



OFFICE OF THE CITY AUDITOR

City and County of Honolulu
State of Hawai'i



Audit of the Tennis Complex of the Central O'ahu Regional Park

A Report to the
Mayor
and the
City Council of
Honolulu

Report No. 07-03
July 2007

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Submitted by

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CITY AND COUNTY
OF HONOLULU
STATE OF HAWAII

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Foreword

This is the report of the *Audit of the Tennis Complex of the Central O'ahu Regional Park*. The city auditor initiated this audit pursuant to Section 3-502.1(c) of the Revised Charter of Honolulu and the Office of the City Auditor's Annual Work Plan for FY2006-07. This audit was conducted to determine the city's total cost to construct the tennis complex at the Central O'ahu Regional Park and related management issues of the Department of Design and Construction.

We wish to acknowledge the assistance and cooperation of the officials and staff of the Department of Design and Construction, the Department of Budget and Fiscal Services, and others who we contacted during this audit.

Leslie I. Tanaka, CPA
City Auditor

EXECUTIVE SUMMARY

Audit of the Tennis Complex of the Central O‘ahu Regional Park

Report No. 07-03, July 2007

This self-initiated *Audit of the Tennis Complex of the Central O‘ahu Regional Park* was conducted pursuant to the authority of the Office of the City Auditor (OCA) as provided by Section 3-502.1(c) in the Revised Charter of Honolulu. This audit was included in OCA’s Annual Work Plan for FY2006-07. The city auditor determined that this audit was warranted due to long-standing concerns from the Honolulu City Council and the public regarding the tennis complex’s total cost, the lack of reporting by the Department of Design and Construction and the former city administration, numerous change orders, and the procurement of the project’s consultants and contractor. This audit focused on reviewing the city’s total cost to plan, design, construct, and equip the tennis complex at the Central O‘ahu Regional Park. This audit also reviewed selected management issues related to the largest sources of increases in the total cost of the tennis complex, including: 1) project contingency; 2) change orders; 3) departmental compliance with legal requirements related to cost control and reporting; and 4) procurement.

Background

In the 1990s, the community of central O‘ahu expressed its desire to the city for recreational tennis courts. The city, in conjunction with tennis organizations, envisioned an expanded *world-class* 25-court tennis facility. As presented to the city council for approval in FY2000-01, the total cost of this complex was estimated at \$9.5 million. During its development, reports of escalating project costs, as well as increasing concerns about the resources required to operate and maintain the city’s existing park facilities, prompted repeated requests from the city council and public for the total cost of the planned tennis complex. Over the years, the Department of Design and Construction and city administration have reported various total costs for the project ranging from \$10 million to approximately \$13.8 million. To date, neither the city administration nor the Department of Design and Construction has publicly reported the city’s total cost to design and construct the tennis complex at the Central O‘ahu Regional Park.

Summary of Findings

1. The cost to construct the city's tennis complex at the Central O'ahu Regional Park could not be completely determined; however project costs will substantially exceed original estimates by \$2.5 million when the construction contract is closed.
2. The department's poor management and weak controls throughout design and construction underlies the project's significant cost overruns, and its failure to follow key legal reporting requirements concealed the project's increasing costs from council oversight.

Finding 1: The Cost to Construct the City's Tennis Complex at Central O'ahu Regional Park Could Not Be Completely Determined; However Project Costs Will Substantially Exceed Original Estimates by \$2.5 Million When the Construction Contract Is Closed.

- When completed, the tennis complex may cost the city as much as \$12,771,216 which exceeds original estimates by \$2.5 million. Departmental cost estimates placed the cost at \$10,290,156. As currently constructed, the city has expended an estimated \$11,485,333 on the tennis complex, including \$758,994 for design costs, \$659,912 for construction management services, and \$10,066,427 for construction costs. There is \$1,285,333 currently encumbered to pay for remaining construction costs.
- Unsupported project accounting, incomplete payment records and the open construction contract hindered total cost determination. The full cost of the tennis complex could not be verified. The department was not able to produce cost information on the design and construction management costs attributable only to the tennis complex. Project files revealed that consultants and sub-consultants submitted limited supporting documents to support payment requests. Furthermore, records for 20 of the 26 payments totaling an estimated \$2,260,150 to the design consultant were not available to review.
- The construction contract remains open with approximately \$1.3 million still encumbered. Although the tennis complex was opened to the public in February 2003, the department has not closed the construction contract, or released a final payment to the contractor, and maintains a \$1,285,883 encumbrance to pay remaining construction costs.

Finding 2: The Department's Poor Management and Weak Controls Throughout Design and Construction Underlie the Project's Significant Cost Overruns, and Its Failure to Follow Key Legal Requirements Concealed the Project's Increasing Costs from Council Oversight.

- The lack of a comprehensive cost control framework was evident throughout the tennis complex's implementation. The department only provides limited guidance for cost control through written policies and procedures, and there is no comprehensive project management resource to ensure that staff properly executes their management responsibilities. Departmental delays in addressing project administration responsibilities were costly. The tennis complex was completed 232 days late, and 24 percent above cost estimates. We estimate that \$1,654,546 in additional costs and time were driven by administration requests for re-design, apparent errors and omissions, and change work from *ad hoc* requests during construction. The department did not pursue available measures to recapture costs from errors and omissions, or liquidated damages for late performance; as a result these costs were paid for by taxpayers.
- Questionable design practices adversely affected project implementation and increased costs. The department's rush to bid the project publicly without final design plans resulted in foreseeable questions, errors, omissions, and delays during construction. The department used the design reimbursable allowance method intended for incidentals on substantial costs including Phase 1 baseball field completion costs and additional design and construction management costs to fund cost design and construction management cost overruns in the tennis complex. Post-contract services added more than \$1.6 million to tennis complex costs, including \$963,874 in construction costs for extra work; \$144,057 for consultant re-design work during construction; \$163,641 in re-design change orders; \$241,860 in additional construction management services; and \$141,114 in change orders for apparent errors and omissions.
- The department overrode statutory, city and internal change order directives. Existing controls and the intent of change orders were overridden, including allowing the contractor to amend the integration clause in change orders which increased the city's liability for costs, and no scrutiny over whether change work was caused by errors or omissions or if work was foreseeable. Change work was also performed prior to formal approvals. Two change orders initiated

after the project was accepted, added an additional \$690,000 to the tennis complex costs.

- Anticipated tennis complex construction cost overruns prompted the inappropriate transfer of \$1.4 million. We found that the department and former city administration anticipated that the tennis complex could run short of construction funds, and sought additional funding from appropriations to non-specific capital project programs and from lapsing capital project balances. In making the transfers, the department and former city administration disregarded applicable legal and administrative requirements. Furthermore, despite the transfer amounts exceeding reporting limits, none were reported to council for review and approval.
- The late addition of construction management services to the project was questionable and costly. Construction management services were not included in the original design contract for the tennis complex. Fiscal guidance to separately procure construction management services under a separate contract was unheeded. Despite no contract, the department received construction management services from its design consultant for nearly a year, resulting in two *after-the-fact* amendments of the design contract, which added \$659,912 to the cost of the tennis complex. There was also an apparent conflict of interest created by the department's procurement of the same firm to perform both design and construction management responsibilities during the development of the park's Phase 2, including the tennis complex. The consultant's dual management role led to foreseeable disputes and delays with the construction contractor, and additional project costs, such as the construction contractor's delay claim of \$498,000.
- The department approved excess and inappropriate uses of construction contingency funds. In planning documents, the department apparently planned for twice the allowable contingency costs permitted by the city's finance policy. Although the city's finance policy permits a ten percent contingency, late in the project, the department requested and received an increase of the project contingency to 19 percent – a violation of the finance policy. We found that contingency funds were used for anticipated cost overruns rather than unforeseen costs, for which contingency funds may be properly used.

Recommendations and Response

We made a number of recommendations to resolve the issues and problems identified during this review. In summary, we recommended that the director of the Department of Design and Construction should:

- resume negotiations with the Phase 2 tennis complex construction contractor to close the construction contract, and lift encumbrances on remaining construction funds;
- prepare a complete and accurate accounting of the city's total cost of the tennis complex when the construction contract is closed out;
- assess and improve existing policies to strengthen cost control throughout the implementation of all phases of the city's capital projects; particularly adherence to the approved budget, and accounting for project costs;
- require adherence to the contracted scope of work, and approved final project design as a prerequisite to proceeding to construction bidding;
- develop policies and procedures for establishing prudent and justifiable use of construction management services; appropriately structuring independent project responsibilities, and ensuring compliance with state procurement requirements;
- comply with legal and administrative requirements for reporting on this project's change orders and transfers of funds to city council;
- consider additional criteria for change orders, such as prohibiting change work for aesthetic reasons or scope changes that are unrelated to the completion of contracted work;
- ensure that the department complies with administrative construction contract contingency limits;
- ensure that contractual obligations are enforced; pursue liquidated damages for improper or incomplete work, and set appropriate amounts for damages, as appropriate;
- cease commingling resources and funds among separate project phases; and

- fully represent project costs in capital budget requests to council and cease using unspecific, generic purposed capital projects or programs as ad hoc sources of project funding.

We also recommended that the managing director should consider solutions to resolve the department's misuse of *after-the-fact* change order practices and ensure that change work proceeds only after formal approval.

Finally, we recommended that the director of budget and fiscal services submit to council for the public record all of the required change order and delay reports for the tennis complex, as required by section 2.4-2, Revised Ordinances of Honolulu; and locate the 20 of 26 missing design consultant contract payment records, totaling an estimated \$2,260,150 and make them available in the department's official procurement files for review.

In its response to our draft audit report, the Department of Design and Construction largely responded by providing background information about the development of the Central O'ahu Regional Park and the tennis complex, and by generally describing the processes with which it must comply for the budgeting, planning, and implementation of capital improvement projects. It confirmed that the development of Phase 2 at the park was driven by the former administration's predetermined timeline, resulting in the accelerated design of the project, the selection of one firm to design and manage construction out of convenience, and the department having to make its best effort to comply with policies and procedures given time constraints. We noted that the department, in its response, affirmed its overall responsibility for the project and its outcomes, acknowledged that it assigned staff to monitor and oversee the project, and made clear that it made all final approvals and decisions on the Phase 2 projects.

The department took no position, and provided no additional information on the total cost of the tennis complex, the cost overruns, or the missing payment information. Nonetheless, we stand by this finding in our report, urge the department to report total cost information regarding the tennis complex to the public, and ensure that it maintains complete and accurate payment records and information in its project files.

The department took no position on the findings of the report related to its management and weak controls leading to this project's significant cost overruns. It reported that it is in general compliance with all of these

requirements, and that, where applicable, the Department of Budget and Fiscal Services reviews and approves of their compliance. We disagree. While we found instances of compliance with policies and procedures, others were contrary to best practices and contributed to the tennis complex's \$2.5 million cost overruns. The department's and finance director's disparate policies and procedures fall short of a comprehensive cost control framework throughout all phases of the project's implementation. Our report also revealed weaknesses in the effectiveness of cost controls within certain policies and procedures, and that compliance alone would not necessarily ensure that a project is delivered on time and within budget. We urge the department to strengthen cost controls throughout all phases of capital project implementation. While we agree that providing additional time to complete final design is beneficial, we believe that requiring approved final designs prior to construction bidding can save significant funds, and eliminate delays resulting from incomplete and erroneous design work.

We acknowledge the department's important role in providing the communities of Honolulu with projects that are well used and enjoyed by the public, such as the tennis complex at the Central O'ahu Regional Park. We commend the department's efforts to address the organizational conflict of interest issue in the future, by amending its policies and procedures with respect to the future procurement of design, construction management, and construction services. We also acknowledge the openness of the department to implement revisions to its policies and procedures as a result of this audit report. There were no substantive changes made to the report based on the department's response.

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Chapter 1

Introduction

This self-initiated *Audit of the Tennis Complex of the Central O‘ahu Regional Park* was conducted pursuant to the authority of the Office of the City Auditor (OCA) provided by the Revised Charter of Honolulu. This audit was included in OCA’s proposed work plan for FY2006-07, which was communicated to the Honolulu City Council and the mayor in June 2006. The city auditor determined that this audit is warranted due to long-standing concerns from the city council and the public about the project’s total cost as reported by the Department of Design and Construction, numerous change orders, and the procurement of the project’s consultants and contractor. To date, neither the city administration nor the Department of Design and Construction has publicly reported the city’s total cost to design and construct the tennis complex at the Central O‘ahu Regional Park.

Background

In the 1990s, the community of central O‘ahu expressed its desire to the city for recreational tennis courts. The city, in conjunction with tennis organizations, envisioned an expanded *world-class* 25-court tennis facility. The original cost estimate for the tennis complex was \$8.2 million. During its development, media reports of escalating project costs as well as increasing concern about the costs to operate and maintain the city’s existing park facilities prompted requests from the city council and public for the total cost of the planned tennis complex. Over the years, the Department of Design and Construction and city administration have reported various total costs for the project ranging from \$9.6 million to approximately \$13.8 million. While acknowledging the various controversies surrounding the project, the focus of this audit was to determine the city’s total cost and related management issues to plan, design, construct and furnish major equipment elements for the tennis complex at Central O‘ahu Regional Park.

Central O‘ahu Regional Park Tennis Complex

In 1999, the city planned a 270-acre regional park in central O‘ahu as a venue for a variety of recreational and sporting activities. To accomplish the considerable scope of this project, the city planned to develop the park’s major components in three phases, beginning with baseball fields, followed by tennis and softball facilities, and then an aquatics complex. Funding and coordination needs led the city to adjust the execution and

sequencing of other athletic facilities within the park's phases. The first phase baseball fields and recreational park space opened in July 2001; the second phase tennis complex opened in February 2003; and the third phase aquatics center opened in 2005.

The tennis complex at the Central O'ahu Regional Park was the product of four years of discussion and planning involving a mayor's task force, local tennis organizations, and the community. The community's initial request for a community recreational tennis facility with four to eight tennis courts evolved into a 25-court *world-class* tennis complex with high quality courts suitable for professional, league, and high school tournament play, as well as community recreation. During the second phase of development at the park, the city committed to constructing a 20-court tennis complex and 20-lane archery range. As constructed, the tennis complex featured two show courts, 18 paired courts, covered rest areas, two comfort stations, a maintenance facility, registration building, and storage building; while plans for a stadium court and four practice courts were deferred to future development.

The project was put out for bids in September 2001, and the city awarded the contract to construct the tennis and archery range project to Dick Pacific Construction. The terms of the construction contract gave the contractor 180 days to construct the tennis complex and archery range from the designated notice to proceed with work date, November 1, 2001.

The grand opening of the tennis complex at the Central O'ahu Regional Park was held on February 15, 2003. It was hailed by the previous administration as enhancing its regional park concept by providing another world-class venue in Honolulu for sports tourism and high level tennis tournaments, increasing public recreational tennis opportunities, and minimizing operational and maintenance costs to taxpayers through partnerships with private operators who would bear those costs. A photo of the tennis complex at the Central O'ahu Regional Park is shown in Exhibit 1.1.

Exhibit 1.1**Photo of the Tennis Complex at the Central O'ahu Regional Park**

Source: Department of Design and Construction

Project roles and responsibilities

All projects, from the simplest buildings to the most complex infrastructure, require a team of individuals, firms, and companies that are responsible for completing the design and construction of the project. The project team may be small or large depending on the project size and complexity. Design-bid-build is a traditional method of moving a project from conception to completion, and involves a project team comprised of the following:

- Owner - initiates the project; establishes project requirements, budget and time constraints for the project; approves the final design plans; provides review and approvals for payments and change orders; negotiates and closes project;
- Design consultant - may include professional architects, engineers, and specialty consultants, who work with the owner to determine the project design; prepare specification documents; and furnish consultation and advice during construction; and

- Construction contractor - constructs the facility for the owner as specified in the construction documents prepared by the design team and approved by the owner.

The Department of Design and Construction acts as the owner of city projects from conception to completion, and is responsible for ensuring that consultants and contractors proceed with the design and construction of city facilities according to the approved plans and specifications, within the allotted time, and ensure that projects adhere to established budgets. The department assigns in-house project managers and inspectors to oversee the planning, design and construction phases, and the work of consultants and contractors.

The design consultant is responsible for preparing accurate and complete project plans and specifications to construct a project that meets the city's needs and functions. In the case of errors or omissions, the consultant may be held liable for the costs to correct such problems. As owner of the project, the department is responsible for approving the final design plans. The construction contractor provides the services to construct the facility in accordance with the approved design plans and specifications; and can be held liable for improper or incomplete work that fails to meet specifications. The construction contractor may subcontract for specialized services, such as electrical or landscaping work. In the case of problems or unforeseen conditions during construction, the department has the discretion to approve time extensions or additional costs through change orders. The department may additionally determine whether the design consultant or construction contractor is financially responsible under contract for the extra costs or for exceeding the project completion date.

For complex or multiple phase projects an owner may hire professional construction management services. According to the *Construction Specifications Institute*, an owner may hire at an additional cost a separate, independent consultant for construction management services to oversee the design consultant and construction contractor. Situations that typically warrant the additional cost are large, complex, or multiple-phase projects. The owner and construction management firm formally establish the nature and extent of decision-making authority on behalf of the owner. An owner typically employs construction management services during the latter portion of the design phase to gain an understanding of the facility's construction requirements. During construction, an independent construction management consultant typically oversees the work of the construction contractor, mediates

design consultant-construction contractor disputes, determines financial responsibility as applicable, recommends reasonable changes for approval, and performs related tasks to ensure that the project is completed according to plans and specifications, on time, and within budget.

The city contracted the services of a design consultant and construction contractor to build the tennis complex at Central O‘ahu Regional Park. The city selected SSFM International (SSFM) to provide architecture and engineering services to plan and design the tennis complex and archery range. The department subsequently amended SSFM’s design contract to include construction management services for Phase 2 as well. Dick Pacific Construction Company (Dick Pacific) was awarded the contract to construct the tennis complex, supporting buildings, and archery range, and was responsible for managing its subcontractors.

Tennis complex budget

On December 30, 1999, the city awarded SSFM the contract for Central O‘ahu Regional Park Phase 2 planning and design and Phase 1 construction management services for \$932,765, of which \$682,765 was intended for the park’s phase 2 planning and design services. This contract also allocated funds for Phase I construction management services. The projected construction cost of the Central O‘ahu Regional Park tennis complex and archery range listed in the bid notice was \$9 million. The city advertised the regional park’s Phase 2b tennis complex and archery range for construction bids on August 13, 2001. On September 18, 2001, the city awarded the Phase 2b construction contract to Dick Pacific for its bid of \$9,576,000. Central O‘ahu Regional Park Phase 2b included the construction of a tennis complex and archery range. The Department of Design and Construction encumbered \$10,054,800 with \$9,576,000 for construction and \$478,800 for contingency. The notice to proceed with construction was given as on or before November 1, 2001. The project was substantially completed and turned over to the department on January 16, 2003, and the city celebrated the grand opening of the city’s largest tennis complex on February 15, 2003.

Audit Objectives

The objectives of the audit were to:

1. Determine the city's total cost and related management issues to construct the tennis complex at the Central O'ahu Regional Park.
2. Make recommendations as appropriate.

Scope and Methodology

This audit focused on the city's total cost to plan, design, construct, and equip the tennis complex at the Central O'ahu Regional Park. This audit also reviewed the Department of Design and Construction's role related to the largest sources of increases in the total cost of the tennis complex, including: 1) project contingency; 2) change orders; 3) departmental compliance with legal requirements related to cost control and reporting; and 4) procurement.

We reviewed project files from the Department of Design and Construction and the Department of Budget and Fiscal Services to determine the city's total expenditures to plan, design, and construct the tennis complex at the Central O'ahu Regional Park. The files reviewed included contracts, contract amendments, change orders, project communications, reports, budgets, expenditure records, plans, and other documents to determine initial cost estimates, funding, and scope of the project, as well as progress and cost reports developed during project implementation relevant to determining the total cost of the project. We prepared spreadsheets documenting expenditures by contract for the city's total cost of the Central O'ahu Regional Park tennis complex. During our fieldwork, we learned that funds appropriated to other capital projects were used as an additional source of funds for the design and construction of the park's tennis complex. We reviewed the purposes of those project appropriations and related information. The audit reviewed project files as of January 2007.

We referred to the criteria and guidance provided by the Revised Charter of Honolulu, the Revised Ordinances of Honolulu, the Hawai'i Public Procurement Code (Hawai'i Revised Statutes Chapter 103D), the state procurement administrative rules, city finance and departmental administrative guidance and policy directives, and internal rules, regulations, policies and/or practices regarding project management functions and controlling costs during design and construction, and the expenditure of funds appropriated for capital improvement projects. We

reviewed applicable contract terms and agreements, contract amendment terms, and change orders. We conducted internet and literature searches to identify criteria, controls and best practices used by government, industry, and professional organizations, including the Construction Specifications Institute, for managing construction project costs, roles and responsibilities, accountability, contract amendments and change orders.

We assessed the Department of Design and Construction's efforts to control project costs in accordance with applicable statutes, charter provisions, ordinances, rules and regulations, departmental policies and procedures, and other documentation guiding the department's management and coordination of projects, cost control, oversight of consultants and contractors, and procurement of professional services.

This audit was conducted in accordance with generally accepted government auditing standards.

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Chapter 2

The Cost to Construct the City's Tennis Complex at the Central O'ahu Regional Park Will Substantially Exceed Original Estimates, Due to Poor Cost Controls, Improper Transfer of Funds, and Deficient Reporting to Council

The cost to construct the city's tennis complex at Central O'ahu Regional Park could not be completely and accurately determined. Significant factors hindered the determination of the total cost including insufficient supporting documentation and details for tennis complex project accounting; incomplete project payment records for the design contract at the time of our fieldwork; and the pending construction contract costs for the project since it has not been closed. Though the tennis complex has been accepted by the city as substantially completed and in use for over four years, we found that \$1,285,883 remains encumbered to pay remaining construction costs. We estimate that the cost to plan, design, construct and equip the regional park's tennis complex may be as much as \$12,771,216. If so, the final cost will substantially exceed original cost estimates by \$2.5 million when the construction contract is closed.

Overall, the department's failure to effectively apply cost controls throughout the project's development is the reason why the tennis complex appears to have run substantially over budget. Several notable factors contributed to project cost increases including: adherence to an aggressive and likely unrealistic timeframe; improper transfer of funds; delays in executing project administration responsibilities; design errors and omissions, as well as allowing *ad hoc* post-contract re-design and construction changes; misuse of change orders; *after-the-fact* procurement of construction management services; and the improper use of contingency funds to cover foreseeable project cost overruns. The effects of these factors may have been minimized or avoided had the department complied with reporting requirements necessary for city council's fiscal oversight of capital projects and the use of those funds.

We found that substantial funds were diverted from the Phase 2 design and planning contract for the tennis complex to the regional park's Phase 1 baseball fields and recreational park space. Years later, during

construction, we found that the department diverted approximately \$1.4 million from several other capital improvement projects to the tennis complex and this was never reported to city council as required by fund transfer requirements. At first glance, what appeared to be a straightforward project to construct a tennis facility was also a funding scheme that subverted the capital budget and appropriation process for the affected projects, independent of council and public scrutiny.

Summary of Findings

1. The cost to construct the city's tennis complex at Central O'ahu Regional Park could not be completely determined; however project costs will substantially exceed original estimates by \$2.5 million when the construction contract is closed.
2. The department's poor management and weak controls throughout design and construction underlies the project's significant cost overruns, and its failure to follow key legal reporting requirements concealed the project's increasing costs from council oversight.

The Cost to Construct the City's Tennis Complex at the Central O'ahu Regional Park Could Not Be Completely Determined; However Project Costs Will Substantially Exceed Original Estimates By \$2.5 Million

Project cost estimates for the Central O'ahu Regional Park tennis complex widely varied, as different configurations in the number of courts and included amenities produced different costs. In June 2001, early cost estimates from the mayor's planning task force projected that constructing a tennis complex comprised of 20 courts, a center tennis court with bleachers, four practice courts, and clubhouse would cost \$7.5 million. Subsequent departmental planning estimates provided different alternatives in the number of tennis courts, from 4 to 8 courts, 16 courts, up to a 20-court complex, with estimates of total costs ranging from \$6.5 million to \$10.3 million. The department's planning documents estimated that the 20-court tennis complex would cost between \$10.3 million to \$11.1 million. In April 2006, the current mayor informed a community member that the total cost of the tennis complex was \$13.8 million.

We found that the city's total cost for the tennis complex at Central O'ahu Regional Park could not be completely and accurately determined. Significant factors hindering this review were the department's insufficient project accounting and lack of supporting documentation and details; incomplete project payment records for the

design contract at the time of our fieldwork; and that the construction contract is still open and has an estimated \$1,285,883 still encumbered.

When completed, the Central O'ahu Regional Park tennis complex may cost the city as much as \$12,771,216

Our efforts to determine the city's cost to design and construct the tennis complex at the Central O'ahu Regional Park were hindered by insufficient information, missing and incomplete records, and an open construction contract. While the department's files lacked sufficient information for a complete accounting of tennis complex costs, a reasonable estimate was computed. As currently constructed, the city has expended an estimated \$11,485,333 on the tennis complex, comprised of \$758,994 for design, \$659,912 for construction management services, and \$10,066,427 for construction costs.

Although the tennis complex was opened to the public in February 2003, the department has not released the construction contract's remaining amount of \$323,844 for completed construction work and \$1,285,883 remains encumbered for the project to pay remaining tennis complex construction costs. We also found that a tennis complex related post-construction change order was charged to the Aquatics and Tennis Complex construction contract in the amount of \$93,397. Depending upon the resolution of the final payment, we estimate the city's cost to plan, design, construct and equip the tennis complex could cost as much as \$12,771,216. Exhibit 2.1 identifies the estimated total cost of the tennis complex by development phase as of March 2003.

**Exhibit 2.1
Estimated Total Tennis Complex Cost by Development Phase,
as of March 2003**

<i>Development Phase</i>	<i>Cost</i>
Design of Tennis Complex	\$758,994
Construction Management for Tennis Complex	\$659,912
Construction of Tennis Complex*	\$10,066,427
Estimated Current Expenditures	\$11,485,333
Construction Encumbrances (current)	\$1,285,883
Estimated Total Tennis Complex Cost	\$12,771,216

Note: *Includes \$93,397 in tennis complex post-construction change order work charged to Central O'ahu Regional Park Aquatics and Tennis Complex contract. Information from Change Order Number 4, Approved June 1, 2005.

Source: Department of Design and Construction

During our fieldwork, what should have been a straightforward task of determining the cost of the tennis complex, was hindered by insufficient information, missing records and the still open construction contract.

Unsupported project accounting, incomplete payment records and the open construction contract hindered total cost determination

Accurate, reliable cost accounting and reporting are integral elements of cost control in the project management process. For example, effective cost control requires accurate and complete records of payments and supporting documents for various components of work, so that costs can be verified throughout the project's development from conception to completion. During our fieldwork, project files revealed that consultants and contractors submitted limited supporting documents to justify payment requests; and records for 20 of 26 payments to the design consultant were missing or unavailable for review. The department has closed out the design contract, but the construction contract remains open with a substantial current encumbrance. As a result of these factors, only an estimate of the city's total cost for the tennis complex is possible at this time.

Full cost of the tennis complex could not be verified

Our efforts to determine the city's total cost for the tennis complex were hindered by insufficient information to verify design and construction management costs for the tennis complex. Instead of itemizing costs for Phase 2 according to structures, i.e. tennis complex, archery range or softball field; by phase for design or construction costs; or by distinguishing costs for construction phase 2a or 2b, the design consultant submitted its bill as a total for all Phase 2 development services rendered. There was no information in the project files indicating that the department requested the consultant to separately account for tennis complex-related design costs.

While indicating that it had not determined the tennis complex's consultant costs, the department suggested apportioning 50 percent of the costs to Phase 2a softball fields and 50 percent to Phase 2b tennis complex and archery range to estimate design and construction management costs for the tennis complex. Where identified, archery range costs were separated to obtain a better estimate of the city's total cost to plan, design, construct and equip the tennis complex at Central O'ahu Regional Park.

Best practices indicate that along with a schedule of values for payment, it is not uncommon for the project owner to require updated schedules, reports, certifications, and other information to justify payment. The department did not require the design consultant to provide such justifications as prerequisites for payment. Instead, we found that the department's policy directives prescribe a format that conforms to a generalized, schedule of values payment approach that summarizes phase work by category, amounts paid, and percentage completed. In the design contract, the consultant was paid upon the completion and acceptance of each stage of development in progress payments. Pursuant to the design contract, the department is responsible for reviewing, approving and rejecting all submittals including those for payment. We found that the design contract did not require that the contractor submit supporting detail or documents regarding these categories of work to justify payment, except for reimbursable expenses.

Original payment records and cost item justifications were provided for only 6 of 26 payments totaling an estimated \$1,574,573. However, 20 payment records, totaling an estimated \$2,260,150 were missing or unavailable from both the department and the Department of Budget and Fiscal Services.

We found that categorical payments and missing payment records concealed the diversion of significant funds from the tennis complex, which is discussed later in this report.

Construction contract remains open with approximately \$1.3 million still encumbered

In the four years since the tennis complex's grand opening, the department closed the design contract in February 2006, but has not closed the construction contract. As such, only expenditures to-date for construction and the amount of work performed can be determined, but not the final construction cost. Expenditures for completed construction work on the tennis complex total approximately \$10,066,427. However, we found that \$1,285,883 is still encumbered in the construction account to pay remaining construction costs.

The department reported that the construction contract is still open and it is withholding the remaining \$323,844 of contract funds because of unfinished work. However, the construction contractor responded that all tennis complex construction work is completed. The contractor believes the department is withholding its final payment to induce the contractor to perform additional work on its construction contract for the regional park's Phase 1 baseball fields.

We estimate that the cost to plan, design, construct and equip the tennis complex at Central O'ahu Regional Park may be as much as \$12,771,216. If so, the final cost will substantially exceed original cost estimates by \$2.5 million. However, a final accounting of the city's total cost for the tennis complex can be determined when the department reaches agreement with the construction contractor, closes the construction contract, and releases any remaining construction encumbrance after final payment.

The Department's Poor Management and Weak Controls Throughout Design and Construction Underlie the Project's Significant Cost Overruns

Poor management and weak controls during the design and construction phases resulted in the project's significant cost overruns. Expediting design and construction timetables to meet the target dedication date led to imprudent shortcuts and numerous problems. Suspect terms in the tennis complex's design contract diverted significant tennis complex funds to a separate project, and the department later diverted funds from other projects for anticipated tennis construction budget shortfalls. Failure to comply with reporting requirements concealed the tennis complex's increasing costs from council's fiscal oversight. The

questionable late addition of construction management services likely violated the procurement code. Correction of these costly and wasteful practices warrants further attention.

The lack of a comprehensive cost control framework was evident throughout the tennis complex's implementation

The terms of various contracts set up the project accountability relationships between and among the design consultant, construction contractor, and the department; but it is the department's ultimate responsibility to ensure that projects proceed in a timely manner, disputes are resolved among the parties to prevent schedule delays, and the project is delivered on-time and within the approved budget. Our review revealed that the department provides only limited guidance for cost control through written policies and procedures, and there is no comprehensive project management resource to ensure that project management staff properly execute their responsibilities. Although largely confined to the department's control, basic project administration tasks such as making payments, approvals, and contract closure were often delayed and resulted in added costs. The tennis complex was completed 232 days late, and at that point, costs exceeded estimates by 24 percent. The department is also responsible for taking corrective actions for errors, omissions, and unacceptable work; holding the responsible party financially accountable through seeking cost adjustments; withholding payment, or imposing liquidated damages for late performance when warranted. We found that the department negotiated certain cost adjustments; however it also sought improper means to pay for the project's substantial cost overruns. When the department met with the consultants and contractor to negotiate during the latter part of the project, costs had already exceeded contract budgets.

Limited guidance for cost control from written policies and procedures

Managing a project's budget and controlling excess costs is a comprehensive effort from project inception through completion. Given the various responsibilities to manage projects, we inquired if the department had a project management manual or other resource to guide project managers throughout the implementation of projects. However, we found that the department lacks current comprehensive policies and procedures for managing the city's capital projects from inception through completion in a prudent and timely manner. The existing policy and procedures manual was developed by the former Department of Public Works and according to the department, is old and out of use. Since the 1998 citywide reorganization, the Department of Design and

Construction has issued a series of policy and procedure memoranda on selected topics related to project management.

Certain memoranda did provide useful policy guidance on specific project management issues. We found that the department's memoranda on change orders and construction contracts reiterate city finance policy that no work should begin before a contract is executed. The change order memorandum additionally provides the key requirements for a change order: the work must be unforeseen or unanticipated; the work must be necessary to complete the project; and the work must be in the scope of the contract. It further states that if these conditions are not met, the change orders should not be issued.

Overall, these memoranda provide guidance on how to complete and format project forms such as change order requests or how to transfer funds from one project or project phase to another. However, existing directives do not address how to apply discretion during project management activities, such as the appropriate use of reimbursable allowance funds or contingency funds. Moreover, we found no policy memoranda or directives requiring approved, final design plans as a prerequisite for proceeding to construction bidding; or firm restrictions on post-contract project design changes especially during construction.

During our fieldwork, the department reported that a consultant is currently assisting them with developing a capital project management manual for implementing the city's capital projects.

Complex completed 232 days late, 24 percent above estimates

Construction of the tennis complex at the Central O'ahu Regional Park began on November 1, 2001. In accordance with the construction contract, the contractor would deliver the park's Phase 2b tennis complex and archery range in 180 days, by April 30, 2002. During the construction phase, the department approved a 30-day extension of the completion date to May 30, 2002. However, the department did not approve substantial completion and accept the tennis complex until January 16, 2003, which by the revised completion date was 232 days late. Pursuant to the contract terms, the department could assess the contractor \$233,100 in potential liquidated damages since the project was completed 232 days late. As of January 2007, an estimated 1,900 days have elapsed, and the department has not released the final payment or the encumbrance on the remaining construction contract funds.

According to the consultant and contractor, the primary reasons for delayed completion were the coordination of project design, re-design and change work requested during construction. Additionally, the project schedule was impacted because the department did not approve change orders or process payments in a timely manner.

Planning cost estimates put the cost of the 20-court complex at \$10,290,156. At the substantial completion of construction in 2003, expenditures on the project including encumbered funds were approximately \$12,771,216. We estimate that \$1,654,546 in additional costs and time were driven by administration requests for re-design, apparent errors and omissions, and change work from *ad hoc* requests during construction.

Department's delays in addressing project administration responsibilities were costly

A common complaint of the consultant and the contractor was that the change order and payment process was not timely. Both reported that the department's delays in processing change orders and payments caused them to pay their subcontractors from company reserves. In one example, the construction contractor explained that their electrical subcontractor had completed their work, but was not paid for four or five months. As a result, the city incurred interest charges for the delay, further increasing the city's cost to construct the tennis complex. The construction contractor further related that a landscaping subcontractor, with whom they had a very close working relationship, sued them because of late payments from the city during the project.

The department's processing time for payments from the date the work was performed to the payment ranged from two weeks to five months. We found evidence of only one payment being delayed because of reasonable project manager scrutiny, which occurred after a site visit revealed that the contractor had not completed certain work as reported.

The department's negotiation with the design consultant for its final payment occurred when there was no money left in the contract to cover additional design services provided. The consultant sought payment for additional post-design services already rendered in response to city administration requests, and billed the city \$226,032 on September 23, 2002. Through negotiations, the department and consultant agreed to settle for \$110,000 in December 2004. However, the department released the final payment three years later on February 17, 2006. The

department closed the design consultant's contract on February 21, 2006.

Although the department accepted the tennis complex on January 16, 2003, the construction contract remains open. Project files indicated that the construction manager at SSFM recommended closure and documented the amounts of final project work. Internally, the department prepared the final payment in March 2003, releasing the retainage to the construction contractor. However, the department subsequently voided this payment because they believe the contractor still has work remaining on the contract.

According to best practices, the construction manager closes out the project, and depending on the agreement, turns over the project files to the owner. For this project, the design consultant, who was also the construction manager, was supposed to close out the project and provide the department with its files. Although the consultant asked its project engineer to close the project and assemble the project files, the department requested that the consultant turn over its files prior to project closure. The department took over the remaining construction management tasks due to lack of project funds.

Although the construction contract remains open, the construction contractor indicated that there is no further work to be done on the contract. According to the contractor, they are not being paid for their work on the tennis complex and archery range for problems the department wants corrected in another part of the park that they also constructed. The contractor noted that they offered to perform this work, even though it should not impact the closure of this project's construction. They further complained about the lack of support they received from the department, and that no one had taken charge of the issue of closing the contract. The construction contract presently remains open even though four years have passed since construction was completed, and the facility has been in use. Exhibit 2.2 presents a chronology of the development of the tennis complex at the Central O'ahu Regional Park from 1997 to 2007.

Exhibit 2.2

Chronology of the Central O'ahu Regional Park Tennis Complex Project, 1997 to 2007

<i>Date</i>	<i>Description</i>
1997	Mayor's Tennis Task Force convened to construct a tennis facility at Central O'ahu Regional Park (CORP).
December 30, 1999	Design Contract for CORP Phase 2 Awarded to SSFM Original Contract Amount = \$932,765
January 3, 2000	Design Contract Notice to Proceed
December 4, 2000	Design Contract Amendment Number 1. Allows Phase 1 work under this contract on a reimbursable basis.
June 19, 2001	Mayor's Tennis Task Force estimates the cost to construct a two-phase, tennis complex project at \$7.5 million.
July to December 2001	Pre-final design approved by Department of Design and Construction (DDC) for construction bid documents.
September 18, 2001	Dick Pacific Construction is the low bidder for the CORP Phase 2b Tennis Complex and Archery Range. Basic Bid = \$9,576,000 Contingency = \$478,800 Total Amount to Encumber = \$10,054,800
October 4, 2001	Construction Contract for CORP Phase 2b Awarded to Dick Pacific Construction
November 1, 2001	Construction Notice to Proceed
December 10, 2001	Design Contract Amendment Number 3 - DDC approves Tennis Complex Final Design.
April 30, 2002	Original Contract Date for Substantial Completion of the Tennis Complex
May 30, 2002	Revised Construction Completion Date.
July - September 2002	Construction Change Orders - Number 2 to 5
November 26, 2002	Design Contract Amendment Number 4 Construction Management Services added to design contract Scope of Work, one year after construction Notice to Proceed.
January 16, 2003	Substantial Completion - CORP Phase 2b Tennis Complex Accepted by DDC
January - February 2003	Post-construction Change Orders - Number 7 and 8
February 15, 2003	Tennis Complex GRAND OPENING
May 7, 2003	Design Contract Completion Date
December 31, 2003	Design Consultant's Construction Management Services completed.
February 21, 2006	Design Contract Final Acceptance - Design Contract Closed
April 13, 2006	Mayor Hannemann: Total cost of the CORP Tennis Complex is \$13,782,253.
Pending	CORP Phase 2b Construction Contract Closing Date

Source: Department of Design and Construction

Taxpayers paid for apparent design errors or omissions and late performance

The department has the power via the city's general contract conditions to withhold money due or payable to protect the city's interests in the satisfaction of the obligations of contractors. It also has the power to enforce the time period agreed upon for completing services by assessing a daily rate of liquidated damages for late performance, or withholding contract compensation amounts until the contractor fulfills its obligations if their performance is unsatisfactory.

As a result of the delayed performance of these services, the tennis complex was delivered seven and a half months late from the revised completion date of May 30, 2002. It was marred by design problems, consultant-contractor disputes, scheduling difficulties, and project cost overruns. All of these problems were timely communicated to the department by both the design consultant and the construction contractor as issues needing resolution. However, the department did not pursue cost adjustments and other contractual remedies to resolve these problems.

Though the performance of the design consultant exceeded its eight contracted months, the department did not seek liquidated damages. If the city's consultant or contractor exceeds the time of performance specified in the contract, the department has the discretion to assess liquidated damages at an agreed upon daily rate to compensate the city for the late performance. The construction contractor exceeded its revised completion date by delivering the tennis complex seven and a half months late. The department related that it assessed a deduction of the construction contractor's delay settlement to provide liquidated damages for late performance. This is not permitted by the contract conditions. None of the documents in the department's files confirmed this assertion. Moreover, the contractor insisted that no liquidated damages were assessed against them.

In fact, we found the liquidated damages provisions in these two contracts to be arbitrary. The liquidated damages provision in the design contract was \$25 per day for each calendar day of late performance. For the construction contract, the liquidated damages provision was \$1,100 per day. Comparatively, the design contract was a third of the value of the construction contract, and was of similar duration and performance objectives. There was no basis provided to explain why there was such a stark difference in liquidated damages provisions in the two contracts.

The department is currently withholding the remaining retainage from the construction contractor, now four years after the department's acceptance of the project, alleging that they have not fulfilled their obligations under the contract. However, for the most part, the department did not seek permissible cost adjustments and assessments from the firm(s) apparently responsible for the problems; instead, as will be discussed later, it applied suspect means to fund contract costs, including adjusting the construction contract's contingency fund to a percentage greater than permissible levels, and transferred funds from lapsing capital improvement project accounts to pay for cost overruns.

Questionable design practices adversely affected project implementation and increased costs

Questionable practices rooted in the design phase adversely impacted the department's implementation of the tennis complex and increased costs. Determined to proceed with construction bidding, the department incorporated pre-final design plans into the bid documents. We also found that the design contract's scope of services was amended to divert significant funds for professional services in Phase 1. Excess costs were added to the reimbursable allowance, and numerous *ad hoc* design changes continued throughout construction. As a result, significant funds were diverted from the tennis complex to the Phase 1 baseball fields.

Department rushed to bidding without final design plans

Approved final project plans and drawings provide a basis to guide construction as well as the work upon which a construction contract is based. Project plans are developed and refined to eliminate uncertainty and ensure that the facility will perform as intended. Completed plans, specifications and drawings establish the expectations of the delivered project and form the basis for reviewing whether the facility meets the owner's specifications. Under normal circumstances, proceeding to construction with approved final designs and plans consistent with the established scope of work is an effective tool to manage project costs by providing the baseline between what is expected work versus unforeseen, extra work.

A final design for Central O'ahu Regional Park's Phase 2 tennis complex was not ready prior to the initiation of the construction bid process. According to project documents, the design consultant explained it was unable to finalize the plans for the tennis complex and archery range due to an uncertain budget and incomplete building designs. On July 3, 2001, the design consultant informed the department that its final design effort for the tennis complex was continuing. The city's decision to proceed to construction bidding on September 6, 2001, using pre-final

design plans led to foreseeable requests for information, errors, omissions and delays during the construction phase. We identified 17 design change work items attributed to design errors or omissions that were subsequently fixed by construction change orders totaling an estimated \$141,114.

Design contract reimbursable allowance for incidentals used for substantial costs

The design contract provided a small funding allocation in a reimbursable allowance for specified out-of-pocket expenses incidental to carrying out the contract services. We found that the department misused the design contract's reimbursable allowance by using those funds for significant project expenses and for projects other than design and planning the regional park's Phase 2b tennis complex and archery range. The original design contract established the reimbursable allowance as no more than \$100,000 with the requirement that excess funds revert back to the city. Pursuant to the original design contract, approved reimbursable costs included photocopying, postage, and long distance charges, but the department also included the regional park's Phase 2 conceptual planning and design costs.

Over the course of the contract, the reimbursable allowance was amended several times and was gradually increased from \$100,000 to \$713,735. The department approved other costs, including many substantial rather than incidental costs, such as the regional park's Phase 1 design and construction management services, public relations, overtime to complete construction, the New Jersey tennis sub-consultant's site visits to Honolulu during the complex's construction, and \$224,353 for the extension of construction management services. Concerns about construction management services are discussed in detail later in this report.

Another questionable reimbursable expense involved one of the two tennis design firms which rendered services on the Central O'ahu Regional Park's Phase 2 tennis complex. The design consultant, SSFM International (SSFM), engaged both a Honolulu firm and a New Jersey firm, Global Sports International (Global Sports), since one of its principals had experience in developing *world-class* tennis facilities. SSFM's subcontract with Global Sports was \$14,400, which included travel as a reimbursable expense subject to the consultant's rate sheet. During construction, the subconsultant conducted site visits, spanning four to six days. There were no supporting documents identifying Global Sports' expenses. These tennis complex site visits, totaling \$51,600

were charged to the city as reimbursable allowance expenses on the design contract even though there was no direct contract between the tennis subconsultant and the city. Furthermore, the reimbursement of the subconsultant's travel related costs is disproportionate to the cost of services rendered.

In the final reconciliation, the reimbursable allowance comprised 19 percent of the design contract's total cost. In essence, the reimbursable allowance was a vehicle to fund cost overruns and services of substantial cost. We found suspect instances where reimbursable expenses were used for unspecified services, excessive travel costs and questionable payments. These irregularities are cause for concern.

Phase 2 design contract inappropriately diverted funds to the baseball fields in Phase 1

During our review, we found that the Phase 2 contract to design the tennis complex and archery range also diverted significant funds for professional services costs under the park's Phase 1 baseball fields. Two Phase 2 design contract amendments allocated funding for services to the park's remaining Phase 1 work. Under this contract, only 24 percent of the amount initially appropriated was spent on the tennis complex and archery Phase 2 planning and design.

The original design contract was awarded for \$932,675, with \$250,000 allocated to the regional park's Phase 1 construction management services; \$682,765 for Phase 2 planning and design services of which \$100,000 comprised the reimbursable allowance, and \$582,675 for extra work.

One year later, the department amended the design contract reallocating compensation amounts. The amendment reduced extra work funds for Phase 2 design from \$582,675 to \$194,465, a reduction of \$388,210. The amendment reallocated the \$388,210 by increasing Phase 1 construction management funds by \$188,300, and also increasing the reimbursement allowance by \$200,000. It also incorporated additional Phase 1 completion costs including additional overtime, public relations, operating expenses, and additional design and construction management services to be reimbursed through this contract.

In the final reconciliation of design contract costs, planning, design, and construction management work were separately identified in the final accounting of services rendered. Only \$164,315, or 24 percent of the amount initially appropriated for Phase 2 planning and design, was

actually spent for that purpose. There was no accounting for the design contract's \$518,360 diverted from Phase 2 to Phase 1 completion costs. Such egregious practices raise serious questions about the department's and former city administration's execution of capital projects and the use of funds for intended purposes as appropriated by council.

Post-contract services added more than \$1.6 million to tennis complex costs

During the design and construction phases, an estimated \$1,654,546 was added to the tennis project's total cost due to the previous administration's requests for re-design, apparent design errors and omissions, and construction change order work. The design consultant commented that design work during the construction phase is normally prompted by two reasons, one is unforeseen conditions, the other is the owner desires a re-design after construction has started. On site visits during construction, the previous administration directed many changes, including removing and replacing elements already constructed, such as removing the comfort stations' metal roofing and replacing it with tile roofing to match the other structures at the tennis complex. The design consultant further noted that there were a lot of changes requiring *design-on-the-fly*, which refers to design changes made while the project was under construction.

We were informed that the former managing director was very involved in the design elements of the tennis complex, personally contacting the consultant and subcontractors, micromanaging details, providing drawings and other suggestions. The design consultant indicated that they delegated some city administration changes to their sub-consultants who considered it extra work and found such changes difficult to complete in the allotted time. Although the project was delivered 232 days late, the department's change orders did not formally document the additional time to implement the change requests. However, we were able to identify the costs of that change work.

The administration's requests for changes during construction of the tennis complex added significant costs to the project. Some requests involved re-designing portions of the tennis complex that were already constructed in accordance with the plans and specifications. Ultimately, extra work on the tennis complex cost \$1,654,546 and attributed to the following categories:

- \$963,874 in construction costs for extra work during construction;

- \$144,057 for the consultant's re-design work during construction;
- \$163,641 for re-design change orders;
- \$241,860 for additional construction management services; and
- \$141,114 for apparent change orders for errors and omissions.

Pressure to proceed to construction bidding despite incomplete design plans and many post-contract design changes while the tennis complex was being constructed were significant factors that compromised this project and increased project costs.

Department overrode statutory, city and internal change order directives

Problems emanating from the previous city administration's decision to proceed to bidding with pre-final design plans likely contributed to errors and omissions requiring corrective work during construction. The department paid for this work through costly change orders during construction and after the tennis complex was completed. We found that the department overrode existing city finance and internal guidelines and controls requiring formal approval of the proposed changes before work commenced. Significant change order work proceeded prior to formal approvals. Moreover, change work approved after the tennis complex was completed in January 2003, added an estimated \$690,000 to the cost of the tennis complex.

During construction, unforeseen or unanticipated conditions, errors or omissions in the project plans may necessitate changes to the original project plans. To ensure compliance with state procurement and city ordinance requirements for change orders, verify the need for proposed changes, and control costs, both the finance director and the department have established change order policies, procedures and directives. The work in change orders must be within the original contract's scope of work, and changes in the time of performance cannot alter the scope of work. We also note that change orders do not always result in increases in cost or time; they may also credit costs or time back to the owner or contractor.

Consistent with the State Procurement Code, city finance policies and procedures require that changes and additional work shall be within the original contract's scope of work and necessary for the completion of the project. Agencies are required to justify whether the change is

necessary for the completion of the original scope of work, and are advised to consider whether the change work or additional work should be treated as a separate contract, subject to procurement requirements.

Agencies must also address why the proposed work was not foreseen during the preparation of the original plans and specifications, and assess whether the change work was due to an omission, error or an unforeseeable condition. Lastly, the department must provide a summary of negotiations, including a cost breakdown from the contractor or subcontractor; otherwise, the agency must explain why it accepted the cost. For change orders exceeding \$100,000, cost or pricing data and certification complying with state procurement requirements must be provided. The department's own internal policy memorandum forewarns that change orders that fail to meet all of these criteria are prohibited; and that such work must be accomplished in a separate project. This did not happen for suspect change work for the tennis complex. The estimated tennis complex construction costs as adjusted by change orders are presented in Exhibit 2.3.

Exhibit 2.3

Estimated Tennis Complex Construction Contract Costs

<i>Item</i>	<i>Tennis Complex Cost</i>	<i>Description</i>
Construction Contract	\$8,914,000	Original construction contract awarded to Dick Pacific Construction for \$9,576,000. Project contingency is \$478,800; five percent of construction contract. Tennis complex work contracted at \$8,914,000
Change Order 1	\$0	Amounts were reallocated within Phase 2, no change to total cost
Change Order 2	\$37,494	Change order work for all tennis items, no archery
Change Order 3	\$18,438	Change order total of \$19,400, archery items: \$963
Change Order 4	\$1,457	Change order total of \$3,721, archery items: \$2,264
Change Order 5	(\$30,055)	Credited change order work for all tennis items, no archery
Change Order 6	\$98,505	Change order work for all tennis items, no archery
Change Order 7	\$121,762	Change order work for all tennis items, no archery
Change Order 8	\$568,219	Change order total \$606,940 Archery items: \$38,721
Retainage (includes unpaid work)	\$243,210	Total retainage owed: \$260,844 Archery items: \$17,634
Aquatics and Tennis Complex Contract Change Work	\$93,397	Change orders total \$159,175. This amount reflects tennis change work only.
Total Estimated Tennis Construction Cost	\$10,066,427	

Note: Figures are rounded to nearest whole number

Source: Department of Design and Construction

Existing controls and the intent of change orders overridden

In each contract change order is the language:

the contractor agrees that this change order represents equitable compensation for all labor, materials, equipment, incidentals, and both direct and indirect costs, including

impacts due to delays and increased time of performance to complete the work described herein.

This language is intended to confine the city's liability to the work contained in the change order itself.

We found that the construction contractor crossed out the provision from change orders 2 through 7, and substituted additional terms which permitted the recovery of additional time and costs associated with the effects of all project changes including those in change orders. The department, corporation counsel and the finance director did not remove the text of the contractor's *ad hoc* changes to the city's change order language. Thus, the revised terms, may have increased the city's liability for yet to be determined project costs.

In change order number 8, the department approved a \$498,000 claim for delays incurred throughout the project and charged this to the tennis complex and site work category. Although approved in the change order, the delay claim was a foreseeable, anticipated consequence of the management of the project and the effect of language approved in previous change orders. In this case, with the department's knowledge and approval, change orders were used to cover project overruns caused by delays, rather than actual change work.

We found the following examples of department or city administration *ad hoc* change requests to planned design or elements already constructed. For example, changes for aesthetic rather than practical reasons included such items as \$18,515 to remove already constructed metal roofing systems of the complex's comfort stations, and reconstruct them to match the overall facility; \$3,402 to install special color clay tile roofs on comfort stations; and \$9,895 to change finishes on tennis complex fences to match other nearby fencing. During one site visit, the city's New Jersey tennis design consultant required the electrical subcontractor to remove pull boxes that had recently been installed. Reportedly, the tennis consultant had not been paid to review the tennis complex's plans beforehand. We found an estimated \$70,182 in change work due to light pole bases not being specified for construction at courts number 13 to 20 in original plans, and later ground coverings were required for safety because the revised specified poles were never installed. In total, the cost of change orders prompted by department or administration requests which do not qualify as change order work amounted to \$163,641.

City finance policy requires the department to evaluate whether the change order work is caused by errors or omissions, or is unforeseeable. From our review of department project files, we found significant change order work attributed to apparent errors or omissions. For example, \$41,808 was spent to provide additional drainage and corrective sealing to modify the terraced seating and retaining wall because as designed, water seeped into tennis court number 2; change work for several disability access requirements cost \$25,445; \$12,097 to install brackets and Simpson connectors for the comfort stations' structural stability not present in the original structural drawings, and \$13,751 to caulk sidewalk expansion joints required for proper installation, but was not specified in the original plans. Altogether, the total cost of change orders to correct apparent errors and omissions in the design of the tennis complex is \$141,114.

The department also approved extra tennis costs that may not qualify as change work consistent with departmental and city finance policies, legal, and administrative change order requirements.

Change work performed prior to approvals

City finance policy and contract terms require formal approval of change orders prior to change order work being performed. Without the approvals, the change work is done by the contractor *at-risk*, meaning that the city is not obligated to pay for the work. In this case, the contractor must either sue the city for the services performed or use the city's claim process. We received conflicting viewpoints on whether change work occurred prior to the approvals of change orders. Both the department and the design consultant indicated that change work had not proceeded prior to change order approvals. The construction contractor indicated that due to the very tight timeline, change work needed to and did proceed without approved change orders to meet scheduling requirements.

Change order justifications submitted by the design consultant's construction manager, indicate that all change order work occurred after change orders were approved, consistent with the department's and the consultant's assertion that complied with requirements. This differs with the construction contractor's work schedule, which revealed that certain change work items were scheduled prior to change order approvals. Moreover, four of the tennis complex's eight change orders were approved after the project was substantially completed. Change orders 5 through 8 were approved after the city had accepted the project on

January 16, 2003. We also note that change orders 7 and 8 were initiated after the substantial completion and acceptance date.

Post-project acceptance change work cost an additional \$690,000

By contract and policy, change work should not proceed until change orders are formally approved to protect the city from claims for unauthorized work. The tennis complex was substantially completed and accepted by the city on January 16, 2003. However, two change orders, dated January 21, 2003 and February 11, 2003, were approved by the city after project acceptance and added \$689,981 to tennis complex construction costs.

Tennis complex change orders after the department accepted the tennis complex provided the bulk of Phase 2b change order costs accrued. Prior to the approval of the post-project acceptance change orders, the initial six change orders approved for all Phase 2b tennis complex construction totaled \$129,065, well under the project's contracted contingency of \$478,800. The approval of an additional \$728,702 for Phase 2b prompted the department to increase the project's contingency from five to ten percent to cover the change order costs. The six original change orders provided \$125,839 for tennis complex change order costs. The last two change orders added \$689,981 to tennis complex construction costs.

The timing of change work in these two change orders is problematic because they occurred after the department accepted the tennis complex as substantially complete. On December 20, 2002, a construction manager's project memorandum indicated that the project was 99 percent completed, and that substantial completion would occur on December 26, 2002. The department accepted the project on January 16, 2003. Normally, after project acceptance, the department proceeds to close out the contract and release project funds.

Instead of proceeding with closing the contract however, the department approved change orders for \$689,981 after substantial completion, a disproportionate amount for a project that is virtually completed, raising concerns that some of the change work was completed prior to their approval and if change orders were a funding source for project cost overruns.

Anticipated tennis complex construction cost overruns prompted the inappropriate transfer of \$1.4 million

The department and city administration anticipated that the tennis complex could run short of construction funds. In preparation of the FY2001-02 capital budget, the Department of Design and Construction, the Department of Budget and Fiscal Services (BFS), and the previous city administration determined that additional funds would come from appropriations to non-specific capital projects and from lapsing fund balances from other capital projects. In the implementation of these plans, the department improperly transferred funds appropriated to budgeted projects and failed to notify city council of these transfers as required by ordinance. These questionable practices subverted the capital budget process for the designated projects and concealed knowledge that the department and previous administration anticipated the total cost of the tennis complex would be higher than the budgeted amounts submitted to council for approval.

Additionally, we learned that the department was also guided by a separate, internal procedure for transferring funds from one capital project to another.

Legal and administrative requirements regarding transfers disregarded

Appropriations are to be used for the purposes set forth in the Executive Capital Budget Ordinance and the Executive Capital Program, and may be subject to provisos or conditions related to the expenditure of funds appropriated in the capital budget ordinance. Funds appropriated to a capital project can be transferred to another project, subject to requirements set forth in city ordinance. All individual transfers between *activities* and all individual transfers between *characters of expenditure* must be filed with the city clerk and a copy provided to the council within 15 days after the end of the month. By ordinance, funds appropriated to a capital project may be transferred to another project subject to specific notification and reporting requirements before such transfers are executed. When amounts to be transferred exceed established thresholds no transfer shall be executed without council approval by resolution.

All individual transfers of funds between *activities* occurring within each month must be filed with the city clerk within 15 days after each month. Reports of individual transfers of funds between *activities* shall include, but not be limited to the following information:

- Amount of funds transferred;
- Source of funding of the transferred funds;
- Originating activity and character of expenditure thereof from which the funds are transferred;
- Activity and character of expenditure thereof to which the funds are transferred;
- Purpose for the transfer; and
- Impact of the loss of funds on the originating activity.

All individual transfers of funds between *characters of expenditure* occurring within each month must be filed with the city clerk within 15 days after the end of each month, along with a copy transmitted to the city council. Similarly, all reports of transfers of funds between *characters of expenditure* shall include, but not be limited to the following information:

- Amount of funds transferred;
- Source of funding of the transferred funds;
- Originating character of expenditure from which the funds are transferred;
- Character of expenditure to which the funds are transferred;
- Purpose for the transfer; and
- Impact of the loss of funds on the originating character of expenditure.

Departments intending to transfer funds between *activities*, meaning the lowest level in the appropriations ordinance at which resources are budgeted, or between *characters of expenditure*, major categories of expenditures, including work phases, that total \$100,000 or more must first be approved by city council by resolution.

Departments are also prevented from transferring funds between *characters of expenditure* within the same activity without council approval by resolution when:

- the cumulative amount of transfers exceeds the lesser of \$100,000; or
- the greater of ten percent of the originating or receiving character of expenditure, or \$10,000.

However, allocations of appropriations between project work phases are permissible. These notifications and approval assist council in its fiduciary responsibilities and discretion in appropriating certain amounts of funds for specific purposes.

In December 2002, the deputy managing director advocated on behalf of the department to locate available lapsing funds from FY2001-02 capital project accounts that could be used to fund the tennis complex due to anticipated cost overruns. The deputy managing director reminded a BFS fiscal administrator that in previous budget discussions with the mayor, that four accounts' lapsing funds were identified as sources of funding intended for the Central O'ahu Regional Park. The amount of these initial appropriations was \$11,400,000. In response, the administrator indicated that transfers from two accounts could not be approved because the appropriations were intended for improvements to existing parks, and improvement funds could not be used on parks in development. Of the \$11,400,000 identified by the deputy managing director, the finance administrator approved \$1,280,000 as eligible to transfer to the regional park.

The deputy managing director requested that the fiscal administrator reconsider on the basis of previous discussions with city administration that identified certain general capital improvement accounts for improvements and renovations at parks to fund work at the Central O'ahu Regional Park. The deputy indicated that previous planning discussions about the capital budget earmarked \$8.4 million to the regional park's projects from all four accounts, even though only \$2.4 million may have been allocated or encumbered to this point. Alternatively, the deputy suggested using the excess funds from other capital projects to pay for Phase 2b construction costs, such as bleachers and other items.

In implementing these plans, funds were transferred from other capital projects, without council notification. Moreover, each of the four transfers exceeded the \$100,000 threshold and subject to council approval by resolution. However, the city council was not notified of these four transfers that had exceeded notification thresholds as required by ordinance. These questionable practices by the department and the former administration subverted the capital budget process for the designated projects, and concealed knowledge that the department and previous administration knew the total cost of the tennis complex might require more funds than the budgeted amounts submitted to council for approval.

We also found that the Department of Design and Construction has an internal policy memorandum, *Request for Release of Funds*, which may be used for transferring funds from other capital improvement appropriations. Additionally, there is no mention of *lapsing* funds as a specific category of funds more or less available or appropriate for transfer purposes. This procedure requires approval by the design and construction section head and branch chief and review by a budget and fiscal services' fiscal administrator. However, we note that the department's procedure does not mention or advise the need to comply with city ordinance reporting requirements, nor thresholds when transferring funds must first be approved by city council through resolution. This internal procedure apparently guided the department's transfer of funds appropriated to other capital projects to the tennis complex.

During construction, the department sought the transfer of funds from three unrelated lapsing capital improvement project accounts to fund construction of the tennis complex, and from another unrelated capital improvement account to fund the regional park's Phase 2 design contract. The department received the finance director's and managing director's approval to transfer \$1,341,007 in funds from three *lapsing* capital accounts to fund construction contract overruns. The department also transferred \$110,000 from another capital project to fund a design contract amendment. Project files at the departments of design and construction and budget and fiscal services, nor other searches provided evidence that these transfers to the tennis complex were approved by council resolution as required.

Until the end of the construction phase, all design contract activity was funded by the Phase 2 design capital project account. We found that the department received the finance director's and the current

administration's approval to transfer money to the design contract, from appropriations to *Miscellaneous Improvements to Recreation District 5*. One of the purposes for this FY2005-06 project appropriation was for planning and designing the expansion of the regional park's existing maintenance facility to accommodate Department of Parks and Recreation personnel, vehicles, and materials serving Mililani area parks. The department redirected money from this capital account in January 2006 to pay for \$110,000 in additional design services for Phase 2, which were rendered in 2003. Although both projects reference Central O'ahu Regional Park, the intent to plan and design a maintenance facility is considerably different from designing the regional park's Phase 2 tennis complex and archery range. As such, the city council should have been informed of the department's intent to transfer funds to the tennis complex.

To fund Phase 2b construction, the department sought the transfer of funds from three capital improvement project accounts in late 2002. The accounts were the *City Beautification Program*, *Landscaping Improvements at Various Parks*, and *Miscellaneous Improvements to Recreation District 3*.

City Beautification Program capital appropriations are intended to improve existing city properties, such as sidewalks, streets, roadways, and public places with trees, shrubs, hedges, groundcover, as well as providing irrigation. As a new city park under construction, the regional park's tennis complex was not listed among the existing parks receiving planned improvements. Projects the department identified as sources of funds to transfer to the tennis complex included appropriations for Kapolei Civic Center and Ulehawa Rocky Point in Nanakuli.

Funds from another parks and recreation capital project, *Miscellaneous Improvements to Recreation District 3*, were also targeted for tennis complex construction. Amidst the public's interest in improving existing city parks, the council appropriated funds to repair, renovate, and improve existing parks, including those in recreation district 3. We found that the department initiated the fund transfer through its internal process and received approval to complete the transfer.

The final capital appropriation account targeted was *Landscaping Improvements at Various Parks*. This project was intended to improve existing recreational resources and parks with landscaping. Transferring these funds from existing parks to the construction of a new regional park's tennis complex is inconsistent and contrary to council's

intent to fund needed landscaping at existing parks. The department and the previous and current city administrations disregarded the ordinance requirement for council notification and approval by resolution for the \$1,451,007 in funds transferred from three separate capital projects; as well as the department's internal procedure to transfer appropriations from and to different capital projects without council notification is troubling.

Despite exceeding reporting limits, none were reported for council's review and approval

Departments are prevented from transferring funds to or from an activity that total in excess of \$100,000 without council approval by resolution. During this project, there were four transfers of funds from unrelated projects to the project construction fund: two transfers of city beautification funds totaling \$727,007; transfer of district 3 park improvement funds totaling \$400,000; and the transfer of park landscaping improvement funds totaling \$214,000. The department also transferred \$110,000 from recreation district 5 improvement funds to pay for additional design services for the regional park's Phase 2. All five transfers were subject to council approval, however we found no evidence that the department complied with this requirement. Moreover, the department did not report the impact of the loss of funds on the originating projects. A list of transfers that should have been reported to council and approved by resolution is presented in Exhibit 2.4. The net result is that \$1,451,007 appropriated for other projects was diverted for the regional park's purposes.

Exhibit 2.4

Capital Project Appropriations Transferred to the Tennis Complex Without Council Notification

<i>Capital Project</i>	<i>Project Contract Funded</i>	<i>Amount Transferred</i>	<i>Council Notification Criteria</i>	<i>Council Notified?</i>
City Beautification Program, FY2001-02	Construction	\$348,039	Greater than \$100,000	No
City Beautification Program, FY2001-02	Construction	\$378,968	Greater than \$100,000	No
Landscaping Improvements at Various Parks, FY2001-02	Construction	\$214,000	Greater than \$100,000	No
Miscellaneous Improvements to Recreation District 3, FY2001-02	Construction	\$400,000	Greater than \$100,000	No
Miscellaneous Improvements to Recreation District 5, FY2005-06	Design	\$110,000	Greater than \$100,000	No
Total Transferred Without Council Notification		\$1,451,007		

Source: Department of Design and Construction, Department of Budget and Fiscal Services

When we discussed the reporting of change orders, contingency funding, and lapsing fund transfers, the department indicated that they only needed to report to budget and fiscal services, which is responsible for submitting the reports to council. Therefore, it is not necessary for the department to also submit a report of transfers to city council. Failure to report these transfers thwarts council's intent in appropriating funds to capital projects by improperly transferring money from these approved priorities to pay for the tennis complex's design or construction cost overruns. Until departments comply with ordinance requirements governing project appropriation transfers, city council has no assurance that appropriations for capital projects will be used as intended.

**Questionable
construction
management services
added an estimated
\$659,912**

The department's procurement of construction management services raised many questions, and its costly services appeared to favor a firm at taxpayers' expense. Contrary to procurement guidance, an apparent conflict of interest, construction nearing completion, and the significant cost of such services, the department with the approval of the former administration incorporated construction management services for Phase 2b construction to the existing design contract. The former DDC director expressed the department's uncertainty about the proper procurement method for these services as the cause for the delay in contracting, and that the consultant had already rendered \$1.2 million in Phase 2 construction management services without a contract. This explanation falls short of an appropriate justification for approving an after-the-fact procurement of construction management services.

In the end, the department's request to amend the design contract was approved and construction management services were incorporated into the consultant's scope of work. The duration of construction management work from city administration approval on November 26, 2002 to completion on December 31, 2002 was 36 days. In the final reconciliation, Phase 2 construction management services added an estimated \$659,912 to the total cost of the tennis complex.

Fiscal guidance to separately procure construction management services unheeded

Professional services, including design and construction management consultants, must be procured in accordance with the State Procurement Code, *Procurement of Professional Services*, Section 103D-304, Hawaii Revised Statutes (HRS). These requirements set forth a review and selection process to provide appropriate consideration of other professional services providers based on demonstrated competence, qualifications to provide the services required, and at fair and reasonable prices. Only those services subject to the procurement process set forth in Chapter 103D-304, HRS are legitimately obtained.

Under the original Phase 2 design contract terms, the design firm would provide concurrent services to two separate projects: planning and design services for the Phase 2 tennis complex and archery range, and construction management services for the regional park's Phase 1 baseball fields.

As discussed earlier in this report, best practices advise that construction management services are an added cost, and as such, situations that warrant the additional cost are typically large, complex, or multiple-

phase projects. In addition, an owner typically retains construction management services during the latter portion of the design phase to gain an understanding of the owner's and facility's construction requirements. During construction, an independent construction management consultant oversees the work of the construction contractor, mediates design consultant-construction contractor disputes, determines financial responsibility as applicable, recommends reasonable changes for approval, and performs related tasks to ensure that the project is completed according to plans and specifications, on time, and within budget.

However, we found that one year after the construction notice to proceed, the department sought approval to amend the design contract to include construction management services for the Phase 2 tennis complex and archery range. Upon reviewing the proposed design contract amendment, a fiscal administrator advised the department in January 2002 that construction management services were outside of the design contract's original scope of work for Phase 2 and such services should be separately procured.

To justify the reason why Phase 2 construction management services were omitted from the original scope of work, the department explained that the *after-the-fact* procurement was due to inadvertent errors, miscommunication, an internal delay in processing a new consultant contract covering construction management services, and differing viewpoints on how construction management services should have been contracted. The department acknowledged that *after-the-fact* procurement was not allowed and that it needed to comply with procurement requirements to separately procure these services. However, the department's urgent request came after the design consultant had reportedly provided \$1.2 million in Phase 2 construction management services. Even though second phase project construction was nearly completed, and despite a fiscal administrator's advice to procure construction management services separately, the department proceeded. Ultimately, the former finance director approved the department's request to amend the scope of services so that the design firm would also provide Phase 2 construction management services. Exhibit 2.5 shows the summarized design and construction management contract costs.

**Exhibit 2.5
Design and Construction Management Costs for the Central O'ahu Regional Park Tennis Complex Design Contract**

<i>Item</i>	<i>Tennis Complex Costs</i>
Design Contract for Phase 2: Tennis, Archery and Softball Fields	D: \$315,621
Design Contract Amendment #1	D: \$228,576
Amendment #2	D: \$272,491
Amendment #3	D: \$632,560
Amendment #4	D: \$632,560
Amendment #5	D: \$683,409
Final Reconciliation	D: \$758,994
	CM: \$659,912
Total Estimated Design & Construction Management Cost	\$1,418,906

Legend:

D: Estimated design and planning costs for the Phase 2b tennis complex
 CM: Estimated construction management costs for Phase 2b tennis complex construction

Source: Department of Design and Construction

In addition to concerns about the questionable contract amendment, other problems with construction management services contributed to project delays, added to the tennis complex's total cost, and an apparent conflict of interest.

After-the-fact procurement twice amended the design contract costing \$1,314,301

In April 2005, the department issued an internal memorandum, incorporating all previous administrative financial directives, prohibiting *after-the-fact* procurement, except for emergency procurements

involving health and safety. It advised that the city finance policy and procedures shall be strictly followed, including Section 1.4, *Construction Contracts*. The department's memorandum prohibited work that the city has not contracted for, including work by consultants and contractors. For construction contracts, no additional work shall proceed prior to the execution of a contract amendment (i.e. change order) or written letter signed by the director authorizing work on a force account basis.

The memoranda warned that *after-the-fact* procurement practices are inappropriate and violate the state procurement statutes, HRS 103D and the city charter. The former finance director emphasized that this applies to all contracts and instructed agencies to stop this practice and initiate requests beforehand so that contracts can be properly executed prior to the receiving services.

Despite budget and fiscal services' guidance, the design contract was amended after-the-fact on two occasions, in November 2002 and January 2006. On November 26, 2002, the department amended the design contract for a fourth time and added construction management services to the scope of services. The department reported that the amendment was necessary to formally approve Phase 2 construction management services that the design consultant rendered informally for over a year. Although the department reported that the services were inadvertently omitted from the original contract, and that errors were made in assessing the proper form of procuring these services, (i.e. contract amendment versus new contract), neither was justifiable as an emergency procurement for health and safety reasons. This appears to be precisely the kind of procurement that budget and fiscal services guidance has sought to prevent through repeated directives to city departments and agencies.

On January 24, 2006, slightly over three years after the tennis complex was completed, the department issued a fifth contract amendment to pay for additional planning and design services rendered without formal approval in 2003. This amendment was used to pay for additional facility enhancements introduced and directed by the city administration during the course of the project. The basis for approving this amendment was the need to resolve work the consultant completed during the previous administration and the department had negotiated a substantially lower fee.

Regardless of the department's explanation, neither the finance director nor managing director required the contractor to file a claim against the city as stated in the previous financial policy memoranda. In its approval, the current assistant managing director cautioned that the approval of payment for this invoice should not be considered an endorsement of the practice of after-the-fact approvals for future procurements of goods and/or services. In the end, after-the-fact procurement twice amended the design contract and cost \$1,314,301.

Apparent conflict of interest created by firm's dual design and construction management responsibilities

When an entity has a financial interest in, or when two organizations have competing or differing interests from each other, a project owner's interests can be harmed through delays or extra costs. Such organizational conflicts of interest can cause two distinct problems, *unfair competitive advantage* and *bias*. Unfair competitive advantage occurs when one firm has access to information not available to other firms in the normal course of business which can provide a competitive advantage in the procurement process.

Bias arises when a consultant or contractor is placed in a situation where it may have an incentive to distort its advice or decisions. The San Francisco Public Utilities Commission formally recognizes that an organizational conflict of interest can evolve through *progressive participation* in various contracts to plan, design and construct its facilities. Its conflict of interest guidelines alert consultants and contractors to potential conflicts applicable to various phases of project development from inception to completion, including preparing requests for proposal, planning, alternatives analysis, design, construction management and construction. For example, the commission notes:

Construction Management. *This work consists of review, assessment and recommendation for actions based on interpretation of contract documents. No firm under one contract can review any of its own work performed under another contract. Conflicts would likely arise had any firm participated in either preparation of final engineering design or any documents enumerated in a contract for construction or documents the (owner) requires a contractor to rely on in the preparation of their bid.*

Best practices advise that potential conflicts can be resolved by re-procuring the services, or by providing prior notice that the design

consultant selected cannot compete for the construction management services contract.

We found no indication in the department's Phase 2 project files recognizing that having the same firm responsible for design and construction management services could pose a conflict of interest during construction since the design firm would likely review its own work during construction. A conflict arises, because the firm would have a financial interest in the outcome of disputes with the construction contractor involving financial responsibility for potential design errors or omissions. Therefore, the department could not reasonably expect the same design firm to independently and objectively perform construction management responsibilities during construction. By ignoring an apparent conflict of interest, the department opened the door to the possibility of delays and extra costs resulting from disputes between the consultant and contractor.

State procurement, city finance and internal department requirements and guidance are silent on the issue of organizational conflict of interest. However, these conflicts can harm the city's fiduciary interests by delaying project completion or adding project costs. Our review of the department's files revealed questionable benefit from the late, suspect and costly addition of construction management services, as the project files are rife with complaints, disputes, scheduling delays and claims for extra costs.

Foreseeable disputes and delays resulted in schedule impacts and additional costs

The construction contract for the second phase of the Central O'ahu Regional Park was on a very tight timeline which both the consultant and contractor attributed to the city administration's timing of the tennis complex's grand opening. Given the administration's timeframe, the department rejected the consultant's request to increase the planned construction schedule by 180 days to adequately complete construction. Proceeding to construction bidding with pre-final design plans led to disputes over design errors and omissions that could jeopardize the project schedule and increase the tennis complex's costs.

During construction, there were on-going disputes between the firm's design consultant and construction manager with the construction contractor. The contentious nature of the relationship between the design consultant's construction management staff and the construction contractor was well documented in many reports and correspondence

throughout the department's Phase 2b project files. Problems commonly cited by the contractor pertained to incomplete, unfinished, and unclear design plans; substantial delays in responses to change proposals, information requests, and approvals; and delays in issuing directives, with some spanning four to six months. Moreover, the construction contractor concluded that the project continued to be designed and re-designed adding cost and time to the project.

The construction contractor commented that when the project responsibility structure is set up so that the design and construction management teams are not at arms length, the construction management team cannot make objective calls to resolve issues involving the design. When the same firm is responsible for design and construction management, the contractor believes that the design firm has a greater tendency to protect the design work. They further suspect that the design consultant's construction management team was not free from the city administration's influence to make independent or objective decisions regarding the design work as required by their role.

The design consultant did not believe having its own employees design and provide construction management services overseeing construction was a conflict of interest. By delegating much of the design work to their subcontractor specialists, the design was not an *in-house* project; and the design consultant believed this arrangement would not create a conflict of interest. However, the consultant acknowledged that delegating work to its subcontractors caused some delays in responding to the construction contractor's requests for information.

In addition, the design consultant expressed that they had a lot of problems with the construction contractor including difficulty enforcing the construction contract and the design of the tennis court, as well as some problems with accepting the quality of certain construction work. They believed that the contractor's constant flow of questions may have been a tactic to increase their compensation through delay claims and extra work.

The design consultant concurred that design changes adversely affected the project timeline and schedules had to be changed. The consultant also noted that their subcontractors protested that certain changes were impossible to accomplish within the department's time frame and that requests to re-design was extra work. In a series of project progress summaries, the construction management project manager indicated that progress was delayed by the design team's slow responses to the

construction contractor's requests. As a result, they anticipated that the contractor would submit a delay claim.

The contentious relationship between the design consultant and construction contractor contributed to timing and scheduling problems for the project. As expected, the design firm and construction contractor exchanged views on the nature of problems with each other's work during the implementation of the tennis complex. Given the problems including the after-the-fact procurement of construction management services one year after construction commenced, the apparent conflict of interest and the additional cost of these services was an estimated \$659,912; the benefit to the city is highly questionable. Lacking formal guidance on both the prudent use of construction management services and recognition of potential organizational conflicts that are contrary to the city's interests, the council and taxpayers cannot be assured about the appropriate use of these services by the department.

The department approved excess and inappropriate uses of construction contingency funds

Contingency funds are incorporated into project construction budgets to prevent disruption of activities or scheduling by unknown or unforeseen project conditions such as weather, labor or material shortages, or economic uncertainties at the time of bidding. Instead, we found that the department used contingency funds to pay for cost overruns, rather than control project costs. By the end of the project, the department nearly doubled the allowable ten percent contingency to 19 percent. As the cost of the tennis complex increased, the contingency amount was increased to cover construction overruns.

Twice the allowable contingency present in early planning documents

City finance policy on construction contingency funds provides that a contingency fund may be established for construction projects to cover additional costs for unforeseen extra work which may occur after the commencement of the project and **which is incidental to and necessary for the satisfactory completion of the project** (*BFS emphasis indicated*). The policy further provides that the contingency fund shall not exceed ten percent of the contract amount.

While the city's policy on construction contingency funds states that the contingency fund shall not exceed ten percent of the contract amount, this policy allows for flexibility to exceed this limitation if the agency determines that ten percent is insufficient or if the contract will exceed the ten percent contingency fund encumbered. If warranted, the agency may

request the approval of the managing director to increase the contingency amount.

During our fieldwork, we found that the department exceeded the city finance policy's ten percent contingency limit in planning the project. Project planning documents included project cost estimates for the 20-court tennis complex with projections for a ten percent and alternatively, a 20 percent contingency fund estimate. While the reason for the cost estimate with the 20 percent contingency fund was unclear, by the end of the project, the construction contract contingency reached an approved level of 19 percent. This raises questions about the actual purposes and effectiveness of the department's oversight and controls over the use of contingency funds. In retrospect, rather than control the cost of the tennis complex, the department instead appears to have planned for excess amounts that would ultimately be paid to the construction contractor.

Contingency funding request of 19 percent violates finance policy

Initially, the contingency for the construction contract was \$478,800 or five percent of the total contract amount. This provided a prospective contingency fund for unforeseen work during construction of the tennis complex and archery range. By November 2002, the total amount owed was approximately \$10,433,768. In response, the department sought and received approval to increase the contract contingency from five percent to ten percent or \$957,600. This request increased the contingency on the contract, but remained within the ten percent limit established in the Department of Budget and Fiscal Services contingency policy on construction contracts.

In December 2002, the department sought and received approval to increase the contract contingency to 19 percent, or \$1,819,807 raising total available contract funds to \$11,395,807 since the department needed to find an additional \$1.2 million to cover anticipated change work proposals. With assistance from the managing director, the department obtained approval to transfer \$1.3 million, increasing the ten percent construction contract contingency funds to 19 percent.

City finance policy on contingency funds permits this situation to occur because it is a procedure for requesting additional funds, not controlling costs. The Department of Design and Construction requested an increase of the contract contingency to 19 percent, because the contract contingency was determined to be insufficient, or had exceeded the ten percent limit. We note that the deputy managing director and the

managing director actively sought additional funds outside of the budgetary process on the department's and project's behalf, rather than acting as an approval control on this project's cost overruns. With the additional approved contingency, \$1,341,007 was encumbered to be spent on the construction of the tennis complex.

Contingency used for anticipated overruns, not unforeseen costs

During construction, the department used contingency funds to pay for foreseeable cost overruns, rather than for unforeseen costs. As a policy, the purpose of construction contingency funds is to prevent disrupting a project's budget or schedule due to the costs of unforeseen extra work which is incidental to and necessary for the satisfactory completion of the project after construction has commenced. During our fieldwork, the department indicated that contingency funds are used to cover projects that are running short of money. While that may be an expedient solution at a critical moment during construction, comprehensive cost control practices are a more effective solution. Using contingency funds when projects run short of money is neither compatible with the finance director's contingency policy, nor a prudent way to use taxpayers' funds.

The department used contingency funds for the costs of delayed and unpaid work. For example, the department was aware that the construction contractor was planning to file a claim for scheduled work that was delayed due to project management issues with the design consultant. The work in the delay claim was consistent with the tennis complex's scope of work, and was not unforeseen extra work. Instead, it appears to be an example of a foreseeable cost overrun that could have been prevented with sufficient oversight and adherence to best practices.

We found that certain cost items funded by additional contingency were aesthetic construction changes, such as changing the installed roof color of the complex's shade shelters to match the color and materials of the rest of the tennis complex, revising the main entrance design which required overseas fabrication and premium shipping, and one month's paid overtime for the contractor and subcontractors to accelerate the project. All of these items also do not qualify as unforeseen extra work, but instead are examples of unnecessary, aesthetic and preference-driven extra costs that were funded by contingency funds.

The city council has limited assurance that the department managed costs at the tennis complex prudently and that the city received the best cost for this project.

Conclusion

A community's request for four to eight recreational tennis courts in the 1990's evolved into a quest to develop a *world class* tennis facility featuring 20 high quality courts for professional, league, tournament and recreational play, when its grand opening was celebrated on February 15, 2003. Developed during the second phase of the master planned Central O'ahu Regional Park, the tennis complex, originally estimated to cost \$8.2 million may cost taxpayers as much as \$12,771,216 when the construction contract is finally closed out. Both the total cost and the cost of project overruns could not be determined due to project accounting that did not identify tennis complex costs separately, missing or incomplete payment records at the time of our fieldwork, and the open construction contract.

The development of the tennis complex at Central O'ahu Regional Park was driven by an aggressive and likely unrealistic timeline, outside pressures unrelated to the tennis complex's construction, project management issues, and practices that increased rather than controlled costs. Certain extra costs may have been avoided had the department implemented the design and construction phases consistent with best practices, such as requiring a final approved design before proceeding to construction bidding, and restricting post-contract design or construction changes. Recapturing cost adjustments for apparent errors, omissions and late performance, ensuring that change orders are used for proper purposes, and restricting post-contract re-design requests unrelated to project scope or schedule concerns could have saved taxpayers significant funds.

The former department director and former managing director disregarded city procurement guidance to separately procure construction management services. Adding construction management services one year after construction commenced is suspect and unnecessarily added an estimated \$659,912 to the cost of the tennis complex. Moreover, granting the same firm responsibilities for design and construction management services created a likely conflict that is contrary to the city's interests as the same firm could not reasonably be expected to render an independent evaluation of its design work due to its financial interest in the outcome. The department's actions were contrary to the city's and taxpayer's fiduciary interests as the conflict led to disputes, delays and increased costs during construction of the tennis complex. There was also failure to address potential harm to the city's interests which organizational conflicts can create.

The department did not require the design consultant to account transparently for direct costs for its design and construction management services and their contribution to the total cost of constructed elements, especially the tennis complex. As such, there was little information on the design contract's \$518,360 diverted to the Phase 1 baseball fields. The department's practice of not requiring the design consultant to submit supporting detail and documents to justify their progress payments is a failure to fulfill their fiduciary responsibilities for the use of taxpayers' funds. This failure to hold the design consultant financially accountable for the payments it requests is troubling. Moreover, the practice of diverting design funds ostensibly for the tennis complex to the park's baseball fields also raises questions about the department's lack of accountability in executing capital improvement projects consistent with council's intent.

The department and previous administration's use of the initial Phase 2 design contract funds was an apparent funding scheme to divert as much as \$518,360 for Central O'ahu Regional Park's first phase baseball fields and recreational park space, as the final reconciliation revealed that only \$164,315 or 24 percent of the initial amount was used for planning and design of the regional park's tennis complex and archery range. When the department anticipated that construction funds were running short, the previous city administration diverted funds appropriated to four other capital projects to the tennis complex construction account. Funds that council appropriated to parks and city beautification projects totaling an estimated \$1.4 million were diverted to Phase 2b construction. Council was not informed of these transfers as required by ordinance. Through the department's and previous administration's failure to control costs on the project, taxpayers' dollars were wasted in many unnecessary ways on a rushed project that doubled as a vehicle to fund cost overruns of earlier development in the park. The transfer of funds from four planned capital projects in neighboring communities appears legally improper, and stripped money away from city council approved priorities without their review of the transfer. In the end, it appears that the transfers were unnecessary as most of the \$1.4 million it diverted, ended up unused as \$1,285,883 remains encumbered in the tennis complex's construction account.

Recommendations

1. The director of the Department of Design and Construction should:
 - a. resume negotiations with the Phase 2b tennis complex construction contractor to close the construction contract, and lift encumbrances on remaining construction funds;
 - b. prepare a complete and accurate accounting of the city's total cost of the tennis complex when the construction contract is closed out;
 - c. assess, improve and incorporate comprehensive cost control policies throughout the implementation of all phases of the city's capital projects, particularly adherence to the approved budget, and accounting for project costs;
 - d. require adherence to the contracted scope work, and approved final project design as a prerequisite to proceeding to construction bidding;
 - e. develop policies and procedures for establishing prudent and justifiable use of construction management services; appropriately structuring project responsibilities to protect the city's interests from potential conflicts of interest, and ensuring compliance with state procurement requirements;
 - f. comply with legal and administrative requirements for reporting this project's change orders and transfers of funds to city council;
 - g. consider additional criteria to control unnecessary change order costs, such as prohibiting change work for aesthetic reasons or scope changes that are unrelated to the completion of contracted work;
 - h. ensure that the department complies with administrative construction contract contingency limits;
 - i. ensure that contractual obligations are enforced; pursue liquidated damages for improper or incomplete work, and set appropriate amounts for damages, as appropriate;

- j. cease commingling resources and funds among separate project phases; and
 - k. fully represent project costs in capital budget requests to council and cease using unspecific, generic purposed capital projects or programs as ad hoc sources of project funding.
2. The managing director should consider solutions to resolve the department's misuse of *after-the-fact* change order practices and ensure that change work proceeds only after formal approval.
3. The director of budget and fiscal services should:
- a. submit to council for the public record all of the required change order and delay reports for the tennis complex, as required by section 2.4-2, Revised Ordinances of Honolulu; and
 - b. ensure that the 20 of 26 missing design consultant contract payment records are located and make them available in the department's official procurement files for review.

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Response of Affected Agency

Comments on Agency Response

We transmitted a draft of this report to the Department of Design and Construction on May 25, 2007. A copy of the transmittal letter is included as Attachment 1. We received the department's request for an extension of the response date on June 13, 2007. The city auditor granted the department an extension to submit its response to the draft report by July 10, 2007. The department submitted a written response to the draft report on July 10, 2007 which is included as Attachment 2.

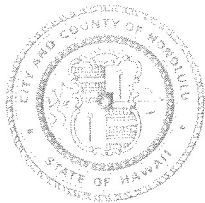
In its response to our draft audit report, the Department of Design and Construction largely responded by providing background information about the development of the Central O'ahu Regional Park and the tennis complex, and by generally describing the processes with which it must comply for the budgeting, planning, and implementation of capital improvement projects. It confirmed that the development of Phase 2 at the park was driven by the former administration's predetermined timeline, resulting in the accelerated design of the project, the selection of one firm to design and manage construction out of convenience, and that the department had to make its best effort to comply with policies and procedures given time constraints. We noted that the department, in its response, affirmed its overall responsibility for the project and its outcomes, acknowledged that it assigned staff to monitor and oversee the project, and clarified that it made all final approvals and decisions on the Phase 2 projects.

The department took no position and provided no additional information on the total cost of the tennis complex, the cost overruns, or the missing payment information. Nonetheless, we stand by this finding in our report, urge the department to report total cost information regarding the tennis complex to the public, and ensure that it maintains complete and accurate payment records and information in its project files.

The department took no position on the findings of the report related to its management and weak controls leading to this project's significant cost overruns. It reported that it is in general compliance with all of these requirements, and that, where applicable, the Department of Budget and Fiscal Services reviews and approves of their compliance. We disagree. While we found instances of compliance with policies and procedures, others were contrary to best practices and contributed to the tennis

complex's \$2.5 million cost overruns. The department's and finance director's disparate policies and procedures fall short of a comprehensive cost control framework throughout all phases of the project's implementation. Our report also revealed weaknesses in the effectiveness of cost controls within certain policies and procedures, and that compliance alone would not necessarily ensure that a project is delivered on time and within budget. We urge the department to strengthen cost controls throughout all phases of capital project implementation. While we agree that providing additional time to complete final design is beneficial, we believe that requiring approved final designs prior to construction bidding can save significant funds, and eliminate delays resulting from incomplete and erroneous design work.

We acknowledge the department's important role in providing the communities of Honolulu with projects that are well used and enjoyed by the public, such as the tennis complex at the Central O'ahu Regional Park. We commend the department's efforts to address the organizational conflict of interest issue in the future, by amending its policies and procedures with respect to the future procurement of design, construction management, and construction services. We also acknowledge the openness of the department to implement revisions to its policies and procedures as a result of this audit report. There were no substantive changes made to the report based on the department's response.



OFFICE OF THE CITY AUDITOR
CITY AND COUNTY OF HONOLULU
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LESLIE I. TANAKA, CPA
 CITY AUDITOR

May 25, 2007

COPY

Mr. Eugene C. Lee, P.E., Director
 Department of Design and Construction
 650 South King Street, 11th Floor
 Honolulu, Hawai'i 96813

Dear Mr. Lee:

Enclosed for your review are two copies (numbers 12 and 13) of our confidential draft audit report, *Audit of the Tennis Complex of the Central O'ahu Regional Park*. If you choose to submit a written response to our draft report, your comments will generally be included in the final report. However, we ask that you submit your response to us no later than 12:00 noon on Tuesday, June 12, 2007.

For your information, the mayor, managing director, and each councilmember have also been provided copies of this **confidential** draft report.

Finally, since this report is still in draft form and changes may be made to it, access to this draft report should be restricted to those assisting you in preparing your response. Public release of the final report will be made by my office after the report is published in its final form.

Sincerely,

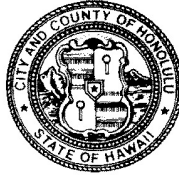
Leslie I. Tanaka, CPA
 City Auditor

Enclosures

DEPARTMENT OF DESIGN AND CONSTRUCTION
CITY AND COUNTY OF HONOLULU

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MUFI HANNEMANN
MAYOR



EUGENE C. LEE, P.E.
DIRECTOR

CRAIG I. NISHIMURA, P.E.
DEPUTY DIRECTOR

211112

July 10, 2007

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Mr. Leslie I. Tanaka, CPA
City Auditor
Office of the City Auditor
1000 Uluohia Street, Suite 120
Kapolei, Hawaii 96707

C & C OF HONOLULU
CITY AUDITOR

Dear Mr. Tanaka:

Subject: Audit of the Tennis Complex and Archery Range
Central Oahu Regional Park – Phase 2B

We are in receipt of the draft audit of the Central Oahu Regional Park (CORP) – Tennis Complex and Archery Range project, and are hopeful that providing access to all of our available information proved helpful. We acknowledge your work on this audit and appreciate the opportunity to respond to your findings and recommendations.

The Central Oahu Regional Park comprises 269 acres and is located in Waipio, Hawaii. The Tennis Complex project is the second phase of development to this regional park. The previous and initial development of the park included 123 acres of site work complete with infrastructure improvements including a reservoir for irrigation purposes. Within the park, six (6) baseball fields (two (2) adult and four (4) youth fields), two (2) comfort stations, five (5) multi-purpose fields, parking and passive park area were constructed. In addition, a maintenance facility was also constructed to service the entire park.

The subsequent Phase 2 development was divided into two (2) projects and encompassed 70.25 acres. Phase 2A was the design and construction of six (6) additional fields (four (4) softball baseball fields, one (1) adult baseball field and one (1) infield practice field), a two-story announcer's booth/comfort station, parking and passive park area.

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Phase 2B was the initial phase of the tennis complex. This project designed and constructed 20 tennis courts, which includes a show court and a sunken stadium style clubhouse court, a tennis pavilion and two (2) comfort stations complete with walkways and landscaped lawn areas. In addition, the project included the design and construction of a twenty-lane archery range surrounded by security fencing and storage facility; parking and passive park area.

The Phase 2 development of the CORP project was divided into two (2) projects in the design phase due to the desire of the Administration to have the project completed to meet their delivery dates. These dates required that the project be divided into two phases to increase the work effort needed to complete the entire Phase 2 within the predetermined completion date. This accelerated effort required close coordination to insure successful outcomes as two (2) projects were started by two (2) General Contractors and completed simultaneously next to each other.

In this case, with the direction to complete the project within an accelerated time period, two (2) General Contractors working side by side, direct participation throughout the project by the Administration, the City made its best efforts to proceed within the applicable policy and procedural guidelines and laws to complete the project.

Due to the accelerated completion schedule, it was determined that the firm that designed the project could assist in expediting the construction by serving as construction manager for both projects. In addition, the Department of Design and Construction assigned staff to monitor and oversee the project. Thus, all final approvals and decisions were made by the City, after considering the recommendations of the construction manager. Nonetheless, the Department of Design and Construction (DDC) – Facilities Division has recognized the appearance of potential organizational conflict and subsequently revised their policy of awarding the Design Consultant with construction management oversight responsibilities to reflect recommended practices.

The City has and had in place policies and procedures with the proper checks and balances to insure adherence to the approved budget, accounting practices and contracted scope of work. For example, contract contingencies are established by DDC to comply with the current administrative construction contract contingency limits. In instances where the limits must be exceeded,

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DDC follows existing Department of Budget and Fiscal Services (BFS) procedures and policies.

In addition, DDC follows the language in the design and construction contracts to enforce compliance with the contract requirements. Liquidated damages are assessed contractors when the contractor does not comply with the contract requirements in completing the construction project within the required contract period. The amount for liquidated damages requested is based on the project and the damages the City would incur in the event the project is not completed within the contract period

Prior to this Audit, DDC has worked with BFS in making the following changes in the funding of construction funds. The City now schedules the construction funds for major projects in separate fiscal years from the planning and design funds to allow sufficient time for the completion of the final design prior to soliciting construction funds. The exception is for projects that are results of consent decrees which mandate the construction to begin as soon as the design phase is complete. In addition, the recently revised City Charter amendment increased the fiscal year funding period from 18 months to 24 months which will allow additional time for the preparation of drawings to be complete prior to bidding.

DDC works with BFS to provide information on project change orders for reports generated to the City Council. Reports on change orders are done through the Appropriation and Allotment Voucher (AV) process. Copies of AVs are provided to the Office of Council Services.

Fund accounts are based on budget ordinances as adopted; no funds are commingled into a subsequent account. DDC complies with the budget appropriation language in the use of funds. BFS provides additional oversight in reviewing DDC's use of funds. Funds appropriated are allotted via the Appropriation and Allotment Voucher (AV) process. Copies of AVs are provided on an on-going basis by BFS to the Office of Council Services.

DDC works with BFS in providing information on all relevant capital budget requests to the City Council as required. Each year, the projects reflected in the Bill Relating to the Executive Capital Budget and Program submitted to the City Council are based on the most current available cost estimates provided by

Mr. Leslie I. Tanaka, CPA
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departmental architects and engineers. From the time the bill is submitted to the City Council to the actual contracting of work, the projects are subject to variable economic conditions such as the availability of construction materials and labor requirements for the project.

DDC's use of funds from so-called "unspecified, generic purposed capital projects or programs," are reviewed by BFS to determine that use of funds are consistent with the budget ordinance. In this project, BFS has deemed the use of funds to be consistent.

In summary, it is our opinion that the departments within the City and County of Honolulu continually strive to comply with all applicable policies, procedures and laws, and consistently work toward providing the community with quality projects that are enjoyed by all users. Thank you again for the opportunity to respond to your draft audit.

We appreciate the report's recommendations and will be working with the appropriate departments to evaluate and implement any warranted revisions to our policies and procedures.

Very truly yours,



Eugene C. Lee, P.E.
Director

ECL:ln (210858)

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