

INTERNAL AUDIT REPORT

Operational- Capital Audit

North Terminal Utilities Upgrade Project Phase 1



June 2016 – November 2021

Issue Date: November 24, 2021

Report No. 2021-20

TABLE OF CONTENTS

Executive Summary	3
Background	4
Audit Scope and Methodology.....	5
Schedule of Findings and Recommendations	6
Appendix A: Risk Ratings.....	8

Executive Summary

Internal Audit (IA) completed an audit of the North Terminal Utilities Upgrade Project (NTUUP) Phase 1 for the period June 2016 through November 2021. The audit was performed to assure the quality of the Port's monitoring of the Project, to assure it was meeting project management standards, and to determine if change orders (COs) were allowable, properly approved, and reasonable.

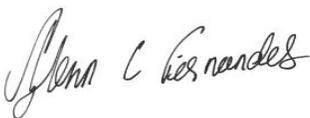
We selected this project to audit based on the number of COs and the delay in schedule completion. Our sample for testing included the largest dollar value change orders, ones that changed the scope of the project, those that approved the extension of the contract, and those that were the result of errors and omissions.

The project was originally approved by Port Commission in June 2016 in the amount of \$21.3 million. The project estimation process began in March of 2019, however, later in 2019, the project was split into two phases. The final construction cost estimate, performed by C&N Consultants, Inc. (C&N), totaled \$10.6 million for phase 1 and \$75,000 for the pet relief area. In February 2020, the Port received four bids for the project. The lowest bidder, James W. Fowler Co. (Fowler), was awarded the contract in the amount of \$12,184,750.

The project delivery method was a design-bid-build with a lumpsum contract. The final construction cost total was \$13.36 million, which included approximately \$1.17 million in COs. The contract required that Fowler substantially complete the work no later than 420 days following the contract execution date, which would have been April 20, 2021. During the project, the Port approved 119 additional days, out of which 89 days were excusable, but not compensable. This was due to the unforeseen effect of supply chain issues caused by the COVID-19 pandemic and extended substantial completion to August 16, 2021. There is a likelihood that similar problems may be encountered in other projects because supply chain issues are anticipated to be a problem in the near term. Port Legal is currently reviewing contract language to ensure it is adequate to address these possibilities.

In general, Port management's monitoring is aligned with policies and procedures. However, our audit identified an opportunity where internal controls could be enhanced or developed. This opportunity is listed below and discussed in more detail beginning on page six of this report.

1. (Medium) We noted instances where the Port's Standard Operating Procedures were not followed, including contractor's submission of inadequate documentation in the justification of change orders, and failure to complete an estimate when required.



Glenn Fernandes, CPA
Director, Internal Audit

Responsible Management Team

Wayne Grotheer, Director, Aviation PMG

Nora Huey, Director, CPO

Tina Soike, Chief Engineer and Director of Engineering Services

Janice Zahn, Asst. Engineering Director- Construction

Background

The purpose of the Project was to replace the existing 45-year-old undersized steam, condensate, and chilled water supply, return piping from the Central Mechanical Plant, and create a redundant interconnected piping loop in two phases. The existing piping was undersized for current and future heating, ventilation, and air conditioning (HVAC) loads.

The Project was divided into two phases. Phase 1 provided new upsized piping from the Central Mechanical Plant to points of connection for the Concourse D Annex and North Satellite. Phase 1 work was critical as it was required for the planned 2021 opening of the newly renovated North Satellite, and Phase 2 will provide capacity improvements to support Concourse C and D and complete the interconnected loop system making the system fully redundant.

The project was originally approved by Port Commission in June 2016 in the amount of \$21.3 million. In March of 2019, the Port hired Notkin Mechanical Engineers (Notkin) to provide an estimate for the NTUUP. Notkin sub-contracted the estimate work to C&N, who estimated the entire construction costs to be about \$22 million. In June of 2019, the Port proposed splitting the project into two phases and C&N provided project estimate updates as follows: Phase 1: \$15.2 million; Phase 2: \$7.3 million; Pet Relief Area: \$100,000. The Port received an updated cost estimate in November 2019 which amended Phase 1 construction costs to \$10.6 million and the Pet Relief Area costs to \$75,000.

The bid opening for the Phase 1 project was on February 04, 2020, and the Port received four bids. The lowest bidder, Fowler, submitted a bid for \$12,184,750, which was 4.5 percent over the Port's construction estimate of \$11,653,000. All other bidders exceed the estimate by at least 15 percent. The procurement team determined that Fowler's bid was an accurate reflection of the construction market at that time and awarded the contract.

The Project experienced multiple construction COs. Some were due to maintaining the schedule for achievement of Milestone 1, which was critical in ensuring that the North Satellite would open on time. These COs resulted in schedule delays and increased Project costs. The project delivery method was a design-bid-build with a lumpsum contract. The final construction contract total was \$13.36 million, which included approximately \$1.17 million in COs. Substantial completion was achieved on August 16, 2021, and a temporary certificate of occupancy was issued. The physical completion date had not yet been determined because Fowler still needed to complete the installation of the door at the Old Post Office building. This was due to supply chain issues, and longer than normal lead times. As of the time of this report, the estimated time for completion of the door work was January 2022. The following table details the current schedule and budget.

Schedule (Per October 29, 2021 Trend Log)	
Original Contract Completion Date	04/20/2021
Approved Time Extension (Calendar Days)	119
Revised Contract Completion	08/16/2021
Budget (Per October 29, 2021 Trend Log)	
Original Contract Sum	\$12,184,750
Executed COs	\$1,174,158
Projected Contract Sum to Date*	\$13,358,908
Original Contingency *	\$1,218,475
Revised Contingency Total*	\$1,218,475
Remaining Contingency	\$3,003

* Contingencies used are included in Project Contract Sum to Date.

Audit Scope and Methodology

We conducted the engagement in accordance with Generally Accepted Government Auditing Standards and the International Standards for the Professional Practice of Internal Auditing. Those standards require that we plan and conduct an engagement to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our engagement objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our engagement objectives.

We used a judgmental method to determine the samples selected for our audit test work. The results of this work cannot be projected to the population as we did not select a statistical random sample.

The period audited was June 2016 through November 2021 and included the following procedures:

Project Cost Estimate and Bid

- Obtained an understanding of the Port's project cost estimate process by interviewing the Cost Estimating Manager and obtaining the original cost estimates for the project.
- Discussed the estimate process with C&N Consultants, Inc.
- Obtained and reviewed bid documentation submitted to the Central Procurement Office.
- Gathered documentation and assessed the reasonableness of choosing the design-bid lumpsum method over other delivery methods.

Change Orders

- Obtained an understanding of the Port's CO review process.
- Verified approvals by required personnel (e.g., Port, Contractor, etc.).
- Confirmed approved change order amounts tied to the Change Order Log.
- Reviewed COs for reasonableness and allowability.
- Recalculated markups.
- Reviewed supporting documentation and change order/claim submissions, specifically error/omission, scope changes, and COVID-19 change orders.
- Obtained additional supporting documents from Fowler and their subcontractors for CO overtime hours.
- Compared the overtime hours submitted by Fowler, to the daily force account field documentation, and subcontractor certified payroll and paystubs.
- Obtained clarification and additional support for discrepancies noted in the CO for overtime.

Critical Milestones

- Obtained an understanding of the Port's monitoring process.
- Obtained the substantial completion date and letters of forbearance.
- Tied out the dates of actual substantial completion to the expected dates.
- Assessed the reasonableness of excused/extended days approved through COs.
- Reviewed if the contractor is liable for liquidated damages.

Schedule of Findings and Recommendations

1) Rating: Medium

We noted instances where the Port's Standard Operating Procedures were not followed, including contractor's submission of inadequate documentation in the justification of change orders, and failure to complete an estimate when required.

We selected seven COs for review, based on those that we considered to be highest risk. Examples include designer error and omissions, owner error and omissions, large dollar amounts, and COs that authorized additional days that extended the contract completion date. Our review covered \$893,687 and 189 days of the approved contract extension days.

In general, the internal controls over the change order management process were adequate. However, opportunities to further strengthen these processes and controls were identified, such as including adequate documentation and support for the COs. We observed the following issues during our CO review.

CO number	Purpose	Audit Observations
CO 9 (Reconciling CO 13)	Relocation of existing electrical conduits	The contractor did not notify the Port when it was at 80% of the Not to Exceed (NTE) amount approved in CO 9.
CO 33	Reroute underground chilled water	An estimate was not performed in accordance with Standard Operating Procedure (SOP) 40.01: Change Orders – Change Management.
CO 40	Premium to meet Milestone 1	<ol style="list-style-type: none"> 1. Inadequate detailed description to support the differences between contract and change order work, and reasons for delays on the contract work. 2. Shinn Mechanical - The daily force account field documentation that was submitted as supporting documentation was illegible. Internal Audit needed to request new documentation. Furthermore, the finalized copies did not include the required signatures (this also was noted in CO 13). The field documentation reports combined weekends instead of listing each day separately as required by SOP. 3. Performance Contracting Inc. (PCI) - The submitted daily force account field documentation did not include all the required signatures.

These observations were contrary to established Port policies and procedures and best practices. We also noted that some of the change orders were approved once the work was completed, which was unique to this project, usually change orders are approved before the work begins as seen in other projects.

During testing of CO 40, discrepancies were identified between the subcontractor timesheets/paystubs and the daily force account field documentation submitted to the Port for overtime hours. Overtime hours billed that did not match pay stubs totaled \$3,000. We also noted PCI reported to the Washington State Labor and Industries (L&I) that no staff worked on this project during the time of the CO work. In addition, Shinn did not report one employee's first three weeks of overtime hours (60 hours) to L&I. This is contrary to State Law.

Recommendations:

- Management should strengthen the control over documentation, approval, and compliance with SOPs.
- Although the Port is not responsible for the contractor, or their subcontractors, to submit accurate certified payroll reports to L&I, CPO should inform L&I about the inaccurate reports.

Management Response/Action Plan:

The Engineering Construction Management and Central Procurement Office – Construction Contracting teams agree with the findings.

Key areas of focus for Construction Management to address these issues will be on training and oversight of staff less experienced with Port processes, both FTEs and Consultants. In addition to referencing published SOPs, we will continue to reinforce our processes through regular meetings with staff, with an expanded attendee list to include Consultants, to increase overall understanding of these processes and best practices for enforcement of the contract and management of changes.

We will continue to coordinate with our CPO Construction Contracting partners to strengthen controls and ensure all required elements are in place before executing changes to the Contract.

DUE DATE: December 31, 2021

Appendix A: Risk Ratings

Findings identified during the audit are assigned a risk rating, as outlined in the table below. Only one of the criteria needs to be met for a finding to be rated High, Medium, or Low. Findings rated Low will be evaluated and may or may not be reflected in the final report.

Rating	Financial Stewardship	Internal Controls	Compliance	Public	Commission/ Management
High	Significant	Missing or not followed	Non-compliance with Laws, Port Policies, Contracts	High probability for external audit issues and / or negative public perception	Requires immediate attention
Medium	Moderate	Partial controls Not functioning effectively	Partial compliance with Laws, Port Policies Contracts	Moderate probability for external audit issues and / or negative public perception	Requires attention
Low	Minimal	Functioning as intended but could be enhanced	Mostly complies with Laws, Port Policies, Contracts	Low probability for external audit issues and/or negative public perception	Does not require immediate attention