OCTA

July 25, 2018

To: Finance and Administration Committee

From: Darrell E. Johnson, Chief Executive Officer

Janet Sutter, Executive Director
Internal Audit

Subject: Interstate 405 Improvement Project: Project Management Contracts, Internal Audit Report No. 18-505

Overview

The Internal Audit Department has completed an audit of oversight controls and contract compliance related to the project management contracts for the Interstate 405 Improvement Project. Based on the audit, billed labor rates complied with the contracts; however, there is excessive use of labor classifications and a lack of controls over labor rate increases for personnel billed within these classifications. There were also concerns related to oversight of consultant staff time.

Consultants were procured in compliance with policy and contract amendments were approved as required; however, amendments have been back-dated outside the limits outlined in procedures. Finally, while cost estimates are submitted to support amendments to increase the contract maximum obligation, management does not validate all of the listed labor rates to payroll registers.

Recommendation

Direct staff to implement four recommendations provided in Interstate 405 Improvement Project: Project Management Contracts, Internal Audit Report No. 18-505.

Background

The Interstate 405 (I-405) Improvement Project will improve 16 miles of I-405 between the State Route 73 (SR-73) freeway in Costa Mesa and Interstate 605 (I-605) near the Los Angeles County line. The project includes adding one regular lane in each direction between Euclid Street and I-605, and making improvements to freeway entrances, exits, and bridges. In addition, the project will add the 405 Express Lanes, incorporating the existing carpool lanes and a new lane in each direction between SR-73 and I-605.

Parsons Transportation Group, Inc. (Parsons) and its sub-consultants provide program management services for the I-405 Improvement Project under Agreement No. C-2-1513, with a current maximum obligation of $93,034,686. In addition, Mott MacDonald (MM) and its sub-consultants provide management consulting services for the Orange County Transportation Authority's (OCTA) Highway Programs on an as-needed basis under Agreement No. C-5-3767, with a maximum obligation of $19,451,043. Through 2017, approximately 79 percent of the MM contract payments have been expended in support of the I-405 Improvement Project.

OCTA pays consultants at hourly labor rates specified in the contracts for each full hour of labor performed. The contract schedules name consultant staff as "key personnel" or "other labor charges" with set labor rates, which are based on actual pay rates in the initial contract year, an overhead rate, and profit rate. OCTA reviews and recalculates these rates at contract inception and negotiates a set escalation rate for each subsequent contract year. The contract schedule reflects the calculated labor rates for the initial and each subsequent contract year, as calculated based on the contract escalation rate.

In recent years, contracts have also included labor classification categories (e.g., Senior Engineer) with rate ranges to cover a wide range of staff who may be needed on the contract from time to time and are not working steadily on the project. Consultants can bill staff under labor classifications based on current pay rates and the contract-negotiated overhead and profit rate, as limited by the rate range. If consultant staff begin to work on a more permanent basis, consultants are supposed to add them as named staff with set labor rates, through contract amendments.

Discussion

The Internal Audit Department (Internal Audit) identified excessive use of labor classifications and a lack of controls to limit labor rate increases for staff billed under these classifications. Parsons billed an average of 29 staff under labor classifications, even though many of these staff bill regularly to the project. Failure to add named staff to the contract in a timely manner results in inefficiencies, as it requires OCTA staff to verify pay rates to payroll registers each time the staff are billed. Further, the rates for staff billed under labor classifications may escalate without limitation provided the labor rate remains within the rate range. During testing, Internal Audit identified 46 staff whose billing rates increased by more than the escalation specified in the contracts for named staff. Internal Audit recommended that management develop and implement controls to ensure labor classifications are only used as intended, and labor rates are held to contract escalation limits. Management agreed with the recommendation, indicating that consultant staff that works, or is proposed to work, on a continuous basis for a period of six months or more will be added as named staff in the contract. Additionally, management will require that consultants receive written approval from OCTA's project manager prior to adjusting the salary of individuals within labor classifications at a rate greater than the contractually allowable escalation rate for named staff.

Also, an OCTA manager initiated the promotion and reclassification of a sub-consultant staff person working under his direction as a project administrator. Rather than changing the sub-consultant staff's title and labor rate, procurement staff removed the named staff from the contract schedule and indicated that future billings should be processed using the project administrator labor classification, which specified a rate range that accommodated the requested 24 percent increase in salary. This action was not consistent with the request and represents misuse of labor classifications as the staff person works full-time on this project. Further, Internal Audit was notified of concerns that this sub-consultant staff person billed for more hours than worked. To address this, Internal Audit reviewed access card reports against billed hours. The records reviewed indicated that the sub-consultant staff regularly worked 30 minutes to two hours less than the billed hours each day. Internal Audit also noted timesheets submitted did not include a supervisory signature. Internal Audit recommended management address whether OCTA managers should be involved in initiating promotions of consultant staff. In addition, procurement staff should process amendments in accordance with requests, or reject requests if there is disagreement about the appropriateness of the requested change. Finally, management should implement controls to ensure only hours worked are billed. Management agreed to instruct OCTA managers not to request promotions of consultant staff and to require the consultant to ensure supervisory oversight and signatures on sub-consultant staff timesheets. Also, management agreed to confer and agree on the scope of requested contract amendments going forward. Management also advised that the sub-consultant staff person has been removed from this assignment.

Review of contract amendments identified multiple amendments that were back-dated more than 60 calendar days prior to execution, contrary to procedures. Internal Audit recommended that management comply with procedures on the effective dating of amendments. Management responded that procedures would be updated to reflect current practices.

Finally, Parsons submitted cost estimates to support two amendments that increased the contract maximum obligation by approximately $30 million and $6 million, respectively. The cost estimates submitted to support the amendments included multiple staff that were not named on the contract. For staff included in the cost estimates that were not part of the contract or amendment, management did not validate the labor rates to payroll registers. Almost all of these consultant staff were billed under the labor classifications and some were eventually added as named staff in later amendments. Internal Audit recommended that management validate labor rates to payroll registers for all new staff included in the cost estimates. In addition, Internal Audit recommended that all staff appearing in cost estimates be added to the contract concurrently. Management agreed to validate labor rates of all proposed staff provided with the consultants' cost estimates using either payroll registers and/or a job offer letter. Management also indicated that staff appearing on cost estimates will be added to the contract when it is anticipated they will be working for six months or more.

Summary

Internal Audit made four recommendations related to labor classifications, consultant staff oversight, and contract amendments. Internal Audit recommended management develop controls to ensure labor classifications are only used as intended and all labor rates are held to contract escalation limits. Management should also implement controls to ensure only hours worked by sub-consultant staff are billed. Internal Audit also recommended that management comply with procedures on the effective dating of amendments and validate labor rates to payroll registers for all staff listed in cost estimates.

Attachment

A. Interstate 405 Improvement Project: Project Management Contracts, Internal Audit Report No. 18-505

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ATTACHMENT A

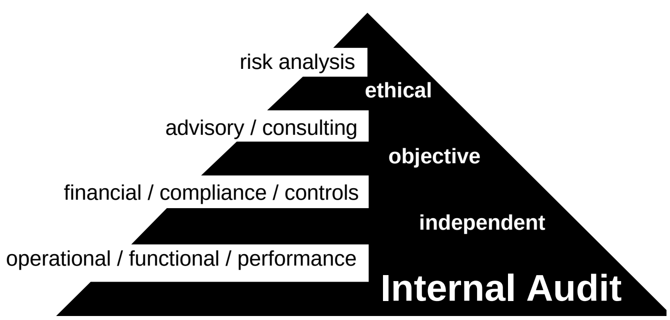
ORANGE COUNTY TRANSPORTATION AUTHORITY
INTERNAL AUDIT DEPARTMENT

OCTA

Interstate 405 Improvement Project: Project Management Contracts

Internal Audit Report No. 18-505

July 12, 2018



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ORANGE COUNTY TRANSPORTATION AUTHORITY
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Conclusion

The Internal Audit Department (Internal Audit) has completed an audit of oversight controls and contract compliance related to the project management contracts for the Interstate 405 (I-405) Improvement Project. Based on the audit, project management consultants were procured in compliance with Orange County Transportation Authority (OCTA) policy and contract amendments have been approved by the Board of Directors, as required; however, on multiple occasions, amendments have been back-dated outside of the limits outlined in procedures. Also, while cost estimates are submitted to support amendments to increase the contract maximum obligation, management does not validate all of the listed labor rates to payroll registers.

Regarding contract costs, billed labor rates complied with contract rates and labor classification rate ranges; however, Internal Audit identified excessive use of labor classifications and a lack of controls over labor rate increases for personnel billed within these classifications. Finally, Internal Audit identified concerns related to oversight of consultant staff time.

Background

I-405 Improvement Project

The I-405 Improvement Project will improve 16 miles of I-405 between the State Route 73 (SR-73) freeway in Costa Mesa and Interstate 605 (I-605) near the Los Angeles County line. The project includes adding one regular lane in each direction between Euclid Street and I-605, and making improvements to freeway entrances, exits, and bridges. In addition, the project will add the 405 Express Lanes, incorporating the existing carpool lanes and a new lane in each direction between SR-73 and I-605. The general-purpose lane portion of the project is a Measure M project and will be funded by a combination of local, state, and federal funds, with the express lanes portion of the project financed and primarily paid for by those who choose to pay a toll and use the 405 Express Lanes.

Project Management Contracts

Parsons Transportation Group, Inc. (Parsons), along with 15 sub-consultants, provides program management services for the I-405 Improvement Project under Agreement No. C-2-1513, effective March 3, 2014 through July 31, 2020, and with a current maximum obligation of $93,034,686. In addition, Mott MacDonald (MM), along with 8 sub-consultants, provides management consulting services for Highway Programs on an as-needed basis under Agreement No. C-5-3767, effective August 24, 2016 through August 23, 2021, and with a maximum obligation of $19,451,043. Through 2017, approximately 79 percent of the MM contract payments have been expended in support of the I-405 Improvement Project. Several staff from MM and its sub-consultants work out of the OCTA offices.

OCTA pays consultants at labor rates specified in the contracts for each full hour of labor satisfactorily performed by personnel. OCTA also pays contractors for Other Direct Costs, such as vehicle, cell phone, and travel costs. The contract schedules name consultant staff as "key personnel" or "other labor charges" with set labor rates, which are based on actual pay rates in the initial contract year, an overhead rate, and profit rate. OCTA reviews and recalculates these rates at contract inception and negotiates a set escalation rate for each subsequent contract year. The contract schedule reflects the calculated labor rates for the initial and each subsequent contract year, as calculated based on the contract escalation rate. For example, Rich Smith's $238.53 rate for 3/3/14-3/2/15 in the excerpt below would have been reviewed by OCTA; the rate for 3/3/15-3/2/16 is then escalated three percent to $245.69. The rate for 3/3/16-3/2/17 is further escalated three percent to $253.06, and so forth.

Key Personnel

Name	Classification	Job Function	Hourly Billing Rate for 3/3/14-3/2/15	Hourly Billing Rate for 3/3/15-3/2/16	Hourly Billing Rate for 3/3/16-3/2/17	Hourly Billing Rate for 3/3/17-3/2/18	Hourly Billing Rate for 3/3/18-3/2/19
Rich Smith	Sr. Project Manager	Deputy Program Manager	238.53	245.69	253.06	260.65	268.47
Macie Jones	Environmental Manager	Environmental Manager	168.22	173.27	178.46	183.82	189.93

Other Labor Charges

Name	Classification	Job Function	Hourly Billing Rate for 3/3/14-3/2/15	Hourly Billing Rate for 3/3/15-3/2/16	Hourly Billing Rate for 3/3/16-3/2/17	Hourly Billing Rate for 3/3/17-3/2/18	Hourly Billing Rate for 3/3/18-3/2/19
Eric James	Sr. Project Engineer	Highway Lead	153.27	157.87	162.60	167.48	172.50
Satya Man	Sr. Engineer	Structure Design Engineer	118.21	121.76	125.41	129.17	133.05

Labor Classifications

Classification	Hourly Billing Rate Range for 3/3/14-3/2/15	Hourly Billing Rate Range for 3/3/15-3/2/16	Hourly Billing Rate Range for 3/3/16-3/2/17	Hourly Billing Rate Range for 3/3/17-3/2/18	Hourly Billing Rate Range for 3/3/18-3/2/19
Senior Engineer	100.52-125.65	103.53-129.42	106.64-133.30	109.84-137.30	113.13-141.42
Planner	87.95-113.08	90.59-116.47	93.31-119.97	96.11-123.57	98.99-127.28

In recent years, contracts have also included labor classification categories with rate ranges to cover a wide range of personnel who may be needed on the contract from time to time and are not working steadily on the project. Using labor classifications allows consultants to utilize and bill for staff not initially identified and named in the contract without having to process a contract amendment. Consultants can bill personnel under labor classifications based on current pay rates and the contract-negotiated overhead and profit rate, as limited by the rate range. For example, the consultant can bill for Joe Williams as a senior engineer based on Joe's current pay rate, as long as his billing rate is within the rate range of $100.52-$125.65. Rate ranges included within these contracts can vary widely and are not validated against actual pay rates. If consultant personnel begin to work on a more permanent basis, consultants are supposed to add them as named personnel through contract amendments.

Objectives, Scope, and Methodology

The objectives were to assess oversight controls, and test for compliance with OCTA procurement policies and contract terms.

The methodology consisted of review of procurement and contract amendments for compliance with procurement policies and adequate support, review of invoices paid on the contracts for contract compliance and evidence of controls, and review of selected contract deliverables.

The scope is limited to Agreement No. C-2-1513 and Agreement No. C-5-3767. All amendments executed through December 2017 were included in testing. Internal Audit tested 44 Parsons invoices totaling $51,055,470, and 15 MM invoices totaling $4,487,984, representing all invoices paid from contract inception through December 2017. Internal Audit also reviewed a judgmental sample of ten contract deliverables from Agreement No. C-2-1513 to ensure OCTA's receipt of such deliverables, with a bias toward deliverables that are significant to the project. For judgmental samples, any conclusions are limited to the sample items tested since sampling is non-statistical. Finally, Internal Audit reviewed the floor logs and access card reports for a few consultant staff working out of OCTA offices, upon notification of concerns about a consultant staff's hours.

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.

Excessive Use of Labor Classifications and Lack of Controls over Escalation

Internal Audit identified excessive use of labor classifications and a lack of controls to limit labor rate increases for staff billed under these labor classifications.

Labor is the most significant part of these contracts, representing approximately 90 percent of the Parsons contract maximum obligation and 99 percent of the MM contract maximum obligation. Charges under labor classifications represent almost half of the $20 million in labor costs to date for Parsons.

Contract schedules include both named personnel (e.g. John Smith) and labor classification categories (e.g. Project Administrator). For named personnel, labor rates for the first year are specified and verified by OCTA and are escalated using a negotiated rate for each subsequent year. However, labor classifications specify rate ranges that can vary widely and are not validated against actual pay rates. For example, the spread of Parsons' labor classification rate ranges averages 22 percent and are as wide as 40 percent. Staff are billed under labor classifications using their current pay rate plus the set overhead and profit rate and are only limited to the maximum of the rate range. As such, staff billed under labor classification categories are not limited to the escalation rates specified in the contract. Pay rates for these staff may escalate without limitation provided the labor rate remains within the rate range specified in the contract.

OCTA staff initiated the use of labor classifications to provide flexibility when a consultant needs to use staff not named in the contract on a temporary basis. Using labor classifications allows consultants to bill for staff without OCTA having to process a contract amendment.

Internal Audit noted that Parsons billed an average of 29 staff under labor classifications, even though many of these staff bill regularly to the project. Failure to add named personnel to the contract in a timely manner results in inefficiencies, as it requires OCTA staff to verify and recalculate rates for these employees each time they appear on an invoice.

In addition, Internal Audit identified 46 staff whose billing rates increased by more than the escalation allowed under the contracts for named staff. Per the Parsons contract, escalation is limited to three percent per year for named staff; however, Internal Audit observed rate increases as high as 27 percent for staff billed under labor classifications.

The use of labor classifications not only allows consultants to provide salary increases above the negotiated rate but allows consultants to award significant salary increases prior to adding staff as named staff. For example, one full-time Parsons staff was billed under a labor classification for over two years and received pay rate increases of 2.8 and 4 percent. Then, just prior to adding this staff person to the contract, he was promoted and given a salary increase of 20 percent. Another Parsons staff person was given pay rate increases of three and five percent while billing under a labor classification, and then awarded a 16 percent promotional increase prior to being added as named personnel. A third Parsons staff was assigned full-time to the project in April 2017, and was billed under a labor classification; prior to adding the staff to the contract, she was given a 27 percent increase.

Recommendation 1:

Internal Audit recommends that management develop and implement appropriate controls to ensure labor classifications are only used as intended and all labor rates are held to contract escalation limits.

Management Response (Capital Programs and Finance and Administration):

Management agrees with the recommendation to develop and implement controls regarding the use of labor classifications. The use of labor classifications and the salary ranges specified for each classification provides the required flexibility to deliver the work with minimal interruption to the project and its schedule.

Staff that works, or is proposed to work, on a continuous basis for a period of 6 months or more will be added as named personnel to the contract. Labor classifications will continue to be utilized for staff working temporarily on the project. Additionally, management will require that consultants receive approval from OCTA's project manager in writing prior to adjusting the salary of individuals within labor classifications at a rate greater than the contractually allowable escalation rate for named personnel.

Initiation and Processing of Consultant Staff Promotion and Overbilling for Hours Worked

An OCTA manager initiated the promotion and reclassification of a sub-consultant staff working under his direction as a project administrator. Based on this request, MM contacted the sub-consultant firm and suggested a revised title of associate real property agent, along with a salary increase for the employee. The sub-consultant agreed to process the reclassification and 24 percent pay increase contingent upon the contract amendment being processed to allow the higher billing rate.

Rather than changing the staff's title and labor rate, the Procurement Department (Procurement) removed the named staff from the contract schedule and indicated that future billings should be processed under the project administrator labor classification, which has a rate range that accommodated the increase in pay. This action was not consistent with the request and represents misuse of labor classifications as the employee works full-time on this project. Procurement management indicated that the request was processed in this manner because, after reviewing the staff's resume, the project administrator title was determined to be more appropriate than associate real property agent.

Further, Internal Audit was notified of concerns that this sub-consultant staff person was billing for more hours than worked. The staff is employed by a sub-consultant to MM and is assigned full-time to OCTA offices. Internal Audit reviewed access card reports against billed hours and, based on the records, it appears this staff person works, on average, 30 minutes to two hours less than the billed hours each day. The reports were provided to MM, who solicited explanations from the sub-consultant staff person for the discrepancies. Review of the details provided noted several errors, and found explanations to be largely unsupported and, in several instances, contrary to corroborating records.

It should be noted that OCTA staff had previously questioned this sub-consultant's hours, and MM advised OCTA that the staff person had asserted that all billed hours were worked. Around the same time, the MM project manager stopped signing this staff's timesheets, asserting that it was a "contractually unnecessary step and redundant" and one that may lead to additional liability for MM. As a result, the staff's timesheets do not contain any evidence of supervisory review and concurrence.

Internal Audit performed review of access records for two additional consultant staff and identified one that appeared to regularly work less than recorded hours, to a lesser degree.

Recommendation 2:

Internal Audit recommends management address the extent to which OCTA managers should be involved in initiating promotions of consultant staff. In addition, Procurement should process amendments in accordance with requests or reject requests if there is disagreement about the appropriateness of the action. Regarding consultant staff, management should implement controls to ensure only hours worked are billed. At a minimum, management should require approval of timesheets by MM supervisory staff.

Management Response (Capital Programs and Finance and Administration):

Management will address the extent to which OCTA managers should be involved in initiating promotions of consultant staff by instructing them not to request any promotions of consultant staff.

With respect to processing amendments as requested by project managers, Procurement staff and project managers will confer and agree upon the scope of a requested contract amendment for changes to consultant personnel. Procurement staff will continue to conduct the due diligence on all requisitions. Each request will be reviewed for clarity and reasonableness. Clarifications and/or concurrence will be sought from project managers prior to executing contract amendments.

Management will require approval of timesheets by MM supervisory staff as recommended. Reimbursements to OCTA for hours billed but confirmed as not worked will be obtained. The sub-consultant employee referred to has been removed from this assignment and is in the process of being removed from the contract. MM will review timesheets signed and certified by all sub-consultant personnel who work full-time at OCTA offices and will agree to the level of effort and performance of duties by the sub-consultant.

Back-Dating of Amendments

Multiple amendments were back-dated more than 60 calendar days prior to executing the amendment, in violation of procurement procedures stating that the effective date may be "up to 60 calendar days prior to executing the amendment."

One amendment that added a project manager to the MM contract was back-dated nearly four months. This allowed the sub-consultant to invoice the project manager's time at a higher labor rate, resulting in additional billings of over $21,000.

Recommendation 3:

Internal Audit recommends management comply with procedures on the effective dating of amendments.

Management Response (Finance and Administration):

Management acknowledges that the procedures as written for back dating letter amendments need to be revised. Procurement will update the Procurement Manual to agree with current practices.

Validation of Consultant Cost Estimates for Amendments

Parsons submitted cost estimates to support two amendments that increased the contract maximum obligation by approximately $30 million and $6 million, respectively; however, these cost estimates included multiple staff that were not named on the contract. For staff included in the cost estimates that were not part of the contract or amendment, management did not validate the labor rates listed to payroll registers. The value associated with the staff whose labor rates were not validated to payroll registers represented 13 and 25 percent of total cost estimates, respectively.

Almost all of these consultant staff were billed under labor classifications and some were eventually added as named staff in later amendments.

Recommendation 4:

Internal Audit recommends that management validate labor rates to payroll registers for staff included in the cost estimates that are not part of the contract or amendment. In addition, new staff appearing on cost estimates should be added to the contract concurrently.

Management Response (Finance and Administration):

As a part of preparing amendments, procurement staff will validate labor rates of all proposed staff provided with the consultants' cost estimates using either payroll registers and/or a job offer letter issued to the personnel. Additionally, new staff appearing on cost estimates will be added to the contract if it is anticipated they will be working in this classification for six months or more.