

**REPORT ON AN AUDIT OF THE CITY'S PRICE  
AGREEMENT FOR CONTRACT LABOR FOR POWER PLANTS  
WITH WATKINS ENGINEERS & CONTRACTORS, INC.**

**AUDIT PROJECT #9803**

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**AUDITING DEPARTMENT**

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## TABLE OF CONTENTS

I. SCOPE AND OBJECTIVES .....	1
II. METHODOLOGY .....	2
III. BACKGROUND.....	3
IV. CONDITION STATEMENTS AND MANAGEMENT ACTION PLANS .....	5
A. Planning Issues .....	5
1. Electric Operations should establish criteria for how and when to effectively utilize the Power Plant Contract Labor Agreement. ....	5
2. Electric Operations should develop procedures to ensure that purchase orders only contain one project.....	7
3. Electric Operations should collect data on hours by labor classification to develop weight factors for the bid evaluation process. ....	9
4. Electric Operations should evaluate the savings achieved through the use of the Agreement. ....	10
5. Electric Operations should collect data to determine the cost effectiveness of acquiring material and equipment under the Agreement.....	11
B. Control Issues .....	12
1. Enforcement of contract provisions by Electric Operations should be improved.....	12
2. Personal safety equipment should be clearly defined in the Agreement.....	16
V. EXIT CONFERENCE.....	18



## **I. SCOPE AND OBJECTIVES**

Our audit plan included a review of the City of Tallahassee's Price Agreement for Contract Labor for Power Plants (Agreement) with Watkins Engineers & Constructors, Inc. (Watkins). Our audit period was from November 1, 1997, to December 31, 1998. Our primary objectives were to determine whether:

- Electric Operations has established adequate internal controls to effectively and efficiently administer the Agreement, and
- Electric Operations and the contractor are operating in compliance with the terms of the Agreement.

## II. METHODOLOGY

Our review was conducted in accordance with generally accepted government auditing standards and accordingly included such tests of the records and such other auditing procedures as we considered necessary under the circumstances.

This audit was conducted under the authority of Section 33 of the Tallahassee City Charter and in accordance with our audit work plan.

We reviewed the Agreement to obtain an understanding of its provisions. Project managers were surveyed to obtain an understanding of how they administered the Agreement. The Agreement includes the City's Request for Bids (RFB) and all addenda and the Contractor's Proposal Form, which are attached to the contract as Exhibits A and B.

To determine the adequacy of internal controls established by Electric Operations and to determine if the contractor was billing the City in accordance with the Agreement, we examined four purchase orders and related contractor invoices and supporting documentation. Two purchase orders each were selected for projects at the Hopkins Power Plant and at the Purdom Power Plant.

Periodic progress meetings were held with the audit liaison. These meetings served to inform the program administrators of the audit progress and as a discussion forum to enhance the effectiveness of the audit.

### **III. BACKGROUND**

On May 2, 1997, the City issued an RFB for a Price Agreement for Contract Labor for Power Plants (Agreement). The RFB was for a three-year period. The City had a previous three-year agreement (1994) with Watkins to provide these services.

The City operates three electric power plants: A. B. Hopkins, S. O. Purdom, and C. H. Corn. The contractor provides labor, materials and equipment to accomplish mechanical, electrical, plumbing, civil, and structural work at the City's power plants. The contractor augments plant work forces during boiler repairs, turbine/generator inspections, scheduled outages, forced outages, specialty work, and construction projects within the Production Division. The RFB identified 24 different classifications of labor to augment plant work forces and requested labor rates (regular, overtime, and holiday) for each class. The RFB also allowed for a markup percentage for materials and rental or contractor-owned equipment used to accomplish work at the power plants.

Work performed pursuant to the contract shall be authorized by issuance of purchase orders. The contractor is to notify the City, in writing, when 80% of the funding of a purchase order is expended. It is the contractor's responsibility not to exceed authorized funding levels. Production management assigns engineers or other staff as project managers to oversee the contractor's work and to review and approve the contractor's invoices and supporting documentation, including weekly time sheets for contractor personnel and invoices for materials. Therefore, project managers have two important roles: 1) ensure that the work is done according to

specifications, and 2) ensure supporting documentation for the invoice is correct and complies with the contract.

On October 30, 1997, the City entered into the second Agreement with Watkins Engineers & Constructors, Inc. (Watkins). This Agreement covers the period November 1, 1997, to October 31, 2000. Table 1 shows the amount of expenditures under the Watkins Agreements for the period June 1994 to May 1999.

**Table 1 - Expenditures under the Watkins Agreements (June 1994 - May 1999)**

<b>Year</b>	<b>Amount</b>
FY '94 (June - September)	\$ 565,586
FY '95	\$1,001,197
FY '96	\$1,155,037
FY '97	\$ 770,294
FY '98	\$ 834,168
FY '99 (October - May)	<u>\$ 473,934</u>
Total	<u>\$4,800,216</u>
Expenditures - 1994 Watkins Agreement	\$3,605,124
Expenditures - 1997 Watkins Agreement	\$1,195,092

#### **IV. CONDITION STATEMENTS AND MANAGEMENT ACTION PLANS**

Generally, internal controls over the administration of the power plant contract labor agreement need improvement. We identified two areas in the administration of the Agreement that management needs to address: planning and controlling. The specific opportunities for improvement in these areas are addressed in the condition statements below.

##### **A. Planning Issues**

Documentation of the planning associated with the Power Plant Contract Labor Agreement should be improved by:

- establishing written criteria for when and how to use the Agreement,
- collecting information to evaluate whether cost saving objectives established for the Agreement were achieved, and
- determining workload for evaluation of future bids.

Each condition below discusses how planning can be improved to ensure the operational objectives of the use of the Agreement are achieved.

##### **1. Electric Operations should establish criteria for how and when to effectively utilize the Power Plant Contract Labor Agreement.**

We found that Electric Operations has not established criteria as to when the Agreement should be used or when a separate bid should be issued. It may be beneficial to issue a separate RFB when the scope of a project is complex or when a certain dollar threshold is reached. A separate RFB would increase competition

and could reduce the overall cost of the project to the City. Electric Operations should establish criteria for when the Agreement should be used and when a separate RFB should be issued.

We also found that Electric Operations staff applied the Agreement using four different pricing methods:

1. **Estimated Cost.** The contractor submits an estimate of the cost to complete a project when the proposed work scope is the installation or repair of equipment and specific specifications or drawings are not available. Electric Operations has primary responsibility to monitor costs.
2. **Fixed Price.** The contractor submits a fixed price when a project has specifications or drawings, such as installation of a piece of equipment. The contractor has the responsibility to monitor costs.
3. **Not To Exceed Amount.** The contractor submits a not to exceed price on a project that has specifications or drawings, but there is the likelihood of some unforeseen problems. An example could be the installation of a piece of equipment. The contractor is told that there may be some additional problem with the installation, so the contractor adds a cushion to the bid to cover any additional work. In this case the responsibility to monitor costs is shared between the contractor and Electric Operations.
4. **Estimated Hours.** Electric Operations staff estimates the number of hours for specific labor classifications (e.g., outage labor) and requests those classifications from the contractor to work on the project. Electric Operations has primary responsibility to monitor costs.

Electric Operations has not established criteria as to when any of these four pricing methods is appropriate. Based on our review, we could not determine any consistency as to when one method was used over another. As noted above, the method dictates which party has the responsibility for monitoring costs.

Electric Operations management reports that they have developed “Project Manager Expectations” and reviewed them with the project managers. These “Project Manager Expectations” outline the project managers duties during the engineering phase, the evaluation and award process, the performance phase and after completion of the work. For example, the engineering phase requires a work scope with adequate specifications that outline the work to be performed.

To shift some of the cost risk to the contractor, Electric Operations should require firm fixed prices or not to exceed estimates whenever possible. Electric Operations has held discussions with project managers to begin identifying criteria for how and when to use the Agreement.

<b>2. Electric Operations should develop procedures to ensure that purchase orders only contain one project.</b>
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We examined four purchase orders, two for Hopkins and two for Purdom, to determine how the Agreement was being used to augment the City’s work forces. One of the four purchase orders we reviewed incorporated three of the four pricing methods discussed in A1 above. The purchase order was initially issued for a total of \$43,850 and was composed of three projects:

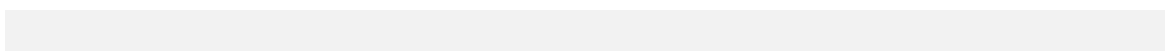
- installation of mist eliminator, \$6,400 estimated cost from the contractor;
- Unit #2 outage labor, \$22,550 estimated by Electric Operations, and
- installation of feed water start up valve, \$14,900, a fixed price estimate from the contractor.

Each of these projects was initiated on a separate purchase order, but all were later consolidated into one purchase order (# 562716). Two different project managers provided the project oversight, which also diffused responsibility.

A change order in the amount of \$6,138 was processed one month later to increase the scope of work associated with the Unit #2 outage. It was not clear from the change order if it related to the Unit #2 outage or the installation of the feed water start up value. This change order increased the purchase order total to \$49,988. Three invoices totaling \$49,201.59 were submitted by Watkins, approved by the project managers, and paid by the City. The invoices and supporting documentation did not identify how much of the labor and materials were associated with any of the three parts of the purchase order. Therefore, we were unable to determine if Watkins was in compliance with the fixed price portion (\$14,900) of the purchase order, or if the \$6,138 change order was appropriate.

Further, three of the four purchase orders we reviewed contained work on more than one project. The invoices and supporting documentation from the contractor did not identify the specific project covered by the invoice. Therefore, we were unable to determine whether Watkins was in compliance with the pricing requirements of the individual projects.

Electric Operations has recently developed guidelines to issue a purchase order for each project. In developing the guidelines, concerns were expressed as to whether this practice might be viewed as splitting purchase orders. The guidelines provide that projects distinguishable by equipment or area or clearly distinct activities of a large project can be separate projects with separate purchase orders. These guidelines will allow project managers to ensure that there is not a mixing of differing modes of project billings (i.e., fixed price, not to exceed pricing or cost estimates, etc.).



**3. Electric Operations should collect data on hours by labor classification to develop weight factors for the bid evaluation process.**

We found that there was an opportunity to improve the bid evaluation process for the 1997 RFB for the contract labor Agreement. The bid evaluation process for the first Agreement (1994) was based on estimates of the number of hours for each labor classification. The bid evaluation process for the second RFB (1997) used the same process. The evaluation process was based on estimates of 7,000 regular hours, 2,000 overtime hours and 1,000 holiday hours for each of 24 job classifications. These hours equate to 4.8 FTE for each classification or a total of more than 115 FTE for all 24 classifications. The evaluation process for the second Agreement did not take into consideration either the classifications actually used during the first contract period, the number of hours worked in each classification, nor the type of hours (regular, overtime, or holiday) worked.

Subsequent to the bid evaluation and prior to bid award, Watkins reported that for the three-year period June 1994 to June 1997, they had billed the City for 117,736 regular hours, 12,388 overtime hours and 8 holiday hours. As shown in Table 2, the differences in the number of overtime and holiday hours in the bid evaluation and those actually used is dramatic. Future bid evaluation processes should be based on estimated hours for each classification taking into consideration past experience and future needs for labor to help ensure reasonable evaluations of bids. Therefore, Electric Operations management should request Watkins to provide an annual listing by classification and type of labor hours billed to the City under the Agreement. This information could be used in future bid evaluations.

**Table 2 - Schedule of Hours**

Hours	Bid Evaluation	Actual June 1994 - June 1997
Regular	168,000	117,736
Overtime	48,000	12,388
Holiday	24,000	8
Number of Personnel	115	62.6

**4. Electric Operations should evaluate the savings achieved through the use of the Agreement.**

Electric Operations management reports that the use of contract labor is a cost effective method of providing personnel. Contract labor is generally integrated into the work force for the duration of a specific project then released at the end of the project. However, Electric Operations has not collected information on the number of hours by labor classification, nor performed an analysis to determine whether cost savings have been achieved, nor whether it would be more economical to hire City staff rather than use contract labor.

Electric Operations management should request labor information from Watkins including the number of hours billed by labor classification over a multi-year period of time. This data could then be used to compare the internal cost of labor to the amount paid to Watkins for those services. Management should continue to review labor at all plants to determine whether positions could be shared. Additionally, such an analysis should be prepared periodically to ensure that resources are being acquired in the most cost effective manner, whether it be internally or externally. Total personnel costs could then be compared against the contract labor costs to periodically evaluate the cost efficiency of the Agreement.

**5. Electric Operations should collect data to determine the cost effectiveness of acquiring material and equipment under the Agreement.**

The RFB provided for a “markup” on materials and for “Non-Owned Rental” and “Owned Rental” equipment needed to work on projects. Watkins bid a markup of 5% on materials and “Non-Owned Rental” equipment and no markup on “Owned Rental” equipment. The Agreement provides no incentive under this “cost plus” arrangement to purchase materials or rent equipment from the lowest and best supplier. In addition, the contractor is not a governmental entity and is subject to the state sales tax so that any materials purchased under the Agreement would be billed to the City at cost plus sales tax of 7%, plus the 5% markup. Electric Operations should collect data and evaluate whether materials should be purchased under the Agreement or purchased directly saving the City 7% sales tax and the 5% markup.

Electric Operations management has developed the following action plan to ensure that planning for the establishment and use of the Agreement is improved.

Objective: To develop and improve the planning processes for the Power Plant Contract Labor Agreement.

<b>Step #</b>	<b>Action/Task</b>	<b>Responsible Employee</b>	<b>Target Date</b>
1.	Develop and adopt procedures to ensure that only one project is included on a purchase order.	Rob McGarrah	6/11/99
2.	Establish criteria for when each type of bid (fixed price, estimate, not to exceed) is appropriate.	Clark Sheehan	8/31/99
3.	Establish procedures to collect information on the number of hours, labor classification, materials and rental equipment included in the contractors invoices.	Diane Blanton	10/30/99
4.	Use the number of hours and labor classification to evaluate the efficiency of the Agreement.	Rob McGarrah	10/30/99
5.	Evaluate the cost effectiveness of purchasing materials through Agreement.	Diane Blanton	10/30/99

6.	Establish a process to estimate the number of hours by type and classification for inclusion in the next bid.	Ben Cowart	7/1/00
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**B. Control Issues**

We found that there were significant opportunities for improvement in the controls established by Electric Operations to ensure the contractor complies with the Agreement. The City’s Internal Control Policy (#220CP) addresses the role of policies and procedures in the system of internal administrative and accounting control required for all departments. The fact that the Agreement prescribes that the contractor will be paid by the hour for labor and cost plus for materials and rental equipment increases the importance of a comprehensive set of procedures for monitoring and administering the work of the contractor. These procedures mitigate risks associated with overpayments, change orders, etc. We found that project managers generally were not familiar with the terms and conditions of the contract. The specific control issues identified are discussed below.

**1. Enforcement of contract provisions by Electric Operations should be improved.**

Production management has not established a process to ensure that project managers are enforcing the Agreement. For example, for the four purchase orders (PO) reviewed, totaling \$131,688, we identified over \$4,000 in calculation errors, claims for non-allowable charges, and billings without supporting documentation. Table 3 shows the PO number, number of projects included in each PO, amount authorized, amount paid, correct amount that should have been paid, and the difference. Table 4 shows the types of errors that we found in our review of the supporting documentation for each PO.

Based on the error rate calculated and the dollar volume under the 1997 Agreement, we estimate that if this practice is consistent over the period (November 1997 through May 1999), the City may have been overbilled by approximately \$43,000.

**Table 3 - Sampled Purchase Orders**

Purchase Order #	Projects Included on PO	Amount of PO	Amount Paid	Correct Amount	Difference
PO #565971	2	\$ 19,500.00	\$ 19,486.00	\$ 19,486.00	\$ -
PO #550147	1	\$ 22,400.00	\$ 20,983.69	\$ 20,677.69	\$ (306.00)
PO #553409	2	\$ 39,800.00	\$ 39,288.54	\$ 39,045.63	\$ (242.91)
PO #562716	3	\$ 49,988.00	\$ 49,201.59	\$ 45,004.86	\$(4,196.73)
Total		\$ 131,688.00	\$ 128,959.82	\$ 124,214.18	\$(4,745.64)

Source: Purchase Orders, FMS, and supporting documentation.

**Table 4 - Identified Errors**

<b>Types of Errors Found</b>	
Non-allowable Charges (Telephone)	\$ (242.91)
Overtime Calculation Errors	\$ (514.00)
Materials Billed in Error	\$ (145.90)
Support Documentation Not Available	\$ (3,842.83)
Total <sup>1</sup>	\$ (4,745.64)
Percent of Total Paid	3.7%

Source: Invoices and supporting documentation.

**Non-Allowable Charges.** According to the Agreement, telephone service will not be provided by the City and is the responsibility of the contractor. Our review of the four purchase orders and related invoices and supporting

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<sup>1</sup> Watkins has issued two credits for overpayments, one for \$90.60 (PO #550147) for overtime and one for \$4,196.73 (PO #562716) for missing support documentation, overtime, and errors in recording.

documentation revealed that Watkins had invoiced the City for local as well as long distance charges in the amount of \$242.91. Neither project managers nor support staff involved in the invoice review process detected this error. When this was pointed out to project managers at Purdom, they indicated that any future phone bills would be returned to the contractor. Electric Operations should review invoices and supporting documentation for telephone charges submitted by Watkins and request credits when appropriate.

In our review of the 1997 Agreement, we compared the provisions of the agreement with the previous agreement with Watkins. We noted that two items (the work week and holiday pay) changed in the 1997 Agreement.

**Work Week.** The work week was changed so that the week begins on Saturday at 12:01 a.m. and ends Friday at 12:00 p.m.. However, Watkins continued to submit their time sheets based on a work week that begins on Monday at 12:01 a.m. and ends on Sunday at 12:00 p.m.. Therefore, due to the change in the work week, hours were paid at the overtime pay rate. The overtime pay rate is one and one-half times the regular pay rate. For example, Watkins would bill an employee working a total of 48 hours, 8 hours a day Monday through Saturday, at 40 hours regular time and 8 hours overtime. However, the time should have been reported in two different weeks for a total of 48 regular hours. Once this was pointed out to Electric Operations, they informed Watkins to adjust their billing cycle to the work week in the Agreement. We were not able to determine how many hours were billed incorrectly, because the number of hours by day in the work week are not identified.

**Holiday Pay.** The other item that changed was the pay rate for holiday time. In response to the 1997 RFB, Watkins bid \$0 for holiday time. We found

one invoice where Watkins billed the City for holiday time at the rate of \$51 per hour which is twice the regular rate (\$25.50). We communicated this error to the project manager who then questioned Watkins. Watkins issued a credit for \$90.60 (6 hours @ \$15.10). The \$15.10 is the difference between the rate charged (\$51) and the overtime rate of \$35.90. Watkins should have issued a credit for \$306, which represents the total holiday time billed.

We also noted in the review of the invoices and supporting documentation that:

- (1) the contractor does not clearly identify all of the projects employees are working on, making it difficult to verify overtime calculations, and
- (2) the time sheets do not always contain the labor classification of the employee.

While project managers are familiar with the classification of Watkins staff, other personnel verifying the time sheets may not know their classification. Electric Operations has requested and Watkins has agreed to:

- conform to the work week outlined in the Agreement;
- include the classification of the employee on the time sheets; and
- prepare a schedule of employees by purchase order.

The “Project Manager Expectations” developed by Electric Operations management requires project managers, following completion of the work, to review and approve all invoices for accuracy and correctness. This review would include reconciliation of supporting documentation to the invoices, submission of time sheets for the specified work week, accurate billing hours and rates, and completion of the work.

**2. Personal safety equipment should be clearly defined in the Agreement.**

We found that there are some terms contained in the Agreement that need further clarification, such as personal safety equipment. The RFB provided that the labor rate shall include all costs including hand tools and small tools less than \$500 and personal safety equipment, except consumables, materials, and special tools. Special tools are described as those that normally cost more than \$500.

Personal safety equipment is not defined in the RFB. Appendix A and B of the RFB list several “safety” items as either small tools or hand tools that a journeyman shall possess when reporting to a job site. These items include safety belts, hard hats, safety glasses, and welding leathers, which should therefore be included in the labor rate. However, we noted that these same type of items were also billed by the contractor and paid for by the City. We found contractor invoices that contained items such as: clear visor lenses, work gloves - long cuff, comfort cup goggles, and smoke lens safety glasses that could be interpreted as “safety” items. Electric Operations personnel agreed that this is an area that needs further clarification in the Agreement.

Electric Operations has developed the following action plan to ensure that the control issues over administration of the Agreement are improved. As indicated earlier, Electric Operations is now receiving a spreadsheet prepared by Watkins that shows employees, classification, and hours by purchase order.

Objective: To improve controls over administration of the Watkins Agreement.

<b>Step #</b>	<b>Action/Task</b>	<b>Responsible Employee</b>	<b>Target Date</b>
1.	Periodically review a sample of purchase orders and invoices for compliance with contract provisions.	Diane Blanton	6/1/99
2.	Establish procedures and fix responsibility for reviewing and approving contractor invoices.	Rob McGarrah	6/30/99
3.	Develop procedures to ensure project managers are informed about changes and interpretations of contract provisions.	Rob McGarrah	7/31/99
4.	Draft contract amendments to clarify definitions contained in the contract.	Ben Cowart	8/15/99
5.	Obtain approval of contract amendments by City Attorney's Office.	Ben Cowart	8/30/99
6.	Execute contract amendments as necessary.	Ben Cowart	9/15/99
7.	Request Watkins to provide a summary table that would show employees and number of hours by project.	Diane Blanton	10/15/99

**V. EXIT CONFERENCE**

An exit conference was held on July 14, 1999. Those attending were:

Executive Office

Ricardo Fernandez, Assistant City Manager

Electric Operations

Kevin G. Wailes, General Manager

Robert E. McGarran, Superintendent, Power Production

Diane C. Blanton, Administrative Specialist III

Auditing

Roberta McManus, Interim City Auditor

James L. Carpenter, Auditor