



INTERNAL AUDIT REPORT

LIMITED OPERATIONAL AUDIT
CAPITAL PROGRAM - INTERNATIONAL ARRIVALS FACILITY

July 2015- July 2017

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EXECUTIVE SUMMARY

Internal Audit (IA) completed an audit of the International Arrivals Facility (IAF) Capital Program for the period July 2015 – July 2017. The audit was performed to assess the design and operating effectiveness of internal controls and to assure that vendors were being paid in a timely and accurate manner.

In general, management controls were adequate to ensure compliance with Contract requirements. However, we identified two opportunities where improving controls would allow Port management and Clark Construction to enhance the accuracy and timeliness of payments to contractors and subcontractors. These are discussed in more detail, beginning on page six.

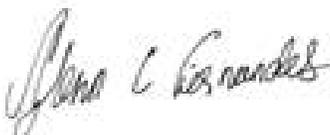
- 1) Important elements of the design-build approach were missing. These resulted in unexpected costs due to rework and resulted in delayed payments to contractors and subcontractors.**
- 2) Internal Controls need to be enhanced to validate invoice totals to payments. This resulted in an overpayment of \$89,454 to Clark in March 2017.**

We also noted one efficiency opportunity¹ for the Port, which will shave off a few days, from payments that need to flow downstream to subcontractors. This is discussed in more detail on page ten.

- 1) Internal processes should be modified to allow faster payment to Clark Construction, which will also allow for faster payment to subcontractors and the small businesses that they employ.**

The IAF payment process is structured, whereby subcontractors that represent small and minority owned businesses submit their invoices to their contractors, who then in turn submit their invoices to Clark Construction. When Clark submits their invoice to the Port, the Port also has to review and approve the invoice, before making payment to Clark. Each step in this process requires review and takes time. The downstream payment process takes time as well, resulting in approximately 90 days before the small businesses are paid for work completed. Although these observations and related recommendations will speed up the process, the fundamental design of the process will continue to result in a slow payment process to subcontractors and small business owners.

We extend our appreciation to Aviation Management and Staff for their assistance and cooperation during the audit.



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Director, Internal Audit



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Senior Auditor

¹ An efficiency opportunity is where controls are functioning as intended; however, a modification would make the process more efficient.

RESPONSIBLE MANAGEMENT TEAM

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Michael Dysart, Capital Project Leader

Ann Paustian, Resident Engineer

Dan Thomas, Chief Financial Officer

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BACKGROUND

The International Arrivals Facility (IAF) at Seattle-Tacoma International Airport will be expanded to enhance the international passenger experience, advance the Puget Sound region as a leading tourism and business gateway, and serve the traveling public.

The IAF will be a multi-level, 450,000 square-foot facility located east of concourse A. It will consist of an aerial walkway, which will span 900 linear feet at a clear height of 85 feet over the existing taxi lane, connecting arriving international passengers from the south satellite, across the top of Concourse A, to the new IAF. With the creation of a secure international corridor on Concourse A, more gates will be available for arriving international flights with a direct connection to the IAF.

Revenue bonds, passenger facility charges, and airport revenue will fund the project which is scheduled for completion by December 31, 2020.

AUDIT SCOPE AND METHODOLOGY

We conducted this performance audit 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 perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

The period audited was July 20, 2015 – July 31, 2017. To obtain an understanding of the program, we performed the following procedures:

- 1) Determined whether payments complied with contractual requirements:
 - Selected five pay applications and verified Port management reviewed the preliminary payment requests prior to payment.
 - Verified that pay applications were approved, accurately calculated, allowable, and supported with sufficient documentation.
 - Evaluated the payment process and its impact on the timeliness of payments to Clark and subcontractors.
- 2) Determined whether the use of contingency and allowance funds complied with the Revised Code of Washington.
- 3) Reviewed the 2015 Washington State Auditor's Legal Compliance Audit and verified that prevailing wage requirements were achieved.
- 4) Performed online research and provided Port management with ideas to improve the design-build approach.

SCHEDULE OF FINDINGS AND RECOMMENDATIONS

1) RATING: HIGH

FUNDAMENTAL COMPONENTS OF THE DESIGN-BUILD PROCESS WERE MISSING

The design-build approach provides the Port a single point of responsibility to carry out all work on the project. Clark Construction, as the design-builder, is contractually responsible to manage the project. To be successful, the approach brings all members of the project team together early in the process to identify and address issues of cost, schedule, and constructability. When executed correctly, this approach reduces risk and overall costs.

The Port plays an important role by communicating the vision and objectives of the final project to the design-builder. Clark as the design-builder manages the project so that Port expectations and specifications are met.

Management of the project includes working closely with the design firm(s) to ensure Port requirements are incorporated. It also includes verifying that designs are accurate and substantially complete, prior to construction, so that once construction begins, expectations and deliverables are clearly understood. Finally, Clark Construction is expected to monitor and correct, if necessary, various phases of construction. If performed effectively, the project meets specifications, is delivered on time, and within budget.

Our audit identified instances that indicate important elements of the design-build approach were missing. Those instances included:

- Designs were incomplete prior to construction creating inefficiencies and increasing the likelihood of unexpected costs due to re-work.
- Clark Construction did not consistently provide the Port monthly status of potential uses of contingency as required by the Contract.
- Clark submitted payment requests that were incomplete and did not meet Port requirements resulting in delayed payments to subcontractors.
- Clark authorized work with its subcontractors prior to signing formal change orders.

SEE EXHIBIT A FOR ADDITIONAL INFORMATION

Recommendations:

Port:

- Although several mini Gross Maximum Price contracts (GMP) were established, the Port needs to establish and finalize one main GMP with Clark Construction, which will minimize potential cost overruns.
- Enhance monitoring and communication with Clark Construction.

Clark Construction:

- Design documents should be completed to an acceptable level, for contractors and subcontractors to provide accurate quotes.
- Change orders and/or agreed upon prices should be signed prior to commencement of work.
- Communication and training, to contractors and subcontractors, should be strengthened.
- Monthly status of potential uses of contingency funds should be submitted to the Port.

Management Response/Action Plan:

Port of Seattle

Management agrees with recommendation number 1, that establishing a single Guaranteed Maximum Price (GMP) for the Contract, would give the Design Builder flexibility to manage and mitigate risk associated with the design build process. However, Clark has yet to produce a GMP that the Port is willing to accept and until that happens Port Management will continue to exercise the contract provision that permits it to issue mini-GMPs to undertake limited scopes of work. The project team is actively reviewing and validating Clark Construction's latest GMP proposal. The GMP must be evaluated and meet contractually required criteria and backup prior to acceptance. **Anticipated Completion: March 31, 2018**

Management agrees that there are opportunities to strengthen oversight of the Design-Builder. Clark Construction has already made improvements to their management of subcontractors through better controls management, and training of the subcontractors on the proper way to submit change requests. Port staff is implementing the following best practices to better monitor Clark Construction management of subcontractors:

- 1.) A more rigorous review of Change Orders Clark issues to its subcontractors. **Implemented**
- 2.) Segregating new scope from design evolution changes in order to identify the appropriate contract mechanism for payment. **Implemented**
- 3.) Timely processing of Change Orders or Authorization between Clark and the Port. **Implemented**

Management further recommends review and appropriate adjustment of the contract terms relating to subcontractor responsibilities in future design build procurements. **Implemented**

Clark Construction

Design was complete for enabling work prior to commencement of construction activities as evidenced by permitted documents. Subsequent changes were made to the design as directed by the POS, and incorporated by Clark Construction. Clark directed subcontractors to proceed with changes. A unilateral CO was issued by the POS for the work, with a reconciliation change order required for the remainder. Based on the nature of the changes and necessity for timely performance of the work, a vehicle allowing confirmation of the final scope and price was not possible without impacting the overall schedule.

Clark agrees that whenever possible, EWAs, WA, etc. should be executed prior to the commencement of the work. This practice will be followed wherever possible and practical for the nature of the design-build work.

Clark / POS review the log of outstanding exposures to Allowances and Contingencies weekly at the scheduled CO meeting, and monthly in the Project Update Report. Clark will work with the POS to review additional delivery methods of the outstanding exposures to ensure the information being presented is accurate and timely. **Implemented**

Additionally, in an effort to enhance the Subcontractor proposal turnaround time, Clark held Subcontractor training to specifically address timeliness and accuracy of Subcontractor proposals (both for work performed and prior to the commencement of the work). The complete proposal forms and process were reviewed with time available for Q&A with each subcontractor. Additional training is scheduled for 10/19 with all on-board subcontractors to review the Labor Rates work sheets to ensure timely approval of wage and equipment rates. **Implemented**

Clark and the POS are working together as a team to improve the review and turn-over times associated with subcontractor proposals and billings to ensure timely payment of Subcontractors. In accordance with the contract, the Clark / POS team share responsibility in ensuring timely processing of quality proposal submissions from Subcontractors. Collaboratively, Clark and the POS are working on a "5 Day Commitment" to ensure timely release of NTPs, WAs, etc. Additionally, the team is working to improve the Force Account notice to ensure immediate action can be taken for occurrences in the field. **Implemented**

2) RATING: MEDIUM

INTERNAL CONTROLS NEED TO BE ENHANCED TO VALIDATE INVOICE TOTALS TO PAYMENTS.

Port Management self-identified an \$89,454 overpayment to Clark in March 2017. In August 2017, Port Management identified and corrected the error by reducing the September payment.

The error occurred because the payment request was incorrectly entered into the Contract Data System (CDS).

Although the invoice was reviewed and approved, a review to verify the final Contractor Payment Request (CPR) voucher amounts matched the amounts on the signed CDS pay application did not occur.

SEE EXHIBIT B FOR ADDITIONAL INFORMATION

Recommendations:

We recommend management:

- Reinforce the existing review process to ensure final CPR voucher amounts match the amounts on signed CDS pay applications prior to payment.
- Provide CDS users written processes/instructions for system use, including guidelines to properly make coding corrections and adjustments.

Management Response and Action Plan:

Management is taking steps to reinforce with the Contract Administrators the importance of checking to ensure the final CPR voucher amounts matches the amounts on signed CDS pay applications prior to payment. The requirement for review is in CPO's standards manual. With this review the overpayment in pay application 21 would have been identified and addressed at that time.

As a result of the overpayment, CPO learned that the new CDS system allowed individuals outside of the CDS Administrator and CPO Management team to make corrections after a final contract pay request has been issued. This capability has been corrected and now only the CDS Administrator and CPO management team can make those changes. Within CDS, any corrections made after a final contract pay request must be discuss with Sr. Manager and CDS Administrator to agree on how to correct error in CDS and associated documentation.

Management is working with CDS Administrator and CDS system developers to better understand the issue related to pay application 28 and will be addressing that system issue.

To maintain system integrity and appropriate system controls we limit who has access to make corrections or adjustments to final pay applications. Currently only the CDS System Administrator and CPO management can address those changes. CDS Administrator and developers are responsible for investigating system matters and making corrections. **Implemented**

1) EFFICIENCY OPPORTUNITY

PROCESSES NEED TO BE ADJUSTED TO EXPEDITE PAYMENTS TO CONTRACTORS.

Best management practice dictate that an organization should pay its vendors as close as possible to the last possible day permitted in a contract, without incurring a late payment penalty. This assures that the organization benefits from the time value of money.

The IAF contract requires payment to Clark Construction 30 days after the Port's approval of pay applications. Once payment is received, Clark Construction has 10 days to pay their contractors, who in turn, have another 10 days to pay their subcontractors. Clark and their subcontractors have not been meeting the 10 day turnaround time for payments. Some of the reasons for this and related recommendations are highlighted and addressed in issue #1.

The payment process for subcontractors includes submitting payment requests to Clark Construction for review. Clark Construction then provides the request to the Port for final review. Although necessary, this multi-layer approach is not efficient and results in delayed payments to subcontractors.

The Commission has heard complaints from small businesses that have done work and not been paid in a timely manner, thereby putting undue stress on small businesses that need these funds to meet their internal payroll.

Construction payments are typically large amounts and accordingly, meet the requirements to be paid according to the Port's Policy: "Protocol for Large Payments". The policy states that the Treasury department needs to liquidate short term investments to fund large payments. This liquidation process adds several additional days to the payment process.

Recommendation:

Although the Port has made payments to Clark Construction within 30 days after approval of invoices, and in full compliance with contract terms and internal policy, this complex contractual situation necessitates shaving off time wherever possible to increase the timeliness of payments to small businesses.

- For this situation and for future situations of a similar manner, where a multilayer approach is adopted, we recommend that Treasury work with the requester, to assure they have adequate advance notice, so as to not be constrained by the "Protocol for Large Payments".

Management Response and Action Plan:

Management acknowledges the Commission's desire to ensure that small businesses serving as subcontractors are paid on a timely basis, and is continuing to work on expediting the Port's payment process to meet this goal.

The Protocol for Large Payments was originally established to provide Treasury with advance notice for large payment requests in order to minimize the need to liquidate investment securities prior to maturity. The Protocol's notice period, which ranges from 4 to 16 days depending on the size of the payment, begins when all paperwork has been completed and submitted to Accounts Payable. The advance notification requirement has, in fact, prevented the need to liquidate any investment securities over the

past several years. Treasury, however, has also recently begun working more closely with Capital Development staff to obtain early indications of upcoming large payments by email prior to receipt of the approved invoice in Account Payable in order to condense the payment time frame while ensuring that funds are available to execute the payments.

As noted above, all payments to Clark Construction have been made within the 30 day contractual requirement, and in practice the majority of payments to Clark since 2015 have been made within 1 to 6 days of Accounts Payable receiving an approved payment request.

Staff will formally update the Protocol for Large Payments to align with the more flexible practice of early email notification prior to receipt of a final approved invoice and will also continue to work with Capital Development staff to ensure a timely and efficient contractor payment process.

APPENDIX A: RISK RATINGS

Findings identified during the course of the audit are assigned a risk rating, as outlined in the table below. The risk rating is based on the financial and/or operational impact the issue identified has on maintenance of an effective internal control environment and management of identified business risks.

Rating	Financial	Internal Controls	Compliance	Public	Port Commission/ Management
HIGH	Large financial impact and risk	Missing, or inadequate internal controls	Material violation of laws, regulations or policies	High probability for external audit issues and/or negative public perception	Important Requires immediate attention
MEDIUM	Moderate financial impact and risk	Partial controls Not adequate to identify noncompliance or misappropriation timely	Inconsistent compliance	Potential for external audit issues and/or negative public perception	Relatively important May or may not require immediate attention
LOW	Low financial impact	Internal controls in place but not consistently efficient or effective Implementing/enhancing controls could prevent future problems	Generally complies with rules and regulations	Low probability for external audit issues and/or negative public perception	Lower significance May not require immediate attention

EXHIBIT A: MISSING COMPONENTS OF THE DESIGN-BUILD PROCESS

In May 2017, Macro-Z-Technology (MZT) notified the Port Commissioners it submitted payment applications to Clark Construction (Design-Builder) for additional work performed from February 2017, through April 2017, in excess of \$6.8 million. As of the date of the letter, there was an unpaid balance of approximately \$6 million.

In August 2017, a sub-contractor of MZT, Sundancer Electric, Inc. (Sundancer) notified the Port Commissioners it had not received payment for work completed through June 2017. This resulted in an unpaid balance of \$925,000.

Subcontract Agreement No. 41554 (Article G-08(D)) states, in part; “the Design-Builder is required to make payment to all subcontractors and suppliers for all work included within the Progress Payment within ten (10) days from the receipt of the Progress Payment. Furthermore, the Design-Builder shall require all subcontracts issued under this contract to all subcontractors and supplier at all tiers to also make all due payments within ten (10) days of their receipt of payment.”

EXHIBIT B: OVERPAYMENT

On a monthly basis, Clark Construction (Contractor) submits a pay application for expenses incurred in the previous month. The pay application reflects detailed approved "Schedule of Values" (SOVs) for various elements of work. After review and approval by Port staff, the pay application is entered into a Port database system, the Contract Data System (CDS), which is used by the Central Procurement Office (CPO). The summarized CDS version of the pay application is printed and signed by the Contractor and Port as the official request for that month. After signature by both parties, a utility within the CDS system distills the summary SOV amounts into a summarized "Contractor Payment Request" form (CPR). The CPR is a voucher request form submitted to Accounting that reflects the Purchase Order line numbers and other chart field coding associated with the payment.

Port staff brought to our attention that in March 2017, the Port miscoded one line of contractor costs within CDS for Pay Application 20. The correct amounts were requested, approved, and paid to the Contractor. However, they were aligned to the wrong lines in CDS database and therefore vouchered to the wrong accounting coding on the CPR. The Port made CDS coding corrections in April 2017, during the processing of Pay Application 21 by crediting the overstated line item and debiting the correct line item. The printed and signed CDS pay application appeared to properly reflect the corrected coding, revealed a net zero effect on the total amount due, and matched the contractor's total request.

These coding corrections and changes were made at a time when a significant new upgrade to the CDS system was issued. Concurrently, the CDS system administrator made additional adjustments to the CDS configuration to situate several new change orders and realign other SOV elements. One of those adjustments involved the line items associated with the coding correction. Port staff involved in processing the pay application was not familiar with the new system and did not realize the coding correction entries, in combination with other database configuration changes, were not properly entered. While the CDS print out was correct, the underlying database elements were not and caused the CPR to calculate incorrectly. As a result, the CPR for Pay Application 21 applied a credit line in the CDS as a positive value on the voucher line. This resulted in an overpayment of \$89,454. Port staff did not ensure the CPR voucher request total matched the signed CDS pay application prior to submittal to Accounting for payment. The discrepancy and overpayment was not noted until after the voucher processed and the check was issued.

Port staff, the CDS administrator, and the database design consultant met in August 2017, to determine the cause and correct the overpayment. Changes and corrections to the underlying database were made and tested at the meeting. It is anticipated that with Pay Application 28, due to be paid in September 2017, the CPR voucher request will generate the coding corrections necessary to recover the overpayment. The actual vouchered and paid amount for Pay Application 28 will be \$89,454 less than the approved and due amount of the request.