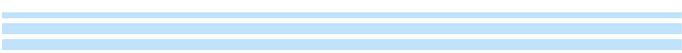




Office of the Public Auditor
Commonwealth of the Northern Mariana Islands

Public School System
Audit of Marianas High School
Gymnasium Contract



Audit Report
AR-98-01



Office of the Public Auditor

Commonwealth of the Northern Mariana Islands

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January 15, 1998

Ms. Marja Lee Taitano
Chairperson of the Board of Education
Public School System
Saipan, MP 96950

Dear Chairperson Taitano:

**Subject: Cover Letter - Final Report on the Audit of Marianas High School
Gymnasium Contract (Report No. AR-98-01)**

The enclosed audit report presents the results of our audit of the Marianas High School (MHS) gymnasium contract covering the period from August 1992 to May 1997. The objectives of our audit were to determine whether (1) the contractor performed work in accordance with the terms and conditions of the MHS gymnasium contract, and (2) the Public School System (PSS) complied with applicable laws and regulations in the procurement and administration of the contract.

Our audit showed that PSS did not terminate the contractor's right to continue the MHS gymnasium contract for default despite (1) the contractor's overall poor performance and slow progress of work, (2) considerable delay in the procurement of the steel building for the gym due to the contractor's financial difficulties, (3) poor quality of construction work (i.e., existing structures may have to be demolished or reworked), and (4) failure of the contractor to address and cure construction problems and deficiencies. In addition, PSS poorly managed the MHS gym project, and was negligent in enforcing applicable contract provisions and procurement regulations. Specifically, PSS's poor management and negligence included (1) failure to scale down the project's specifications to conform with available funds and negotiating with the contractor instead of rebidding the project, (2) awarding the contract to a contractor with inadequate financial resources, (3) refunding of amounts retained to assure completion despite the failure of the contractor to complete the project, (4) failure to adequately monitor the contractor's performance and progress billings, (5) allowing the contractor to continue working on the project without first securing extension of the performance and payment bond coverage, (6) issuance of a stop work order instead of terminating the contractor for default, and (7) attempting to negotiate a settlement agreement favorable to the contractor instead of demanding compensation for damages. As a result, (1) contract provisions and procurement regulations were violated, and (2) \$969,631 in government funds, time, and effort may have been wasted and spent without any public benefit.

We recommended that the Chairperson of the Board of Education (1) instruct the Commissioner of Education (COE) to cancel the stop work order and immediately terminate for default the contractor's right to proceed with the project instead of negotiating a settlement agreement with the contractor, (2) instruct the COE to reject the settlement agreement improperly favoring the contractor and demand liquidated damages for contract extensions that were caused by the contractor's delay and nonperformance, (3) request an independent architectural and engineering firm to review the actual percentage of completion of the project, and the quality of materials used and work performed by the contractor, (4) take appropriate disciplinary actions against the responsible PSS officials for failure to terminate the contract for default, and for poor management and negligence in enforcing contract provisions and procurement regulations, (5) issue a directive to all PSS officials involved in procurement to stop favoring nonperforming contractors and to ensure that any action taken or decisions made will be in compliance with applicable contract provisions and procurement regulations, and (6) identify or request funding to complete the MHS gymnasium and ensure that any new contract to be procured for the project undergoes competitive bidding and does not exceed available funds.

After the draft report was issued, PSS approved a change order terminating the contractor for convenience effective October 24, 1997 with no further payments. PSS also subsequently issued a request for proposal (RFP) to restart the MHS gym project and transferred the administration of the project to the Department of Public Works (DPW). The scope of work per RFP consisted of disassembling all of the steel frame columns currently erected, replacement of the footings for the columns, removing of rust and repainting of the steel, and assembling the entire steel frame.

According to DPW, the gym will be completed in two phases. The first phase involves work on the steel frame as per RFP. The second phase, however, will involve new construction that will require a redesign of the gym. The plan was to eliminate the second floor to reduce costs. We asked for a cost estimate. The Director told us, however, that a cost estimate will be available upon completion of the redesign of the gym. In a recent discussion (December 1997) with the DPW Architect/Consultant involved in the project, he told us that the redesign had not yet been completed so a government estimate was still not available. It is expected, however, that a substantial amount would be needed to complete the second phase of construction of the gym.

We followed up with DPW on the results of the RFP for the first phase. DPW officials informed us that three contractors submitted proposals. According to the DPW Architect/Consultant, the proposals have already been evaluated; however, the result has not yet been approved by the Secretary of DPW (as of December 1997).

The COE's letter response dated October 14, 1997 did not address any of our recommendations. Instead, the COE generally presented arguments against the findings raised in the draft audit report. Most of these arguments were discussed with the COE and other PSS officials during our exit conference on December 3, 1997. We also issued a separate letter on November 14, 1997 commenting on the arguments contained in the PSS letter response. The PSS letter response and OPA comments are presented together in Appendix B.

Based on the subsequent actions of PSS and DPW, we consider Recommendations 1, 2, and 3 as closed. Recommendations 4,5, and 6, however, are considered open. The additional information or actions required to close the recommendations are presented in Appendix C.

Sincerely,

ORIGINAL SIGNED

Leo L. LaMotte
Public Auditor, CNMI

cc: Governor
Lt. Governor
Eleventh CNMI Legislature (27 copies)
Acting Commissioner of Education
Secretary of Finance
Attorney General
Special Assistant for Management and Budget
Public Information Officer
Press

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EXECUTIVE SUMMARY

Our audit showed that the Public School System (PSS) did not terminate the contractor's right to continue the Marianas High School (MHS) gymnasium contract for default despite (1) the contractor's overall poor performance and slow progress of work, (2) considerable delay in the procurement of the steel building for the gym due to the contractor's financial difficulties, (3) poor quality of construction work (i.e., existing structures may have to be demolished or reworked), and (4) failure of the contractor to address and cure construction problems and deficiencies. In addition, PSS poorly managed the MHS gym project, and was negligent in enforcing applicable contract provisions and procurement regulations. Specifically, PSS's poor management and negligence included (1) failure to scale down the project's specifications to conform with available funds and negotiating with the contractor instead of rebidding the project, (2) awarding the contract to a contractor with inadequate financial resources, (3) refunding of amounts retained to assure completion despite the failure of the contractor to complete the project, (4) failure to adequately monitor the contractor's performance and progress billings, (5) allowing the contractor to continue working on the project without first securing extension of the performance and payment bond coverage, (6) issuance of a stop work order instead of terminating the contractor for default, and (7) attempting to negotiate a settlement agreement favorable to the contractor instead of demanding compensation for damages. As a result, (1) contract provisions and procurement regulations were violated, and (2) \$969,631 in government funds, time, and effort may have been wasted and spent without any public benefit.

Background

This audit was initiated upon the request of Representative Dino M. Jones who was concerned about the expenditure of funds for the construction of the Marianas High School Gymnasium. After preliminary inquiry, the Office of the Public Auditor determined that an audit should be conducted.

On July 23, 1993, B & R Construction Co. (B & R) signed a contract to construct the MHS gymnasium for \$1.21 million. The contract was originally funded by a \$1,000,000 donation from Niizeki International, a private real estate

developer, and \$210,000 from the Non-Resident Worker's Fee Fund. The Commissioner of Education (COE) issued the official notice to proceed with construction work on August 2, 1993, with an expected completion date of August 17, 1994. The completion date, however, was repeatedly extended by PSS upon the request of the contractor. The final completion date under the last extension granted by PSS was May 25, 1996, more than one year and nine months after the original projected completion date.

During the construction period, several problems surfaced which delayed the

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completion of the project. These included financial difficulties encountered by the contractor, delays in the procurement of the steel building, and disagreements on several matters affecting the completion of the project.

On May 8, 1996, the COE issued a stop work order on construction activities pending architectural and engineering review of the project. PSS planned to resume construction activities with an expected completion date of June 1997. As of the date of this report, however, the MHS gymnasium is far from completion.

Objectives and Scope

The objectives of our audit were to determine whether (1) the contractor performed work in accordance with the terms and conditions of the MHS gymnasium contract, and (2) the Public School System complied with applicable laws and regulations in the procurement and administration of the contract.

The scope of our work covered the period from August 1992 to May 1997. To accomplish our objectives, we examined all contract-related documents, correspondence, and reports available at the Public School System, including payment records and internal memos from the contractor. We also interviewed the contractor and PSS officials who were knowledgeable about the contract. Information was also obtained from other sources.

Failure To Terminate the MHS Gym Contractor for Default

Under the PSS standard construction contract, the contractor's right to proceed with the contract may be terminated for

failure to diligently perform or complete the contract in a timely manner. Our audit showed, however, that PSS did not terminate the contractor's right to continue the MHS gym contract for default despite (1) the contractor's overall poor performance and slow progress of work, (2) considerable delay in the procurement of the steel building for the gym due to the contractor's financial difficulties, (3) poor quality of construction work (i.e., existing structures may have to be demolished or reworked), and (4) failure of the contractor to address and cure construction problems and deficiencies. This occurred because PSS officials did not adequately perform their duties and responsibilities. As a result, (1) the opportunity for other responsible contractors to complete the project was lost, (2) there is no assurance that the proposed MHS gymnasium will be completed in the near future, and (3) public funds expended for the construction project amounting to more than \$969,000 may have been wasted.

Poor Management and Negligence in Enforcing Contract Provisions and Procurement Regulations

PSS as contracting agency, should safeguard and protect the government's interest by implementing and enforcing applicable contract provisions and procurement regulations. Our audit showed, however, that PSS poorly managed the MHS gym project, and was negligent in enforcing applicable contract provisions and procurement regulations. Specifically, PSS's poor management and negligence included (1) failure to scale down the project's specifications to conform with available funds and negotiating with the contrac-

tor instead of rebidding the project, (2) awarding the contract to a contractor with inadequate financial resources, (3) refunding of amounts retained to assure completion despite the failure of the contractor to complete the project, (4) failure to adequately monitor the contractor's performance and progress billings, (5) allowing the contractor to continue working on the project without first securing extension of the performance and payment bond coverage, (6) issuance of a stop work order instead of terminating the contractor for default, and (7) attempting to negotiate a settlement agreement favorable to the contractor instead of demanding compensation for damages. This occurred because PSS officials did not adequately perform their duties and responsibilities. As a result, (1) contract provisions and procurement regulations were violated, and (2) \$969,631 in government funds, time, and effort may have been wasted and spent without any public benefit.

Accordingly, we recommended that the Chairman of the Board of Education:

1. Instruct the COE to cancel the stop work order and immediately terminate for default the contractor's right to proceed with the project for default instead of negotiating a settlement agreement with the contractor.
2. Instruct the COE to reject the settlement agreement improperly favoring the contractor. Instead, PSS should charge liquidated damages for contract extensions that were caused by the contractor's delay and nonperformance.
3. Request an independent architect-

tural and engineering firm to review the actual percentage of completion of the project, and the quality of materials used and work performed by the contractor. Based on the findings, the contractor should be required to replace without charge any materials or correct any workmanship that does not conform with contract specifications.

4. Take appropriate disciplinary actions against the responsible PSS officials for failure to terminate the contract for default, and for poor management and negligence in enforcing contract provisions and procurement regulations.
5. Issue a directive to all PSS officials involved in procurement to stop favoring nonperforming contractors and to ensure that any action taken or decisions made will be in compliance with applicable contract provisions and procurement regulations.
6. Identify or request funding to complete the MHS gymnasium and ensure that any new contract to be procured for the project undergoes competitive bidding and does not exceed available funds.

Subsequent Actions

After the draft report was issued, PSS approved a change order terminating the contractor for convenience effective October 24, 1997 with no further payments. PSS also subsequently issued a request for proposal (RFP) to restart the MHS gym project and transferred the administration of the project to the Department of Public Works (DPW).

The scope of work per RFP consisted of disassembling all of the steel frame columns currently erected, replacement of the footings for the columns, removing of rust and repainting of the steel, and assembling the entire steel frame.

According to DPW, the gym will be completed in two phases. The first phase involves work on the steel frame as per RFP. The second phase, however, will involve new construction that will require a redesign of the gym. The plan was to eliminate the second floor to reduce costs. We asked for a cost estimate. The DPW Director of Technical Services told us, however, that a cost estimate will be available upon completion of the redesign of the gym. In a recent discussion (December 1997) with the DPW Architect/Consultant involved in the project, he told us that the redesign has not yet been completed so a government estimate was still not available. It is expected, however, that a substantial amount would be needed to complete the second phase of construction of the gym.

We followed up with DPW on the results of the RFP for the first phase. DPW officials informed us that three contractors submitted proposals. According to the DPW Architect/Consultant, the proposals have already been evaluated; however, the result has not yet been approved by the Secretary of DPW (as of December 1997).

Public School System Response

The COE's letter response dated October 14, 1997 did not address any of the recommendations. Instead, the COE generally presented arguments against the findings raised in the draft audit report. Most of these arguments were discussed with the COE and other PSS officials during our exit conference on December 3, 1997.

Office of the Public Auditor Comments

We issued a separate letter on November 14, 1997 commenting on the arguments contained in the PSS letter response. We also conducted an exit conference with PSS officials on December 3, 1997. The PSS letter response and OPA comments are presented together in Appendix B.

Based on the subsequent actions of PSS and DPW, we consider Recommendations 1, 2, and 3 as closed. Recommendations 4, 5, and 6, however, are considered open. The additional information or actions required to close the recommendations are presented in Appendix C.

Introduction

Background

This audit was initiated upon the request of Representative Dino M. Jones who was concerned about the expenditure of funds for the construction of the Marianas High School Gymnasium. After preliminary inquiry, the Office of the Public Auditor determined that an audit should be conducted.

Marianas High School Gymnasium Contract

Procurement for the construction of the Marianas High School (MHS) gymnasium began on August 12, 1992 when the Commissioner of Education (COE) advertised an invitation for bid in local newspapers.

On bid opening day, September 30, 1992, B & R Construction Co. (B & R) was identified as the lowest bidder at \$1,918,000 which exceeded the \$1.21 million budget. Instead of scaling down the project's specifications and re-bidding it, PSS informed B & R that it intended to award the project for \$1,210,000, and that the contract would be amended when additional funding was made available as promised in a letter sent by the Saipan Legislative Delegation. No additional funds, however, were approved by the Legislature for the project.

On July 23, 1993, B & R signed a contract to construct the MHS gymnasium for \$1.21 million. The contract was originally funded by a \$1,000,000 donation from Niizeki International, a private real estate developer, and \$210,000 from the Non-Resident Worker's Fee Fund. The COE issued the official notice to proceed with construction work on August 2, 1993, with an expected completion date of August 17, 1994. The completion date, however, was repeatedly extended by PSS upon the request of the contractor. The final completion date under the last extension granted by PSS was May 25, 1996, more than one year and nine months after the original projected completion date. During the construction period, several problems surfaced which delayed the completion of the project. These included financial difficulties encountered by the contractor, delays in the procurement of the steel building, and disagreements on several matters affecting the completion of the project.

On May 8, 1996, the COE issued a stop work order on construction activities pending architectural and engineering review of the project. PSS planned to resume construction activities with an expected completion date of June 1997. As of the date of this report, however, the MHS gymnasium is far from completion.



MHS Gymnasium Project as of March 1997

Objectives,
Scope, and
Methodology

The objectives of our audit were to determine whether (1) the contractor performed work in accordance with the terms and conditions of the MHS gymnasium contract, and (2) the Public School System complied with applicable laws and regulations in the procurement and administration of the contract.

The scope of our work covered the period from August 1992 to May 1997. To accomplish our objectives, we examined all contract-related documents, correspondence, and reports available at the Public School System, including payment records and internal memos from the contractor. We also interviewed the contractor and PSS officials who were knowledgeable about the contract. Information was also obtained from other sources.

We performed our audit at the PSS accounting office on Saipan between November 1996 and May 1997. We completed our field work on May 12, 1997. This performance audit was made, where applicable, in accordance with Government Auditing Standards issued by the Comptroller General of the United States. Accordingly, we included such tests of records and other auditing techniques as were considered necessary in the circumstances.

As part of our audit, we evaluated controls over the procurement and administration of construction contracts. We found internal control weaknesses in this area which are discussed in the Findings and Recommendations section of this report. Our recommendations, if implemented, should improve internal controls in this area.

Prior Audit
Coverage

No audit reports were issued by OPA during the past five years regarding PSS construction contracts.

Findings and Recommendations

A. Failure to Terminate the MHS Gym Contractor for Default

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Under the PSS standard construction contract, the contractor's right to proceed with the contract may be terminated for failure to diligently perform or complete the contract in a timely manner. Our audit showed, however, that PSS did not terminate the contractor's right to continue the MHS gym contract for default despite (1) the contractor's overall poor performance and slow progress of work, (2) considerable delay in the procurement of the steel building for the gym due to the contractor's financial difficulties, (3) poor quality of construction work (i.e., existing structures may have to be demolished or reworked), and (4) failure of the contractor to address and cure construction problems and deficiencies. This occurred because PSS officials did not adequately perform their duties and responsibilities. As a result, (1) the opportunity for other responsible contractors to complete the project was lost, (2) there is no assurance that the proposed MHS gymnasium will be completed in the near future, and (3) public funds expended for the construction project amounting to more than \$969,000 may have been wasted.

Contract Provisions for Termination of Contract

Section 12 (Termination for Default) of the PSS standard construction contract states in part:

"If the contractor refuses or fails to perform any of the provisions of this contract with such diligence as will insure its completion within the time specified in this contract, or any extension thereof, or otherwise fails to timely satisfy the contract provisions or commits any other substantial breach of this contract, the Chief Procurement Officer may notify the contractor in writing of the delay or non-performance and if not cured in ten (10) days or any longer time specified in writing by the Chief Procurement Officer, such Officer may terminate the contractor's right to proceed with the contract or such part of the contract as to which there has been delay or failure to properly perform. In the event of termination in whole or in part, the Chief Procurement Officer may procure similar supplies, goods, construction, and/or services in a manner and upon terms deemed appropriate by the Chief Procurement Officer." (Emphasis added).

Under the PSS standard construction contract, if the contractor fails to perform or comply with any provision of the contract in a timely manner, PSS may notify the contractor in writing of the delay or nonperformance and if not cured within 10 days, PSS may terminate the contractor's right to proceed with the contract.

Our review showed that PSS should have terminated B & R's contract for default because of the contractor's repeated delays and failure to diligently perform its work. There were several grounds for termination. These included (1) the contractor's overall poor performance and slow progress of work, (2) considerable delay in the procurement of the steel building for the gym due to the contractor's financial difficulties, (3) poor quality of construction work (i.e., existing structures may have to be demolished or reworked), and (4) failure of the contractor to address and cure construction problems and deficiencies.

Poor Performance and Slow Progress of Work

The project was repeatedly delayed because of the contractor's poor performance and slow progress of work at the job site. In its monthly reports and regular communications to PSS, Entech, the construction management firm hired to oversee construction work, repeatedly informed the COE about B & R's poor performance and slow progress of work. A number of these reports, minutes of meetings, and other communications are summarized as follows:

- On March 7, 1994, Entech submitted a report to the COE showing that the contractor had an accumulated work slippage of 28.57%.¹
- On March 14, 1994, Entech and PSS officials met with B & R and discussed its poor performance. Entech advised the contractor to take action or it may default on the contract.
- On March 15, 1994, Entech reported to the COE and B & R that the accumulated slippage had increased from 28.57% to 46.84%. Entech recommended that the contractor increase its manpower, provide equipment and materials in sufficient quantity, and diversify its construction activities to meet the deadline.
- On May 6, 1994, Entech reported to the COE that the slippage in construction of the project was continuing to increase due to delays caused by the contractor.
- On May 31, 1994, Entech reported to the COE that it had "overwhelmingly" insisted to the contractor that it perform its work but to no avail. Entech recommended that PSS give the contractor 10 working days to correct its deficiencies or take further actions against it.
- On June 20, 1994, Entech and PSS officials (including the COE) met with the contractor to discuss its problems. The contractor admitted its financial difficulties and requested a time extension on the project. The COE recommended that B & R secure lines of credit from banks and suppliers to finance its operations.
- On July 6, 1994, Entech informed the COE that the contractor had failed to address its financial problems and that progress at the job site had not improved.

¹ The percentage of work slippage refers to the difference between the estimated percentage of work that should have been accomplished compared to the actual work performed by the contractor. A high rate indicates that the contractor has a large backlog of work and is behind schedule.

- On August 5, 1994, Entech reported to the COE that the incurred slippage had reached 53.43% due mainly to insufficient manpower, lack of materials, equipment delays, delay in pouring concrete and procurement of the steel building. Entech stated that PSS had the capability to terminate for default the right of the contractor to proceed with the project.
- On September 6, 1994, Entech gave the COE a draft letter of a notice of termination for default if the deficiencies in the construction of the gym were not remedied within 10 days.

Following Entech's advice, the PSS Procurement and Supply Officer issued a cure notice to B & R on September 12, 1994 informing the contractor of PSS's intent to terminate the contract for default, and that PSS would resort to the performance bond to ensure completion of the gym by another contractor if B & R failed to address the deficiencies in the construction of the gym within 10 days. B & R responded to this notice on September 26, 1994 alleging that uncertainties in the scope of work, problems in the procurement of the steel building, disagreements on sand removal, and discrepancies on drawings and specifications had caused the delays. B & R requested an additional six to eight months extension without penalties to be able to complete the project.

Reacting to B & R's response, Entech issued a letter to the COE on September 29, 1994 informing him that the contractor did not address PSS's recommendation to cure the deficiencies causing slippage and delays at the jobsite. According to Entech, the contractor presented his response mainly as a request for extension of time. Entech concluded that PSS should pursue further actions as stated in its cure notice to the contractor. PSS, however, did not follow Entech's advise to terminate the contract for default. Instead, PSS repeatedly granted time extensions to B & R (as further discussed on pages 11-12 of this report).

On October 28, 1994, Entech informed the COE that its engineer would be relocating to the mainland (because PSS did not renew Entech's services which effectively ended September 30, 1994).²

Delays in the Procurement of the Steel Building

Another major cause of repeated delays was the contractor's inability because of financial difficulties to finance the procurement of the steel building needed for the construction of the gym. The steel building, which was included in the contract specifications to be provided by the contractor, was eventually procured by assigning part of B & R's contract payments to the vendor. B & R, however, shifted the responsibility for the steel building to PSS and alleged that the building was procured without the contractor's participation (B & R subsequently claimed that the steel building contained design errors). B & R's allegations, however, were contrary to

² Entech's contract ended August 30, 1994. However, Entech extended its services for one month to assist PSS.

the actual circumstances which led to the procurement of the building. Based on available documents, the following is a summary of what actually transpired:

- On October 26, 1993, B & R signed a purchase order (PO) for the steel building amounting to \$154,500. The PO was addressed to Island Pride Inc, a local agent of Hicorp Steel Buildings, Inc.
- On December 21, 1993, B & R sent a letter to Hicorp approving the corrections and changes on the plans for the steel building. On February 16, 1994, Hicorp informed Island Pride that a \$20,000 down payment was required no later than February 18, 1994 or the order for the steel building would be canceled.
- On February 18, 1994, B & R responded to Hicorp stating that the signature appearing on the purchase order and commitment letter were “forged” without its knowledge and authorization. B & R asked to be provided with new terms and conditions since it was still interested in purchasing the building.
- On February 19, 1994, Island Pride sent a letter to B & R stating that its response to Hicorp was “imaginative.” Island Pride reminded B & R that it was B & R’s president who personally handed the letter of approval for the steel building plans to the President of Island Pride. Also, the B & R president was present when the purchase order was handed over by one of its officials. Island Pride insisted that the \$20,000 down payment be immediately paid if B & R was still interested in the building. On March 28, 1994, B & R informed Island Pride that it was still willing to purchase the steel building subject to revisions and approval of shop drawings by PSS and Entech.
- On April 8, 1994, Island Pride informed B & R that it had received B & R’s letter of transmittal to Entech approving the factory drawing for the steel building. However, Island Pride stated that the building would not be released for production unless a 50% deposit (amounting to \$70,639) was paid by B & R or a letter of credit (LC) was prepared to cover the deposit.
- On May 26, 1994, Entech inquired of B & R about the status of the steel building and what was causing the tremendous delays in the project. Entech also informed B & R that it had reviewed the drawings and had submitted them to the building manufacturer for corrections.
- On June 20, 1994, PSS met with B & R to discuss the problems which were delaying the project, including the procurement of the steel building. The contractor admitted its financial difficulties and requested a time extension on the project. The COE recommended that B & R secure lines of credit from banks and suppliers to finance its operations.
- On June 30, 1994, Entech requested B & R to provide information regarding the status of its application for lines of credit. On July 1, 1994, a letter from a local bank showed that B & R’s application for credit had been turned down. The bank said it entertained requests for construction financing only by those with repayment sources other than specific construction projects.

- On July 12, 1994, Island Pride informed B & R that its \$50,000 check dated June 25, 1994 issued to Hicorp as down payment for the steel building was not honored by the bank. Island Pride instructed B & R to make the check good by July 13, 1994 or it would take further action. On the same date, B & R wrote a letter to Entech. According to B & R, Entech's negotiation with Hicorp did not relieve B & R from responsibilities for the steel building. B & R added that it would make good on its promise regarding the issuance of the \$50,000 check only if it received the approved shop drawings. General Condition 18.2 of the contract specifications states that "shop drawings" shall include fabrication, erection and setting drawings, schedule drawings, manufacturer's scale drawings, wiring and control diagrams, cuts or entire catalogs, pamphlets, descriptive literature, and performance and test data. from the manufacturer.
- On July 13, 1994, Entech informed B & R that it was not engaged in any type of negotiation with Hicorp and that its actions were only limited to necessary revisions or corrections of the shop drawings. Entech also informed B & R that Hicorp had indicated that the drawings would not be provided unless its payment terms were met. Entech reminded B & R that its negligence in securing required materials for the project could not be considered when requesting time extensions.
- On August 22, 1994, the COE met with B & R and Island Pride officials to discuss the problems in procuring the steel building. B & R admitted that the down payment was not met because of its financial difficulties. Island Pride suggested the assignment of funds from B & R's contract directly to Hicorp to pay for the steel building.
- On August 25, 1994, B & R issued a letter of consent to PSS requesting it to directly pay Hicorp in accordance with the terms and conditions agreed upon with Island Pride.

Based on B & R's requests for payments, PSS subsequently paid Hicorp \$45,000 for the steel building on October 13, 1994 and \$114,278 on January 17, 1995. The delays caused by B & R concerning the steel building, however, did not stop upon completion of payment to Hicorp. Several issues about the steel building were brought up by B & R as the main cause of delays in the project. B & R shifted responsibility for the steel building to PSS and claimed that the building was procured without its participation.

- On April 27, 1995, B & R informed PSS that the steel building had arrived. According to B & R, freight charges and taxes on an additional container had not been paid. B & R maintained that it had no hand in the approval of the building and should not be a party to any related costs. B & R's stance, however, is not accurate because the steel building was part of the contract deliverables. Further, the circumstances clearly showed that PSS agreed to directly pay the vendor only upon the concurrence of B & R (per its August 25, 1994 consent letter and request for payment letters dated October 13, 1994 and January 17, 1995). PSS made the payments as a favor to B & R which had admitted its financial difficulties in financing the procurement of the steel building.
- On May 15, 1995, B & R wrote a letter to the COE informing him that the fifth container for the steel building was still at the ship yard. Instead of taking action, B & R urged PSS to expedite the release of the container. B & R also told PSS that it suspected that the building was not in accordance with specifications.

- On August 28, 1995, B & R informed the COE that discrepancies were noted during installation of the steel building. According to B & R, the shop drawings that were used for manufacturing the building were beyond its responsibilities. B & R claimed that it only had a chance to review the shop drawings after full payment for the building. Again, B & R's statements were not accurate. The shop drawings were in fact approved by B & R per its letter to Hicorp dated December 21, 1993. B & R also added that insulation materials for the building had not yet been received.
- On August 29, 1995, Hicorp, the building manufacturer, informed the COE that the shop drawings had been properly approved and that there was no notation of any problems. Hicorp also explained that if there were discrepancies, they could be remedied. Hicorp, however, said that it was not responsible for the insulation materials for the building. In addition, Hicorp reported to the COE that the last container for the steel building was still at the port and that it appeared that B & R had no intention of claiming it.
- On August 31, 1995, Hicorp informed the COE that due to the lack of cooperation and payments from B & R, the job dragged on for over one year before PSS stepped in and took over. Hicorp added that it had no intention of spending any more time or money to remedy the situation created by B & R's lack of performance.

After spending more than five months at the port, the last container of the steel building was finally released in October 1995 when PSS approved a change order which included a \$17,753 payment for the port charges. On January 29, 1996, B & R issued a memo to the COE informing him that the "steel building that was purchased by PSS" was not suitable for the gymnasium project and that B & R "cannot be responsible for something it did not want initially or approve." Based on the available information listed above, however, it is clear that the steel building was B & R's responsibility. PSS paid for the building upon the request of and as a favor to B & R which admitted that it was having financial difficulties in securing the procurement of the building.

Poor Quality of Construction Work

PSS should have also terminated B & R for default because of the poor quality of its construction work. This matter was brought to the attention of PSS when B & R entered into a memorandum of understanding with another construction firm to help finish the construction of the gym. Apparently, the other construction firm requested several architectural firms to evaluate the status of the construction project. The architectural firms reported that the quality of the construction was one of the worst they had seen and that all above-ground structures would have to be demolished and reconstructed. B & R then wrote to PSS disowning responsibility for the steel building, and claiming that the building's design did not meet the CNMI building standards and that it needed to be replaced by another system which could be erected easily. PSS consulted Entech, the construction management firm which was initially involved with the project, about the design of the steel building. Entech responded that the building was not severely underdesigned and met existing standards. It concluded, however, that the construction work was poorly done. PSS

also requested a local structural engineer to assess the construction project. The engineer subsequently recommended changes in the project's design and construction. A more detailed account of these events is shown as follows:

- On January 10, 1996, B & R entered into a memorandum of agreement with Core Construction, Inc. (CCI) to help finish the construction of the MHS gym.
- On or before January 25, 1996, the COE requested Entech (which was based in the U.S. mainland) to review the design documents for the steel building because of several problems. The COE was apparently referring to information based on the following documents from CCI and DPW:
 - Report to CCI dated October 5, 1995 by a professional architect. The report stated that (a) the project was found to be only approximately 20% complete, (b) the architectural design reflected a constricted flow considering that a large number of people would have to be accommodated [i.e., narrow corridors and exit stairs], (c) workmanship was generally very poor, especially on the concrete walls, and (d) concrete columns and beams were poorly constructed. The architect recommended that the existing structure be demolished and rebuilt with another system.
 - Report to CCI dated October 5, 1995 by another architectural firm. The report stated that (a) there was slow progress of work at the job site, (b) design of the floor plan was confused and not well planned to accommodate large crowds, (c) quality of work was extremely poor and appeared to have been completed with little supervision and inspection, and (d) all above-ground structures might have to be demolished and reconstructed.
 - Reports to a principal of another architectural firm dated October 5 and November 7, 1995 by its consultant. The reports stated that, based on the consultant's inspection, the concrete walls were poorly constructed and the quality of construction was one of the worst it had seen. In the event of a major earthquake or typhoon, the windows and walls could fail. In the opinion of the consultant, the existing structure might have to be demolished and replaced with a new structure (i.e., with a different design).
 - Memorandum to DPW Secretary by one of its staff dated September 20, 1995. The memo indicated a support beam was severely underdesigned.³
- On January 29, 1996, B & R wrote a memo to the COE stating that the "steel building purchased by PSS" was not suitable for installation in the project because (a) it did not fully comply with the CNMI building code. B & R said that the building might not be able to withstand 155 mile-per-hour winds, (b) design was not structurally sound for various reasons, and (c) several parts for the steel building were missing or did not align properly. B & R proposed to replace the steel building with another structure using

³ The DPW representative mentioned that "bond beam BB, which is unsupported for about 26'-6" is severely underdesigned and recommended to be replaced by a new beam 2B-15. and needed to be replaced.

a new system. B & R emphasized that it could not be responsible for something it neither wanted initially nor approved.

- On January 30 and 31, 1996, Entech responded to the COE and explained that (a) the design was based on contract specifications, (b) design was in accordance with existing standards, (c) steel structure was certified by manufacturer to withstand 155 mile-per-hour winds, and (d) the beam was not severely undersigned. Entech stated that it had no comments on the quality of construction and whether the contractor adhered to the design plan because it has no first hand knowledge (Note: Entech's construction management services ended on September 30, 1994 and were not renewed by PSS. Starting October 1994, supervision of the project was handled only by the PSS's CIP Coordinator).

In response to the COE's February 5, 1996 letter requesting Entech to evaluate the opinion of the engineers, Entech reported on February 15 and 20, 1996 that, based on pictures of the construction project, it appeared that the construction of the walls was extremely poor and looked non-reinforced. It also concluded that the construction work appeared to have been performed by unskilled and untrained workers managed by an inexperienced contractor without any full time supervision and inspection. Entech stated that the quality of construction as well as the quality of materials used were unacceptable.

- On February 15, 1996, B & R wrote to the Chairman of the Board of Education informing him that B & R had aligned itself with "knowledgeable individuals." B & R stated that they studied how to complete the gym expeditiously in accordance with the building code and within a reasonable budget. B & R proposed to complete the building for an additional funding of \$1.696 million.
- On March 12, 1996, the PSS CIP Coordinator reported that based on the assessment of a local structural engineer requested by PSS, several work items were needed to obtain a sound and safe building at an additional cost of \$150,000.

In a subsequent report dated April 24, 1996, Henry K. Pangelinan and Associates, an engineering firm, recommended several structural changes and testing for defective concrete. The engineer's recommendation would require demolishing the existing concrete pedestals, walls, and other structures.

The above information indicates that B & R was attempting to cover up the poor quality of its construction work by proposing the replacement of the steel building, which would require demolishing most of the steel and concrete structures that were already installed or constructed. PSS took no action on B & R's proposal, however, and on April 4, 1994, CCI canceled its memorandum of understanding with B & R.

Contractor's Failure to Address Construction Problems and Deficiencies

Instead of terminating B & R's contract for default, PSS granted the contractor at least four time extensions totaling 548.5 days⁴ and imposed several conditions for addressing problems and deficiencies plaguing the construction project. The time extensions proved useless as the contractor repeatedly failed to address the PSS conditions. The related transactions are summarized below.

- On December 28, 1994, the CIP Coordinator prepared a status report on the MHS project. Based on the report, the contract should have been completed on September 29, 1994. However, the percentage completed was only 21.05%. The report further stated that the main causes of the delays were as follows: (1) insufficient manpower, (2) insufficient materials, (3) insufficient equipment on site, (4) delays in procuring the steel building, and (5) lack of financial capability of the contractor. According to the report, the contractor was given up to January 4, 1994 to submit its plan of action or PSS would turn over the contract to the bonding company or have it re-bid.
- On February 13, 1995, the COE approved a 212 calendar day time extension up to September 10, 1995 for the contractor to complete the project. The COE imposed several conditions which should be met within one month or PSS would issue a stop work order. The conditions included providing equipment on a permanent basis, increasing manpower at the job site, submission of a detailed plan of work activities, submission of materials for approval, providing schedule of pouring concrete, etc...
- On April 5, 1995, the COE issued a letter to B & R reiterating that the conditions contained in his February 13, 1995 letter should be met by the contractor.
- On May 1, 1995, the COE again issued a letter to B & R giving it five (5) working days to comply with the conditions in his letters dated February 13, 1995 and April 5, 1995. The five days passed but no action was taken by PSS.
- On June 13, 1995, the COE issued a third follow-up letter to B & R reiterating his recommendations to comply with the conditions in his previous letters.
- On September 5, 1995, the COE finally informed B & R that it would be assessed liquidated damages of \$500 per day from September 10, 1995.
- On September 20, 1995, B & R responded to the COE and stated that imposing liquidated damages was not acceptable for the following reasons: (a) the gymnasium plan was incomplete and filled with errors, (b) revisions had been made by PSS, (c) there were pending change orders, and (d) the steel building was shipped freight collect and B & R was not responsible for payment of the additional freight charges. B & R demanded that PSS approve a change order to cover performance bond requirements and extension of the construction period for six months without penalty. It should

⁴ This included two time extensions totaling 113 days which were initially granted to B & R before Entech recommended the termination of the contractor for default. The extensions were for additional time for B & R to submit contract documents, change in start up date, and revision of projected completion date.

be noted, however, that B & R should have been responsible for any errors in the gymnasium plan since it was given the opportunity to review and clarify the project's plans and specifications prior to awarding of the contract. B & R should have addressed and resolved these errors before accepting the project. Similarly, any errors not apparent from the plans should have been addressed promptly during the construction period. Further, the contractor should be responsible for insurance and bond coverage under PSS procurement regulations.

- On October 5, 1995, despite PSS's knowledge of the contractor's inability to diligently perform its work, the COE again granted a 223.5 calendar day extension up to April 13, 1996.
- On November 29, 1995, the COE issued a letter requesting B & R to address the conditions delaying the project. These included increasing manpower, submission of a progress chart, extension of performance and payment bonds, and submission of materials for approval. The COE gave B & R ten working days to comply with the conditions.
- On February 8, 1996, the COE again issued a letter reiterating the conditions which B & R needed to address. Another ten working days were given to B & R to comply with the conditions.
- On April 14, 1996, B & R again requested an extension to May 25, 1996 explaining that the 223.5 days should begin on the date when the contractor signed the change order. B & R also requested additional extensions because of inclement weather and faulty design of the gym. On April 24, 1996, the COE approved another extension up to May 25, 1996. B & R was requested to address the same conditions as before.

Finally, on May 8, 1996, the COE issued a stop work order to B & R instructing it to stop construction of the gym. The appropriate action, however, should have been termination for default of B & R's right to proceed with the contract so that the contractor could be held liable for excess costs if PSS chose to hire another contractor to complete the project.

B. Poor Management and Negligence in Enforcing Contract Provisions and Procurement Regulations

PSS Failed to Safeguard and Protect the Government's Interest

PSS, as contracting agency, should safeguard and protect the government's interest by implementing and enforcing applicable contract provisions and procurement regulations. Our audit showed, however, that PSS poorly managed the MHS gym project, and was negligent in enforcing applicable contract provisions and procurement regulations. Specifically, PSS's poor management and negligence included (1) failure to scale down the project's specifications to conform with available funds and negotiating with the contractor instead of rebidding the project, (2) awarding the contract to a contractor with inadequate financial resources, (3) refunding of amounts retained to assure completion despite the failure of the contractor to complete the project, (4) failure to adequately monitor the contractor's performance and progress billings, (5) allowing the contractor to continue working on the project without first securing extension of the performance and payment bond coverage, (6) issuance of a stop work order instead of terminating the contractor for default, and (7) attempting to negotiate a settlement agreement favorable to the contractor instead of demanding compensation for damages. This occurred because PSS officials did not adequately perform their duties and responsibilities. As a result, (1) contract provisions and procurement regulations were violated, and (2) \$969,631 in government funds, time, and effort were spent without any public benefit.

Penalties for Violation of Procurement Regulations

The PSS standard construction contract and procurement regulations contain several provisions to protect the agency from nonperformance or noncompletion of the contract. PSS officials should be responsible for implementing and enforcing these provisions for the best interest of the agency. As provided under Section 6-211 of the PSS procurement regulations, any employee who violates the provisions of procurement rules and regulations is subject to adverse action as may be appropriate under the circumstances. This action includes but is not limited to reprimand, suspension without pay, termination of employment, civil injunction, civil suit for damages or return of PSS money, or criminal prosecution.

Our audit showed that PSS poorly managed the MHS gym project and was negligent in enforcing applicable contract provisions and procurement regulations. PSS's poor management and negligence are discussed as follows:

Failure to Scale Down And Rebid Project To Conform With Available Funds

Section 3-102(9)(c) of the PSS procurement regulations allows negotiation with the lowest responsive bidder (i.e., to conform with the available funding) only when the bid price does not exceed available funds by 5%.

Our audit showed that PSS failed to exercise prudent judgement when it (1) solicited bids for the project that was estimated to cost \$2.9 million when it had available funding of only \$1.21 million, and (2) did not scale down the project's specification and rebid the contract when the lowest bid of \$1.918 million exceeded available funds by \$708,000, or more than 58%.

In December 1990, PSS commissioned Entech to design the MHS gym. Entech's original design placed the cost of the gym at \$900,000. Subsequent revisions requested by PSS, however, increased the estimated construction cost (by an outside contractor) to about \$2.9 million. This information was communicated to PSS by Entech in a formal cost estimate report dated October 1, 1991.

In August 1992, PSS solicited bids for the project. At the time, however, the identified funding available for the project amounted only to \$1.21 million. Despite the shortfall of funds of almost \$2.0 million (based on the government estimate of \$2.9 million), PSS pursued the procurement of the contract. PSS's action was irresponsible since it was fully aware that available funds were insufficient to finance the construction project.

As expected, the bids received by PSS exceeded the available funding by a large margin. B & R submitted the lowest bid at \$1.918 million which exceeded the available funding of \$1.21 million by \$708,000. At this point, PSS should have scaled down the project's specifications and rebid the contract because of the large difference between available funding and the lowest bid price. It should be noted that Section 3-102(9)(c) of the PSS procurement regulations allows negotiation with the lowest responsive bidder only when the bid price does not exceed available funds by 5%. In this case, the excess was more than 58%, and therefore negotiation should not have been an option. PSS should have also investigated the large difference between the lowest minimum bid of \$1.918 million and the government estimate of \$2.9 million. The unreasonableness of the bid amount should have also prompted PSS to re-bid the project.

On May 17, 1993, PSS awarded the contract to B & R for \$1.21 million. Before awarding the contract, PSS informed B & R that PSS could only execute a contract for \$1.21 million. PSS told B & R that it had received a letter from the Saipan Legislative Delegation which promised to support a bill seeking additional funding for the project. PSS told B & R that if funding became available, the contract would be amended to reflect its total bid of \$1,918,000. The bill, however, was not approved by the Legislature. Again, PSS failed to exercise good judgment in awarding the contract without actual approval of the additional funding.

To reflect the \$708,000 reduction in price, PSS requested Entech to prepare a cost breakdown of all non-essential items that could be removed without diminishing the structure of the project. This cost breakdown was provided by Entech to the COE in May 1993 and was followed by Entech when the project started in August 1993. Several months later, in November 1993 however, B & R submitted its own cost reduction breakdown. B & R's submission, however, was denied by the COE and the contractor was told to follow Entech's cost breakdown. We found no written documentation indicating that B & R agreed to Entech's cost breakdown. During our March 1, 1997 interview of B & R's president, however, he informed us that B & R followed Entech's reduced scope of work. B & R subsequently requested and was granted a 62-day time extension for "uncertainty of scope of work." Again, this matter should have been addressed earlier by PSS at the start of the project and not during the construction period.

Contractor Had No Adequate Financial Resources

Under Section 3-301 (1)(a) of the PSS procurement regulations, awards shall be made only to responsible bidders. One of the factors to be considered for determining a responsible bidder is that the contractor should have adequate financial resources to perform the contract or the ability to obtain them. Section 13 of the contract specifications also provide that award of the contract will not be made until after necessary investigation into the responsibility of the low bidder.

At the onset, there were already indications that B & R, the contractor which was awarded the gym contract, had inadequate financial capability to finance the project. Before the award, in November 24, 1992 memorandum to the COE, the PSS Procurement and Supply Officer (PSO) concluded that B & R had a limited amount of cash and might not be able to perform the scope of work unless it obtained lines of credits from banks and suppliers. Our own review of B & R's financial statements showed that as of September 1992, cash on hand amounted only to \$10,775 while the book value of its equipment was only \$6,126. Working capital ratio (current assets vs. current liability) was also not favorable at 1.07:1 (ideally, the ratio should be 2:1 or \$2 of assets for every \$1 of liability). It was clear that B & R could not finance a \$1.21 million contract on its own.

On December 1, 1992, PSS required B & R to submit additional information including a letter from its bank outlining the relationship, types and sizes of accounts, with particular attention to B & R's line of credit. B & R responded to this requirement by submitting (1) copy of a letter from an insurance company stating that B & R's credit line had been approved; (2) memorandum from the proprietor of a group of companies involved in the construction business stating that a credit line had been approved to provide materials and equipment to B & R; (This was later not honored by the companies) (3) certification letter from a financing company that B & R had a credit application for \$200,000 which at the time was still subject to approval; and (4) B & R's letter to PSS claiming that B & R obtained a commitment from a bank to provide \$300,000 line of credit upon approval of the

MHS contract. Instead of requiring B & R to submit an approved line of credit from the bank, PSS relied on the credit application and B & R's claims. As PSS later found out, B & R was refused credit by the banks.

During the construction period, there were also numerous instances evidencing that the contractor could no longer complete the project due to lack of financial resources. PSS, however, failed to terminate the contract despite these conditions:

- As early as January 6, 1994, the COE was provided a copy of the letter from the bonding company to B & R stating its failure to pay the balance of the insurance premium.
- On May 26, 1994, Entech requested B & R to clarify its financial situation in order to expedite the procurement of the steel building which had been causing a tremendous delay for the project.
- In a June 20, 1994 meeting with PSS, B & R admitted its financial difficulties and requested time extension to complete the project. B & R said that its lines of credit with suppliers were not honored. PSS recommended that B & R secure lines of credit with banks and other suppliers.
- On July 6, 1994, Entech informed the COE that B & R efforts to secure a line of credit with a local bank were not successful.
- On August 5, 1994, Entech informed the COE that the \$50,000 check paid by B & R for the steel building was not honored by the bank. Entech also said that B & R was not pursuing its application for a line of credit with another bank (Note: the steel building was subsequently paid for by assigning part of the contract payments to the vendor).
- On September 29, 1994, Entech informed the COE that B & R had failed to cure the deficiencies causing slippage and delays of the project. The deficiencies included B & R's failure to submit proof of lines of credit from banks or suppliers.
- On January 23, 1995, B & R's bonding company provided the COE a copy of its final demand letter to the contractor for its failure to settle its obligations (amounting to \$79,800). On March 19, 1996, B & R informed PSS that all future payments should be made to its bonding company until the amount it owed had been fully paid (In a March 11, 1997 interview of the bonding company's representative, we were informed that B & R still had outstanding balances for bonding insurance).
- On February 2, 1995, B & R informed PSS that all future payments were to be made to "B & R and Sablan Enterprises" because of an assignment agreement for the supply of materials for the project.
- On March 1, 1996, B & R granted a Special Power of Attorney to CCI which included the authority to "collect and receive" all payments from the MHS project (Apparently, this was in connection with the January 10, 1996 memorandum of agreement between B & R and CCI to help B & R finish the construction of the MHS gym.)

At this point, B & R had already directed PSS to remit future payments to three separate companies. As the above information clearly showed, B & R had no financial capability to complete the project.

Improper Refunding of Retention Amounts

General provision 7 of the contract specifications states in part that in making progress payments, 10 percent of the estimated amount shall be retained until final completion and acceptance of the contract work. However, if the contracting officer, at any time after 50 percent of the work has been completed, finds that satisfactory progress is being made, he may authorize any of the remaining progress payments to be made in full. Also, whenever the work is substantially complete, the contracting officer, if he considers the amount retained to be in excess of the amount adequate for the protection of the government, at his discretion may release to the contractor all or a portion of such excess amount. Our audit showed that, despite issuance of a stop work order and awareness of the contractor's unsatisfactory performance, PSS irresponsibly refunded more than \$68,000 of amounts retained from progress payments. This occurred because of negligence on the part of PSS officials who were very much aware of the imminent failure to complete the project.

- On April 24, 1996, the COE amended the completion date of the project from April 13, 1996 to May 25, 1996. In the same letter, B & R was again requested to address its deficiencies (e.g., failure to submit additional performance and payment bonds, increase its manpower on the project, etc...).
- Several days after extending the completion date, the COE issued a stop work order on May 8, 1995 pending "additional architectural and engineering review" of the project.
- On May 10, 1996, the Special Assistant for CIP recommended the payment of 40% of the outstanding retention amount citing the provisions of the contract specifications. B & R was subsequently paid \$40,053 despite its unsatisfactory performance.
- On November 26, 1996, B & R billed PSS for \$28,391 representing 50% of the remaining balance of the retention amount. At this time, negotiations were already ongoing to finalize B & R's exit from the project. PSS, however, approved B & R's request and paid the contractor at the recommendation of the PSS Facility Specialist, who explained that it was appropriate to pay the contractor because there was still \$30,000 left.

(Note: Our review showed that B & R's computation of the 50% of the remaining balance was erroneous. The correct amount should have been \$30,039 or 50% of \$60,079, computed as follows: total value of projected completed per B & R's progress schedule of \$1,001,319 less previous payments of \$941,239.. Thus, the balance of the retention amount after the payment was \$31,688).

Instead of protecting the agency's interest, PSS officials sided with the contractor and refunded the retention amounts in violation of contract specifications.

Consequently, PSS is left with limited funds to cover damages arising from the contractor's failure to complete the project.

Contractor's Performance and Billings Not Adequately Monitored

To ensure that a construction project is completed in accordance with the contract specifications, there is need for a construction manager to monitor and review the status of a project on a continuing basis. For government agencies such as PSS without a full-time construction manager, construction management services can be contracted out or requested from the Department of Public Works.

Our audit showed that the construction management services being performed by Entech for the MHS project were cut short upon the expiration of its contract on August 30, 1994. At the time, the project was only 21.05% complete. Instead of renewing the contract or seeking technical assistance from DPW, PSS relied on its CIP Coordinator to monitor the contractor's accomplishment and review progress billings. On April 5, 1995, the CIP Coordinator issued a memo stating that, "from now on, the CIP coordinator will not prepare an inspection report to accompany the progress payment request submitted by B & R." According to the CIP Coordinator, his signature shown in the application for payment was sufficient to ensure that the application was correct. The CIP Coordinator certified \$569,978 out of the \$969,631 payments to B & R.

The lack of professional construction management services plus the fact that inspection reports were not prepared by the CIP Coordinator could have resulted in possible overpayments to the contractor as well as construction deficiencies. Several reports and documents obtained from third parties supported these conclusions.

- An October 5, 1995 report by a professional architect stated that the project was found to be only about 20% complete and workmanship was very poor.
- Another October 5, 1995 report by an architectural firm stated that the quality of work was extremely poor and appeared to have been completed with little supervision and inspection.
- In February 15 and 20, 1996 letter responses to an inquiry of the COE, Entech reported that the construction work appeared to have been performed by unskilled and untrained workers managed by an inexperienced contractor without any full-time supervision and inspection.

Further, an evaluation of the status of the project as of December 1995 by CCI, the former construction partner of B & R, noted that the project was about 40% complete. CCI added that approximately 12%, however, needed to be reworked. Therefore, the project's acceptable completion percentage was calculated to be 28%. The evaluation report further stated that, based on examination of B & R's records and

the actual work performed and billed, an approximate sum of between \$150,000 to \$200,000 may have been overpaid by PSS. Considering that B & R has already been paid \$969,631 or almost 70% of the contract price, PSS should conduct an independent review of the actual percentage of completion of the project and determine if overpayments were made.

Contractor Allowed to Continue Work Without First Securing Extension of Performance and Payment Bond Coverage

Section 4-101 of the PSS procurement regulations provides that for contracts in excess of \$25,000, contractors are required to deliver performance and payment bonds equal to 100% of the contract price, to protect PSS from possible losses arising from nonperformance or noncompletion of work. General provision 16 of the contract specifications also states that additional performance and payment bond protection shall be furnished by the contractor for any contract modification for new or additional work or a 25% increase in contract price.

Our audit showed that the project's completion date was extended at least four times. PSS, however, allowed B & R to continue working on the project without first ensuring that the bonding coverage for the project had been extended.

- On February 6, 1995, four months after the passage of the original completion date of September 29, 1994, B & R finally submitted to PSS a copy of the insurance policy for the extension of the bonding coverage for the MHS gym contract.
- On February 13, 1995, PSS granted B & R a 212 calendar day extension up to September 10, 1995.
- On October 5, 1995, PSS granted a change order to B & R which required extending the completion date by 223.5 calendar days up to April 24, 1996. The change order was granted without B & R's extending the bonding coverage. Instead, B & R was required to fulfill several conditions under the change order. One of the conditions was the submission of additional performance and payment bonds.
- On November 29, 1995, PSS informed B & R to address several issues which included submission of a "new extended performance bond per change order."
- On February 12, 1996, the COE demanded that B & R submit "proof of bonding compliance."
- On April 24, 1996, almost two weeks after the passage of the completion date of April 13, 1996, the COE again extended the completion date to May 25, 1996. The COE reminded B & R to submit additional performance and payment bonds. On May 8, 1996, the COE issued a stop work order to B & R.

Completion Dates	Extension Dates	Extended After	Bonding Coverage
09/29/94	02/07/95	4 months	09/09/94 to 08/08/95
09/29/95	11/08/95	2 months	09/11/95 to 04/13/96
04/13/96	04/14/96	1 day	04/14/96 to 05/05/96
05/25/96	No Extension	-	-

Table 1

Based on available information gathered from the bonding company and the contractor, the performance and payment bonds were extended only after the completion dates had passed. Further, no extension was made to cover the stop work order period (See Table 1)⁵.

PSS should have required the contractor to extend the bonding coverage several weeks before the completion dates. The failure of the contractor to take action should then have prompted PSS to immediately terminate the contract for default so the bonding company could be held responsible for completing the project. Instead, PSS allowed B & R to continue working on the project and even extended the project's completion dates without first ensuring that the bonding requirements had been met. Because of the negligence of its officials, PSS was left "holding the bag" because the project had no insurance when the contractor pulled out of the project.

Further investigation also showed that the contractor still owed the bonding company \$49,175, the amount equivalent to the insurance premiums for the last two extensions of the bonding coverage and a partial amount for the first extension. As previously discussed, the contractor was simply financially incapable of payment. Consequently, there was also no assurance that the bonding company would have honored the insurance coverage, had PSS chosen to terminate the project during the extension periods, because of the lack of payments.

Issuance of Stop Work Order Instead of Terminating Contract For Default

Under Section 8 of the PSS standard construction contract, the chief procurement officer may, by written order to the contractor at any time and without notice to any surety, require the contractor to stop all or any part of the work called for by the contract.

Under Section 12 of the PSS standard construction contract, if the contractor fails to perform or comply with any provisions of the contract in a timely manner, PSS may notify the contractor in writing of the delay or nonperformance and if not cured within 10 days, PSS may terminate the contractor's right to proceed with the contract. In the event of termination, the contractor shall be held liable for excess costs incurred in completing the contract.

⁵ The extension dates were based on the date of B & R's submission of the extended policy to PSS and/or the invoice transaction dates indicated on the bonding company's statement of accounts (There were no approval dates indicated on the original insurance policy as well as the extension policies). Also, there was no policy covering the third extension (apparently, only an invoice was issued). We also noted that the policy for the second extension was not signed by the contractor).

Our audit showed that, instead of terminating the contract for default, PSS issued a stop work order when it was already apparent that the contractor would not be able to finish the project by the completion date. This action favored the contractor because the stop work order effectively postponed the deadline for completing the work. The following is a summary of the events leading to the issuance of the stop work order:

- Almost two weeks after the April 13, 1996 completion date had passed, the COE issued a letter to B & R on April 24, 1996 moving the completion date to May 25, 1996. The COE reminded the contractor to comply with several conditions under the contract requirements.
- On April 26, 1996, B & R received \$40,198 from PSS as progress payment.
- Less than three weeks before the new completion date of May 25, 1996, the COE issued a stop work order on May 8, 1996 requesting B & R to stop working on the project “pending architectural and engineering review.”

PSS’s issuance of the stop work order was useless since it was already obvious that the contractor had no capability to continue the project. The appropriate action should have been termination of the contract for default so that PSS could hold the contractor liable for any excess cost of completing the project.

Negotiating Improper Settlement Agreement Instead of Demanding Compensation for Damages

Under Section 13 (4) of the PSS standard construction contract, if a contract is terminated for convenience, the chief procurement officer and the contractor may agree to a settlement agreement. However, the total sum to be paid to the contractor may not exceed the total contract price plus reasonable settlement costs reduced by payments made, proceeds of any sales, and the contract price of work not completed at termination.

Under Section 8 of the PSS standard construction contract, the stop work order issued by the chief procurement officer shall be for a specified period not exceeding ninety (90) days after the order is delivered to the contractor, unless the parties agree to any further period. Before the stop work order expires or within any further period to which the parties have agreed, the chief procurement officer shall either (a) cancel the stop work order or (b) terminate the contract for default or for convenience. If the stop work order is canceled, the contractor has the right to resume work on the project.

General provision 22 (b) of the contract specifications provides that if the contracting officer unreasonably suspends the work of the contractor, an adjustment shall be made for any increase in the cost of performance of the contract excluding profits. However, no adjustment shall be made for any suspension where performance would

have been suspended for any other cause, including the fault or negligence of the contractor.

Improper Settlement Agreement

Our audit showed that PSS is currently negotiating a settlement agreement with B & R to permit the contractor to “exit” from the project. A draft of the agreement dated May 9, 1997 showed that PSS would have to pay \$149,859 to the contractor. Based on our analysis, however, the proposed settlement agreement should be rejected because it is extremely unfavorable to PSS. Besides, the contract has not been terminated for convenience, and thus settlement is not yet an option. Even if the contract should be terminated for convenience, the losses claimed by B & R do not qualify as amounts payable because the losses by B & R (1) did not arise from issuance of the stop work order, (2) were not supported by receipts or appropriate documents, (3) were due to the contractor’s fault, or (4) were simply unbelievable (See Appendix A for separate analysis). Furthermore, the wording of the sections in the settlement agreement is inaccurate, misleading, and portrays B & R as without fault. As discussed throughout this report, it was B & R’s failure to cure and address construction problems and deficiencies which led to repeated delays of the project.

At the time of the audit, the stop work order has not yet been canceled. Under the contract provisions, the options available to PSS at this point are as follows: (1) cancel the stop work order and require the contractor to complete the work, (2) terminate the contract for default because of the contractor’s repeated failure to cure or address the conditions delaying the project, or (3) terminate the contract for convenience. If the contract is terminated for convenience, only reasonable costs arising from the stop work order shall be allowed to the contractor. Under the circumstances, however, the appropriate action that should be taken by PSS is termination for default of the contractor’s right to proceed with the contract, and not negotiating a settlement.

Failure to Charge Liquidated Damages

The instructions to bidders, which were made part of the contract specifications, provide that, in the event of failure of the contractor to complete the work within the completion date, liquidated damages will be assessed at \$500 for each and every day that the work is delayed.

Our audit showed that PSS neglected to charge liquidated damages for failure of the contractor to complete the contract within the completion date. In a January 18, 1997 memorandum, the PSS CIP Specialist indicated that the total liquidated damages that should be charged against B & R amounted to \$111,500 (for 223 days covering the period from September 10, 1995 through April 23, 1996). The damages were supposed to be considered in negotiating the settlement agreement with B & R. For unexplained reasons, the damages were excluded from the final draft of the settlement agreement. Based on our analysis, the liquidated damages are due because

of the contractor's failure to complete the work. Therefore, PSS officials should stop favoring the contractor and enforce payment of the liquidated damages, whether or not the settlement agreement is pursued.

Cause and Effects

These conditions occurred because PSS officials did not adequately perform their duties and responsibilities. Instead of acting in the best interest of the CNMI, PSS officials made decisions which unduly favored the contractor. As a result, (1) the opportunity for other responsible contractors to complete the project was lost, (2) there is no assurance that the proposed MHS gymnasium will be completed anytime in the near future, and (3) public funds expended for the construction project amounting to more than \$969,000 may have been completely wasted. In addition, (4) contract provisions and procurement regulations were violated, and (5) a significant amount of government time and effort was spent over almost a five year period from August 1992 (start of procurement) to May 1997 (negotiation of settlement agreement) without any public benefit.

Conclusion and Recommendations

The MHS gymnasium project was mismanaged by PSS officials who failed to act in the best interest of the CNMI or PSS despite substantial evidence showing that the contractor had no ability to complete the project in a timely manner. Their negligence and improper actions left PSS with an unusable structure that needs major rework and without any insurance to cover its completion. The same officials are negotiating with the contractor a settlement agreement whose terms are extremely unfavorable to PSS. Accordingly, we recommend that the Chairman of the Board of Education:

1. Instruct the COE to cancel the stop work order and immediately terminate for default the contractor's right to proceed with the project instead of negotiating a settlement agreement with the contractor.
2. Instruct the COE to reject the settlement agreement improperly favoring the contractor. Instead, PSS should charge liquidated damages for contract extensions that were caused by the contractor's delay and nonperformance.
3. Request an independent architectural and engineering firm to review the actual percentage of completion of the project, and the quality of materials used and work performed by the contractor. Based on the findings, the contractor should be required to replace without charge any materials or correct any workmanship that does not conform with contract specifications.
4. Take appropriate disciplinary actions against the responsible PSS officials for failure to terminate the contract for default, and poor management and negligence in enforcing contract provisions and procurement regulations.

5. Issue a directive to all PSS officials involved in procurement to stop favoring nonperforming contractors and to ensure that any action taken or decisions made will be in compliance with applicable contract provisions and procurement regulations.
6. Identify or request funding to complete the MHS gymnasium and ensure that any new contract to be procured for the project undergoes competitive bidding and does not exceed available funds.

Subsequent Actions

After the draft report was issued, PSS approved a change order terminating the contract for convenience effective October 24, 1997 with no further payments. It would have been more appropriate had PSS terminated the contract for default. PSS apparently chose to terminate the contract for convenience to avoid protracted litigation. PSS also subsequently issued a request for proposals (RFP) to restart the MHS gym project, and transferred the administration of the project to the Department of Public Works (DPW). The RFP was supposedly for the "partial completion of the MHS gym." The scope of work showed that the project consisted of disassembling all of the steel frame columns currently erected, replacement of the footings for the columns, removing of rust and repainting of the steel, and assembling the entire steel frame. During our exit conference, the COE told us that the steel frame structure needs to be taken down and cleaned because it had been exposed to the environment for a long time. We discussed the RFP with the DPW Director of Technical Services Division who was in charge of the project and asked him the purpose of the work. According to him, the steel frame has to be taken down primarily because the construction of the footings by the contractor was defective and substandard.

We also asked the Director how DPW plans to complete the gym. According to him, the gym will be completed in two phases. The first phase involves work on the steel frame as per RFP. The second phase, however, will involve new construction that will require a redesign of the gym. The plan was to eliminate the second floor to reduce costs. We also asked for a cost estimate. The Director told us, however, that a cost estimate will be available upon completion of the redesign of the gym. In a recent discussion (December 1997) with the DPW Architect/Consultant involved in the project, he told us that the redesign has not yet been completed so a government estimate was still not available. It is expected, however, that a substantial amount would be needed to complete the second phase of construction of the gym.

We followed up with DPW on the results of the RFP for the first phase. DPW officials informed us that three contractors submitted proposals. According to the DPW Architect/Consultant, the proposals have already been evaluated; however, the result has not yet been approved by the Secretary of DPW (as of December 1997).

PSS Response

The COE's letter response dated October 14, 1997 did not address any of the recommendations. Instead, the COE generally presented arguments against the findings raised in the draft audit report. Most of these arguments were discussed with the COE and other PSS officials during our exit conference on December 3, 1997.

Among others, the COE argued that (1) PSS relied on the Legislature's promise and an Attorney General's (AG) opinion when PSS approved the MHS gym contract although available funds were not sufficient, (2) the contractor was awarded the project because PSS felt secure that the project would be completed since the contractor was able to obtain bonding and the upfront payment of mobilization costs would enable the contractor to pay its suppliers despite its limited cash position, (3) the retention was refunded because the contractor's progress on the job was satisfactory according to the recommendation of knowledgeable persons, (4) the project was regularly inspected and monitored as evidenced by daily inspection reports, (5) bond provisions do not require extension beyond the project's estimated completion date, (6) the stop work order was issued upon the advice of an independent engineer because of design problems, and (7) PSS was attempting to remove the contractor from the project without cost and was not negotiating a settlement agreement that would involve payments to the contractor. (Note: items 1-5 were based primarily on our discussions with the COE during our exit conference. Items 6 & 7 were based on the PSS letter response and were not discussed during the conference because of time constraints. The COE, however, said that items 6 & 7 have been addressed by PSS subsequent actions - *i.e.*, termination of the contractor and restarting of the project by DPW).

OPA Comments

We issued a separate letter on November 14, 1997 commenting on the arguments contained in the PSS letter response. We also conducted an exit conference with PSS officials on December 3, 1997. The following is a summary of our comments in our letter and during the exit conference: (1) it was a violation of the procurement regulations to negotiate with the contractor when the lowest bid significantly exceeded available funds - reliance on the Legislature's promise to provide additional funds (which subsequently did not materialize) is not an excuse for violating procurement regulations. Also, the AG's opinion was specifically for another contract involving construction of classrooms. What was being contemplated by the AG was the use of change orders to construct additional classrooms. The AG also advised PSS to issue a request for proposal for the additional classrooms should funding become available after the project period, (2) the contractor's financial statements and subsequent actions clearly showed that it has no financial capability to perform the project. The contractor failed to obtain credit lines from banks. Relying on upfront payment was a "red flag" which should have prompted PSS to reconsider award of the contract. There were also numerous instances during the construction

period evidencing the inability of the contractor to complete the project due to financial problems (For example, PSS bailed out the contractor by making payments directly to the supplier of the steel frame building). The point was that PSS failed to terminate the contractor despite these conditions, (3) retention was refunded despite the issuance of a stop work order two weeks before the expected completion date. A simple visual inspection of the gym would have led any knowledgeable person to conclude that it was largely incomplete. There were also several reports showing that the contractor's work was defective. There was even evidence showing that PSS was already aware of the contractor's plans to pull out of the project when it refunded the retention, (4) payments to the contractor were not supported by status reports describing the contractor's progress compared to schedule. The contract of the construction manager responsible for monitoring the project expired and was not renewed. The PSS CIP Coordinator informed the COE that inspection reports would no longer be prepared. The "daily" reports submitted by the Coordinator did not contain the necessary information to determine whether the contractor had performed its work in accordance with the project's schedule, (5) PSS misunderstood the bond provisions. The provisions simply mean that the bonding company will not be liable if the contractor completes the project whether or not it was informed of any time extension. The point of the finding was that PSS should have acted and held the bonding company responsible before the coverage expired, (6) there were several reports stating that the contractor's work was defective. The independent engineer's report also confirmed that the design of the steel frame for the gym was not the problem. The problem was the poor quality of installation and construction work of the contractor. This should have prompted PSS to terminate the contractor instead of issuing a stop work order, and (7) contrary to PSS's claims that it was attempting to remove the contractor without cost, a draft settlement agreement being negotiated by PSS officials showed that the agency would have to pay more \$149,000. There were also other evidence showing that PSS and the contractor were close to finalizing the agreement. Had OPA not issued the draft report criticizing the agreement, PSS would have probably push through with the settlement and paid the contractor to pull out of the project.

For better understanding, the PSS letter response and OPA comments are presented together in Appendix B.

Status of Recommendations

Based on the subsequent actions of PSS and DPW, we consider Recommendations 1, 2, and 3 as closed. Recommendations 4,5, and 6, however, are considered open. The additional information or actions required to close the recommendations are presented in Appendix C.

Appendix A

ANALYSIS OF PROPOSED SETTLEMENT AGREEMENT

Description of Contractor's Claims	Amounts Claimed	OPA's Analysis
1. Retention amounts.	\$ 31,688	Contractor failed to complete and turn over project; thus, he is not entitled to refund of retention funds. These amounts should be offset against liquidated damages due from the contractor.
2. 45 days salaries of employees and bonding cost from 10/5/93 to 12/15/93 due to delays because of alleged foundation plan deficiencies.	16,391	The expenses did not arise from issuance of stop work order. Further, it is not believable that these employees did not work on other aspects of construction since evidence showed that the contractor was severely undermanned.
3. Additional expenses for transferring sand to designated schools per PSS request (these expenses were incurred several months before the stop work order).	4,125	The expenses did not arise from issuance of stop work order. Further, the contractor is required to perform this work under the contract specifications.
4. Material price increases from 1992 to 1995.	14,440	The expenses did not arise from issuance of the stop work order. Further, the contractor is responsible for procurement of materials under the contract. Due to his own financial difficulties, he failed to procure materials on time.
5. 90 days salaries of employees and bonding costs because of delays due to steel building deficiencies.	14,654	The expenses did not arise from issuance of the stop work order. Further, the steel building was the responsibility of the contractor under the contract. It was part of the contract deliverables. Moreover, due to the contractor's financial difficulties, procurement of the building was significantly delayed until PSS stepped in at the request of the contractor.
6. 30 days salaries of employees and bonding costs from 4/23/96 to 5/24/96 because of delays in concrete pouring per instructions of PSS architect and engineer.	6,770	The expenses did not arise from issuance of the stop work order. Further, it is not believable that these employees did not work on other aspects of construction since evidence showed that the contractor was severely undermanned.
7. Overhead costs such as housing, bonding, employee salaries from 5/8/96 to 11/8/96.	35,879	Claims are not supported by payroll slips, receipts, and related documents. Moreover, under the provisions of the contract, the contractor is required to take all reasonable steps to minimize the occurrence of costs during the period of the stop work order.
8. Utilities for barracks and offices from 5/96 to 10/96.	2,558	See comments on No. 7 above.
9. Salaries of construction supervisor, accountant, and draftsman from 5/8/96 to 11/1/96.	16,972	See comments on No. 7 above.
10. Additional reinforcement work per DPW and PSS recommendation.	6,382	The CIP specialist noted that no work has been done on this aspect. Further, no change order was approved.
	\$ 149,859	

PSS LETTER RESPONSE AND OPA COMMENTS

PSS Letter Response	OPA Comments
<p>October 14, 1997</p> <p>Mr. Leo LaMotte Office of the Public Auditor P.O. Box 1399 Saipan, MP 96950</p> <p>Dear Mr. LaMotte:</p> <p>We are writing in response to the draft audit report prepared by your office as a result of your audit of the Marianas High School Gymnasium Contract.</p> <p style="text-align: center;"><u>Executive Summary</u></p> <p>The Office of the Public Auditor (OPA) issued a draft report based on their audit of the records relating to the construction of the Marianas High School Gymnasium. OPA concludes that \$960,000 of government funds may have been wasted. PSS concludes that nothing could be further from the truth. The construction performed to date has been adequate, and can be completed without having to destroy the existing structure.</p> <p>PSS admits that there were delays in the project, and that time extensions were granted. The delays were caused by many factors, including a dispute by the hired construction manager over ownership of sand on the site, problems with drawings and design, and procurement of a steel building. An additive change order was granted which confirms the claim that there were problems with the drawings and the design.</p> <p>The OPA listed seven "findings" in their report, and recommended quite severe actions based on their "findings". PSS representatives have reviewed the draft audit report and have prepared responses to the "findings". It should be noted that PSS personnel disagree with all seven findings, except for part of one finding.</p>	<p>It is a fact that the project has not been completed more than four years after the start of construction work. PSS, however, has not submitted any evidence to prove that construction is adequate. PSS should request an independent review of the project by a professional architectural and engineering firm to determine whether it is cost effective to complete the project. This is necessary because documents from the contractor, a private construction firm (Core Construction), the engineering firm hired by PSS (HK Pangelinan), and Department of Public Works (DPW) all showed that construction work was defective and certain portions (e.g. concrete pedestals, CMU walls) may have to be demolished. These facts are documented on pages 8 to 10 of the draft report.</p> <p>Our audit showed that the project was repeatedly delayed because of the following reasons: (1) contractor's overall poor performance and slow progress of work, (2) financial difficulties of the contractor in the procurement of the steel building, (3) poor quality of construction work, and (4) failure of the contractor to address construction problems and deficiencies. Despite the delays, PSS failed to terminate the contractor for default. The reasons for the delay were discussed and supported by documents as shown on pages 4 to 12 of the draft report.</p> <p>The draft report presented two (2) major findings. These are (1) failure of PSS to terminate the contractor for default, and (2) poor management and negligence in enforcing applicable contract provisions and procurement regulations. Our recommendations were based on these two findings. The seven "findings" mentioned by PSS are the conditions supporting our second finding. The PSS letter response did not address our first finding.</p>

PSS LETTER RESPONSE AND OPA COMMENTS

PSS Letter Response	OPA Comments
<p>Pages 1-2</p>	
<p>PSS must conclude that the OPA staff did not perform a thorough review of the documents, did not exercise objectivity in the performance of their work, did not interview the appropriate personnel, and approached the engagement with a bias against certain employees of PSS. Given that this work was requested by a known opponent of the Commissioner of Education, this bias is understandable, though unprofessional.</p> <p>It should be noted that this report casts the Commissioner of Education in an extremely unfavorable light, yet the OPA staff NEVER BOTHERED TO DISCUSS THIS WORK OR THEIR PRELIMINARY FINDINGS WITH THE COMMISSIONER OF EDUCATION! Had OPA staff included the Commissioner in their interview process, many of the "findings" would not have even appeared in the report.</p> <p>It should also be noted that, unlike all previous audit reports involving PSS, this report was not submitted to the Commissioner of Education, but was submitted to the Board of Education. This makes it appear that the OPA really didn't expect a response to the report. They made their conclusions and their harsh recommendations, and handed the report over without leaving any opening for appropriate responses.</p>	<p>OPA staff performed the audit in accordance with generally accepted government auditing standards.</p> <p>Anyone can request an audit from OPA. In fact, OPA has published telephone hotlines to entertain anonymous audit requests. All audit requests received by OPA, however, are investigated for merit and prioritized accordingly. In the case of the MHS Gym, the failure of the contractor to complete the project despite substantial payments made by PSS is an important matter that needs to be audited.</p> <p>The report is still in draft form and has not yet been finalized. It is our opinion that a complete picture of our findings should be presented to the Commissioner in writing so he can properly respond to them. It would be impractical to request the Commissioner to answer every item during the audit.</p> <p>OPA also had the opportunity to briefly discuss the MHS gym issue with the Commissioner after a meeting concerning the construction of emergency classrooms. We discussed the possible termination of the contractor and the proposed settlement agreement with the Commissioner and his staff. Even in those brief discussions, it appeared that the Commissioner and his staff were very much undecided on how to end the contract for the gym.</p> <p>We have also previously informed the Commissioner when we provided the draft report that he can schedule a meeting with us anytime. The Commissioner, however, requested and was granted three (3) time extensions to respond to the draft report on top of the 30 day grace period. This gave PSS more than three (3) months to respond and schedule a meeting with us. As stated in our transmittal letter dated July 17, 1997, the Commissioner may request a meeting with us at his convenience should he believe that our findings need further discussion or explanation. We do, however, prefer written explanations as oral ones can be easily denied.</p> <p>The fact is that our draft report's transmittal letter dated July 17, 1997 was addressed to both the PSS Board Chairman and the Commissioner of Education. The draft was also addressed to the PSS Board Chairman because our findings necessitate that the report should be reported to a higher level official other than the Commissioner. This is in accordance with government auditing standards on report distribution.</p>

PSS LETTER RESPONSE AND OPA COMMENTS

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<p>Pages 2-3 PSS does not blame the OPA for the leakage of the draft report to the press. More caution should be exercised in the future over the handling of matters such as these. This is a very small island, and word travels fast.</p> <p>On a more positive note, PSS has begun the process of restarting the project. A request for proposals has been finalized, and funding has been identified to complete the first phase and part of the second phase. Additional funding will be needed to complete the second phase.</p> <p style="text-align: center;"><u>HISTORY OF THE PROJECT</u></p> <p>This section was no longer presented because it contained chronological information similar to information already obtained by OPA.</p> <p style="text-align: center;"><u>REPORT METHODOLOGY</u></p> <p>The report issued by the OPA states that interviews were conducted with “knowledgeable” PSS staff. As mentioned above, OPA staff never bothered to discuss any of this with the Commissioner of Education!</p> <p>There is much valuable information known to the Commissioner, which could have been incorporated into the OPA report.</p> <p>Excluding the Commissioner from the interview process must lead us to conclude that the OPA formed their conclusions in advance. This work was performed at the request of a hostile party who was a member of the Board of Education while this project was in progress! What did this Board member do to facilitate the completion of the project? This failure to interview the chief executive officer of the organization subject to scrutiny is a serious flaw in the audit process, and throws the entire draft report into question.</p> <p>Pages 3-9</p>	<p>It is OPA’s policy to treat all draft reports as confidential. Recipients of draft reports are informed of this “confidentiality requirement” in our draft report cover page.</p> <p>The PSS letter response did not include documentary evidence supporting this claim. Before restarting the project, PSS should (1) provide evidence showing that the contractor has been terminated or agreed to pull out of the project, (2) submit an independent report showing that it is more cost effective to continue construction, (3) submit plans showing target completion dates, (4) submit copy of the request for proposal, and (5) identify source and amount of funding for the project.</p> <p>As previously mentioned, the report is in the draft stage and the Commissioner was properly informed through our transmittal letter if he wants to meet and discuss the report. The report has not been finalized and OPA is open for discussion. We also intend to conduct an exit conference with the Commissioner and the PSS Board before finalizing the report.</p> <p>PSS needs to specify what valuable information is known only to the Commissioner so we can incorporate it in our report. The PSS letter response did not provide or identify this information. For the record, OPA staff repeatedly met and obtained documents from the contractor, bonding company representatives, PSS procurement officer, PSS-CIP Coordinator, PSS CIP Specialist, PSS Accountant, and interested third parties.</p> <p>As stated in our draft report (introduction section), the audit was requested by Representative Dino Jones. OPA entertains audit requests from legislators and any other individual based on their merits and not because of any hostile intentions.</p> <p>Again, the report has not been finalized. As stated in our transmittal letter, we will consider comments and explanations of the PSS Board Chairman and the Commissioner before finalizing the report.</p>

PSS LETTER RESPONSE AND OPA COMMENTS

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<p>Further, one of the stated objectives of the OPA report was to "...determine whether the contractor performed work in accordance with the terms and conditions of the contract...". The terms and conditions of the contract are only a part of the contract. There are many other aspects to the contract's performance on the project that are outside the terms and conditions section. It is not enough to evaluate the contractor solely with respect to part of the contract; rather, the entire contract must be considered.</p> <p style="text-align: center;"><u>APPROPRIATENESS OF STAFFING AND CONCLUSIONS</u></p> <p>As you will read later in the document, it is quite evident that the OPA sent out staff to perform this engagement who are not knowledgeable about construction accounting, construction issues, and who did not perform a thorough job. This indicates to PSS that the conclusions in the PSS report were forgone.</p> <p>Further, we have serious doubts about the recommendations included in the draft audit report. We wonder if anyone in the OPA office actually reviewed the report prior to its issuance.</p> <p>We find it rather severe and even unbelievable that one of the recommendations from this work was to terminate the Commissioner of Education!</p> <p>Seriously, shouldn't the Commissioner have been interviewed to clear up some of the errors made by the OPA staff prior to releasing such an indictment?</p>	<p>To fulfill our audit objective, OPA reviewed and evaluated all available types of evidence (documentary, testimonial, and physical evidence) to determine whether the contractor performed the work in accordance with the contract.</p> <p>The PSS letter response did not specify what aspects of the contractor's performance on the project were not considered by OPA. We cannot think of any other "aspects" of the contract which were not considered in relation to our audit objectives.</p> <p>PSS has no basis to determine the qualifications of OPA staff. For the record, OPA staff are accounting graduates and passed professional certifications. Senior staff members have auditing experience in the construction industry. Further, in accordance with government auditing standards, OPA staff are required to complete at least 80 hours of continuing education training every two years. These trainings include subjects on government contracting and audits of construction contracts.</p> <p>All OPA draft reports undergo extensive review. In the case of the MHS draft audit report, it was reviewed by a senior auditor, the audit manager, legal counsel, and the Public Auditor.</p> <p>The fact is that the draft report did not recommend the termination of the Commissioner of Education. Recommendation 4 of our draft report provided that the PSS Board Chairman take action against the Commissioner and responsible PSS staff members in accordance with the standard penalty provisions for violating procurement regulations. (See Section PSSPR 6-211 - Penalties - which provides that any employee who violates procurement rules and regulations is subject to adverse action as may be appropriate in the circumstances. This action includes, but is not limited to reprimand, suspension without pay, termination of employment, civil suits for damages or return of government money or criminal prosecution).</p> <p>PSS needs to specify what errors were made by OPA staff so we can correct the draft report.</p>
<p style="text-align: center;"><u>FINDINGS AND RESPONSES</u></p> <p>We have attempted to place OPA's findings in the format normally utilized by external auditors, and have incorporated PSS responses and corrective action plans, as follows:</p> <p>Pages 9-10</p>	<p>This section of the PSS letter response is directed only to discussions supporting our second finding - PSS's poor management of the construction project and negligence in enforcing contract provisions and procurement regulations. PSS presentation was inaccurate and incomplete; thus, we will present the actual discussion as shown in our draft report.</p>

PSS LETTER RESPONSE AND OPA COMMENTS

PSS Letter Response	OPA Comments
<p><u>Finding No. 1 - Insufficient Funding for the Procurement of the Project</u></p> <p>Per Office of the Public Auditor Criteria - Section 3-102(9)(c) of the PSS procurement regulations allows for negotiation with the lowest responsive bidder only when the bid price does not exceed available funds by 5%.</p> <p>Condition - PSS solicited bids on a project estimated to cost \$2.9 million when the available funds were only \$1.21 million. PSS did not scale down the project and re-bid the contract when the lowest bid of \$1.918 million exceeded available funds by \$708,000.</p> <p>Cause - PSS believed that the additional \$708,000 would be provided from the Legislature, based on a letter it had from the Saipan Legislative Delegation.</p> <p>Effect - PSS may not have obtained the best possible price for the project, since PSS did not scale down the project and rebid the contract.</p> <p>Recommendation - PSS should terminate the contract and reject the contractor's claims. PSS should not enter into a settlement agreement with the contractor.</p> <p>Pages 10-11</p>	<p>Procurement of Contract Despite Insufficient Funding (See pages 13 - 14 of the draft report)</p> <p>Section 3-102(9)(c) of the PSS procurement regulations allows negotiation with the lowest responsive bidder (i.e., to conform with the available funding) only when the bid price does not exceed available funds by 5%.</p> <p>Our audit showed that PSS failed to exercise prudent judgement when it (1) solicited bids for the project that was estimated to cost \$2.9 million when it had available funding of only \$1.21 million, and (2) did not scale down the project's specification and rebid the contract when the lowest bid of \$1.918 million exceeded available funds by \$708,000, or more than 58%.</p> <p>In December 1990, PSS commissioned Entech to design the MHS gym. Entech's original design placed the cost of the gym at \$900,000. Subsequent revisions requested by PSS, however, increased the estimated construction cost (by an outside contractor) to about \$2.9 million. This information was communicated to PSS by Entech in a formal cost estimate report dated October 1, 1991.</p> <p>In August 1992, PSS solicited bids for the project even when the funding available was only \$1.21 million. And despite the shortfall of funds of almost \$2.0 million (based on the government estimate of \$2.9 million), PSS pursued the procurement of the contract. PSS's action was irresponsible since funds were insufficient to finance the construction project.</p> <p>As expected, the bids received by PSS exceeded the available funding. B & R submitted the lowest bid at \$1.918 million which exceeded the available funding of \$1.21 million by \$708,000. At this point, PSS should have scaled down the project's specifications and rebid the contract because of the large difference between available funding and the lowest bid price. It should be noted that Section 3-102(9)(c) of the PSS procurement regulations allows negotiation with the lowest responsive bidder only when the bid price does not exceed available funds by 5%. In this case, the excess was more than 58%, and therefore negotiation should not have been an option. PSS should have also analyzed the lowest bid of \$1.918 million because of the large difference with the government estimate of \$2.9 million. How can a contractor reasonably cut the cost of a \$2.9 million project by \$1.0 million?</p> <p>On May 17, 1993, PSS awarded the contract to B & R for \$1.21 million with a promise that if funding became available, the contract would be amended to reflect its total bid of \$1,918,000. PSS told B & R that it received a letter from the Saipan Legislative</p>

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<p>PER PSS Auditee Response/Corrective Action Plan - We disagree with the finding. First, there is a difference between the bids received and the government's cost estimate. The government's first estimate for the project was \$900,000. This was for a 14,000 square foot gym. The cost estimate increased to \$2.6 million in June of 1991, as the size of the gym increased to 23,000 square feet, among other factors. The final cost estimate of \$2.9 million was developed in October 1991.</p> <p>It is interesting to note that the difference between the cost estimate of \$2.6 million and \$2.9 million seems to be the result of a miscalculation. In the \$2.9 million figure, it seems that markups were calculated at 35%, and in the \$2.6 million figure, they were calculated at 25%.</p> <p>Four of the bids submitted did not exceed \$2.0 million. The lowest bid was \$1,918,000. There were other bids of \$1,950,000, \$1,970,000, and \$1,989,000. The difference in these four bids was barely more than \$80,000. We must conclude that the government's cost estimate was incorrect.</p> <p>Page 11</p>	<p>Delegation which promised to support a bill seeking additional funding for the project. PSS told B & R that the bill, however, was not passed by the Legislature.</p> <p>To reduce the price by \$708,000, PSS requested Entech to prepare a cost breakdown of all non-essential items that could be removed without diminishing the structure of the project. The cost breakdown was provided by Entech to the COE in May 1993 and it was followed when the project started in August 1993. In November 1993, however, B & R submitted its own cost reduction breakdown but it was denied by the COE, and B & R was told to follow Entech's cost breakdown. B & R subsequently requested and was granted a 62-day time extension for "uncertainty of scope of work." Delay could have been avoided if the cost reduction was addressed by PSS before the start of the project and not during the construction period. In addition, there should have been concurrence among PSS, Entech, and B & R on the cost reduction breakdown.</p> <p>This information was disclosed in our draft report on page 13.</p> <p>The final cost estimate submitted by the Entech on October 1, 1991 was \$2.9 million.</p> <p>PSS did not provide any documentary evidence showing that the \$2.9 million government estimate was incorrect. Further, PSS excluded certain facts in concluding that the government estimate was incorrect. There were a total of nine bidders, five of which bid more than \$2.0 million compared with only four bids claimed by PSS which did not exceed \$2.0 million. These five bids ranged from \$2.1 million to \$3.1 million. Therefore, PSS's conclusion was simply without basis and should be disregarded.</p>

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<p>PSS did seek a reduction in the scope of the project. There is an attached cost estimate prepared by Entech reflecting a reduction of nearly \$700,000 for non-structural items. This cost estimate was prepared well before the contract was awarded.</p> <p>Second, regarding the awarding of the contract. It is very clear in our letter to the contractor that the only available funding for the project was \$1.2 million. At no point in time did PSS ever commit to more than \$1.2 million. The contractor signed the contract, which very clearly indicated that the contract amount was \$1.2 million.</p> <p>We can't understand how you reached your conclusion that PSS committed for more than \$1.2 million. This casts doubt in our minds about the reliability of your work product. It does seem that you were pre-disposed to casting your findings in a negative fashion regardless of the truth of the matter.</p> <p>Third, PSS relied on the advice of the Attorney General's office to determine whether PSS could commit to only part of the project amount because of the lack of funding. The Attorney General's office concurred with PSS on a similar project involving construction of six classrooms. PSS relied on this concurrence in proceeding to award the MHS contract. In fact, there were three attorneys who reviewed this contract and approved it.</p> <p>Fourth, the CNMI Legislature was very much in support of this project. They initially committed to providing \$708,000 in funding. This funding never materialized; but then again, PSS did not commit to spending these funds. The Legislature made \$400,000 in funding available from the Non-Resident Worker's fee fund. Unfortunately, they used \$190,000 of these funds in 1991 to build emergency classrooms at the Marianas High School.</p> <p>Pages 12-13</p>	<p>This information was disclosed on page 14 of the draft report. As noted in the report, however, we found no written documentation that the contractor agreed to Entech's cost breakdown. The project started in August 1993. Several months later, in November 1993, the contractor submitted his own cost reduction breakdown to PSS. The Commissioner did not approve the contractor's submission. However, the contractor was granted a 62-day time extension for "uncertainty of scope of work." The point is, this matter should have been addressed earlier by PSS at the start of the project and not during the construction period. The delay may have also been avoided if all parties (PSS, Entech, and B & R) agreed on the cost reduction breakdown and documented such agreement.</p> <p>This information was disclosed on page 14 of our draft report.</p> <p>Nowhere in the draft report has OPA concluded, stated, or implied that PSS committed more than \$1.2 million. The thrust of our discussion was that PSS failed to scale down the project's specifications and rebid the contract when the lowest minimum bid exceeded available funds by more than \$700,000 or 58% of available funding. This is contrary to Section 3-102(9)(c) of the PSSPR which allows negotiation with the lowest bidder only when the bid price does not exceed available funds by 5%.</p> <p>The Attorney General's Office did not advise PSS on the negotiation for the MHS Gym contract. The Attorney General's Office advice involving the construction of six classrooms pertained only to that project. Moreover, the contract for this project specifically provided that only five classrooms would be constructed. The advice also stated that "if funds become available after the project period, then we would have to issue an RFP for the construction of the sixth classroom at the sites."</p> <p>This information was disclosed on page 14 of our draft report.</p>

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<p>Should similar circumstances arise in the future, PSS will cancel the bid, reduce the scope of work so it is within the available funding limit, and ask for a re-bid. PSS is also considering requesting for base bids and additive bids when the circumstances are appropriate.</p> <p>It must be understood that PSS did not act irresponsibly in proceeding with this contract, since PSS relied on the following:</p> <ul style="list-style-type: none"> ● The Saipan Legislative Delegation's commitment letter, ● The Attorney General's guidance, ● PSS Legal Counsel's guidance, ● The contractor's acquiescence in accepting the contract notwithstanding the funding situation, and ● Approval of the procurement for the project by the Board of Education <p>ATTACHMENTS</p> <p>Minutes of Pre Bid Meeting - August 1993 Minutes of Pre bid Meeting for finish work- Sept. 1995 Entech Cost Estimate for Deduction of Non-Struc. Items May 17, 1993 letter to B&R - intent to award contract May 4, 1993 letter from Saipan Legislative Delegation Memo to Assistant Attorney General from PSS Excerpt from contract between PSS and B&R November 24, 1992 analysis of sealed bid opening</p> <p><u>Finding No. 2 - Contractor's Lack of Financial Resources</u></p> <p><u>Per Office of the Public Auditor</u> Criteria - Section 3-301(1)(a) of PSS procurement regulations states that contracts will be awarded only to responsible bidders. One factor to be considered is that the bidder has adequate financial resources to be able to complete the project. Also, section 13 of the PSS contract provides that contracts will not be awarded until after investigation of the responsibility of the low bidder.</p> <p>Condition - Prior to the contract award, PSS's Procurement and Supply officer informed the Commissioner of Education that the contractor would not be able to perform the contract without obtaining bank financing and credit from suppliers. The contractor's financial statements at this time clearly indicated that the contractor did not have adequate resources to perform the project.</p> <p>Pages 13-14</p>	<p>In this paragraph, PSS agreed that it will reduce the scope of work and rebid a project if it exceeds available funding, which is the main point of OPA's discussion. Previously, PSS said it disagreed with our findings. It is ironic that PSS refuses to acknowledge its mistakes but will follow our suggestions.</p> <p>PSS violated Section 3-102(9)(c) of the PSSPR which allows negotiation with the lowest responsive bidder only when the bid price does not exceed available funds by 5%.</p> <p>Further, PSS management failed to exercise prudent judgment when it solicited bids for the project that was estimated to cost \$2.9 million when it had available funding of only \$1.21 million, and (2) did not scale down the project's specifications and rebid the contract when the lowest bid of \$1.918 million exceeded available funds by \$708,000 or by more than 58%.</p> <p>Contractor Had No Adequate Financial Resources (See pages 14 - 16 of the draft report)</p> <p>Under Section 3-301 (1)(a) of the PSS procurement regulations, awards shall be made only to responsible bidders. One of the factors to be considered for determining a responsible bidder is that the contractor should have adequate financial resources to perform the contract or the ability to obtain them. Section 13 of the contract specifications also provides that award of the contract will not be made until after necessary investigation into the responsibility of the low bidder.</p> <p>At the onset, there were already indications that B & R, the contractor who was awarded the gym contract, had inadequate financial capability to finance the project. Before the award, in a November 24, 1992 memorandum to the COE, the PSS Procurement and Supply Officer (PSO) concluded that B & R had a limited amount of cash and might not be able to perform the scope of work unless it obtained lines of credits from banks and suppliers. Our own review of B& R's financial statements showed that as of September 1992, cash on hand amounted only to</p>

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<p>Cause - Unknown</p> <p>Effect - Because of the financial condition of the contractor, PSS had to pay certain suppliers directly. Most importantly, the procurement of the steel building was delayed for several months because of the contractor's inability to come up with a down payment for the building.</p> <p>Recommendation - See finding no. 1 above.</p>	<p>\$10,775 while the book value of its equipment was only \$6,126. Working capital ratio (current assets vs. current liability) was also not favorable at 1.07:1 (ideally, the ratio should be 2:1 or \$2 of assets for every \$1 of liability). It was clear that B & R could not finance a \$1.21 million contract on its own.</p> <p>On December 1, 1992, PSS required B & R to submit additional information including a letter from its bank outlining the relationship, types and size of accounts, with particular attention to B & R's line of credit. B & R responded to this requirement by submitting (1) copy of a letter from an insurance company stating that B & R's credit line had been approved; (2) memorandum from the proprietor of a group of companies involved in the construction business stating that a credit line had been approved to provide materials and equipment to B & R; (This was later not honored by the companies) (3) certification letter from a financing company that B & R had a credit application for \$200,000 which at the time was still subject to approval; and (4) B & R's letter to PSS claiming that B & R had obtained a commitment from a bank to provide a \$300,000 line of credit upon approval of the MHS contract. Instead of requiring B & R to submit an approved line of credit from a bank, PSS relied on the credit application and B & R's claims. As PSS later found out, B & R was refused credit by the banks.</p> <p>During the construction period, there were also numerous instances evidencing that the contractor could no longer complete the project due to lack of financial resources. PSS, however, failed to terminate the contract despite these conditions:</p> <ul style="list-style-type: none"> • As early as January 6, 1994, the COE was provided a copy of a letter from the bonding company to B & R stating its failure to pay the balance of the insurance premium. • On May 26, 1994, Entech advised B & R to clarify its financial situation in order to expedite the procurement of the steel building which had been causing tremendous delay for the project. • In a June 20, 1994 meeting with PSS, B & R admitted its financial difficulties and requested time extension to complete the project. B & R said that its lines of credit with suppliers were not honored. PSS recommended that B & R secure lines of credit with banks and other suppliers. • On July 6, 1994, Entech informed the COE that B & R efforts to secure a line of credit with a local bank were not successful. • On August 5, 1994, Entech informed the COE that the \$50,000 check paid by B & R for the steel building was not

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<p>PER PSS Auditee Response/Corrective Action Plan -We disagree with the finding. The contractor was able to secure performance and payment bonds from an insurance company. The insurance company has strict requirements that contractors must comply with in order to secure bonding. PSS felt secure that the project would be completed and that the contractor would pay their vendors because of the bonds that were issued.</p> <p>Page 15</p>	<p>honored by the bank. Entech also said that B & R was not pursuing its application for a line of credit with another bank (Note: the steel building was subsequently paid for by assigning part of the contract payments to the vendor).</p> <ul style="list-style-type: none"> On September 29, 1994, Entech informed the COE that B & R had failed to cure the deficiencies causing slippage and delays of the project. The deficiencies included B & R's failure to submit proof of lines of credit from banks or suppliers. On January 23, 1995, B & R's bonding company provided the COE a copy of its final demand letter to the contractor for its failure to settle its obligations (amounting to \$79,800). On March 19, 1996, B & R informed PSS that all future payments should be made to its bonding company until the amount it owed had been fully paid (In a March 11, 1997 interview of the bonding company's representative, we were informed that B & R still had outstanding balances for bonding insurance). On February 2, 1995, B & R informed PSS that all future payments were to be made to "B & R and Sablan Enterprises" because of an assignment agreement for the supply of materials for the project. On March 1, 1996, B & R granted a Special Power of Attorney to CCI which included the authority to "collect and receive" all payments from the MHS project (Apparently, this was in connection with the January 10, 1996 memorandum of agreement between B & R and CCI to help B & R finish the construction of the MHS gym.) <p>At this point, B & R had already directed PSS to remit future payments to three separate companies. As the above information clearly showed, B & R had no financial capability to complete the project.</p> <p>The point of OPA's discussion is that there was a preponderance of evidence showing that the contractor had no adequate financial resources before the award of the contract and during the construction period. The lack of financial capability of the contractor led to numerous delays in completing the project. Yet, PSS chose to ignore the evidence and failed to terminate the contract.</p>

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<p>PSS relied on the documents provided by the contractor in deciding to award this contract. The documents included credit line approval for the materials and equipment needed for the job. Given the large mobilization payment of over \$70,000, PSS concluded that the contractor should be able to pay their employees from progress billing collections, and should be able to meet their obligations to the insurance company and the materials supplier as the job progressed. PSS does not believe that a contractor must have significant amount of cash on hand in order to successfully complete a project. The fact that the contractor was able to secure credit, and the fact that performance and payment bonds were issued, was sufficient for PSS to feel secure in their decision.</p> <p>PSS strives to review the financial statements of all contractors submitting bids on PSS projects. In future bid situations, PSS will ensure that adequate documentation for credit lines is obtained.</p> <p>ATTACHMENTS</p> <p>Example of requirements to obtain bonding October 1, 1992 letter to B&R requesting additional documents B&R financial statements for 9/30/92, 12/31/91 and 12/31/90 B&R BGRT returns for Sept. 1991 to June 1992 December 1, 1992, letter to B&R requesting further documentation December 14, 1992 letter from B&R acknowledging PSS request December 17, 1992 letter from B&R providing further documentation. B&R's submission to meet requirements 3,4,5,8,10 and 11 Letter from JTS insurance granting credit for bonding premiums Letter from J&G Group granting credit for materials and equipment</p> <p>Pages 15-16</p>	<p>As discussed in the draft report, the contractor had only \$10,775 cash in bank while the book value of its equipment was only \$6,126. These were the only available resources it had to construct a \$1.21 million project. Securing bonding coverage alone is not sufficient to award a contract. PSS should consider other factors limiting the financial capability of the contractor to complete the project. For example, the contractor had to obtain lines of credit for the purchase of materials and equipment as well as for bonding coverage. PSS, however, failed to analyze the impact of the contractor's overextending its credit lines. Consequently, there came a point in time when the contractor had to direct PSS to remit all of its future collections to three separate companies.</p> <p>Relying on the supplier's line of credit was a mistake because the supplier eventually refused to extend credit to the contractor. PSS should have insisted on a secured line of credit from a bank (which the contractor failed to provide because it was refused credit by banks). PSS should also be aware that most suppliers will promise to extend credit because this will mean additional business to the suppliers. Payment for the bonding premiums also posed a problem for the contractor when it failed to pay the balance of the insurance premiums.</p> <p>During the construction period, there were also numerous instances evidencing that the contractor may not be able to complete the project. These instances were documented on pages 15 - 16 of the draft report.</p>

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<p>Finding No. 3 - Premature Release of Retention to Contractor</p> <p><u>Per Office of the Public Auditor</u> Criteria - Section 7 of PSS's contract specifications states that, in making progress payments, there shall be retained 10 percent of the estimated amount until final completion and acceptance of the contract work. However, if the contracting officer, at any time after 50 percent of the work has been completed, finds that satisfactory progress is being made, he may authorize any of the remaining progress payments to be made in full. Also, whenever the work is substantially complete, the contracting officer, if he considers the amount retained to be in excess of the amount adequate for the protection of the government, at his discretion may release to the contractor all or a portion of such excess amount.</p> <p>Condition - PSS refunded more than \$68,000 of retention, despite the fact that the project was not substantially complete, was not more than 50 percent complete, and had already been stopped.</p> <p>Cause - PSS CIP personnel misinterpreted the section of the contract dealing with retention.</p> <p>Effect - More than \$68,000 was released to the contractor improperly.</p> <p>Recommendation - See finding no. 1 above.</p>	<p>Improper Refunding of Retention Amounts (See pages 16 - 17 of the draft report)</p> <p>General provision 7 of the contract specifications states in part that in making progress payments, there shall be retained 10 percent of the estimated amount until final completion and acceptance of the contract work. However, if the contracting officer, at any time after 50 percent of the work has been completed, finds that satisfactory progress is being made, he may authorize any of the remaining progress payments to be made in full. Also, whenever the work is substantially complete, the contracting officer, if he considers the amount retained to be in excess of the amount adequate for the protection of the government, at his discretion may release to the contractor all or a portion of such excess amount.</p> <p>Our audit showed that, despite issuance of a stop work order and awareness of the contractor's unsatisfactory performance, PSS irresponsibly refunded more than \$68,000 of amounts retained from progress payments.</p> <p>This occurred because of negligence on the part of PSS officials who were very much aware of the imminent failure to complete the project.</p> <ul style="list-style-type: none"> • On April 24, 1996, the COE amended the completion date of the project from April 13, 1996 to May 25, 1996. In the same letter, B & R was again requested to address its deficiencies (e.g. failure to submit additional performance and payment bonds, increase its manpower on the project, etc...). • Several days after extending the completion date, the COE issued a stop work order on May 8, 1995 pending "additional architectural and engineering review" of the project. • On May 10, 1996, the Special Assistant for CIP recommended the payment of 40% of the outstanding retention amount citing the provisions of the contract specifications. B & R was subsequently paid \$40,053 despite its unsatisfactory performance. • On November 26, 1996, B & R billed PSS for \$28,391 representing 50% of the remaining balance of the retention amount. At this time, negotiations were already ongoing to finalize B & R's exit from the project. PSS, however, approved B & R's request and paid the contractor at the recommendation of the PSS Facility Specialist, who explained that it was appropriate to pay the contractor because there was still

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<p>PER PSS Auditee Response/Corrective Action Plan - We disagree with the finding with respect to the \$40,000 payment in May 1996. Under the standard contract, PSS must retain at least 50% of the retention. Since this contract was for \$1.21 million, the required retention is \$60,000. The contractor's progress billing submitted at the point in time was for just over \$1.0 million. The appropriate retention at that point would be \$100,000. Since PSS is required to retain at least \$60,000, it was not necessarily improper to release the difference (\$100,000 - \$60,000 = \$40,000). The two criteria that must be met to release retention are that the project is at least 50% complete, and progress on the job is satisfactory.</p> <p>At the time of the release of this retention, which was shortly after the stop work order, the project was 71.7% billed, 69.4% paid, and approximately 64.5% physically complete. The fact that a stop work order was issued is not an indication that progress was unsatisfactory. In a letter from an independent engineer dated April 24, 1996, work stoppage was recommended not because of faulty installation. The stoppage was recommended due to concerns about the suitability of the steel structure.</p>	<p>\$30,000 left. (Our review showed that B & R's computation of the 50% of the remaining balance was erroneous. The correct amount should have been \$30,039 or 50% of \$60,079. Thus, the balance of the retention amount after the payment was \$31,688).</p> <p>Instead of protecting the agency's interest, PSS officials sided with the contractor and refunded the retention amounts in violation of contract specifications. Consequently, PSS is left with limited funds to cover damages arising from the contractor's failure to complete the project.</p> <p>There was an abundance of evidence showing unsatisfactory performance of the contractor and its incapability to complete the project. It is incredible that PSS chose to ignore such evidence. At the time the \$40,000 retention was released, the following are some of the facts available to PSS:</p> <ol style="list-style-type: none"> 1. The construction project had been repeatedly delayed by the contractor for more than two years. 2. Several professional firms and individuals had already informed PSS of the poor quality of the construction work. These included Entech, the original construction manager for the project (See discussions on pages 8 to 9 of the draft report). 3. The contractor was financially incapable of completing the project. The contractor had previously requested PSS to remit all future collections to at least three other companies to whom the contractor owed money (See discussions on pages 14 to 16 of the draft report). 4. A stop work order was issued to the contractor. <p>The Commissioner issued the stop work order on May 8, 1996 pending "additional architectural and engineering review." A review of the April 24, 1996 report by the independent engineer showed a number of findings which required additional work by the contractor. For example, the report stated "Defective concrete - on our field investigation, the existing concrete pedestals...does not meet the required design strength. The contractor must demolish the pedestals up to the footing, clean all reinforcement and re-cast. All pedestals must be checked if the concrete meets the required strength..."</p> <p>It should also be noted that the percentage of completion claimed by PSS was based on the contractor's report. There was no reliable report on the actual progress of the contractor because there was no independent construction manager (i.e., the construction manager's contract had expired and was not renewed by PSS). On the other hand, the PSS CIP Coordinator, who supposedly made daily inspection of the project, did not prepare monthly status reports on the progress of the project.</p>

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<p>Once again, the reliability of the work product produced by the Public Auditor's office must be questioned. Had your staff fully understood the relevant provisions and asked the right questions, they would have come to the same conclusion.</p> <p>We agree with the finding with respect to the \$28,000 payment in December. The contractor was paid this retention in a good faith effort to continue the project and expedite its completion. The contractor had cash flow difficulties. PSS thought that releasing the retention would ease the contractor's problems and allow them to continue their work uninterrupted. The contractor had obligations to meet during the stop work period. PSS realized that releasing the retention would enable the contractor to avoid labor payment problems and therefore would allow them to continue their work uninterrupted. There was no indication that the contractor would be unable to complete the project at the time the retention was paid.</p> <p>We will ensure that CIP and Fiscal and Budget personnel all review section 7 of the contract dealing with retention. We will only release retention in accordance with section 7 of the contract.</p> <p>ATTACHMENTS</p> <p>Billing from B&R and approval for release of \$40,198.06 retention. Billing from B&R and approval for release of \$28,391.05 retention</p> <p><u>Finding No. 4 - Inadequate Performance Monitoring or Inspection of Project and Progress Billing/Payment Request</u></p> <p>Per Office of the Public Auditor Criteria - To ensure that contractors complete their projects in accordance with the contract specifications, there must be monitoring of the contractor's progress. If an entity such as PSS does not have a construction manager, the entity may contract out the work or may request these services from the Department of Public Works.</p> <p>Pages 18-20</p>	<p>PSS chose to ignore evidence of the contractor's unsatisfactory work and incapability to complete the project. The purpose of retention is to protect the government. This amount should not be released unless there is adequate assurance of the completion of the project. The fact that the project was significantly delayed, the contractor's work was defective, and the contractor was financially incapable of continuing the project, should have been enough to deny the release of the retention.</p> <p>PSS stubbornly claims that there was no indication that the contractor would be unable to complete the project at the time the retention was paid. PSS, however, acknowledged that the contractor had cash flow difficulties. It is difficult to believe that PSS still thinks that the contractor can complete the project despite its "cash flow" problems.</p> <p>The truth is when the \$28,000 retention was paid in December 1996, PSS was already aware that the contractor was planning to pull out of the project as early as November 1996. The Commissioner was informed that B&R wished to terminate involvement in the construction project through several memos issued by the PSS Facility Specialist (memos dated November 18 and 19, 1996).</p> <p>We can only conclude that, instead of protecting the agency's interest, PSS officials sided with the contractor and refunded the retention amounts in violation of contract specifications. Consequently, PSS is left with limited funds to cover damages arising from the contractor's possible failure to complete the project. This possible failure, of course, is now a fact.</p> <p>Contractor's Performance and Billings Not Adequately Monitored (See pages 17 - 18 of the draft report)</p> <p>To ensure that a construction project is completed in accordance with the contract specifications, there is need for a construction manager to monitor and review the status of a project continuously. For government agencies without a full-time construction manager such as PSS, construction management services can be contracted out or requested from the Department of Public Works.</p> <p>Our audit showed that the construction management services being provided by Entech for the MHS project stopped when its contract ended on August 30, 1994. At the time, the project was only 21.05% complete. Instead of renewing the contract or</p>

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<p>Condition - PSS allowed the contract of the construction manager to lapse, when the project was barely 20% complete. PSS did not request the assistance of the Department of Public Works to monitor the project.</p> <p>Cause - PSS did not have funds available to continue to pay for the independent construction manager.</p> <p>Effect - The project was not completed in a timely manner. The quality of the work performed was substandard. The contractor has been overpaid based on the percentage of completion actually performed. Much of the work that has been completed will have to be either reworked or destroyed and constructed anew.</p> <p>Recommendation - See finding no. 1 above.</p>	<p>seeking technical assistance from DPW, PSS relied on its CIP Coordinator to monitor the contractor's accomplishment and review progress billings. On April 5, 1995, the CIP Coordinator issued a memo stating that, "from now on, the CIP coordinator will not prepare an inspection report to accompany the progress payment request submitted by B & R." According to the CIP Coordinator, his signature shown in the application for payment was sufficient to ensure that the application was correct. The CIP Coordinator certified \$569,978 out of the \$969,631 payments to B & R.</p> <p>The lack of professional construction management services plus the absence of inspection/progress reports from the CIP coordinator could have resulted in possible overpayments to the contractor as well as construction deficiencies. Several reports and documents obtained from third parties supported these conclusions.</p> <ul style="list-style-type: none"> • An October 5, 1995 report by a professional architect stated that the project was found to be only about 20% complete and workmanship was very poor. • Another October 5, 1995 report by an architectural firm stated that the quality of work was extremely poor and appeared to have been completed with little supervision and inspection. • In February 15 and 20, 1996 letter responses to an inquiry of the COE, Entech reported that the construction work appeared to have been performed by unskilled and untrained workers managed by an inexperienced contractor without any full-time supervision and inspection. <p>Further, an evaluation of the status of the project as of December 1995 by CCI, the former construction partner of B & R, noted that the project was about 40% complete. CCI added that approximately 12%, however, needed to be reworked. Therefore, the project's acceptable completion percentage was calculated to be 28%. The evaluation report further stated that, based on examination of B & R's records and the actual work performed and billed, an approximate sum of between \$150,000 to \$200,000 may have been overpaid by PSS. Considering that B & R has already been paid \$969,631 or almost 70% of the contract price, PSS should conduct an independent review of the actual percentage of completion of the project and determine if overpayments were made.</p>

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<p>PER PSS Auditee Response/Corrective Action Plan - We agree with the finding with respect to the independent construction manager. The construction manager's contract was allowed to lapse, as available funds had not been identified.</p> <p>We disagree with the finding with respect to our monitoring of the project and certification of progress billings. PSS CIP personnel monitored the project on a daily basis. This monitoring included certification of payment requests after physical inspection of project completion, review of materials submittals, witnessing field-testing, review of contractor correspondence files, and preparation of daily reports. Attached you will find several examples of our inspection reports and documentation of our review of progress billings. The entire file containing these types of documents has always been available at our office. Apparently your staff auditor did not ask for these documents, did not review them fully, or simply disregarded the physical evidence available.</p> <p>Once again, it appears that the work of the Public Auditor's office was incomplete. These inspection reports and progress billing reviews were readily available during your audit. We don't know how you failed to consider these documents or how you reached your conclusions.</p> <p>PSS also sought the assistance of the Building Safety Office and the Department of Public Works. There is an attached letter dated June 27, 1994 along these lines. PSS tried to secure construction management services from the Department of Public Works after funding for Entech lapsed. DPW had difficulty monitoring the project, since they were also responsible for managing consolidated CIP pursuant to Public Law 9-1.</p> <p>As far as the quality of the work, we believe that physical testing should be performed before any demolition is approved. These areas of testing should be consistent with the independent assessment of DPW's structural engineer.</p> <p>ATTACHMENTS</p> <p>List of contract payments prepared by Herman Cabrera Example of review of progress billing Example progress billing, with adjustments by PSS CIP personnel June 27, 1994 letter requesting assistance & funding from DPW Example of filed testing reports & materials submission</p> <p>Pages 20-22</p>	<p>Contrary to PSS claims, the available evidence showed that the contractor's performance and billings were not adequately monitored:</p> <ol style="list-style-type: none"> 1. The PSS CIP Coordinator issued a memo on April 5, 1995 stating that "from now on, the CIP coordinator will not prepare an inspection report to accompany the progress payment request submitted by B & R" (See pages 17 - 18 of the draft report). 2. The inspection reports cited by PSS as examples were prepared before the CIP Coordinator issued the above April 5, 1995 memo. There were no inspection reports prepared after that date. Further, we found only two such reports prepared by the CIP coordinator. Unlike the progress reports prepared by Entech, however, the reports prepared by the CIP coordinator did not describe the contractor's performance and status of work compared to the project's schedule or time table. The reports only indicated the percentage of completion for payment purposes. 3. Documents from the contractor, a private construction firm (Core Construction, Inc - CCI), a private engineering firm (HK Pangelinan), and DPW all showed that the construction work was defective (See pages 8 to 10 of the draft report). The CIP Coordinator never reported these deficiencies. Furthermore, the private construction firm noted that as of September 12, 1996, the project was about 40% complete. CCI added that approximately 12%, however, needed to be reworked. Therefore, the project's acceptable completion percentage was calculated to be 28%. The evaluation report further stated that, based on examination of B & R's records and the actual work performed and billed, an approximate sum of between \$150,000 to \$200,000 may have been overpaid by PSS (See page 18 of the draft report). 4. OPA repeatedly requested all inspection and monitoring documents from the CIP Coordinator both orally and in writing. OPA even prepared a formal letter dated January 1, 1997 requesting these documents from the CIP Coordinator. Therefore, PSS statements claiming that we did not ask for these documents were, of course, incorrect. 5. The "daily inspection" reports which PSS is now submitting to OPA were not useful for monitoring the project and were not the documents we were looking for. What those daily inspection reports showed were the time in/out of the PSS coordinator in the construction site, the number of contractor's employees and the description of the construction work

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<p><u>Finding No. 5 - Lack of Time Extension on Performance and Payment Bond</u></p> <p>Per Office of the Public Auditor Criteria - Section 4-101 of the PSS procurement regulations provides that, for contracts in excess of \$25,000, contractors are required to deliver performance and payment bonds equal to 100% of the contract price to protect PSS from possible losses arising from nonperformance or nonpayment.</p> <p>Condition - The project deadline was extended at least four times. PSS did not ensure that the contractor was protected by performance and payment bonds during the extended periods.</p> <p>Cause - PSS allowed the contractor to work on the project without obtaining proper documentation from the contractor that bonding was in place. It does appear that it was difficult to get the contractor to produce this documentation, despite repeated requests.</p> <p>Effect - PSS unnecessarily subjected itself to the risk that the contractor would not complete the work or would not pay all of its creditors, thus forcing PSS to expend additional funds to complete the project.</p> <p>Recommendation - See finding no. 1 above.</p> <p>Page 23</p>	<p>for the day. What was important and missing in the reports were the description of the contractor’s performance and the status of the project compared with the project schedule/time table. The reports submitted by Entech which accompanied payment requests of the contractor contained such information. We also noted that not one of the “daily inspection” reports was signed or acknowledged by the contractor and no one from PSS appears to have reviewed any of them.</p> <p>6. There were also other documents evidencing the lack of proper monitoring of the project (These were pointed out on page 18 of the draft report). For example, Entech, the former construction manager, informed the Commissioner on February 15 and 20, 1996 that the construction work appeared to have been performed by unskilled and untrained workers managed by an inexperienced contractor without any full-time supervision and inspection.</p> <p>Contractor Allowed to Continue Work Without First Securing Extension of Performance and Payment Bond Coverage (See pages 18 - 20 of the draft report)</p> <p>Section 4-101 of the PSS procurement regulations provides that for contracts in excess of \$25,000, contractors are required to deliver performance and payment bonds equal to 100% of the contract price to protect PSS from possible losses arising from nonperformance or noncompletion of work. General provision 16 of the contract specifications also states that additional performance and payment bond protection shall be furnished by the contractor in any contract modification for new or additional work or a 25% increase in contract price.</p> <p>Our audit showed that the project’s completion date was extended at least four times. PSS, however, allowed B & R to continue working on the project without first ensuring that the bonding coverage for the project had been extended.</p> <ul style="list-style-type: none"> On February 6, 1995, four months after the passage of the original completion date of September 29, 1994, B & R finally submitted to PSS a copy of the insurance policy extending the bonding coverage for the MHS gym contract. On February 13, 1995, PSS granted B & R a 212 calendar day extension up to September 10, 1995. On October 5, 1995, PSS granted a change order to B & R which requires extension of the completion date by 223.5 calendar days upto April 24, 1996. The change order was granted without B & R’s extending the bonding coverage. Instead, B & R was required to fulfill several conditions under

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	<p>the change order. One of the conditions was the submission of additional performance and payment bonds.</p> <ul style="list-style-type: none"> On November 29, 1995, PSS instructed B & R to address several issues which included submission of a "new extended performance bond per change order." On February 12, 1996, the COE demanded that B & R submit "proof of bonding compliance." On April 24, 1996, almost two weeks after the passage of the completion date of April 13, 1996, the COE again extended the completion date to May 25, 1996. The COE reminded B & R to submit additional performance and payment bonds. On May 8, 1996, the COE issued a stop work order to B & R. <p>Based on available information gathered from the bonding company and the contractor, the performance and payment bonds were extended after the completion dates as follows:</p> <table border="1"> <thead> <tr> <th><u>Completion Dates</u></th> <th><u>Extension Dates</u></th> <th><u>Extended After</u></th> <th><u>Bonding Coverage</u></th> </tr> </thead> <tbody> <tr> <td>09/29/94</td> <td>02/07/95</td> <td>4 months</td> <td>09/09/94 to 08/08/95</td> </tr> <tr> <td>09/10/95</td> <td>11/08/95</td> <td>2 months</td> <td>09/11/95 to 04/13/96</td> </tr> <tr> <td>04/13/96</td> <td>04/14/96</td> <td>1 day</td> <td>04/14/96 to 05/05/96</td> </tr> <tr> <td>05/25/96</td> <td>-</td> <td>-</td> <td>-</td> </tr> </tbody> </table> <p>PSS should have required the contractor to extend the bonding coverage several weeks before the completion dates. The failure of the contractor to take action should then have prompted PSS to immediately terminate the contract for default so the bonding company could be held responsible for completing the project. Instead, PSS allowed B & R to continue working on the project and even extended the project's completion dates without first ensuring that the bonding requirements were first met. Because of the negligence of its officials, PSS was left "holding the bag" because the project had no insurance when the contractor pulled out of the project.</p> <p>Further investigation also showed that the contractor still owed the bonding company \$49,175, the amount equivalent to the insurance premiums for the last two extensions of the bonding coverage and a partial amount for the first extension. As previously discussed, the contractor was simply financially incapable of payment. Consequently, there was also no assurance that the bonding company would have honored the insurance coverage, had PSS chosen to terminate the project during the extension periods, because of the lack of payments.</p>	<u>Completion Dates</u>	<u>Extension Dates</u>	<u>Extended After</u>	<u>Bonding Coverage</u>	09/29/94	02/07/95	4 months	09/09/94 to 08/08/95	09/10/95	11/08/95	2 months	09/11/95 to 04/13/96	04/13/96	04/14/96	1 day	04/14/96 to 05/05/96	05/25/96	-	-	-
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<p>PER PSS Auditee Response/Corrective Action Plan - We totally disagree with the finding. General provision #16 in the standard PSS contract requires additional performance and payment bond protection only if there is a contract modification for new or additional work or a 25% increase in contract price. PSS believes that the contractor is required to provide a performance and payment bond equal to the contract price.</p> <p>Your report states that there are at least four time extensions. In fact, only two time extensions were granted - one from September 29, 1994 to September 10, 1995 and one from September 11, 1995 to May 25, 1996. There was a correction of the notice to proceed date from August 23, 1993 to October 5, 1993. This was not an extension.</p> <p>Page 24</p>	<p>This finding and our discussion were not about securing additional coverage. They were about the failure of PSS to require the contractor to extend the bonding coverage before the expected completion date and during the stop work order period. PSS should have acted and held the bonding company responsible before the coverage expired. Because of the negligence of PSS officials, PSS can no longer pursue the bonding company. This is the fact, and we seriously doubt if PSS can still recover from the bonding company.</p> <p>Again, PSS "facts" were simply incorrect. Available documents showed that the contractor was granted at least four time extensions as follows:</p> <ol style="list-style-type: none"> 1. On September 10, 1993, the contractor requested a time extension to comply with bonding requirements. On September 15, 1993, the Commissioner granted 10 working days from the date of his letter. On May 10, 1994, the contractor argued that the start date should be changed to October 6, 1993 because he received the extension letter from the Commissioner on September 21, 1993. The contractor also argued that the number of calendar days to complete the project should be changed from 300 days (as shown in the contract) to 360 days per notice to proceed letter (This is despite the fact that the contractor's scope of work was supposedly reduced). The Commissioner requested everyone to concur on the time extensions in a meeting dated August 22, 1994. Although these events could be considered two separate time extensions, we conservatively counted them as one time extension since they were approved at the same time (i.e., 8/22/94). A total of 123 days was granted for this first time extension. 2. Three days before the expected completion date of September 29, 1994, the contractor, on September 26, 1994, requested an additional six to eight months time extension for a variety of reasons ranging from uncertainty of scope of work to discrepancies in drawings and specifications. On February 13, 1995, the Commissioner granted a 212 day time extension up to September 10, 1995. 3. Ten days after the expected completion date of September 10, 1995, the contractor on September 20, 1995 requested another six months extension because the gymnasium plan was "incomplete and filled with errors," revisions were made by PSS, pending change orders, etc... On October 5, 1995, the Commissioner granted a 223.5 day extension up to April 13, 1996.

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<p>The language included in the performance and payment bonds issued for this contract reads as follows:</p> <p><u>Performance Bond</u> "...if the Principal shall: (a) perform and fulfill all the undertakings, covenants, terms, conditions, and agreements of said contract during the original term of said contract and any extensions thereof that may be granted by the Government, with or without notice to the Surety(ies)...then the above obligations shall be void and of no effect."</p> <p><u>Payment Bond</u> "...if the Principal shall promptly make payment to all persons supplying labor and material in the prosecution of the work provided for in said contract, and any and all duly authorized modifications of said contract that may hereafter be made, notice of which modifications to the Surety(ies) being hereby waived, then the above obligation shall be void and of no effect."</p> <p>Based on the above wording, it is PSS's opinion that additional bonding was not needed beyond the original bonds issued. PSS is therefore covered for the full contract amount throughout the life of the project, including extensions.</p> <p>Pages 24-25</p>	<p>4. One day after the expected completion date of April 15, 1996, the contractor on April 14, 1996 requested another time extension up to May 24, 1996. The contractor argued that the 223.5 days should have started from the date it signed the change order on October 16, 1995. In addition, the contractor requested additional time extensions for inclement weather, faulty design and specifications, etc...On April 24, 1995, the Commissioner granted a time extension up to May 25, 1996.</p> <p>The above evidence proved that the contractor was granted at least four time extensions. Of course, we all know that before the expected completion date of May 25, 1996, the Commissioner issued a stop work order on May 8, 1996 effectively postponing the completion date for the project.</p> <p>PSS misunderstood the above provisions. These provisions were for the protection of the surety (i.e., bonding company), not the owner of the project (i.e., PSS). They simply mean that if the principal (i.e., contractor) performed or complied with all contract requirements within the contract period or any extensions thereof, then the surety would be free from any liability (take note of the wordings - "then the above obligations (referring to the surety bonds) shall be void and of no effect").</p>

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<p>There does seem to be some misunderstanding about the coverage provided by the bonds. From the above excerpts, it is clear that the original bonds issued should cover the contractor through the completion of the project, including time extensions.</p> <p>What is not clear is why the bonding company demanded additional premiums from the contractor and did not inform the contractor that additional bonding was not necessary. We have asked our legal counsel to give us an opinion on this matter. We may have some recourse against the insurance company.</p> <p>We also verified our understanding with the President of the CNMI Insurance Association. He stated that additional premiums should not be charged if the extensions were simply extensions of time granted by the project owner. He also stated that the original bonds would suffice to provide coverage through the project period, including extensions.</p> <p>We do believe that, if your auditor had read the bonds and understood the language contained therein, he or she would have noticed this problem and would have advised us accordingly. We must once again call into question the reliability of the work product produced by the Public Auditor's office.</p> <p>ATTACHMENTS</p> <p>January 31, 1996 letter from JTS Insurance extending the bonding October 8, 1993 letter from B&R transmitting the bonds for the project March 19, 1996 letter from B&R assigning payment for the bonds July 1 1, 1994 letter from Entech regarding amendment of number of days.</p> <p>Pages 25-26</p>	<p>There is no misunderstanding. Had PSS reviewed these provisions carefully, it would have found out that these were included only to limit the liability of the surety or bonding company.</p> <p>The additional premiums were required because the period of coverage had expired and PSS agreed with the time extensions. If PSS had not agreed with the time extensions, it could have declared the contractor in default and pursued the bonding company. The bonding company would then be required to complete the contract during the extended period. Had PSS declared default, then no additional insurance premiums would have been required to be pay for an extension.</p> <p>According to the Insurance Commissioner, the period for which a performance or payment bond is valid will vary according to the terms of the related contract. There is no doubt that the bonding company for the MHS project limited the validity of its bonds to the contract period indicated on the face of the policy. That's why they charged additional premiums for time extensions agreed upon by PSS and the contractor. This is also true for most of the major insurance companies offering bonding services in the CNMI. We made inquiries of five major insurance companies. Four of the five companies said that bonding coverage is effective only for the duration of a project as stated in the policies. Any extensions thereof will require review and approval by the bonding company and additional premiums will be definitely be charged (the fifth company said that they have to check with their Guam office on the matter).</p> <p>It is clear that it is PSS who should have closely read the language of the bonds. At any rate, this issue is not the main point of our discussion. Before getting sidetracked, we want to emphasize that the finding was all about the failure of PSS to require the contractor to extend the bonding coverage before the expected completion date and during the stop work order period. PSS should have acted and held the bonding company responsible before the coverage expired. Because of the negligence of PSS officials, PSS can no longer pursue the bonding company.</p>

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<p><u>Finding No. 6 - Inappropriate Issuance of Stop, Work Order Instead of Default Termination</u></p> <p>Per Office of the Public Auditor Criteria - Section 8 of the PSS standard construction contract specifies that the chief construction officer may require the contractor to stop all or any part of the work called for by the contract. This stop work order must be in writing, and does not require notice to the surety.</p> <p>Section 12 of the PSS standard construction contract allows PSS to terminate the contractor's right to proceed with the contract, if the contractor fails to perform or comply with any provisions of the contract in a timely manner, and does not cure the deficiency within 10 days after written notice of the delay or nonperformance.</p> <p>Condition - PSS issued a stop work order, even though it appeared that the contractor would not be able to complete the project. This action favors the contractor, because it effectively extends the deadline for the project without penalty to the contractor.</p> <p>Cause - PSS apparently intended to perform "architectural and engineering" reviews of the project before taking further action. PSS did not properly monitor the progress on the contract.</p> <p>Effect - As stated above, the stop work order delays the project without penalty to the contractor. Further, failure to terminate the contract prevents PSS from holding the contractor liable for any excess cost of completing the project.</p> <p>Recommendation - See finding no. 1 above.</p> <p><u>PER PSS</u> Auditee Response/Corrective Action Plan - We disagree with the finding. A brief history of events would be appropriate here.</p> <p>Pages 26-28</p>	<p>Issuance of Stop Work Order Instead of Terminating Contractor For Default (See pages 20 - 21 of the draft report)</p> <p>Under Section 8 of the PSS standard construction contract, the chief procurement officer may, by written order to the contractor at any time and without notice to any surety, require the contractor to stop all or any part of the work called for by the contract.</p> <p>Under Section 12 of the PSS standard construction contract, if the contractor fails to perform or comply with any provisions of the contract in a timely manner, PSS may notify the contractor in writing of the delay or nonperformance and if not cured within 10 days, PSS may terminate the contractor's right to proceed with the contract. In the event of termination, the contractor shall be held liable for excess costs incurred in completing the contract.</p> <p>Our audit showed that, instead of terminating the contract for default, PSS issued a stop work order when it was already apparent that the contractor would not be able to finish the project by the completion date. This action favored the contractor because the stop work order effectively postponed the deadline for completing the work. The following is a summary of the events leading to the issuance of the stop work order:</p> <ul style="list-style-type: none"> • Almost two weeks after the April 13, 1996 completion date had passed, the COE issued a letter to B & R on April 24, 1996 moving the completion date to May 25, 1996. The COE reminded the contractor to comply with several conditions under the contract requirements. • On April 26, 1996, B & R received \$40,198 from PSS as progress payment. • Less than three weeks before the new completion date of May 25, 1996, the COE issued a stop work order on May 8, 1996 requesting B & R to stop working on the project "pending architectural and engineering review." <p>PSS's issuance of the stop work order was useless since it was already obvious that the contractor had no capability to continue the project. The appropriate action should have been termination of the contract for default so that PSS could hold the contractor liable for any excess cost of completing the project.</p> <p>As shown below, there was no basis for PSS to disagree with the findings.</p>

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<p>In June 1995, PSS approved a change order due to structural deficiencies. This change extended the due date to April 1996.</p> <p>In July 1995, the DPW wrote to PSS regarding "weakly supported" roof beams and slabs.</p> <p>There were a series of letters in October 1995 involving Core Construction, Inc. It is interesting to note that some of these letters were written to officers of Core Construction by themselves or their spouses or other officers of Core Construction. These letters seem to be nothing more than an attempt by Core Construction to market their products. These letters also affect the objectivity of Core Construction with respect to the actual percentage of completion. It would be to Core's benefit to state that the percentage of completion was less than it actually was, so that Core could negotiate for higher fees to complete the project.</p> <p>Page 28</p>	<p>There was no change order approved by PSS in June 1995. Following is the sequence of events in June 1995:</p> <p>On June 13, 1995, the Commissioner of Education gave the contractor five (5) working days to comply with several issues which were contained in his three previous follow-up letter to the contractor (dated February 13, 1995, April 5, 1995, and May 1, 1995). These issues were as follows; (1) contractor should increase manpower, (2) contractor should provide detailed plan of activities, (3) contractor must submit all pending submittals, (4) contractor must provide appropriate and sufficient equipment on a regular and consistent manner, and (5) contractor must require its workers to perform overtime. The Commissioner warned that PSS will exercise its authority under the contract for non-compliance (i.e. a "stop work order" will be issued per February 13, 1995 letter) if the contractor did not comply with the requirements (See summary of transactions on page 11 of the draft report).</p> <p>The five days passed but PSS did not "exercise its authority." On June 23, 1995, the contractor responded to the Commissioner and explained that (1) detailed schedule of activity was available at the job site, (2) change order needs to be approved because of the deletion of the airconditioning system which entailed a change in electrical requirements, (3) overtime work cannot be performed until the necessary change orders are approved. On the same date, the contractor submitted a detailed cost breakdown of proposed change orders.</p> <p>The DPW representative mentioned that "bond beam" is severely underdesigned and recommended it be replaced by a new beam. Entech, the former construction manager, subsequently informed the Commissioner that the beam was not severely underdesigned.</p> <p>The contractor entered into an agreement with Core Construction (CCI) to help finish the construction of the gym. The "series of letters" came about because CCI requested several professional firms to evaluate the status of the project before taking over from the contractor. That is why the letters were addressed to CCI and its officers. By the way, the findings cited in the letters were mainly directed to the "poor quality of construction work" performed by the contractor (See detailed account on page 9 of the draft report). Similar findings were noted by Entech when it informed the Commissioner that "construction work appeared to have been performed by unskilled and untrained workers..."</p> <p>It is interesting to note that during this period, PSS had repeatedly warned and followed up with B&R to speed up construction work (See discussions on page 11 of the draft report). Finally, on September 5, 1995, the COE informed B&R that the project was due on September 10, 1995 and actual accomplishment was only</p>

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<p>In January 1996, the contractor informed PSS that the steel building purchased for the project was not suitable for installation.</p> <p>In February 1996, PSS wrote to the contractor and rejected their position on suitability. PSS sent this letter to an independent engineer for analysis.</p> <p>In March 1996, PSS and DPW agreed that the Entech design would be used with slight modifications for reinforcement purposes.</p> <p>On March 22, 1996, the independent engineer informed PSS that there were inconsistencies in the project drawing and design deficiencies. The independent engineer advised PSS to stop work on the project immediately and to investigate the design and construction deficiencies.</p> <p>It is obvious that there were problems with the design and drawings. The drawings should have been approved by the contractor. It would be highly inappropriate to lay all blame on the contractor, when they effectively had no input into the specifications and design of the structure.</p> <p>Pages 28-29</p>	<p>57.43%. The Commissioner said that the contractor would be assessed liquidated damages of \$500 per day whether or not any request for time extension was granted or denied.</p> <p>On October 5, 1995, despite PSS's knowledge of the contractor's inability to diligently perform its work, the Commissioner again granted a 223.5 calendar day extension to the contractor up to April 13, 1996.</p> <p>Entech, in its communication to the Commissioner dated January 30 and 31, refuted the claims of the contractor that the steel building for the gym could not withstand 155 mph winds. The contractor actually was attempting to cover up the poor quality of its construction work by proposing replacement of the steel building which would require demolishing most of the steel and concrete structure that had already been installed or constructed (See discussion on pages 8 - 10 of the draft report).</p> <p>In a PSS board meeting dated February 16, 1996 attended by PSS officials and the contractor and its partner, the contractor's partner admitted that "he looked at the building with Mr. Juan Sablan from DPW and they came into the conclusion that workmanship was not the greatest and that it was very shoddy."</p> <p>This only proves that the gym was not severely underdesigned. The problem lies mainly in the poor quality of construction work performed by the contractor.</p> <p>The shop drawings for the steel building were, in fact, approved by the contractor per its letter to the steel building manufacturer dated December 21, 1993. It is also important to note that the steel building is the responsibility of the contractor. It is part of the contract specifications. The contractor was given the opportunity to review the design plans before accepting the project. Any errors not apparent from the plans should have been brought up by the contractor at the onset of construction and not when the completion date was near (See discussion on pages 5 - 8 of the draft report).</p> <p>On April 13, 1996, the project completion date passed without any action from the Commissioner. At this point, it was already obvious that the contractor could not fulfill the requirements stipulated in the Commissioner's numerous followup letters (e.g. letters dated February 12, 1996, February 8, 1996, November 29, 1995, October 5, 1995, June 13, 1995, etc...), and there was sufficient evidence showing that the contractor was financially incapable of completing the project. For example, the contractor had already instructed PSS to remit all future collections to at least three other companies to whom the contractor owed money (i.e., bonding company, supplier, and CCI). The Commissioner should have acted responsibly and declared the contractor in default.</p>

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<p>On April 24, 1996, the independent engineer reported on the steel frame and foundation to DPW.</p> <p>On May 8, 1996, PSS issued a stop work order pending A&E review.</p> <p>Our decided course of action was to issue the stop work order so that PSS could review the existing condition of the project and direct any necessary structural and architectural modifications. Our stop work order was executed upon the recommendation from an independent structural engineer, to enable proper consultation with the architect and engineer of record - Entech. This stop work order was instigated by the onslaught of correspondence generated by interested parties and by the 5th Board of Education's concerns based on meetings with the contractor.</p> <p>Given the degree of culpability demonstrated by the many parties involved with the project, there was insufficient justification to single out the contractor for immediate termination. PSS felt that this course of action would most certainly lead to protracted and expensive litigation.</p> <p>Pages 29-30</p>	<p>On April 24, 1996, the independent engineer submitted a report to DPW which was limited to the steel frame portion and foundation only. The results of the structural evaluation of the existing steel rigid frame for the MHS gym showed that the frame did not exceed the allowable limits for bending stress (tension and compression). This means that the building could withstand 155 mph winds contrary to previous claims made by the contractor (This was confirmed by an experienced engineer from the DPW-Building Safety Office who reviewed the structural evaluation of the independent engineer). It is also interesting to note that the same report found that the contractor used defective concrete to construct the concrete pedestals. The engineer recommended that the contractor demolish and replace the pedestals.</p> <p>On the same date, April 24, 1996, the Commissioner again extended the completion date of the project from April 13, 1996 to May 25, 1996. The same letter reiterated that the contractor should (1) submit performance and payment bonds, (2) new progress chart, (3) pending material submittals, and (4) increase manpower from 35 to 40.</p> <p>On May 8, 1996, the Commissioner issued a stop work order "pending additional architectural and engineering review." The contractor was also instructed to clean and prime the "steel structural members."</p> <p>It is interesting to note that, on May 10, 1996, the PSS CIP Specialist recommended refunding 40% of the outstanding retention to the contractor. The contractor was subsequently refunded \$40,053 despite its unsatisfactory performance.</p> <p>A more appropriate course of action was to terminate the contractor for default. Issuance of the stop work order only temporarily postponed the impending failure by the contractor to construct the MHS gym.</p> <p>In addition, contrary to PSS claims, the report of the independent engineer showed that the design of the steel frame structures was not the problem. The problem was the poor quality of installation and construction work performed by the contractor.</p> <p>There was more than compelling evidence to terminate the contractor and such evidence was clearly documented, discussed, and summarized in our report. Among others, PSS should have terminated the contractor for default because of the following reasons; (1) contractor's overall poor performance and slow progress of work, (2) financial incapability of the contractor to complete the project, (3) poor quality of construction work, and (4) failure of the contractor to address construction problems and</p>

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<p>PSS is attempting to remove the contractor from the project without cost and without facing litigation. PSS sought the assistance of the Public Auditor's office in responding to the demands made by the contractor, as more fully discussed below.</p> <p>ATTACHMENTS</p> <p>May 8, 1996 stop work order August 8, 1996 letter to B&R regarding restarting the project April 24, 1996 letter from Henry K. Pangelinan recommending work stoppage January 29, 1996 letter from B&R noting problems with the steel structure February 15, 1996 letter from B&R proposing to finish the project for an additional \$1.69 million Minutes of February 16, 1996 meeting of the Board of Education</p> <p><u>Finding No. 7 - Inappropriate Settlement Agreement Instead of Compensation to PSS for Damages by Contractor</u></p> <p>Per Office of the Public Auditor Criteria - The bid specifications contain a liquidated damages provision for \$500 per work day that the project extends beyond the deadline. Payments to contractors should be based on actual work completed to date.</p> <p>Condition - PSS extended the contract on at least four occasions. These extensions totaled over 500 days. PSS paid the contractor based on the percentage of completion indicated on the progress billings, which appears to be exaggerated. PSS failed to charge liquidated damages to the contractor. PSS prepared a draft settlement agreement that calls for payment of more than \$149,000 to the contractor.</p> <p>Cause - PSS did not properly manage this contract or monitor the contractor's progress on the project. PSS acted in a manner that unduly benefited the contractor to the detriment of PSS.</p> <p>Pages 30-31</p>	<p>deficiencies. Details are presented on pages 3 - 12 of the draft report.</p> <p>Contrary to PSS claims that it was attempting to remove the contractor without cost, the draft settlement agreement with the contractor dated May 9, 1997 showed that PSS would have to pay the contractor more than \$149,000 to "exit" from the project (See page 21 of the draft report).</p> <p>Negotiating Improper Settlement Agreement Instead of Demanding Compensation for Damages (See pages 21 - 22 of the draft report)</p> <p>Under Section 13 (4) of the PSS standard construction contract, if a contract is terminated for convenience, the chief procurement officer and the contractor may agree to a settlement agreement. However, the total sum to be paid to the contractor may not exceed the total contract price plus reasonable settlement costs reduced by payments made, proceeds of any sales, and the contract price of work not completed at termination.</p> <p>Under Section 8 of the PSS standard construction contract, the stop work order issued by the chief procurement officer shall be for a specified period not exceeding ninety (90) days after the order is delivered to the contractor, unless the parties agree to any further period. Before the stop work order expires or within any further period to which the parties shall have agreed, the chief procurement officer shall either (a) cancel the stop work order or (b) terminate the contract for default or for convenience. If the stop work order is canceled, the contractor has the right to resume work on the project.</p> <p>General provision 22 (b) of the contract specifications provides that if the contracting officer unreasonably suspends the work of the contractor, an adjustment shall be made for any increase in the cost of performance of the contract excluding profits. However, no adjustment shall be made for any suspension to the extent that</p>

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<p>Effect - There is no assurance that the project will be completed in a timely manner. Public funds amounting to more than \$969,000 may have been wasted. A significant amount of government time and effort may have been expended without any public benefit.</p> <p>Recommendation - See finding no. 1 above.</p>	<p>performance would have been so suspended for any other cause, including the fault or negligence of the contractor.</p> <p>Improper Settlement Agreement</p> <p>Our audit showed that PSS is currently negotiating a settlement agreement with B & R to permit the contractor to "exit" from the project. A draft of the agreement dated May 9, 1997 showed that PSS would have to pay \$149,859 to the contractor. Based on our analysis, however, the proposed settlement agreement should be rejected because it is extremely unfavorable to PSS. Besides, the contract has not yet been terminated for convenience, and thus settlement at this time is not appropriate. Even if the contract should be terminated for convenience, the losses claimed by B & R do not qualify as amounts payable because the losses by B & R (1) did not arise from issuance of the stop work order, (2) were not supported by receipts or appropriate documents, (3) were due to the contractor's fault, or (4) were simply unbelievable (See Appendix A for separate analysis). Furthermore, the wording of sections in the settlement agreement is inaccurate, misleading, and portrays B & R as without fault. As discussed throughout this report, it was B & R's failure to cure and address construction problems and deficiencies which led to repeated delays of the project. At the time of the audit, the stop work order has not yet been canceled. Under the contract provisions, the options available to PSS at this point are as follows: (1) cancel the stop work order and require the contractor to complete the work, (2) terminate the contract for default because of the contractor's repeated failure to cure or address the conditions delaying the project, or (3) terminate the contract for convenience. If the contract is terminated for convenience, only the reasonable costs arising from the stop work order shall be allowed to the contractor. Under the circumstances, however, the appropriate action that should be taken by PSS is termination of the contractor's right to proceed with the contract for default, and not negotiating for settlement.</p> <p>Failure to Charge Liquidated Damages</p> <p>The instructions to bidders, which were made part of the contract specifications, provide that, in the event of failure of the contractor to complete the work within the completion date, liquidated damages will be assessed at \$500 for each and every day that the work is delayed.</p> <p>Our audit showed that PSS neglected to charge liquidated damages for failure of the contractor to complete the contract within the completion date. In a January 18, 1997 memorandum, the PSS CIP Specialist indicated that the total liquidated damages that should be charged against B & R amounted to \$111,500</p>

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<p>PER PSS Auditee Response/Corrective Action Plan - We disagree with the finding with respect to liquidated damages and with respect to the settlement agreement.</p> <p>First, only two extensions were granted, as detailed above. The other two changes in dates were misrepresented in your audit report. The granting of extensions was necessary due to delays caused by factors beyond the control of the contractor, in some cases. There were several disputes regarding the drawings and the suitability of certain materials for the project.</p> <p>It is frankly unbelievable that the actual sequence of events that occurred could be construed by the OPA as attempts to negotiate a settlement with the contractor. Allow us to refresh your memory of what really happened.</p> <p>Page 32</p>	<p>(for 223 days covering the period from September 10, 1995 through April 23, 1996). The damages were supposed to be considered in the negotiation of the settlement agreement with B & R. For unexplained reasons, the damages were excluded from the final draft of the settlement agreement. Based on our analysis, the liquidated damages are due because of the contractor's failure to complete the work. Therefore, PSS officials should stop favoring the contractor and enforce payment of the liquidated damages, whether or not the settlement agreement is pursued.</p> <p>PSS contention is incorrect! There were four time extensions as previously pointed out on pages 22 to 23.</p> <p>With regard to liquidated damages, it is surprising that PSS is now disagreeing that liquidated damages should be charged to the contractor. PSS itself had informed the contractor that it would be charged liquidated damages if it failed to complete the project in a timely manner; for example, in its second extension letter dated February 13, 1995, the Commissioner stated that "any liquidated damages beyond September 10, 1995 (the new completion date) will be the responsibility of the contractor and its bonding company, and will be assessed at \$500 per calendar day." Five days before the completion date, on September 5, 1995, the Commissioner warned the contractor that it would be assessed liquidated damages of \$500 per day whether or not any request for time extension is granted or denied. As we have previously discussed, the completion date was extended two more times, to April 13, 1996 and then to May 25, 1996.</p> <p>The fact is that PSS granted time extensions to the contractor four times totaling more than 500 days (this gave the contractor more than 800 days vs. 300 contract days) and still the contractor failed to complete the project. It is amazing that PSS never charged liquidated damages for delays committed by the contractor despite the abundance of evidence that it was at fault.</p> <p>Numerous evidence point to the fact that PSS was indeed negotiating a settlement agreement with the contractor. For example, a draft settlement agreement dated May 9, 1997 between PSS and the contractor called for payment of more than \$149,000 to the contractor. This agreement was obtained from the PSS Facilities Specialist who noted in his transmittal letter that the Attorney General had recommended a number of changes. During this time, the contractor's legal counsel had also contacted OPA's legal counsel and informed OPA that PSS and the</p>

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<p>After the stop work order was issued, the contractor hired an attorney, who submitted a document to PSS demanding a substantial sum to allow them to "walk away" from the project. The contractor submitted their demands to PSS. PSS forwarded these demands to OPA with a request for assistance in responding to these demands. The OPA wrote back to PSS and did not offer any assistance. The OPA told PSS that only PSS could decide what was best for PSS.</p> <p>PSS officials did meet with OPA officials to discuss the contractor's demands and possible termination of the contractor. PSS wanted to determine how much, if any, might be owed to the contractor. OPA recommended that PSS put together an independent team to analyze the percentage of completion. If this team determined that money was owed to the contractor, PSS should pay them. If it was determined that no money was owed, PSS should terminate the contractor.</p>	<p>contractor were close to finalizing the agreement, except that PSS had to wait for the results of our audit.</p> <p>The following is a more accurate summary of what actually transpired based on supporting evidence:</p> <p>On October 1, 1996, the Commissioner directed the PSS Facility Specialist to focus efforts on completion of the MHS Gym Project on or before June 1997. The Commissioner said that all documents should be submitted to him for review prior to submission to anyone else.</p> <p>As early as November 18, 1996, the PSS Facility Specialist informed the Commissioner through a memo that in a meeting with the contractor and the PSS team, "all parties are joined in the goal of amicable termination to B&R's involvement with the MHS gym by the end of the year."</p> <p>On January 14, 1997, the contractor submitted a settlement request. On the same date, the PSS Facility Specialist prepared a memo and requested assistance from the independent engineer to determine the accuracy and fairness of the settlement request.</p> <p>On May 9, 1997, PSS Facility Specialist informed us that a preliminary draft of a settlement agreement was being reviewed by PSS. The PSS Facility Specialist told our staff that PSS wanted to finalize a settlement agreement with the contractor as soon as possible. Our staff informed the PSS Facility Specialist that PSS should wait until the draft report was issued before entering into any settlement agreement with the contractor.</p> <p>On May 21, 1997, the Commissioner wrote a letter saying that PSS has been informally requested by OPA not to terminate the contractor until the audit findings are released. This, of course, was not accurate since we only told the Facility Specialist not to finalize any settlement agreement before the draft report was issued.</p> <p>On May 28, 1997, OPA responded to the Commissioner's letter. In the response, we clarified that our conversation with the PSS Facility Specialist was "meant to caution PSS about any settlement agreement with B&R." In this response and in our subsequent discussions with PSS officials, we informed PSS that it should assign a team to thoroughly review any settlement agreement with the contractor.</p>

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<p>Page 33 In this case, it appears that OPA prematurely concluded that PSS was negotiating a settlement. In fact, PSS was seeking assistance from OPA to resolve this issue, which led to a meeting with OPA officials and PSS officials. We have to question the reliability of the work product once again.</p> <p>ATTACHMENTS</p> <p>January 15, 1997 receipt of document from B&R requesting \$235,135 January 18, 1997 analysis by PSS CIP of B&R's request May 1, 1997 letter from Eric Smith with proposed settlement May 21, 1997 letter from COE to OPA requesting guidance May 28, 1997 letter from OPA September 19, 1997 memo to Eric Smith regarding amounts possibly owed to B&R October 7, 1997 memo to COE regarding lack of overpayment to B&R</p> <p>* * * * *</p> <p style="text-align: center;"><u>CONCLUSION</u></p> <ul style="list-style-type: none"> PSS asserts that they did not act irresponsibly in awarding the contract. <p>Pages 33-34</p>	<p>It is clear from the above discussions that PSS was in fact negotiating a settlement agreement with the contractor. The truth is that, had we not cautioned PSS officials to wait for the issuance of the draft report, they probably would have finalized a settlement agreement favoring the contractor. The contractor's legal counsel himself informed OPA's legal counsel that PSS was just waiting for OPA to issue our report before finalizing the settlement agreement.</p> <p>Subsequent Events</p> <p>It is also interesting to note that the PSS Facility Specialist recently requested three engineers to analyze the MHS construction project (as of September 19, 1997). Their analysis showed that, based on visual inspection of the project, the contractor may have been overpaid by as much as \$250,000 (computed by averaging their estimates of actual completion and multiplying the average percentages by the related contract amounts). As expected, on October 7, 1997, the CIP Coordinator refuted the evaluation of three engineers and insisted that they were wrong because they did not have all the available documents in preparing their computations. It should be noted that the CIP Coordinator's assessment is the least reliable because he was responsible for signing the contractor's application for payment.</p> <p>Given three professional opinions contradicting the CIP Coordinator, PSS should order an independent review of the project by a professional architectural and engineering firm. The review should (1) determine whether it is cost effective to continue the project, (2) compare the actual percentage of completion with the contractor's claims and compute any overpayment, (3) determine the cost to replace defective materials or to correct any workmanship that does not conform to contract specifications (these should be charged to the contractor), and (4) determine the additional costs to complete the project.</p> <p>PSS poorly managed the MHS gym project, and was negligent in enforcing applicable contract provisions and procurement regulations. Specifically, PSS poor management and negligence included (1) procurement of the MHS gym project despite insufficient funding, (2) awarding the contract to a contractor with inadequate financial resources, (3) refunding of amounts retained to assure completion despite the failure of the contractor to complete the project, (4) failure to adequately monitor the contractor's performance and review progress billings, (5) allowing the contractor to continue working on the project without first securing extension of the performance and payment bond coverage, (6) issuance of a stop work order instead of terminating</p>

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<ul style="list-style-type: none"> • The CNMI Director of Finance at the time certified that funds were available in the amount of \$1.2 million. • There are many responsible parties in this type of project, not just the Commissioner of Education or the PSS CIP Coordinator. The Board of Education, PSS Legal Counsel, the Attorney General's office, the Department of Public Works, the CNMI Legislature, the consulting engineers, and the contractor all share responsibility. • PSS believes that the Office of the Public Auditor performed their work with a bias against PSS from the inception of the engagement. • The OPA investigation was requested by a person who was on the Board of Education at the time of the project. This person has been, is now, and has promised to continue to be, hostile to the Commissioner. • OPA staff should not editorialize in their reports about their concerns with respect to students in the CNMI. PSS is far more concerned about the education of CNMI students than the OPA will ever be. If transferring all present and future construction to the Department of Public Works is necessary to demonstrate PSS's commitment to education, PSS is ready to do so. • The report by the OPA, while it must be largely discounted, did provide some useful information that PSS will incorporate into future projects. <p>Pages 34-35</p>	<p>the contractor for default, and (7) negotiating a settlement agreement favorable to the contractor instead of demanding compensation for damages (See page 12 of the draft report).</p> <p>This was not questioned by the audit. The point of our finding as discussed on page 13 of the draft report was that PSS failed to exercise prudent judgement when it (1) solicited bids for the project that was estimated to cost \$2.9 million when it had available funding of only \$1.21 million, and (2) did not scale down the project's specification and rebid the contract when the lowest bid of \$1.918 million exceeded available funds by \$708,000 or by more than 58%. This violated PSSPR Section 3-102(9)(c).</p> <p>We agree. However, the Commissioner, as contracting officer, was primarily responsible for overseeing contract administration. Among other factors, the Commissioner did not terminate the contractor's right to continue the Marianas High School (MHS) gym contract for default despite (1) the contractor's overall poor performance and slow progress of work, (2) considerable delay in the procurement of the steel building for the gym due to the contractor's financial difficulties, (3) poor quality of construction work (i.e., existing structures may have to be demolished or reworked), and (4) failure of the contractor to address and cure construction problems and deficiencies (See page 3 of the draft report).</p> <p>PSS presented no evidence to support this conclusion.</p> <p>As previously discussed, anyone can request an audit. All audit requests, however, are investigated and prioritized for merit. In the case of the MHS gym, OPA finds that the failure of the contractor to complete the project despite substantial payments made by PSS warranted an audit.</p> <p>Our findings were based on facts and were reported objectively. As government auditors, we are concerned about apparent waste and abuse of public funds and resources as noted in our findings on the MHS gym contract.</p> <p>PSS did not specifically address the six (6) recommendations included in the draft report. PSS needs to identify which "useful information" will be incorporated in future projects.</p>

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<ul style="list-style-type: none"> On a more positive note, this project will be restarted and completed shortly. <p>In conclusion, the report on the MHS project by the OPA is biased and is based on incomplete and misguided work efforts. As we all know, hindsight is 20/20. It is easy to criticize past actions; it is far more difficult to advise on what current and future actions should be.</p> <p>We believe that the OPA far overstepped the bounds of propriety in their recommendations. It appears that the OPA is far too easily swayed by the whims of certain elected officials and lacks objectivity in their conclusion.</p> <p>We recommend that the OPA review the documents attached to this response and conduct further interviews with "knowledgeable" persons before completely rewriting their report. PSS would like to see a completely revised report before it is finalized.</p> <p>Pages 35-36</p>	<p>No evidence was submitted to support this claim either. Among other things, PSS should (1) provide evidence showing that the contractor has been terminated or agreed to pull out of the project, (2) submit an independent report showing that it is more cost effective to continue construction, (3) submit plans showing target completion dates, (4) submit copy of a request for proposal, and (5) identify source and amount of funding for the project.</p> <p>The PSS letter response made incorrect assumptions and conclusions which were contradicted by the factual information presented in this comment section.</p> <p>It is the job of OPA to "criticize" past actions, especially if these actions are improper, and offer recommendations to correct them, which OPA has done. This is the basic nature of auditing.</p> <p>The draft report presented only factual information along with supporting documents and evidence.</p> <p>The PSS letter response presented no additional evidence or information from "knowledgeable" persons that will change the facts reported by the audit. We urged PSS to specifically identify such information in our forthcoming exit conference with the Commissioner.</p> <p>We also carefully reviewed the documents. Most of these documents were the same ones which we previously obtained from PSS. In fact, some of the documents were obtained from our work paper files (a PSS representative copied several documents from our files because, according to him, our files were already organized).</p>

STATUS OF RECOMMENDATIONS

Recommendations	Agency to Act	Status	Agency Response/ Additional Information or Action Required
<p>1. Instruct the COE to cancel the stop work order and immediately terminate the contractor's right to proceed with the project for default instead of negotiating a settlement agreement with the contractor.</p>	PSS	Closed	<p>Per our exit conference with the COE, the contractor was subsequently terminated without any payment made.</p> <p>OPA Comment</p> <p>Our review of supporting documents showed that the contractor was terminated for <i>convenience</i> through a change order. It would have been more appropriate had PSS terminated the contractor for default. PSS, however, chose to terminate the contractor for convenience to avoid protracted litigation.</p>
<p>2. Instruct the COE to reject the settlement agreement favoring the contractor. Instead, PSS should charge liquidated damages for contract extensions that were caused by the contractor's delay and nonperformance.</p>	PSS	Closed	See Agency Response on No. 1.
<p>3. Request an independent architectural and engineering firm to review the actual percentage of completion of the project, and the quality of materials used and work performed by the contractor. Based on the findings, the contractor should be required to replace without charge any material or correct any workmanship that does not conform to contract specifications.</p>	PSS	Closed	<p>Per our exit conference with the COE, PSS has already transferred the project to DPW.</p> <p>OPA Comment</p> <p>Based on our discussions with the DPW's Director of Technical Services Division, the plan is to construct the gym in two phases. The first phase involves taking down the steel frame to replace defective concrete footings/pedestals. Second phase involves completion of construction of the gym.</p> <p>The contractor was terminated for convenience to avoid protracted litigation. This effectively discharges both parties (PSS and the contractor) from any obligations against each other.</p>
<p>4. Take appropriate disciplinary actions against the responsible PSS officials for failure to terminate the contractor for default, and for poor management and negligence in enforcing contract provisions and procurement regulations.</p>	PSS	Open	No action was taken to address the recommendation. PSS should reconsider and implement the recommendation.
<p>5. Issue a directive to all PSS officials involved in procurement to stop favoring nonperforming contractors and to ensure that any action taken or decisions made will be in compliance with applicable contract provisions and procurement regulations.</p>	PSS	Open	No action was taken to address the recommendation. PSS should reconsider and implement the recommendation.

STATUS OF RECOMMENDATIONS

Recommendations	Agency to Act	Status	Agency Response/ Additional Information or Action Required
<p>6. Identify or request funding to complete the MHS gymnasium and ensure that any new contract to be procured for the project undergo competitive bidding and does not exceed available funds.</p>	<p>PSS</p>	<p>Open</p>	<p>The COE gave us documents showing that additional funding for the project of about \$426,000 for the first phase and about \$633,000 for the second phase of the project was identified and available. DPW, however, plans to redesign the project, and a government estimate of the total costs to complete the project was not available as of the date of this report.</p> <p>OPA Comment</p> <p>PSS should provide us documents showing that the government estimate to complete the project will not exceed available funding.</p>