Secretary of State

State of Oregon

DEPARTMENT OF CORRECTIONS

Prison Construction Oversight

Audits Division

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This report contains the results of our audit of the Department of Corrections' prison construction program, specifically the department's oversight of the Snake River project. The expansion of the Snake River Correctional Institution is the first project completed on the department's current prison construction plan. Because this $1 billion construction program is the largest prison construction program in state history, the Oregon Audits Division has been reviewing this program through a series of audits. This audit of the department's construction oversight is the fourth such review. It is our intention that, by reviewing the department's construction program as it progresses, we will provide the state with meaningful recommendations for improvements.

This audit found that the department can improve its oversight of contractor payments, better monitor contract requirements, and strengthen contract terms. The department has already made some changes from the experience it gained from the Snake River project, and it should continue to make necessary improvements in its management and oversight practices to benefit both current and future construction projects. The department's response to our audit has been inserted throughout the report.

OREGON AUDITS DIVISION

John N. Lattimer
Director

Fieldwork completion date:
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EXECUTIVE SUMMARY

The Snake River project is the first in a series of prisons planned under the department's $1 billion prison construction program.

The Oregon Department of Corrections (department) is in the midst of a $1 billion prison construction program. The $179 million expansion of the Snake River Correctional Institution (Snake River), the largest single state-financed construction project in Oregon history, is the first prison in a series of prisons planned under the department's current construction program. Our review of the Snake River project identified the following areas where the department can improve its management and oversight practices to benefit both current and future construction projects:

The department should seek recovery of $465,000 and review an additional $3.7 million in other payments for possible collection.

- **The Department Should Improve Its Oversight of Contractor Payments.** A critical area in which the department has opportunities for oversight improvement involves payments made to contractors. Ensuring that progress payment expenditures are reasonable and appropriate is essential to project cost control. We reviewed project expenditures incurred by the construction manager/general contractor (CM/GC), project management, and materials testing firms for the Snake River project. For all contractors reviewed, we found that the department paid for inappropriate expenditures, including the following for the CM/GC: more than $170,000 in unallowed overhead and purchasing markups, $23,000 for catered luncheons, and almost $107,000 for excessive travel and living expenses. We recommend that the department conduct a thorough review of contractor payments, and for any payments found in error, seek monetary recovery from the responsible firm. In total, we identified $465,000 in recoverable expenditures that the department should collect; $1,700,000 in expenditures which were not in compliance with contract requirements; and an additional $2,000,000 in payments that need further review by the department.

- **The Department Should Improve Its Monitoring of Contract Requirements.** Each contract specifies certain requirements for deliverables and expertise that contractors are to provide the department. We found several instances in which the department did not receive all promised deliverables from its contractors. When the department does not receive reports, schedules, and other project performance documents, its ability to monitor and control the project is limited. This also constitutes a form of overpayment as the department paid for services it did not receive. The CM/GC, project management, architect, and

The department did not receive all promised deliverables and expertise from contractors.

materials testing firms all failed to provide the department with certain required documents. For example, the CM/GC contractor promised a thoroughly documented and controlled project. One of the documents the CM/GC prepares is a monthly progress report, which it provides to the department. Our review found, however, that as of September 1998, the last monthly report the department received was for April 1997. In addition to deliverables, contractors promised specific experts to the Snake River project. We found that the CM/GC and project management firms did not comply with their contractual agreements on the use of these experts. For example, the project management firm committed 25 percent of the project director's time to the Snake River project. Our review of time billed during a four-month period found that the project director spent only four hours (less than ¼ of 1 percent of his time) on the Snake River project. We recommend that the department closely monitor its construction contracts to ensure that all requirements, including promised deliverables and expertise, are fulfilled.

The department needs to ensure that contract fees are clearly defined and reimbursable costs are specific and limited.

- **The Department Should Strengthen Its Contract Terms.** Contract formulation is critical to a construction project's success because the acceptance of imprudent terms and conditions impacts both project cost and quality. To ensure that the best interests of all parties are well protected, it is important that contracts be clear and enforceable. Our review of project expenditures noted opportunities for the department to improve its contract development practices. Two specific areas for improvement include ensuring that contract fees are clearly defined and that reimbursable costs are specific and limited. For example, the department agreed to reimburse the CM/GC firm for the cost of its safety program. The contract did not specify allowable safety program costs or establish a limit for these expenditures. As part of the contractor's safety program, we found that the department paid for safety awards, which included $5,000 for items like baseball caps and jackets, and more than $10,000 in monetary awards. To preclude overcharges and increase the ease of managing project expenditures, we recommend that the department improve its definition of and establish limits for reimbursable expenses and fees.

Agency Response

The department's response to our audit has been inserted throughout the report.

Background and Introduction

The department is in the midst of a $1 billion prison construction program.

The Oregon Department of Corrections (department) is in the midst of a $1 billion prison construction program. The department's current long-range construction plan includes seven new prison facilities and expansion to several existing facilities, most with completion dates in the next ten years. The expansion of the Snake River prison was the first project on the department's plan and was the largest state-financed construction project ever. This project was a 2,348-bed medium security expansion to the existing Snake River Correctional Institution in Ontario. At an estimated cost of $179 million, this project was substantially completed as of November 1998.

To construct the expansion of the Snake River prison, the department used the construction manager/general contractor (CM/GC) approach. The CM/GC is a fast track approach by which a single firm is hired to provide both construction management and general contracting services. Under this process, the site work, building foundation and other early construction work may be designed and bid before the design for later stages of the construction is completed. Subsequent parts of the project can also be designed, bid, and started in stages. The CM/GC provides professional management services for the construction project and assumes responsibility for competitively bidding and awarding construction trade contracts and managing and coordinating the activities of the trade contractors.[1]

Roles and Responsibilities

The department used four primary contractors on the project.

For the Snake River prison construction project, the department used four primary contractors: the construction manager/general contractor (CM/GC), the architect, the professional project management firm, and the materials testing firm. The following describes the general roles and responsibilities of these four firms and the department in the construction process.

[1] We have reported on CM/GC issues and on prison construction in three additional reports:
OAD 98-26 Prison Construction: Infrastructure Planning and Development;
OAD 98-30 Prison Construction: Procurement and Contract Development; and
OAD 98-43 Prison Construction Program: Long-Range Planning and Budgeting.

The CM/GC Firm was responsible for coordinating and managing the building process with the department, the architect, and other firms working on the project. Responsibilities included providing construction management services in the programming, planning, design, and construction phases of the project. The CM/GC also was responsible for working with the architect and the department to provide a project “guaranteed maximum price” and for ensuring that the project was constructed within that amount.

The Architect was responsible for providing design and construction administration services. These services included programming and master planning, architectural programming, schematic designs, design development, construction documentation, bidding, construction contract administration, interior design and space planning, and supplemental services.

The Project Management Firm was responsible for providing a full range of project management services, including overseeing the CM/GC and construction activity; providing technical advice and assistance regarding cost estimates, code requirements, consultant services, and construction procedures; and participating in the design and construction process to ensure that the project is completed on time and on budget. The department hired this firm to represent the interests of the department.

The Materials Testing Firm provided independent laboratory testing and special inspection services required by the Uniform Building Code. Services included the testing and inspection of earthwork, soil, concrete, paving, unit masonry, structural steel welding, and metal fabrication. The tests and inspections were conducted throughout the course of the project to ensure construction quality.

The Department of Corrections was responsible for managing the procurement of the key firms working on the construction projects, developing and administering contracts, and ensuring that the construction projects received adequate oversight and supervision. The department also had a staff member serve as a project manager on site at the Snake River project.

Chapter 1: The Department Should Improve Its Oversight of Contractor Payments

We identified about $465,000 in inappropriate payments and $3.7 million in payments needing additional review for possible collection by the department.

A critical area where the department has opportunities to improve its oversight involves payments made to contractors. To receive payment for the cost of work completed, contractors submit a written monthly progress payment request to the department. These payment requests itemize the expenditures claimed for reimbursement and include supporting documentation such as invoices and timesheets. Ensuring that progress payment expenditures are reasonable and appropriate is essential to project cost control. For the Snake River project, we identified about $465,000 in inappropriate payments to contractors and $3.7 million in payments needing additional review for possible collection by the department. These expenditures are described below and summarized in Figure 2 at the end of this chapter.

The Department Paid the CM/GC for Inappropriate Expenditures and Expenditures Needing Additional Review

The department could detect inappropriate expenditures through enhanced monitoring.

To determine if the department paid contractors for expenditures that were not allowable under the contract, we reviewed several months of progress payments to the construction manager/general contractor (CM/GC). We identified many instances where the department reimbursed the CM/GC for inappropriate expenditures and expenditures needing additional review. The department, through enhanced monitoring of contractor payments, could have detected these expenditures. We found the following:

The department reimbursed the CM/GC approximately $596,000 for equipment rental.

- **Equipment Rental.** The contract allowed for the CM/GC to be reimbursed for the actual costs of equipment rental, subject to the department's approval that equipment rental rates and quantities for the project were reasonable and appropriate. We estimate that during the course of the Snake River project, the department reimbursed the CM/GC approximately $596,000 for equipment rental from itself, including all-terrain vehicles, fax machines, generators, radios, safety equipment, and trucks. While the CM/GC renting equipment from itself was allowed by contract, the contract required that reimbursement be made on an actual cost basis. Instead of charging the department for the equipment's rental based on actual cost, the contractor charged a monthly rate based on 75 percent of the market rental rate. We attempted to verify

We noted several instances of excessive rental rates.

the CM/GC's actual cost for equipment rented to the project by requesting this information from the contractor. The CM/GC told us that this information was not available. Without this information, we were not able to confirm that reimbursement was made on actual cost basis. However, we did note several instances of excessive rental rates, as described in Figure 1:

Figure 1: Excessive Rental Charge Examples

Item Rented	Description
Fax machines	The CM/GC rented six fax machines to the department at a rate of $165 per month. We estimate that, as of January 1998, the department paid more than $14,000 for fax machine rentals. Several fax machines are available through state purchasing; the most expensive model costs $500. **Estimated Excessive Charge: $11,000**
Copier	The department paid the CM/GC $27,390 for a copier which could have been obtained through state purchasing for $11,310. **Estimated Excessive Charge: $16,080**
All-terrain vehicles	The department paid $24,913 for the rental of four all-terrain vehicles; or $6,228 per vehicle. The department could have purchased each vehicle for approximately $3,260. **Estimated Excessive Charge: $11,873**
Flatbed truck	The CM/GC rented a 1978-flatbed truck to the department for $1,620 per month over a period of six and a half months for a total cost of $10,530. According to a local heavy-equipment rental company, it is unusual for a vehicle of that age to be rented out, and in fact, any vehicle made before the year 1990 is difficult to rent. Depending on the condition of this 1978 truck, the estimated market value ranges between $3,500 and $6,500. **Estimated Excessive Charge: $4,030 – $7,030**

Agency Response:
*The department brought this to the contractor's attention and purchased the FAX machines and the all terrain vehicles effective **March 5, 1998**. The department paid the contractor's purchase price for the equipment and received a credit for the rental charges exceeding the final purchase price. While it is true some FAX machines are only $500, it is also true FAX*

machines are more expensive depending on their capabilities. The contractor has agreed to the amount of the overcharge for the copier and the amount will be deducted from the contractor's next payment. The rental charges associated with the flatbed truck are being reviewed and appropriate action will be taken.

The department paid the CM/GC almost $107,000 for inappropriate travel and living expenses.

- **Travel and Living Expenses.** The contract allowed for reimbursement of reasonable travel and subsistence expenses for CM/GC employees incurred while traveling in discharge of duties connected with the Snake River project. The contract, however, did not specifically define when an employee was considered on travel status versus when an employee was considered permanently relocated. According to the department, it deferred to the CM/GC's company policy on this issue. The CM/GC's company policy considers an assignment temporary if it is expected to last less than one year. For those assignments greater than a year, the policy defines rules for relocation and allowable expenses under such circumstances. The allowable expenses did not include such items as rent, utilities, and meals. According to the contract, the Snake River project was expected to be a three-year project; thus, employees assigned to the project for more than one year should be reimbursed under the relocation rules. We identified six CM/GC employees who worked on the project for more than one year. For these six employees, the department continued to pay subsistence expenses, such as rent, utilities, and meals totaling $106,987 after the first twelve months of work on the project. Further, we question the reasonableness of certain items reimbursed, such as silverware, dishes, chairs, bedding, towels, winterizing of an employee's permanent home, shipping costs for three personal vehicles (from Alaska), childcare, cable television, lawn service, a burglar alarm, water softener rental, and bottled water.[2]

  Agency Response:
  The department is seeking advice from the Department of Justice concerning the contractor's allowable travel and living expenses.

[2] The department reimbursed these items during the CM/GC employees' first twelve months of work on the Snake River project.

The department reimbursed the CM/GC about $171,000 in unallowable overhead fees and purchasing markups.

- **Overhead Fee.** The contract allowed the CM/GC to perform some general conditions work on the project (as described in Chapter 3) and be reimbursed for the actual cost of that work. Although, the contract specifically excluded overhead expenses from reimbursement, we found that the department reimbursed the contractor for a three percent markup for payroll processing on this work. We estimate that, as of September 1998, the department overpaid the CM/GC $141,281 for this overhead fee.

- **Purchasing Markup.** According to the contract, the CM/GC was to be reimbursed for the actual cost of work. We found, however, that the contractor charged the department a 10 percent markup on certain purchases. These items were purchased by the contractor from its own inventory warehouse. We reviewed supporting documentation for a month of these expenditures and identified the markup. According to the contractor, it is their company policy to add a 10 percent markup to items obtained from their warehouse. We estimate that, during the course of the project, the CM/GC charged the department a markup of approximately $30,400 for these purchases.

  Agency Response:
  The department is currently reviewing with the Department of Justice the contract terms relating to the allowable expenses of the overhead and purchasing markup. Once this is determined, the department will take appropriate action.

The department paid almost $24,000 for six catered safety luncheons.

- **Catered Safety Luncheons.** The CM/GC's contract did not specifically allow reimbursement for catered luncheons. According to the department, these were safety luncheons held on site for all workers, including inmates working on the project. We reviewed project expenditures and found that the contractor requested reimbursement for seven catered luncheons from May 1996 to February 1998 totaling $28,495. The department disallowed reimbursement for one catered lunch because the payment request lacked an agenda and list of attendees. For the remaining six luncheons, we could not find sufficient evidence to support the purpose and attendance for the catered luncheons. The cost of these luncheons totaled $23,739.

  Agency Response:
  The contract states the department will participate in the contractor's safety program. The catered luncheons are

brought to the construction site as part of the contractor's safety program to reward the workers for a safe construction project. The department will require additional documentation in the future. For clarification, the department delayed reimbursement for the referenced safety lunch. It was not disallowed.

The department paid about $20,000 more than necessary for insurance.

- **Insurance Rates.** The contract allowed the CM/GC to be reimbursed for project-related insurance costs. A type of insurance reimbursed by the department was the commercial general liability insurance. The CM/GC billed this insurance as a percentage of the cost of work each month; however, based on rate information provided by the CM/GC, we found that the department was charged too high a rate for a ten-month period. As a result, the department overpaid the CM/GC $19,656. The CM/GC agreed that the wrong rate had been charged.

  Agency Response:
  The department has already taken action by reducing the contractor's January 1999 billing for the $19,656 overpayment.

The department needs to review about $1.1 million in expenditures made by the CM/GC for others and for work not competitively bid.

- **Expenses for Others.** The contract allowed the CM/GC reimbursement for costs it incurred. During the course of the project, however, the department reimbursed the CM/GC approximately $192,328 for expenditures on behalf of others. The project management firm's contract did not include a provision for purchasing office supplies; therefore, the CM/GC purchased at least $10,891 in office supplies for the project management firm. The CM/GC also made purchases on behalf of the department.

- **Biddable Work.** The CM/GC contract required that all work be competitively bid except for limited work allowed to be self-performed by the CM/GC (as described in Chapter 3). We found that the contractor used subsidiary companies to perform work such as field surveying and mechanical work instead of competitively bidding this work. We estimate that, during the course of the project, the department paid more than $959,000 for this non-competitively bid work.

  Agency Response:
  A majority of the referenced $192,328 of expenses paid for others ($181,437) are related to department requests made of the contractor to ensure adequate construction site security or for completing construction projects assumed by the

*department. To title these expenses as Non-Compliant is **not** accurate. For example: a computerized security identification recording system for checking construction workers in and out of the prison site was purchased for $85,500. This system was needed for public and institution safety because the construction site was within an operational prison. The construction project could not proceed without this system and the department will use this system at other construction sites. Other purchases included: a vacuum system for cleaning heating and cooling vents ($27,000); concrete sealer for inmate cells not required by code, but required for sanitation purposes ($18,000); computer equipment for the DOC Project Manager ($16,800); rental of portable buildings for inmate construction workers for changing and toilet facilities ($8,800); and lawn irrigation supplies for the department's work on the grounds ($3,700). All of the items purchased were approved by the department and were necessary for the construction project.*

With reference to biddable work: Most of the $959,000 was paid for survey work. Section 10.1 of the contract states, "Those portions of the Work that the CM/GC does not customarily perform with the CM/GC's own personnel shall be performed under subcontracts or by appropriate agreements with the CM/GC." Surveying work on construction projects is often considered general condition work performed by the CM/GC. The department approved the hourly rate charged by the subsidiary and has received the necessary service.

Audits Division Comment:

While the items may have been needed by the department, these expenditures were not allowed as a reimbursable cost by the CM/GC's contract. To obtain these items, the department should have followed state purchasing rules rather than purchasing through the contractor at a potentially higher cost. For example, the $16,800 of computer equipment purchased for the department employee should have been purchased by the department from the state's price agreement. Additionally, the $85,500 security system exceeds the dollar limit requiring the department to obtain competitive bids. Therefore, these expenditures were both not in compliance with the CM/GC's contract and also not in compliance with state purchasing rules.

With regard to the biddable work, because the CM/GC did not perform the work with its own personnel as required by the contract, this work should have been competitively bid.

The department needs to enhance its review of payments made to subcontractors.

- **Subcontractor Payments.** The CM/GC contract allowed reimbursement for payments made to subcontractors. Of the 55 subcontractors who worked on the project through September 1998, we judgmentally selected payments made to 11 subcontractors, representing almost 50 percent of subcontractor payments, for review. For seven subcontractors who appeared to have finished work on the project, we found that the CM/GC billed $38,480 more than actually paid to five of them. The four remaining subcontractors were still working on the project and were owed more than $2 million. The department should enhance its review of all subcontractor payments to ensure that it paid the CM/GC no more than the amount paid to the subcontractors.

  Agency Response:
  There is no mention in the report that these payments relate to contractor retainage, which is held pending completion of the work. The releasing of subcontractor retainage is a decision of the CM/GC. The department only has contractual relationship with the CM/GC. The department is also relying on the contractor's certification in accordance with section K 3 of the Standard General Conditions requiring disclosure that all subcontractors and suppliers have been paid in full and no claims are outstanding on the project.

  <u>Audits Division Comment:</u>
  The department has the responsibility to ensure that it pays the CM/GC no more than the amount the CM/GC paid to the subcontractors. Relying on the CM/GC's certification that the subcontractors were paid in full is not adequate assurance.

The Department Paid for Inappropriate Project Management and Materials Testing Contractor Expenditures

In addition to reimbursing the CM/GC for inappropriate and questionable expenses, we also found that the department reimbursed the project management and materials testing contractors for inappropriate expenses. The following summarizes what we found:

The department paid the project management firm about $5,600 for unallowable business meals.

- **Business Meals.** The project management firm was allowed reimbursement for travel and meal expenses at state rates. The state does not allow reimbursement for business lunches. As of January 1998, the department reimbursed the project management firm approximately $5,586 for business meals. These meals were usually at a local restaurant with either co-workers or employees of other firms. The department agreed with our assessment and, in January 1998, began disallowing business meals as a reimbursable expense.

  Agency Response:
  The amount paid prior to January 1998 for business lunches will be reviewed and recovered from the contractor as appropriate.

The department reimbursed the materials testing firm almost $42,000 for inappropriate travel and living expenses.

- **Travel and Living Expenses.** The materials testing firm was also allowed reimbursement for travel expenses at state rates. The state limits travel expenses to those incurred during travel away from the official workstation. Applying federal tax guidelines, after one year the official workstation of onsite materials testing staff should be Ontario, since employees living at the Ontario site for more than one year should show Ontario as their official workstation. We found that the department reimbursed the materials testing firm $41,768 for lodging and meal expenses of four employees after these employees had lived and worked in Ontario for more than one year. In addition to the above lodging and meal expenses, we also identified an instance where the department paid for excessive meal reimbursement. In this instance, the department paid a full month of meal reimbursement totaling $806 to a materials testing employee who charged only seven hours during that month to the Snake River project.

  Agency Response:
  *The materials testing contract for the Snake River Correctional Institution requires the contractor to be reimbursed according to the Oregon Department of Administrative Services administrative rules for travel allowances. The federal tax guidelines are **not** an appropriate measure of allowed contract reimbursement. The department will review travel expenses to determine reimbursement was in accordance with contract terms.*

The department paid almost $46,000 to the project management and materials testing firms for items not specifically allowed by the contract.

- **Items Not Allowed By Contract.** Although the contracts for the project management and materials testing firms specified certain items as reimbursable, we found that the department reimbursed these firms for expenditures that were not specifically allowed by their contracts. The department paid the project management firm approximately $10,227 for non-reimbursable expenses including an all-terrain vehicle; maintenance for this vehicle; office supplies; computer-related equipment; a fax machine; cleaning supplies; food items; and Christmas cards. While the department allowed the project management firm $1,550 for miscellaneous supplies in its contractual budget, the actual expenditures greatly exceeded this amount. The department also paid the materials testing firm approximately $37,226 for non-reimbursable expenses, including two all-terrain vehicles and maintenance, gasoline, office trailers, office supplies, computer equipment, work clothes, and rental of a water cooler and bottled water.

  Agency Response:
  The all-terrain vehicles were purchased for the project management consultant and the materials testing contractor because the Snake River Correctional Institution has 100 acres inside the institution. This allowed the contractors to move around the construction site more efficiently. These vehicles will be turned over to the department and either used at SRCI or at future construction sites. Expenses of $13,800 for the portable laboratory shown in the report as disallowed are allowed according to the contract. All other expenditures in question will be reviewed according to the contract and, if appropriate, reimbursement requested from the contractor.

Recommendations

We recommend that the Department of Corrections seek monetary recovery from the responsible contractors in the amount of $465,000. For the $596,000 in equipment rental, the department should request actual cost information. If the department is unable to obtain this information, then the department should seek monetary recovery of this amount. For the $181,437 in purchases that were not in compliance with the contract, the department should seek recovery of some or all of this amount. As the $959,000 in work performed by CM/GC subsidiary companies was not bid in compliance with contract requirements, the department should seek monetary recovery of some or all of this amount. In addition, the department should also conduct a thorough review of the $2,000,000 in subcontractor payments to ensure that it paid the CM/GC no more than the amount paid to the subcontractors. When seeking monetary recovery, the department should consult with the Department of Justice. For current and future construction projects, the department should more closely review contractor payments to ensure that the expenditures are allowable under the contract prior to payment.

We recommend that the department establish a system to monitor contractor payments and make necessary policy decisions regarding certain issues such as determining whether purchasing equipment is more feasible than renting, establishing detailed travel and relocation policies, and implementing procedures to ensure that subsidiary company work is competitively procured.

Agency Response:
We have determined some of the items mentioned were already recovered from the contractors over a year ago and others are allowed according to the contract terms. The department will work with the Department of Justice to determine if any of the other items are recoverable from the contractors.

The department is not in a position to recover the full amount of the rental equipment charges. The contract allows the CM/GC to charge for the rental equipment and the department received a benefit. The reason the department recovered the rental charges on the other equipment was that the rental charges exceeded the cost of the equipment. The department will review the rental charges for any possible overcharges.

The items totaling $181,437 were required by the department during construction as noted earlier. These items are neither recoverable nor in non-compliance with the contract terms.

As previously noted, the department approved payment for survey work on an hourly basis and the work was done. The department has no reason to recover the entire $959,000 from the contractor once the work has been completed to our satisfaction. If reimbursement exceeded a reasonable bid price for equivalent effort, there may be an issue. This will be explored.

<u>Audits Division Comment:</u>
While the department has attempted to recover the equipment rental costs as noted in their response on page 4, the department still needs to request actual cost information for all equipment rented. As the contract required reimbursement to be made on an actual cost basis, the department should have paid rental rates based on the CM/GC's actual costs rather than on market rates. Further, the department needs to address the policy decisions regarding equipment rental as stated above in our recommendation.

Figure 2: Summary of Expenditures

Inappropriate/Recoverable Expenditures	
Item	**Amount**
CM/GC:	
Travel and living	$106,987
Overhead fee	$141,281
Purchasing markup	$30,400
Catered luncheons	$23,739
Insurance rates	$19,656
Expenses for others	$10,891
Subcontractor payments	$38,480
Other Contractors:	
Business meals	$5,586
Travel and living	$41,768 806
Items not allowed by contract Less allowable amount	$10,227 (1,550) 37,226
Total	**$465,497**

Non-Compliant Expenditures	
Item	**Amount**
CM/GC:	
Equipment rental	$596,000
Expenses for others	$181,437
Biddable work	$959,000
Total	**1,736,437**

Expenditures Needing Further Review	
Item	**Amount**
CM/GC:	
Subcontractor payments	$2,000,000

Chapter 2: The Department Should Improve Its Monitoring of Contract Requirements

Each construction contract specifies certain requirements for deliverables and expertise that contractors are to provide the department. Examples of deliverables include reports, schedules, estimates, and analyses. It is important for the department to monitor contract compliance. Our review identified opportunities for the department to improve in this area.

The Department Did Not Receive All Promised Deliverables

The department's ability to monitor and control the project is limited when it does not receive reports, schedules, and other project performance documents.

To determine whether the department received promised deliverables, we conducted a limited review of contract requirements. Not receiving reports, schedules, and other project performance documents limits the department's ability to monitor and control its construction projects. Our review found the following instances where the department was not receiving all required documents from contractors:

- The materials testing firm was required by contract to provide the department with an established schedule or procedure for testing and inspection. We could find no evidence that this documentation was prepared and provided to the department.

- The architect was required by contract to provide the department with daily, weekly, and monthly reports. In addition, the architect was required to provide the department with a staffing analysis and operational cost estimate for the design development phase of the project. We could find no evidence that these reports were prepared and delivered to the department.

- The project management firm was required by contract to prepare a daily report, which noted significant activities and progress at the project site each day. In one of the months we reviewed, we found that almost half of these daily reports were missing. The project management firm was also required to review and certify progress payments made to the architect. As of September 1997, the department paid the architect more than $8 million without the project management firm's review and certification. Because the department hired this firm to represent the department's interests, we are concerned by this lack of oversight.

- The CM/GC was also required to provide the department with project report documentation. In its proposal, this contractor promised a thoroughly documented and controlled project. One of the documents the CM/GC prepares to meet this obligation is a monthly report. In October 1997, we requested a copy of the CM/GC's monthly report for December 1996 and found that the department had not received this report or any monthly reports since that time. We followed up with the department again in September 1998 to confirm whether the CM/GC provided all promised monthly reports. We found that the department still had not received a complete report record, and that the last monthly report received was for April 1997. While the CM/GC planned to eventually provide the department with complete monthly report documentation, the department's ability to monitor the Snake River project was impaired when these required monthly reports were received, in some cases, more than a year (17 months) late.

  Agency Response:
  The department recognizes the importance of receiving the contractors reports, however, some daily and weekly reports were determined to be of little value. The local building code inspectors specified the number and types of tests required during the construction project. Therefore, the planned schedule of testing required by the contract was also determined to be unnecessary. The CM/GC monthly reports indicated as being late for the Snake River Correctional Institution are now current. Since the SRCI project has been completed, the department reviewed the current reporting procedures for the Two Rivers Correctional Institution to ensure report compliance with the contracts. The Two Rivers Correctional Institution project manager has established a monthly reporting process that incorporates comments from all contractors assigned to the project. This process ensures the department receives the required reports and provides a project team assessment that clearly assesses the project in a team approach.

The Department Did Not Receive Promised Expertise

In addition to agreeing to meet reporting requirements, the project management and CM/GC firms also promised that specific individuals would provide expertise to the Snake River project. We found that these firms did not comply with their contractual agreements on the use of these experts. The contract required the project management firm's project director, who is considered an expert in justice systems, to commit 25 percent of his time to the Snake River project. Our review of the project management firm's invoices for a four-month period found, however, that the project director spent only four hours (about ¼ of 1 percent of his time) on the Snake River project. These four hours were a significant shortage compared to the contractual time commitment of approximately 160 hours for the time period.

The project management and CM/GC firms did not provide promised experts.

In its proposal, the CM/GC also promised 10 core team members, many having experience from the first phase of the Snake River project, completed in 1991. In its selection process, the department weighted key individual and team experience as 35 percent of the proposal evaluation score, and of all proposing firms, this firm scored highest in this area. Our review of the hours incurred by the ten promised staff, however, found that only half (5 of the 10 promised individuals) spent a significant amount of time on the Snake River project.

Agency Response:
In its Request for Proposal, the project management consulting firm estimated the amount of time the project director would commit to the project. The department determined not to use the project director as often as originally planned and since the contract was on an hourly basis the department realized cost savings. The project director remained available to assist the department on the project as needed. The department's project manager assumed the duties originally assigned to the project director.

Recommendations

We recommend that the Department of Corrections more closely monitor its construction contracts to ensure that all requirements are fulfilled. The department should establish a monitoring system which identifies all required elements in the contract and the specified due dates, and includes notification and follow-up procedures when deadlines are not met. Any exceptions to meeting contract requirements should be fully documented, and if necessary, the cost for work not performed should be recovered by the department. To further ensure contract compliance, the department should establish additional incentives, such as monetary penalties or payment withholding, to encourage contractors to be more responsive to their contractual requirements.

Agency Response:
As noted earlier, the department has reviewed the current construction project to ensure required contract reports are being received. The department does withhold retainage on the CM/GC contract until the final closeout of the project has been completed. The other contract consultants are paid on an hourly basis.

Chapter 3: The Department Should Strengthen Its Contract Terms

Contract formulation is critical to a construction project's success.

A written contract defines the responsibilities, rights, and monetary consideration between the department and its contractors. Contract formulation is critical to a construction project's success because the acceptance of imprudent terms and conditions impacts both project cost and quality. To ensure that the best interests of all parties are well protected, it is important that contracts be clear and enforceable. To determine the appropriateness of project expenditures as described in Chapter 1 of this report, it was necessary for us to review and understand applicable contract terms. Through this review process, we identified additional opportunities for the department to improve its contract development practices.

Contract Fees Should Be Clearly Defined

As of November 1998, the department paid about $5.6 million in CM/GC fees.

To provide its services, the department paid the CM/GC on the basis of a fixed percentage fee and an allowance for reimbursable costs. This fee compensates the firm for its construction management services and was established as 3.95 percent of the total cost of work. As of November 1998, the department paid about $5.6 million in CM/GC fees. As determined by the department, the fixed fee covered several specified items, including the costs of salaried personnel and services such as accounting and data processing. Figure 3 is a summary of the items that were to be included, at a minimum, in the 3.95 percent Snake River CM/GC fee:

Figure 3: Construction Management Fee Content

Operations Manager	Corporate Executives	Secretarial
General Superintendent	Principal In Charge	Clerk/Typist
Project Manager	Estimating	Computer
Project Superintendent	Cost Engineering	Data Processing
Scheduling Engineer	Value Engineering	Legal Services
Time Keeper/Checker	Scheduling	Main Office Staff:
Safety & EEO Officer	Drafting and Detailing	Fringe Benefits
Bonuses/Job Site Staff	Purchasing & Contracts	Vacation Time
Project Manager's Auto	Accounting	Bonuses
Project Superintendent's Auto	Bookkeeping	

When contract terms are not clearly defined at the beginning of a project, these terms may be subject to interpretation later.

The cost items included in the CM/GC fee were not intended to also be reimbursable costs. However, as described in Figure 3, the cost items included in the CM/GC fee were listed in general terms, which makes it difficult to determine the appropriateness of expenses. The terms did not specify, for example, whether the CM/GC fee was to cover only the salary of specified staff or all related expenses, including travel and subsistence expenses. This distinction is important, as these additional expenses can be substantial. During the course of the project, travel and subsistence expenses for the project manager alone totaled more than $71,000. When contract terms are not clearly defined at the beginning of a project, these terms may be subject to interpretation later. In this case, the department allowed the project management firm to make the determination that travel and subsistence expenses for CM/GC staff were reimbursable costs rather than expenses included in the CM/GC fee.

Agency Response:
The construction management fee items identified in the Snake River Correctional Institution contract were contract boilerplate items established by the Department of Administrative Services. The department agrees to a certain extent that a more detailed explanation of the management fee items is needed. However, these items can not be specified in enough detail to remove all questions as to what is or is not included in the fee. The department uses industry practices to help determine the propriety of items in question.

The department did ***not*** *allow the contractor to determine what travel and subsistence expenses were reimbursable or part of the management fee. Article 7 of the contract, titled "Costs To Be Reimbursed", states in section 7.5.5, "That portion of the reasonable travel and subsistence expenses of the CM/GC's personnel incurred while traveling in discharge of duties connected with the Work, except for travel costs of main office staff." The contractor's project manager was at the Snake River Correctional Institution construction site for three years. His travel and subsistence expenses are allowed according to the contract while his salary and benefits are considered part of the fee.*

Reimbursable Costs Should Be Specific and Limited

In addition to fees, the department compensated contractors for project expenses through reimbursable costs. Each contract specified certain expenditures as allowable for reimbursement. Our review of contract expenditures noted opportunities for the department to improve its definition and establish limits for these reimbursable costs. The following are some examples of contract terms that need strengthening:

No parameters were established on the type of work that the CM/GC could self-perform.

- The department allowed the CM/GC reimbursement for self-performed work commonly known as "general conditions." According to industry experts, general conditions work is work that is temporary in nature and can include activities like site supervision, temporary sanitation, temporary water, safety, debris removal, dust control, and winter protection. It is the department's responsibility to determine which work is appropriate "general conditions" work and to establish a maximum expenditure amount. For the Snake River project, the department defined this work as "normal general conditions and pick-up work" and did not place a maximum dollar limit on this work. The department did not specify the type of work the contractor could perform. We found that the CM/GC billed time to a variety of activities including field surveying, electrical wiring, carpentry, painting, and excavation. We also found that as of November 1998, the CM/GC exceeded the original estimate for general conditions work by almost $5 million.

The department placed no limits on the CM/GC's safety program and travel expenses.

- Another reimbursable expense the department paid the CM/GC was for safety program costs. According to the terms of the contract, the CM/GC would be reimbursed for the "cost of the CM/GC's safety program." As part of this safety program, we found that the department paid for safety awards, including baseball caps, jackets, and safety dollars. During the course of the project, the department paid more than $15,000 for safety awards. Of this amount, approximately $10,000 was paid in monetary awards to 13 individuals for being accident free. The contract did not specify the types of expenses allowable for the safety program and it did not set any dollar limits.

- The department also did not establish cost limits for CM/GC travel expenses. According to the contract, the CM/GC would be reimbursed for "that portion of the reasonable travel and subsistence expenses of the CM/GC's personnel incurred while traveling in discharge of duties connected with the work…." The contract did not specify the types of allowable travel expenses and establish a maximum dollar limit. We found that the CM/GC requested reimbursement for a variety of travel-related costs. As described in Chapter 1, our review of travel expenditures found that the department paid for travel expenses including apartment and house rentals, house hunting, cable television and utilities, personal vehicle shipping, lawn mowing, and burglar alarm systems.

Agency Response:
The original general conditions work estimate for SRCI was established early in the design stage using industry standards. Since this was a rough estimate, contingency costs were set aside to account for any site-specific problems that might be incurred. In addition, due to Ballot Measure 17 and to keep construction costs down, the department used inmate labor on the construction project. The cost associated with this was charged to the general conditions cost code.

For the Two Rivers Correctional Institution the definition and scope of the safety program are now dictated by the terms of the Contractor Controlled Insurance Program (CCIP.) The department will monitor the safety program expenses to ensure compliance with the CCIP requirements.

All contracts for the Two Rivers Correctional Institution require the contractors to be reimbursed according to travel rates established by the Department of Administrative Services.

Recommendations

We recommend that the Department of Corrections strengthen its contract terms by clearly defining requirements and establishing cost limits. Contract fees and reimbursable costs should be clearly defined to preclude overcharging and to increase the ease of managing project expenditures. The department should review existing prison construction contracts to determine if terms are sufficiently clear and if necessary, amend the contracts to ensure that terms, costs, and allowable charges are adequately defined.

Agency Response:
The department holds precontract signing meetings with each contractor to discuss the scope of the work to be completed. As part of these meetings for future construction projects, the department will include a more detailed review of the fee and reimbursable expenses.

Other Matters

During the course of our audit work, other matters came to our attention that are important for the department to review and consider. In general, these areas were outside the scope of our review; therefore we performed limited audit work.

Travel Expenditures for Department Staff

The department allowed an onsite employee to be on permanent travel status and reimbursed this employee about $38,000 in travel expenditures.

To provide additional oversight for the Snake River project, the department hired an employee in April 1995 to serve as its onsite project manager. This employee worked full-time for the department at the Snake River project site in Ontario. It came to our attention that the department established Salem as this employee's official workstation, which is almost 400 miles from Ontario. By doing so, the department allowed this employee to be on permanent travel status and incur significant expenditures to commute and live in Ontario. The department reimbursed this employee about $38,000 for meals, mileage, hotel, and telephone charges over a 22-month period. Because this employee was hired to provide full-time, onsite management for the Snake River project, we question the department's decision to establish Salem rather than Ontario as the official workstation. A basic principle of the state travel policy is that travel be conducted in the most efficient and cost-effective manner resulting in the best value to the state. In this case, it appears that the department should have designated Ontario as the official workstation for this employee. The department should re-evaluate the reasonableness of travel expenditures for department staff and the official workstations for staff assigned full-time to construction projects.

Project Expenditure Documentation

The department paid contractor expenses without adequate supporting documentation.

During our review, we identified additional opportunities for the department to improve its monitoring of contractor payments. This includes ensuring that adequate supporting documentation is obtained to verify the appropriateness of project expenditures prior to payment. For the following examples, we requested and reviewed limited documentation. We did not identify any discrepancies; however, the department should have requested this documentation prior to payment. For example, the department reimbursed the CM/GC more than $300,000 for expenditures, the majority of which lacked sufficient documentation to support the actual cost and validity of the purchase. Another example of the department's lacking supporting documentation was for labor charges incurred by the materials testing firm. Our review of five months of labor invoices totaling more than $146,000 found that the department did not have supporting timesheet documentation for four months of the billings. Without this support, the department cannot verify that the labor hours billed were actually worked.

Agency Response:
It is the department's policy to require detailed vendor invoices for all purchases. However, some invoices received on the CM/GC letterhead showing what was purchased may not have included a copy of the originating vendor invoice.

With respect to the labor charges, the department is requiring actual timesheets for the current Two Rivers Correctional Institution construction project.

Objectives, Scope and Methodology

This audit is the fourth in a series of audits of the Department of Corrections prison construction program. The first audit (#98-26) reviewed the department's planning for infrastructure; the second audit (#98-30) reviewed the department's procurement and contract development practices; and the third audit (#98-43) reviewed the department's long-range construction planning and budgeting process. As part of the second audit described above, we conducted a preliminary review of contractor payments. This audit reports on the results of our additional work on this issue. The objectives of this audit were to:

(1) determine if the department paid contractors for expenditures that were reasonable and reimbursable under the terms of their respective contracts; and

(2) perform a limited review of contract deliverables.

To accomplish these objectives, we reviewed applicable contracts, laws, rules, policies and procedures, and records related to the department's Snake River construction project in Ontario. For the testing of contractor payments, we judgmentally selected five months and reviewed invoices and supporting documentation for each month. Based on this review, we limited our detailed testing to payments made to the CM/GC, project management, and materials testing firms. We reviewed electronic expenditure data and other supporting documentation from each contractor. For certain expenditure categories, we expanded our review to include all payments made during the course of the project from September 1995 to September 1998. We interviewed department and contractor officials and visited the Snake River construction site.

We also reported other less significant findings, totaling $1,592, to the department in a separate letter.

We conducted our audit from June to December 1998.[3] This work was in accordance with generally accepted government auditing standards.

[3] This report includes work from audit #98-30, which was conducted from July to December 1997. This audit work was held pending the results of additional work conducted from June to December 1998.

Commendation

The courtesies and cooperation extended by the officials and staff of the Oregon Department of Corrections were commendable and much appreciated.

Audit Team

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AGENCY'S RESPONSE TO THE AUDIT REPORT

The agency's response to the audit report has been inserted in *italics* throughout the report. The following is the Department of Corrections cover letter that accompanied their written response.

Oregon

DEPARTMENT OF CORRECTIONS

OFFICE OF THE DIRECTOR

March 8, 1999

John N. Lattimer, Director
Oregon Audits Division
255 Capitol Street NE Suite 500
Salem, Oregon 97310

Dear Mr. Lattimer:

The Department of Corrections is responding to the audit recently completed entitled "Prison Construction Oversight." This is the final audit in a series of four audits conducted by your staff of our prison construction planning, procurement, and contract development practices. This has been an exhaustive audit of our construction process taking approximately two and one years to complete. The department appreciates the time and effort devoted to these audits by your staff. Several of the recommendations have already been implemented. As noted in previous audits, the department has also disagreed with other recommendations and has stated its objections to them.

Attached is the department's written response to be included in this latest construction audit report. Should you or your audit staff have questions concerning this response, please do not hesitate to contact Sue Acuff, Assistant Director for Business and Finance (945-9007.)

Sincerely

David S. Cook
Director

cc: Drummond Kahn
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Les Dolecal
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