

COUNCIL AGENDA: 9/26/2017
ITEM: 7.1 (17-111)

Memorandum

TO: HONORABLE MAYOR AND
CITY COUNCIL

FROM: Toni J. Taber, CMC
City Clerk

SUBJECT: SEE BELOW

DATE: September 15, 2017

SUBJECT: AUDIT OF ENVIRONMENTAL SERVICES DEPARTMENT CONSULTING SERVICES.

RECOMMENDATION: As recommended by the Transportation and Environment Committee on September 11, 2017, accept the audit report on ESD Consulting Services.



Office of the City Auditor

**Report to the City Council
City of San José**

**AUDIT OF
ENVIRONMENTAL
SERVICES DEPARTMENT
CONSULTING SERVICES:
AGREEMENTS REQUIRE
ADDITIONAL OVERSIGHT**

**Report 17-05
September 2017**

September 1, 2017

Honorable Mayor and Members
Of the City Council
200 East Santa Clara Street
San José, CA 95113

Audit of Environmental Services Department Consulting Services: Agreements Require Additional Oversight

The City of San José's Environmental Services Department (ESD) provides solid waste and recycling services, stormwater management, recycled and wastewater management, and potable water delivery. The purpose of this audit was to evaluate ESD's use, monitoring, and payment for professional consulting services. Our review focused on eleven agreements with a total value not-to-exceed \$46.1 million.

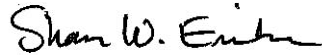
Finding 1: The Proposed Amendment to the Agreement for Project Management Services Provides an Opportunity to Improve Cost Controls. ESD has a five-year, \$39 million agreement with MWH America's, Inc. (MWH) for program management of the Capital Improvement Program at the San José-Santa Clara Regional Wastewater Facility. As of June 2017, ESD has spent \$30 million and is proposing to extend the MWH agreement term by 5 more years and increase the not-to-exceed value to \$78 million. To strengthen controls over expenditures, we recommend the amended agreement include limits on hourly billing rates and salary increases; require preapproval of sub-consultants and staffing changes; limit geographic pay differentials; clarify reimbursable travel expenses including per diems and mileage; and clarify sub-consultant markups and multipliers.

Finding 2: ESD Should Improve Its Contract Management Processes for Other Professional Services Agreements. In addition to the project management agreement discussed above, we reviewed 10 other professional consulting services agreements with a not-to-exceed value of \$7.1 million. Some problems, identified in prior audits, persist today. In some instances, staff overlooked key agreement terms. This included adjusting tasks, the compensation schedule, and sub-consultants without prior approval.

Management of individual agreements largely depends on the contract manager in charge. While many of the agreements we reviewed were managed by staff who had prior work experience managing agreements, this was not always the case. In our opinion, ESD administrative staff should periodically distribute the City's instructions on "Using and Completing the City of San Jose Standard and Master Consulting Agreement Forms" to all contract monitoring staff; and offer more robust contract monitoring training for staff who manage agreements.

This reports includes 10 recommendations to improve the oversight of professional consulting agreements. We plan to present this report at the September 11, 2017 meeting of the Transportation and Environment Committee. We would like to thank the Environmental Services Department, MWH Americas, Inc. (now known as Stantec Inc.), and the Office of the City Attorney for their assistance during the audit process. The Administration has reviewed this report and its response is shown on the yellow pages.

Respectfully submitted,



Sharon W. Erickson
City Auditor

finaltr
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This report is also available online at www.sanjoseca.gov/audits.

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Introduction

The mission of the City Auditor's Office is to independently assess and report on City operations and services. The audit function is an essential element of San José's public accountability, and our audits provide the City Council, City management, and the general public with independent and objective information regarding the economy, efficiency, and effectiveness of City operations and services.

In accordance with the City Auditor's Fiscal Year (FY) 2016-17 Audit Work Plan, we have completed an audit of Environmental Services Department (ESD) consulting service agreements. The purpose of this audit was to evaluate ESD's use, monitoring, and payment for consulting services.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. We limited our work to those areas specified in the "*Audit Objective, Scope, and Methodology*" section of this report.

The Office of the City Auditor thanks the management and staff from the Environmental Services Department, the Public Works Department, the Finance Department, and the City Attorney's Office for their time, information, insight, and cooperation during the audit process.

Background

ESD's mission is to deliver world class utility services and programs to improve our health, environment, and economy.

ESD's expected service delivery in FY 2017-18 includes the following:

- Build, operate, and maintain the City of San José's (City) wastewater, recycled water, and potable water utility infrastructure to ensure system reliability and public health and safety.
- Promote the health of the environment and South Bay watershed through collection, treatment, and management of wastewater and stormwater runoff.
- Oversee programs to collect, recycle, and dispose of solid waste to maximize diversion from landfills and protect public health, safety, and the environment.

- Reduce the City's environmental footprint through energy efficiency, waste reduction, and environmentally preferable purchases.
- Support sustainable infrastructure, equipment, and behaviors throughout the community through education, and public-private partnerships.

Budget and Staffing

ESD is primarily funded by user fees. In FY 2016-17, less than one percent of ESD's total budgeted funding (\$257.8 million) was from the General Fund (\$1.4 million). Funding for most of ESD's staff, contractors, consultants, and construction projects comes from other funds including: Integrated Waste Management Fund (\$117 million), San José-Santa Clara Treatment Plant Operating Fund (\$85.2 million), Water Utility Fund (\$37.5 million), Storm Sewer Operating Fund (\$11 million), Capital Funds (\$4.4 million) and Sewer Service and Use Charge Fund (\$1.3 million).

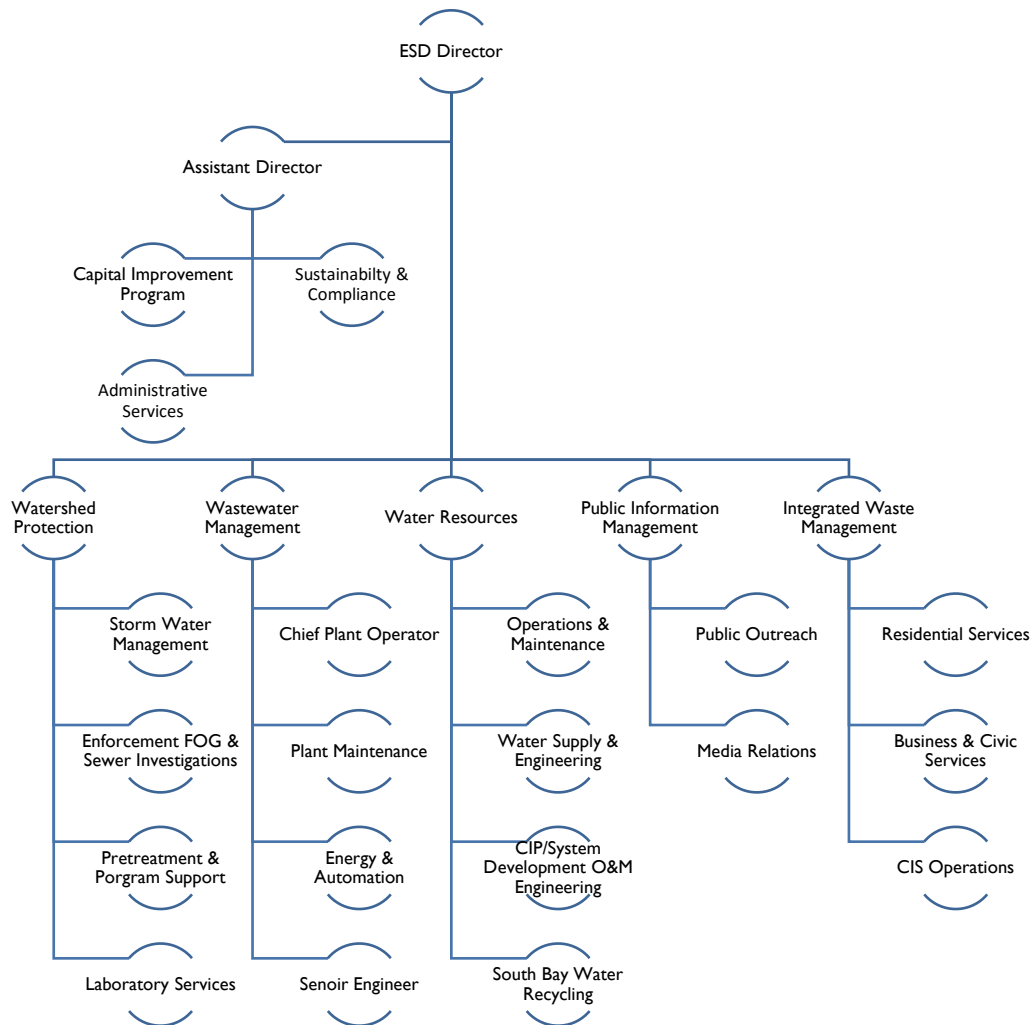
The FY 2017-18 ESD budget includes 552 full time equivalent positions. This is 48 positions (9.5 percent) more than in FY 2013-14. Although the number of budgeted full time positions has increased every year over the past five years, ESD still has vacancies. As of June 2017, there were 64 total vacancies remaining in ESD.¹

Five divisions report directly to the Director: Watershed Protection, Wastewater Management, Water Resources, Public Information Management, and Integrated Waste Management. The Assistant Director oversees three additional sectors (administrative services, Capital Improvement Program² [CIP], and sustainability and compliance) and the council liaison. Exhibit I, below, shows ESD's organizational structure.

¹ Most of these vacancies are at the Regional Wastewater Facility.

² The CIP is guided by the Plant Master Plan, a 30-year planning-level document focused on long-term rehabilitation and modernization of the Plant.

Exhibit I: ESD's FY 2017-18 Organizational Chart



Source: Auditor adapted from ESD's Organization Chart as of July 2017

City Manager's Contracting Authority

If money has been appropriated and there is a sufficient balance to pay for the expense, the City Manager is authorized to execute agreements for the City of San José. City Council approval is required for most departmental agreements that exceed \$290,000. All agreements less than \$290,000 must be reviewed and approved by the City Manager's Office.

Prior to execution, departments send the proposed agreement to the City Manager along with a contract transmittal form. This form summarizes basic information such as the contracting department, the purpose of the agreement, and the type of procurement.

The City Attorney's Office (CAO) also typically reviews and approves individual consultant agreements; however, it generally does not review the details of

agreements under \$100,000. The CAO has standard templates available for departments to use for agreements that do not meet the \$100,000 threshold. These do not require additional review by the CAO unless there is a change to the template.

ESD Contracting Activity

ESD contracts with vendors for a variety of reasons. As discussed earlier, ESD builds and maintains the City's wastewater and potable water infrastructure, provides recycling and solid waste services, and supports sustainable infrastructure. The single largest annual contracting activity in ESD is for solid waste and recycling services with the City's waste haulers. In addition to those services, ESD also has agreements for construction, professional consulting services, legal services, etc.

According to ESD, contracting with outside entities may be necessary for the following reasons:

- Lack of in-house expertise;
- Need for short-term services;
- Staffing challenges, including vacancies;
- Need for an independent and objective opinion; and,
- Possible cost savings.

Contract Procurement and Management

The City has a decentralized approach to contract procurement and management. When ESD identifies the need for a consultant, it begins the procurement process. ESD's internal procurement staff is responsible for providing resources to assist with managing consulting agreements and following City processes. In addition to providing ongoing project support, they offer trainings to educate staff about City resources, procurement types, procurement steps, how to write a statement of work, and some best practices for contract development.

ESD staff also provide guidance on what documents to keep for the agreement, including council memos, a checklist of deliverables with milestone dates, and relevant correspondence. Each division is responsible for maintaining agreement documents and ensuring that deliverables and invoices are received. Agreements that are part of the CIP are managed slightly differently than other agreements procured by ESD. Those agreements follow the Department of Public Work's procurement and contract management process.

Monitoring Consulting and Professional Services Agreements

Consulting and professional services can vary significantly, and can include anything from environmental testing and compliance reporting to sustainability studies to assessing the impact of environmental policies. ESD assigns staff to monitor contracts, but it does not utilize standard operating procedures, manuals, or offer post-procurement contract monitoring training.

CIP-related Consulting and Professional Services Agreements

CIP-related professional services agreements tend to be expensive, time intensive, and related to larger construction projects. Therefore, ESD spends much time and effort to support project management teams and coordinate between projects. CIP contract managers attend a multitude of meetings with other managers, leadership, and departments to ensure compliance and to stay informed about other projects. CIP team members participate in bi-weekly “*Workload Review Meetings*” with the City Attorney’s Office, regular program performance reviews, and monthly package performance meetings. Not only do these meetings offer an opportunity to check in with CIP contract managers but they also offer a chance to exchange information and seek guidance from leadership.

In addition to regular meetings, project managers have access to numerous management and monitoring resources on the CIP project portal. Some of the resources include design guidelines, an invoice checklist, and standard operating procedures for processing service orders.

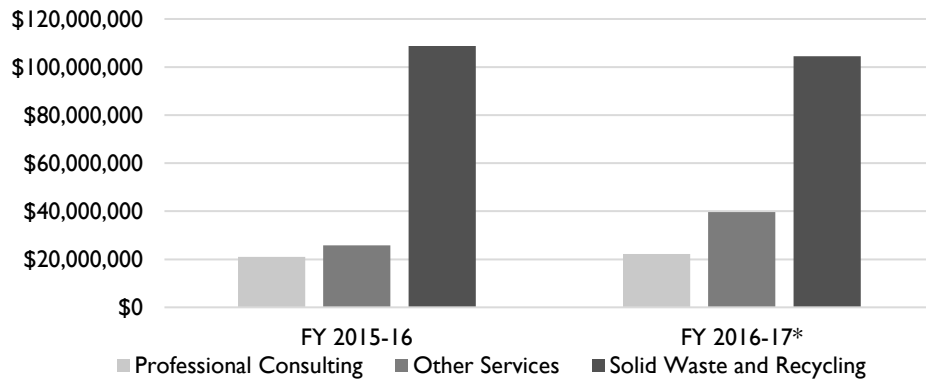
There are documents that outline procedures for project managers, which include: how long a project manager should expect each step to take before receiving a notice to proceed; what signatures are required for service orders; and what to look for in an invoice.

ESD Contracting Expenditures FY 2015-16 and FY 2016-17

In FY 2015-16, ESD spent \$156 million on construction, consulting and professional services, government agreements, non-profit grants, legal expenses and other miscellaneous activities. Of this, nearly \$109 million (or 70 percent) was spent on solid waste and recycling agreement expenditures. Much of the remaining contractual expenditures were for the Regional Wastewater Facility rebuild, described in greater detail later in the report.

In FY 2016-17 (as of June 2017), ESD spent over \$166 million on these types of activities (as described above). Of this, 63 percent or approximately \$104 million was for the solid waste and recycling agreement expenditures. The remaining \$62 million was spent on agreements for legal services, non-profits, professional consulting agreements, CIP expenditures, and other services. This expenditure breakdown is shown in Exhibit 2.

Exhibit 2: Most ESD Contract Expenditures in FY 2015-16 and FY 2016-17 Were for Solid Waste and Recycling



*FY 2016-17 data as of June 2017
 Source: Auditor Analysis of FMS

Previous Audits and Audit Recommendations

This is the fourth in a series of related audits including:

- [Audit of Environmental Services—A Department at a Critical Juncture \(2012\)](#)
- [Consulting Agreements: Better Enforcement of Procurement Rules, Monitoring and Transparency is Needed \(2013\)](#)
- [Regional Wastewater Facility Master Agreements: New Procedures and Better Contract Management is Needed \(2013\)](#)

Many of the findings from the previous audits focused on issues with consistency, training, and citywide policies. For this audit, our focus was reviewing sufficiency of ESD oversight and whether the City received the agreed-upon deliverables. As described in the findings below, some of the previous concerns continue to persist.

Audit Objective, Scope, and Methodology

The audit objective was to review ESD consulting agreements. This audit was conducted at the request of a City Councilmember and in accordance with the City Auditor’s FY 2016-17 Audit Work Plan. We focused on ESD’s management of consulting agreements to determine if oversight was sufficient and if the City got what it paid for.

As previously pointed out in our 2013 Audit of Consulting Agreements, the City still does not maintain a complete list of awarded consulting agreements. Therefore, to determine ESD’s contracting activity, we started by reviewing ESD’s FY 2015-16 and FY 2016-17 transaction activity in the City’s Financial Management System (FMS) to narrow our focus on ESD’s consulting agreements.

We then cross-checked the FMS data with the Clerk’s contract database (CHAD) and reviewed the scope of services. Finally, we collaborated with ESD to group agreement expenditures into the following categories (listed in order of FY 2015-16 expenditures):

1. Solid Waste and Recycling – agreements with the City’s waste haulers for solid waste and recycling services (\$109 million)
2. Construction – agreements for construction activity, including construction at the regional wastewater facility’s Capital Improvement Program (\$19.6 million)
3. *Capital Improvement Program (CIP) Professional Consulting – agreements for consulting services that fall under the City’s CIP program (\$18 million)*
4. Miscellaneous – all other services, including custodial agreements (\$3.8 million)
5. *Non-Capital Improvement Program Professional Consulting – agreements for consulting services that do not fall under the City’s CIP program (\$3 million)*
6. Non-Profit – agreements with non-profits for either specific services or grants (\$1.5 million)
7. Legal – agreements for legal services (\$450,000)
8. Government – grants or “pass-throughs” to other government entities (\$360,000)

We limited our review to consulting and professional services agreements for the CIP and the non-CIP programs, shown above in italics.

Sample Selection

We selected ten non-CIP professional consulting agreements for review—seven standard agreements and three master agreements³ totaling \$1.9 million expenditures in FY 2015-16 and FY 2016-17 with a not-to-exceed (NTE) value of \$7.1 million over the entire term of the contracts. We also selected one CIP master agreement with expenditures totaling \$19.7 million in FY 2015-16 and FY 2016-17, with a not-to-exceed amount of \$39 million.

These agreements cover a broad range of activities and were managed by different divisions within ESD. We reviewed the following agreements:

³ A standard consulting agreement includes a well-defined scope for a specific project. Whereas, a master consulting agreement outlines a category of work, rather than a specific project with a well-defined scope, that the consultant will perform.

1. **MWH America's, Inc.** – In September 2013, the City entered into a \$39 million master agreement with MWH America's, Inc. (MWH).⁴ This agreement provides program management services for the Capital Improvement Program at the San José-Santa Clara Regional Wastewater Facility (RWF) through September 2018.
2. **HydroScience Engineers, Inc.** – ESD entered into a \$2 million master agreement with HydroScience Engineers, Inc. (HydroScience) in February 2014 to provide construction project management and engineering services to projects in the Operations and Maintenance section at the RWF.⁵
3. **ABB, Inc.** – This is a software purchase agreement for the installation of an upgrade to the Distributed Control System Upgrade at the San José-Santa Clara Regional Wastewater Facility. This agreement was for a total not-to-exceed amount of \$1.8 million with a 10 percent contingency of \$181,479 to cover unanticipated expenses and change orders.
4. **EnfoTech & Consulting, Inc.** – This is a software maintenance agreement. ESD first contracted with EnfoTech & Consulting, Inc. in 2003 to help track and manage the Storm Water and Pretreatment Inspection Program. The City currently pays \$49,500 annually for system maintenance for an agreement that originally cost approximately \$1 million.
5. **Cornerstone Earth Group, Inc.** – One of four master service agreements awarded in 2014 for on-call environmental consulting services in diverse environmental issue areas such as soil and groundwater contamination and air quality and permitting. The agreement is for a not-to-exceed amount of \$550,000.
6. **HF&H Consultants, LLC.** – This is a master service agreement with a not-to-exceed amount of \$270,000 to provide solid waste and recycling consulting services on an as-needed basis for various projects. The services include multiple projects that analyze San José's commercial waste collection system, as well as collection and processing of materials obtained from commercial and industrial sites throughout the City.
7. **Trussell Technologies** – The City is interested in modifying its wastewater disinfection process by reducing the chlorine contact time. The City entered into an agreement with Trussell Technologies in May 2016, for a not-to-exceed amount of \$270,000, to analyze existing tertiary recycled water infrastructure. Trussell was tasked with designing, constructing, and managing the construction and testing of a pilot system.

⁴ In March 2016, Stantec Inc. acquired MWH Global, Inc.

⁵ This agreement was broken into four parts. The original master agreement had a not-to-exceed value (NTE) set at \$500,000, followed by three one-year options to extend that had set NTE at \$500,000 each.

8. **Harper & Associates, Inc.** – In June 2015, the City entered into an agreement with Harper & Associates, Inc. (Harper) to provide inspection services during the rehabilitation of two reservoirs for a not-to-exceed amount of \$150,000. Harper monitors the construction contractor’s work and provides the ESD project manager with daily inspection logs of the work done.
9. **Cascadia Consulting Group, Inc.** – The City approved a unique services agreement with Cascadia Consulting Group, Inc. (Cascadia) in May 2012. Motivation for this \$130,700⁶ agreement came at a time when the council was developing the *Foam Food Container Ordinance*⁷ that would “reduce the pervasive and persistent type of litter by banning food service ware containers made from expanded polystyrene (EPS) foam” (commonly referred to as Styrofoam™). Among other tasks, Cascadia researched and developed a list of alternatives that restaurants could use instead of Styrofoam™.
10. **Cleanbit Systems, Inc. DBA Joulebug** – Joulebug is a mobile application that aims to encourage users to practice sustainable behaviors, for example, using reusable water bottles and recycling. The City started a one-year pilot program for \$22,500 to customize the Joulebug mobile application to be more specific to the City of San José.
11. **Rincon Consultants, Inc.** – ESD contracts with a consultant to provide verification service and greenhouse gas reports for the San José-Santa Clara Regional Wastewater facility in accordance with the California Air Resources Board’s Mandatory Greenhouse Gas Reporting Regulation. This agreement with Rincon Consultants, Inc. is for under \$10,000. The City has used the same vendor three times in the past three years.

We reviewed each of these agreements to determine the type of procurement process that was followed and whether:

1. The terms of the agreement were met;
2. Deliverables were received and documented prior to authorizing payments;
3. Sufficient oversight of consultants was provided by ESD; and,
4. City contract management procedures and processes were followed.

To meet our audit objectives, we also reviewed:

⁶ The original agreement with Cascadia was for \$40,000. An amendment increased the total not-to-exceed value to \$130,700.

⁷ <http://www.sanjoseca.gov/eps>

- Previous audit reports conducted by the City Auditor's Office and status of those recommendations
- Relevant Municipal Code and City Policy Manual sections
- Relevant ESD internal policies and procedures (where available)
- Council History and Documents (CHAD) and the Award of Contract (AC) report
- Relevant Requests for Qualifications
- Terms of each agreement, subsequent amendments, and service orders
- Interviewed staff including contract managers, project managers, and budget analysts
- Invoices as well as payments to consultants in the City's Financial Management System
- Project deliverables including City Council updates and memoranda
- Sample backup MWH payroll documentation

For the MWH agreement, we also used benchmark comparisons with:

- The City and County of San Francisco's \$30 million agreement with MWH America's, Inc. and URS Corporation for the *Central Bayside System Improvement Project*
- A City of San José agreement during capital construction at the Norman Y. Mineta San José International Airport (Airport)
- A City of San José agreement with MWH and the Department of Public Works

We also looked at best practices including the *California State Contracting Manual*.⁸

We limited our review to the City's management of the agreements and did not review each agreement to determine whether the procurement process was appropriately followed or if outsourcing for a consultant was justified. Nor did we assess the quality of the consultants' work.

⁸ <http://www.dgs.ca.gov/ols/Resources/StateContractManual.aspx>

Finding I The Proposed Amendment to the Agreement for Project Management Services Provides an Opportunity to Improve Cost Controls

Summary

ESD has a five-year, \$39 million agreement with MWH America's, Inc. (MWH) for program management of the Capital Improvement Program at the San José-Santa Clara Regional Wastewater Facility (RWF). As of June 2017, ESD has spent \$30 million and is proposing to extend the MWH agreement term by five more years and increase the not-to-exceed value to \$78 million.

In our opinion, the proposed amendment to the agreement should include limits on hourly billing rates and salary increases; require preapproval of sub-consultants and staffing changes; limit geographic pay differentials; clarify reimbursable travel expenses including per diems and mileage; and clarify sub-consultant markups and multipliers.

Agreement for Project Management of the San José-Santa Clara Regional Wastewater Facility Upgrade

The San José-Santa Clara Regional Wastewater Facility (RWF), built in 1956, is the largest advanced wastewater treatment facility in the western United States. Working at all hours of the day, it serves eight cities, tributary agencies, and sanitary districts.⁹ The RWF serves more than 1.4 million residents and approximately 17,000 businesses while processing an average of 110 million gallons of wastewater per day.

Improving the San José-Santa Clara Regional Wastewater Facility is one of several large projects identified in the City of San José's adopted Capital Improvement Program. The 30-year master plan, completed in late 2013, included more than 114 capital improvement projects at an estimated investment level of approximately \$2 billion. The 2018-2022 Proposed Capital Improvement Program anticipates \$1.5 billion for the RWF, with \$198 million budgeted in FY 2017-18.¹⁰

⁹ The six tributary agencies and sanitary districts that the RWF receives and treats waste water from, includes the City of Milpitas; the Santa Clara County Sanitation Districts No. 2 and No. 3; the West Valley Sanitation District (serving Campbell, Los Gatos, Saratoga, and Monte Sereno); and the Cupertino, Burbank, and Sunol Sanitary Districts.

¹⁰ The proposed CIP responds to changing technologies, applicable local, state, and federal regulatory requirements, and the City's economic and population growth.

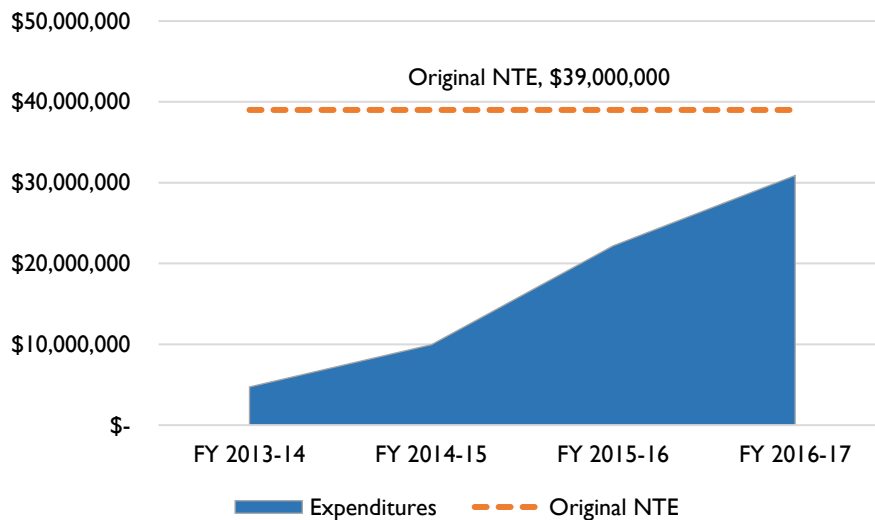
MWH Awarded Agreement for Program Management Services

ESD determined that managing a CIP of this magnitude required technical expertise and a breadth of additional resources that at the time exceeded City resources. Other jurisdictions with similar wastewater programs have used program management consultants to provide services and tools to help implement projects.¹¹

After issuing a Request for Qualifications in March 2013, the City received submissions from five consultants. All five firms were assessed based on expertise of key personnel, experience in program management for large water/wastewater projects, staffing, approach to resource management, and business location. In September 2013, MWH Americas, Inc. (MWH), was awarded a \$39 million agreement from the City,¹² to provide program management services.¹³

As of June 2017, ESD has spent about \$30 million with one additional year left on the original contract term. Exhibit 3 shows the annual cumulative expenditures for the MWH agreement since 2013.

Exhibit 3: MWH Year-to-Date Expenditures



Source: Auditor summary of FMS expenditures as of June 2017

¹¹ The City Auditor’s 2012 report, [Environmental Services Division: A Department at a Critical Juncture](#), also noted the benefit of project management assistance.

¹² Concerns raised during the initial adoption of the agreement were addressed by ESD in a memo. See <http://sanjoseca.gov/DocumentCenter/View/21708>.

¹³ Other services include: program start-up, program controls, quality assurance / quality control, health and safety, pre-project planning, design of conventional projects, alternative delivery, construction administration, operations and maintenance (O&M) input and coordination, asset management and knowledge transfer, and other supplemental services.

The Consultant's services are provided through a master agreement with specific tasks authorized through service orders.¹⁴ MWH is authorized to use additional companies (known as sub-consultants) that are specially trained, experienced, and competent in a specific part of the work needed. Sub-consultants are typically identified in the primary agreement, amendments, or in a service order.¹⁵

Progress and performance on the delivery of the Facility CIP are reported to the Treatment Plant Advisory Committee (TPAC)¹⁶ monthly and to the City Council twice every year. All service orders are also reported to TPAC in the monthly summary of procurement and contract activity. To date, 23 service orders have been issued with not-to-exceed values ranging from \$68,900 to \$12.4 million.

MWH Was Intended to Temporarily Supplement City Staff

Management of the RWF's CIP is led by ESD in partnership with the Department of Public Works. ESD's program management strategy involves a mix of City staff and external resources to provide sufficient capacity and unique technical experience. Some of the service delivery expectations of MWH include initiating, planning, executing, monitoring, commissioning, and closing out projects.

The program management structure integrates MWH staff with City staff. According to ESD, this approach not only allows for better communication and transfer of knowledge but it also provides opportunities for professional development and growth for City staff. Eventually, "*consultant involvement tapers off and the program transitions entirely to City staff.*" At the time of contract approval, City staff told the City Council that they anticipated most of the transitions would be complete in five years.

As of June 2017, ESD reported that there were 23 CIP projects underway at the RWF. MWH was leading six of these projects, including: aeration tank rehabilitation, blower improvements, cogeneration, digested sludge dewatering, and headworks critical improvements. The remaining 17 projects were led by ESD staff.¹⁷

¹⁴ Service orders provide a description of the services and deliverables that the Consultant must provide. They also detail the timeframe for completion and compensation for the work.

¹⁵ Sub-consultants may be added at different times during the agreement term so long as the Director has given formal written approval.

¹⁶ The Treatment Plant Advisory Committee (TPAC) consists of nine members including the Mayor of San José, Vice Mayor of Milpitas, councilmembers from San José and Santa Clara, and the Directors from Cupertino Sanitary District, and West Valley Sanitation District. TPAC advises both San José and Santa Clara on operations, maintenance, repair, and improvement of the RWF, and development and administration of related programs and policies.

¹⁷ The roles and responsibilities for a consultant project manager and a City project manager, or leader, are the same. Leading a project means overseeing the project scope, budget, and schedule.

Proposed Amendment

Initially, the master agreement with MWH was presented as a \$39 million, five-year (2013-2018) agreement with two, one-year options to extend. Following the presentations at TPAC and City Council the agreement was set at \$39 million for five years, with two, one-year options to extend. Staff was directed to return to City Council for approval if extensions were required.

ESD plans to extend the MWH agreement term by five more years and double the not-to-exceed value to \$78 million. The proposed amendment will be presented at the Treatment Plant Advisory Committee (TPAC) in September 2017.

The Proposed Amendment Should Include Limits on Hourly Billing Rates

ESD's agreement with MWH has non-standard terms (compared to many other City agreements) that impact costs and how the consultants are paid. For the service orders we reviewed, the City agreed to pay MWH consultants on a time and materials basis. This means that the Consultant's invoice is based on an hourly rate. The City negotiated to pay the Consultant based on "actual hourly salary rates" with overhead costs applied separately in the form of a multiplier and an associated project cost. The master agreement states that:

- The **multiplier** includes all indirect labor and related fringe benefits, payroll taxes, insurance costs, and related expenses as well as, general and administrative (G&A) costs. The multiplier also includes the Consultant's profit.
- The **associated project cost (APC)** includes support costs like computer costs, in-house photocopying, information technology (IT) networks, and telecommunications.

The agreement allows for different multipliers and APC rates depending on whether staff is *onsite* or *offsite*. These differences are described below:

- **Onsite:** Consultant works in San José at the RWF for more than 180 consecutive calendar days. The billing rate for these staff is their actual hourly salary X 2.83 (multiplier to cover overhead, etc.) plus \$5.35 per labor hour (to cover associated project costs).
- **Offsite:** Consultant is not required to be onsite in San José for 180 consecutive calendar days. The billing rate for these staff is their actual hourly salary X 3.08 (multiplier to cover overhead, etc.) plus \$9.50 per labor hour (to cover associated project costs).

The agreement does not limit hourly billing rates. The City pays billing rates "based on 'actual hourly salary rates' times a multiplier" as well as an associated project cost (APC) rate "for each labor-hour worked."

For example, for one hour worked for an offsite employee making \$100 per hour the City will be charged \$317.50 per hour:

$$(\$100 \text{ per hour} \times 3.08) + \$9.50 \text{ per hour fee} = \$317.50 \text{ per hour}$$

Then, if MWH increases this offsite employee's salary by \$10 per hour, the hourly billing rate charged to the City would increase by \$30.80 to a total of \$348.30 per hour:

$$(\$110 \text{ per hour} \times 3.08) + \$9.50 \text{ per hour fee} = \$348.30 \text{ per hour}$$

Other Agreements with MWH Have a Schedule of Billing Rates

The City and County of San Francisco (San Francisco) has a \$30 million agreement with MWH for planning and engineering services for the Central Bayside System Improvement Project from 2012 to 2021. Similar to the San José agreement, the billing rate includes the actual hourly rate of the consultant as well as the multiplier, overhead, and profit.¹⁸ However, unlike San José's agreement, the MWH agreement held by San Francisco outlines a schedule of billing rates that will be invoiced for each individual consultant employee.

Additionally, an agreement between the City of San José's Public Works Department and MWH also lists a schedule of allowable rates by position.¹⁹ These rates are based on the employee title, for example – Senior Engineer or Designer.

ESD staff told us that its agreement was deliberately structured to allow flexibility in hiring more experienced staff.²⁰ In our opinion, setting maximum limits on hourly billing rates would serve at least two purposes: (1) to limit potential cost escalation, and (2) to increase transparency on the prices being paid.

Additional Limits on Billing Rates in San Francisco

San Francisco's agreement includes a clause that states, "*the billing rate may not exceed the lowest rate charged to any other governmental entity except the City and County of San Francisco.*" It goes further by stating, "*no increase, including the annual CPI adjustment, is allowed to [be added to] billing rates exceeding \$250 per hour, unless Project Manager and Bureau Manager authorize an increase to the rate in writing.*"

¹⁸ The multiplier for MWH in this agreement is set at 3.5; within this rate, the effective overhead and profit rate is 2.52.

¹⁹ The schedule of hourly billing rates included; Vice President – \$260; Principle Engineer – \$220; Supervisor – \$180; Senior Engineer – \$160; Associate Engineer – \$120; Senior Designer – \$160; Designer – \$120; Project Controls Specialist – \$140; Senior Administrative Assistant – \$110; and, Administrative Assistant – \$80

²⁰ According to City staff, they intend to cap the maximum profit that MWH can make from the current project with the City. ESD had informally capped this profit at 10 percent. MWH certified that it has complied with the 10 percent cap. We should note that this cap is not memorialized in the City's agreement. Per City staff, this was discussed as part of the original contract negotiations. Further, language has been included in the current contract amendment to memorialize capping profit at 10 percent.

Potential Limits On City Paid Salary Increases

The agreement with MWH requires the City to pay the Consultant and its employees their actual hourly rate. It does not put any limitation on whether the City would pay for raises, position changes, or promotions; nor does it limit the number of times that this could occur in any given year. It only indicates that the payroll information for Consultant's staff must reflect "*most current audit of the [...] payroll and financial records, or mutually agreed upon best available financial information.*"

MWH's employees received raises at various times throughout the year. In our review, we found some employees received raises in March 2016, and another employee received a raise in December 2016. In one service order, one employee had three different rates of pay that increased over the span of one calendar year.

Further, half of the employees listed on the March 2016 invoice appeared to receive a raise. Increases in billing rates ranged from \$2.60 to \$34 per hour. When multiple people receive raises at once the total amount invoiced becomes significantly larger.

Other City agreements list a rate schedule for consultant hourly rates. For example, in an agreement between the Airport and a different consultant company for program management, raises were limited. (The agreement allowed for hourly rates to be increased every January 1st). If rate increases are tied to inflation this limits the cost increases that the City would have to pay. In our opinion, these types of controls are crucial to controlling cost increases.

Without limiting increases in compensation, the City could be responsible for paying raises that are not only significantly above an average City employees' salary increase but also significantly higher than the rate of inflation.

Recommendation #1: To increase transparency, in its upcoming amendment, ESD should:

- a) Renegotiate the multiplier and establish not-to-exceed hourly billing rates by position in future service orders; and**
- b) Include limits on the amount and number of salary increases for key staff positions in any given year that it will pay.**

Importance of Preapproving Sub-consultants and Staffing Changes

The master agreement states that the Consultant requires written approval from the Director of ESD before adding, replacing, or changing key staff and sub-consultants. However, in a service order early in the project, a key staff member was added without written approval. Additionally, in a more recent service order,

additions were made that did not receive preapproval. These included: construction managers, senior management consultants, various levels of project managers, a quality manager, and different levels of engineers.

The definition of “key” is unclear. In the example above, only 11 out of 60 individuals who billed against the service order were identified as “key”. City guidelines do not require preapproval for individuals who only engage in clerical or administrative activities, or whose work will receive significant review. However, based on staff titles and the frequency in which they worked on the project, it is unclear that all of these staff were just performing clerical or administrative work.

According to ESD, contract monitoring has improved over time. One of the tools that project managers started using more frequently for staff changes are “side letters” — letters that recognize and provide written Director approval for changes to the service orders.²¹ This is important because each service order is akin to a new agreement and any staffing needs and changes that occur during the course of the service order should be documented.

Key Information Sometimes Absent from Side Letters

While side letters can be used to approve changes to consultant staff and sub-consultants, the letters we reviewed did not always include information such as rates for individual sub-consultants or if a conflict of interest form 700 was needed. Side letters can help City staff memorialize changes. It is important that they include all the necessary information so that, for example, the consultant does not make staffing changes at will without communicating with the City. These seemingly small changes could have a budgetary impact on the project. ESD staff should ensure written Director approval is on file for all changes to the project and includes all the necessary information; and that an amendment is used when appropriate.

ESD staff told us that its service orders and side letters now list all key staff and whether they are onsite.²² The service orders now state that all staff not designated as *onsite* shall be considered *offsite*. As previously discussed, this designation determines billing rates and eligibility for travel and relocation benefits.

In our opinion, it is important that the Director preapprove staff and sub-consultant changes before the City is invoiced, both to control costs and to ensure consultant staffing levels are appropriate. Due to the size of the agreement and

²¹ For example, in one service order, ESD used side letters to document staffing changes and the addition of some sub-consultants.

²² The designation is important because an offsite designation would require higher rates than an onsite designation. Staff not considered to be principally responsible for the work are not required to be named in the service order or in a side letter; however, charges for unnamed additions can prove costly. The cost of unnamed staff additions from May 2014 to August 2014 was approximately \$50,000 for about 245 hours of work.

the number of people involved, it is important that written records are up-to-date to mitigate the risk of the City being invoiced incorrectly.

Recommendation #2: To make invoice review easier and ensure staffing levels are appropriate, ESD should ensure the following information is included in all relevant side letters:

- **Changes to key staff**
- **Sub-consultant firms and their key staff**
- **Billing rates and charges**
- **Form 700 filing**
- **Onsite or offsite designation**

Geographic Pay Differentials

The MWH agreement specifically disallows inclusion of bonuses, profit sharing, and benefits in the hourly rate. During our review we found the City was paying a geographic pay differential that was neither referenced in the agreement nor separately approved by the City. We observed at least two consultant employees that received a geographic pay differential (“*geographical uplift*” and “*geo prem*”) on top of their hourly rate in one service order. This added rate can significantly increase the amount billed to the City.

For example, as described previously, for one hour worked for an onsite employee making \$100 per hour the City will be charged \$288.35 per hour:

$$\$100 \text{ per hour} \times 2.83 + \$5.35 \text{ per hour APC} = \$288.35$$

However, if they are receiving a geographic pay differential of \$25 per hour, the hourly billing rate charged to the City, would increase by \$70.75, bringing the total hourly billing rate to \$359.10:

$$(\$100 + \$25) \text{ per hour} \times 2.83 + \$5.35 \text{ per hour APC} = \$359.10 \text{ per hour}$$

If applied for a full year, one consultant receiving a \$25 geographic pay differential adds \$147,000 to the City’s costs (because of the 2.83 added multiplier). Were this to continue for five years, this would add about \$735,000 to the City’s costs for one employee’s geographic pay differential alone.

ESD staff stated that the intent of adding this pay differential was to make up for the employee relocating to a more expensive area. According to ESD staff, since the beginning of the program, seven consultant employees received these added pays.

In our opinion, if the City wishes to continue paying the geographic pay differential with the hourly rate, this should be renegotiated in the upcoming amendment and the multiplier should not be applied.

Recommendation #3: ESD should work with the City Attorney's Office to determine:

- a) **Whether the City should seek repayment of geographic pay differentials (including multiplier), and**
- b) **If future agreements include a geographic pay differential, the amount of the differential and that the multiplier should not apply.**

Lack of Clarity Around Some Reimbursements

The MWH master agreement allows for the Consultant to be reimbursed for various costs incurred as a result of the project. For example, with ESD Director approval, the Consultant can be reimbursed for travel expenses and up to \$50,000 for relocation of some staff positions. Many of these reimbursements are tied to staff designation as *onsite* or *offsite*.

Per Diem Rates Were Inappropriately Applied

The City's agreement disallows per-diem²³ meal and incidental reimbursements for onsite staff assigned to the PMO. We found that per diems were inappropriately billed for at least one service order. Specifically, in one service order \$11,128, or 90 percent, of meal and incidentals charged to the City were for onsite positions versus \$1,295 for offsite positions. City staff agreed that onsite staff, per the agreement, are ineligible for per diem reimbursements – if they were compensated, it was an oversight.

The agreement clearly states that onsite staff members are ineligible to receive per diem reimbursements. The City should request reimbursement for the overpayments described above and disallow similar payments on a go-forward basis.²⁴

²³ The agreement states that meals and incidental expenses, referred to here as per diem expenses, "shall be reimbursed at the per diem rate based on the U.S. General Services Administration Government published rates." The rates for 2013-2014 were \$56 per day, and \$42 (75%) for days with travel.

²⁴ ESD recently entered into a professional consulting agreement with Williams, Adley, & Company – CA, LLP to provide audit services that could encompass this type of work.

Recommendation #4: ESD should enforce the agreement's restrictions on per diem reimbursements for onsite employees and request MWH repay the City for past incorrect per diem reimbursements.

Unclear Mileage Reimbursement Guidelines

Over the course of our review we also found that the City routinely reimbursed consultants for mileage from their home to the airport. In one service order, we found six individual consultants receiving mileage reimbursement for distances ranging from 15 miles to 63 miles.²⁵ While the agreement with MWH allows for reimbursement of mileage from their home office to the PMO (the project site in San José), the specifics are unclear. The agreement states:

Consultant staff not working full time at the PMO shall be eligible for mileage reimbursement at the IRS approved rate, if driving over 65 miles from their home office to the PMO.

The agreement also indicates that mileage and travel expenses must be reimbursed in accordance with City policy. The City's policy on Private Vehicle Mileage Reimbursement states:

In instances when an employee's first and/or last point of duty is outside City of San Jose limits, an employee shall be reimbursed for the number of miles driven between the employee's home and the first and/or last point of duty, minus the number of miles the employee normally commutes from home to and/or from the employee's regular work location.

The agreement appears to allow for mileage reimbursement for consultants who travel more than 65 miles from their *home office* to the PMO. However, we found the City also reimburses for mileage below 65 miles. This is, in part, because it is unclear what is meant by the *home office*. ESD staff told us that the home office was the consultant's office in Walnut Creek, California. However, this is not specified in the agreement. In our opinion, ESD

San Francisco's Reimbursable Travel

San Francisco limits the type of travel that MWH may claim for reimbursement. Their agreement allows for reimbursement of a rental vehicle or personal vehicle mileage, less their standard commuting miles, for out-of-town travel. However, San Francisco limits reimbursable travel expenses to exclude all other travel, relocation costs, and all meals.

²⁵ Consultants traveled from Georgia, Oregon, Missouri, Washington, etc.

should clarify whether consultant staff should be reimbursed for mileage less than 65 miles, if the consultant's regular commute should be accounted for, and what is meant by *home office*.

Recommendation #5: To ensure consistent enforcement, ESD should clarify mileage reimbursement limits in the MWH agreement and define home office.

Compensation for Some Sub-Consultants Is Unclear and Inconsistent

During our review of this agreement, we found that one sub-consultant is receiving some of the same markups as the primary consultant. The markups include the sub-consultant's rates with a multiplier and APC. Further, the reimbursement for travel and markups on that travel is unclear and should be clarified. These are described below.

One Sub-Consultant – Carollo Engineering, Inc. is Treated Differently

Carollo Engineering, Inc. (Carollo) receives markups that are not outlined in the City's master agreement with MWH. Specifically, Carollo employee rates include an added multiplier (2.69 for onsite and 2.93 for offsite)²⁶ as well as an associated project cost (APC) charge even though the agreement only allows for reimbursement of actual rates and charges. The agreement states:

*[MWH] can invoice the city for no more than the **actual cost** of each subconsultant plus up to a 5 percent markup. [...] Any subconsultant rates and charges set forth in the Schedule of Rates and Charges must be the subconsultant's actual rates and charges exclusive of any markup. The City will compensate the Consultant in accordance with those rates and charges.*

Multipliers can add a significant cost to the project by greatly increasing the employee hourly rate paid by the City, especially if additional percentage markups are also allowed. For example, an offsite sub-consultant employee who normally make \$100 per hour would invoice the City for \$293. MWH then adds a five percent markup to this already marked up rate.²⁷

Further, the City did not formally agree to these rates. Per City staff, the additional multiplier and use of APC is based on a separate agreement that MWH has with

²⁶ The City agreed to a multiplier of 3.08 for offsite and 2.83 for onsite for MWH staff.

²⁷ City guidelines, "Using and Completing the City of San Jose Standard and Master Consultant Agreement Forms", allows for the sub-consultant actual costs plus a markup of no more than five percent.

Carollo outside of the City's agreement. This unusual arrangement should be revisited or memorialized formally.

It should be noted that other sub-consultants listed on MWH invoices receive a base billing rate and a five percent markup.

Carollo was one of the original sub-consultants assigned to the project, which could be the reason that the way the rates are calculated differ from those of other sub-consultants. In our opinion, ESD should revisit Carollo's compensation in the upcoming amendment, or future service orders, to clarify the appropriate compensation rates for its employees. Once this is clarified, their rates and charges should be included in the upcoming amendment and/or corresponding service orders.

Recommendation #6: In its upcoming amendment to the MWH agreement, ESD should clarify the appropriate compensation rates for Carollo Engineering.

Sub-Consultant Reimbursements for Travel Expenses

Although the master agreement specifies that the **Consultant** shall be reimbursed for select travel expenses, the agreement does not explicitly state that the **sub-consultants** travel expenses shall be reimbursed. In fact, sub-consultants are being reimbursed for travel expenses including: mileage and air travel from their homes to the facility; lodging while in San José; meals and per diem expenses; and rental cars in San José.

Travel reimbursement can be significant. For example, one service order, spanning a year and a half, included \$175,000 in travel reimbursements including a five percent markup fee by MWH. Most of this reimbursement was for Carollo's staff.

In our opinion, ESD should clarify that sub-consultants are allowed reimbursement for travel expenses, and specify that the reimbursements must comply with the City's Travel Policy. In one instance, the City reimbursed one sub-consultant for a rental car on multiple occasions while at their home location on weekends and days off. According to City staff, this expense was approved based on MWH's explanation – that it was cheaper than reimbursing the expenses for this individual to travel from their home to the airport and back. This explanation did not consider that, regardless of which method was more cost effective, this type of reimbursement is not allowed under the City's Travel Policy.

Recommendation #7: In its upcoming amendment to the MWH agreement ESD should clarify what sub-consultant travel expenses can be reimbursed.

Finding 2 ESD Should Improve Its Contract Management Processes for Other Professional Services Agreements

Summary

ESD contracts with consultants for a variety of professional services outside of the CIP. In addition to reviewing the primary project management agreement in the CIP, we reviewed 10 professional consulting agreements not related to the CIP with a not-to-exceed value of \$7.1 million over the entire term of the contracts. We found that in some instances, staff overseeing the agreement overlooked key agreement terms. This included adjusting tasks, the compensation schedule, and sub-consultants without prior approval. In our opinion, ESD administrative staff should periodically distribute the City's instructions on "Using and Completing the City of San Jose Standard and Master Consulting Agreement Forms" to all contract monitoring staff.

Additionally, we found some problems that were identified in prior audits persist today. Currently, management of individual agreements largely depends on the contract manager in charge. While many of the agreements we reviewed were managed by staff who had prior work experience managing agreements, this was not always the case. In our opinion, ESD should offer more robust contract monitoring training for staff who manage agreements.

ESD Uses a Variety of Consultants Across its Different Divisions

ESD uses professional consultants for a variety of services outside of the Regional Wastewater Facility Capital Improvement Program rebuild. In addition to reviewing the primary project management agreement in CIP, we reviewed 10 other professional consulting agreements from six separate divisions within ESD with a total not-to-exceed value of \$7.1 million.

Exhibit 4: Other Professional Consulting Agreements Were Sampled Across Divisions

Watershed Protection ⇨	•EnfoTech & Consulting Inc.
Wastewater Management ⇨	•HydroScience Engineers, Inc. •ABB, Inc.
Water Resources ⇨	•Harper & Associates, Inc. •Trussell Technologies
Public Information Management ⇨	•Clean Bit Systems, Inc. DBA Joulebug
Integrated Waste Management ⇨	•Cascadia Consulting Group, Inc. •HF&H Consultants, LLC.
Sustainability & Compliance ⇨	•Cornerstone Earth Group. Inc. •Rincon Consultants, Inc.

Source: ESD

Each of the agreements we reviewed is unique. For example, ESD’s agreement with Trussell Technologies is for a pilot study focused on increasing the production of recycled water using existing structures. In contrast, ESD’s agreement with Cascadia Consulting Group, Inc. (Cascadia) included work developing a report on products to be used instead of expanded polystyrene (commonly known as Styrofoam™) restaurant take-out containers.

Although these and the other agreements differ in the type of work being performed, there are similar processes and procedures that are necessary for monitoring the agreements, including collecting deliverables, reviewing invoices, and developing amendments.

Some Agreement Terms Were Overlooked in Some Other Professional Consulting Agreements

The City’s contract managers are responsible for ensuring compliance with all agreement provisions by monitoring work and checking that work is completed on time.²⁸ However, during our review we found instances where staff overlooked key agreement terms and adjusted tasks, the compensation schedule, and sub-consultants without prior approval. On the other hand, we did not find significant reportable issues during our review of the following contracts: Trussell Technologies, Cornerstone Earth Group, EnfoTech & Consulting, HF&H Consultants, and Rincon Consultants.

²⁸ [California State Contracting Manual Volume I](#)

Changing Tasks and Compensation Schedule

We identified three consultants where changes to the tasks and/or compensation schedule occurred without formal authorization. For example, in the Harper & Associates, Inc. (Harper) agreement for inspecting the rehabilitation of two water reservoirs, we found that the compensation schedule was adjusted. The first task in this agreement was supposed to be paid on a “fixed fee” basis, invoiced at the “completion of task”, yet the City paid Harper based on the number of hours worked across multiple invoices. In addition, the invoice was paid before the task was completed.

While reviewing the Cascadia agreement for research on Styrofoam™ alternatives, we identified three issues including similar inconsistencies with the compensation schedule. The compensation schedule for the same agreement outlined each task would be paid “on a lump sum basis upon completion of each task.” However, only the first three tasks out of 13 were paid on a lump sum basis.²⁹ In addition to changing the compensation schedule, we found that Cascadia included three supplemental tasks to the last invoice. These three new tasks replaced four previous tasks outlined in the original agreement. While there was an informal proposal from Cascadia to add two of the three tasks, these were never *formally* added to the agreement.

On a different agreement, we found that adjustments had been made to the compensation schedule without formal approval or amendment. Informally, the contract manager and the consultant, HydroScience Engineers, Inc. (HydroScience), adjusted payment amounts from one task to another, but never received formal authorization for this adjustment.

Adjusting Sub-Consultants Without Prior Approval

In the HydroScience agreement, we also found the contract manager allowed sub-consultants to be used and changed without prior approval from the Director. For example, on one service order, a sub-consultant was replaced with a different sub-consultant.³⁰ Furthermore, in a separate service order, a completely new sub-consultant was added to the project. According to the agreement with HydroScience:

[Each] Approved Service Order will state whether or not the Consultant can use subconsultants to provide any part of the Work. If [it] does not authorize the Consultant to use subconsultants, then the Director’s prior written

²⁹ Although these 13 were not paid on a lump sum basis, they were still below the total amount in the compensation schedule. After further review of this agreement, we found that Cascadia began conducting work on this agreement prior to the execution of this agreement. In 2013, the City Auditor’s office made a recommendation limiting retroactive agreements. This has since been implemented as of December 2016.

³⁰ Although this second sub-consultant was not listed in this service order, it was listed in a different service order within this agreement.

approval is required for the Consultant to use a subconsultant to perform any part of the Work. [...] If [...] an Approved Service Order authorizes the use of one or more subconsultants, then it will identify the name of each such subconsultant and the portion of Work each such subconsultant will perform. The Director's prior written consent is required for the Consultant to remove, replace or add to the subconsultants identified...

It appeared that there was an overall lack of understanding of when contract manager discretion is appropriate to adjust sub-consultants, tasks, or compensation schedules. Contract managers rationalized approving the addition of sub-consultants to a project without seeking an amendment if it was for under \$10,000. It appeared that contract managers approved invoices without verifying that they were aligned with the terms of the agreement.

The City recently made instructions on “Using and completing the City of San Jose standard and master consulting agreements forms” available on the City’s Intranet. These instructions include how to amend service orders, task orders, and compensation schedules. However, some ESD staff were not aware of these instructions.³¹

Recommendation #8: To address the problem of service orders, tasks, compensation schedules, and sub-consultants not being consistent with approved agreements, ESD Administrative staff should periodically distribute the City’s instructions on “Using and Completing the City of San Jose Standard and Master Consulting Agreement Forms” to all contract monitoring staff.

Sales Tax Provisions Were Overlooked

The City did not pay approximately \$42,700 in sales tax for purchases made under its agreement with ABB, Inc. The applicable sales taxes were for hardware and switch purchases. According to the City’s agreement with ABB, Inc.;

[The] City shall be responsible for filing sales and use tax reports applicable to the purchase of hardware and other goods from Contractor under this Agreement. These reports shall be filed on a quarterly basis following receipt of invoice for payment, and City shall pay the applicable sales and use tax. The estimated taxes are in the amount

³¹ Our previous 2013 audit of *Consulting Agreements: Better Enforcement of Procurement Rules, Monitoring, And Transparency is Needed* pointed out the need for Citywide policies and procedures on consulting contract monitoring. Many recommendations from this audit remain outstanding, leaving departments to develop their own processes and training.

of Forty Two Thousand Seven Hundred Ninety Three Dollars (\$42,793.00)...

We should note that as of May 2017, when we brought this lack of payment to ESD's attention, ESD accrued \$44,000 in sales tax payable since November 2013. Finance made the appropriate payment to the State Board of Equalization in June 2017.

One of the reasons the payment was not made may be the City's decentralized contract management process. Finance staff indicated that they rely on ESD staff to alert them when sales tax is due. ESD staff would have to separately encumber the sales tax in FMS. In this instance that did not occur. The City does not provide training on sales tax requirements to staff even though this process has been decentralized. This can be problematic when staff move to different positions or leave the City.

A Pilot Mobile Application Remained Active Even After the Pilot Ended

One of the agreements that we reviewed was with Cleanbit Systems, Inc. (Joulebug) for \$22,500 to customize a mobile application (app) to encourage sustainable behavior, for example, using reusable water bottles and recycling.

New users were prompted to include a full name as well as other information such as location and email. Last names of users, a required field, are visible for anyone accessing the application. Since the agreement with Joulebug ended in February 2016, the app remained available but was not being monitored.³² This is potentially problematic because the application was launched as a competition among 192 students (possibly minors) in local high schools.³³

After we brought these issues to their attention, ESD decommissioned the app in August 2017. It appears monitoring and/or closeout had not been done due to the contract manager retiring. When there is turnover, duties that go beyond the standard job description may get lost in transition to the next person in that position.

Invoices Were Paid Without Adequate Review

An important piece of the contract manager's job is to review invoices, verify work performed, and ensure costs claimed are in accordance with the agreement. City training materials, and the Standard Consultant Agreement

³² Even though the City did not renew the contract, the mobile app was still available for download with the City logo. The ongoing use of the logo gives the appearance that City staff actively monitor the application. Residents trust the City to keep their information secure in accordance with the City's commitment to protecting personally identifiable information.

³³ The high school competition lasted from April 20, 2015 to April 27, 2015.

Template, state that it is the contract manager's responsibility to confirm that the invoices are both accurate and sufficiently detailed.

While reviewing the \$150,000 agreement with Harper for reservoir inspection support services, we identified instances where invoices were unclear and did not align with the hours recorded in the Consultant's daily inspection logs. When examining this issue, staff were only able to verify that the Consultants were working during the invoiced period; however, they could not verify if the invoiced hours were correct. Additionally, we found that ESD paid Harper hourly rates for project managers even though the project manager role was not listed in the "*Schedule of Rates and Charges applicable to this agreement.*"

Furthermore, we found that detailed information in the daily logs and weekly inspection reports was not always provided. Reports were to include, for example: pictures, weather conditions, descriptions of work completed that day, progress and passing inspections, among other requirements. On multiple occasions there was missing information, yet the City paid Harper \$700 for each invoiced weekly inspection report.

In our opinion, ESD should review invoices from Harper to determine if the City was billed for the correct number of hours, and whether payment for Harper's project manager role is allowed.

Recommendation #9: Because Harper & Associates, Inc. invoices were paid without being adequately reviewed, ESD should assign independent personnel to go back and determine whether any payment adjustments are needed.

Improve Contract Management Consistency by Offering Additional Training

As mentioned in the introduction, contract management resources are not as robust as the resources available for CIP projects. Currently, management of individual agreements largely depends on the contract manager in charge. Several of the agreements we reviewed were managed by staff who had prior work experience managing agreements while others lacked similar experience.

While contract managers are encouraged to follow City procedures and processes, currently there are few resources and tools available to assist contract managers. For example, while forms like the invoice checklist are used for all CIP projects, they are not used for all non-CIP projects.

It is important to provide consistent oversight and project management methods on all projects to save staff time, ensure continuity when staff change, and guarantee that the City receives the services that it paid for. ESD can ensure

consistent contract management by offering more robust training for other agreements. This could include invoice review including linking payments to agreement deliverables (see CIP Invoice Checklist in Appendix A).

We believe that some of the tools and trainings that CIP managers benefit from would also help project managers across divisions to better oversee consultant relationships and ensure that when staff leave or change roles there are still processes and procedures in place that new managers can follow. Further, more intermediate and advanced training would offer managers additional opportunities for professional development.

Overall ESD has made strides in improving their contracting processes and procedures. Many of the issues identified during the audit could be prevented from future reoccurrence by providing additional contract management training and resources to project managers.

Previous Audit of Consulting Agreements Raised Similar Concerns

Our previous 2013 audit, *Consulting Agreements: Better Enforcement of Procurement Rules, Monitoring and Transparency is Needed*, highlighted similar issues. According to that audit:

[T]he City faces significant financial and programmatic consequences from inadequate contract monitoring. [...] We found that the City does not have any Citywide policies governing contract monitoring. Staff has dual responsibilities of program management along with monitoring contracts, for which they have received no training.

Although improvements have been made, similar problems persist today. We found that ESD generally followed competitive procurement processes, had assigned project managers, and generally maintained records of invoices and deliverables. Inconsistencies may be due to the fact that contracting personnel had various levels of experience with procurement and contract management. While several project managers cited prior work experience that helped them to manage ESD contracts, others did not have the same prior contract monitoring experience. Contract managers generally expressed interest in participating in more robust training to better learn the City's contract monitoring best practices. However, the City so far has not made additional training available for contract management staff.

Recommendation #10: To improve consistency across all divisions, ESD should offer additional contract management training. Contract management training should include, but is not limited to the following:

- **Invoice review**
- **Situations that require amendments**
- **Sales tax accrual process**
- **Standard operating procedures for contract monitoring**
- **Managing consultant relationships**

Conclusion

The Environmental Services Department (ESD) contracts with consultants for various reasons. Our review of ESD's Capital Improvement Program project management consultant agreement uncovered areas of risk and ambiguity that could lead to increased costs. Finally, our review of 10 other consulting agreements found issues with consistency in project management and a need for more intermediate and advanced contract monitoring training.

RECOMMENDATIONS

Recommendation #1: To increase transparency, in its upcoming amendment, ESD should:

- a) Renegotiate the multiplier and establish not-to-exceed hourly billing rates by position in future service orders; and
- b) Include limits on the amount and number of salary increases for key staff positions in any given year that it will pay.

Recommendation #2: To make invoice review easier and ensure staffing levels are appropriate, ESD should ensure the following information is included in all relevant side letters:

- Changes to key staff
- Sub-consultant firms and their key staff
- Billing rates and charges
- Form 700 filing
- Onsite or offsite designation

Recommendation #3: ESD should work with the City Attorney's Office to determine:

- a) Whether the City should seek repayment of geographic pay differentials (including multiplier), and
- b) If future agreements include a geographic pay differential, the amount of the differential and that the multiplier should not apply.

Recommendation #4: ESD should enforce the agreement's restrictions on per diem reimbursements for onsite employees and request MWH repay the City for past incorrect per diem reimbursements.

Recommendation #5: To ensure consistent enforcement, ESD should clarify mileage reimbursement limits in the MWH agreement and define home office.

Recommendation #6: In its upcoming amendment to the MWH agreement, ESD should clarify the appropriate compensation rates for Carollo Engineering.

Recommendation #7: In its upcoming amendment to the MWH agreement ESD should clarify what sub-consultant travel expenses can be reimbursed.

Recommendation #8: To address the problem of service orders, tasks, compensation schedules, and sub-consultants not being consistent with approved agreements, ESD Administrative staff should periodically distribute the City's instructions on "Using and Completing the City of San Jose Standard and Master Consulting Agreement Forms" to all contract monitoring staff.

Recommendation #9: Because Harper & Associates, Inc. invoices were paid without being adequately reviewed, ESD should assign independent personnel to go back and determine whether any payment adjustments are needed.

Recommendation #10: To improve consistency in contract monitoring across all divisions, ESD should offer additional contract management training. Contract management training should include, but is not limited to the following:

- Invoice review
- Situations that require amendments
- Sales tax accrual process
- Standard operating procedures for contract monitoring
- Managing consultant relationships

APPENDIX A

Invoice and Contract Checklist to Approve Invoice for Payment

Contract: Agreement Title

Term of Contract: Start Date – End Date

AC No.: #####
Name

Contract Amount: \$, \$, \$, \$, \$, \$

Vendor: Consultant

SO Number: ##

SO Name: Name

SO Amount: \$, \$, \$, \$, \$

APPN: ##### **RC:** #####

FMS Line:

Invoice No.: ###

Period: Invoice Period

Amount: \$, \$, \$, \$, \$

Date of Submittal for Payment: Invoice Date

- Valid Professional Services Titles
- Valid Rates for Professional Services Titles
- Valid Mileage Rate (N/A)
- Valid Subcontractor Mark-up
- Receipts included for all Reimbursable Expenses Billed in the Invoice (N/A)
- Valid Dates for Work Completed
- Work Completed was verified either verbally or with deliverable
- Valid Amount for Work Completed
- Billing does not exceed the Not-To-Exceed (NTE) amounts for each Task
- Work Completed for Each Task is within Scope
- Copy of Final Report given to the WPCP Library (N/A)

The attached invoice has been reviewed by the Project Manager in regards to contract requirements. If there are any questions, please call:

Project Manager: Name

Extension: Phone Number

Signature: _____

Date: _____

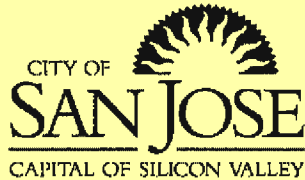
Notes:

Invoice amount, appropriation, and RC are Correct

Division Analyst: _____

Senior/Principal Engineer:

Date: _____



Memorandum

TO: SHARON W. ERICKSON
SUBJECT: SEE BELOW

FROM: Kerrie Romanow
DATE: August 31, 2017

Approved

D. DSYL

Date

8/31/17

SUBJECT: RESPONSE TO THE AUDIT REPORT – AUDIT OF ENVIRONMENTAL SERVICES DEPARTMENT CONSULTING SERVICES: AGREEMENTS REQUIRE ADDITIONAL OVERSIGHT

BACKGROUND

The Administration appreciates the City Auditor's work on evaluating the Environmental Services Department's Consulting Services Agreements. The Administration has reviewed the Audit Report entitled, *Audit of Environmental Services Department Consulting Services: Agreements require additional oversight*. Although the Administration generally agrees with the recommendations it is important to note that many of the recommended improvements related to the MWH agreement had already been implemented by staff or included in the proposed amendment prior to the start of the audit. The following is the Administration's response to each recommendation.

RECOMMENDATIONS AND RESPONSE

Recommendation #1: To increase transparency, in its upcoming amendment, ESD should:

- a) **Renegotiate the multiplier and establish not-to-exceed hourly billing rates by position in future service orders; and**
- b) **Include limits on the amount and number of salary increases for key staff positions in any given year that it will pay.**

Administration response to Recommendation #1

The Administration does not agree that these recommendations would improve transparency. However, the Administration does agree with the Auditor that the work completed by staff prior to the start of this audit as well as the additional proposed improvements are prudent. The Administration strongly believes that the capital improvement program at the Wastewater Facility already has an unprecedented level of transparency. Although some of these recommendations would further clarify in the proposed amendment practices that are already in place, they would do little to increase the already high level of transparency. Furthermore, as communicated to the Auditor, ESD had already negotiated a lower multiplier for the proposed

amendment prior to the start of this audit so the Administration finds this recommendation somewhat redundant.

While the MWH agreement uses a multiplier compensation structure that is less commonly used for other City agreements, it offers a number of benefits including greater transparency (i.e. billed based on consultant's direct labor times multiplier) and ability to negotiate the multiplier and associated project cost (APC). For master agreements involving a wide range of expert services and a longer contract duration, staff believes it is more cost effective and beneficial to use the multiplier form of compensation verses the fully loaded hourly salary rate form of compensation. This ensures that the City will be billed for the actual hourly direct labor rate that is earned by an individual on a real-time basis verses paying for services based on fully loaded hourly billing rates that would be charged to the City on day one of the contract whether the individual is actually paid that hourly labor rate. It also avoids more junior level staff being assigned to the program at maximum profit to the consultant.

Staff strongly believes that the comparison to two other agreements that MWH has with the City and County of San Francisco (San Francisco) and the City of San Jose Public Works Department is not a good comparison. The agreement with San Francisco uses a similar multiplier compensation form of payment; their multiplier is much higher at 3.5 (compared to 2.83 and 3.08 on the RWF CIP program) and includes a maximum hourly billing rate of \$250. This structure of a higher multiplier and billing rate cap means the consultant takes a loss on high level, experienced staff and makes a larger profit on lower level staff who can bill at inflated billing rates. This incentivizes the consultant to assign a majority of the work to less experienced staff. Similarly, the Public Works agreement uses a fully loaded hourly rate (i.e. includes direct labor, overhead, profit) that builds in multiple years of escalation and assumes top steps for specific positions. The type of services and projects included under the Public Works master agreement is also substantially different (i.e. on-call engineering services such as third-party design reviews, engineering studies and analysis, and preliminary engineering services for various sewer and pump station projects) with a total agreement not-to-exceed amount of \$500,000. The size and level of complexity associated with sewer and pump station projects are substantially less in comparison to projects at the Wastewater Facility, yet the comparable hourly rate for a Principal Engineer under the Public Works master agreement is \$220/hour (based on 2012-2014) to \$240/hour (escalated to 2017 at an assumed 3% annual increase) whereas the 2017 billing rate for highly-experienced consultant project managers assigned to work on projects valued up to \$100 million at the Wastewater Facility range between \$208/hour to \$260/hour.

Also, while the current MWH agreement does not limit hourly billing rates, ESD has the ability to review and control cost through the annual service order negotiations process. Currently, each service order is negotiated to include a detailed scope of work, deliverables and schedule of performance, and level-of-effort (LOE) compensation table. The LOE identifies key staff assigned to work on the service order, on-site or off-site multiplier and APC designation, each person's hourly bill rate (direct labor rate times applicable multiplier), maximum labor hours assigned by task, task sub-totals, estimated reimbursable expenses and markups, and overall not-to-exceed total. Resumes for key consultant staff are reviewed and approved by ESD staff to

ensure that the proposed personnel have the right combination of experience and expertise to perform the work required, are fully available and committed for the duration of the service order and/or program term, and that salary costs are reasonable and within the available budget. Given the magnitude of the Wastewater Facility CIP and high level of complexity involved, staff does not recommend establishing not-to-exceed hourly billing rates by position in future service orders. However, for additional clarity going forward, staff will attach the final LOE compensation table to each service order.

The current agreement does not state a limit on the amount and number of salary increases that the consultant can give to staff in any given year. However, ESD has the ability to review and control cost through the annual service order negotiations process as described above. The current mutual understanding between ESD and MWH with regards to annual increases is a 3% increase for MWH each April and 3% increase for Carollo each January. In some cases, an employee may have received more than one raise due to position changes or promotions, which is not unreasonable. ESD recognizes the benefit and greater control afforded by formalizing the limits on annual salary increases as long as some flexibility is provided.

Response to Recommendation #1 (a):

As part of the original MWH agreement, staff had negotiated both an on-site and off-site multiplier (2.83 and 3.08 respectively) and APC (\$5.35/hr and \$9.5/hr, respectively). As part of the proposed contract amendment, prior to the audit, staff had already negotiated a reduction to the multiplier from 2.83 to 2.81 (on-site) and 3.08 to 3.06 (off-site) which will be applied to the consultant's direct labor costs. The on-site and off-site APC remains the same. Going forward, staff will attach the final LOE compensation table to each executed service order for additional clarity.

Green – The proposed amendment to the Stantec agreement includes a lower multiplier rates of 2.81 (on-site) and 3.06 (off-site). The reduced multiplier rates will be applied to both Stantec and its major subconsultant (Carollo Engineers, Inc.) and will result in an estimated savings of \$275,000. Future service orders will include the final LOE compensation table for additional clarity.

Target Date for Completion: September 30, 2017

Response to Recommendation #1 (b):

The proposed amendment now includes an annual maximum salary increase of up to 3%, unless otherwise approved by the City.

Green – The proposed amendment has been revised to include an annual maximum salary increase of up to 3%, unless otherwise approved by the City.

Target Date for Completion: September 30, 2017

Recommendation #2: To make invoice review easier and ensure staffing levels are appropriate, ESD should ensure the following information is included in all relevant side letters:

- **Changes to key staff**
- **Sub-consultant firms and their key staff**
- **Billing rates and charges**
- **Form 700 filing**
- **Onsite or offsite designation**

Administration response to Recommendation #2

The Administration agrees that staff work completed prior to the start of this audit was prudent since almost all of these recommendations had already been implemented by ESD staff as part of ongoing improvements in managing this contract, prior to the start of this audit.

Almost all of the information suggested by the Auditor is already either included in each service order or side letter. Attachment B of each approved service order states whether or not the consultant can use one or more subconsultants to perform any part of the work. The name of each subconsultant firm and the area of work that they will be performing are listed in Attachment B. In addition, the key consultant staff that are principally responsible for providing the work under the service order are listed along with their task assignment and Form 700 filing requirements. After a service order has been executed, if the consultant wishes to add, replace, or change key staff and/or sub-consultants, they must receive written approval from the Director of ESD.

All of the service orders issued to date under the MWH agreement have appropriately identified key staff, sub-consultants, task assignments, and Form 700 filing requirements. Given the duration and variety of services to be provided under the master agreement, it is expected that some changes to key staff and/or sub-consultants will occur. The master agreement allows for the substitution and/or addition of key staff and/or sub-consultants with the Director's prior written approval. Side letters are used to approve these changes.

ESD acknowledges that in a service order early in the program, a key staff member was added without written approval. However, the substitution was informally approved through resume review and in person interview with ESD staff. On a more recent service order, the audit report stated that certain consultant staff (such as construction managers, senior management consultants, various levels of project managers, a quality manager, and different levels of engineers) were added (i.e. appeared on invoices) that had not received preapproval by the Director. These staff were not required to be pre-approved as key staff because they provide limited administrative or technical support functions on the service order (e.g. data entry, database support, programmatic technical support, graphics support). Given the size of the agreement and number of people on the program, ESD meets bi-weekly with MWH to discuss invoices, staffing levels, upcoming changes to personnel and whether a side letter needs to be issued, etc.

To date, almost all side letters related to consultant or subconsultant staffing changes have included the following information:

- a. Changes to key staff (e.g. additions, substitutions)
- b. Addition of new subconsultants
- c. Onsite and off-site designations

ESD has updated the side letter template to incorporate the City Auditor's recommendation to also include billing rates and charges, and Form 700 designation.

Green – ESD has updated the side letter template to incorporate the City Auditor's recommendation.

Target Date for Completion: September 30, 2017

Recommendation #3: ESD should work with the City Attorney's Office to determine:

- a) **Whether the City should seek repayment of geographic pay differentials (including multiplier), and**
- b) **If future agreements include a geographic pay differential, the amount of the differential and that the multiplier should not apply.**

Administration response to Recommendation #3

The Administration agrees with this recommendation.

To leverage the breadth and depth of specialized resources available from MWH, staff needs the ability to approve a temporary geographic pay differential on a case by case basis to bring in the best qualified wastewater professionals. The temporary geographic pay differential is intended to cover state tax differentials and cost of living adjustments for consultant staff who are normally based outside of the nine Bay Area counties, but whom are brought in to work full-time on the program. To date, a very limited number of consultant staff have received the geographic pay differential.

This adjustment is not spelled out specifically in the current agreement, but staff believes it is important to allow the geographic pay differential so that consultant staff assigned to the program are fairly compensated and made "whole" for the duration that they are assigned to work in the Bay Area.

ESD will work with the City Attorney's Office to determine whether the City should seek repayment of geographical pay differential. In addition, the proposed amendment has been revised to specifically reimburse the consultant for geographic pay differential, so that the City can take full advantage of the consultant's expertise. Onsite consultant staff whose home base is

outside of the nine Bay Area counties will be eligible, subject to the pre-approval by the ESD director. The multiplier will not be applied to the geographic pay differential.

Green

- a) ESD will work with the City Attorney's Office to determine whether the City should seek repayment of geographical pay differential.
- b) The proposed amendment has been revised to specifically reimburse the consultant for geographic pay differential, subject to pre-approval by the ESD director. The multiplier will not be applied to the geographic pay differential.

Target Date for Completion: September 30, 2017

Recommendation #4: ESD should enforce the agreement's restrictions on per diem reimbursements for onsite employees and request MWH repay the City for past incorrect per diem reimbursements.

Administration response to Recommendation #4

The Administration agrees that staff work completed prior to the start of this audit was prudent and would like to note that the audit references a single error in the early part of the contract. Since then, and well in advance of this audit, the invoice review process had already been significantly improved to avoid such errors.

ESD will continue to enforce the restrictions on per diem reimbursements for onsite consultant staff. The error occurred in an early service order wherein the City was billed for per diem reimbursements for onsite staff, which is not allowed per the master agreement. Since then, both ESD and MWH have improved its internal invoice review process with more senior staff performing quality review. ESD has requested MWH to repay the City for past incorrect per diem reimbursements in the amount of \$11,683. A credit of \$11,683 has been reflected in the June 2017 invoice.

Green – MWH has credited \$11,683 for the incorrect per diem reimbursement as part of their June 2017 invoice.

Target Date for Completion: September 30, 2017

Recommendation #5: To ensure consistent enforcement, ESD should clarify mileage reimbursement limits in the MWH agreement and define home office.

Administration response to Recommendation #5

The Administration agrees with this recommendation.

Green - The proposed amendment has been revised to clarify mileage reimbursement limits. Going forward, mileage will be reimbursed in accordance with the City's policy on Private Vehicle Mileage Reimbursement.

Target Date for Completion: September 30, 2017

Recommendation #6: In its upcoming amendment to the MWH agreement, ESD should clarify the appropriate compensation rates for Carollo Engineering.

Administration response to Recommendation #6

The Administration agrees that staff work completed prior to the start of this audit was prudent and would like to note that additional clarification about compensation rates for Carollo Engineering was already included in the proposed amendment prior to the start of this audit. Furthermore, compensation rates for Carollo Engineering were not incorrect but simply required explicit language in the proposed amendment to reflect Carollo Engineering's unique role as a lead sub-consultant.

In response to the City's 2013 "Request for Qualifications for Program Management Services for the San Jose/Santa Clara Water Pollution Control Plant Capital Improvement Program", MWH and Carollo Engineering, Inc. (Carollo) had proposed together as a team with MWH identified as the Prime Consultant and Carollo identified as a Lead Sub-Consultant. During the negotiations process, City staff negotiated a multiplier and associated project cost (APC) form of compensation with MWH with the mutual understanding that this compensation structure would be passed through to Carollo via a separate agreement between MWH and Carollo. It is not standard practice for the City to enter into separate agreement(s) with sub-consultant(s) identified in Statements of Qualifications (SOQs) and/or Consultant Master Agreements. To memorialize this arrangement, the proposed amendment has been revised to include Carollo's multiplier and APC compensation.

Staff strongly disagrees with the audit statement that multipliers can add a significant cost to the project by greatly increasing the employee hourly rate paid by the City.

The employee's direct salary (or hourly rate) is a completely different cost component from the multiplier. The multiplier covers the consultant's payroll burden, indirect cost, and profit. Payroll burden can generally be described as all costs associated with the employee's benefits (e.g. sick leave, vacation pay, holiday pay, unemployment and other payroll taxes, retirement benefits). Indirect cost (or overhead) can generally be described as occupancy cost (e.g. rent, lighting, heat, taxes and insurance); accounting and legal services; business development and marketing expenses; etc. The amended agreement also caps the consultant's profit at 10 percent maximum.

As with any business, all consultants have payroll burden and overhead expense, whether the multiplier form of compensation or fully loaded hourly rate form of compensation is used. The audit states that other subconsultants listed on the MWH invoices receive a base billing rate and a five percent markup. In actuality, these base billing rates include the subconsultants' direct and indirect cost. Their hourly billing rates may appear lower than some of the MWH's rate but this is because they are very small firms or individual contractors with very low overhead expenses.

Green – The proposed amendment now identifies Carollo as a Major Subconsultant along with their multiplier compensation and allowable reimbursables.

Target Date for Completion: September 30, 2017

Recommendation #7: In its upcoming amendment to the MWH agreement ESD should clarify what sub-consultant travel expenses can be reimbursed.

Administration response to Recommendation #7

The Administration agrees that staff work completed prior to the start of this audit was prudent and once again would like to note that ESD had already included additional clarification about sub-consultant travel expenses in the proposed amendment, prior to the start of the audit.

Green – The proposed amendment includes language to clarify what subconsultant travel expenses can be reimbursed.

Target Date for Completion: September 30, 2017

Recommendation #8: To address the problem of service orders, tasks, compensation schedules, and sub-consultants not being consistent with approved agreements, ESD Administrative staff should periodically distribute the Finance Department's instructions on "Using and Completing the City of San Jose Standard and Master Consulting Agreement Forms" to all contract monitoring staff.

Administration response to Recommendation #8

The Administration partially agrees with the recommendation. Staff will include a weblink to the City's instructions on "Using and Completing the City of San Jose Standard and Master Consulting Agreement Forms" on our ESD webpage: [http://inside.sjcity.net/esd/administrative_services/Shared%20Documents/Request for Proposal s Contract Processing.aspx](http://inside.sjcity.net/esd/administrative_services/Shared%20Documents/Request%20for%20Proposal%20Contract%20Processing.aspx) and will reference this document it in the annual ESD Introduction to Contracts training and ESD Contract Management training. Additionally, ESD Contracts staff will periodically send contract managers an e-mail that references the topic and provides staff with a weblink to the resource.

Green – The Environmental Services Department will add a weblink to the City’s instructions on “Using and Completing the City of San Jose Standard and master Consulting Agreement Forms” by September 30, 2018. ESD Staff already sent the link to this document to ESD contract managers and will continue to periodically do so. ESD Staff will reference this document in the Contracts courses scheduled for Spring 2018.

Target Date for Completion: June 30, 2018

Recommendation #9: Because Harper & Associates, Inc. invoices were paid without being adequately reviewed, ESD should assign independent personnel to go back and determine whether any payment adjustments are needed.

Administration response to Recommendation #9

The Administration agrees with this recommendation. ESD Professional Accounting staff is reviewing the Harper & Associates, invoices and contract terms to determine if any payment adjustments are needed.

Green – ESD Fiscal staff has initiated this review which will be completed by September 30, 2017.

Target Date for Completion: September 30, 2017

Recommendation #10: To improve consistency in contract monitoring across all divisions, ESD should offer additional contract management training. Contract management training should include, but is not limited to the following:

- Invoice review
- Situations that require amendments
- Sales tax accrual process
- Standard operating procedures for contract monitoring
- Managing consultant relationships

Administration response to Recommendation #10

The Administration agrees with this recommendation. ESD Contracts staff is developing Standard Operating Procedures (SOPs) that include instructions and guidance on reviewing invoices, when an amendment is needed, the sales tax accrual process, and managing consultant relationships. Contracts Management training will be provided to all ESD staff who manages contracts. Additionally, ESD will bring forward a mid-year budget proposal for a third party consultant to review and set up a standardized contracts management process for the department.

SHARON W. ERICKSON

August 31, 2017

Subject: Audit of ESD Consulting Services

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Green – The Environmental Services Department staff is currently developing Standard Operating Procedures (SOPs) which will be completed by December 31, 2017. In the Spring 2018, ESD staff will providing training to ESD staff following completion of the SOPs. If funding is approved mid-year for a third party consultant agreement to establish a standardized contracts management process for the department, a consultant will be brought on board in summer 2018

Target Date for Completion: SOPs December 2017. Training June 30, 2018. Procure consultant to establish standardized contracts management process by September 2018.

CONCLUSION

We would like to thank the City Auditor for recommending ways to improve our contracts management process. Given the variety and volume of contracts in the department we will be exploring ways, including the use of a third party, to establish a standardized contracts management and tracking process.

In recognition of the magnitude of the capital improvement program at the Wastewater Facility ESD has already established several controls and shares information about the program and the contracts at an unprecedented level of transparency. As noted above, staff had already either implemented the recommended improvements or included language to address five of the seven recommendations related to the proposed contract amendment. We appreciate the additional timely recommendations to further strengthen the City's contract with MWH/Stantec.

COORDINATION

This response was coordinated with the City Attorney's Office.

/s/ Ashwini Kantak for
KERRIE ROMANOW
Director, Environmental Services

For questions, please contact Ashwini Kantak, Assistant Director, at (408) 975-2553.