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INTERNAL AUDIT REPORT
OPERATIONAL AUDIT
DELEGATION OF AUTHORITY

JANUARY 2019 – JULY 2020

ISSUE DATE: NOVEMBER 18, 2020
REPORT NO. 2020-15

INTERNAL AUDIT

Delegation of Authority

TABLE OF CONTENTS

Executive Summary	3
Background	4
Audit Scope and Methodology	5
Schedule of Findings and Recommendations	6
Appendix A: Risk Ratings	9

2

Delegation of Authority

Executive Summary

Internal Audit (IA) completed the Delegation of Authority audit for the period January 2019 through July 2020. The audit was performed to evaluate internal controls to assure monetary and contractual delegation compliance with rules, policies, and dollar limitations governing redelegations by the Executive Director to staff.

The Port of Seattle’s (Port) Delegations of Authority schedule EX-2A specifies limits of authority for conducting day-to-day business transactions. Limits are established based on the individual’s business needs and are typically commensurate with the individual’s title/position in the company.

In general, we concluded that Port management’s internal controls are operating effectively. We did not identify any issues that warranted reporting.

This audit employed a unique approach. While we conducted the audit using protocols consistent with Internal Audit Standards, we partnered with the Strategic Initiatives Department so that any recommendations resulting from the audit could then be implemented, leveraging the knowledge and insight gained from the audit experience. We also invited Mr. John Okamoto to participate in weekly status meetings and considered his subject matter knowledge and expertise.

Delegation limits are generally established by balancing risk and efficiency. Transactions that represent significant financial risk typically receive governing body approval, while delegating to management those of lesser value, to execute unilaterally. Due to the scale of the capital program at the Port, and the burden placed on various teams, we believe the Port has an opportunity to re-evaluate the \$300,000

limit from the Port Commission to the Executive Director. This is reflected as an efficiency opportunity¹ and is discussed in more detail on page six and seven.

1) In March 2010, the Port's Delegation of Authority limit was established at \$300,000. The limit requires Port Commission approval for expenditures that exceed \$300,000. Re-evaluating the limit using a risk-based approach could result in increasing the limit, thereby allowing the Commission to maintain a more strategic focus while providing greater autonomy for the Executive Director and staff to carry out day-to-day business.

We extend our appreciation to Port management and staff for their assistance and cooperation during this audit.

Glenn Fernandes, CPA
Director, Internal Audit
Responsible Management Team
Dave Soike, Chief Operating Officer
Nora Huey, Director, Central Procurement Office

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

3

Delegation of Authority Background

The Port's Delegation of Responsibility and Authority to the Executive Director (ED), as amended June 13, 2017, incorporated Commission Resolutions 3605, 3628, and 3704, and established general redelegations from the Commission to the ED. Policy EX-2 captures the ED's administrative, monetary, and contractual redelegations of his authority to Port staff. The Policy specifies the responsibilities of the Central Procurement Office (CPO), Executive Leadership Team Members, Delegates, Directors, and Managers. Similarly, Policy EX-2A redelegates non-monetary authority from the ED to Port staff.

The Delegations of Authority Schedule EX-2A specifies the limits of authority to Port staff for conducting day-to-day business transactions. Limits are established based on the individual's business needs and are typically commensurate with the individual's title/position in the company. The 43-page schedule is organized by business unit (Aviation, Legal, Maritime, etc.) and lists the role and action that a title/position is authorized to take.

Delegation limits are generally established by balancing risk and efficiency. Transactions that represent significant financial risk typically receive governing body approval, while delegating to management those of lesser value to execute unilaterally.

Delegation structures should not only require governing body approval for transactions that meet a certain financial threshold. For example, publicly traded companies require board approval to repurchase stock or issue a dividend. Board approval is also required for a merger or acquisition. Government Agencies are no different. For example, government oversight boards may want to review and approve business-critical transactions that impact the agencies' mission. For example, the Port Commission may want to approve efforts that promote social responsibility or impact environmental sustainability although they may not exceed the delegated limit.

Traditionally, the governing body (board of directors, commission, council, etc.) establishes policy and allows management to carry out the governing body's mission and policy directives. The governing body then evaluates the Chief Executive Officer (CEO) or ED's performance against those measures.

This audit employed a unique approach. John Okamoto, under the direction of the Port's Chief Operating Officer, Dave Soike, provided outside expertise and perspective. Mr. Okamoto serves on the Executive Review Panel and provides recommendations, to the ED and the Commission, related to the International Arrivals Facility. Mr. Okamoto has unique expertise and knowledge in policy oversight and large-scale capital project development, both as a management consultant and through his experience serving as a senior executive in the public sector at the Port of Seattle, Washington State Department of Transportation, and the City of Seattle.

Larry Ehl, Executive Chief of Staff and Director of Strategic Initiatives and Mandela Thomas, Process Improvement Manager, participated in status update meetings where audit results were reviewed. Mr. Thomas will help management implement recommendations after the audit concludes.

4

Delegation of Authority

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.

The period audited was January 1, 2019 through July 31, 2020 and included the following procedures:

Policy and Procedure Review

- Reviewed foundational documents, including the Port's Delegation of Responsibility and Authority to the Executive Director, as amended June 13, 2017, Policies EX-2 and EX-2A, and Schedule EX-2A.

- Reviewed CPO's policy/schedule communication, training, and monitoring processes.

Data Analysis

- Analyzed major construction contract and service agreement data. Used this data to determine the number of items requiring Commission approval and measured the percentage of spend within financial groupings (refer to Table 2 on page six).

Management Interviews

- Conducted interviews with management and staff from various departments to gain anecdotal evidence of the time and resources required to compile material and to present to the Commission seeking authorization.

- Gauged staff's general understanding of the delegation schedules, monitoring and ratification processes, and training opportunities.

- Elicited feedback, using open-ended questions, to identify opportunities that may improve the limits and delegation process.

Benchmarking

- Obtained delegation limits/schedules for comparison from several Government Agencies in Washington State.

- Obtained best practice information from various sources, including the California multi-city agencies Capital Improvement Plan (CIP) benchmarking report.

Substantive Tests

- Selected six major construction contracts, four service agreements, and three purchase orders exceeding \$300,000 and determined whether commission approval was granted, and if the contracts/agreements, related amendments, service directives, or change orders (if any), were authorized within the limits reflected in the schedule.

- Reviewed the ratification log and supporting documentation to determine whether the responsible executive member was aware, provided justification, and took corrective action.

5

Delegation of Authority

Schedule of Findings and Recommendations

1) Efficiency Opportunity

In March 2010, the Port's Delegation of Authority limit was established at \$300,000. The limit requires Port Commission approval for expenditures that exceed \$300,000. Re-evaluating the limit using a risk-based approach could result in increasing the limit, thereby allowing the Commission to maintain a more strategic focus while providing greater autonomy for the Executive Director and staff to carry out day-to-day business.

Prior to entering into an agreement, Commission approval is required for contracts that exceed \$300,000. Table 1 reflects contracts that were executed over the 19-month period ending July 31, 2020. Commission approval was required for 74 contracts and represent 98 percent of the overall spend.

Table 1:

Major Construction / Service Agreements	# of contracts	Amount	% of Spend
> \$300,000	74	\$598,831,699	98%
210		\$608,894,829	100%

Table 2 reflects the number of contracts and the percent of spend within financial ranges. If Commission delegated authority increased from \$300,000 to \$1,000,000, Commission approval would still be required for 95 percent of the overall spend.

Table 2:

Major Construction / Service Agreements Contracts Amount % of Spend

>\$10,000,000	6	\$418,496,152	69%
\$5,000,001 - \$10,000,000	11	\$73,677,331	12%
\$3,000,001 - \$5,000,000	15	\$63,031,110	10%
\$1,000,001 - \$3,000,000	14	\$25,113,715	4%
\$300,001 - \$1,000,000	28	\$18,513,391	3%
\$0 - \$300,000	136	\$10,063,130	2%
	210	\$608,894,829	100%

We also performed limited benchmarking with other Government Agencies in Washington State. This information is not intended to illustrate why the Port's limits should be increased. Rather, it provides a reference point for comparison that may be useful when evaluating current delegated limits.

Agency Governing Body Delegate Amount Delegated

King County 9-member council King County Executive No limit *

City of Seattle 9-member council City Mayor No limit *

Sound Transit 18-member board Chief Executive Officer \$5,000,000/\$2,000,000 **

Northwest Seaport Alliance 10-member commission Chief Executive Officer \$300,000

Port of Seattle 5-member commission Executive Director \$300,000

Port of Tacoma 5-member commission Executive Director \$300,000

*Council approves a budget (King County – biennially; City of Seattle – annually). Management is not required to obtain Council approval if the contract amount is within the Agency's adopted appropriation authority.

** Sound Transit's delegations limits are dependent on type of contract.

6

Delegation of Authority

King County has a biennial budget that is approved by the 9-member council. Part of the budget process includes approval of the CIP, which details out the major capital projects for the year and the related spend. The City of Seattle has a similar process, whereby its budget and CIP approval is the key authorization mechanism from the governing body. The Port also has an annual budget and CIP that is approved by the governing body. However, the Port has an additional control, by which, prior to any contract over \$300,000 being executed, approval of the Commission is needed. Memos and PowerPoint Presentations are prepared for this, and the average Memo is revised 30 times with various touchpoints within the Port and approximately 15 hours is spent on each iteration of the Memos¹.

In September of 2018, Sound Transit passed resolution R2018-40 to ensure that the Board's time was optimized on key issues facing the agency. This resolution delegated up to \$50 million to the Standing Board Committees for contracts, agreements, and real property agreements. It also delegated, up to \$5 million to the CEO for the approval of competitively procured construction contracts and architectural and engineering services contracts, and up to \$2 million to the CEO for the approval of competitively procured materials, technology, and other services contracts.

Internal Audit also conducted interviews with several business leaders at the Port. During these interviews, we asked for feedback on the time and resources used to prepare materials for Commission authorization. We commonly heard that an inordinate amount of time is spent gathering information, revising material, and preparing for Commission presentations.

Recommendations:

Based on our discussions with management, review of data, and benchmarking with other organizations, we recommend that management work with the Commission to identify if the current process and thresholds can be modified to maintain or increase transparency and governance, while alleviating part of the burden on staff. Sound Transit held an open public meeting in 2018, as part of a board workshop, prior to making substantial changes to their delegation of authority. Where possible, the Port should also consider leveraging standing committees to achieve efficiencies and increase transparency.

Internal Audit also advocates applying a risk-based approach, to determine items that require full commission attention. Risk factors not only include financial exposure that the Commission is willing to delegate to management, but should also include non-financial factors, such as social, environmental, reputational or regulatory elements.

If limits are raised, we also recommend frequent (monthly) and robust reporting to the Commission and the public. This approach would allow for a "passive approval" while preserving Commission oversight and transparency. Raising the limit could also result in management spending more effort on "value added" activity and simultaneously allowing the Commission more time to maintain their strategic focus.

Management Response/Action Plan:

We concur that this audit found that the Port's Delegation of Authority controls were operating correctly

and that no concerns were found. An opportunity for greater efficiency was noted and we agree that efficiencies could be gained with a risk and lean based approach to raise the overall, and/or selected aspects, of the delegation limit to the Executive Director (ED). The impact of delegations spans many employees across operations, capital, and corporate functions, and ranges through staff levels, to management and executives, and all the way to the Commission. Increasing delegation limits may speed staff work, and ultimately may free up Commission's time for other important and strategic work.

1 September 27, 2017 Aviation Program Management Group Study of 26 Commission Memos. Unaudited directional Information.

7

Delegation of Authority

The management staff's fully detailed response and recommendations cannot be identified within ten days, as research and data analyses are necessary to determine if current thresholds can be raised along with providing added transparency and governance control. The intention of any added transparency controls would be to alert the Commission and ED of situations where relative significant risk would not otherwise be raised. For example, adjusted existing or new procedures may alert the Commission and ED to important scope changes in construction, professional service contracts, or significant purchases of goods.

Determining an optimum balance of delegations and transparency involves many processes and internal controls that reach to a large portion of the Port's workforce across the wide number of departments involved. The audit looked at capital, consultant contracts, and purchase of goods and services. Just capital work itself involves a large segment of the Port's workforce, so the potential for internal staff efficiency gain may be significant.

Our objectives will be efficiency for processes and those involved, along with public transparency for the Commission and ED, while considering higher delegation levels in various instances.

The initial focus areas for our research and analyses will include:

- 1) Establishing a port-wide team across relevant departments and business units.
- 2) Identifying and resolving gaps between existing and benchmarked transparency procedures and controls and what may be needed with higher delegations, in addition to seeking input from the Commission and ED.
- 3) Considering necessary 'checks and balances' of controls for increased delegations.
- 4) Evaluating delegation level options, considering risks, and test for balance against transparency and efficiency needs; updating and interacting with the Commission and ED regarding recommendations.

The broad team will help ensure any recommendations work within the level of ongoing operational, capital, consulting, purchasing, equity, environmental, technology, and all other work of the Port.

We recognize that with the COVID-19 pandemic, and its uncertainty, has placed added burden on employees. The workload of Port employees has shifted to having to balance the needs of home and work throughout long days. However, staff are resilient and flexible, and will want to get this right to gain efficiencies. With those factors in mind, staff will report progress back to the Commission and ED by the end of Q1, 2021.

DUE DATE: 3/31/2021

8

Delegation of Authority

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.

Financial Internal Commission/

Rating Compliance Public

Stewardship Controls Management

High probability

Non-compliance

Missing or not for external audit Requires

with Laws, Port
High Significant followed issues and / or immediate
Policies,
negative public attention
Contracts
perception
Partial Potential for
Partial controls
compliance with external audit
Requires
Medium Moderate Laws, Port issues and / or
Not functioning attention
Policies negative public
effectively
Contracts perception
Functioning as
Low probability
intended but Mostly complies Does not
for external audit
could be with Laws, Port require
Low Minimal issues and/or
enhanced to Policies, immediate
negative public
improve Contracts attention
perception
efficiency