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March 21, 2007

Matthew Garrett, Director
Oregon Department of Transportation
355 Capitol Street NE, Room 135
Salem, OR 97301-3871

Dear Mr. Garrett:

We have completed our investigation of the Oregon Department of Transportation's (department) contracting practices related to Oregon Bridge Delivery Partners.¹ The Audits Division received allegations in January 2005 that Oregon Bridge Delivery Partners (Bridge Partners) had engaged in questionable billing and contract practices with the department and had made inappropriate contract expenditures.

The purpose of our investigation was to determine the validity of the allegations. We determined the allegations relating to questionable billing and inappropriate contract expenditures were not substantiated. Although Bridge Partners may have incurred expenditures for items such as parties and furniture, we could not verify that they billed and received reimbursement from the department for those expenditures. During our investigation, we identified opportunities for the department to improve its contract management procedures to properly oversee payments made to Bridge Partners. Our findings and recommendations are discussed in the accompanying results section.

Methodology

We performed procedures and reviewed documents to follow up on the allegations. We also reviewed the first contract in a series of contracts to occur between the department and Bridge Partners and the payments made under that contract. We interviewed the department's and Bridge Partners' management and responsible staff, and some subcontractors. We reviewed pertinent contracts, agreements, laws, state administrative rules, and the department's policies and procedures. We also obtained and reviewed relevant documentation such as subcontractor invoices and corresponding payments.

We conducted the majority of our fieldwork during the period February 2005 through June 2005. We suspended this work in the summer of 2005 until the present to complete other higher-priority audit work and manage the June 2006 departure of the Audit Manager who was responsible for this assignment.

¹ Oregon Bridge Delivery Partners is a private-sector firm under contract with the department to help manage the department's \$1.3 billion state bridge repair and replacement program.

Results

Ensure Sufficient Contracting Policies and Procedures Are in Place

During our review, we found that the department had not fully completed and implemented contract review policies and procedures. The department's Bridge Delivery Unit began receiving and approving invoices in June 2004 from Bridge Partners. The department's invoice review policy, however, was still in draft form and had not yet been approved nearly seven months later, in March 2005. By that date, the department had paid Bridge Partners approximately \$14,300,000.

Because the department did not have adequate contract review procedures, it could not always ensure that invoices were complete, accurate and in compliance with contract requirements. When we reviewed invoices Bridge Partners submitted to the department from June 2004 to February 2005, we found instances of contract overruns and other potentially inappropriate payments that might have been prevented had the department implemented a comprehensive review process. Those instances are described below.

- A Bridge Partners subcontractor performed work before a contract was established and billed Bridge Partners more than the contract value by the time the contract was signed. According to documentation Bridge Partners provided, the subcontractor billed over \$183,000 for work performed from April through June 2004; the contract, valued at \$25,750, was signed on July 21, 2004. An additional \$164,000 was billed on the contract before it was amended to \$530,000 in September 2004.
- A Bridge Partners subcontractor hired a subcontractor without first obtaining Bridge Partners' written consent as stipulated in the contract. Work was performed in October and December 2004 and invoiced to Bridge Partners in October 2004 and January 2005, respectively. Bridge Partners did not approve the subcontractor's hiring decision until May 11, 2005, nearly seven months after the work began.
- Bridge Partners did not always retain adequate supporting documentation for the invoices it submitted to the department. For example, we obtained copies of invoices from a subcontractor and compared them to documentation available from Bridge Partners. From a list of 52 invoices and credit memos, Bridge Partners could provide only 27 of the documents.

Department management is responsible for designing and implementing adequate controls to monitor contracts. Those controls help ensure contractors comply with contract terms, achieve performance expectations, and submit requests for payments that are accurate, adequately documented, and support cost containment. A review process can identify contract overruns, off-contract payments, and insufficient documentation. Without an effective review process in place, management cannot be assured that work is performed in accordance with contract terms and payments are accurate and appropriate.

Ensure Contracts Include Adequate Compensation Conditions

The department and Bridge Partners entered into an Agreement to Agree for Bridge Partners to provide initial program management services necessary to plan for and begin implementation of the OTIA III State Bridge Delivery Program. The agreement stipulated the general terms and conditions to be followed in subsequent Work Order Contracts. The

Agreement to Agree and first six contracts, however, did not clearly address pay rates or rate changes for Bridge Partners' employees. Subsequent contracts were more explicit and more restrictive regarding compensation conditions.

The department's first Work Order Contract with Bridge Partners was silent about pay rate increases for employees. During the period covered by that contract, April 2004 through December 2004, the department paid for more than a 16 percent increase for one employee and 10 to 12 percent increases for three other employees. Ten months after the first contract, in Work Order Contract Number 7, the department modified its stance and required Bridge Partners to obtain the department's advance and written approval of any individual wage increase in excess of 4.5 percent.

Department management stated that pay rate increases were acceptable as long as they did not exceed the average hourly rate per an entire classification of employees. The first contract, however, did not restrict pay rates in this manner. As a result, Bridge Partners was not prohibited from increasing pay rates to any level. We compared the pay rates stipulated in the first contract for the Project Coordinator and Resident Engineer to the rates billed to and paid by the department. Bridge Partners billed the department \$12,884 in excess of the average for this classification. According to Bridge Delivery Unit's management, current contracts will be modified to ensure that Bridge Partners' pay rates do not exceed the stipulated average pay rates in total.

Contracts should protect the interests of the department by clearly defining payment parameters, including escalation factors. By not timely and adequately addressing employee compensation contract terms, the department has not taken sufficient steps to contain costs.

We recommend the department's Bridge Delivery Unit management more effectively monitor its contracting activities with Bridge Partners. At a minimum, department management should:

- Develop, document, and implement contracting policies and procedures that (1) prescribe the invoice review and approval process, (2) ensure contracts are in place and approved prior to making contract payments, and (3) ensure contractor invoices are accompanied by adequate supporting documentation prior to payment.
- Ensure future agreements timely and adequately address compensation conditions.

Sincerely,
OREGON AUDITS DIVISION

Charles A. Hibner, CPA
Director

CAH:brk

cc: Mike Marsh, Deputy Director, Central Services Division
Marlene Hartinger, Chief Internal Auditor
Lindsay Ball, Director, Department of Administrative Services

Agency Response:

The Oregon Department of Transportation (ODOT) appreciates the March 5, 2007 draft letter concerning contracting practices related to the Oregon Bridge Delivery Partners (OBDP). We also appreciate the formal recognition that the allegations leading to the investigation were not substantiated. ODOT submits that we act in a prudent manner in all of our contracts and feel that this investigation substantiates that belief.

With respect to the individual recommendations, ODOT agrees with and has implemented the recommendations as they pertain to our contracts with prime contractors. Following are our comments on the specific recommendations.

“Develop, document and implement contracting policies and procedures that (1) prescribe the invoice review and approval process, (2) ensure contracts are in place and approved prior to making contract payments, and (3) ensure contractor invoices are accompanied by adequate supporting documentation prior to payment.”

- (1) ODOT concurs with the Secretary of State’s (SOS) recommendation. The Bridge Delivery Unit (BDU) has implemented invoice related policies and procedures.
- (2) ODOT concurs with the SOS recommendation. ODOT has not made payments to OBDP (ODOT’s prime contractor) without contracts in place. ODOT has been advised by the Department of Justice (DOJ) legal counsel not to intervene between the fundamental contractor/subcontractor relationship and we have followed DOJ’s advice. DOJ has warned that if management direction is taken from the prime contractor related to its subcontracts, there is potential that the prime contractor could seek relief from any attempt by ODOT to hold them to their contractual obligations.
- (3) ODOT concurs with SOS recommendation. BDU has implemented invoice related policies and procedures. The policies and procedures require appropriate documentation to support payment.

“Ensure future agreements timely and adequately address compensation.”

ODOT concurs with the SOS recommendation. The Bridge Delivery Unit has improved our negotiation processes. This has resulted in implementation of internal controls policies and the transference of agency risk to the consultant. We have a direct labor rate assessment that was prepared to determine reasonableness of the OBDP’s proposed direct labor. In addition, BDU continually scrutinizes hourly wage rate increases.