Item 2

Lookback

Audit Overview

Update on the Green Build Construction Audit

Joint Meeting of the
Audit Committee
and the
Terminal Development Program Committee
February 6, 2012

Lookback – Audit Overview

- Audit's Goals & Objectives
- Lookback – Audit Process
- Three Significant Observations
- Four Observation Criteria
  - Condition
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- Audit Function Going Forward

Audit's Goals & Objectives

- Become involved early in the Green Build Program so Audit can play an important and effective role in the Program.
- Help the Green Build Team develop an effective risk avoidance strategy that acts to reduce the likelihood of encountering avoidable risks without delaying the work.
- Understand that in the audit oversight process there is not always going to be full agreement between auditors and project implementers, but always work to promote a healthy respect and cooperation between the parties.

Lookback – Audit Process

- R.W. Block & Company (RWB) has now completed the review of Green Build Program costs from 2006 through December 31, 2010.
- The purpose of the audit was to identify risk exposures related to Green Build Program costs and funding.
- The review methodology consisted of the following activities:

Lookback – Audit Process (cont.)

- Gathered documentation for Contracts 1, 2, and AECOM from 2006 through December 31, 2010;
- Extracted terms and conditions related to applicable contracts;
- Reviewed invoices against extracted contract requirements.

- Draft document was provided to the Green Build Program on August 31, 2011, for feedback.

Lookback – Audit Process (cont.)

- Since September 2011 the Office of the Chief Auditor (OCA), RWB, Green Build, and Finance staff have met to:
  - Review/clarify initial Audit Findings
  - Issue Finding Responses
  - Discuss supplemental information supplied to the OCA to augment the original audit
  - Weigh the merits of various possible mitigation options
  - Implement mitigation measures, as appropriate

Observation 1: Fully Absorb PFC Funding

CONDITION

The Green Build Program is an $864 million program funded by:

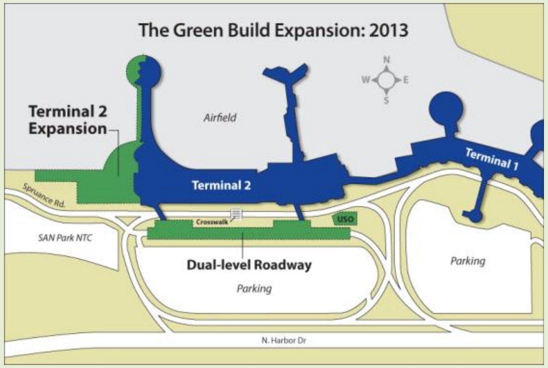
1. Airport Funds
2. General Airport Revenue Bonds (GARBS) not Passenger Facility Charge (PFC) supported
3. Passenger Facility Charges, both PAYG and leveraged
4. Airport Improvement Program (AIP) Grants
5. Transportation Security Administration (TSA) American Recovery and Reinvestment Act (ARRA) Grant
6. Voluntary Airport Low Emissions (VALE) grant

Observation 1: Fully Absorb PFC Funding (cont.)

CONDITION

Each of these funding sources has varying compliance requirements that limit how (and on what work elements) the funding can be used.

- Using a Square Foot Analysis, Finance and Green Build determined that 69.1% of the terminal building would be eligible for PFC funding. This was reviewed by the Authority's financial advisor, FAA consultant, and was approved by the FAA.



Observation 1: Fully Absorb PFC Funding (cont.)

CONDITION

Passenger Facility Charges:

PFCs are a Federally administered and locally generated fund source. In general, there are two sets of restrictions for PFCs:

1. When used in conjunction with AIP funds (e.g., apron work), PFCs have the same compliance requirements as AIP funds.
2. When used separately from AIP funds, PFCs follow their own guidelines.

Observation 1: Fully Absorb PFC Funding (cont.)

CONDITION

Passenger Facility Charge Guidelines:

To be reimbursable from PFCs, expenditures must be:

1. Reasonable costs to carry out the project.
2. Necessary costs to carry out the project.
3. Approved in a Final Agency Decision (FAD).
4. The sole source of funding, i.e., cannot be used to co-mingle funds for the same work elements.
5. Allowable under applicable laws & regulations (less stringent than AIP funds).

Observation 1: Fully Absorb PFC Funding (cont.)

RISKS & OPPORTUNITIES

- An inherit risk with any construction is that funding eligibility of the final project may differ from the original estimates.
- Continual analysis is needed to determine eligibility and usage of all funding sources, including grants, PFCs, and airport revenue bonds.
- Unforeseen decreases in the eligibility and use of grants or PFCs could result in an increase in Authority debt or cash needed to cover Green Build costs at Program closeout, which could impact airline rates.

Observation 1: Fully Absorb PFC Funding (cont.)

RECOMMENDATIONS

- Consider amending the existing Final Agency Decision approvals to maximize PFC eligibility by using a "functional cost methodology" versus "square foot methodology".
- Complete a more detailed analysis to evaluate work elements to optimize PFC eligibility for the Green Build.
- Track funds at a level to evaluate exposure real time.
- PFC supported debt be tracked separately from non- PFC supported debt, and eligibility reviews of PFC requirements be made for commitments using PFC supported debt.

Observation 1: Fully Absorb PFC Funding (cont.)

CORRECTIVE ACTIONS AND/OR RESPONSE

- Finance and The Green Build Team are developing a model to evaluate terminal costs by function. This will allow an option of the selection of the most favorable methodology for maximizing PFC eligibility (square footage or functional cost) at a future date.
- Utilizing internal and external resources, Finance and The Green Build Team continue to analyze forecast and actual costs to optimize funding source usage.
- Finance is tracking funding sources at a level of detail that allows for risk analysis and Plan of Finance scenarios.
- The Plan of Finance does include schedules to track PFC supported debt separately from non-PFC supported debt.

Observation 2: Markups of Pay Applications

CONDITION

- During the review of contractor Pay Applications, Green Build personnel sometimes identify and deny unallowable costs.
- The submitted invoice is then adjusted by Green Build personnel through handwritten markups to reflect the disallowed costs.
- Accordingly, the payment to the contractor can be less than the submitted invoice amount. (When this happens the contractor receives a list and explanation of any rejections.)
- Audit found no record of logs showing amounts disallowed and the subsequent resolution (either a complete disallowance of the cost or a notation stating where such costs were allowed under a subsequent application for payment).

Observation 2: Markups of Pay Applications (cont.)

RISKS & OPPORTUNITIES

- Although this process enables the Authority to make payments within the 30 day contractual time frame by processing partial payments, it creates additional review effort on subsequent applications for payment where balances of disallowed costs are resubmitted.
  - The source of the hand-markup may not be known.
  - The current process creates the possibility of duplicate charges because the amount invoiced is not the amount paid.
- Unresolved markup pay applications that are not resolved with contractor may result in material pay disputes at close-out.

Observation 2: Markups of Pay Applications (cont.)

RECOMMENDATIONS

- All rejected amounts on invoices should be resubmitted separately from subsequent pay applications. This would permit an aging pay application for A/R, thus preserving the integrity of the total invoiced vs. paid amounts to date.
- The Authority should require a separate resubmission of denied amounts with a corresponding pay application number, as opposed to allowing the inclusion of rejected billings in the next invoice submitted numbering.

Observation 2: Markups of Pay Applications (cont.)

CORRECTIVE ACTIONS AND/OR RESPONSE

- The number of markups have now been reduced significantly since January 2011. Corrected items are now submitted 2 days after the Payment Application Review meetings that precede the submission of the final Pay Application.
- All markups will be initialed by the objecting party beginning December 2011.
- Duplicate payments are prevented by reviewing past Payment Applications for invoices submitted from prior periods.
- On a monthly basis, Document Control submits a record of disallowed items to Contract 1 and Contract 2 Joint Venture partners.

Observation 3: *Structuring of GMP Limits the Ability to Evaluate Funding Eligibility*

CONDITION

- Guaranteed Maximum Price (GMP) 1 through 4 were negotiated using conventional industry standard work breakdown structures segregated by subcontractor trade.
- However, the GMP Reserve Accounts limit the ability to quickly evaluate funding eligibility.

Observation 3: *Structuring of GMP Limits the Ability to Evaluate Funding Eligibility (cont.)*

RISKS & OPPORTUNITIES

- The use of GMP Reserve Accounts for potential work that, for the most part has been designed, creates difficulties for Audit when reviewing scope and its alignment to funding source.
- As such, the forecasted alignment of scope and funding could be compromised, since analysis and determinations of the Reserve Accounts and associated compliance requirements require additional effort to complete.

Observation 3: *Structuring of GMP Limits the Ability to Evaluate Funding Eligibility (cont.)*

RECOMMENDATIONS

- An analysis should be prepared to define the exact scope of work covered by each GMP Reserve Account item from a funding perspective.
- Allowances and E-holds should be defined so that highest amount of non-rate impacting funding can be applied.
- This function should be performed by Audit, Finance, and Green Build staff, since there are many data points for which data and associated compliance requirements fall outside of the Green Build Program.

Observation 3: *Structuring of GMP Limits the Ability to Evaluate Funding Eligibility (cont.)*

CORRECTIVE ACTIONS AND/OR RESPONSE

- The scope of each GMP is delineated in the GMP Schedule of Values (SOV).
- Separate Reserve Account exist with line items that reflect work scope and negotiated value.
- The Contract 1 GMP Payment Application SOV and Reserve Account logs indentify the transfer of each Reserve Account line item budget to a SOV line item.
- The Contract 2 GMP Payment Application contains each Reserve Account line item that will be billed, with a cross reference to a SOV line item.

Observation 3: *Structuring of GMP Limits the Ability to Evaluate Funding Eligibility (cont.)*

CORRECTIVE ACTIONS AND/OR RESPONSE

- Finance, Accounting, and Green Build personnel are continuously reviewing the Plan of Finance, each GMP SOV, and Reserve Account line item to discuss cost eligibility for the grants and PFC funding sources.
- The GMP imposes no structural limitations on our ability to track costs by funding source. With current open book procurement and detailed unit prices for self-performed work, additional detail and/or breakouts are available as needed to coordinate with Audit Reviews and the Plan of Finance.

Progress and Focused Awareness

- Internal Audit facilitated discussions are ongoing between R.W. Block, TDP, and Finance to examine and clarify underlying concerns about PFC funding, GMP structure, Payment Applications documentation, and other related topics.
- These discussions provide clarity and a common understanding of what we need to start, continue, and stop doing, to effectively manage our costs and our funding sources in a compliant manner.
- Established open communication that is leveraged to share ideas to optimize funding eligibility.

Audit Function Going Forward

- OCA and RWB signed a new Task Authorization for RWB to focus work around the Project Plan of Finance and to ensure compliance for multiple funding sources (AIP / ARRA / TSA / PFC Bonds).
- OCA staff will be utilized to review administrative control functions, and to provide audit services as requested by Green Build staff.