City and County of San Francisco

Office of the Controller - City Services Auditor

PUBLIC UTILITIES COMMISSION:

The Sixth Review of Its Professional Services Agreement For Management Services of Its Capital Improvement Program

FINANCIAL AUDITS DIVISION

03017
January 12, 2006

CITY AND COUNTY OF SAN FRANCISCO
OFFICE OF THE CONTROLLER

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January 12, 2006

Audit Number 03017

Public Utilities Commission
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President and Members:

The Office of the Controller (controller) presents its report on the review of the agreement between the Public Utilities Commission (PUC) of the City and County of San Francisco and the Water Infrastructure Partners (partners) to provide program management and construction management services that support the PUC's water, power, and sewer capital improvement program. This audit is the sixth in a series of audits that the controller is conducting of the agreement, and the second on fulfillment of the agreement between the PUC and the partners.

The audit found that the partners continued to perform satisfactory work, and that the PUC has improved its management of the agreement since the last review of its agreement with the partners. However, the report concludes that both the partners and the PUC need to make further improvements in their administration of the agreement. For example, the PUC should establish a formal system to track all of the invoices submitted by the partners, and to account for all of the payments and resulting adjustments made by both the PUC and the partners. Given that work is nearing completion on this contract, the PUC should ensure that it incorporates these improvements in its management of the next program management services agreement, if it is not feasible to implement the improvements for the current agreement.

The PUC's and partners' responses are attached to the report. The controller's Financial Audits Division will be working with the PUC to follow up on the status of the recommendations made in this report.

Respectfully submitted,

Ed Harrington
Controller

SUMMARY

Audit Highlights…

Our audit of the Water Infrastructure Partners revealed the following:

- ☑ ***The PUC concluded that the partners met requirements in performing its work.***
- ☑ ***The partners did not always comply with compensation provisions.***
- ☑ ***The PUC improved the timeliness of payments to the partners.***
- ☑ ***The partners needs to improve administration of payroll costs.***
- ☑ ***The partners continued to incorrectly charge provisional overhead rates rather than actual overhead rates.***
- ☑ ***The PUC and the partners need to ensure the PUC's prior approval of subcontracting.***
- ☑ ***Some other direct charges were not approved in advance or were not allowable.***
- ☑ ***The PUC should further improve its management of the agreement.***

RESULTS IN BRIEF

In its review of contract performance, the Public Utilities Commission (PUC) of the City and County of San Francisco generally found that the work conducted by the Water Infrastructure Partners (partners) in its professional services agreement (agreement) with the PUC to be satisfactory. However, we found that the partners did not always fulfill the compensation provisions of its agreement to provide program management and construction management services that support the PUC's water, power, and sewer capital improvement program.

The PUC staff members responsible for managing and evaluating the projects that the partners performed concluded that the partners met requirements in performing its work. During the period from January 2003 through December 2003, the partners performed work on 26 task or subtask orders. The PUC evaluated the work performed by the partners as meeting requirements on 16 of the 26 tasks or subtasks, and partially fulfilling performance requirements for the remaining 10 tasks or subtasks.

The partners submitted invoices totaling $9,883,224 for services rendered from January 2003 through December 2003. We reviewed in detail $1,918,987 (19 percent) of the invoices and found that the partners generally complied with agreement requirements for submitting and supporting its expenses. As we found during our last audit, the PUC did not pay all of the invoices the partners submitted to the PUC for payment within 30 days after receiving them. However, the PUC improved its performance and paid most invoices on time during the last five months of the audit period.

Although the partners generally complied with the agreement when submitting its invoices and supporting documents, we also found that the partners needs to improve its administration of payroll costs. Our review disclosed that many timesheets were improperly completed or approved, with 72, or 19 percent, of the 373 timesheets we tested not signed or dated by employees or not properly approved by the supervisor. The proper completion and approval of timesheets is a critical control to ensure that hours billed under the agreement are correct.

We also found that that the partners incorrectly adjusted some billed direct labor rates. The agreement provides that direct labor payroll rates can be adjusted annually and that the amount of the adjustment will be limited to a maximum of the Consumer Price Index (CPI) for San Francisco Bay Area wages for the previous year. Our review disclosed that the joint venture partners and three subconsultants increased their labor rates in excess of the 1.7 percent maximum allowable increase. These firms increased their billed direct labor rates by averages of 2.3 percent to 15.3 percent. We found that the PUC and the partners need to establish a specific methodology for administering rate increases in accordance with the agreement, and that credits may be due to the PUC as a result of increases in billed direct labor rates in excess of those allowable.

The agreement requires the partners to use the actual overhead rates established by annual audits, and to adjust any payments that were made based on provisional rates. For the period covered by this audit, the partners and its subconsultants continued to charge the provisional overhead rates initially established in the agreement in September 2000, instead of actual overhead rates. The PUC contract manager has stated that the PUC plans to develop and complete a plan for establishing actual overhead rates. This work will need to be completed so that necessary adjustments can be calculated in conjunction with closing out the agreement, which, according to the PUC contract manager, is scheduled for early 2006.

In our prior audit of the agreement between the PUC and the partners, we found that the PUC paid some subconsultants at fixed rates, although the agreement did not specifically allow for this basis of compensation. The PUC subsequently amended the agreement to provide for fixed rate and other types of subconsultant and subcontractor compensation. However, we found that the PUC and the partners need to ensure that the PUC's prior approval of subcontracting is obtained and documented.

We reviewed $212,451, or 48 percent, of the $438,114 of other direct charges billed during the audit period. We found that most amounts invoiced were in accordance with the agreement. However, we found some instances in which expenses invoiced had not received the required prior approval of the PUC, and instances in which the partners invoiced expenses that were not specifically identified in the agreement as allowable. Furthermore, our review of performance fees paid disclosed that amounts paid were materially correct. However, we found that we could not conclude that the methodology used in calculating the fixed and performance fees was in compliance with the agreement, because we found no basis in the contract language for this methodology.

Since we started our audits in 2001, we identified a number of recurring problems for which the PUC had not taken sufficient corrective actions. We found improvements in several areas during the period covered by this report. However, we also found that there is need for further improvements to ensure that the PUC properly monitors the financial and performance aspects of the agreement. Areas requiring improvement include the PUC's procedures for tracking costs incurred and paid under the agreement. In particular, the PUC needs to ensure that total actual payments made to the partners are properly reconciled with amounts reflected in the Controller's Financial Accounting and Management Information System (FAMIS).

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INTRODUCTION

BACKGROUND

The Public Utilities Commission (PUC) of the City and County of San Francisco (City) has a professional services agreement with the Water Infrastructure Partners (partners), a joint venture of Jacobs Civil, Inc. and Primus Infrastructure, LLC. Under the agreement, the partners provide program management and construction management services that support the PUC's water, power, and sewer capital improvement program. The agreement requires the partners to provide overall direction and guidance to the program; to supply project and construction management services to individual projects; and to furnish technical support services, primarily in defining engineering needs, optimizing the selection of design alternatives, and providing technical expertise to manage workload peaks.

This audit is the sixth in a series of audits that the City's Office of the Controller (controller) is conducting of the agreement, and the second audit on fulfillment of the agreement between the PUC and the partners. The PUC previously had contracted with the San Francisco Water Alliance (alliance) to provide the services now being provided by the partners. However, the alliance was effectively dissolved on May 7, 2002, when the PUC allowed one of the alliance's joint venture partners, Bechtel Infrastructure Corporation, to withdraw from the alliance and approved the assignment of the agreement to a reconstituted alliance made up of the remaining joint venture partners of Jacobs Civil, Inc. and Primus Infrastructure, LLC, formerly known as Sverdrup Civil, Inc. and the Jefferson Company, respectively. The City's Board of Supervisors (board) approved the assignment on June 17, 2002, and the alliance changed its name to Water Infrastructure Partners on September 5, 2002.

The agreement was approved by the board on September 8, 2000, and there have been six subsequent amendments to the agreement. As amended, the agreement has a term of five years and three months and continues until December 31, 2005. Unless the controller certifies first the availability of funds for each specific task identified by the PUC, the partners cannot furnish any services and cannot receive payment for any work. In addition, the PUC and the partners cannot extend the term of the agreement unless the City's Civil Service Commission and the board approve a modification. The board is to approve annually the continuation of the agreement for another year, and the controller is to certify the availability of funds for that year. If the board disapproves a subsequent annual phase of the agreement, the agreement ends without the City incurring any liability to the partners.

The agreement further states that if the board does not end the agreement, and if the board's inaction is not the result of the PUC's untimely submission of reports to the board, the agreement shall continue. However, if the City's board does not appropriate funds to the partners for the next succeeding fiscal year, or if it appropriates funds for only a portion of a fiscal year, the agreement will terminate without penalty, liability, or expense of any kind to the City at the end of the term for which the board appropriated the funds.

The PUC is to pay the partners within 30 days after the partners presents a satisfactory invoice for work it performed during a specified month. The total amount paid under the agreement is not to exceed $45 million. The agreement includes a provision for the PUC to pay the partners a fee in addition to the reimbursement of direct salaries and overhead. The provision adds fixed and performance elements to the fee's calculation. During the first year of the agreement, the fee is fixed at 8 percent. In the second year, the fixed fee drops to 7 percent, and the agreement adds to this base fee a semiannual performance fee between 0 and 4.5 percent. For the third year, the fixed fee drops to 6 percent, and the performance fee is specified as between 0 and 5.5 percent. The agreement specifies that the PUC is to pay the performance fee based on the partners' performance according to benchmarks that both parties agree upon during the first review after the first 18 months of the agreement. The second contract amendment, executed on May 5, 2003, specifies that, beginning with the third year of the agreement, an annual performance review will be conducted by City staff and verified by an Independent Review Panel (panel), allowing the City to evaluate the partners' performance and make a determination regarding the amount of performance fee to be paid. Prior to payment of any fee, the panel must produce, and transmit to the board, a report verifying the City's evaluation of the partners' performance. The second amendment states that the board's action to release funding for the continuation of the agreement shall also constitute its concurrence for the payment of the previous year's performance fees.

The agreement requires the PUC, through the controller, to conduct, at least semiannually, an audit that evaluates whether the partners' costs and performance meet the agreement's specifications. While this is the second audit the controller is conducting on the fulfillment of the agreement between the PUC and the partners, the controller issued four previous reports on the audits of the agreement between the PUC and the alliance.

SCOPE AND METHODOLOGY

The purpose of this audit was to determine whether the partners complied with the agreement, particularly those provisions applying to performance and compensation. Therefore, we reviewed the terms of the agreement between the partners and the PUC, assessed the partners' procedures for billing the PUC, and evaluated the PUC's procedures for paying the partners.

To analyze billings and payments related to the agreement, we selected a sample of invoices submitted by the partners, as of September 27, 2004, for services rendered from December 28, 2002, through January 2, 2004. For clarity, this report refers to this audit period as January 2003 through December 2003. For those invoices we examined, we determined whether the requests for payment had proper support and did not exceed budgeted amounts. To determine whether the labor rates that the partners billed to the PUC met the agreement's requirements, we assessed a sample of payroll costs. In addition, we reviewed the increases in a sample of the hourly rates billed for partners and subconsultant employees, to determine if the partners limited the increases to the maximum change in the Consumer Price Index (CPI) for the San Francisco Bay Area wages in the previous year, as required by the agreement. We also reviewed a sample of other direct charges to determine whether the agreement allowed those charges. Further, we reviewed the performance fee the partners billed the PUC to determine if the performance fee was correctly calculated. Finally, we assessed whether the partners and its subconsultants charged the correct overhead rates.

In addition to examining invoices, we also reviewed the evaluations prepared by the PUC for the task orders in effect during the period under review. We did not evaluate the work products that resulted from the individual task orders because we do not possess the necessary technical expertise. Instead, we relied upon the expertise of the PUC staff to issue accurate evaluations of the partners' performance, and on the expertise of the panel in reviewing the evaluations.

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AUDIT RESULTS

THE PUBLIC UTLITIES COMMISSION GENERALLY FOUND THE WATER INFRASTRUCTURE PARTNERS' WORK SATISFACTORY

Since our audit report dated June 30, 2003, when we last reviewed the Water Infrastructure Partners, the Public Utilities Commission has continued to find that the partners performed satisfactory work. For the 12 months in 2003, the partners performed work on 26 tasks or subtasks. The PUC evaluated the work performed, and when we reviewed evaluations of those 26 task and subtask orders, we learned that the PUC rated the partners as having delivered as agreed on 16 of the 26 evaluations. On the remaining 10 evaluations, the PUC assigned a rating of partial fulfillment. The evaluation scores for the tasks or subtasks appear in Appendix A.

Background

The PUC's task order project managers (project managers), many of whom are PUC engineers, write final evaluations when the partners complete each task and the project managers also complete interim evaluations for long-term projects. The project managers are usually the PUC employees who requested the tasks for a specific project and who work with partners staff to ensure that the staff completes the tasks to the PUC's satisfaction. After the project manager completes the evaluation, the evaluation first goes for review and approval to the representative from the PUC's project management division. This representative, usually the program manager for the agreement, then forwards the evaluation to the manager of the PUC's Project Management Bureau for final review and approval[1].

In evaluating the tasks, the PUC listed weighted criteria that it multiplied by a number score tied to the following definitions: *delivered as agreed* (3 points); *partial fulfillment* (2 points); and *did not deliver as agreed* (1 point).

[1] As required by the second contract amendment, beginning with the third year of the agreement, an Independent Review Panel (panel) must produce, and transmit to the Board of Supervisors, a report verifying the performance evaluation.

The Partners Delivered Work for Most Tasks As Agreed

The PUC concluded that the partners delivered work for 16 of the 26 tasks or subtasks as agreed. For the remaining 10 task or subtask orders, the PUC rated the partners with average ratings of 2.09 to 2.90, or partially fulfilled. The task with the lowest average rating of 2.09 was for the Irvington Tunnel Alternatives Analysis. The PUC project manager for this task commented on the evaluation that the draft Alternatives Analysis report was delivered late, and that the partners' project manager was spread thinly through many other projects and tasks. Further, the PUC project manager wrote that cost estimators did not provide timely and satisfactory cost estimates until numerous complaints were made by the project team, and that weekly and monthly progress reports were not submitted.

In our prior audit on the fulfillment of the agreement between the PUC and the partners, we reported on the PUC's assessment of the partners' work for the period from June 2002 through December 2002. For this period, the PUC used five qualitative assessments ranging from *poor* to *excellent* and found that the partners completed almost all of the tasks satisfactorily, rating 14 of the 17 task or subtask orders as meeting or exceeding requirements. To obtain a more quantitative summary of the evaluations, we converted the descriptions to a numerical five point scale with poor being equivalent to 1, and excellent being equivalent to 5. Appendix B presents a summary of the evaluations.

THE WATER INFRASTRUCTURE PARTNERS DID NOT ALWAYS COMPLY WITH THE AGREEMENT'S COMPENSATION PROVISIONS

We found that the Water Infrastructure Partners generally followed requirements for submitting its invoices. However, we also found, as we did during our last audit, that the partners did not always comply with all aspects of the compensation provisions of its agreement with the PUC. As we also found during our last audit, the PUC did not pay all of the invoices the partners submitted to the PUC for payment within 30 days after receiving them, as required by the agreement. However, the PUC improved its performance and paid most invoices on time during the last five months of the audit period.

Our audit also revealed that the partners needs to improve its administration of payroll costs. We found that the partners did not adequately ensure that hours billed under the agreement are proper, as evidenced by the fact that many partners' timesheets were improperly completed or approved. Our audit also disclosed that the partners incorrectly adjusted some billed direct labor rates, and that the PUC and the partners need to agree on a specific methodology for administering direct labor rate increases in accordance with the agreement.

For the period covered by this audit, the partners and its subconsultants continued to charge the provisional overhead rates initially established in the agreement in September 2000, instead of the required actual overhead rates. According to the PUC contract manager, the PUC plans to develop and complete a plan for establishing actual overhead rates. This work will need to be completed so that necessary adjustments can be calculated in conjunction with closing out the agreement. According to the PUC contract manager, the closeout of the agreement is scheduled for early 2006.

In our prior audit of the agreement between the PUC and the partners, we found that the PUC paid some subconsultants at fixed rates, although the agreement did not specifically allow for consultants to be paid on a fixed rate basis. The PUC subsequently amended the agreement to provide for fixed rate and other types of subconsultant and subcontractor compensation. However, we found that the PUC and the partners need to further improve subcontracting procedures to ensure that the PUC's prior approval of subcontracting is obtained and documented.

Our review of other direct charges disclosed that these charges were supported by documentation such as invoices, and that most amounts invoiced were in accordance with the agreement. However, we did find some instances in which expenses invoiced had not received the required prior approval of the PUC, and instances in which the partners invoiced expenses that were not specifically identified in the agreement as allowable.

Finally, we found that the total amount of fixed plus performance fee paid was materially correct. However, we could not conclude that the methodology used in calculating the fixed and performance fees was in compliance with the agreement, because we found no basis in the contract language for this methodology.

The Partners Generally Followed Requirements for Submitting Bills

The PUC paid the partners $9,828,734 in approved invoices.

The partners submitted invoices totaling $9,883,224 for services rendered from January 2003 through December 2003. Table 1 shows the total amount of invoices submitted by the various joint venture partners and subconsultants that make up the partners, as well as subcontractors and suppliers. We reviewed in detail $1,918,987 (19 percent) of the invoices and found that the partners generally complied with agreement requirements for submitting and supporting its expenses. We found that the partners submitted required supporting documents, such as timesheets and suppliers' invoices. However, as discussed in a later section of this report, our review disclosed that many timesheets were improperly completed or approved. As shown in Table 2, as of September 2004, the PUC paid the partners $9,828,734 of the total, and correctly disallowed $54,490.

The PUC Improved the Timeliness of Payments to the Partners During the Audit Period

According to the agreement, the PUC should pay the partners within 30 days after the PUC has received a satisfactory invoice. The PUC did not pay all of the 185 invoices the partners submitted to the PUC for payment within the required 30 days, but the PUC improved its performance and paid most invoices on time during the later half of the audit period. Of the 185 invoices submitted for the audit period, we reviewed the 158 submitted for the period from January through November 2003[2], and found the PUC took more than 30 days to pay 72 of the invoices. Of these 72 late payments, 70 occurred in the period January 2003 through July 2003, with the PUC paying late only 2 of the 60 invoices reviewed for the period after August 2003. According to the PUC contract manager, the PUC did not pay the invoices within the required 30 days because the PUC did not have sufficient staff to monitor the invoice payment process in the first 7 months of 2003, but took corrective action when it hired 2 additional staff, so that payments are now generally made within 25 days.

[2] The December 2003 invoices had not yet been processed when we conducted this testing.

TABLE 1

Water Infrastructure Partners
Joint Venture Partners and Subconsultants
Billings For 2003

Consultant	Total Invoices Billed
Jacobs Civil, Inc.	$2,410,812
Primus Infrastructure, LLC	1,766,456
Olivia Chen Consultants	2,644,721
Cooper Pugeda Mgmt, Inc.	654,564
Raines, Melton & Carella	476,518
Westland Management Solutions, LLC.	371,031
Greg Roja and Associates	169,714
Geomatrix Consultants, Inc.	140,736
Reputation, LLC	129,110
Malcolm Pirnie, Inc. dba Red Oak Consulting	104,379
Other Subcontractors and Vendors	780,978
WIP *ODCs only*	234,205
Total	$9,883,224

Note: The billings for each individual subconsultant included in the Other Subcontractors and Vendors total are detailed in Appendix C.

TABLE 2

Water Infrastructure Partners
Invoices Submitted by the Partners and Paid by the PUC
As of September 27, 2004

Month During 2003	Number of Invoices	Total Amount on Invoices	Amount Paid	Amount Not Paid
January	14	$704,962	$679,841	$25,121
February	14	826,429	810,593	15,836
March	14	1,092,558	1,086,584	5,974
April	15	755,546	749,879	5,667
May	13	701,726	701,726	0
June	14	841,457	841,457	0
July	13	664,390	663,814	576
August	14	699,656	699,656	0
September	15	778,228	778,228	0
October	15	844,799	844,799	0
November	17	857,368	857,368	0
December	27	1,116,105	1,114,789	1,316
Total	185	$9,883,224	$9,828,734	$54,490

The Partners Need to Improve Its Administration of Payroll Costs

Because many partners' timesheets were improperly completed or approved, we found that the partners did not adequately ensure that hours billed under the agreement are proper. Our audit also disclosed that the partners incorrectly adjusted some billed direct labor rates, and that the PUC and the partners have not established a specific methodology for administering direct labor rate increases in accordance with the agreement.

The Partners and Some Subcontractors Improperly Completed or Approved Many Timesheets

We performed detailed testing of payroll costs for one sample month in the audit period, June 2003. In addition, we judgmentally selected for review a sample of four subcontractors added during the period July 2003 through December 2003, and for each of those subcontractors, selected one month for detailed testing of payroll costs. Our audit tests included, among other audit work, determining if the hours billed by the partners and subcontractors were supported by properly completed and approved partners timesheets.

19 percent of the timesheets we reviewed were improperly completed or approved.

Our review disclosed that the partners and some subconsultants submitted many timesheets that were improperly completed or approved. We found that 72 of the 373 timesheets we tested, or 19 percent, included one or more errors or omissions. Nine of the timesheets were not signed or dated by the employee, and 30 of the timesheets included approval signatures that were not dated or included dates that were earlier than the last date for which the hours were being reported and billed. In addition, 33 of the timesheets included changes that were not initialed, as necessary to certify their authenticity, and 8 of the timesheets listed time reporting dates that were not the same as the dates for which the hours were being reported and billed. We also found instances in which the chief executive officer of one of the joint venture partners signed as the approver for his own timesheets. The proper completion and approval of partners timesheets is a critical control to ensure that labor costs billed under the agreement are correct. According to the PUC contract manager, labor costs and the associated charges for overhead and fees represent approximately 95 percent of the total amounts invoiced under the agreement.

The Partners Incorrectly Adjusted Some Billed Direct Labor Rates

In the audit report of our first review of the PUC's agreement with the partners, dated June 30, 2003, we stated that the partners and its subconsultants gave wage increases to their employees that exceeded the maximum applicable change in the CPI by 1.6 to 11.1 points. In responding to the audit report, the partners stated that there are problems with the applicable contract clause, in that the contract does not provide a clear definition of which employees are considered to be dedicated to the contract, and that the contract states that direct labor pay rates can be adjusted annually but the annual date is not defined.

Wage increases by the partners and some subconsultants exceeded the maximum allowable wage increases.

The agreement provides that direct labor payroll rates can be adjusted annually and that the amount of the adjustment will be limited to a maximum of the Consumer Price Index (CPI) for San Francisco Bay Area wages for the previous year. The agreement further provides that adjustments for individual employees may exceed the maximum provided that the total adjustment dollars for employees dedicated to the contract does not exceed the maximum dollars based on the total direct salary paid on the contract for the previous year plus the CPI. The agreement states that any adjustments would be made once per year and the first adjustment shall not be made any earlier than six months after the execution of the agreement.

We found that the agreement inadequately defines the maximum allowable rate of increase. For example, the agreement does not specify what constitutes the previous year. The previous year could refer, for example, to the year ending with the month in which the increase occurred, the previous calendar year, or the previous contract year.

To determine whether the partners complied with the agreement provisions regarding maximum allowable rate increases, we used the CPI for Urban Wage Earners and Clerical Workers for the year ending on the last month of the prior contract year, which was December 2002. We compared the average increase in direct labor rates for each applicable joint venture partner and subconsultant to the change in this CPI. Therefore, we found the applicable CPI increase to be 1.7 percent.

To determine the average rate increases for each partner or subconsultant, we calculated the average percentage increase in direct labor rates for all employees who had billable hours in the previous, second contract year and who had billable hours in the third contract year. The sample of employees we tested included 73, or 77 percent, of the 95 employees for whom the partners billed charges to the PUC during the audit period. Our review disclosed that the joint venture partners and three subconsultants increased their labor rates in excess of the 1.7 percent maximum allowable increase. These firms increased their billed direct labor rates by averages of 2.3 percent to 15.3 percent. Table 3 shows the percent increase in direct labor rates given by the partners and subconsultants[3].

Table 3

Water Infrastructure Partners
Average Percentage Increase in Direct Labor Rates
From January 2003 through December 2003

Partners/Subconsultants	Number of Staff (Note 1)	Average Percentage Increase
Jacobs Civil, Inc.	15	9.0
Primus Infrastructure, LLC	13	4.5
Olivia Chen Consultants	23	9.4
Cooper Pugeda Mgmt, Inc.	6	2.3
Raines, Melton & Carella	10	15.3
Westland Management Solutions, LLC.	5	N/A (Note 2)
Orion Environmental Associates	1	0.0
Total	73	

Notes:
1. The number of staff includes those who were newly hired during the audit period. However, the calculations for the average percentage increases do not include employees that were hired, and did not receive rate increases, during the audit period.
2. N/A denotes not applicable, since the partners added Westland Management Solutions, LLC. as a subconsultant during the audit period, and there were no applicable rate increases.

The partners' contracts manager stated that he did not agree with the basis for our calculations, and adjusted the calculations based on his interpretation of the contract terms. The partners revised our calculations by excluding a few types of employees who received rate increases from the calculation of average direct rate increases. For example, according to the partners' contracts manager, the partners' revised calculations excluded all employees with fewer than 500 hours paid by the PUC in the contract year because the

[3] We did not include subconsultants in this analysis that are compensated on the basis of fixed hourly rates.

partners does not consider these employees as dedicated to the contract. However, the contract does not specify that any employees can be excluded from the limits on rate increases. Further, even though the partners' calculations incorrectly excluded many employees who received rate increases, the calculations still show that both joint venture partners and two subconsultants gave increases in excess of the 1.7 percent rise in the CPI.

In the audit report of our first review of the PUC's agreement with the partners, we recommended that the PUC confirm that hourly rates do not exceed the amounts allowed by the agreement. However, the PUC contract manager for the partners' contract has stated that the PUC does not verify that increases comply with the agreement terms, and that the PUC relies on the partners to ensure that billed direct labor rate increases comply with the agreement. We found that the PUC and the partners have not established a specific methodology for administering rate increases in accordance with the agreement, and that the PUC has not required the partners to provide a verifiable yearly report showing all direct labor rate increases and average percentage increases calculated in accordance with the agreement. Requiring and reviewing such a report would enable the PUC to determine if the partners complied with the agreement. Adjustments may be due to the PUC as a result of increases in billed direct labor rates in excess of those allowable.

The Partners and Subconsultants Continued To Charge Original Provisional Overhead Rates

The partners and subconsultants continued to charge incorrect overhead rates.

The agreement requires the partners to use the actual overhead rates established by annual audits, and to adjust any payments that were made based on provisional rates. In our audit report dated June 30, 2003, we stated that the Water Infrastructure Partners and its subconsultants charged their provisional overhead rates instead of the required actual overhead rates in their reimbursement requests to the PUC for the work the partners and subconsultants conducted on the agreement. We also stated that, although the PUC had not obtained the results of overhead audits for the second year of the agreement, Bechtel Infrastructure Corporation (Bechtel) had recommended changes from the provisional overhead rates used for the first year of the agreement.

For the period covered by this audit, the partners and its subconsultants continued to charge the provisional overhead rates initially established in the agreement in September 2000, instead of actual overhead rates. The partners also did not use the overhead rates recommended by Bechtel as the actual overhead rates for the subconsultants for 2000, and did not adopt those rates as the provisional rates for subsequent periods. Using the provisional overhead rates established in the agreement in September 2000, for the entire term of the agreement to date, has increased the likelihood that total adjustments to payments that were made based on provisional rates will be significant.

The third amendment to the agreement, which was approved by the Public Utilities Commission in April 2004, adds language to the agreement stating that the PUC may perform billing rate evaluations in lieu of overhead audit rate audits. The amendment specifies that the evaluations may assess the partners' and subconsultants' overhead rates or billing rates used on other City contracts or contracts with other agencies, and that the evaluations may also consider rates used by similar firms on other City contracts. According to the PUC contract manager responsible for the agreement, the PUC plans to take advantage of the flexibility provided by the third amendment by developing and completing a plan for establishing overhead rates.

The contract manager has agreed to a plan whereby the PUC, with requested input from the partners and the controller, will select partners' firms and subconsultants to be subjected for review, and define the initial scope of work, based on several criteria. These criteria will include invoiced amounts, types of financial statements available, the PUC's experience with the firms, and other factors. According to the PUC contract manager, the plan will propose a cost-effective approach that complies with the agreement and with the Code of Federal Regulations, Federal Acquisition Regulations, Title 48, Chapter 1 (FAR). When PUC management approves the plan, the PUC will enter into a letter of understanding with the controller for the performance of required audit work. This work will need to be completed so that necessary adjustments can be calculated in conjunction with closing out the agreement, which, according to the PUC contract manager, is scheduled for early 2006.

The PUC and the Partners Should Implement Additional Improvements in Subcontracting Practices

In our prior audit of the agreement between the PUC and the partners, we found that the PUC paid some subconsultants at fixed rates for the services they provided to the PUC, although the agreement did not specifically allow for consultants to be paid on a fixed rate basis. The PUC subsequently amended the agreement to specifically allow for the compensation of subconsultant firms on a fixed rate basis, and to provide for other types of subconsultant and subcontractor compensation. However, we found that the PUC and the partners need to improve procedures to ensure that the PUC's prior approval of subcontracting is obtained and documented.

The PUC Amended the Agreement to Provide for Fixed Rate and Other Types of Compensation

The PUC amended the agreement to specify allowable bases of compensation.

In our audit report dated June 30, 2003, we stated that the PUC paid three subconsultants at fixed rates for the services they provided to the PUC, although the agreement does not specifically allow for consultants to be paid on a fixed rate basis[4]. We recommended that the PUC determine whether it will allow some subconsultants to be paid at fixed rates and, if so, that the PUC amend the agreement to reflect this practice. The fourth amendment to the agreement, which was approved by the Public Utilities Commission in April 2004 and includes an effective date of June 5, 2002, specifies that subconsultant firms can be compensated either on a basis of cost plus base fee plus performance fee, or on a basis of fixed labor billing rates that include overhead and fee, plus the cost of other direct charges. The amendment also states that the decision to use fixed labor billing rates shall be at the sole discretion of the PUC general manager or designee, and restricts the use of fixed billing rates to subconsultants that are not routinely audited by a federal or a state agency. The amendment further states that these compensation formulas may be applied retroactively to June 5, 2002, also at the sole discretion of the PUC general manager or designee.

In addition to permitting compensation of subconsultant firms on the basis of fixed labor billing rates, the fourth amendment also specifies that, for subcontractors providing technical services such as drilling, excavation, shoring, surveying, and other technical services, compensation will be based on unit prices or time and materials. The amendment also states that the PUC may allow lump sum compensation for subconsultant or subcontractor work for which a fixed scope can be determined. The bases of compensation specified in the fourth amendment conform to FAR.

We reviewed all subcontracts added by the partners during 2003, and also reviewed a sample of purchase orders added during the

[4] The agreement originally provided for named subconsultants to be paid on a basis of cost plus base and performance fees.

same period. We found that the partners added 14 subcontracts during the period, and that all of them include bases of compensation that are consistent with the fourth amendment and with FAR. All of the six purchase orders in our sample also include bases of compensation that are consistent with the fourth amendment and with FAR.

The PUC and the Partners Need to Improve Subcontracting Approval Procedures

Although we found that subcontracts and purchase orders added by the partners include bases of compensation that are consistent with the fourth amendment and with FAR, we also found that the PUC and the partners need to improve procedures to ensure that the PUC's prior approval of subcontracting is obtained, as required by the agreement, and properly documented. For six of the 14 subcontracts we reviewed, we found that the documented dates that the partners requested approval were after the effective dates of the subcontracts and the beginning dates of the term of the subcontracts. For one other subcontract, the documented request for approval date was the same date as the beginning date of the subcontract term. In addition, for 13 of the 14 subcontracts, the actual approval date was not documented because the designated PUC approver did not include a date when he signed to indicate his approval.

The Partners Did Not Obtain Advance Approval for Some Other Direct Charges

Most other direct charges paid by the PUC were properly approved and allowable.

The agreement states that all other direct charges must be approved in advance by the manager of the utilities engineering bureau, and also limits other direct charges to the types of expenses specifically identified in the agreement. We reviewed a sample of other direct charges invoiced by the partners and subconsultants during the period from January 2003 through December 2003. The other direct charges we reviewed represented $212,451, or 48 percent, of the $438,114 of other direct charges invoiced during the period. We found that all goods and services invoiced were supported by documentation such as invoices, and that most amounts invoiced were in accordance with the agreement. However, of the $212,451 in other direct charges we reviewed, we found that the PUC should not have paid other direct charges totaling $12,532 because these charges did not comply with the requirement for other direct charges under the agreement. Four of these other direct charges, totaling $681, such as a San Francisco business license fee and State of California permit fee, were not among those specifically allowed under the agreement. In addition, $11,851 was for drilling charges the PUC paid in excess of the pre-approved amount of $142,829. The partners did not first secure PUC approval before incurring the additional drilling charges, as required by the agreement. In other instances we reviewed, the PUC properly refused to reimburse the partners because the partners had not obtained the prior approval of the PUC or for other reasons. The PUC properly refused to reimburse the partners for $21,228 of the $438,114 of other direct charges invoiced during 2003.

We also found that the partners should have required better support for the rates charged by a subconsultant for specialized services, materials, and equipment not provided by the PUC, which are allowable other direct charges under the agreement. One invoice for this category of other direct charges included $1,800 in charges for field vehicle and equipment usage, which the subconsultant invoiced at daily rates of $100 and $200. According to a PUC administrative analyst, the subconsultant stated that the flat rate per day includes charges for vehicles that are generally owned by the subconsultant, and for special tools, equipment, and supplies. The administrative analyst stated that the subconsultant typically invoices a flat rate per day rather than invoicing for each item separately. Since there is no third party invoice to substantiate the rates, the partners should require the subconsultant to substantiate its rates with a published price list or other acceptable documentation.

The third amendment to the agreement, which was approved by the Public Utilities Commission in April 2004, deletes agreement language stating that all other direct charges must be approved in advance by the manager of the utilities engineering bureau, and amends the approval requirement in several ways. The amendment states that authority to incur other direct charges must be approved in advance by the PUC manager of the agreement, and it specifies that in advance means prior to incurring costs. The amendment also states that approval of other direct charges budgets in a task order shall constitute authorization to incur other direct charges, but also specifies that the partners shall obtain approval prior to exceeding the total other direct charges amount approved in a task order. Further, the amendment stipulates that the PUC manager of the agreement shall have the right to approve other direct charges not authorized in advance, if in the judgment of the PUC manager of the agreement and the assistant general manager of infrastructure, or his or her designee, the charges are justified and reasonable, and the circumstances causing lack of advance approval are valid. This amendment was not effective during the period covered by this audit.

The PUC Should Clarify Contract Language Regarding Performance Fees

The agreement provides that the PUC is to pay the partners a fee, with fixed and performance elements, in addition to the reimbursement of direct salaries and overhead. For the third year, which approximately coincides with the audit period, the fixed fee is to drop to 6 percent, and the performance fee is to range between 0 and 5.5 percent. The agreement further specifies that the PUC is to pay the performance fee based on the partners' performance according to benchmarks that both parties agree upon during the first review after the first 18 months of the agreement.

To determine whether the third year[5] performance fees were properly paid, we reviewed a sample representing 56 percent of the total performance fees paid since our last audit. The total amount of performance fees paid was $470,475, with $355,119 of the total paid for services rendered during the period under review.

We found that the total amount of the fixed plus performance fee paid was materially correct. However, we could not conclude that the methodology used in calculating the fixed and performance fees was in compliance with the agreement. The percentages used by the partners to calculate the fees for the work performed in the third year of the agreement were based on the contract year in which the relevant task order funding was approved, which for many task orders was in the second year of the agreement. For these task orders, the partners calculated the fixed and performance fees using the second year percentages of 7 percent and a maximum 4.5 percent respectively, and not the third year percentages of 6 percent and 5.5 percent. Since the total maximum fee percentages for both the second and third years equal 11.5 percent, and because the partners received almost the maximum performance fee percentage based on their performance evaluations, we found that the total amount of the fixed plus performance fee paid was materially correct. However, we could not conclude that the methodology used in calculating the fees was in compliance with the agreement, because we found no basis in the contract language for calculating the fee amounts using the contract year in which the task order

[5] According to the PUC contract manager, the PUC has not yet paid performance fees for the fourth year of the agreement.

funding was approved, instead of the year that the task order work was performed.

THE PUC SHOULD FURTHER IMPROVE ITS MANAGEMENT OF THE AGREEMENT

This is the second audit report on the agreement between the PUC and the Water Infrastructure Partners, and we previously issued four reports on our audits of the agreement between the PUC and the San Francisco Water Alliance. Since we started our audits in 2001, we identified a number of recurring problems for which the PUC had not taken sufficient corrective actions. However, we found improvements in several areas during the audit period covered by this report.

The PUC has taken corrective actions, but additional improvements are needed.

The PUC has assigned two additional staff members to assist in the management of the agreement, and we found that PUC management of the agreement has improved in some areas since the prior audits. For example, in our four audit reports on the PUC and the alliance and the first audit report on the PUC and the partners, we stated that the PUC was slow in paying the alliance and partners. As we discuss in this report, the PUC improved the timeliness of payments during the period covered by this audit, and was generally paying within the required 30 days in the last 5 months of the audit period.

The PUC has also taken corrective actions in other areas. In our prior audit of the agreement between the PUC and the partners, we found that the PUC paid some subconsultants at fixed rates for the services they provided to the PUC, although the agreement did not specifically allow for consultants to be paid on a fixed rate basis. As discussed in this report, the PUC took corrective action by amending the agreement to allow for the compensation of subconsultant firms on a fixed rate basis, and to allow for other common types of compensation. The PUC also took corrective action in the area of other direct charges by amending the agreement. The amended agreement more clearly defines the required procedures for approving other direct charges, and revises approval requirements in several ways.

We found that PUC management of the agreement has improved since the prior audit. However, we also found that there is need for further improvements to ensure that the PUC properly monitors the financial and performance aspects of the agreement, in several areas in addition to those discussed in previous sections of the report.

We found that there is a substantial number of PUC and partners staff assigned to the agreement, many of whom are responsible for approving documents such as timesheets and invoices. However, there is no formal delegation of authority procedure or approved signatory list that covers the staff assigned to the agreement. Such a procedure and signatory list would clearly document the types and amounts of documents that each staff person is permitted to approve, and would enable supervisory and other personnel to verify the authenticity of PUC and partners signatures. Maintaining such a document with accompanying detailed procedural instructions could also help prevent some of the procedural deficiencies described in this report.

In our prior report on the agreement between the PUC and the partners, we stated that the PUC had not yet established a formal system to track all of the invoices submitted by the partners, and to account for all of the payments and resulting adjustments made by both the PUC and the partners. The PUC currently uses a number of different spreadsheets for different purposes, none of which are sufficient for tracking in detail the actual costs incurred and paid under the agreement. In addition, according to PUC accounting and other staff, the PUC does not reconcile the total actual payments made to the partners as recorded in the Controller's Financial Accounting and Management Information System (FAMIS) with the amount authorized for payment in the invoices. The PUC should perform such reconciliations on a regular basis to ensure that all payments are properly recorded in FAMIS.

RECOMMENDATIONS

To ensure that the Water Infrastructure Partners fulfills the compensation provisions of its agreement with the Public Utilities Commission, the PUC should take the following actions:

- Require the partners to submit properly completed and approved timesheets to ensure that hours billed under the agreement are correct.

- For each year of the agreement, require the partners to submit detailed documentation demonstrating that increases to direct labor rates are in compliance with the agreement. This documentation should reflect specific methodology for administering rate increases that are in accordance with the agreement, as agreed between the PUC and the partners. The documentation should include a verifiable report showing all direct labor rate increases and average percentage rate increases. The PUC should then analyze the documentation, and if the partners and its subconsultants are found to have used labor rates in excess of the amounts allowed by the agreement, the PUC should adjust amounts due or bill the partners for the excess amounts charged.

- Develop and complete a plan for establishing actual overhead rates. Any overhead rate audits or billing rate evaluations should be planned in compliance with the agreement and with the Code of Federal Regulations, Federal Acquisition Regulations, Title 48, Chapter 1. This work will need to be completed so that necessary adjustments can be calculated in conjunction with closing out the agreement.

- Remind the partners to request and obtain the prior approval of the PUC before adding subcontracts or purchase orders. The PUC must properly document its approval by signing and dating approval documents.

- Require the partners and subconsultants to properly substantiate other direct charges for which there is no third party invoice. This could be accomplished by providing a published price list or other acceptable documentation in support of the billed other direct charges amounts.

- Withhold payment of any performance fees for year four of the agreement pending any adjustments to amounts paid, or owed, to the partners resulting from the direct labor rate and overhead rate reviews recommended by this report.

- Amend or clarify the agreement language regarding performance and fixed fees. The language should specify that the applicable percentages used in the calculations are based on the contract year in which the task order funding was approved or on the contract year that the task work was performed.

- Develop and maintain a formal delegation of authority procedure and approved signatory list and accompanying detailed procedural instructions. The procedure and signatory list should cover the PUC and partners staff assigned to the agreement and should clearly document the types and amounts of documents that each staff person is to approve.

- Establish a formal system to track all of the invoices submitted by the partners, and to account for all of the payments and resulting adjustments made by both the PUC and the partners. This system should include a summary of the actual costs incurred and paid under the agreement, and a reconciliation of the total actual payments made to the partners as recorded in the Controller's Financial Accounting and Management Information System (FAMIS) with the amount authorized for payment per the invoices. These reconciliations should be performed on a regular basis in order to ensure that no unauthorized payments are being made for the agreement.

We conducted this audit according to the standards established by the Institute of Internal Auditors. We limited our audit to those areas specified in the audit scope section of this report.

Staff: Robert Tarsia, Audit Manager
Ann Foley
Kathy Buckley
Edwin DeJesus
Leon Valle

APPENDIX A

THE PUC'S EVALUATIONS OF THE WATER INFRASTRUCTURE PARTNERS
Task Order Numbers 55 – 79 for Year Three of the Agreement
As of December 21, 2003

Task Order	Sub Task	Description	Possible Score	Total Score Achieved	Percentage
			Evaluation Scores		
55-2		Irvington Tunnel – Alternatives Analysis	3.00	2.09	70%
56-2		Pulgas Dechloramination Project Field Inspection	3.00	3.00	100%
57-2		Bay Division Pipelines – Alternatives Analysis	3.00	2.19	73%
58-2		Reliability Study – Phase III	3.00	3.00	100%
60-2		Crystal Springs Bypass Tunnel – Conceptual Engineering Report	3.00	3.00	100%
61-2		Baden Pump Station Resident Engineer	3.00	3.00	100%
64-2		Regional Water System Performance Standards	3.00	3.00	100%
67-2		Seismic Upgrade, Bay Division Pipelines 3 and 4, Hayward Fault	3.00	3.00	100%
71-2		San Joaquin Pipeline No.4 – Needs Analysis	3.00	3.00	100%
73-2		Wastewater System Reliability Study	3.00	3.00	100%
74-2		Communications Support	3.00	2.90	97%
75-2		Executive/Commission Team Building	3.00	3.00	100%
78-3	1	Oversight and Administration	3.00	2.84	95%
78-3	2	Work Plan Development	3.00	2.13	71%
78-3	3	Staff and Organizational Development	3.00	3.00	100%
78-3	4	Capital Improvement Program and Environmental Planning	3.00	3.00	100%
78-3	5	Communications and Public Information	3.00	2.50	83%
78-3	6	Diversity Program Support	3.00	3.00	100%
78-3	7	Program Controls and Reporting	3.00	2.90	97%
78-3	8	Cost Estimating Database	3.00	3.00	100%
78-3	9	Engineering Practices	3.00	2.90	97%
78-3	10	Records Management	3.00	3.00	100%
78-3	11	Graphic Design and Audio/Visual Support	3.00	3.00	100%
78-3	12	Quality Assurance and Quality Control Planning	3.00	2.80	93%
78-3	13	Construction Management Plan	3.00	2.63	88%
79-3		Polhemus Creek Slope Monitoring Program	3.00	3.00	100%
		Total	78.00	73.88	95%

APPENDIX B

THE PUC'S EVALUATIONS OF THE WATER INFRASTRUCTURE PARTNERS
Completed and Interim Task Order Numbers 54 – 63 for Year Two of the Agreement
As of December 21, 2002

			Evaluation Scores				
Task Order	Sub Task	Description	Possible Score	Total Score Achieved	Percentage	Invoiced Costs as of Dec 21, 2002	Budgeted Cost as of Dec 21, 2002
54-2B	1	Oversight and Administration	5.00	3.00	60%		
54-2B	2	Scoping	5.00	3.50	70%		
54-2B	3	Staff and Organizational Development	5.00	5.00	100%		
54-2B	4	Implementation of the Capital Improvement Repair and Rehabilitation Organization	5.00	5.00	100%		
54-2B	5	Communications and Public Affairs	5.00	4.00	80%		
54-2B	6	Diversity Program Support	5.00	3.25	65%		
54-2B	7	Program Controls	5.00	3.00	60%		
54-2B	8	Cost Estimating Database	5.00	3.70	74%		
54-2B	9	Engineering Practices	5.00	3.90	78%		
54-2B	10	Records Management	5.00	4.00	80%		
54-2B	11	Graphic Design and Audio Visual Development	5.00	3.00	60%	$2,589,566	$2,928,245
55-2		Irvington Tunnel / Alameda Siphons	3.00	1.30	43%	182,680	600,000
56-2		Inspection Services	N/A	N/A		42,467	291,882
57-2		Bay Division Pipelines – Alternative Analysis	3.00	1.30	43%	146,464	486,637
58		Reliability Phase 3 Implementation Plan	3.75	2.25	60%	62,140	182,975
59-2		Stoner Model Validation	5.00	2.65	53%	15,081	36,086
60-2		Pre-Design	N/A	N/A		99,380	1,038,672
61-2		Baden Pump Station Resident Engineer	5.00	3.00	60%	33,416	319,584
62-2		Sunol Valley Water Treatment Plant Instrumentation and Control Inspection Services	3.75	2.25	60%	32,056	45,645
63-2		Diversity Support	N/A	N/A		10,940	21,493
		Total	78.50	54.10	69%	$3,214,190	$5,951,219

N/A = Not Available

APPENDIX C

Water Infrastructure Partners
Joint Venture Partners and Subconsultants
Billings For 2003

Consultant	Total Invoices Billed
Jacobs Civil, Inc.	$2,410,812
Primus Infrastructure, LLC	1,766,456
Olivia Chen Consultants	2,644,721
Cooper Pugeda Mgmt, Inc.	654,564
Raines, Melton & Carella	476,518
Westland Management Solutions, LLC.	371,031
Greg Roja and Associates	169,714
Geomatrix Consultants, Inc.	140,736
Reputation, LLC	129,110
Malcolm Pirnie, Inc. dba Red Oak Consulting	104,379
Hydroconsult Engineers, Inc.	102,348
DTN Engineers, Inc.	84,216
C.H. Guernsey & Company	75,728
Pearson Exploration	72,071
Orion Environmental Associates	71,574
Dr. Thomas D. O'Rourke	59,782
Essex Environmental, Inc.	53,502
Red River Associates	48,951
G&E Engineering Systems Inc.	42,712
Mr. Raz Konyalian	31,859
Mr. Jeppe Eskilsson	30,450
Lane Denton Consultants	22,000
Pitcher Drilling Co.	21,898
Norman A. Abrahamson, Inc.	16,640
Martin M. Ron Associates, Inc.	15,805
Applied Materials & Engineering, Inc.	8,920
QBIS Group, Inc.	7,800
On The Move Staffing Services	5,950
Cross Land Surveying, Inc.	4,861
Dr. T. Leslie Youd	3,911
WIP *ODCs only*	234,205
Total	$9,883,224

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SAN FRANCISCO PUBLIC UTILITES COMMISSION
RESPONSE TO THE AUDIT:

SFPUC
WATER
WASTEWATER
POWER

SAN FRANCISCO PUBLIC UTILITIES COMMISSION

Office of the Assistant General Manager, Infrastructure
1155 Market Street, 11th Floor, San Francisco, CA 94103
Tel.: (415) 554-0740 * Fax: (415) 554-2466 * Email: hkelly@sfwater.org

October 26, 2005

Mr. Noriaki Hirasuna
Director, Office of the Controller
City and County of San Francisco
City Hall Room 388
San Francisco, CA 94102

Subject: Response to Audit Number 03017
Second Review (January 2003 – December 2003) of the Water Infrastructure Partners Contract (formerly the San Francisco Water Alliance Contract)

Dear Mr. Hirasuna:

We would like to thank you and your staff for conducting the sixth audit of the above said contract. The following is our response to the comments found on pages 23 and 24 of the Recommendations section of the audit report:

1) **Comment: Require the partners to submit properly completed and approved timesheets to ensure that hours billed under the agreement are correct.**

   Response: Agreed. The problems encountered in 2003 were corrected in 2004

2) **Comment: For each year of the agreement, require the partners to submit detailed documentation demonstrating that increases to direct labor rates are in compliance with the agreement. This documentation should reflect specific methodology for administering rate increases that are in accordance with the agreement, as agreed between the PUC and the partners. The documentation should include a verifiable report showing all direct labor rate increases and average percentage rate increases. The PUC should then analyze the documentation, and if the partners and its sub-consultants are found to have used labor rates in excess of the amounts allowed by the agreement, the PUC should adjust amounts due or bill the partners for the excess amounts charged.**

   Response: Agreed. Documentation is being prepared by WIP.

3) **Develop and complete a plan for establishing actual overhead rates. Any overhead rate audits or billing rate evaluations should be planned in compliance with the agreement and with the Code of Federal Regulations, Federal Acquisition Regulations, Title 48, Chapter 1. This work will need to be completed so that necessary adjustments can be calculated in conjunction with closing out the agreement.**

   Response: Agreed. The overhead audit is currently being performed.

4) **Remind the partners to request and obtain the prior approval of the PUC before adding subcontracts or purchase orders. The PUC must properly document its approval by signing and dating approval documents.**

Response: Agreed. The problems encountered in 2003 were corrected in 2004.

5) **Require the partners and sub-consultants to properly substantiate other direct charges for which there is no third party invoice. This could be accomplished by providing a published price list or other acceptable documentation in support of the billed other direct charges amounts.**

Response: Agreed

6) **Withhold payment of any performance fees for year four of the agreement pending any adjustments to amounts paid, or owed, to the partners resulting from the direct labor rate and overhead rate reviews recommended by this report.**

Response: Agreed

7) **Amend or clarify the agreement language regarding performance and fixed fees. The language should specify that the applicable percentages used in the calculations are based on the contract year in which the task order funding was approved or on the contract year that the task work was performed.**

Response: Work on the current contract has been completed, therefore an amendment to clarify the language will not be processed. Although language in the contract was unclear, PUC and WIP have always agreed that the percentages used in the calculations are based on the contract year that the task work was approved.

The new contract with Parsons does not require PUC to pay a performance fee and limits subcontractor administration markup to "actual cost not to exceed 5%".

8) **Develop and maintain a formal delegation of authority procedure and approved signatory list and accompanying detailed procedural instructions. The procedure and signatory list should cover the PUC and partners staff assigned to the agreement and should clearly document the types and amounts of documents that each staff person is to approve.**

Response: Since work has been completed, a signatory list and procedures will not be developed for the current contract. However, a formal procedure is being developed for the new contract with Parsons. Labor hours will be entered online by individual employees and the approval process will be automated.

9) **Establish a formal system to track all of the invoices submitted by the Partners and to account for all of the payments and resulting adjustments made by both the PUC and the partners. This system should include a summary of the actual costs incurred and paid under the agreement, and a reconciliation of the total actual payments made to the partners as recorded in the Controller's Financial Accounting and Management Information System (FAMIS) with the amount authorized for payment per the invoices. These reconciliations should be performed on a regular basis in order to ensure that no unauthorized payments are being made for the agreement.**

Response: A formal tracking system has been in place since January 2004. The system tracked actual costs invoiced, costs disallowed by PUC, reason for the disallowance, payment authorized by PUC, date paid by the Controller.

To assist PUC in managing the new contract, a database is currently being developed and a reconciliation will be performed to ensure that no unauthorized payments are being made for the agreement.

If you have questions or need additional information, please contact Rosie Tamsil at 554-1549. I appreciate the time and effort that your office put into this audit.

Sincerely,

Harlan L. Kelly, Jr.

c: Steve Maiolini
Annie Li
Lourdes Cunanan
Rosie Tamsil
Les Tift

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WATER INFRASTRUCTURE PARTNERS RESPONSE TO THE AUDIT:

Water
Infrastructure
Partners

A Joint Venture of Jacobs Civil, Inc & Primus Infrastructure, LLC

November 4, 2005

Mr. Noriaki Hirasuna
Director, Office of the Controller
City and County of San Francisco
City Hall Room 388
San Francisco, Ca. 94102

CCN # 03468

Subject: Response to Audit Number 03017'
Second Review (January 2003 – December 2003) of the Water Infrastructure Partners Contract (formerly the San Francisco Water Alliance Contract)

Dear Mr. Hirasuna:

As the Program Director of the Water Infrastructure Partners (WIP) I would like to take this opportunity to file a formal response to the audit comments found on pages 23 and 24 of the Recommendations section of the audit report:

1) **Comment: Require the partners to submit properly completed and approved timesheets to ensure that hours billed under the agreement are correct.**

   Response: Agreed. The problems encountered in 2003 were corrected in 2004

2) **Comment: For each year of the agreement, require the partners to submit detailed documentation demonstrating that increases to direct labor rates are in compliance with the agreement. This documentation should reflect specific methodology for administering rate increases that are in accordance with the agreement, as agreed between the PUC and the partners. The PUC should then analyze the documentation, and if the partners and its sub-consultants are founds to have used labor rates in excess of the amounts allowed by the agreement, the PUC should adjust amounts due or bill the partners for excess amounts charged.**

   Response: Per Amendment Three, Appendix D of Contract #CS-524, contract wide direct labor rate adjustments are to be determined by the San Francisco Bay Area wages of the National Compensation Survey – Wages prepared by the US Department of Labor. This factor from the 2003/2004 timeframe was 4%. The amendment accepts that individual rates may vary around this number and that promotion is an agreed exception to the rule.

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Water
Infrastructure
Partners
A Joint Venture of Jacobs Civil, Inc & Primus Infrastructure, LLC

Contract #CS-524 does specify the above method to calculate the annual rate adjustment but does not define the individuals that should be included in the calculation. There are numerous exceptions to dedicated personnel in the WIP labor force, including but not limited to, non-dedicated personnel, part time employees, employees who start work mid-year and employees who receive promotions or new jobs during the year.

The SF Controllers office, in their second review of this contract, has acknowledged the fact that this measurement has not been clearly defined. Their requirement was for WIP to demonstrate a calculation that will show compliance with this survey while taking into account all of the variables listed above.

The following page shows the methodology of this calculation by including only full time, dedicated staff and by breaking down the amounts of yearly increases from any rate changes due to promotions. The global rate of increase, without taking account of promotion, is calculated at 4.63%, somewhat above the median figure of 4%. However, after taking account of promotions, and assuming that for promoted individuals 4% of any rate increase is for cost of living (thus making those individuals neutral in any comparison) the global rate increase is 3.58%, significantly below the guideline of 4%. ①

Included after the spreadsheet are all the approvals from SFPUC for the promotions which are reflected in the calculation.

3) **Comment: Develop and complete a plan for establishing actual overhead rates. Any overhead rate audits or billing rate evaluations should be planned in compliance with the agreement and with the Code of Federal Regulations, Federal Acquisition Regulations, Title 48, Chapter 1. This work will need to be completed so that necessary adjustments can be calculated in conjunction with closing out the agreement.**

   Response: After continual requests by WIP to finalized overhead rates, there is an overhead audit currently in progress.

4) **Comment: Remind the partners to request and obtain the prior approval of the PUC before adding subcontract or purchase orders. The PUC must properly document its approval by signing and dating approval documents.**

   Response: The majority of the subcontracts and purchase orders that were created by direction of the PUC Program Managers. Where there was advanced notice given to WIP

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① The Controller's Financial Audits Division's comments on the response from the Water Infrastructure Partners to the audit are on page 39.

by the Program Managers, WIP created subcontracts and purchase orders and advised the PUC of such.

5) **Comment: Require the partners and sub-consultants to properly substantiate other direct charges for which there is no third party invoice. This could be accomplished by providing a published price list or other acceptable documentation in support of the billed other direct charges amounts.**

   Response: Agreed

6) **Comment: Withhold payment of any performance fees for year four of the agreement pending any adjustments to amounts paid, or owed, to the partners resulting from the direct labor rate and overhead rate reviews recommended by this report.**

   Response: While we understand the Controller's concerns regarding retaining funds in the event that WIP owes the SFPUC monies based on these two criteria, it is outside the contract terms for any of these fees to be held in assurance of future adjustments. ②

   We therefore disagree with the recommendation that these fees be withheld on the grounds that it is in direct violation of the Contract #CS-524. Further, we believe that the Audit report should not promote breach of contract and should be adjusted to recommend proper acceptance of the contract terms and conditions.

7) **Comment: Amend or clarify the agreement language regarding performance and fixed fees. The language should specify that the applicable percentages used in the calculations be based on the contract year in which the task order funding was approved or on the contract year that the task work was performed.**

   Response: Work on the current contract has been completed and there are will be no more amendments to the contract.

8) **Comment: Develop and maintain a formal delegation of authority procedure and approved signatory list and accompanying detained procedural instructions. The procedure and signatory list should cover the PUC and partner's staff assigned to the agreement and should clearly document the types and amounts of documents that each staff person is to approve.**

Comment: No signatory list and procedures were developed before the end of the contract.

9) **Comment: Establish a formal system to track all of the invoices submitted by the partners and to account for all of the payments and resulting adjustments made by both the PUC and the partners. This system should include a summary of the actual costs incurred and paid under the agreement and a reconciliation of the total actual payments mad to the partners as recorded in the Controller's Financial Accounting and Management Information System (FAMIS) with the amount authorized for payment per the invoices. These reconciliations should be performed on a regular basis in order to ensure that no unauthorized payments are being made for the agreement.**

Response: This is a PUC action.

If you have questions or need additional information, please contact Les Tift at 551-4534.

Regards,

Mike Kane
Program Director
Water Infrastructure Partners
1155 Market Street, 6th Floor
San Francisco, Ca. 94542

Cc: Steve Maiolini
Annie Li
Lourdes Cunanan
Rosie Tamsil
Margaret Berry
Ken Fredrickson
Les Tift

CONTROLLER'S FINANCIAL AUDITS DIVISION COMMENTS ON THE RESPONSE FROM THE WATER INFRASTRUCTURE PARTNERS:

To provide clarity and perspective, we are commenting on the response to our audit report from the Water Infrastructure Partners. The following numbered responses correspond to the numbers we have placed in the response from the Water Infrastructure Partners.

① – As stated in the report, our review disclosed that the joint venture partners and three subconsultants increased their labor rates in excess of the 1.7 percent maximum allowable increase. Also as stated in the report, the partners' own calculations provided during the audit showed that both joint venture partners and two subconsultants gave increases in excess of the 1.7 percent rise in the CPI.

② – We do not agree that it is outside contract terms for fees to be held in assurance of future adjustments. Furthermore, the audit report does not promote breach of contract.

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cc: Mayor
Board of Supervisors
Civil Grand Jury
Budget Analyst
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