

DEPARTMENT OF GENERAL SERVICES

Certain Units Can Do More to Ensure That Client Fees Are Reasonable and Fair

REPORT NUMBER 2002-108, DECEMBER 2002

Department of General Services' response as of December 2003

Audit Highlights . . .

We found that certain units within the Department of General Services (General Services) often missed their estimates of project fees charged to client departments by more than 20 percent. These units, which are within General Services' Real Estate Services and Telecommunications divisions, could improve the accuracy of their estimates by more consistently employing the following best practices:

- Document how estimates are calculated.*
- Ensure the review and approval of estimates.*
- Use multiple estimating approaches—along with historical data—to validate estimates.*
- Evaluate estimates on completed projects.*

Further, we found that certain units could more accurately prepare and report cost data that General Services' management uses to decide on hourly rates. Finally, the Office of Public Safety Radio Services needs to improve its billing practices.

The Joint Legislative Audit Committee (audit committee) requested the audit after hearing concerns from the Legislative Analyst's Office (LAO) regarding the appropriateness of the Department of General Services' (General Services) capital outlay project management fees. We evaluated General Services' estimates of fees it charges departments for capital outlay and telecommunications projects—which generated three-quarters of General Services' project management fees during fiscal year 2001–02—and concluded that improvements can be made. Specifically, we found:

Finding #1: Some units do not always follow best practices or their own procedures when estimating project costs and fees.

Although units within General Services' Real Estate Services Division (Real Estate Services) and Office of Public Safety Radio Services (Radio Services) do well with certain aspects of estimating costs and fees for capital outlay and radio equipment installation projects, they do not always follow the best practices we identified or their own procedures. Specifically, staff were unable to provide us with documentation to demonstrate how the estimators derived the estimated cost for all line items for eight of the 10 projects we reviewed. In addition, Radio Services could not always demonstrate that its project estimates received either client or supervisory approval. The lack of client approval for two projects may lead to Radio Services absorbing \$93,000 of the projects' costs. Moreover, these units are not consistently using multiple cost estimating approaches—along with historical data—when preparing estimates and are not conducting end-of-project reviews to evaluate the success of their estimates. We also found that Radio Services had not compared actual results to the estimates it generated using an estimating tool. As a result of these deficiencies, General Services cannot ensure that fees charged to client departments for these services are reasonable and fair. Further, the significant variances we found in project

estimates and line item estimates—many exceeding actual costs by more than 20 percent—further support the need to follow best practices when estimating fees.

To ensure that its estimates of project costs and fees are accurate and defensible and to improve the reliability of its process for estimating project costs, we recommended that General Services employ the following best practices:

- Adopt and follow a procedure to thoroughly document assumptions used in creating project estimates.
- Document evidence of supervisory and client review and approval and, if needed, develop a process for expedited client approval when clients of Radio Services insist that projects start immediately.
- Conduct evaluations at the end of each major project.
- Develop a historical database of completed projects and use the database to provide support for future estimated project costs for all major projects.
- Use multiple cost-estimating approaches for all significant line item estimates of major projects.
- Periodically review the performance of its cost-estimating tools against actual results and update the tools when necessary.

General Services' Action: Partial corrective action taken.

General Services agrees with the elements of best practices identified in our report and is striving to implement processes that include those practices. Specifically, General Services states that both Real Estate Services and Radio Services now require staff to document assumptions used to prepare fee and project estimates, along with the supervisory approval of these estimates. However, Radio Services continues to begin work on telecommunications projects before clients approve the costs, but does require that clients put their requests to start work on projects without approved costs in writing. While Real Estate Services indicates it has taken steps to better evaluate the estimates for completion projects, Radio Services believes that it is unable to perform in-depth post-evaluations of all major telecommunications

projects until it implements a new system known as the Automated Enterprise Support and Oversight Product system. This system will integrate Radio Services' existing automated and manual systems to allow for better management of its business practices. Because Radio Services does not expect to award a contract to develop this system until January 2004, it modified existing systems to include more relevant budget and cost information for staff to use when making estimates. Finally, General Services states that as more historical cost information becomes available, both Real Estate Services and Radio Services will be able to use additional cost estimating approaches.

Finding #2: Reports used to determine client hourly rates do not always reflect actual costs and Fiscal Services does not always allocate its overhead fairly.

Although General Services' process for developing the hourly rates of staff—which are the basis of many fee estimates—appears reasonable, it can improve the accuracy of a report that management uses to decide on the hourly rates. Units that provide services—with the assistance of General Services' Office of Fiscal Services (Fiscal Services)—provide management a report to allow it to make the decisions on hourly rates. The report recommends hourly rates for each type of service and is designed to include the at-cost rate for each service, which is calculated by dividing projected costs by the projected billable hours. However, we found that Radio Services' staff made \$10.2 million in arbitrary or unsupported adjustments, such as shifting costs between units when calculating its at-cost rate. In addition, Fiscal Services allocated its overhead—which amounted to \$7.6 million for fiscal year 2001–02—to units based partly on the units' ability to absorb the costs rather than on actual services provided. Although some of these adjustments may be justified, staff told us that some of the adjustments were made to achieve hourly rates similar to the prior-year rates. This preliminary “leveling” process distorts the picture that management sees when making rate decisions, and may lead to setting rates inappropriate to recover actual unit costs. In addition, some adjustments cause other units within General Services to shoulder more than their fair share of costs.

To ensure that the reports General Services uses in setting hourly rates reflect the true projected cost for each unit, we recommended that it require units to include in their

cost-recovery proposals the actual, unadjusted, at-cost hourly rate and clearly document the existence of and retain support for any adjustments designed to achieve a desired or recommended hourly rate. Also, to improve its method of allocating overhead and to make the process more objective, Fiscal Services should consider using another method to allocate its overhead costs to other units, such as using an average of two or three years' actual costs per unit.

General Services' Action: Corrective action taken.

General Services stated that as a part of its annual financial plan process, its executive management team will be provided at-cost rates as well as various other rate scenarios that will impact an operating unit's ability to be financially solvent and avoid rate volatility. In addition, Radio Services now requires that staff retain all documents and data to support adjustments to hourly rate calculations. Finally, Fiscal Services has revised its method of allocating its overhead costs to other General Services' units to be based on the average actual cost of services provided to each unit from the most recent three fiscal years.

Finding #3: Radio Services can improve its methods for assessing consulting fees related to system services and can improve its billing practices.

In addition to installing and maintaining telecommunications equipment, Radio Services provides consulting services such as preparing cost studies, developing reports, attending client meetings, and common services such as Federal Communication Commission (FCC) license renewals, representing the State before the FCC, and developing equipment specifications. However, we could not determine whether the consulting fees that Radio Services charges to client departments were reasonable and fair because of weaknesses in its cost accounting system. Further, we also found that Radio Services does not review for errors in invoices before they are sent to departments but instead it relies upon departments to detect billing errors. In one instance, the lack of review resulted in an under billing of \$126,000 to a department. Compounding the problem is that Radio Services' invoices generally contain insufficient detail to allow departments to detect billing errors.

To improve the reliability and accuracy of its client fees, we recommended that Radio Services improve its cost accounting system so that it can ensure billings to client departments are reasonable and fair. In addition, we recommended that Radio Services review the accuracy of all invoices and continue its efforts to provide its clients with an adequate amount of invoice detail for them to review the accuracy of charges.

Radio Services' Action: Partial corrective action taken.

Radio Services reports that it has improved the controls over how staff charges time to client departments and strengthened the procedures for reviewing client invoices. In addition, for departments that request to be billed an annual fixed amount for services, Radio Services now bases these invoices on a three-year average of past costs to provide these services. However, Radio Services believes that it cannot provide client departments additional invoice detail to review the accuracy of charges until after it implements the Automated Enterprise Support and Oversight Product system. As mentioned previously, Radio Services does not expect to award a contract to develop this system until January 2004.

