

INTERNAL AUDIT REPORT

Operational Audit - Capital

Interim Westside Fire Station Project



May 2019 - February 2022

Issue Date: March 25, 2022

Report No. 2022-04

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Executive Summary

Internal Audit (IA) completed an audit of the Interim Westside Fire Station Project (Project) for the period May 2019 through February 2022. The audit was performed to provide an independent assessment of performance, with the purpose of determining how goals and objectives were achieved, and to determine if there were opportunities for improvement.

The Project was originally approved by Commission as a modular building in February 2018 with a total project cost of \$5.5 million. The Project changed to a stand-alone building, as a design-build with a lumpsum contract in May of 2019. By this time, approximately \$460,000 was already spent in sunk design costs for the modular building and an additional \$390,000 in Port soft costs.

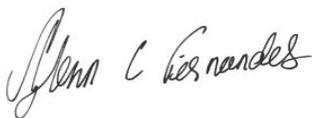
Macro-Z Technologies (MZT) was selected as the successful bidder and was awarded the Project on October 31, 2019 in the amount of \$4,950,000. Substantial Completion was to occur by November 24, 2020, and Physical Completion to occur within 60 after Substantial Completion.

During the Project, the Port approved an additional 150 days, extending the Substantial Completion date to April 23, 2021. As of the date of this audit report, Substantial Completion has not been attained. Project costs have reached a total of \$9,010,000. Construction costs paid to MZT total \$4,801,947 and other costs, including soft costs, are \$4,208,053. We estimate liquidated damages (LDs) to be approximately \$682,974 as of March 31, 2022, however the actual amount is unknown until the Project is completed and a full reconciliation is performed.

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

1. **(Medium)** The Contractor did not complete the Project by the Substantial Completion date, resulting in a delay of use of the fire station.
2. **(Medium)** The Port was potentially overbilled approximately \$106,983 out of \$140,942 in COVID-19 Not-to-Exceed change orders. Payment for COVID-19 related expenses were approved prior to receiving accurate and complete supporting documentation from the Contractor.

We also noted opportunities to improve processes, that we communicated to Port management via a management letter.



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Director, Internal Audit

Responsible Management Team

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Nora Huey, Director, Central Procurement Office
Tina Soike, Chief Engineer and Director, Engineering Services
Janice Zahn, Assistant Engineering Director, Construction

Background

In February 2018, Port Commissioners authorized the design and construction of an interim fire station on the west side of the airport. The total estimated cost of the fire station was \$5.5 million. The design included two distinct adjacent elements: a pre-engineered fire truck shelter and a modular crew quarters building. During the design phase, it was determined the risks involved with using a modular type building were greater than first thought because of manufacturing lead times and runway closure coordination to deliver the modular units.

On May 20, 2019, Port Commission authorized a design-build contract to establish a stand-alone, fully functional fire station. The building would provide adequate accommodations for Fire Department staff and equipment, enabling the Fire Department to meet the Federal Aviation Administration's mandated airfield response time. Changing from the modular to a stand-alone building, resulted in the Port being unable to utilize the original design. This resulted in the Port incurring approximately \$460,000 in sunk design costs for the modular building, and \$390,000 in additional Port soft costs prior to May 2019.

The Port used the alternative public works contracting procedures to solicit bidders for the Project. In September 2019, the Port received two bids and selected the lowest bidder, MZT. A contract in the amount of \$4,950,000 was awarded on October 31, 2019. The Contract's terms required Substantial Completion to occur by November 24, 2020, with Physical Completion to occur within 60 after Substantial Completion.

Port Commission approved the following total budget for the Project:

Date	Action	Amount (\$)
May 2019	Stand-alone building approval	5,500,000
October 2019	Budget increase	3,679,000
February 2021	Budget increase	609,000
September 2021	Budget increase	300,000
Total		10,088,000

Events including COVID-19, Port design errors, and scope changes resulted in an extension of Substantial Completion:

Schedule	
Original Substantial Completion Date	November 24, 2020
Approved Time Extension (Calendar Days)	150
Revised Substantial Completion Date	April 23, 2021

At the time of this audit report, the Project has not reached Substantial Completion. The total costs of the Project have reached \$9,010,000. Of this amount, construction costs paid to MZT total \$4,801,947 and other costs, including soft costs, are \$4,208,053. The Construction Management (CM) group has withheld \$300,000 towards LDs – see page six for additional information.

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.

In some cases, 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 random sample.

The period audited was May 2019 through February 2022 and included the following procedures:

Project Cost Estimate and Bid

- Obtained an understanding of the cost estimate process by interviewing the Cost Estimating Manager and obtaining the original cost estimates for the Project.
- Reviewed bid processes and documentation from the Central Procurement Office.

Quality Control Review and Quality Materials

- Obtained an understanding of the Port's quality control process.
- Reviewed supporting documents, submittal logs and non-compliance reports.

Change Orders

- Obtained an understanding of the Port's CO review process.
- Verified approvals by required personnel.
- Confirmed the approved change order amounts tied to the Change Order Log.
- Reviewed COs for reasonableness and compliance with contract requirements.
- Reviewed supporting documentation and change order/claim submissions, specifically errors/omissions, scope changes, and COVID-19 change orders.

Key Personnel

- Obtained a listing of the key personnel assigned to the Project.
- Confirmed the personnel listed in the contract worked on the Project.
- Verified the Port was informed in a timely manner of key personnel changes.

Substantial Completion/Liquidated Damages

- Reviewed the contractual obligations for the collection of LDs.
- Calculated the potential LDs for collection since Substantial Completion was not met.

Port Allowance Use

- Obtained an understanding of the Port's Allowance review process.
- Selected a sample of work authorizations for testing based on risk.
- Reviewed supporting documentation of allowances for reasonableness, compliance with contract provisions and proper approval.

Schedule of Findings and Recommendations

1) Rating: Medium

The Contractor did not complete the Project by the Substantial Completion date, resulting in a delay of use of the fire station.

The Project was awarded to MZT on October 31, 2019 with a Notice to Proceed date of December 05, 2019. The Contract's terms required Substantial Completion to occur by November 24, 2020. Events such as COVID-19 impacts, Port design errors, and scope changes resulted in the Port's approval of 150 excusable days which extended the date of Substantial Completion to April 23, 2021. As of the date of this audit report, Substantial Completion had not been met.

MZT did not complete the Project by the Substantial Completion date, resulting in a delay of use of the fire station. Currently, there are numerous unresolved punchlist items that may not be completed prior to Substantial Completion. The CM group confirmed they would not grant Physical Completion, which is to occur within 60 days after Substantial Completion, until these punchlist items are resolved. There is potential for an assessment of Physical Completion delays in the amount of \$985 per day, starting 60 days after Substantial Completion.

On January 25, 2021, the Port issued Serial Letter #013 (Letter of Forbearance). The letter stated the Port was willing to forbear from taking action on imposing LDs for 90 days from the date of the letter if MZT completed the Project, submitted information justifying the delay, and provided time for the Port to complete its analysis within the 90-day timeframe. The letter stated that if MZT did not meet the criteria, the Port reserved the right to assess LDs from the original milestone date. MZT did not meet the requirements of the letter.

The Port issued Serial Letter #014 (Schedule Concerns) on March 23, 2021, to discuss concerns with MZT about successfully meeting the Substantial Completion date. The letter required MZT to submit a written recovery plan by March 31, 2021. MZT did not submit a recovery plan as required by the letter.

The Port issued Serial Letter #015 (Letter of Forbearance #2) on April 23, 2021, which provided MZT an additional 65 days to meet the requirements stated in Serial Letter #013. MZT failed to meet the requirements of this letter as well.

On January 21, 2022, the Port issued Serial Letter #020 (Withholding Payment) which notified MZT that the Port will withhold any future payments. The letter stated, "Withholding payment and assessment of these Liquidated Damages shall not in any way release MZT from any contractual obligations to complete the work as required by the contractual documents and do not preclude or reduce the Port's legal right to pursue other remedies is related to or arising out of the delay for which LDs are assessed." The CM team withheld \$300,000 towards LDs from previous Pay Estimates.

On March 4, 2022, the Port issued Serial Letter #021 (Cure Notice) informing MZT and its surety company that MZT was in material breach of at least four material obligations of the contract documents. The letter stated, in part, "If any element of the breach is not cured within the applicable cure period set in the serial letter, the Port intends to terminate MZT for default and transfer the performance of the Contract to Fidelity, the surety that issued the performance bond for the project." Per this letter, if MZT fails to perform within the cure period ending April 13, 2022, the Port is entitled to take action against MZT.

The Contract allows the Port to pursue LDs of \$1,997 per day from the revised Substantial Completion date of April 23, 2021. As Substantial Completion is yet to be determined, for the purpose of the report,

we used March 31, 2022 to calculate LDs. Based on a projected eleven-month delay, we estimate the Port will be entitled to pursue approximately \$682,974 in LDs, however, the final amount is unknown until the Project is complete and a full reconciliation is performed.

In addition to the calculation of potential LDs, we performed an additional test to determine whether the Port’s soft costs were accurately estimated. We reviewed the LD calculation sheet and determined that the amount estimated for the daily inspector was based on a Full-Time Employee rate instead of a consultant rate. Based on our calculation, we estimate that the Port will incur additional inspector soft costs of \$596 per day, that the Port will not be able to collect, to keep the daily field inspector on site until the Project is complete. The table below reflects the estimated additional uncollectable costs:

Average Inspector rate per LD calculation sheet	Estimated Inspector daily costs	Difference	Number of Days	Additional costs the Port will incur until 03/31/2022
\$250	\$846	\$596	342	\$203,832*

*This is an estimate; the final amount is unknown until the Project is complete.

Recommendation:

- Upon completion of the Project, Port management should calculate and pursue LDs from the Contractor.
- Port management should consider contractors performance in future solicitations.

Management Response/ Action Plan:

Response #1 – Liquidated Damages

The team is in agreement with the recommendation that liquidated damages should be imposed in the amount of \$1,997 / day for unexcused delays beyond the revised Substantial Completion date and \$985.00 / day for unexcused delays beyond the Physical Completion date. The team fully intends to pursue liquidated damages and that has been previously conveyed to the Contractor. This will be done once the Contractor achieves Substantial Completion and Physical Completion when we can quantify the actual delay.

Response #2 – Future Solicitations

The Port agrees, and currently has a process with which to evaluate including contractor performance in a solicitation, by either adding supplemental bidder responsibility criteria or past performance evaluation criteria. The team intends to review our acquisition planning process to ensure that these options are clear for our customers.

DUE DATE: 12/31/2022

2) Rating: Medium

The Port was potentially overbilled approximately \$106,983 out of \$140,942 in COVID-19 Not-to-Exceed change orders. Payment for COVID-19 related expenses were approved prior to receiving accurate and complete supporting documentation from the Contractor.

In April 2020, the Washington Department of Safety and Health issued Directive 1.70 detailing employer requirements for the continuation of work during the COVID-19 pandemic. Specifically, the Directive included five basic categories of prevention elements, including education for workers about COVID-19, wearing face coverings, distancing, regular cleaning and sanitization, frequent employee handwashing, and the ability to ensure sick employees stay home (or go home if at the worksite.)

On April 10, 2020, the Port issued a Construction Jobsite Safety letter that required contractors to implement additional COVID-19 safety measures. In recognition of the additional costs contractors would incur, the letter agreed to compensate 100% of the actual costs, plus the applicable markup, for a full-time COVID-19 Supervisor (Supervisor), plus 50% of the actual costs of sanitation items and PPE with proper receipts. The letter also outlined responsibilities for the Supervisor that included daily monitoring, sanitizing, and ensuring staff working on the job site complied with safety protocols. The Supervisor was supposed to maintain and submit to the Port a daily COVID-19 written report of activities. The Port issued CO 14 on September 4, 2020, with a not-to-exceed (NTE) amount of \$120,000. The Port then issued CO 20 on April 13, 2021, increasing the NTE amount to \$200,000.

On January 19, 2021, the Port's RE issued Serial Letter #012 (COVID-19 Letter of Concern) to MZT which discussed the Port's concern that MZT had not implemented adequate safety controls to protect workers from the possible spread of COVID-19. Furthermore, on July 12, 2021, the Port issued a memo to MZT stating the Port would stop payment for a supervisor, as of February 18, 2021, because MZT assigned the role as collateral duty to someone already onsite and did not meet the requirements outlined for a full-time COVID-19 Supervisor.

We requested a copy of MZT's Job Cost Ledger and timesheets from the CM group. The CM group stated that requesting the documentation from MZT would affect MZT's ability to complete the Project, which was already past the scheduled completion date. As an alternative approach, we obtained MZT Certified Payroll Reports from the Washington Department of Labor and Industries. These were additional documents that are not usually provided to CM. We noted that in some instances the Daily Force Account Field Documentation sheets, that were submitted and certified to be complete and accurate by MZT, did not accurately reflect actual labor hours worked. Additionally, we noted instances in which MZT did not provide the Port's CM group invoices to support additional costs related to COVID-19 safety supplies as required. Instead, the Port CM paid MZT by estimating the costs. Additional information from our testing is listed in the following table.

We identified the following instances of non-compliance:

Issue	Questioned Costs (\$) Includes 20% markup
The Port was billed for 12 days that a supervisor was not onsite. One instance where a supervisor was onsite for 6 hours but billed 8 hours.	10,467
From September 2020 through February 2021: <ul style="list-style-type: none"> • One Supervisor was assigned dual duties, not meeting the requirement for a full-time COVID-19 Supervisor. Internal Audit was not provided documentation to determine the number of daily hours that differentiated between his Supervisory duties and his regular duties. • One Supervisor where Internal Audit was not provided documentation, as requested, to verify the hours billed. • Six instances where the Daily Force Account Field Documents were submitted that included the Supervisor’s time, although the Supervisor was not on site. • MZT did not submit Daily Force Account Field Documents for 5 days. 	87,362
One full-time Supervisor was billed at \$89 per hour instead of their actual rate of \$52 per hour, in accordance with change order terms.	8,568
The Port’s Resident Engineer recommended that MZT be paid \$586 without requiring supporting documentation from MZT.	586
MZT did not submit Daily COVID-19 written reports of activities, as required.	-
The Port paid \$900 by estimating the cost for handwashing stations and disinfection costs even though MZT did not submit receipts, as required. We were unable to substantiate the actual costs that MZT incurred.	-
MZT did not submit actual invoices for subcontractor costs as required by the CO and requested by the Port’s Resident Engineer (RE). The RE created an estimate of costs, however, we were unable to substantiate the actual costs of the \$20,942 billed to and paid by the Port.	-
Total Questioned Costs:	<u>\$106,983</u>

Contractors have the primary responsibility to submit accurate documents and billing requests to the Port; however, the Port also has a responsibility to review those documents to assure that they are accurate.

Recommendations:

- Port personnel should require contractors to submit all required supporting documentation related to COs prior to approving payments. Additionally, given that we have encountered similar results in previous audits where contractors have inaccurately reported labor hours on Daily Force Account Field Documents, we recommend that the CM Standard Operating Procedures be updated to require contractors submit payroll reports as additional supporting documentation.
- CM should seek and recover any amount due to the Port from the overbilling.

Management Response/Action Plan:

Response #1 – Force Account Requirements

The Port Engineering, Central Procurement Office (CPO), and Legal will meet to consider modifications to the Force Account process in future contracts.

Response #2 – Recover any Overbilling

A reconciliation change order will be issued to close out Change Order 20 based on validated actual costs incurred by the contractor once Physical Completion is achieved. We will require the additional documentation identified by Internal Audit from the contractor as part of the validation process and deduct any amounts overpaid.

DUE DATE: 12/31/2022

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