

PUBLIC TESTIMONY SUMMARY

I-900 STATE AUDITOR'S PERFORMANCE AUDIT: Port of Seattle Construction Management (December 20, 2007)

As Heard by the Joint Legislative Audit & Review Sub-Committee on I-900 Performance Audits
on January 9, 2008

The performance audit being discussed at this hearing was conducted solely and independently by the office of the State Auditor, under the authority of legislation approved by the voters in Initiative 900. The State Auditor is elected directly by the people of the State of Washington and operates independently of the Legislature and the Joint Legislative Audit and Review Committee. Staff to the Joint Legislative Audit and Review Committee prepare a summary of public testimony on State Auditor reports. These summaries are for informational purposes only, and do not serve as an assessment by committee staff of the findings and recommendations issued by the State Auditor nor do they reflect a staff opinion on legislative intent.

Title: Port of Seattle Construction Management

Audit Scope and Objectives:

This performance audit reviewed Port of Seattle construction projects and related consulting agreements active from January 2004 through March 2007. The firms conducting the audit performed field work between March and October 2007.

In terms of audit objectives, the report lists the nine objective elements of Initiative 900, plus the following two objectives:

- 1) Determine if the Port of Seattle effectively planned, designed and managed its construction projects, including its Third Runway Project, in order to:
 - Minimize all costs associated with its construction projects, including but not limited to engineering, land acquisition, environmental review, permitting, and construction;
 - Minimize unnecessary change orders and delays that result in extra costs; and
- 2) If not, determine the resulting costs and what can be done to reduce them.

SAO Findings:

The report has six major findings:

1. Port construction management lacks cost controls and accountability;
2. The Port circumvents competition requirements in violation of its own policies and sometimes in violation of state law;

SAO Recommendations:

The audit has two over-arching recommendations and 49 more specific recommendations, directed primarily to the Port of Seattle.

The audit includes three recommendations to the State Legislature:

- Clarify the RCW with respect to the competition required in procurements that result in expenditures of public funds and revise the section that governs small works roster contract procedures.

<p>SAO Findings (cont.):</p> <ol style="list-style-type: none"> 3. Port policies and Port management’s interpretations of its policies result in a lack of transparency and thwart Commission oversight of construction management activities; 4. Port construction management records are incomplete and disorganized; 5. The Port fails to enforce basic contract requirements, resulting in delays, extra costs, and an inability to defend against claims; 6. Port construction management is vulnerable to fraud, waste and abuse. <p>The audit also identified \$97.2 million in unnecessary costs.</p>	<p>SAO Recommendations (cont.):</p> <ul style="list-style-type: none"> • Make a decision whether or not state and local governments should have wide latitude to award sole source contracts for goods and services. • Consider revising the law entitled “small works roster contract procedures, limited works process” to remove the phrase “other than a port district” from the law.
<p>Agency Responses in Audit Report?</p>	<p>Yes, in Appendix E.</p>
<p>Legislative Action Requested?</p>	<p>Yes; see three recommendations above.</p>

Staff Summary of Testimony from Audited Agency:

The Port of Seattle embraces the objectives of I-900 and agrees with the majority of the recommendations in the audit. We are taking steps to improve construction management and contracting practices. We have developed a preliminary action plan to address the recommendations; as the plan is formalized, we will make it available on our website so that the public can track our progress. There are a number of areas where we are already taking action. We have major and important work to do on improving our processes and controls. Given the announcement yesterday of an investigation by the U.S. Department of Justice, we welcome any such investigation and will cooperate fully. The Port has zero tolerance for fraud. The performance audit indicates areas where the Port could be vulnerable to fraud. We will be hiring an independent firm to conduct a fraud audit which will specifically review these areas. We do disagree with some of the audit findings. Some of the media coverage suggests the Port is dragging its feet in making changes; this is not the case.

The Port Commission takes the audit seriously and welcomes its recommendations. A new subcommittee of the Commission is reviewing the current policy on delegation of authority to the chief executive. The Commission has also asked for additional regular public reporting on the status of projects. We have directed the chief executive to update the employee code of conduct. The new action plan will address every item found in the audit, and there will be quarterly reporting to the Commission on the status of the action plan.

Staff Summary of Testimony from Other Parties:

We have had problems with the Port of Seattle for years. More audits like this one should be coming. The Port is a rogue agency. While this audit was well done, it only touched a three-year tip of a 20-year corruption iceberg. The Port collected approximately \$179 million in

property taxes during the three-year period covered by the audit, and the audit revealed that \$97 million of that was squandered. The Port retains all incoming revenue and taxes for internal use; none is returned for taxpayer benefits. The Port should produce revenue like the marina operated by the City of Des Moines. The following changes should be made to state law: 1) the clause allowing the Port Commission to collect property taxes without a public vote must be deleted; 2) drastic belt tightening is needed to return Port earnings to the taxpayers; 3) container taxes and air or maritime passenger facility charges are appropriate to pay off the huge taxpayer debt generated by foreign flag corporate welfare; 4) Commissioners should be partisan positions, and Commissioner districts should be required; 5) Commissioners should be adequately reimbursed and have their own staff; and 6) these audits or outside investigations should be continued until this rogue Port is brought under control.

The state Legislature should pass legislation to reform the Port of Seattle and strip the Port of its property taxing authority. There was a lot of grandstanding and finger-pointing by the Port at the State Auditor's Office. I do not trust an organization that is under a federal criminal investigation to reform itself. An incentive for the Legislature to change the property tax authority is that the Legislature would get to draft the law, rather than Tim Eyman. I would like to rebut the Port's statements that some of the expenditure for the third runway contract was not wasteful. The Port did not accurately estimate project costs; did not develop other qualified bidders through a request-for-proposals process; did not hire a testing firm to certify the quality of the embankment fill; did not consult the Commission on the cost overrun; failed to forecast the increase in the price of diesel fuel; and waited until December 2005 to open bids on a contract that started in February 2006. The Port is incapable of reforming itself.

We have seen firsthand the Port's mismanagement of projects and substantiate the findings in the audit. In order for us to be paid on one project, Port staff demanded that our company not bid on any Port projects for three years and wanted to put restrictions on our employees working on any other projects, even if with another company. When we pointed out that the provisions in the agreement were illegal and against the public interest, the Port attorney said that this was a settlement agreement, so it was irrelevant whether it was legal. There are other examples of the Port interfering with contractor selection and avoiding competitive bidding. The Port's inconsistent and inaccurate record-keeping allows contractors to over-charge. The Port uses contractors as the "fall guy" for Port mismanagement. The Port does not act as transparently as other airports around the country. At other airports we have worked at, project change orders were about eight percent; at the Port of Seattle for three projects, change orders ran over 60 percent. I question the statement by the Port that it will not drag its feet in making changes. The new hotline on fraud is being run by Port personnel; they should not be allowed to police themselves. We are preparing a complete report on our company's experience with the Port.

The following recommendations are consistent with the audit of the Port of Seattle. The Port must finally comply with best practices. These recommendations will reconcile with the public interest and comply with the standard of full disclosure. First, the New York/New Jersey port authority model includes governor oversight and veto authority over major projects. Second, the Port's taxing authority should be suspended until it demonstrates that tax dollars would be well spent and without waste. Third, major changes must be made to private business meetings, which must be reflected in minutes and records. It is the role and the duty of the Legislature to follow through on the work of the State Auditor.

I urge the Legislature to review the legal practices at the Port and ensure that there is adequate oversight. The last financial corruption scandal of this magnitude was chronicled in the *Seattle Times* in December 1997, including the role of then Attorney General Christine Gregoire and the Clinton-appointed United States attorney. I would describe the Port hearing yesterday as “arrogance.” Some additional descriptions are, “harassment, extortion, sedition.” There is a connection between the Port’s financial oversight and Sound Transit’s financial scandal.

We have found the Port to be very professional, accessible, and pleasant to work with on most issues. The Port has also taken the lead on the clean air initiative. They have been collaborative. There needs to be another side to the testimony.

The Port has always worked closely with its customers and operators to meet the changing needs of the maritime industry. The Port showed vision and leadership when it took the calculated risk to build facilities to handle the increase in international trade. The Port has a reputation in the construction community of dealing fairly and equitably with required changes. The Port has been a wise steward over its resources. The Port has been tough but fair during negotiations with us. We view the Port as a strategic partner in growing business at the port. The Port has developed a solid relationship with its overseas customers. The Port also supports organized labor and a large body of support industries. It is committed to maximizing returns to the community and understands the most effective way to accomplish this.

Our organization supports the Auditor and the audit, but we disagree with some key findings. It serves the public poorly to suggest that the Port wasted \$97 million on the airport project and to say it was not competitive or well-managed. The staff who oversaw the project and the contractors were professional, diligent, and held everyone accountable for quality, schedule, and safety. The Port is being criticized for providing the private sector the opportunity to manage the project, but the Port would have been criticized even more if it had instead padded the rolls of public employees. Other agencies in the area routinely do not verify contractors’ legal responsibilities or adherence to prevailing wage requirements. The expansion of the SeaTac airport over the last decade is one of the best public works projects ever undertaken in this area. Many people in the community appreciate what the Port does. These audits can be a useful tool in business and in government. They can identify areas where we can improve. The Port is taking a serious look at the recommendations and looking for ways to improve. These are exactly the constructive responses that my board would expect from me for a performance audit. The public expects the Port to be good stewards of taxpayer dollars. The Port is a leader in economic development. The Port has a terrific new CEO and a Commission that is committed to doing the best job for our community. We know the Port will not tolerate illegal activities. We need to let the CEO and the Commission do their work. The public expects that work to be thorough, prompt, and transparent to the public. We need to support the new CEO, protect the Port and its reputation in the world, and deal with any changes from the audit in a measured and professional way.

The State Auditor has been doing an extraordinary job and hiring top-notch teams to examine these agencies. The initiative we are doing this year is to adopt the recommendations from one of the audit reports. Our primary motivation is to make it clear to this Legislature that every audit report needs to be viewed as a potential initiative. World-class experts have been hired to identify recommendations to help agencies deliver services more effectively, our Legislature has

refused to implement those recommendations, and we are going to let the people decide. These recommendations should be looked at as a bare minimum. We are disappointed that the work that our Auditor is producing is not producing the results that voters were voting for with this initiative. These hearings are viewed as fulfilling an obligation, and that is not true. It is a waste of taxpayer money for the State Auditor to produce these reports and the Legislature let them gather dust. The Legislature should hear from the citizens first, then let the agencies make their excuses after the hearing. The Legislature could draft a bill that only affects the Port of Seattle. There are many audit reports that you are ignoring that have the potential for future initiatives. We would go further in drafting initiatives than the bare minimum in the audit recommendations. Finally, it is a squandering of taxpayer dollars to have these audited agencies hire independent people to watch-dog them. No one will believe the people they hire.

After I-900 passed, there was a lot of discussion about which committee should hold the public hearings. I think that JLARC was the right decision. This is the committee that can follow up on these hearings. I commend Brian Sonntag, Linda Long, and the SAO team. A firm such as Cotton & Company would not risk its reputation in writing some of the things in this audit if the conditions were not pervasive. This ought to be alarming to everyone. The Port says it takes the audit report seriously and has zero tolerance for fraud, but sometimes actions belie words. Recent action by the Port indicates that they are not taking the findings and recommendations as seriously as they would have you and the public believe. The Port did not respond to any of the 47 indicators of fraud listed in two findings in the report. Instead the Port indicated that they disagreed with the underlying instances or state a conclusion that these were unintentional errors. Reading through the auditors' remarks will show that Cotton & Company thinks the issues are serious and pervasive.

I worked with the Port for six years. We were sometimes adversarial. But they were always good for their word. They were always transparent and ready to meet with me. Use of construction managers on major capital projects is something that goes on nationwide. I think allegations of fraud are premature since the report only says possibility of fraud. People should prove that there has been fraud at the Port before they make the allegation.

The results from the in-depth look at how the Port manages construction projects are shocking and egregious. All of the findings contained in the audit report revealed situations that undermine the ability of small businesses to enjoy fair and equitable access to procurement and contracting opportunities with the Port. A legitimate way for the Port and others to provide fair and equitable access to contracts that fall under the small works roster threshold is for them to integrate into their procurement procedures the changes enacted this year to RCW 39.04.155. The small business communities should expect the Port Commission to take remedial and disciplinary action to mitigate the detrimental impact to small businesses. I request that JLARC insist that the interests of small businesses be an imperative for the Port of Seattle as it addresses the issues identified in the Auditor's report.

I am here to talk about the audit finding that asserts the Port "wasted" \$60 million. The Port's request for proposals to hire a program manager specifically reflected the advice that the Port had received from its peer airports. In the cost analysis, the \$60 million estimate is unrealistic, inaccurate, and misleading. By using a calculation based on temporary agency rates, the audit ignored all of the support staff and support costs. Finally, it ignored the whole risk question.

Federal procurement guidelines say that, when you look at cost, you should also evaluate risks. A last question for you is, “Who is auditing the auditors?”

This was an excellent quality performance audit. Unfortunately, the audit findings are among the most serious that I have seen. The report includes statements on how the scope of the audit was limited due to actions by the Port, as do the remarks submitted by Cotton & Company. The letter sent by the Port CEO on Monday minimizes the seriousness of the audit findings and is an indication of business-as-usual by the Port management. The six major findings indicate a need for swift and decisive action on the part of the Legislature, the Commissioners, and the Port CEO. I believe in the sincerity and commitment of the Port Commissioners, but I do not believe they have the staffing or the time as part-time Commissioners to make sure the job is done. I believe the \$97 million estimate. My recommendations to the Legislature: 1) take away the taxing power of all ports; 2) create a separate district for SeaTac airport; 3) if the Port lacks the authority to make the job of Commissioner a full-time position, you should give them the authority to do so; 4) revise the law on sole source contracts as the Auditor recommends; and 5) revise the law on small works roster contract procedures.

As a taxpayer and a citizen, I am upset about these audit findings and the amount of money that may have been misspent. The audit showed that Port policies and interpretations of Port policies resulted in a lack of transparency. This type of thwarting of transparency and oversight is endemic in all the ports in the state. The Washington Public Ports Association is supposed to act as a clearinghouse for public information, but it is a private organization. It uses public money that it gets from the ports to lobby.

Agencies Testifying:

The Port of Seattle (Tay Yoshitani, Chief Executive Officer; John Creighton, Commission President; Lloyd Hara, Commission Audit Committee member)

Other Parties Testifying:

Dan Caldwell
Chris Gower
Mike Malkowski, G&T Conveyer Company
Douglas Tooley
Dan Gatchet, West Coast Trucking
Bob Luxa, SSA Marine
John Littel, Northwest Carpenters
Jim Warjone, Port Blakely Companies
Tim Eyman, ReduceCongestion.org
Mike Dunmire
Jack Gilchrist
Ralph B. Ibarra, Bruno Enterprises
Howard Hillinger, Parametrix, Inc.
Bob Williams, Evergreen Freedom Foundation
Arthur West