



**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

**Prepared by:**

*Serena K. Ng*

Serena Ng  
Senior Manager, Internal Audit  
714-560-5938

**Approved by:**

*Janet Sutter*

Janet Sutter  
Executive Director, Internal Audit  
714-560-5591