*

The District has a comprehensive system in place to review change orders for proper documentation. The primary person to prepare the documentation for any change order is the project manager. Invoices are also reviewed by the architect, and then submitted to the District's accounting department for review. The adoption of the 2008 Superintendent Procedures added a requirement for review of major changes by legal counsel.

However, the District acknowledges that the incidents identified in the audit should not have occurred, and will conduct a review of change order and invoice documentation practices to identify improvements.

8. *BEX Program management and CM should monitor billings to ensure invoices are not paid without sufficient documentation*

See Recommendation 7 and the accompanying response.

9. *Include the status of major contracts (including scheduled completion and actual vs. budgeted costs) in monthly reports.*

As noted above, the monthly reports to senior management and the oversight committee were developed by the oversight committee to incorporate the level of detail it desired to receive each month. They are at a senior management level of detail. The most recent report was 24 pages long. Because this issue was never presented in a preliminary audit finding, we believe that SAO is not aware that, in addition to the formal report, detailed change order summaries and project cost reports are issued for each project monthly, to all members of the Oversight Committee and the School Board Operations Committee, along with the agenda and minutes of the Oversight Committee.

There is no indication that the inclusion of more detail is desired or would be deemed useful. Nonetheless, the District will review the current format for the monthly reports with senior management and the Oversight Committee to identify whether any changes should be made.

10. Require compliance with contract provisions, specifically, require: (a) AE contractors to provide written notice of changes, (b) the construction manager to properly document contract changes and modifications, (c) maintenance of appropriate project records.

The audit report identifies a limited number of situations where proper procedures were not followed. The District concurs that these are appropriate requirements. The requirements are included in contracts and will be enforced.

Response to Other Comments in Audit Report

The report makes a number of other comments which should be addressed:

The audit report notes at page 8 that the audit was not completed in a timely basis, due in part to delays in receiving documents. SAO notified the District in May 2009 that no further documents were needed. Thus, any documentation issues are not the cause of any audit delays after that time. In addition, as noted above, the District believes it has responded to virtually all requests made.

The audit report states at page 10 that the BEX II levy exceeded original cost estimates. However, this does not take into account additional revenues for the program, including state match funds, investment earnings and insurance proceeds. It also does not reflect the addition of new projects, such as the Center School in 2001 and South Lake High School in 2009

The report notes several gaps in the procedures for selection of architect firms, i.e., School Board policies and procedures lacked guidance on the minimum number of proposals received, which individual serves as chair of the screening team, documentation requirements for evaluation of the initial proposal, and documentation that negotiations were conducted in accordance with state law. These concerns have been addressed in changes to Superintendent Procedure G45.03 SP, adopted in December 2010.

The project estimates shown in Exhibit 1 require some clarification: (1) The \$18.4 million shown in the BEX II levy was for renovation of the Lincoln campus to permanently relocate the Hamilton program there, which did not take place; (2) Note 4 regarding the "District

adjusted budget” should read: “District management stated that these amounts reflect the estimated expenditures once all levy funds, state match funds and other revenues were taken into account. These were not subject to audit.”

APPENDIX A: INITIATIVE 900

Initiative 900, approved by Washington voters in 2005 and enacted into state law in 2006, authorized the State Auditor’s Office to conduct independent, comprehensive performance audits of state and local governments.

Specifically, the law directs the Auditor’s Office to “review and analyze the economy, efficiency, and effectiveness of the policies, management, fiscal affairs, and operations of state and local governments, agencies, programs, and accounts.” Performance audits are to be conducted according to U.S. General Accountability Office government auditing standards.

In addition, the law identifies nine elements that are to be considered within the scope of each performance audit. The State Auditor’s Office evaluates the relevance of all nine elements to each audit. The table below indicates which elements are addressed in the Seattle Public Schools Construction Audit.

Initiative 900 Elements	Addressed in Audit
1. Identification of cost savings.	Yes. We identified avoidable costs, overpayments, transactions without adequate evidence of cost, and lost opportunities to control costs. Cost savings of \$547,900 represent the following: 1. Contractor claim for \$454,000 due to delay and inefficiency caused by the District’s decision to redesign the Roosevelt HVAC system. 2. Overpayments of \$93,900 to contractors.
2. Identification of services that can be reduced or eliminated.	No. We did not identify opportunities to reduce or eliminate services.
3. Identification of programs or services that can be transferred to the private sector.	No. The District has already outsourced the management of projects under the BEX program.
4. Analysis of gaps or overlaps in programs or services and recommendations to correct gaps or overlaps.	Yes. We identified gaps in between District policies and procedures and best practices and recommended strategies to address them.
5. Feasibility of pooling information technology systems within the department.	No. Construction project records systems are owned and managed by a third-party construction management firm. The District maintains an accounting system to track all financial transactions, including construction costs.
6. Analysis of the roles and functions of the department and recommendations to change or eliminate department roles or functions.	Yes. We thoroughly analyzed the program and recommended improvement opportunities.
7. Recommendations for statutory or regulatory changes that may be necessary for the department to properly carry out its functions.	No. We did not identify the need for statutory changes.
8. Analysis of departmental performance data, performance measures and self-assessment systems.	Yes. We recommend the District improve its monitoring of contractors and of those who manage BEX projects using periodic performance evaluations.
9. Identification of best practices.	Yes. We recommend several best practices, particularly in project planning and performance management.

APPENDIX B: METHODOLOGY

We hired consultants with expertise in all phases of construction and construction project management to help us perform the audit.

We selected specific projects to audit based on project information provided by the District, interviews with key management and staff, concerns brought to our attention by citizens, and by reviewing BEX Oversight Committee and Seattle School Board meeting minutes. To ensure we obtained a comprehensive perspective of the District's performance, we also considered:

- Projects for which the construction cost significantly exceeded original levy estimates.
- The projects' size and complexity.
- Citizen concerns about cost escalation on specific projects.
- Projects in various stages of the project life-cycle, including projects being designed, constructed or completed.
- Projects for which different methods of procurement were used, such as design-bid-build and those overseen by a General Contractor/Construction Manager.

We audited contracts for:

- Architectural and engineering services.
- Construction management for BEX II projects.
- Construction contracts for individual projects.

To evaluate the District's effectiveness, we analyzed:

- Documents and management processes to solicit, select, and award contracts to vendors.
- The District's management of contract modifications, change orders, and invoices for construction services, and their review and approval.
- Performance monitoring of those who manage BEX projects and how that information was used.
- Records to assist in our understanding of the communication between District personnel and the School Board regarding contract changes, contractor performance and project costs.

We also reviewed contract terms and conditions, District policies and procedures in effect during the period under audit (July 1, 2005 to June 30, 2008), state laws, best practices in project management¹ and other

¹ *A Guide to the Project Management Body of Knowledge, Third Edition 2004, Project Management Institute. This publication is recognized as a source for best project management practices, including construction. Best Practices in Contracting for Construction Services, 2005, National State Auditors Assoc. Construction Project Management Handbook, 2006, Federal Transit Administration.*

construction practices the District indicated it used². Our subject-matter experts provided best practices from various sources to evaluate business and management processes and to develop recommendations. We compared the District's system for managing the projects to the leading practices outlined in **Appendix D**. We identified gaps in the District's established practices as reported on page 13.

The evidence used for this audit included construction documents managed by the District's contracted construction management representative and reports used by District staff and management. The District had difficulty in providing all information in response to our information requests and, in some cases, could not locate support we requested to perform our audit. Therefore, we were not assured of completeness of the evidence received. We have presented these conditions as an issue and recommendation in this report on page 13. We were able to complete our work based on the information the District provided us and corroborated our results of our testing with the District as the audit progressed.

To assess whether the District's executive management and facilities and BEX construction management staff followed best practices and District policies and procedures in managing the BEX school construction projects, the auditors selected seven school construction projects to review. We selected 15 contracts related to those projects—at least two per project. Altogether, we examined \$38.3 million of \$280.9 million spent on those seven projects as of June 30, 2008.

The contracts within each project that were selected are summarized in **Exhibit 1**.

Two other contracts were examined as part of the audit - the \$19.2 million to hire a construction manager to oversee the day-to-day operations of the BEX program and a \$1.9 million contract for interior design and furnishings. Transactions from both contracts were charged to multiple BEX projects and are included in the amounts above.

² *Building Excellence II, Program Procedure Manual*

APPENDIX C: CRITERIA

Throughout the report, we refer to leading best practices. These leading practices were identified by various sources including our subject matter experts, who are a team of multi-disciplined team who have expertise in cost estimating, capital planning, asset management, cost control processes and overall construction project management. This appendix includes references and links (where available) to sources for best practices, presented by issue.

Project Management Institute, A Guide to the Project Management Body of Knowledge (PMBOK Guide), 2004 Third Edition, This guide is widely recognized as best practices in project management, including construction. It provides guidance on all phases of project development, execution and monitoring, including assessing, reporting and tracking project risk.

Federal Transit Administration, Construction Project Management Handbook, Revision 1 April 2007,

- Section 5.8 – Risk Assessment;
http://www.fta.dot.gov/documents/Construct_Proj_Mangmnt_CD.pdf
- C-Risk, Consults in Risk Management,
http://www.c-risk.com/Construction_Risk/Const_Risk_Dir01.htm

The Washington State Department of Transportation (WSDOT) applies the Association for Advancement of Cost Engineering (AACE)'s Total Cost Management (TCM) framework to construction management. WSDOT's 'Project Management On-Line Guide' can be accessed at:
www.wsdot.wa.gov/Projects/ProjectMgmt/process

The Washington State Office of Financial Management's, State Administrative & Accounting Manual, provides contracting requirements for state agencies. It is available at www.ofm.wa.gov/policy/poltoc.htm. Relevant sections include:

- 15.20 – Personal Services Contracts – Competitive Procurement Requirements
- 15.20.30.f – Evaluation Criteria
- 15.20.30.g – Evaluation Team
- 15.20.30.k – Written Evaluation
- 15.40 – Personal Service Contracts – Contract Award, Management, and Monitoring
- 15.40.15.e – Contract Signatures
- 15.40.30a – Fiscal Principles
- 15.40.50 – Contract management principles
- 15.40.55 – Managing and monitoring contracts

The Committee of Sponsoring Organizations of the Treadway Commission (COSO), Effective Enterprise Risk Oversight, The role of the Board of Directors. This document discusses the critical role played by boards of directors in overseeing risk management. (2009). <http://internalaudits.duke.edu/documents/ERM-TheRoleoftheBoardofDirectors.pdf>.

The National State Auditors Association's, Best Practices in Contracting for Construction Services includes all facets of contracting for construction services. The monitoring best practices were particularly useful to this audit.

APPENDIX D: LEADING PRACTICES

We compared the leading practices listed in Appendix C to the systems developed by Seattle Public Schools to manage construction projects. This list of the District's processes does not include changes the District made in late 2008 and again in 2010. We have not examined those changes.

Process	Leading Practices	Seattle Public School System
<p>Develop Project Charter</p>	<p>This process identifies the need for the project, authorizes the use of resources to complete the project, and should provide project information, including:</p> <ul style="list-style-type: none"> • Assigned project manager and authority level. • Establish standardized guidelines, work instruction, proposal evaluation criteria and performance measurement criteria. • Project selection methods. • Project management methodology. • Defined scope of projects. • Record retention procedures. • Communication with stakeholders. • Risk control procedures. • Procedures for issuing and approving work authorizations. <p>(PMBOK, 2004, Section 4.1)</p>	<p>2010 Facilities Master Plan:</p> <ul style="list-style-type: none"> • Capital and community based planning. • Alignment with strategic plan. • Financial plan. <p>Building Excellence II, Program Procedure Manual</p> <ul style="list-style-type: none"> • Statement of projects. • Change order authority for CM and for District BEX, Facilities and executive management.
<p>Develop Preliminary Project Scope Statement</p>	<p>This process defines the project and what needs to be accomplished. The statement defines the characteristics and boundaries of the work and provides methods of acceptance of the work and scope control. It also includes:</p> <ul style="list-style-type: none"> • Project objectives. • Project and service requirements and deliverables. • Initial defined risks. • Order of magnitude cost estimate. • Approval requirements. <p>(PMBOK, 2004, Section 4.2)</p>	<p>Capital Improvement Plan</p> <ul style="list-style-type: none"> • Project specific scope. <p>Building Excellence II, Program Procedure Manual Design Phase Procedures, September 2001:</p> <ul style="list-style-type: none"> • Statement of projects. • Approval requirements. <p>Contracts with Construction Management Firm Scope of services include performing all coordination services on behalf of the District and in collaboration with the Architects for the completion of the construction of the BEX II program, including:</p> <ul style="list-style-type: none"> • Planning, budgeting, scheduling and estimating, design review and value engineering. • Public relations. • Contractor selection and contract administration. • Related support services. <p>Contracts with Architects/Engineers: Scope of services includes all design activities, as well as permitting activities in collaboration with the Construction Management firm.</p>

Process	Leading Practices	Seattle Public School System
<p>Develop Project Management Plan</p>	<p>This process defines how the project will be executed, monitored and controlled, and closed. It includes:</p> <ul style="list-style-type: none"> • The project management process selected by the project management team. • How work will be executed to accomplish the project objectives. • How changes will be monitored and controlled • How integrity of performance measurement baselines will be maintained and used. • The need and technique for communications among stakeholders. • Key management reviews for content, extent, and timing to facilitate addressing open issues and pending decisions. • How risks will be identified and monitored through a risk register. • Provisions for communication requirements including communication with stakeholders. • (PMBOK, 2004, Section 4.3) • Best practices covering all facets of contracting for construction services: • Clearly defined performance standards and measurable outcomes. • Identification of how vendor performance will be evaluated, including positive or negative performance incentives. • Identification of staff responsible for monitoring vendor performance. • (NSAA, Best Practices in Contracting for Construction Services) 	<p>Auditor’s Guide to the BEX Program, August 1, 2008</p> <p>Program and project/construction management organization</p> <ul style="list-style-type: none"> • Staff Roles and Responsibilities. • Consultant project/construction management team roles. • Electronic record keeping and data file organization. • Development of a master implementation schedule. • Schedule is incorporated into contract general requirements and general conditions. • Weekly schedule reviews with contractor. • Uses Construction Directives to mitigate delays resulting form change orders. <p>Building Excellence II, Program Procedure Manual:</p> <ul style="list-style-type: none"> • Established an overall management and execution plan and statement of projects. • Change order authority for CM and for District BEX, Facilities and executive management. • Producing and reviewing the construction schedule. • Establishes review committees to monitor and provide input on projects, focus on plans and designs of projects.

Process	Leading Practices	Seattle Public School System
<p>Direct and Manage Project Execution</p>	<p>This process requires project managers to perform multiple actions to execute project management plan to accomplish the work defined in the project scope statement, including:</p> <ul style="list-style-type: none"> • Staff, train, and manage the project team. • Obtain quotes, bids, or proposals. • Obtain, manage, and use resources. • Manage risks and implement risk response activities. • Adapt approved changes into the project scope and plan. • Collect project data and report cost, schedule, technical and quality progress, and status information to facilitate forecasting. • Collect and document lessons learned, and implement approved process improvement activities. • Implement approved corrective actions to improve project performance. • Conduct procurement, negotiate contracts. • (PMBOK, 2004, Section 4.4, 12.4) <p>Contract provisions can be used to facilitate project management, by representing the agency's interests by including:</p> <ul style="list-style-type: none"> • Performance standards, performance incentives and/or clear penalties and corrective actions for non-performance, with a dispute resolution process. • Include provisions to ensure that rented equipment rates are competitive, and if the equipment is rented directly from the contractor, that the rental rate reflects actual costs. • Include provisions to protect the integrity of subcontractor bids to ensure that such bids are competitive. (NSAA Best Practices in Contracting for Construction Services) 	<p>Auditor's Guide to the BEX Program, August 1, 2008</p> <ul style="list-style-type: none"> • Techniques employed for minimizing construction escalation include accelerating the design and bidding. <p>Building Excellence II, Program Procedure Manual</p> <ul style="list-style-type: none"> • Roles and responsibilities for construction manager, District and architect for soliciting, evaluating bids and contract awards, pre-approval of subcontractors. • Communication flow during the construction phase. • Established review committees to monitor and provide input on projects, focus on plans and designs of projects. <p>School Board Policy:</p> <ul style="list-style-type: none"> • Policy H46 - obtain contracted services using sound business practices, which will provide the greatest assurance that the desired services will be provided on time and within budget, while minimizing cost and risk to the District. • Policy H22.01 – establishes A/E proposal evaluation and selection procedures and committees. <p>Contracts with Construction Managers and other Construction Contracts:</p> <ul style="list-style-type: none"> • Contracts include provisions for corrective action. • Contract General Conditions identifies risk sharing. • Construction only contracts include requirements for compliance with state laws, performance and payment bonds, retainage, prevailing wages and bidding of selected subcontracts.

Process	Leading Practices	Seattle Public School System
<p>Monitor and Control Project Work</p>	<p>Monitoring and controlling is performed throughout the project and includes collecting, measuring, and communicating performance information, and assessing measurements and trends for process improvements. This process is concerned with:</p> <ul style="list-style-type: none"> • Comparing actual project performance to the project plan. • Assessing performance to identify the need for corrective or preventative action. • Analyzing, tracking, and monitoring the project to identify risks, and revise and execute the risk response plan. • Maintain accurate and timely information and documentation. • (PMBOK, 2004, Section 4.5) • Effective contract monitoring includes: • Assign contract manager with the authority, resources, and time to monitor the project. • Ensure that the contract manager possesses adequate skills and training to properly manage the contract. • Track budgets and compare invoices and charges to contract terms and conditions. • Monitor, at least periodically, subcontracts to ensure that all subcontractors are authorized and that amounts paid are consistent with reported costs. • Ensure deliverables are received on time and document the acceptance or rejection of deliverables. • Retain documentation supporting charges against the contract. • After contract completion the agency evaluates the contractor’s performance against a set of pre-established, standard criteria and retain record of performance for future use. • (NSAA, Best Practices in Contracting for Construction Services) 	<p>Contract with construction management firm:</p> <ul style="list-style-type: none"> • Optional District performance review of construction managements performance • Required construction manager to observe the progress of construction on a daily basis by qualified staff. • Required construction manager to assist the District in reviewing, analyzing, and processing change orders, and claims; negotiations, administrative proceedings, litigation, or dispute resolution when contractors’ were not performing in accordance with contract provisions. • The District and construction manager will develop a monthly budget. • Construction manager prepares daily reports for new problems or developments, weekly reports providing a summary of the work performed monthly reports for project budget and schedule status and the status of any problems with the project. <p>Building Excellence II, Program Procedure Manual</p> <ul style="list-style-type: none"> • The Manual states the construction manager will: • Review pay applications for completeness, supporting documentation and accuracy and process invoices. • Manage and supervise all contracts. • Verify that dates of services match backup and that billing rates match contract, reject invoices for insufficient backup, incorrect billing rates or incorrect reimbursable. • Negotiate changes to work and related costs, prepare change order forms and require backup. • The Manual states the District will verify proper documentation prior to authorizing payment.

Process	Leading Practices	Seattle Public School System
<p>Integrated Change Control</p>	<p>The Integrated Change Control process is performed from project inception to project completion to accommodate necessary changes to the project:</p> <ul style="list-style-type: none"> • Managing factors that circumvent integrated change order so that only approved changes are implemented. • Reviewing and approving requested changes. • Reviewing and approving all recommended corrective and preventative actions. • Controlling and updating the scope, cost, budget, schedule and quality requirements based upon approved changes across the entire project. For example, a proposed schedule change will often affect cost, risk, quality and staffing. • Documenting the complete impact of the requested change. (PMBOK, 2004, Section 4.6) 	<p>Auditor’s Guide to the BEX Program August 1, 2008</p> <ul style="list-style-type: none"> • Controlling changes and delays by: • Constructability reviews by third party consultants. • Identifies the design phase at the time to minimize unnecessary change orders. • Owner caused delays are mitigated using construction directives to authorize contractors to proceed with changes. <p>Building Excellence II, Program Procedure Manual</p> <ul style="list-style-type: none"> • Weekly meetings between construction manager and the District to discuss project status, problems affecting cost and schedule, change order proposals, change directives. • Construction manager negotiates changes to work and any costs, prepares change order form and required backup. • Establishes dollar thresholds for change order approval. <p>Contract with construction management firm:</p> <ul style="list-style-type: none"> • Required construction manager to review all requests for changes and additional compensation from a contractor and submit its recommendations to the District. <p>School Board Policy H46.01 provides the basis for dollar limits on authority to approve change orders as cited in the BEX II Program Procedure Manual.</p>

Process	Leading Practices	Seattle Public School System
<p>Close Project</p>	<p>The Close Project process includes:</p> <ul style="list-style-type: none"> • Finalizing all activities completed. • Procedures for verifying and documenting the project deliverable. • Formalizing acceptance of the deliverables. • Investigating and documenting the reasons for the actions taken in terminating a project prior to completion. <p>Administrative closure procedures include:</p> <ul style="list-style-type: none"> • Collecting project records. • Analyzing project success or failure. • Gathering lessons learned from the project. • Archive project information for future use. • Contract closure procedures include: • Verifying the deliverables is consistent with the contract terms and conditions. • Updating all project records to reflect the results for archive and future use. <p>(PMBOK, 2004, Section 4.7)</p>	<p>Contract with construction management firm:</p> <p>Assigns responsibility to the construction manager for managing the commissioning process, confirming to the District the successful completion of the start-up and testing of electrical, HVAC, communications, mechanical and other systems and equipment in coordination with the District.</p> <p>Construction manager is required to deliver all keys and operating manuals prior to recommending final payment to the contractor. CM is also required to transfer all records, reports, drawings, correspondence and other documents prepared or maintained under the contract and can retain a copy of all documents at its expense.</p>

Sources: *

A Guide to the Project Management Body of Knowledge (PMBOK), Third Edition 2004.
Project Management Institute Leading Practices in Contracting for Construction Services,
National State Auditors Association, 2005.

APPENDIX E: GLOSSARY

This appendix includes definitions of terms used in the report. Project phases are listed chronologically. Other terms are alphabetized.

Project phases

1. **Pre-Design:** The phase of analysis that occurs after some form of funding is available and before design begins. During the pre-design phase, studies are done to analyze space requirement issues, the constraints and opportunities of the proposed site, and the cost versus the budget. The amount of funding available in the pre-design phase varies and is a critical factor in determining which studies take precedence. Funds may be available to develop a detailed project program or only to investigate certain technical issues in order to determine scope, budget, or project schedule.
2. **Design:** Consists of three phases: Schematic Design, Design Development and Construction Documents
3. **Schematic Design:** First phase in the design of a project where an architect/engineer prepares schematic diagrams giving a general view of the components and the scale of the project after detailed discussions with the client (owner).
4. **Design development:** Transitional phase of an architect/engineer (A/E) services in which the design moves from the schematic phase to the contract document phase. In this phase, the A/E prepares drawings and other presentation documents to crystallize the design concept and describe it in terms of architectural, electrical, mechanical, and structural systems. In addition, the A/E also prepares a statement of the probable project cost.
5. **Construction document:** Third stage of design services provided by architect and/or engineer in which he or she prepares working drawings, specifications, and bidding documents.
6. **Construction:** Specific period, stipulated in a contract (beginning from the date stated in the notice to proceed) during which the general contractor must complete construction, subject to the conditions of the contract.
7. **Education Specifications:** The school district's listing of the various classrooms and other spaces needed, plus the features for each and equipment to be provided to make the school ready for use to meet the District's educational goals.

Other terms

Architect/Engineer: The architect/engineer is the professional who will be contractually responsible to the school board throughout the project. The architect/engineer translates the educational specifications into design concepts, which are then developed into building plans and specifications.

Subcontractor Bid package: A set of tasks selected by the general contractor to complete a major element of a construction project. For example, excavation and earthwork and foundation work may require excavation,

hauling, leveling of the foundation area, and foundation pouring. The subcontract bid package would request a subcontractor's proposal to perform these tasks in response to the general contractor's call for bids to perform the work.

Competitive solicitation: The process of notifying prospective or qualified firms of the owners desire to receive bids on the specified product or project. Solicitations include invitation-to-bid (ITB), request for proposals (RFP), request for quotations (RFQ), and request for sealed bids, which may be made public through advertising, mailings, or some other method of communication. Under Washington law, school districts must advertise request for proposals for construction projects costing more than \$50,000.

Change order: Unilateral written order by a project owner directing the contractor to change contract amount, requirements, or time. Such changes must be within the scope of the contract and in accordance with the contract's Changes clause to be legally implemented without the consent of the contractor.

Construction Management: Construction management (CM) is a delivery system that applies modern management techniques to provide planning, supervision and monitoring of construction, and project commissioning in order to control time and costs and ensure quality for school district projects.

CM may include a comprehensive array of professional activities spanning all phases of a project, starting at the study phase and continuing through budget development, funding, education specification preparation, direction of design professionals and the construction contractor, and commissioning/warranty period. CM may be performed by a qualified member of the school district staff or may be selected based on professional qualifications and experience.

The school district is responsible for developing and implementing a project management plan that will achieve the goals of the school district, the OSPI state assistance program, and community, within budgetary and schedule parameters established by the plan.

The CM process is most effective when continuity is provided from the beginning of the project, allowing the school district and the project team to identify and resolve issues prior to construction. It is recommended that a qualified project manager be assigned and become involved during the advance planning (Study and Survey) phase. The CM process includes acting as the owner's representative and coordinating design and construction to ensure that the school district's quality goals are realized in the completed project.

Contract Change Order or Modification: Written, unilateral (but within the scope of changes clause) or mutually agreed upon (bilateral), change to the terms, drawings or specifications of the contract. A contract modification may introduce or cancel specifications or terms of an existing contract, while leaving intact its overall purpose and effect. Unilateral modifications are issued usually through a change directive. Bilateral ones through a mutually executed change order or a contract amendment or modification of a contract.

Contract settlement: Resolution of a contract related matter or dispute.

Design–Bid–Build: Traditional contracting method in which design and construction phases of a construction project are bid and performed by two independent contractors under two distinct contracts.

Fixed price contract: Contract that provides for a price which normally is not subject to any adjustment except for certain provisions (such as contract change or unforeseen conditions) included in the agreement. These contracts are usually used where reasonably definite specifications are available, and costs can be estimated with reasonable accuracy. A fixed price contract reduces the administrative burden on the contracting parties, but subjects the contractor to more risk arising from full responsibility for all cost escalations. Also called firm price contract.

General Contractor: Construction firm that performs a contract all by itself, or through the use of subcontractors whose activities it supervises and coordinates. Selection is based on the lowest responsive, responsible bid, or through the GCCM method.

General Contractor / Construction Manager (GCCM): A delivery method authorized by separate state law in which the public owner selects an Architect/Engineer to design the project, and separately selects a GCCM to serve as the general contractor. The GCCM assumes the risk for construction at a negotiated guaranteed price and provides design phase consultation in evaluating costs, schedule, implications of alternative designs and systems and materials during and after the design of the facility. Selection is based on criteria that combine qualifications, experience and price.

Incentive contract: Contract in which the contractor is eligible for increased compensation based on achievement of preset objectives. For example, for a cost-based incentive, a target cost, price, or fee (profit) is used as a point of departure for various monetary-incentives (subject to a maximum amount). After completion of the contract, the incentive payment is computed on the basis of the contractor's actual cost plus a sliding scale of profit. The profit varies directly (in case of cost under-run) or inversely (in case of cost over-run) with the difference between the contract cost and the maximum allowable cost. Other incentives may be based upon schedule objectives, safety performance, or energy savings.

Notice to proceed: Letter from the owner to a contractor stating the date the contractor can begin work subject to the conditions of the contract. The performance time of the contract starts from the NTP date.

Scope change: Owner-directed alteration that causes a modification in a project's cost or schedule. Common types of scope changes are (1) design change, (2) quantity change, (3) support change, and (4) schedule change. The cost of such changes is typically borne by the owner, unless the contract shifts the risk to the contractor. Under typical contract provisions, the owner's ability to unilaterally make such changes is limited to changes, which do not change the basic character of the project. Changes which go beyond this restriction are termed "cardinal" changes.

Scope of work: Description of work or services to be performed under a contract or subcontract in the completion of a project. Also called work scope.

Time and materials contract: Arrangement in which a contractor is paid on the basis of:

1. Actual cost of direct labor, usually at specified hourly rates
2. Actual cost of materials and equipment usage and
3. Agreed-upon fixed add-on markup to cover the contractor's overheads and profit.

Unforeseen condition: Unanticipated or unexpected circumstance or situation that affects the final price and/or completion time of a contract or project. The contract typically defines such risks for which the owner will bear the costs.

STATE AUDITOR'S OFFICE CONTACTS

STATE AUDITOR BRIAN SONNTAG, CGFM

(360) 902-0361

BRIAN.SONNTAG@SAO.WA.GOV

LARISA BENSON

DIRECTOR OF PERFORMANCE AUDIT

(360) 725-9720

LARISA.BENSON@SAO.WA.GOV

MINDY CHAMBERS

DIRECTOR OF COMMUNICATIONS

(360) 902-0091

MINDY.CHAMBERS@SAO.WA.GOV

To request public records from the State Auditor's Office:

MARY LEIDER

PUBLIC RECORDS OFFICER

(360) 725-5617

MARY.LEIDER@SAO.WA.GOV

GENERAL INFORMATION

Headquarters

(360) 902-0370

Website

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