



Cayman Islands

SPECIAL REPORT

OF

THE AUDITOR GENERAL

On the

Royal Watler Cruise Terminal

Capital Project

Cayman Islands Audit Office

January 2006

Royal Watler Cruise Terminal Capital Project

Audit Report

Table of Contents

Executive Summary	1
Audit Objective	1
Audit Criteria	2
Scope	3
Summary of Findings	3
Overall Audit Conclusion	4
Project Background	5
Strategic Planning	5
Description of the Cruise Terminal Project	6
Project Costs	7
Project Financing	9
Audit Criterion 1: Planning	10
There Was No Project Implementation Strategy	11
Financial Viability of the Project	13
Conclusion	21
Audit Criterion 2: Procurement	22
The Tender Process was Flawed	23
Flaws in Contractor Selection Led to Escalations in Costs	29
Review of the Marine Contract	31
Review of the Upland Works	36
Conclusion	40
Audit Criterion 3: Project Management	42
Authorization of Designs and Changes	42
Breakdown of Agency Relationship	44
The Project has Undergone Several Delays	46
Payments Were Authorized Before Contractors Met Their Obligations	47
Frequency of Payments for Upland Contractor	49
Conclusion	49



Audit Criterion 4: Corporate Governance.....	50
Lack of Effective Regulations Governing Officers and Employees.....	50
No Tendering Guidelines.....	51
Failure to use Legal Counsel.....	52
Erosion of Distinction between Statutory Authority and Government Departments	52
Entering into Agreements without Board/Management Consultation.....	52
Consultants hired without any written contracts.....	53
Conclusion	54
 Acknowledgements.....	 54
 Appendix 1 Royal Watler Cruise Terminal Project Drawings	 55
Appendix 2 Management Comments.....	56



Royal Watler Cruise Terminal Capital Project

Executive Summary

1.1 The Royal Watler Cruise Terminal Capital Project (“the Project” or “RWCT Project”) was undertaken by the Cayman Islands Port Authority in 2002 and has been substantially completed as at report date. The Project can be viewed in two components – a marine portion and an upland portion. The marine portion consists of the reclamation of land and construction of a finger pier for tender boats to offload cruise ship passengers. The upland portion involves the erection of buildings for immigration, customs and commercial leasing. As at 30 June 2005, the Project had costs of over \$16 million; the main components being the marine contract (\$8.5 million), the upland contract (\$3.9 million) and land allocated to the Project (\$3 million). It is estimated that the final project cost will be in the vicinity of \$18.5 million by the time the Project will be completed (estimated to be June 2006).

1.2 The Audit Office decided to review this project because of both the magnitude of the Project and issues concerning the award of contracts. From our discussions with the Port Authority’s management, and our review of Board Minutes and correspondence, we became aware of several other issues concerning this project. This report addresses these issues within four broad audit criteria with specific findings reported under each criterion.

Audit Objective

1.3 The overall objective of our audit was to determine whether the project for the Royal Watler Cruise Terminal was effectively and economically planned and managed within its accountability structure. We considered the key events that should take place at each stage of the design and construction process and appraised it against best practices for project management.

Audit Criteria

1.4 Below are the general audit criteria (or outcomes) that need to be satisfied for us to conclude that the Project has been planned and managed economically and effectively. These criteria were reviewed and agreed to by Port management prior to the commencement of our audit.

AC1: Proper planning

1.5 The Project is necessary and the selected solution meets the needs in the most cost effective way. The design meets the original criteria and is in accordance with the principles of good value for money.

AC2: Proper procurement of services and related assets

1.6 Amounts paid toward the completion of the Project are obtained at the most competitive prices without compromise of the quality of the goods and services being procured.

AC3: Project management activities: milestones, monitoring, quality control

1.7 The work certified for payment is properly carried out and monitored in accordance with the original design (or variances thereof properly approved) and the terms of the contract.

AC4: Corporate Governance

1.8 The Authority has in place the proper governance structure, adequate legal guidelines and corporate pronouncements necessary for securing value for money on any major capital project.



Scope

1.9 We identified all costs directly related to the Project, e.g. consultants, contractor, quantity surveyor, project manager, material and sites acquired for the project. We did not measure indirect costs, e.g. the amount of Port staff time and overheads dedicated to the Project. This review covered the period 1 January 2002 to 30 June 2005.

1.10 We reviewed the governance and accountability structure of the Port Authority in relation to capital construction projects. The operational efficiency and effectiveness of the Port beyond this specific project did not form part of this audit.

Summary of Findings

AC1: Planning

- There was no project implementation strategy.
- There were duplications of tasks.
- A financial assessment was not undertaken prior to commencement of the Project.
- The Project appears financially viable but is subject to a moderate amount of risk based on our financial analysis.

AC2: Procurement

- The contractor selection process was flawed.
- Overcharges are present in both contracts.
- The quality of the marine contract was compromised.
- Contract prices were higher than those submitted under tender.
- The upland contract was not legally vetted.
- Conditions of the upland contract were weighted in favour of the contractor, to the Port Authority's disadvantage.

AC3: Project Management

- The initial design and subsequent changes were not properly authorized.
- The agency relationship between the Port Authority and the project manager was not effectively managed.
- The phasing of works on the project was not well managed.
- Payments were authorized before the contractor's obligations were satisfied.

AC4: Corporate Governance

- There is a lack of effective regulations governing the officers of the Port Authority.
- There are no written guidelines on tendering.
- The distinction between statutory authority and government department was blurred.
- The Port Authority failed to use legal counsel on a very large contract.
- Consultants were engaged without signing any contracts.
- Agreements were entered into without consulting the Port Authority Board or Management.

Overall Audit Conclusion

1.11 Based on our assumptions, the Project is financially viable but we are of the opinion that it was poorly planned and managed. The procurement activities did not secure the best value for money and there is strong evidence of overcharges. I believe the Project could have been completed for at least \$4.2 million less than the final project amount, which is estimated to be \$18.5 million when completed. There are significant corporate governance issues, which need to be addressed to ensure a proper planning and accountability structure is in place for any future major capital projects.

1.12 I have obtained Management's comments on the report which are reproduced in **Appendix 2**.



PROJECT BACKGROUND

Strategic Planning

2.1 In 1994 a Master Port Development Plan was delivered to the Port Authority by Post, Buckley, Schuh & Jernigan Inc. (PBSJ) in association with Onions Bouchard & McCullough Ltd. The purpose of the plan was to:

“...allow the Port Authority of the Cayman Islands to look ahead, and with a flexible framework for port development, understand what its options are, and how they can be implemented in a financially, socially, and environmentally sound manner.....to establish goals and objectives, alternative development scenarios, and then the full master plan.”

2.2 The Audit Office did not see an official strategic plan for the Port Authority from which the Royal Watler Cruise Terminal emanated showing the long-term direction, goals and capital expansion strategy of the Authority. However, the Master Port Development Plan did a fair job of highlighting the needs and providing capital expansion concepts. This document was a comprehensive study of both cruise and cargo operations. It assessed the then current operating conditions, forecast growth scenarios and identified facilities improvements needed. Among the areas of concern outlined in this report were:

- Cruise ship tender berths were congested and restrictive.
- The cruise passenger receiving and tour-loading area was inadequate and unsafe.
- The mix of recreational (diving) activities and container port operations presented a conflict of safety and operations.
- Coral reef damage due to cruise ship anchoring.

2.3 The report outlined some long term improvement options for the areas of concern. These included the possibility of installing moorings, adding tender berths and cruise ship berthing facilities. The report provided conceptual alternatives for port expansion. None of these concepts were eventually fully implemented but some may have been adapted into the final design of the Royal Watler Cruise Terminal Project.

2.4 In the period 1994 to 2000 several architects were consulted to submit designs for expanding the port facilities. However, it was not until 2001 that the RWCT Project began, under the stewardship of a new Port Authority Chairman. The passage of Hurricane Michelle in 2001 fortuitously aided in the acceleration of the Project, as the cargo area of the Port necessitated repairs by a marine contractor. The Port Authority contacted a marine construction firm from Florida for these repairs and sought to combine the repair work and the planned dock expansion into one project and award one contract to this firm. However, in the interest of expediency, the cargo repair work was awarded under a separate contract, but these events instigated the RWCT Project.

Description of the Cruise Terminal Project

2.5 The cruise terminal project is located north of the existing cargo pier facilities, opposite to Fort Street, and is divided into two main parts – marine works and upland works. The marine works involved the reclamation of land (filled to 4 feet above sea-level) westward from Harbour Drive into the Caribbean Sea, with a total area of approximately 3 acres, as well as the construction of a bulkhead and tender-boat pier. The upland works involved additional filling of part of the reclaimed area to an additional four feet above sea level and the erection of buildings. The total square footage of the buildings is approximately 14,000 and consists of a two storey commercial retail building, an administrative building for immigration and customs and seven retail kiosks. See **Appendix 1** for drawings of the RWCT Project and picture of the project as at 17 July 2004.



Project Costs

2.6 Table 1 below summarizes the costs incurred on the project up to 30 June 2005.

**Table 1: Summary of Costs on Royal Watler Cruise Terminal Project
(Source: Port Authority General Ledger)**

	2002	2003	2004	2005 (six months)	Total
Marine Contractor			\$7,827,054	\$632,197	\$8,459,251
Upland Contractor			1,614,210	2,333,845	3,948,055
Land and Buildings			3,000,000		3,000,000
Bank Fees and Interest			11,960	388,943	400,903
Legal and Statutory			304,262	1,000	305,262
Project Management	\$31,533	\$18,949	157,575	85,833	293,890
Miscellaneous	168,322		7,290	11,210	186,822
Architect	66,573				66,573
Demolition		57,727			57,727
Other Consultants	22,341		16,560	9,630	48,531
Total	\$288,769	\$76,676	\$12,938,911	\$3,462,658	\$16,767,014

Marine Contractor - \$8,459,251

2.7 The amount paid for the marine works, undertaken by Misener Marine Corporation Inc. (Misener) was \$8,459,251. The firm was awarded a contract for US\$10,224,397 (CI\$8,384,006). The amount charged to the project is CI\$75,245 more than the contract sum because of variations of work. The contract was signed in March 2004 and the work was completed in February 2005.

Upland Contractor - \$3,948,055 up to 30 June 2005

2.8 The upland contract was awarded to Hurlstone Limited in May 2004 for \$6,287,483. As at 30 June 2005 \$3,948,055 had been paid, including \$294,421 for work variations. The work is expected to be completed in June 2006. As at reporting date, this contract has incurred total costs of \$6.5 million with variations of approximately \$591,000. The final projected contract sum is estimated to be \$6.9 million.

Land - \$3,000,000

2.9 The Fort Street Building was purchased in 1998 for a price of \$3,030,500. In 2003 this building was demolished and the land on which it sat committed to the Royal Watler Cruise Terminal project. Thus this item constitutes an opportunity cost, being the fair value that could have been obtained for the property had it been sold to a third party. We have not carried out a valuation of this property but the carrying cost in the books of the Port Authority prior to demolition was approximately \$2.8 million; we have thus used \$3 million as an estimate of fair value of the land for the purpose of our audit.

Other costs - \$1.3 million

2.10 The other costs of the Project are not as significant as the foregoing and total approximately \$1.3 million as at 30 June 2005. Interest costs comprise the largest portion of the bank and interest costs, and stamp duty makes up most of the legal and statutory fees. The project manager, Burns Conolly Group Limited has been paid approximately \$300,000 since the inception of the project to 30 June 2005.



Project Financing

2.11 The Project is financed via a loan from the Royal Bank of Canada with a limit of US\$17,500,000 (CI\$14,350,000). The loan is for a fifteen year term at a rate of London Interbank Offered Rate (LIBOR) plus one and a half percent. As at reporting date, the loan has been fully drawn down and the remainder of the costs will have to be paid out of Port Authority's own funds.

2.12 An agreement has been signed between the Port Authority and the Florida Caribbean Cruise Association (FCCA) to provide funding for this project via a "Loan Repayment Fee". This fee is paid by the FCCA members to the Port Authority (and not directly to the lending bank) based on the number of passengers calling on Grand Cayman. The fee is initially US\$1.00 per passenger over the next five years, with subsequent adjustments, depending on whether or not the amounts collected were more or less than loan repayments.

AUDIT CRITERION 1: PLANNING

3.1 In this section of the report we will document our review of the RWCT Project against specific criteria. These criteria were reviewed and approved by management of the Port Authority at the beginning of the audit. The box below shows the benchmark criteria against which the planning was assessed.

The Project is necessary and the selected solution meets the needs in the most cost effective way. The design meets the original criteria and is in accordance with the principles of good value for money.

3.2 As mentioned in the Project Background chapter, the Port Authority did not have a Strategic Plan that included this project. Additionally, in our opinion, a proper and complete financial assessment was not undertaken prior to the commencement of the Project. The absence of this exercise contributed to and at the same time stemmed from not having a comprehensively formulated implementation strategy. There seems to have been an inordinate amount of “gut feel” incorporated into the planning process of the cruise terminal. Because no financial assessment was done by the Port Authority, we carried out our own assessment of the financial viability of the Project. Notwithstanding the inferences made from our financial assessment, it is important that, in future capital projects, a structured approach to planning is adopted. In the absence of a structured approach, any success of the project involves fortuity. The problems of not having a proper implementation strategy are discussed after our commentary on the financial viability of the project.



There Was No Project Implementation Strategy

3.3 In our financial assessment we drew attention to the fact that the Port Authority did not perform its own assessment prior to commencement of the Project. A financial assessment is an integral part of any well planned and managed project. It forces the investors to establish scope, objectives, resources necessary and set parameters on the project. If no planning had been done up to the point of performing a financial assessment, the financial assessment could help instigate such a plan. We are of the opinion that this failure was part of the wider failings of the planning process as described in paragraphs 3.6 to 3.8.

3.4 One of the major criticisms we have is the open-ended nature of most decisions made. The Master Port Development Plan did a good job of identifying the needs/goals of the Port Authority, yet it seems management did not take the time to formulate an implementation plan for meeting those needs. An implementation strategy would identify objectives, assign responsibilities, determine priorities and resources needed and establish a time-table for completion of major events. The Port Authority hired architects for design and project managers for implementation without properly establishing a framework for such activities to be undertaken. The net effect of all this is less than optimum decision-making throughout the Project leading to:

- duplication of design efforts and other costs;
- non-existent financial planning/budgeting;
- poor contractor selection methodology; and
- cost over-runs.

3.5 Contractor selection and cost over-runs are discussed under our audit criterion on procurement.

Poor Planning of the Design Phase

3.6 Throughout the period between the Master Port Development Plan and the final design of the Royal Watler Cruise Terminal there were several drawings requested of several architectural firms for the project. There seemed to be a pattern of designs and re-designs. We did not see any evidence of bids being invited from architectural firms for the design of the facility. Eventually, when it seemed that a design had finally been settled on and one firm was fairly advanced in their engineering drawings, their employment was abruptly terminated and construction contracts were thereafter solicited on a “design-build” basis.

3.7 Due to poor planning from the start, the process of soliciting and agreeing on a final design was so ad hoc that the Project incurred significant (and redundant) costs. Fees were also paid for project costing and other surveying services. Based on management representations, the Port Authority paid over \$200,000 for design and consultancy services prior to the commencement of the Project. Subsequent to that, the design-build contracts included over \$600,000 for design and engineering. Thus in the period 2001 to 2005 the Port Authority incurred over \$800,000 simply for designing the works. We are of the opinion that this cost was too high and discuss this further in our comments on Audit Criterion 2: Procurement on page 22.

3.8 According to Port Authority management, there was a period of overlap of project managers. From a review of correspondence and Board Minutes during the period 1998 to present, there are several names mentioned as project managers. Some were Port Authority employees and some were consultants. We discuss the role of project management under Audit Criterion 3: Project Management on page 40. However, at this point we highlight that the use of several project managers, with conflicting duties and schedules is symptomatic of poor planning.



Financial Viability of the Project

3.9 As no financial assessment was done by the Port Authority, we performed our own assessment. It was necessary to establish a cut-off date from where the project was deemed to have truly commenced. The idea was to put ourselves in the position of management and recognize that (at the chosen cut-off date) we could ignore the sunk costs of the project and focus on the relevant costs or opportunity costs. In 1994 the Master Port Development Plan was procured. In the intervening period, several drawings and designs were requested by the Port Authority, each with their own costs. Additionally, assets were purchased in connection with the Project, including the Old Fort Building in 1998 for a value of \$3 million. However, it was not until 2002 that the Project really started to accelerate. It was then that drawings already in the Port's possession were used to actively seek contractors to carry out the construction of the facilities. Thus for the purpose of our review, 1 January 2002 was used as the relevant date that management should have assessed the financial viability of the project. All costs incurred before that time are deemed sunk costs, except in the event of them having an opportunity cost, e.g. the Old Fort Building and land could have been sold because of its prime commercial location.

Project Return

3.10 The method of assessment used was the Internal Rate of Return (IRR) method. IRR calculates the "yield" inherent in an investment given a series of periodic cash flows. We calculated figures from the point of view of the Port Authority investing its own equity in the project treating debt financing and servicing as cash inflow or outflow, respectively. Table 2 on the next page shows the annual cash flows estimated for the project after it is commissioned:

Table 2: Projected Annual Cash Flows After Commissioning

Item	Amount (CI \$)
Passenger Fee Revenue (based on assumption of 2,000,000 passengers per annum)	\$1,680,000
Rental Income (based on 80% occupancy)	1,080,632
Total budgeted income from project	2,760,632
Operating Expenses	(871,813)
Net operating cash flows from project	1,888,819
Debt servicing cash flows	(1,476,000)
Net cash flows per annum from project, at current debt servicing levels	\$412,819

3.11 One assumption in our calculations above is that the monthly loan repayments will not be adjusted by the bank above the current levels of \$123,000 per month. Any shortfall due to interest rate increases is assumed to be paid off as a lump sum in the final year. Using assumed interest rate scenarios of 5%, 6.738%¹, 7% and 10% levels, the lump sum payments required at the end of the 15-year loan term will be \$0, \$861,000, \$2,405,795 and \$13,194,843 respectively. The last scenario of 10% is not deemed likely to occur (see later discussion on interest rate risk in paragraphs 3.19 to 3.21) and is considered a “worst case scenario”. It should also be noted that should the bank restructure loan payments with interest at 10% and the balance of the loan is paid off over its full term, this worst case scenario would require debt servicing of \$1,850,470 per annum which, assuming no other changes in cash flow, still result in a positive project cash flow.

Results of Calculations

3.12 Because the financing rate is variable, we performed scenario analysis using different interest rate amounts. Based on our assumptions, the results of this exercise are shown in Table 3 on the next page.

¹ Interest rate inherent in the current repayment levels on the loan



Table 3: Rates of Return at Different Interest Rate Scenarios

Average Interest Rate Scenarios Over Repayment Period	Projected Internal Rate of Return
5%	19.0%
6.378% (implicit in the repayment amount)	18.1%
7%	17.6%
10%	12.1%

3.13 Assessing the Project in this manner gives the readers of this report the opportunity to ask themselves whether they are satisfied with the level of return versus the implicit risk of the project. Risk analysis is discussed later in the report at paragraphs 3.14 to 3.25. Given the scenario interest rates employed, the forecast returns to the project range from 12.1% to 19.0%. These amounts are considered the “real” rates of return so no further discounting is needed for the impact of inflation.

Assumptions and parameters in the calculations:

- The project commissioning date is 1 July 2006.
- Only relevant cash flows are included. Relevant cash flows are incremental cash flows based on the decision to undertake the Project and ignores the “sunk costs” that would have transpired irrespective of the Project. Included as a relevant cost is the opportunity cost of land used in the Project.
- Management representations of income and expenditures are true and fair.
- All estimates are conservative, which means income is estimated on the low side and expenditures on the high side. In particular, no increase in either total passengers or revenue per passenger was included in the analysis.

- With the exception of interest rates, risk factors beyond the control of the Port Authority have not been included in this analysis. These include macro-economic factors, natural or other catastrophes, etc. These are discussed later in this section.
- The effect of inflation on income and expenditure is ignored. Implicit in rates of return calculations is the understanding that income and expenditure will increase in tandem.
- Permitted fee increases beyond the initial US\$1.00 per passenger, per the FCCA agreement, have not been factored in. This agreement is discussed under Risk Analysis below.
- The correlation among interest rates, passenger fee arrivals and rental income has not been estimated. A discussion on this interrelation is also included under Risk Analysis below.
- In keeping with the conservative estimates, the residual value of the project is based on net book values.

Risk Analysis

3.14 A pillar of conventional financial wisdom is that the return on an investment must be commensurate with the risk of that particular investment. In gauging the investment, only specific financial risk is addressed. That is the risk that is present due to the decision to invest. Macro-economic and other risks may be ignored because such risks would affect the Port Authority's operations whether or not the decision to invest in the new terminal was made. We outline in paragraphs 3.15 to 3.24 the risks particular to this project. In examining these risks, we recommend that a risk mitigation strategy be formulated for each identified risk.



The Role of the FCCA

3.15 Fundamental to the analysis of this Project is the impact of the Florida Caribbean Cruise Association (FCCA) on the income from the Project. The main points of the agreement between the Port Authority and the FCCA are as follows. Firstly, the Port Authority is to obtain its own financing for the Project and repay the loan out of the Port Authority's own cash flows. The FCCA would then in turn pay to the Port Authority a quarterly amount calculated as US\$1.00 per passenger for calls on the Port. At the end of each five year period, the rate per passenger would be adjusted depending on the difference between the amounts paid by FCCA to the Port Authority and the Port Authority's loan repayments. The maximum increase allowed at the end of the first five year period would be US\$1.00 and after the next five year period, a maximum of US\$2.00.

3.16 The FCCA is not agreeing to repay a fixed amount on a periodic basis toward the loan. The FCCA is essentially giving the Port Authority permission to charge US\$1.00 per passenger with adjustments after five and ten years. However, in exchange for these fixed fee levels, the FCCA has not guaranteed any minimum number of calls or pledged to meet any shortfall in revenues towards repaying the loan. Therefore in our opinion, all the cash flow risks of the agreement fall on the Port Authority.

3.17 If the FCCA agreement were to be applied in its strictest interpretation, based on our forecast revenues, most likely the Port Authority would be faced with a decrease in the Port Development Fee at the end of the five years. This is because the agreement does not allow for surpluses in passenger fee collections to accrue to the benefit of the Authority but instead to be considered a prepayment of fees for the next five year period, necessitating a downward adjustment. However, Port Authority management are of the opinion that the FCCA will not enforce the strict interpretation and would tolerate the maximum increases stipulated in the agreement.

3.18 We suggest that these maximum increases be included in an amended agreement with the FCCA. We believe the exchange of a fixed fee period by the Port Authority for a guaranteed minimum number of calls by FCCA members has its merits and could also be agreed to as an amended term. Questions of increasing passenger fees have always been sensitive to the impact on cruise visits. If the Port Authority can be permitted to increase its fees, without fear of back lash from the FCCA, the Project is protected from inflationary pressures. A case can be made that perhaps the Port Authority should be allowed to increase fees annually instead of once every five years to allow better management of cash flows. However, assuming no significant increases in debt repayments, the forecasted annual cash flows are positive.

Financial Risk

3.19 The debt financing used for this Project is based on an interest rate of LIBOR plus one and a half percent. Because of the decision to borrow at a variable rate of interest, the presence of interest rate risk is quite significant. If LIBOR rises, the return on the investment will fall. In our return computations, we did not factor the impact of interest rates on the project's revenue because that is a macro-economic factor beyond the control of the Port Authority. However, it would be imprudent to assume there is no relation between interest rate levels and passenger numbers. Intuitively, an increase on LIBOR could cause a decrease in spending on discretionary items like cruise vacations. The income from the Project is directly related to passenger arrivals through the Port Development Fee levied on passengers. As noted previously, the Port Authority receives revenue from the FCCA based on the number of calls. If total calls decrease, then revenue for the loan repayment will decrease. Additionally, it is safe to assume that passenger numbers would in turn affect rental income as lower arrivals would most likely reduce the occupancy levels of the commercial retail building. Management should therefore be cognizant of the multiple impacts that increased interest rates can have on the Project's financial status.



3.20 Since 1990, on just two occasions (or 1% of the time) has the one-month LIBOR increased above 8.5% (which equates to a cost of debt of 10% for the Authority). The average one-month LIBOR for the period 1990 to present is 4.5%, while the highest average over any consecutive 12 month period since that time has been 8.3%. We have therefore set an average interest rate of 10% over the term as the worst case interest rate scenario. From our calculations, even at the 10% level, the Project would still return a positive cash flow of approximately \$38,000 per annum if there are no reductions in passenger numbers. However, given that most likely revenue will decrease at that level of interest rates, a projected profit or breakeven may be too optimistic. Forecasting the amount of passenger revenue lost at 10% interest and the likelihood of such interest rate shocks are considered outside the scope of our analysis, but we draw attention to the fact that the risk exists.

3.21 Another facet of financial risk is the going-concern impact. The lender has secured its funds by a letter of comfort obtained from Government as well as registered charges over the Port Authority's facilities to a value of CI\$14.35 million (US\$17.5 million). The charges give the bank the right to appoint a receiver to take the necessary steps to recover any defaulted loan amounts. This Project has raised the indebtedness of the Port Authority from approximately \$9 million as at 31 December 2003 to approximately \$22 million as at the date of this report. In percentage terms, debt has risen from 25% of total capital to 37% of total capital at those respective dates. Though the level of gearing² has risen to moderately high levels, the Project seems viable enough that the going concern risk is not deemed high.

² Gearing = percentage of debt present in a firm's capital structure.

Hurricane/Severe Weather Risk

3.22 Whilst it is true that the impact of severe weather is a wider event that affects the entire economy of the Cayman Islands, it is also true that the nature of the Port's operations renders it extremely sensitive to adverse weather. We can see how extensive the damage a hurricane can cause such as Hurricane Ivan (September 2004). However, a hurricane need not pass directly over the islands to affect the Port and cause significant damage, as evidenced by Hurricanes Michelle in November 2001 and Wilma in October 2005. While the Port can take proactive measures to mitigate the risk of damage through robust design specification, they can not easily do anything about the lost revenue from aborted cruise ship stops.

3.23 Not only does damage sustained due to faulty design result in restorative costs, there is lost revenue from the interruption of operations. Additionally, there is an inflationary effect on insurance premiums thereafter.

Overall Conclusion: Return versus Risk Compatibility

3.24 Typically, the method used for gauging the adequacy of the return on an investment is to first establish a benchmark return and then factor the specific risks of the investment to determine what should be a suitable return. This is a subjective exercise and depends on the risk tolerance of the investors. The Audit Office has provided the return figures based on different interest rate scenarios in Table 3. We have also established a benchmark using a Return on Equity, employing the Port Authority's cash flows from 1995 to 2001 (the period prior to the project). Based on those figures, the benchmark return should be about 14.5%. In the next section we provide a commentary on risk tolerance. We have thus provided the return scenarios, a benchmark and risk analysis. We leave the final appraisal of the Project (in view of those aspects) to the readers of this report.



Risk Tolerance

3.25 The question of risk tolerance depends on the perspective of the investor. Risk tolerance is based on the investor's ability and willingness to accept additional risk. Being a steward of a Statutory Authority, there are factors that should temper the risk tolerances of the Port Authority. These include:

- The socio-economic responsibility. The Port Authority does not only earn revenue in its own right but acts as a conduit for one of the biggest contributors to the economy's revenue, namely cruise tourism. Additionally, the Port Authority's cargo operations are fundamental to the very subsistence of the residents of Grand Cayman.
- The Port Authority's role as a provider of employment. The Port Authority presently provides employment for 174 persons, almost 100% Caymanian.
- The Port Authority's impact on the marine environment. Decisions made by the Port Authority have a direct impact on the marine environment within which it operates. It is the implied duty of the Port Authority to ensure its actions are not detrimental to this environment.

Conclusion

3.26 Based upon our review of the documentation, the Audit Office believes that the RWCT Project was necessary and the design fairly meets the objectives of the Port Authority. In addition, the Project appears to be financially viable. However, we are not satisfied with the level of planning that went into the Project. There was no project implementation strategy and the design phase was too long and too costly. In addition, there was no financial viability study done by the Port Authority. We strongly suggest that future projects should be planned in a more structured manner, with appropriate documentation at all stages of the project.

AUDIT CRITERION 2: PROCUREMENT

Amounts paid toward the completion of the Project are obtained at the most competitive prices without compromise of the quality of the goods and services being procured.

4.1 Proper procurement procedures are a fundamental aspect of successful project management. Not following proper procurement procedures results in more costs than necessary for any project. Our review has raised some serious questions on the procurement of goods and services for this Project.

4.2 As at 30 June 2005, the following amounts have been charged to the Project (based on calendar years):

Table 4: Summary of Costs 2002-2005
(Source: Port Authority General Ledger)

	2002	2003	2004	2005 (six months to June)	Total
Marine Contractor	\$0	\$0	\$7,827,054	\$632,197	\$8,459,251
Upland Contractor	0	0	1,614,210	2,333,845	3,948,055
Project Manager	31,533	18,949	157,575	85,833	293,890
Others	257,236	57,727	340,072	410,783	1,065,818
Total	\$288,769	\$76,676	\$9,938,911	\$3,462,658	\$13,767,014

4.3 The focus of our audit was on the larger contracted items, which were the amounts paid to the marine and upland contractors.

4.4 It is conventional financial wisdom that the competitive tendering of large contracts contributes to cost savings. Unfortunately, the Port Authority's attempt to tender the contracts was fraught with disruptions and ineffective procedures,



eventually resulting in the process being abandoned. In our opinion, the Port Authority suffered from higher than necessary costs because of the failure of that process, up to an amount of possibly \$4.2 million. We base this figure on the belief that the upland works could have been secured for \$2.5 million less (see paragraph 4.19), while the marine works underwent an unjustified price escalation of \$1.7 million (see Table 6 and paragraph 4.39).

4.5 The awarding of contracts and prices charged by contractors on the Project were done without the benefits of competitive pricing. Though a tender process was attempted, the final contracts were awarded before that process was complete. The entire process was not well planned.

The Tender Process was Flawed

4.6 The awarding of the contract to both Misener Marine Corporation Inc. and Hurlstone Limited did not go through the Central Tenders Committee. Instead, a Tenders Assessment Committee (TAC) was formed from the Port Authority Board members (three members) along with the Project Manager, Burns Conolly Group advising on the process. Having elected to bypass the Central Tenders Committee, it was imperative that the procedures for contractor selection produce the best possible value for money. We are of the opinion that the process used by the Tenders Assessment Committee and the Project Manager was flawed. We have several criticisms of the procedures and methods used.

Lack of clearly documented guidelines for assessing the tenders

4.7 Since the Port Authority opted not to refer the Royal Watler Cruise Terminal contract to the Central Tenders Committee, it was important that the procedures adopted for contractor selection were pro-actively formulated, documented and communicated to all persons involved in the process. By so doing, those responsible for tender assessment would be able to demonstrate a justifiable basis for their choice. It also would have created an action plan leading to the eventual choice of contractor without any risk of arbitrary procedures being introduced. Unfortunately, the process was not formally documented prior to the bidding exercise. We do not know what

terms were established for the TAC, how binding its recommendations were and how the votes counted toward any resolutions they made (i.e. tie-breaking votes). No doubt this lack of guidelines contributed to the problems with assessing bids; the practical demonstration of these problems can be seen in the following actions:

4.8 The committee unanimously recommended on 3 December 2002 that:

“...McAlpine (Cayman) Ltd./Arch & Godfrey be awarded the contract for this project based on their experience, proven track record and they have requisite licenses to commence work immediately.”

4.9 Subsequent to this 3 December 2002 decision the Project Manager tabled his report with the Port Authority Board. This report outlined the tender results, analysis of submittals and analysis methodology in assessing the bids, his conclusion and recommendations. In this report the project manager cited the following:

*“The PM suggested to the ‘TAC’ that a review of the contractors should be made to confirm the scope and quality of project included in the tender as the initial drawings were not complete at time of tender and this was a Design/Build tender and subject to interpretation. The ‘TAC’ thus instructed the PM to setup (sic) interviews with the contractors to confirm scope and quality.”*³

*“The Project managers recommends that the Port Authority of the Cayman Islands enter into negotiations with the two leading contractors, McAlpine/Arch & Godfrey JV and Hurlstone Ltd, to ascertain the best financial and design scenario for the Port Authority. Currently, McAlpine/Arch & Godfrey JV provides the best price, while Hurlstone Ltd. provides the best quality project.”*⁴

4.10 Also subsequent to the 3 December 2002 TAC meeting the Project Manager interviewed the contractors and had them fill out questionnaires as part of a follow-up

³ Per Analysis of Contractors Tenders prepared by the Burns Conolly Group, January 9, 2003, p.8.

⁴ Per Analysis of Contractors Tenders prepared by the Burns Conolly Group, January 9, 2003, p.13.



exercise. Thus it appears that a conclusive and unambiguous recommendation as to a particular contractor made by the members of the Tenders Assessment Committee was overridden.

4.11 The handicapping nature of not having clear guidelines was displayed in the Board of Director's meeting on 9 January 2003. During this Board meeting a motion was put forward that the Project Manager produce detailed specifications and that McAlpine/Arch & Godfrey, K-Coast Construction and Hurlstone Ltd. be asked to re-bid on the Fort George Cruise Terminal project only. From that time to September 2003 there was a series of Board meetings discussing the potential bids and revisions to designs/specifications with revised pricing being sought. After such exhaustive efforts, however, in September, quoting delays already experienced, the Board voted unanimously to award the contract to Misener/Hurlstone. Thus an entire year after the bids were first invited and after a series of back and forths between the Project Manager and contractors, the process was abandoned and contracts awarded, with eventual prices being substantially higher than those under the original competitive quotes.

Lack of proper pre-qualification procedures

4.12 There was never a public invitation to tender. Instead, the Request for Proposal (RFP) was circulated to the following contractors for their response:

- Arch and Godfrey
- Hadsphaltic International Ltd
- Hurlstone Ltd
- K-Coast Development Ltd
- McAlpine Ltd
- UBC Ltd

4.13 Whilst this approach is supposed to save time in short listing responders, the use of it was undermined by subsequently questioning the competencies of some of the responders. What use is it to shortlist names for invitation and then second-guess their abilities to perform the task? Such considerations are usually reserved for responses to public invitations to tender. It goes without saying that a proper vetting

of contractors' capabilities before invitation would have saved time with the bid assessment by enabling the focus to remain on quality, price and technical aspects of the bids. The Audit Office is of the opinion that the Project Manager should have spent more time pre-qualifying the invitees. We also believe that the contracts should have been separated into marine and upland works. Consideration should then have been given to inviting special marine contractors for pre-qualification.

4.14 The Audit Office is aware that a pre-qualification assessment is somewhat different from traditional "open invitations to tender" but it is deemed a valuable procedure that can save time. To ensure that no potential contractor complains about the process being unfair, a request for qualification (with the stated qualifying criteria) can be advertised. Given that the contract was awarded a full year after invitations were first sought, the Audit Office is of the opinion that a better formulated sequence of procedures would have afforded time to screen invitations from a wider range of qualified contractors.

Failure to separate the Marine Works from the Upland Works

4.15 From the review of several contract related documents, we are of the opinion that the project could have been easily separated into two autonomous phases or projects – for marine work, and then upland work. Yet the requests for proposal combined the two sets of works into a single project starting with the reclamation of land and construction of the tender pier and other marine facilities, followed by the erection of terminal buildings on the reclaimed land. That the projects could have been separated is demonstrated by the eventual separation of the joint bidders of Misener Marine Corporation Inc. and Hurlstone Ltd. into two separate contract awards.

4.16 We believe the amalgamation of the works undermined a proper bid assessment, since a joint analysis had to be performed on two projects differing in methodology, expertise requirements and domestic contractor availability. Thus the emphasis for selection was placed on the marine contractor's portion due to the specialized nature of that component of the works. There was a certain amount of indifference to the upland portion of the works as evidenced by the questionnaire that



short-listed bidders were required to complete. The result was the upland contractor that piggybacked on the successful marine contractor was guaranteed to obtain the upland portion of the contract. This was not in the best interest of value for money, as there was no guarantee that the best upland contractor necessarily paired himself with the successful marine contractor. Additionally, the combination of the marine work with the upland work caused one qualified building contractor to drop out of the process and two others were obliged to form a joint venture. Hence the range of bidding building contractors shrunk from six to four, diminishing the competitiveness of the process.

4.17 Table 5 below shows the low bids received for upland/building works, marine works, overlap/shared costs, compared to that of Misener/Hurlstone. It is worth noting that the Misener/Hurlstone bid was also the highest submitted.

Table 5: Comparison of Range of Bids Received

	Misener / Hurlstone	Low Bid
Purely upland portion	<u>\$3,051,095</u>	<u>\$2,130,445</u>
Purely marine portion	<u>3,580,326</u>	<u>1,534,118</u>
Shared costs/overlaps	<u>5,257,726</u>	<u>1,671,434</u>
Overall costs (not a summation of the above)	<u>\$11,989,147</u>	<u>\$7,697,690</u>

4.18 From Table 5 above, there are two points to be made. Firstly, separation of the works into upland and marine portions, coupled with the invitation to experienced marine contractors could have arguably led to a more competitive price for the marine portion of the contract. At the very least it would have mitigated against the subsequent price hike when the bid process was surrendered, as the marine contractor would have been forced to submit a clear, autonomous bid, on a clearly defined scope. They would have found it difficult to subsequently revise those figures

without justification. We discuss this cost escalation later in paragraphs 4.25 and 4.26.

4.19 Secondly, a strong case can be made that the upland contractor was too expensive. The lowest upland portion of the bids is \$920,650 cheaper than the upland portion of the bid submitted by Hurlstone Ltd. Coincidentally, the lowest upland bid also had the lowest shared costs. Thus we are fairly satisfied that the upland portion of the work could have been secured for no more than \$3,801,879 (upland plus shared costs of the low upland bid) versus the final contract awarded to Hurlstone for \$6,287,483. It is therefore difficult not to conclude that the Port Authority paid at least \$2,485,604 (\$6,287,483 - \$3,801,879) more than necessary for the upland works.

One Bidder was Privy to Details of the Project

4.20 The two contractors eventually awarded the contract were privy to the project needs before bids were officially invited because Misener was already involved in negotiations for the cargo pier repairs and the idea was to lump all George Town projects into one contract and negotiate directly with them. To illustrate the poor planning of the project, this idea was first authorized by Board resolution in July 2002 but reversed afterward and a tender process requested.

4.21 The Request for Proposal was not sent out until September 2002. This gave the joint venture of Misener and Hurlstone an unfair advantage in being able to submit comprehensive bids demonstrating a superior understanding of the project requirements. This is not only a question of fairness to bidders, but the fact that the Misener/Hurlstone joint bid was the highest priced implies that value for money was surrendered. The Port Authority ceded whatever intangible gains they may have secured (by having a contractor thoroughly knowledgeable about the project) to the extra amounts they had to pay for such an advantage.



The Assessment Criteria Were Too Subjective

4.22 The assessment of design-build proposals is inherently fraught with a high level of subjectivity. The assessment of bids for the Royal Watler Cruise Terminal contract was no exception. The entire process was led by the Project Manager, including what appears to be his veto of a Tenders Assessment Committee (consisting of three board members) recommendation. When a high level of subjectivity is involved, it is better to obtain a consensus of several analyses rather than an individual party's opinion.

4.23 The Project Manager prepared a spreadsheet, employing a scoring system with points awarded for (the maximum available points shown in brackets):

- Marine Subcontractor (100)
- Design/Build Experience (75)
- Methodology (50)
- Teamwork Experience (50)
- Upland Contractor (60)
- Key Personnel (50)
- Marine Engineer/Other Consultant (80)
- Proposed Price (-100)

4.24 The scoring system did little to mitigate the subjectivity of the process. Terms like “marine contractor”, “upland contractor” and “methodology” are very generic. The scoring system also seems to unduly favour the rating of the contractors' abilities rather than a rating of the proposals. In the absence of proper pre-qualification of contractors, it was indeed important to do a proper assessment of the contractors. However, the broad terms used were insufficient for establishing a proper trail of how points were awarded.

Flaws in Contractor Selection Led to Escalations in Costs

4.25 The final contractors selected for both the marine and upland components of the project submitted final contract prices that were higher than the original amounts they submitted in their bids when tenders were invited. We mentioned earlier that the two contracts formed part of a unitary bid during the tender process. Table 6 shows that after the process was abandoned and separate contracts were awarded, the total of

the two contracts were \$2.7 million higher than the amount quoted in the joint bid. Having abandoned the selection of contractor via competitive tender, the Port Authority was a victim of what could possibly be interpreted as price gouging. We obtained the figures for marine, upland and shared costs from the original submissions to tender – these are shown in the second column of the table. Using the final contracts’ schedule of values, we identified the marine, upland and formerly shared costs; these are shown in the third column. The formerly shared costs had to be re-aggregated for the third column; these consist mainly of design/engineering, preliminaries, fill-and-compaction, mobilization, performance bonding and insurance costs.

Table 6: Increases in costs after abandonment of bid exercise

Contractor	Amount Bid	Final Submission	Increase	Increase (%)
Misener (Marine component)	\$3,580,326	\$5,275,897	\$1,695,571	47.4
Hurlstone (Upland Component)	3,051,095	4,034,486	983,391	32.2
Shared costs (disaggregated in final submission)	5,357,726	5,361,105	3,379	0.1
Total	\$11,989,147	\$14,671,488	\$2,682,341	22.4

4.26 As noted these two contracts were negotiated and subsequently signed, but from examining the requests for proposal and the signed contracts, it is hard to determine what factors accounted for such cost increases other than the opportunism of obtaining a contract without tender. The Audit Office did not see evidence of significant revisions to the projects that would have led to increased costs of approximately \$2.7 million.



Review of the Marine Contract

4.27 The Misener contract is essentially for the marine work portion of the Royal Watler Cruise Terminal. It is a design-build contract with an initial contract price of \$8,384,006⁵. Subsequent variations amounting to \$181,873 yielded a total contract price of \$8,565,879. Stated simply, the works carried out was for the reclamation of land north of the existing Port's cargo facilities and the construction of a finger pier and bulkhead.

4.28 We wish to draw attention to the following examples within the Misener contract where we believe value for money was not obtained. Some of these issues may have stemmed from the contract being a design-build contract.

Overcharges

4.29 Our review of payments for the Misener contract leads us to believe that the Port Authority was overcharged in the following areas:

- Materials
- Design and Engineering
- Performance Security

4.30 The contractor submitted a bill of lading showing materials and equipment to be shipped to site, supported by the costs of such items. This is a requirement of the United States' Export Administration Regulations. We used this bill of lading and compared the quantities quoted to the amount charged to the Port Authority under the contract to determine the profits made from furnishing these materials. Table 7 on the next page summarizes our findings.

⁵ All currencies shown in CI\$, using factor of US\$1.00 = CI\$0.82; contract amount in US\$ = \$10,224,397.

Table 7: Comparing Misener Schedule of Values to Bill of Lading Costs

Item	Quantity charged per contract	Value per contract	Quantity shipped	Value per Bill of Lading	Difference
Sheet pile	920 Tn	\$1,174,903	788 Tn	\$563,322	\$611,581
Waler	1,434 Linear Ft	160,126	40 pcs	18,860	141,266
Tie rods	75 pcs	47,676	75 pcs	10,410	37,266
Rebar	423,600 lb	138,749	380,000 lb	68,552	70,197
Encapsulation form	1 each	143,500	2 each	34,440	109,060
Totals		\$1,664,954		\$695,584	\$969,370

4.31 Based on Table 7, the contractor made, through a combination of over-estimated quantities and high-mark-ups, a profit of \$969,370 (139%) on the above materials. Moreover, as discussed in a later finding, by demanding immediate payment for materials shipped to site, the contractor was able to extract this profit even before work was begun on the project. Whilst it is reasonable for the contractor to make a profit on materials supplied, we believe the mark-up here to be unsupportable, especially when one considers that these mark-ups were not obtained in a competitive environment.

4.32 In our opinion, too much money was paid for “Design and Engineering Services.” It is expected that money will have to be paid for design services in a design-build contract. However, inherent in the nature of design-build contract is that each contract will have some level of input by the owners into the design and specifications of the project. The more complete the design presented to the contractor, the less the owner should expect to pay for the design work by the design-builder. Thus when the Project Manager submitted significantly completed drawings for the marine work, one would have expected (barring significant revisions) a minimal fee for design and engineering services. The Port Authority had already paid \$173,886 for its design work (with fairly completed marine drawings) used to solicit



bids for the project. After successfully securing the contract, Misener’s list of values included \$480,791 for “Outside Engineering/Design”. We did not see evidence of significant revisions to the drawings and it is therefore difficult from our perspective to understand how such a large fee could be charged when Misener were given fairly complete marine drawings with which to work. This cost therefore appears to be more significant than we would have expected for work that had already been substantially done.

4.33 The Audit Office is also of the opinion that the amount paid for performance security and insurance was too much. The amount guaranteed by the performance bond was 10% of the contract value. The contract value is \$8,384,006, meaning that the amount guaranteed by the bond was \$838,401. The amount charged by Misener for obtaining this bond is \$115,447. This is approximately 14% of the performance security. From our research on surety bonds in the United States, it is typical that the premium charged by surety companies range from 1% to 5%⁶. Higher amounts are charged in proportion to the risk of contractor default. Reviewing comparable bids submitted during the tender process corroborates the 1 to 5% range. Using 5%, the amount charged for the Misener bond should have been no more than \$41,920. Thus there is a possible overcharge of \$73,527.

4.34 The Audit Office realizes that contractors aim to secure profits. We agree that a reasonable mark-up on the core of their construction activity is fair, as well as an amount to recover administrative expenses. However, we cannot endorse a mark-up of over one hundred percent on any of the administrative activities of the contract or where the firm was already in possession of significantly complete designs. Neither are we comfortable with many of the construction activity mark-ups. It would appear that many of these mark-ups stem from the abandonment of the tendering process.

⁶ Surety Bonds Basics © 1996 by Federal Publications, Incorporated, written by Messrs. Donahue and Thomas.

Quality Compromise

4.35 One disadvantage in design-build contracts is the risk of losing control over quality management. Since the contract is a fixed sum contract, there is the temptation for the contractor to compromise quality for profit maximization. For example, a case can be made for this potentially happening on this project in regards to the use of sheet piles. In the drawings accompanying the invitations to tender, the sheet piles specified for the project were supposed to be AZ-26. However, in the eventual contract, the contractor elected to use AZ-18 and AZ-13 sheet piles, which are thinner and hence less expensive. According to the resident engineer, the AZ-26 sheet piles are more robust, especially in the event of a major hurricane. We recommend that an independent specialist be engaged to carry out a review of this item to determine feasibility of using AZ-18 and AZ-13 sheet piles instead of AZ-26. We are not certain why the contractor changed the specification given to him in the drawings that were provided in the Request for Proposal nor why a credit was not issued to the Port Authority if less expensive material was used.

Securing all-risk insurance – exemption from Contract

4.36 As a particular condition of the contract, the contractor invalidated a general condition of the standard FIDIC⁷ design-build contract and exempted himself from obtaining all-risk insurance. According to Port Authority management, the reason given by the contractor was that the premiums were inordinately high, even with a deductible of \$1 million. The contractor argued that, in any event, the insurance premium would have simply been passed on to the Port Authority and therefore the contract was negotiated without this particular condition of all-risk insurance being secured. The Audit Office is not convinced of the accuracy of this assertion.

4.37 The tender amount (contract offer) was for a fixed sum of \$8,384,006. Implicit in this figure would be that all risks have been evaluated, and where necessary, insurance coverage sought and that associated costs of coverage were included in the contract sum. This is underlined by the fact that the Request for

⁷ International Federation of Consulting Engineers; publishes industry documentation including standard forms of contract.



Proposal, on which bids were originally received, specifically informed that the successful bidder would be required to furnish contractor's all-risk insurance. Thus, unless the Port Authority willingly consented, the contractor would have found it difficult to pass on such costs to the Port Authority after the tender amount was accepted.

4.38 Additionally, within the schedule of values presented in the contract, there is a figure of \$154,970 for "insurance". Although it is not clear that this amount was for all-risk insurance, it is difficult to understand how the contractor can argue for a pass through of contractor's all-risk insurance with such a fairly high figure already included in their schedule of values.

Cost of Marine Works Significantly Higher than Tender Submissions

4.39 The Marine contractor significantly increased prices above the amounts originally submitted via the invitation to tender. There are some common costs stemming from the original intention to have joint submissions for the marine and upland works. These include insurance, performance bond, engineering and design and backfill. Omitting such common costs from our comparison of bid and contract values we noted that the contractor had a cost escalation of \$1,695,571 (47%) above his original figures (which would have already included their profit element). The Audit Office does not consider that there were any significant changes in design that warranted such an escalation of costs; the fact that the contract was a design-build contract renders such a defense virtually moot. We have not seen evidence of increased material costs to warrant this change. We therefore deem the increased costs unjustifiable.

Contractor sold a crane to the Port Authority at a significant profit after Hurricane Ivan

4.40 Hurricane Ivan severely damaged the equipment of the Port Authority. Among the items damaged was a crane used for cargo unloading. As a result, the Port Authority approached Misener for use of its crane with a view to a leasing arrangement. Misener refused, citing the risk of saltwater corrosion as the reason.

The Port Authority subsequently purchased the crane from Misener at a price of \$615,000 (US\$750,000). It is interesting to note that Misener declared the same crane on their bill of lading, in accordance with Export Administration Regulations, at a cost of \$369,000 (US\$450,000). Thus the contractor made a 67% profit on this item plus any cost savings from demobilizing. Ironically, demobilizing costs of approximately \$80,000 were also charged to the port as an element of the contract price. The savings that Misener had from not having to ship the crane back to the United States was not passed on to the Port Authority.

Review of the Upland Works

4.41 The Hurlstone Contract was for the upland portion of the Royal Watler Cruise Terminal. It consists of filling the area, land reclaimed by Misener Marine Corporation Inc., from plus four feet above sea level to plus eight feet above sea level, as well as the construction of new cruise terminal buildings and commercial buildings.

4.42 A recurring theme in most of the findings pertaining to this contract is the disproportionate transfer of cash flow burdens and other risks from the contractor to the Port Authority. These findings raise the question of whether the contractor was financially capable in the first place of executing such a large project. The terms of the contract were extremely one-sided. When the fact that this contract was not legally vetted and was obtained after abandonment of the tender process is considered, the Audit Office simply has to wonder what form of planning went into the award of this contract. The main findings are shown below.



The tender process was flawed

4.43 We believe that a flawed tender process led to a contract award that was substantially higher than it should have been. In our review of contractor selections we outlined many reasons why we thought the process was flawed. We reiterate the point made earlier in that we felt the marine and upland works should have been treated as two separate projects prior to inviting bids. The effect of the collaborative bidding was that the upland contractor was determined on the strength of the marine contractor. There was no guarantee that the best choice of upland contractor would be secured through this process. Given that most, if not all, of the contractors invited are well-qualified contractors with tangible evidence of their works on display throughout the island, their capabilities of doing the works should hardly have been in doubt. Also, the nature of the upland works was not considered to be unduly complex. Once the indifference in contractor ability to perform the upland works was established, the sole determinant should have been the contract amount.

4.44 From our review of tender submissions, we sought to separate the upland costs from the marine costs. Though there were some common costs present in the price submissions, the contractor with the lowest building costs also had the lowest such shared costs. The total of both upland and shared costs for this particular contractor was less than \$4 million. Given that the price of the awarded upland contract is \$6,287,483 the Audit Office is of the opinion that a separate tendering process for the upland works could have resulted in savings of over \$2 million.

The uplands contract was not vetted by an attorney

4.45 As far as we can ascertain, there was no legal review of the terms before the signing of the Hurlstone Contract. In our opinion, the lack of a proper legal review may have contributed to two particular conditions being included in the contract that placed the Port Authority under a disproportionate sharing of contract risk. These conditions pertain to advance payments and force majeure termination. Each point is discussed separately below.

The terms for the advance were too generous

4.46 Hurlstone obtained an advance for 10% the contract sum (\$628,748) prior to commencement of its work. Our Office is concerned about the Particular Conditions the contractor managed to secure in connection with receiving this advance. These pertain to the length of the repayment period, and the omission of requirement for performance security as a condition for the advance.

4.47 According to the contract, the repayment of the advance was not to commence until the contract was 65% complete. In our opinion this is an unusually long time. After the advance was paid, the contractor certified works for more payment without deducting the advance (or any part thereof) until most of the work was complete. This negated the effectiveness of contract retentions. The contract specifies 5% retention with a limit of 2.5% of the contract sum. In dollars, this means the limit for retentions was \$157,187 and would occur when 50% of the contract value had been certified for payment. At that point, the Port Authority would be holding \$157,187 as “protection” while the contractor held four times that amount themselves as an advance. The whole exercise of retentions was thus rendered moot.

4.48 In addition, the standard wording of a FIDIC contract was changed to ensure that the advance was paid to the contractor without providing evidence of performance security. The importance of performance security is discussed in more detail in paragraphs 4.53 to 4.55. Suffice to say, the payment of advances with no receipt of performance bonding is an act that bears inordinate business risk to the employing party.

4.49 It must also be noted that the advance was paid approximately six months before the marine contractor was scheduled to begin the works. This placed the Port Authority at a disadvantage because there was a possible loss in interest earnings potential and the Port Authority’s cash flows would have been negatively impacted.



The termination for force majeure includes a 15% penalty to the Port Authority

4.50 A Particular Condition was added to the contract that entitled the contractor to receive 15% of the contract sum in the event of termination of the contract due to a force majeure event. This is additional to FIDIC's standard clauses on payments to contractors in such events.

4.51 Force majeure clauses are included in contracts to provide protection to both parties should an event outside the control of both parties affect the ability of either party to conclude their contractual obligations. Upon the cessation of works due to a force majeure event, the standard contract obliges the engineer (in this case the Project Manager, Burns Conolly Group) to determine the value of work done and issue a payment certificate for such works.

4.52 The standard contract clause afforded the contractor significant protection in the event of force majeure. It is difficult to understand the reason for including an additional 15% penalty payable to the contractor. Such a term seems extremely one-sided in nature and does not seem to be a term negotiated in good faith as it places the Port Authority at a significant disadvantage.

Breach of contract: The contractor did not provide a performance bond

4.53 The contractor did not deliver a performance bond, as required by the contract. This is a direct breach of the contract which requires the contractor to obtain and deliver performance security worth \$628,748 to the Port Authority within 28 days of receiving the Letter of Acceptance. Under the terms of the contract the Port Authority could have, upon giving notice, terminated the contract for this breach.

4.54 The provision of performance security is a universally accepted condition of almost all construction contracts. It is a fundamental form of protection to the employer against escalating costs in the event that the contractor is not able to perform his contractual duties. The inability of a contractor to obtain performance

security can be taken as an indication that the contractor may not be in the best financial position to undertake such a large contract.

4.55 When one considers that the contractor did not provide a performance security in conjunction with his advance payment, it would appear that the contractor anticipated not being able to provide the security. Moreover, the contract price quoted an amount of \$50,000 for this item and the Port Authority would be within its rights to deduct this cost from the overall contract sum. In our opinion, this amount should not be paid. Currently, the \$50,000 payment has not been made.

Conclusion

4.56 Based upon our review of the financial elements of the RWCT Project, it is the opinion of the Audit Office that value for money has not been obtained via the procurement procedures. We stress that, in our opinion, a failed attempt at tendering contributed significantly to the overcharges. For the two contracts (Misener and Hurlstone) costing in total \$14,746,734 , there is ample reason to believe that:

- The contracts for the marine and upland components were overpaid by up to \$4.2 million. This is in part due to the escalation of the marine portion by approximately \$1.7 million after bid abandonment, as well as the fact that there were much lower bids for the upland portion, including a bid of \$2.5 million less than the eventual contract awarded.
- Based on industry norms, there was a possible overpayment of approximately \$73,000 for the performance bond for the marine contract. Additionally, materials shipped for the marine contract included mark-ups of up to 139%.
- Misener did not pass on any savings (approximately \$40,000) for demobilization costs when they sold the crane to the Port Authority.
- The upland contract includes a figure of \$50,000 for a performance bond which was never given to the Port Authority.

4.57 The calculation of these amounts does not include the cost savings resulting from the difference in the size of sheet piles used by the marine contractor, which



should have accrued a benefit to the Port Authority. Given the size of the contract, it seems impossible to escape the conclusion that value for money for this project was not obtained in the awarding of these contracts.

AUDIT CRITERION 3: PROJECT MANAGEMENT

The work certified for payment is properly carried out and monitored in accordance with the original design (or variances thereof properly approved) and the terms of the contract.

5.1 From 2002 to the date of this report, the Port Authority has spent \$327,416 on project management costs, which was mostly paid to a third party, the Burns Conolly Group. One would surmise the reason for contracting a third party is that the Port Authority lacked the capacity in-house to carry out a capital project of this size and complexity. However, we learned that the Port Authority already had a project manager working on the repair of the cargo pier. So it is with some surprise that we learned that another project manager was recruited. We have already touched on many of the areas where project management activities fell short under the areas of Planning and Procurement. In this section we discuss the overall monitoring and control over the implementation of the project.

5.2 We found that the normal channels of authority inherent in an agent-principal relationship were not followed for this Project. There was a breakdown in communications leading to the Port Authority management being unaware of changes made to the design until a request for payment was submitted in some instances. In our opinion, numerous changes to the upland works are also indicative of poor project planning and management, as a design-build contract is supposed to minimize such changes.

Authorization of Designs and Changes

5.3 When an entity decides to employ a contractor under a design-build relationship, they acknowledge that they surrender a fair amount of control over the design process. However, this does not absolve them of any responsibility in the design of the project. It is up to the owners to ensure that the parameters for the works are properly scoped and documented to ensure the eventual design is commensurate with their needs. Additionally, any specific requirements in terms of materials to be used needs to be documented and formalized. The FIDIC standard contract, used by



the Port Authority for the RWCT Project provides for such requirements to be noted in a document called “Employer Requirements”. This document should be referenced in the signed contract. The contractor would then design the project based on such parameters.

No Employer Requirements Were Prepared for the Marine Contract

5.4 We have noted that there were no Employer Requirements prepared for the marine works portion of the contract. While there was a request for proposal document used in the invitation to tender, which supposedly forms the Employer Requirements, the signed contract does not reference to this document. The Audit Office believes that an eight million dollar contract should have included a formal set of Employer Requirements that would have documented the materials required for the job.

5.5 As the Port Authority did not properly set out the scope of works, it was incumbent upon them to ensure that the eventual design and specifications incorporated into the contract was acceptable. However, we note that the contractor had already started procuring materials for the project before the contract was formally signed, some of which were different from the materials specified in the request for proposal. The implications of the different materials have been discussed in our section on Procurement. The Port Authority initially ceded a significant amount of control over the design process when they opted for a design-build contract and compounded this issue by not properly formalizing the scope of work.

Hurlstone Limited Contract

5.6 Unlike the Misener Contract, there was a list of Employer Requirements attached to the Hurlstone contract. However, pertaining to this contract, at date of writing, there has been over \$519,000 shown in the payment certificates for “variation of works”. Many of the variations arise when the owner approves changes made to the original design or specification to which they originally signed off. According to Port Authority management, they did not make these requests and they are of the opinion that the Project Manager initiated those changes. Port Authority management

have represented to us that 15 out of the 28 variations were not approved by them. However, the Project Manager has represented to us that 21 of the 28 variations were initiated by Port Authority management and/or the Port Authority Board and therefore they were aware of the changes and had approved the costs of the variations.

5.7 In terms of validity, the Project Manager is a bona fide agent of the Port Authority and can bind the Port Authority to any requests for changes. After the contractor has acted in good faith and gone ahead with the changes, the Port Authority is legally bound to pay these amounts. In our opinion, there was a clear lack of communication between Port Authority management and the Project Manager on key decisions and approvals. An example of this is the confusion over design changes noted in the previous paragraph. We have not attempted to resolve this difference of opinion between the two parties but we note that a disagreement on such an important matter is proof of our contention that there was, and continues to be, a lack of clear communication between the Port Authority and the Project Manager.

5.8 Part of the reason for these disagreements is that the Port Authority management took a hands-off approach in regards to monitoring the actions of the Project Manager. In our view, Port Authority management should have pro-actively communicated with the Project Manager to ensure all the “variations of works” were necessary and authorized the changes to the design before the variations were physically made. It appears the Port Authority management still do not know what these changes are or how they were authorized. We believe that design-build contracts should have fewer variation requests than a design-bid-build type of contract. In our opinion the high percentage of change requests in this contract are indicative of poor design and project management.

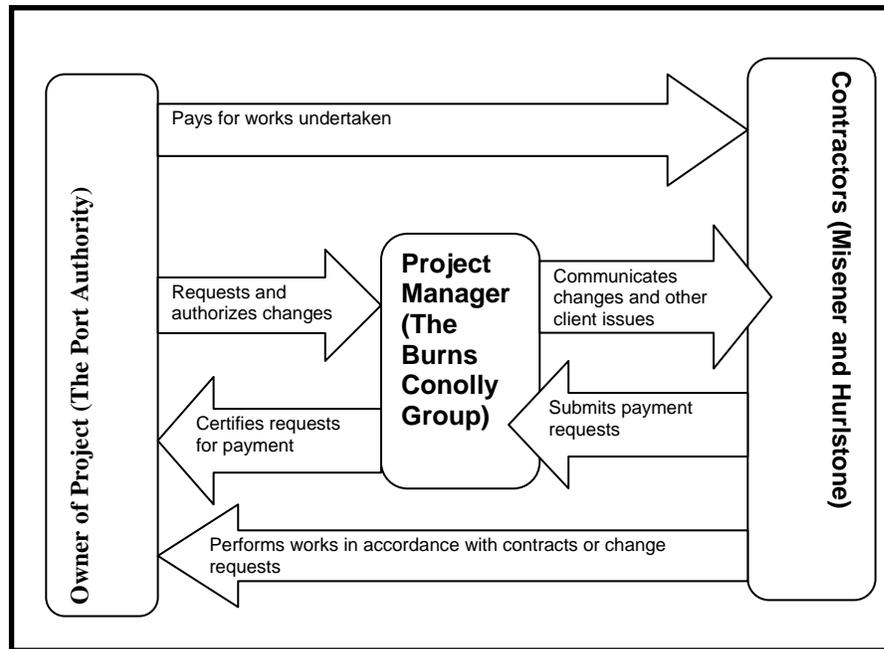
Breakdown of Agency Relationship

5.9 In our opinion, there appears to have been a serious breakdown of the principal-agent relationship between Burns Conolly and the Port Authority management. The typical structure of the project manager’s relationship with the owner is fairly simplistic in nature and is shown in Figure 1. The project manager



performs tasks for the owner who has overall authority for approving design and other aspects of the project. The project manager is an agent acting on behalf of the owner, and communicating issues with the contractor.

Figure 1: Standard relationship between project manager and owner



5.10 In the case of the relationship between the Port Authority and its Project Manager we found that there were instances where the conventional relationship was not followed. These are discussed below.

The Project Manager did not consult the Port Authority for change requests

5.11 As previously mentioned, Port Authority management represented to us that there were several variations in the Hurlstone contract that were not authorized by the Port Authority prior to the works being carried out. Despite a demonstrated pattern of unauthorized changes, we have noted no evidence of the Port Authority management proactively attempting to have the Project Manager seek written authorization before requesting such changes. The Port Authority management also failed to attend many

project progress meetings. The control over the project then became reactive, in that, only when variations showed up on payment certificates did the Port Authority management get involved with the process.

Ambiguity in Establishing Lines of Authority

5.12 From our review of the tender process, we noted in paragraph 4.10 that the Tenders Assessment Committee unanimous decision in selection of the contractor was overridden. While part of this is attributable to the failure to establish guidelines for the TAC, we are of the opinion that the Port Authority Board should have had control over this particular type of decision. It is true that the Board eventually did ratified the Project Manager's decision to select another contractor, but in effect, the Board had little choice as the Project Manager had already, in his capacity as agent, communicated to the bidders that more information was needed. Thus the review of bids was extended beyond the conclusion reached by the TAC. Ironically, the process was never completed, as already discussed in more detail in the Planning section of this report.

The Project has Undergone Several Delays

5.13 Notwithstanding the interruption due to Hurricane Ivan, the project has been significantly delayed. The original stated deadline for completion was to be 27 May 2005. Due to the delays of Hurricane Ivan, the marine contractor completed their works in January 2005 instead of December 2004, a delay of only one month. The upland contractor is now five months over the deadline and the new completion date for the completed terminal is estimated to be March 2006, nine months later than originally planned. Contributing to the delay is the number of variations included in the project.

5.14 Delays to the completion of the project results in lost revenue for the Port Authority. With budgeted rents of \$1.3 million per annum, the Port Authority is losing over \$100,000 for each month that completion is delayed.



Payments Were Authorized Before Contractors Met Their Obligations

5.15 Before the contract was signed, Misener submitted bills valued at approximately \$3 million for payment. This action effectively transferred the implicit interest burden directly from Misener to the Port Authority. It also constitutes a quasi-advance payment to the contractor and hence undermines the effectiveness of performance bonding and retention monies.

5.16 To view this finding in context, it is important to gain an understanding to some important event dates relating to the Misener Contract. The table below shows some of these key events.

Table 8: Summary of Pre-Construction Events with Misener

Date	Event	Remarks
9 th May 2003	Letter of Tender Submitted by Misener.	An official offer by Misener for the works on the RWCT with an expiration date of 31 st October 2003.
26 th September 2003	Board of Directors resolve to award marine contract to Misener.	Authorization of acceptance of offer by Port Authority.
29 th October 2003	Letter of Intent signed by Chairman of the Port Authority.	Communication of acceptance of the offer, in principle
30 th December 2003	First application for payment made by Misener.	\$1,385,238 after retentions.
2 nd February 2004	Second application for payment made by Misener.	\$1,600,672 after retentions.
11 th March 2004	Royal Bank Funding Agreement signed.	Costs incurred in connection with project before funds were secured.
16 th March 2004	Official Contract Agreement signed by Misener and the Port Authority.	Includes a particular condition that the first two applications for payment be made immediately, instead of the 56 days turnaround time specified in FIDIC general conditions.
30 th March 2004	First payment to Misener.	Amount paid was \$2,985,910 for the first two applications for payment.

5.17 The breakdown of the total payment made on the 30 March 2004 is shown in Table 9 below.

Table 9: Breakdown of Payment Made to Misener

Item	Amount
Procurement of materials- sheet piles, tie-rods, etc. en-route to site	\$2,014,045
Mobilization, insurance, bond	696,306
Engineering	432,712
Sub-total	3,143,063
Less retention	(157,153)
Net amount paid to Misener	<u>\$2,985,910</u>

5.18 There is a logical sequence of events that seems not to have transpired. It seems unlikely that within the first 60 days, the drawings and designs to a value of over \$400,000 could have been prepared by the contractor, submitted to the Project Manager and reviewed to a satisfactory enough point to facilitate the procurement of the sheet piles. It would appear the contractor proactively started procuring materials for the works before the specification and quantity of such materials were even agreed. The entire process seems to have been rushed through to expedite works and obtain payments. This is underlined by the contractor's request for immediate payments of their first two submissions instead of the contracted 56 day turnaround period for such payments. Before the ink on the funding agreement was dry, the Port Authority sought their first drawdown of \$2,985,910. With prevailing interest rates of 2.6% (and rising) this resulted in a monthly interest expense of approximately \$7,800 before there was ever any tangible evidence of the works being started.

5.19 It is interesting to note that the contractor purchased materials in November/December 2003 while the final schedule of values was not submitted to the Port Authority until March 2004. In essence, the Port Authority was committed to purchasing materials blindly. Compounding this issue is the fact that the schedule of values included AZ-18 and AZ-13 sheet piles as opposed to the requested AZ-26. The



implications of using different materials have been discussed already (see paragraph 4.35).

5.20 To date, Hurlstone has not furnished its performance security as required by the contract, yet the payment certificates submitted for payment continue to be certified. A special condition was inserted into the contract to ensure the contractor received his advance payment without providing performance security; but even thereafter, payment requests kept being submitted with no indication that the performance security will be provided. We have already mentioned the implications of not having performance security. We are concerned that more forceful measures were not taken to ensure the contractor deliver performance security. One practical and effective measure would have been to withhold payments on contract until it was delivered.

Frequency of Payments for Upland Contractor

5.21 As a particular condition of the contract, the upland contractor required that applications for payments be made bi-weekly with payments due within 7 days of submission. From our experience in auditing other government contracts, as well as our knowledge of the construction industry, we are of the opinion that such a timeframe is unnecessarily short. The administrative burden it places on the Project Manager and the Port Authority simply do not seem justifiable. This is yet another indication of the questionable financial capabilities of the contractor.

Conclusion

5.22 In our opinion, this project was not well managed. Variances and design changes were not properly communicated and authorized. There was poor communication between Port Authority management and the Project Manager. The oversight by the Port Authority Board and management was neither effective nor proactive enough. In our opinion, the overall project management was poor.

AUDIT CRITERION 4: CORPORATE GOVERNANCE

The Authority has in place the proper governance structure, adequate legal guidelines and corporate pronouncements necessary for securing value for money on any major capital project.

6.1 The success of any major capital project is dependent on proper governance. The governance function establishes the paradigms against which all officers and employees of an organization discharge their duties. The governance functions achieve this by setting the course for the Port Authority and developing ethos, regulations and systems necessary for pursuing the established course. Without being aware of the need for proper governance, the Port Authority, indeed any organization, cannot realistically expect to have repeatable success in its undertakings, much less a large capital project.

6.2 Although the Port Authority is a successful Statutory Authority as measured by financial performance, the future viability of the Port Authority is subject to the ability of its appointed Board members to govern effectively. During our review of this Project, we noticed that there was no code of conduct or regulations/bylaws relating to the performance of the Board. Based on our findings, we are of the view that many of the issues noted in this report could have been prevented had such documents been prepared and incorporated as part of the Port Authority's governance process.

Lack of Effective Regulations Governing Officers and Employees

6.3 Although the Port Authority Law contains a set of regulations as a schedule to the Law, most of those regulations relate to maritime affairs pertaining to vessels' use of the coastal waters and items of that nature. There is very little provision on how the officers of the Port Authority are supposed to behave. In the absence of proper legislative guidelines, it is incumbent on a company to undertake some form of self-



regulation. However, the Port Authority has never drafted any bylaws, nor does it have a written code of conduct.

6.4 In the absence of written regulations and codes of conduct, the actions of officers are judged against “best practices”. Whilst we agree the term “best practices” is one of subjective interpretation, the standards we have used are based on the behaviour that we expect from any person holding a fiduciary position in a public office. Thus the issues we have noted in this section of our report are based on practices common to members of most professional associations. Two of the main principles universally accepted as part of the fiduciary duties of officers are:

- Objectivity and independence of officers – Officers should act in a way that does not promote bias in decisions that they make in the discharge of their duties.
- Duty of care and due diligence – Actions of officers should be based on sufficient care and due diligence so as not to subject the organization to undue risks.

6.5 We have found that the actions of the officers did not always conform to these two principles, as is demonstrated in the remainder of the findings within this section.

No Tendering Guidelines

6.6 Statutory Authorities often employ the Central Tenders Committee (CTC) for awarding large contracts. However, there is no legal obligation for them to do so. The use of the CTC has been a convention adopted by most Statutory Authorities to ensure proper guidelines are followed for the awarding of contracts as well as to quell any perception of impropriety in the process. In our opinion, if an Authority decides not to use the CTC, it should have in place sufficient alternative controls to ensure that value for money is obtained for all capital projects.

6.7 Therefore, a Statutory Authority can be excused for not referring a contract to the CTC if they had clearly formulated guidelines to be followed for large contract awards. This was not the case for the Port Authority and much of the problems described in the Audit Criterion on Procurement stem from a lack of clear guidelines.

Failure to use Legal Counsel

6.8 We found that two of the contracts awarded for the project were not referred to the legal department for vetting prior to signing: the upland contract, Hurlstone Limited and the Project Manager contract, Burns Conolly Group Limited.

6.9 The reason the contracts were not legally vetted is not clear. In the case of the upland contractor, work could not practically commence until the marine contractor had completed a certain amount of his duties, so there was time available for legal review. Also, we saw no reason as to why the contract for Burns Conolly Group Limited was not subject to legal review. In our opinion, due diligence necessitated such a review.

Erosion of Distinction between Statutory Authority and Government Departments

6.10 In a matter not directly related to the Royal Watler Cruise Terminal but pertinent to the relationship between the Port Authority and the marine contractor, we noted correspondence with Misener Marine Corporation Inc, in a letter dated 29 April 2003, regarding possible cruise ship berthing facilities, signed by the former Chairman of the Port Authority Board. This letter was not on Port Authority letterhead but was instead on the letterhead of the Ministry of Tourism, Environment, Development and Commerce. Moreover, the Chairman signed the letter, simultaneously quoting the titles of Leader of Government Business, Chairman of the Port Authority and Minister of Tourism.

6.11 This action is contrary to the idea of establishing Statutory Authorities as separate legal entities. The basis of establishing Statutory Authorities is to grant them autonomy from government in their decision making processes.

Entering into Agreements without Board/Management Consultation

6.12 We noted a few instances where the Chairman either engaged or attempted to engage employees, consultants and contractors with the Port Authority without first referring to the Port Authority Board or management. The letter of 29 April 2003



referred to above is one such example. In this letter, the Chairman was attempting to give Misener, albeit with caveats, the exclusive right to design, build and finance a cruise ship berthing facility. This is an example of unilateral decision making without consultation with other Board members.

6.13 At the time this letter was sent, the contract for the Royal Watler Cruise Terminal was not yet awarded and bids were still being reviewed. Yet, a possibly larger project was being contemplated with “exclusive rights” to one of the bidders on the Royal Watler Cruise Terminal contract. This not only undermined the tendering process for the Royal Watler Cruise Terminal project, it is also highly presumptuous. It assumed that Misener would perform quality work before such an assessment could actually be performed.

6.14 There is another pertinent point regarding the letter of 29 April 2003. The copy we examined bears the imprint of a fax transmittal from the offices of Quarry Products Limited (QPL). As far as we can establish, there is no reason for private and confidential Port Authority information to be at the premises of Quarry Products Limited. This constitutes a breach of confidentiality by the Chairman in dealing with Port Authority affairs. Overall, this item constitutes an abandonment of objectivity and due care.

Consultants hired without any written contracts

6.15 A firm of architects, Chalmers Gibbs Martins Joseph (CGMJ), was hired, but no written contract was ever signed. To date \$173,886 was paid to this firm in connection with the Royal Watler Cruise Terminal.

6.16 Failure to have signed agreements for provision of services can be detrimental to both parties involved, thus it is difficult to understand why it was done. From the point of view of the Port Authority, it is hard for them to protest overcharges if they never first established the rates to be used. It is also impractical to claim that the service/product delivered was different from that requested if such requests are not formalized.

Conclusion

6.17 In our opinion, the Port Authority does not have in place a proper governance structure, adequate legal guidelines and corporate pronouncements necessary for securing value for money on any major capital project. The lack of such a process significantly added to the management problems of this contract.

Acknowledgements

6.18 In closing, I wish to acknowledge and thank all those who assisted and cooperated with my Office during the course of our work, especially the senior management at the Port Authority. I would also like to acknowledge the efforts of my own staff in the production of this report.

Don Duguay

*Dan Duguay, MBA, CGA
Auditor General
George Town, Grand Cayman
Cayman Islands*

20 January 2006

Audit Team:

*Manager: Garnet Harrison
Senior Auditor: Vijay Parabdeen
Auditor: Gay Frye*



Appendix 2: Management Comments

Management comments provided via e-mail on January 30, 2006:

Dear Mr. Harrison,

Re: Draft Royal Walter Cruise Terminal Report

I have read the draft report and believe that it represents the facts as presented. The report is comprehensive and captures the major events surrounding the Royal Walter Cruise Terminal project.

Your conclusions in this report are accurate. The section under Audit Criterion 4: Corporate Governance contains some practical and pertinent recommendations. My attention was drawn to section 6.10, which may well be the core issue that caused the failures in the system and highlighted in the report.

I should state that the current management of the Port Authority is well aware and is indeed proficient in correctly managing all aspect of a project such as the Royal Walter Cruise Terminal. However, to do so management must in theory and in practice be given the necessary authority to act. I refer to sections 5.7 to 5.11 in the report. The Project Manager is employed to act on behalf of management and as such is instructed by and answerable to management. One of the roles of the Project Manager is to attend on behalf of management, project management meetings and report to management accordingly. One of the difficulties that the Royal Walter Cruise Terminal project experienced was that the Project Manager due to other factors, was instructed and answerable to certain members of the Board of Directors, and in that way the management of the Port Authority was to a large extent circumvented from the decision making process. Management attempted to correct this, but was unsuccessful as this project appeared to be considered more a Board of Directors project rather that of the Port Authority of the Cayman Islands.

A key point that therefore resonates in my mind is that it is critical for proper policies to exist for the management of capital projects. However, perhaps equally important is that managers must be allowed to manage within the confines of these policies. The Royal Walter Cruise Terminal project clearly demonstrated the weakness and potential problems that can occur when others takes the lead role instead of management. However, as is usually the end result in these circumstances management is ultimately held accountable at the end of the day.

Yours Sincerely,
Paul W. Hurlston
Port Director

