SOUNDTRANSIT

Internal Audit Report

Indirect Costs for Co-located Consultants

Report Number: 2017-04 | Report Date: August 28, 2017

SOUNDTRANSIT

Executive Summary

Audit Report No.: 2017-04 **August 28, 2017**

WE AUDITED the agency management controls over co-located consultants.

AUDIT OBJECTIVE was to determine whether the agency has effective controls to ensure that consultant firms with co-located staff are not also billing ST for indirect costs related to home office expenses.

The audit examined management controls in place as of March 2017.

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WHAT DID WE FIND?

Sound Transit utilizes consultants when specific subject matter experts are needed for less than full-time. Co-locating the consultant can be beneficial and in some cases is considered a best practice. The decision to co-locate consultant staff is determined on a contact to contact basis usually during contract negotiations, and generally includes staff that is assigned 100% to the project.

There is a cost for co-locating consultants.

- Initial Setup – it can run as much as $11,000, depending much on the hardware and software required.
- Rent or Ongoing Utilities and Maintenance – the average annual cost per consultant is about $5,000.
- Opportunity Costs – there are cost gains and losses associated with providing dedicated spaces to consultants, such as the costs to lease additional spaces and/or locations.

As of December 2016, there were 269 co-located consultants at the Union Station, 5th & Jackson, 625 and 705 locations. Approximately 211 consultants were managed by DECM and PEPD in support of planning, project management, design and engineering and construction management activities. Many of these consultants have been co-located for multiple years and work on multiple projects. These co-located consultants either bill at fully burdened rates or direct costs plus overhead. In case of the latter, the agency has negotiated with a number of consultant firms a reduced overhead rate, or a field rate, to exclude some costs related to their home office because co-located consultants do not receive the support from their home offices in their day-to-day activities. For billing purposes, this negotiated field overhead rate is used for the co-located staff time.

The audit concluded that management has not implemented effective controls to reasonably ensure consultant firms with co-located staff are not also billing ST for indirect costs related to home office expenses. The audit noted opportunities to improve controls.

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Background

Sound Transit utilizes consultants when specific subject matter experts are needed for less than full-time. Co-locating the consultant can be beneficial and in some cases is considered a best practice. It enables a more collaborative work environment and facilitates timely project progress through improved communication and cooperation among agency staff and multiple consultants. The decision to co-locate consultant staff is determined on a contact to contact basis usually during contract negotiations, and generally includes staff that is assigned 100% to the project.

There is a cost for co-locating consultants.

- Initial Setup - Based on estimates provided by the Facilities and IT Divisions, the initial cost per consultant can run as much as $11,000, depending much on the hardware and software required.
- Rent or Ongoing Utilities and Maintenance - Based on GL payment data (i.e. rent, janitorial, utilities), the average annual cost per consultant is about $5,000.
- Opportunity Costs – There are cost gains and losses associated with providing dedicated spaces to consultants, such as the costs to lease additional spaces and/or locations.

As of December 2016, there were 269 co-located consultants at the Union Station, 5th & Jackson, 625 and 705 locations. This included 58 consultants to support Sounder operations, Information Technology, Accounting, and others.

Department	625 Bldg.	705 Bldg.	5th & Jackson	Union Station	Total
DECM	79	69	9	25	182
Executive			3	1	4
FIT			30	6	36
Legal				2	2
Operations				16	16
PEPD		4	25		29
Total	79	73	67	50	269

The remaining 211 consultants were managed by DECM and PEPD in support of planning, project management, design and engineering and construction management activities. Many of these consultants have been co-located for multiple years and work on multiple projects.

Some co-located consultants are billed at fully burdened rates while others are billed direct costs plus overhead. In case of the latter, the agency has negotiated with a number of consultant firms a reduced overhead rate, or a field rate, to exclude some costs related to their home office because co-located consultants do not receive the support from their home offices in their day-to-day activities. For billing purposes, this negotiated field overhead rate is used for the co-located staff time.

Audit Objectives

To determine whether the agency has effective controls to ensure that consultant firms with co-located staff are not also billing ST for indirect costs related to home office expenses.

Scope and Methodology

We conducted this performance audit in accordance with Generally Accepted Government Auditing Standards and the International Standards for the Professional Practice of Internal Auditing. 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 gained an understanding of consultant firm contract terms and conditions, as well as management practices related to co-located consultant billings. We identified risks and assessed management controls in place to mitigate those risks. Based on the assessment of risks and controls, we determined to focus our efforts on management controls over Design Engineering and Construction Management and Planning, Environmental and Project Development co-located consultants, as of March 2017.

To determine whether the agency has effective controls to ensure that consultant firms with co-located staff are not also billing ST for indirect costs related to home office expenses, we conducted the following procedures:

1. A total of 12 staff were interviewed to determine whether there are controls in place to monitor and detect instances where consultant firms with co-located staff are also billing ST for indirect costs related to home office expense. We selected eight staff from DECM and one from PEPD based on the large number of co-located consultants under their responsibility. Additionally, the sample included a supervisor and specialist from Procurement and Contracts, and a manager from Project Controls.

2. Selected eight consultant firms with co-located staff working on multiple ST projects. Tested 54 individual consultant/sub-consultant invoices from 16 contracts for the months March 2016, November 2016 and January 2017 to determine whether indirect costs were billed appropriately by:
    a. Reviewing overhead rates billed on invoice (field vs. home).
    b. Validating consultant location with ST staff.
    c. Comparing building access records to co-located consultant time card records.

Conclusion

Management has not implemented effective controls to reasonably ensure consultant firms with co-located staff are not also billing ST for indirect costs related to home office expenses. See Finding 1.

Findings and Recommendations

1. Management Controls Over Co-located Consultant Billings Should Be Strengthened.

Interviews with the DECM and PEPD staff overseeing co-located consultants demonstrated that staff generally had good knowledge of which consultants were on site, why they were on site and how often they were on site. However, the interviews indicated that there is no defined process for verifying the overhead rate during the consultant invoice review process. Instead, a number of incomplete and disconnected invoice reviewing practices were observed:

- Two DECM staff indicated they review the overhead rates billed, while other seven DECM/PEPD staff indicated they do not review the overhead rates billed, as Project Controls or Procurement & Contracts reviewed them.
- Project Controls indicated that Procurement & Contracts reviewed OH rate on invoices per Project Control Policy and Procedure 7.
- Procurement & Contracts Division staff indicated that review OH rates only to verify the alignment between the contract and the invoice. Their process does not verify whether a home or field rate should be applied.

A well designed process, when consistently applied, can systematize staff knowledge into an effective management tool. The current overhead rate review processes do not have such a defined process. As a result, the existing staff knowledge about co-located consultants' presence/absence is not effectively used in ensuring correct billings.

There were a number of billing errors. Consultant firms did not always bill the field overhead rate for their co-located staff, and the current management processes did not detect these incorrect billings.

	Test Population Reviewed				Test Result	
	# of Co-Located Consultants	# of Contracts	# of Invoices	# of Billings	Incorrectly Billed	Estimated Overbilling
HDR	63	3	6	96	44	$25,309
HNTB	25	2	5	70	7	8,451
LTK	11	8	14	42	16	7,155
CH2MHill	8	2	6	17	0	0
Jacobs Engineering	20	3	8	36	0	0
Jacobs & Associates	14	1	3	25	10	10,385
Parson Brinckerhoff	9	1	3	7	0	0
Hatch Mott MacDonald	8	3	9	4	0	0
Totals	**158**			**297**	**77**	**$51,300**

The majority of co-located consultants do not work on-site full time at agency facilities. During the periods reviewed, there were 297 billing instances from 158 consultants. Of the total number of instances, 77 (26%) were incorrectly billed at home overhead rates. In addition, testing indicated inconsistent billing practices. Some co-located consultants, whose firm has multiple contracts with the agency, were correctly billed on one contract but not on another for the same period.

The estimated overbilling from four firms on 22 invoices ($8.1 million) was approximately $51,000.

Recommendations:

We recommend that Management:

1. Analyze prior billings of consultant firms with co-located staff and obtain credits for incorrect billings if any, as appropriate.
2. Establish an agency process for reviewing overhead rates for co-located consultant staff to ensure field rates are billed when applicable.

   For the new process, the following specific attributes are suggested for management consideration:
   - A space utilization threshold (e.g., 3 weekday use, 15 days in a month, etc.) should be defined. Utilization exceeding the threshold would initiate the application of a field rate.
   - Space utilization should be reviewed at regular intervals to ensure continuing use at an expected rate.

Management Response

Management appreciates the level of effort that went into this audit. We concur with your recommendation that an Agency process for reviewing overhead rates for co-located consultant staff is necessary to ensure that field overhead rates are appropriately applied to direct labor as applicable. We commit to the following:

Defining the basis for applying field and home overhead rates.

The conclusions drawn in the audit report were based on key card access to facilities and whether an office had been set up for the consultant staff member. There are a number of instances where the co-located individual only uses Sound Transit facilities on a **part** time basis. Management recommends a different approach to measuring the use of Sound Transit facilities by co-located consultants. A review of the number of hours billed on a monthly basis by each co-located individual over successive billing periods will provide a better idea of how Sound Transit space is being utilized by co-located consultants. The home overhead may be appropriate when co-located consultants are not utilizing Sound Transit facilities full time and the consultant is still utilizing an office outside Sound Transit property or when the duration of co-location is too short to allow the consultant to release their home office space. Additionally, key card data is not accurate given that the Agency has not been diligent in requiring the consultant to return their access card upon completion of the on-site assignment. Those individuals may no longer be co-located on campus but still require access to Sound Transit facilities.

Determining if the overhead is to be consistent across the life of the contract.

Sound Transit will determine how to appropriately apply either the field rate or the home rate and how that rate will be applied through the life of the contract. We will establish how to effectively track the location of an individual over the passage of time to ensure that the appropriate overhead rate is applied.

Determining whether a field overhead rate specifically negotiated for one ST contract on which an individual consultant is working shall apply to all ST contracts the individual is working on.

Developing and piloting a procedure that ensures overhead rates are appropriately applied to co-located consultants.

These work activities will be completed by the end of 2Q 2018 through the collective efforts of DECM, PEPD, and Procurement & Contracts staff. Following the pilot, the procedure will be refined as necessary and will be implemented for all contracts where a field overhead rate is contractually required for co-located staff.