



## **Port of Seattle**

### ***Internal Audit Report***

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Port-Wide Professional Service Agreement (PSA) Practices

Issue Date: August 8, 2007  
Report No. 2007-04

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### Internal Auditor's Report

We have completed an audit of Professional Services Agreements (PSAs). The purpose of the audit was to determine the level of Port-wide compliance with the current PSA related policies and procedures. The audit was open ended with concentration on PSA agreements awarded after 2004.

We conducted the audit using due professional care, and we planned and performed the audit to obtain reasonable assurance about whether the current PSA practices are in compliance with applicable policies and procedures.

The audit identified a number of issues as well as areas for improvement. The issues are discussed in detail in the subsequent sections of this report.

We extend our appreciation to management and staff for their timely cooperation and assistance during the audit.



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## Executive Summary

**Background Information** The Port utilizes Professional Service Agreements (PSAs) as a vehicle to supplement necessary professional resources for a wide range of purposes from a simple engagement of a local Human Resources consultant to a national project management company on a multi million construction project. PSAs taken as a whole constitute a significant part of the Port's non-payroll expenditures. For the period between 2003 and 2005, PSAs accounted for 16%,\$106 million) 19%(\$137 million), and 16%(\$114 million) of the total non-payroll vouchered expenditures in 2003, 2004, and 2005, respectively.

The Port has established and implemented under Resolution 3181, as amended, a set of PSA related policies and procedures commonly referred to as PUR-2 - Consultant Procedures. The policy was designed based on three tiers of the contract dollar amount under two broad categories: architectural/engineering and non-architectural/engineering. The policy fully integrates all applicable state competitive procurement requirements related to professional services and delineates, for each tier under each category, individual procedures to be followed regarding when and how to initiate, authorize, monitor, and close professional service agreements.

**Audit Scope and Objective** The audit objective was to determine whether the current PSA practices Port-wide as reflected in the project files and the financial system complied with the Port existing policies and procedures. The Port's financial system, PeopleSoft, provided the basis for analytical review of related financial information. We employed risk-based sampling, and the risk was defined using an assortment of contract attributes such as amount, status, change order, and nature. A representative number of agreements from each risk group were selected and tested. We reviewed 80+ PSA agreements from many departments across the Port providing a substantial and Port-wide basis upon which to assess the compliance level.

**Audit Result Summary** The audit indicated seven areas of concern: 1) lack of policy, 2) change orders, 3) PSA agreement templates, 4) Scope of work, timeline, and deliverable 5) project file documentation, 6) consultant selection, and 7) Consultant Procedures for Categories 1 & A. Because this was a Port-wide audit, findings are not division/department specific; they simply reflect practices currently in use and the risks associated with such practices.

### Noted Internal Control or Noncompliance Weaknesses:

**1. Lack of Policy on Open Order PSA Agreements**

The Port currently does not have policies and procedures on the open order PSA agreements.

**2. Change of the Original Scope of Work**

We noted a number of instances where subsequent change orders to the agreement departed materially from the original scope of work.

**3. Lack of Agreement End Date in PSA Templates**

The current PSA templates do not provide a placeholder for the contract term.

**4. Scope of Work, Timeline, and Deliverable – Too General and Vague**

We noted a number of PSA agreements that lacked auditable scope of work, timeline, and deliverable because the scope was too general.

**5. PSA Insurance Requirements**

We noted a number of instances where the PSA project files contained inadequate documentation on insurance requirements.

**6. Non-Compliance with the PUR-2 Policy - Port Consultant Roster**

We noted many instances of noncompliance with the Port policy which requires certain PUR-2 category consultants be selected from the Port Consultant Roster. This requirement is specifically significant for architectural and engineering services because noncompliance with Port procedures implies noncompliance with state laws.

**7. Port Consultant Procedures for PSA Agreements - Category 1 & A**

Per Port policy, when hiring a consultant for a scope of work that is worth less than or equal to \$50,000, no consultant interview is required. We noted a number of consultants who have been awarded multiple \$50,000 consulting agreements for scope of work that seems related. This practice would seem to circumvent and or violate Port required consultant interview procedures.

Additionally we noted certain issues including incomplete consultant selection documentation that do not rise to the level of findings but warrant comments for improvement.

## Background

The Port utilizes Professional Service Agreements (PSAs) as a means to procure professional services for which it has needs but does not have necessary resources (time, staff, and/or expertise) to meet the needs. A wide range of professional services can be acquired using the PSA from an engineering consultant to a project management company.

PSAs as a whole constitute a significant part of the Port's non-payroll expenditures. For the period between 2003 and 2005, PSAs accounted for 16%, 19%, and 16% of the total non-payroll vouchered expenditures of \$642 millions in 2003, \$711 millions in 2004, and \$719 millions in 2005, respectively.

The Port has established and implemented under Resolution 3181, as amended, a set of PSA related policies and procedures commonly referred to as PUR-2 - Consultant Procedures. PUR-2 was designed to delineate the Port's intent and to prescribe specific procedures based largely on three tiers of the contract dollar amount under two broad categories: architectural/engineering and non-architectural/engineering. The policy implements all applicable state competitive procurement requirements related to professional services.

## Audit Objective

The audit objective was to determine the level of Port-wide compliance with the current PSA related policies and procedures as reflected in the project files and the Port's financial system--PeopleSoft.

## Scope of the Audit

The audit scope was open ended with concentration on PSA agreements awarded after 2004. In addition, the Internal Audit also conducted a limited review of PSA agreements in 2006.

## General Statistics and Highlights

The following statistics and highlights provide perspective as to how the PSAs taken as a whole relate to the Port's overall financial landscape.

### General PSA statistics

	FY 2003	FY 2004	FY 2005
Total \$\$	105,677,406	136,969,705	114,391,213
% of the total vouchers	16%	19%	16%
Total # of PSA vendors	664	606	593
Total # of PSA vouchers issued	8,705	8,617	8,238

**PSA breakdown by PUR2 category for the 3-year period between 2003 and 2005**

<b>Contract Category</b>	<b>Contract Amount</b>	<b>Number of Agreements</b>	<b>Percentage</b>
Cat A & 1	< \$50,000	619	56%
Cat B & 2	>\$50,000 and <\$200,000	201	18%
Cat C & 3	> \$200,000	288	26%
Grand Total		1,108	100%

**Audit Approach**

We performed the following audit procedures:

- We obtained an understanding of PSAs.
- We analyzed PSA related financial information to define risk.
- We selected groups of PSAs based on risk and tested for compliance with the Port's policies and procedures.

The audit procedures primarily consisted of financial information analysis and document review. The Port's financial system, PeopleSoft, was a source of information for the analysis, and departments provided soft/hard copies of relevant contract documentation for review.

The preliminary analysis provided an understanding and thereby enabled us to place PSAs into the following separate risk groups.

1. Active agreements after 1/1/2004 with amt > \$50,000 with change orders
2. Active agreements after 1/1/2004 with amt > \$50,000 and <\$80,000 with change orders
3. Active agreements before 1/1/2004 with amt > \$50,000 with/without change orders
4. Active agreements after 1/1/2004 with amt < \$50,000 with/without change orders

In addition to the above samples selected based on auditor's judgment on risk, other agreements were selected based on inconsistent information such as an A&E consultant with a supplies agreement or an agreement with a reference to an expired project.

We developed test attributes and grouped them into four distinct categories to mirror the life span of the PSA: 1) Consultant Selection, 2) Contract Award, 3) Service Procurement, and 4) Agreement Closure Process. Each group contains a list of sub-components against which we tested relevant documents to determine compliance.

**Conclusion**

We noted a number of weaknesses in seven areas: 1) lack of policy 2) change orders, 3) PSA agreement templates, 4) Scope of work, timeline, and deliverable 5) project file documentation, 6) consultant selection, and 7) Pur-2 Consultant Procedure for Categories 1 & A.

<b>Schedule of Findings and Recommendations</b>
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**1. Lack of Policy on Open Order PSA Agreements**

Polices and procedures specific to the open order PSA agreements currently do not exist.

An open order PSA refers to a type of agreement with a scope of work that is not specifically defined. While open order agreements are used Port-wide, they are particularly popular in large-scale projects as they provide the project management with necessary flexibility to accommodate the unforeseen that is inherent in the project.

There are risks associated with open order agreements especially in the absence of applicable policies and procedures. Open order agreements are written in general terms and provide no specific measurement basis. Such generality makes determining the level of compliance and consultant performance a difficult task. The biggest risk associated with open order agreements is varying interpretations and inconsistent applications. This may lead to contracting practices that are contrary to management intent.

**We recommend** the Port determine whether to continue the current practice of open order agreements. If open order agreements are considered to be in the best interest of the Port, we further recommend the Port design and implement a set of clearly defined polices and procedures to govern open order agreements.

**Management Reponses**

Efforts have been underway to complete a policy. A final draft has been prepared and is pending final Executive level review and approval. We anticipate having a policy finalized and in place by 3Q, 2007.

**2. Change of the Original Scope of Work**

We noted a number of agreements (10%) where the scope of subsequent change orders departed materially from the original scope.

The term change order refers to any change to the original agreement. Generally the change order is to the price to be paid and/or the work to be performed. If the change represents a material departure from the original scope, applicable state statues may require a separate competitive procurement process.

The change orders as a whole represent real risk of noncompliance with applicable state competitive procurement requirements, if not carefully reviewed.

**We recommend** a system of review and approval for proposed change order to ensure that proposed changes are scrutinized for any material departure from the original scope of work.

**Management Reponses**

We will strengthen protocols for PSA amendments to include an additional independent management level of review in relation to the original scope of work, location of services and the period of time, prior to executing amendments. Also, refinements will be made to ensure that a clearly defined scope of services is provided in PSAs, an end date is specified, and training is provided. We anticipate completing these refinements by 4Q, 2007, along with training during 1Q, 2008.

### **3. Lack of Agreement End Date in PSA Templates**

The current PSA agreement templates do not provide the agreement end date (i.e., contract term).

The Port has a number of PSA agreement templates for different PUR-2 categories. The templates provide a convenient and efficient way to address risks that are specific to each category in a consistent manner. The templates include records, insurance, and defaults/remedies, to name a few, but currently do not provide the agreement covered term.

The absence of the agreement end date exposes the Port to continuous contractual obligation with potentially unfavorable financial consequences. In the absence, an expiration date must be communicated from the PSA initiating department to Accounting and Procurement Services for timely closure of the agreement and related Purchase Orders (POs). The audit disclosed that such communication has not been effective as 40% of the agreements we reviewed exhibited untimely closure. Such open completed agreements, especially ones with a remaining encumbrance, could introduce a risk of inappropriate vendor payments, intentional or otherwise.

**We recommend** a placeholder for an end date in the PSA agreement templates subject to change with mutual consent.

#### **Management Responses**

We have now completed revising the Port's PSA template to include an end date field. This will facilitate formally incorporating contract end dates in all PSAs. The formal end date will also facilitate the timely closing of contracts reducing the risk of misuse. The new templates will be available end of Q3 along with communication to staff of the changes.

### **4. Scope of Work, Timeline, and Deliverable – Too General**

A number of agreements (37%) lacked auditable scope of work, timeline, or deliverables.

To a large degree, PSA agreements are essentially controlled by scope of work and timeline statements as the attributes define the Port's expectation as to the services to be provided, and the period in which to receive the service.

The generality in scope of work and timeline could obscure performance expectation and can lead to unwarranted compliance complication. Additionally unspecified deliverables

could make measuring and monitoring consultant performance a difficult task as the agreement requires no work product that could be measured.

**We recommend** Port management and staff define measurable scope of work, timeline, and deliverables from consultants.

### **Management Responses**

We will strengthen protocols for PSAs to establish clearly defined scope of work, timelines and deliverables. Refinements will include stating specific deliverables and how those deliverables will be measured, listing timelines and deadlines for deliverables, and reviewing subsequent amendments for consistency and compatibility with the original contract intent and scope of work. Also, further steps will include developing enhanced guidelines for the development of the scope of services and deliverables/schedules, and providing training on PSAs. A team comprised of representatives from the Aviation & Seaport PMG and Maintenance groups, Engineering, PCS, Environmental, ICT and APS Procurement will be established to develop these guidelines. We anticipate completing the initial action focuses by 4Q 2007, along with the PSA guidelines and training during 1Q & 2Q, 2008.

## **5. PSA Insurance Requirements**

We observed insurance related weaknesses in a large number of agreements (29% to 54%).

An effective risk management practice requires an insurance to limit liability exposure stemming from contractual relationships. In case of PSAs, the requirement must be observed not only at the onset of the relationship but also throughout the life of the agreement.

The current policy requires the receipt of evidence of insurance (i.e., insurance certificate) within two weeks upon execution. The compliance with the policy is not evident in the contract files. In many instances (29%) adequate evidence (i.e., timestamp) did not exist to indicate whether insurance certificates were received within the required time period. Further a number of agreements (54%) did not have current certificate of insurance on file.

**We recommend** stronger due diligence and care to obtain evidence of insurance at the onset of the contractual relationship and to maintain the insurance certificates current throughout the life of the agreement.

### **Management Responses**

An addendum to PUR-2 "Consultant Insurance Policy & Guidance" is nearing finalization via Risk Management, which will provide clarity as to the protocols over insurance requirements. Additional refinements will focus to improve monitoring the receipt of insurance renewal certificates. Further, the role of Accounting & Procurement Services will be leveraged as a control point at the onset of PSAs via use of a new PSA control cover sheet, reviewed prior to establishing purchase orders against which contract payments can

be made. The control sheet will require that an insurance certificate is attached along with the PSA. We anticipate completing these refinements by 4Q, 2007.

## **6. Port Consultant Roster**

In a number of agreements (18%), consultants were not properly selected from the Port's consultant roster as required by PUR-2 Port procedures.

The Port maintains a roster of qualified professional consultants on file as a means to comply with applicable state professional services procurement requirements. The current Port policy requires the consultant be selected from the file for PUR-2 category type "A" and "B" agreements. For architectural/engineering related work, this requirement is particularly significant as the compliance is deemed having complied with applicable state professional service procurement requirements.

**We recommend** consultants be selected from the Port roster in accordance with the PUR-2 Port consultant procedures.

### **Management Responses**

Refinements will be made to strengthen oversight and compliance with procurement protocols involving the Port roster. Aviation & Seaport PMGs, Engineering and PCS will team together on this focus. As a secondary measure, the role of Accounting & Procurement Services will be leveraged as a control point via use of a new PSA control cover sheet, reviewed prior to establishing purchase orders against which contract payments can be made. The control sheet will require an attestation that the A&E consultant was selected from either the Port Roster or alternatively selected via a public bid process. We anticipate completing these refinements by 4Q, 2007.

## **7. PUR-2 – Consultant Procedure for Categories 1 & A ≤ \$50,000**

Based on the Port PUR-2 consultant procedures, no interview is required when hiring a consultant if the PSA agreement is less than or equal to \$50,000. During the course of our audit, we analyzed consultant agreements that fall under the PUR-2 Category 1 & 2 and Category A & B and noted many instances where consultants are issued multiple \$50,000 agreements for scope of work that seems related. This practice of dividing scope of work into small segment seems to:

- a. Circumvent and/or violate Port required consultant interview procedures.
- b. Violate state statutory requirements and Port delegation of authority.
- c. Establish continuous long-term working relations with some consultants and this could lead to the question whether a consultant is an employee or an independent consultant.

**We recommend** that PUR-2 Consultant Procedures be strictly adhered to in order to avoid violation of state laws or other jurisdictions.

### **Management Responses**

We will review for opportunities to clearly define scope of work and ensure there exist distinguished differences between contracts, and to enhance processes to mitigate risks of non-compliance with Port procurement policies. The division efforts focused to address items 2. and 4. will facilitate this. Also, as a secondary measure, the role of Accounting & Procurement Services will be leveraged as a control point via use of a new PSA control cover sheet, reviewed prior to establishing purchase orders against which contract payments can be made. The control sheet will require identifying current or previous contracts with the contractor/consultant and a description and differentiation of the nature of work related to each. On this latter focus, we anticipate completing these refinements by 4Q, 2007.

**Auditor's Closing Remark**

We would like to thank management and staff from various departments for their timely cooperation and assistance during the audit.