

Audit Report



February 2010

Bid to Goal

Efficiencies Have Been
Achieved, but
Improvements Are
Needed in
Documentation,
Management, and
Internal Review of the
Program

This Page Intentionally Left Blank



THE CITY OF SAN DIEGO

February 2, 2010

Honorable Mayor, City Council, and Audit Committee Members
City of San Diego, California

Transmitted herewith is an audit report on the Public Utilities Department Bid to Goal Program. This audit found that efficiencies have been achieved, but improvements are needed in documentation, management and internal review of the program. This report is in accordance with City Charter Section 39.2. Management's response to our audit recommendations can be found in appendix III on page 49 of the report.

If you need any further information please let me know. We would like to thank the Public Utilities Department staff for their assistance and cooperation during this audit. All of their valuable time and efforts spent on providing us information is greatly appreciated. The audit staff responsible for this report are Erin Noel, Toufic Tabshouri, and Kyle Elser.

Respectfully submitted,

Eduardo Luna
City Auditor

- cc: Jay M. Goldstone, Chief Operating Officer
Wally Hill, Assistant Chief Operating Officer
Mary Lewis, Chief Financial Officer
Ken Whitfield, City Comptroller
Jim Barrett, Public Utilities Director
Jim Fisher, Assistant Department Director
Alex Ruiz, Assistant Department Director
Ann Sasaki, Assistant Department Director
Tom Crane, Program Manager
Andrea Tevlin, Independent Budget Analyst
Jan Goldsmith, City Attorney



This Page Intentionally Left Blank

Contents

Introduction	1
Background	1
Objectives, Scope, and Methodology	4
Results in Brief	6
Audit Results	11
Two of Five B2G Programs' Employee Bids Exceeded Industry Benchmarks and Department Lacks Accurate B2G Documentation Which Made It Challenging to Assess the Program	11
Efficiencies Have Been Achieved, but Are Also Attributable to Other Factors and Improvements Are Needed to Better Manage Program	15
Goals Have Improved and Administrative Provisions for Gainsharing Have Been Met, but Department Lacks a System for Involving All Levels of Employees	32
Discrepancies Have Occurred in Savings Calculations and Goal Achievement Due to Department's Lack of Detailed Guidance and Internal Controls	35
Conclusions	41
Recommendations	41
Appendices	
Appendix I: Survey of Public Utilities Department Deputy Directors	43
Appendix II: Public Utilities Department's Recommended Out-of-Scope and In-Scope Items	46
Appendix III: Management's Response to Audit Recommendations	49
OCA Contacts	64

Tables

Table 1: B2G Savings for Applicable Fiscal Years 2005-2008	13
Table 2: Number of Water and Wastewater Budgeted Positions, Fiscal Years 2005-2008	17
Table 3: Administrative Time Spent on the B2G Program, Fiscal Year 2009	25
Table 4: Number of Employees Receiving and Not Eligible to Receive B2G and Pay for Performance Payouts, Fiscal Years 2005-2008	29
Table 5: Total B2G and Pay for Performance Payouts Made in Fiscal Years 2006-2009	31
Table 6: Public Utilities Department Divisions Have Met Best Practices for Operating and Administrative Provisions of Gainsharing	33
Table 7: Differences in Calculated and External Audited Savings by Department/Division, Fiscal Years 2005-2008	37
Table 8: Discrepancies in Water and Wastewater Divisions Achievement of Performance Goals, Fiscal Years 2005-2008	39

Figures

Figure 1: Water Department Budget, Fiscal Years 2005-2008	16
Figure 2: Wastewater Budget, Fiscal Years 2005-2008	17
Figure 3: Reduction in Sanitary Sewer Overflows, Calendar Years 2000-2009	18
Figure 4: Savings in Treated Water Costs, Fiscal Years 2005-2009	19
Figure 5: Wastewater Department: Average Annual Percentage of Savings to Ratepayers, Fiscal Years 1998-2008	20
Figure 6: Water Department: Average Annual Percentage of Savings to Ratepayers, Fiscal Years 2005-2008	20
Figure 7: Major Events and Milestones for Water, Wastewater, and B2G, 1995-2009	22-23
Figure 8: Total Water and Wastewater EEIR Expenditures (excluding payouts) by Type, Fiscal Years 2005-2008	27
Figure 9: Steps for Calculating B2G Savings	36
Figure 10: Total Differences in Calculated and Audited Savings for all B2G Programs, Fiscal Years 2005-2008	38

Abbreviations

AMRIS	Accounting Management Resource Information System
B2G	Bid to Goal
EEIR	Employee Efficiency Incentive Reserve
EPA	Environmental Protection Agency
FTE	Full time equivalent
ISO	International Standards Organization

Introduction

In accordance with the City Auditor’s Annual Risk Assessment and Audit Work Plan for Fiscal Year 2010 and in response to a request from Audit Committee Chairman Kevin Faulconer and City Council Member Carl DeMaio, we conducted a performance audit of the Bid to Goal (B2G) program within the Public Utilities Department. We conducted our review from August 2009 to January 2010 and limited our work to those areas specified in the Objectives, Scope, and Methodology section of this report. 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. We also evaluated the internal controls related to our audit objectives. Our conclusions on the effectiveness of these controls are detailed within the following audit results.

The Office of the City Auditor thanks Department staff for their assistance and cooperation during this audit. All of their valuable time and efforts spent on providing us information are greatly appreciated.

Background

Public sector organizations in the 21st century are confronted with complex challenges, competing demands, and limited resources. As San Diego continues to deal with unprecedented budgetary and resource pressures—evidenced by the Mayor’s and City Council’s recent efforts to balance the budget, for example, by reducing discretionary spending by 27 percent and 6 percent reduction citywide in employee pay—it is critical for officials to continually seek more effective approaches to incentivize workers, optimize operations, and ensure that services are provided as efficiently as possible. Water and wastewater utilities, in particular, often face a combination of financial, regulatory, and operational challenges. Much of the nation’s infrastructure for the supply, treatment, and distribution of water and wastewater was built 100 or more years ago and is in need of repair and replacement. In addition, population growth in many areas, including San Diego, requires the expansion of water and wastewater systems to meet growing needs of consumers. Decisions for allocating resources for the needed infrastructure repair and replacement are made in the context of limited or shrinking city budgets. The resulting backlog of deferred maintenance on water and wastewater systems has caused problems—such as sewer spills into oceans and rivers—resulting in increased oversight, regulatory guidance, and fines by agencies such as the Environmental Protection Agency (EPA) and California Regional Water Quality Control Board.

During the late 1990s, the privatization of water and wastewater systems became a politically appealing alternative as private companies offered proposals to minimize rate increases, expedite long-delayed maintenance, provide capital for system expansion, and meet increasing water quality standards. During this time, San Diego's Water and Wastewater Departments faced public and political pressures based on financial challenges, performance issues, and violations of the Clean Water Act. In addition, San Diego's Mayor, Susan Golding, was a proponent of managed competition—a form of privatization where both private sector companies and current employees of the utility provide a bid for the contract. Following the Zero-Based Management Reviews of water and wastewater operations,¹ which identified ineffective management and cost controls, among other things, the Wastewater Department piloted the B2G program in fiscal year 1998 in the Treatment and Disposal Division (formerly Operations and Maintenance). The intent of the program was to promote optimization and change by combining the best features of the public and private sectors, including retaining public ownership of valuable infrastructure, such as sewer pipelines and wastewater treatment plants, while incorporating competitive private sector benchmarks provided by a third party contractor. B2G includes elements of a managed competition whereby employees compete with the private sector benchmark and a gainsharing incentive program to motivate employees to achieve cost savings and performance goals. B2G was subsequently initiated in the Wastewater Department's Collection Division in fiscal year 2002 and the Water Department's (1) Operations Division in 2005 and (2) Customer Support Division in 2007. The Wastewater Department combined existing B2G programs and expanded the program department-wide in fiscal year 2008. Although wastewater and water functions were merged into the Public Utilities Department in 2009, the funds operate separate B2G contracts. The Department currently has two B2G programs—the Wastewater Fund B2G Program is currently in the third year of a five-year contract (fiscal years 2008 through 2012) and the Water Customer Support Division is in the fourth year of a five-year contract (fiscal years 2007 through 2011). The Water Operations B2G contract expired in fiscal year 2009; however, the Public Utilities Department is in the process of developing a new contract—the Water Fund B2G Program—which is intended to incorporate all eligible water employees.²

The B2G program has evolved over the years and currently incorporates both a bid process and a gainsharing incentive program—previously known as Pay for Performance. The purpose of the bid process is to have the organization compete with a benchmark established by a private contractor. The bid process, which is done about every five years, begins when managers and employees develop a statement of work to identify, in contractual terms, the work requirements and service levels to provide the San Diego metropolitan area with water and wastewater services. Based on the statement of work and industry data, the private contractor—in the past this has been HDR Engineering—provides a private market

¹ Nonprofit Management Solutions, *Zero-Based Management Review of the Water Utilities Department* (San Diego, CA: June 1996) and Nonprofit Management Solutions, *Zero-Based Management Review of the Metropolitan Wastewater Department* (San Diego, CA: June 1997).

² The Public Utilities Department's Business Support Branch includes employees paid from both the water and wastewater budgets who are covered by the respective B2G programs. The new Water Fund B2G Program is intended to also incorporate the former Water Customer Support Division's B2G contract which began in fiscal year 2007.

proposal to establish the benchmark cost for the private sector to provide these services.³ Department management uses industry benchmark costs from the private market proposal to identify cost savings and efficiencies to develop the employee bid—also known as the Most Efficient Organization.⁴ Department management and the Labor-Management Partnership, which includes employees and labor union representatives, develop a memorandum of understanding to establish guidelines and a contract for the employee bid, which must be approved by the Mayor and City Council. The Department identifies savings as being achieved when actual operating costs are less than the employee bid. Generally, half of the savings remains in the appropriate operating fund—either water or wastewater—providing a benefit to ratepayers, and the other half is used for an employee assurance fund, also known as the Employee Efficiency Incentive Reserve (EEIR).⁵ The Labor-Management Committee recommends and the Department Director approves how to use EEIR funds. Funds are used (1) for division-wide employee payouts or bonuses to eligible employees in sections that achieve their gainsharing goals;⁶ (2) for new technologies, equipment, and training; and (3) as credits in subsequent years when savings are not sufficient.

B2G also includes a gainsharing incentive program. Gainsharing programs generally incentivize groups of employees to improve performance through better use of labor, capital, and resources. Part of the resulting savings from increased efficiencies and performance gains are shared with employees in the form of a bonus based on group rather than individual performance. The Department's gainsharing incentive program has evolved from previous water and wastewater Pay for Performance incentive programs and includes the establishment of annual performance or gainsharing goals which must be achieved in order for employees to receive payouts. In recognition of gainsharing's team focus, all individual payout shares are equal, without regard to seniority or classification. Individual payouts are prorated based on the proportion of time an employee has worked with a unit and percentage of gainsharing goals that the unit has achieved. Eligible employees could potentially receive a maximum of \$3,000 and \$1,000 (net of taxes⁷) for achieving department-wide B2G goals and Pay for Performance goals, respectively. For fiscal year 2010, the Wastewater B2G Program and Water Fund B2G proposal include department-wide core service levels which include essential services. If these core service levels are not achieved, savings will be decremented by 10 percent per goal. The Wastewater B2G Program and Water Fund B2G proposal have also developed unit-wide gainsharing goals that must be achieved in order to receive payouts. Maximum payouts under the combined program are \$4,000 (net of taxes) per

³ Prior to fiscal year 2005, there was no standard terminology for the private market proposal and it was called a "mock" bid, among other things. The contract for the third party consultant has been competed at least twice for the Wastewater Department and once for the Water Department. HDR Engineering has always been awarded the contracts except for the fiscal year 2000 Wastewater contract awarded to RW Beck. HDR Engineering was the only company that put in a proposal for the most recent Water Fund B2G Program contract in fiscal year 2008.

⁴ The employee bid also became known as the Most Efficient Organization—a term adopted when the Wastewater Department underwent business process reengineering in 2006.

⁵ The EEIR is capped at \$10 million for each of the two funds—water and wastewater—and at \$2.197 million for the Water Customer Support B2G program.

⁶ Eligibility for payouts is based on the amount of time an employee worked within a division or section and other factors, such as whether disciplinary action has been taken against an employee. Unclassified employees, such as Department managers, are not eligible for payouts.

⁷ Net amounts do not include federal and state taxes.

employee. The calculated savings and performance goal verification are audited by an external auditor before payouts are made.⁸

Objectives, Scope, and Methodology

To improve oversight and ensure that City programs are effective and efficient, Audit Committee Chairman Kevin Faulconer and City Council Member Carl DeMaio requested that we review the B2G programs within the Public Utilities Department. Our objectives were to determine the extent to which (1) the departments/divisions employee bids are competitive with private sector benchmarks; (2) the departments/divisions have achieved savings and efficiencies and are effectively managing the program; (3) management is involving employees in establishing challenging and measurable gainsharing goals; and (4) management is providing review and oversight over the program.

In conducting this review, we focused our scope on the B2G and Pay for Performance programs within the Wastewater Department's Treatment and Disposal (formerly Operations and Maintenance) and Wastewater Collection Divisions and the Water Department's Operations and Customer Support Divisions for applicable fiscal years 2005 through 2008. This also included a historical review of the development of the Pay for Performance program in 1997 and B2G program in 1998. We also assessed the extent to which of the Water Fund B2G proposal meets best practices for administrative and operational provisions of gainsharing. To determine the extent to which divisions have achieved efficiencies below industry benchmarks and improved the efficiency and effectiveness of operations, we reviewed the bid process documents for each B2G contract, including the statement of work, private market proposal, memorandum of understanding and employee bid; evaluated compliance with contracts; assessed the department's budget and staffing data; and reviewed performance metrics over applicable fiscal years. We also interviewed Department managers and employees involved in developing and administering the program and an HDR Engineering representative who have developed recent private market proposals.

To determine the extent to which the Department is effectively managing the program, we reviewed federal guidance for the competition of public services and applied these criteria to various aspects of the bid process. To determine the extent to which the gainsharing incentive program serves as an effective performance management system, we identified best practices for performance management and evaluated a sampling of water and wastewater gainsharing goals for fiscal years 2008 through 2010 against departmental guidance to determine compliance and levels of improvement. We also conducted a survey of the Department's deputy directors to assess the process for including employees in the

⁸ AKT (formerly GLT) has been the external auditor for water and wastewater B2G programs since fiscal year 2005. The City Auditor and Comptroller's Office provided this function prior to this time.

development of goals; motivating and communicating with employees; tracking goals, measuring success, rewarding employees; and using performance information to manage the divisions. The survey questionnaire can be found in appendix I. We also evaluated the results of external audits of savings and performance goal verification for fiscal years 2005-2008, developed a database to analyze these findings, and interviewed an AKT representative. To determine the extent to which savings calculations are meeting departmental guidelines or industry best practices and how the savings are being used by the department, we reviewed annual performance reports, cost savings calculations, and interviewed Department officials.

Results in Brief

Two of five B2G programs' employee bids we reviewed for fiscal years 2005 through 2008 exceeded industry benchmarks, and the Public Utilities Department lacks accurate B2G documentation which made it challenging for us to assess the program. The intent of the B2G program is to (1) meet or exceed industry benchmarks provided by a third party contractor and (2) achieve savings which are calculated by subtracting the departments/divisions' actual costs from the employee bid amount.⁹ It is important for the Department's employee bid to be less than the private sector benchmark, because it sets the initial bid target and reflects total costs associated with a more efficient and competitive organization. Department officials told us that for the first year of the contract, the employee bid must be at or below the private sector benchmark or have justification as to why it is higher. We found that employee bids were less than industry benchmarks in three of the five B2G programs we reviewed. For example, in fiscal year 2008, the Wastewater Department's employee bid was less than the benchmark by about 6.7 percent.¹⁰ However, employee bids for two of the five programs we reviewed—the Water Operations Division and Wastewater Treatment and Disposal Division¹¹—exceeded the private sector benchmark for each year of the B2G contract. For example, the Water Operations Division's bid was about \$60.5 million for fiscal year 2005, exceeding the private market proposal benchmark of \$55.2 million by about \$5.3 million. This occurred because some private market proposals, such as for the Water Operations Division, only include an industry benchmark for the first year of their five-year B2G contracts and a lag time sometimes occurs between when the private sector benchmark and the employee bid are prepared. For example, the Water Operations Division's private market proposal was done in fiscal year 2003 for a B2G program that began in fiscal year 2005. The Water Department made adjustments to the employee bid, such as inflating the bid to fiscal year 2005 dollars; however, no similar adjustments were made to the private sector benchmark. Because of the way that savings are calculated, this differential between the private sector benchmark and employee bid had no effect on savings or the resulting payouts. According to Public Utilities Department officials, the B2G program design does not call for adjusting the private sector benchmark for inflation in the same way as the employee bid annual adjustments, because once the employee bid is adopted, it becomes the relevant benchmark for determining savings. Without obtaining a private sector benchmark every 5 years and providing a benchmark which is comparable with the employee bid for at least the first year of the contract, the bid process is neither transparent nor auditable and the Department cannot establish that its bid was competitive.

⁹ Metropolitan Wastewater Department, *Memorandum of Understanding: Labor-Management Partnership Bid to Goal Public Contract Operations Agreement* (San Diego, CA: Oct. 29, 2007); Water Customer Support Division, *Bid to Goal Memorandum of Understanding* (San Diego, CA: June 26, 2006); Public Utilities Department, *Draft Memorandum of Understanding: Water Enterprise Fund Bid to Goal Public Contract Operations Agreement* (San Diego, CA: Dec. 27, 2009).

¹⁰ The Wastewater Department combined existing B2G programs (Wastewater Collection and Treatment and Disposal) and expanded the program to department-wide in fiscal year 2008.

¹¹ The Wastewater Operations and Maintenance Division became the Treatment and Disposal Division in fiscal year 2007.

We faced challenges in obtaining accurate and complete data and documentation on the B2G program, because (1) there has been no central source in the Public Utilities Department with this information and (2) the departments/divisions generally have not maintained updated and complete historical information on the program. The external auditor has recommended each year since fiscal year 2005 that the departments/divisions reconcile financial information in their annual reports or establish a system to ensure the accuracy of annual performance reports and this has still not occurred.¹² Further, we faced challenges in assessing the program because the department does not track or maintain accurate records on several aspects of the program, such as administrative costs and payouts, which are addressed throughout this report. Department officials told us that they are establishing a central office for B2G documentation which will improve the accuracy of financial data. Without an accurate historical record of B2G, the transparency, auditability, and credibility of B2G will be affected and Department management and other stakeholders will be deprived of a key source of information upon which to base future assessments of the program. We are recommending that the Department solicit the development of a private sector benchmark at least every five years and ensure that the benchmark is comparable with the employee bid for at least the first year of the contract; establish a central location for B2G documentation and a core of employees with knowledge of the program; ensure that accurate and updated records are maintained that will allow the results of the program to be easily reviewed, including reconciling financial data in the annual performance report; and include previous years' annual reports on the Department's website to maintain a public, historical record of the program.

The departments/divisions have achieved savings and efficiencies, but these are also attributable to other factors and improvements are needed to better manage the program. The intent of the B2G program is to motivate employees to operate water and wastewater systems more efficiently, effectively, and competitively while providing economic benefits to the ratepayers. The Department defines savings as being achieved when the departments'/divisions' actual costs are less than the employee bid amount. We found that the departments/divisions have achieved actual costs below the employee bid for fiscal years 2005 through 2008 with a total savings of about \$116.2 million. In addition, the departments/divisions have generally improved performance since the program was established, for example, the Wastewater Department reduced sanitary sewer overflows by 81 percent from 365 in calendar year 2000 to 69 in calendar year 2009. However, B2G has been closely linked with other systems and efforts, such as Business Process Reengineering and Environmental Management Systems, which encouraged employees to find new and better ways to perform. We conclude that efficiencies would have occurred to some extent through other efforts. Further, the Water and Wastewater Departments' close linkage between B2G and the other efforts made it difficult to directly attribute efficiencies to any one specific program.

¹² This includes nine recommendations for audits of fiscal years 2004 through 2008 made to at least one participating department/division in each year. Later in this report, we discuss the issue of repeat findings identified by the external auditor, because the departments/divisions lack a system for implementing recommendations.

We identified four areas where improvements are needed for managing the B2G program.

- Roles and responsibilities in the bid process for the departments/divisions and the contractor are not clearly defined and distinct. For example, in addition to providing a private market proposal or industry benchmark, the Wastewater Department has used HDR Engineering to assist in tasks that would be performed within the department during a competitive process—such as developing the statement of work, employee bid, and calculating savings—which affects the transparency and credibility of the process.
- The administrative time and costs for B2G are not tracked. A Department official told us that requirements for tracking administrative costs are included in the draft memorandum of understanding for the proposed Water Fund B2G Program, but the Department has not developed a method for effectively tracking these costs. Without a system for tracking all administrative time and costs associated with the program, the department cannot fully assess its benefits.
- The departments/divisions lack a dedicated fund in the City’s accounting system for the EEIR and has tracked authorized rather than actual expenditures. Although this information is recorded in the City’s financial system, it is not being collected or analyzed by the Department. This is occurring because the department lacks an effective system for tracking these expenditures. Without such a system, the department will not have a transparent and accurate record of what is being spent on new technologies and efficiencies.
- The departments/divisions B2G and Pay for Performance payouts are not externally audited and records of the total gross payouts and the number of employees receiving payouts have not been maintained. The external auditor, AKT, does not conduct audits of payouts because the Department does not include this function in its contract. In addition, the Department does not maintain a record of final payouts made, because officials believe that the City’s accounting system constitutes the City record; however, we found it challenging to identify accurate payout amounts. Without external audits of payouts, the Department cannot ensure that all employees who received payouts were eligible and resulting payout amounts are accurate. In addition, by not maintaining a record of total payout amounts each year, the total and accurate payout costs to the City are not transparent, particularly for stakeholders who cannot easily access the City’s payroll system and overcome the challenges that we faced in obtaining this information.

We are recommending that the Department (1) clearly identify distinct roles and responsibilities for the bid process; (2) develop a system for accurately tracking administrative costs; (3) develop a process for tracking and reconciling EEIR expenditures and include this information in annual performance reports; and (4) require an external audit of payouts, maintain an accurate record of the audited total gross payout amounts and number of employees receiving payouts, and evaluate whether setting net rather than gross payout caps is the most equitable and appropriate limit.

The Department has improved goals and met the operational and administrative provisions for gainsharing, but lacks a system for involving all levels of employees in developing gainsharing goals.

Departmental guidance establishes that gainsharing goals should incentivize performance above and beyond core service levels and be measurable and auditable. We found that the Department's goal summaries for fiscal year 2010 have more specific descriptions and include more robust information on the goals relevance and justification, making them more measurable than goals in the previous two years. Best practices for performance measurement systems and gainsharing programs establish operating and administrative provisions for gainsharing programs and ascertain that a structured method for involving employees at all levels is critical to the success of a gainsharing program.¹³ We found that the memorandums of understanding for the Wastewater Fund B2G Program and proposed Water Fund B2G Program generally contain such provisions. We surveyed the Department's deputy directors to identify the extent to which they involve employees in developing gainsharing goals and found that they generally rely on supervisors and senior staff to solicit employee input and ideas for gainsharing goals. Five of the 11 deputy directors said that input from employees below this level is limited and largely a function of the (1) employee's individual initiative and interest and (2) extent to which senior staff proactively solicit input.

Employee involvement is voluntary below the supervisory and senior staff level, and the deputy directors reported challenges in engaging all employees in the gainsharing process, ensuring that employees take their responsibility for submitting goals seriously, and avoiding "come to work" goals. Employee representatives who work in the field told us that they would like to be more involved in setting goals because they have the first hand knowledge and expertise on the work to be performed, but that they do not provide input on goals because their ideas have not been implemented in the past. In contrast, supervisory level employee representatives told us that B2G has motivated employees at all levels to work together as a team to achieve goals. Success with employee participation and the establishment of effective goals has varied across divisions and sections, because the Department lacks guidance and a structured process for ensuring that employees at all levels are involved and participation for employees below the senior or supervisory level is voluntary. Department managers told us that a top-down management system is more appropriate for goal setting, because managers have a broader view of the organization's needs and are better equipped to develop stretch goals that are above and beyond core service levels. However, gainsharing programs are generally based on a more inclusive approach where ideas for improving efficiency and effectiveness from front line employees are solicited and valued. Further, management buy in for this approach is required for the program to be successful. The performance goals of an organization are a shared responsibility for all employees—each of whom has a stake in the success of the organization.¹⁴ Without a structured system for involving all levels of employees in the goalsetting process, the Department is missing an opportunity to obtain ideas and input from employees for improving the efficiency and effectiveness of operations and hold these employees accountable and responsible for each performance measure. We are recommending that the Department ensure that gainsharing goals continue to be measurable and auditable and establish a structured system for involving all levels of employees in the goalsetting process, such as encouraging participation on goalsetting teams on a rotational basis.

¹³ National Performance Review, *Best Practices in Performance Management* (Washington, D.C.: June 1997) and Boyett and Boyett, *The Gainsharing Design Manual* (Lincoln, NE: 2004).

¹⁴ National Performance Review, *Best Practices in Performance Management* (Washington, D.C.: June 1997) and Boyett and Boyett, *The Gainsharing Design Manual* (Lincoln, NE: 2004).

The departments/divisions have over- and understated B2G savings. The employee bids establish that, for the purposes of B2G, costs are limited to those associated with core operations and maintenance and direct support functions and exclude out-of-scope costs such as those associated with Capital Improvement Projects. The Wastewater Department provided general guidance in fiscal year 2008 on financial reporting procedures, such as posting the department's approved budget and expenditures, calculating encumbrances, and procedures for out of scope expenses.¹⁵ Based on our review of findings identified during external audits of B2G cost savings, we found that program savings were overstated by \$10,696,448 or about 8.4 percent from fiscal years 2005 through 2008.¹⁶ Discrepancies in reported savings were primarily due to errors with encumbrances¹⁷ and the overstatement or improper inclusion of out-of-scope expenditures. We also found that the departments/divisions have incorrectly reported on gainsharing goal performance in 56 out of an estimated 140 goals tested or 40 percent from fiscal years 2005 through 2008. For example, AKT identified discrepancies due to calculation errors, reliability and measurability issues, and insufficient or inappropriate supporting documentation.

Discrepancies in savings calculations are occurring because the Department lacks: (1) specific guidance and procedures for preparing savings calculations, (2) a process for ensuring that recommendations made by the external auditor are implemented, and (3) an internal control and review process. Internal controls are an integral component of an organization's management and provide reasonable assurance that operations are effective and efficient, financial reporting is reliable, and the organization is complying with applicable laws and regulations.¹⁸ According to Department officials, the Wastewater Department established a B2G team that performed an internal review of savings in fiscal year 2008; however, the variance in savings for that year was \$3,867,310.¹⁹ Recognizing that internal controls are needed, the Department established the Employee Services and Internal Controls Section within the Business Support Branch. While the Department has not developed a plan or processes for specific internal controls for the B2G program, the intent is to use this office to provide internal review and oversight of the program. Without specific and detailed guidance for developing standardized B2G savings calculations and an effective system of internal review and oversight, managers cannot ensure that B2G results are reliable and safeguard the integrity of the program. By not implementing and sharing external auditor recommendations across divisions, the Department is losing an opportunity for lessons learned, risks the continued reoccurrence of these issues, and is not maximizing the benefit of the external auditor's knowledge and experience. We are recommending that the Department develop detailed guidance for savings calculations; procedures for ensuring that recommendations from external audits are implemented; and internal controls for reviewing all aspects of the B2G program.

¹⁵ Metropolitan Wastewater Department, *Bid to Goal Financial Reporting Procedures* (San Diego, CA: 2008).

¹⁶ Note that payouts do not occur until after the external audit of savings and goal achievement.

¹⁷ Encumbrances represent commitments related to unfilled purchase orders or unfilled contracts and serve as a placeholder so that budgeted funds are not spent elsewhere.

¹⁸ Office of Management and Budget, Circular Number A-123 *revised* (Washington, D.C: Dec. 21, 2004), 7.

¹⁹ The total difference was initially \$8,548,949; however, Department management made the decision to adjust the employee bid by removing the Director's Contingency of \$4,681,639 from the savings calculation prior to the submission of the annual report. The contingency had been disallowed by the external auditor for Water Operations for fiscal years 2005 through 2007.

Audit Results

TWO OF FIVE B2G PROGRAMS' EMPLOYEE BIDS EXCEEDED INDUSTRY BENCHMARKS AND DEPARTMENT LACKS ACCURATE B2G DOCUMENTATION WHICH MADE IT CHALLENGING TO ASSESS THE PROGRAM

Two of Five B2G Program's Bid Exceeded Benchmarks

The intent of the B2G program is to (1) meet or exceed industry benchmarks provided by a third party contractor and (2) achieve savings which the Department calculates by subtracting actual costs from the employee bid amount.²⁰ Savings achievements will be discussed in the next section of this report. It is important for the employee bid to be less than the private sector benchmark, because it sets the initial bid target and reflects total costs associated with a more efficient and competitive organization. Department officials told us that for the first year of the B2G contract, the employee bid must be at or below the private sector benchmark or have justification as to why it is higher. We found that employee bids were less than industry benchmarks in three of the five B2G programs we reviewed during fiscal years 2005 through 2008. For example, in fiscal year 2008, the Wastewater Department's employee bid was less than the benchmark by about 6.7 percent (see table 1).²¹ We also found that the employee bids of the Wastewater Collection and Water Customer Service Divisions were less than private sector benchmarks provided in their respective private market proposals in applicable fiscal years 2005 through 2008. For example, the Collection Division averaged about two percent less than the benchmark over fiscal years 2005 through 2007. However, employee bids for two of the five programs we reviewed—the Water Operations and Wastewater Treatment and Disposal Divisions²²—exceeded the private sector benchmark for each year of the B2G contract. For example, the Water Operations Division's employee bid was about \$60.5 million for fiscal year 2005, exceeding the private sector benchmark of \$55.2 million by about \$5.3 million. This occurred because some private market proposals, such as for the Water Operations Division, only include a private sector benchmark for the first year of their five-year B2G contracts and a lag time sometimes occurs between when the private sector benchmark and the employee bid are prepared. For example, the Water Operations Division's private market proposal was done in fiscal year 2003 for a B2G program that began in fiscal year 2005. The Water Department made adjustments to the employee bid--the bid was inflated to fiscal year 2005 dollars (about \$2.3 million) and adjusted for a change in the classification and compensation of field crews (\$1.5 million) and a polyservice replacement program (\$1.1 million); however, no similar adjustments were made to the private sector benchmark. This is also the case with the Wastewater Treatment and Disposal Division—the private sector benchmark figures

²⁰ Metropolitan Wastewater Department, *Memorandum of Understanding: Labor/Management Partnership, Bid to Goal Public Contract Operations Agreement* (San Diego, CA: Oct. 29, 2007); Water Department, *Operations Division Bid to Goal Annual Report for Fiscal Year 2005* (San Diego, CA: 2005); Water Department, *Customer Support Division Bid to Goal Assessment Report* (San Diego, CA: Nov. 30, 2005).

²¹ The Wastewater Department combined existing B2G programs (Wastewater Collection and Treatment and Disposal) and expanded the program department-wide in fiscal year 2008.

²² The Wastewater Operations and Maintenance Division became the Treatment and Disposal Division in fiscal year 2007.

were projected in 2002 dollars and no adjustments were made to them.²³ Because of the way that the Department calculates savings, this differential between the private sector benchmark and employee bid had no effect on savings or the resulting payouts. According to Department officials, the B2G program design does not call for adjusting the private sector benchmark for inflation in the same way as the employee bid annual adjustments, because once the employee bid is adopted, it becomes the relevant benchmark for determining savings. Without providing a private sector benchmark which is comparable with the employee bid for at least the first year of the contract, the process is neither transparent nor auditable and the Department cannot establish that its bid was competitive.

²³ Department management could not provide the original private market proposal for the Wastewater Treatment and Disposal Division which covered fiscal years 1998 and 1999. They did provide another benchmarking report that was prepared in fiscal year 2002. The memorandum of understanding for this B2G program was amended twice extending the contract from fiscal year 2000 through 2003 and then from fiscal year 2004 through 2007.

Table 1: B2G Savings for Applicable Fiscal Years 2005-2008

Program	Fiscal Year			
	2005	2006	2007	2008
Wastewater Treatment and Disposal (formerly Operations and Maintenance)				
Private Sector Benchmark	\$73,791,698 ^a	\$73,639,826 ^a	\$73,639,826 ^a	
Employee Bid	\$86,395,124	\$89,688,147	\$91,411,951	
Actuals	\$75,621,064	\$77,232,112	\$80,620,949	
Savings	\$10,774,060	\$12,456,035	\$10,791,002	
Wastewater Collection				
Private Sector Benchmark	\$41,800,000 ^b	\$43,050,000 ^b	\$44,350,000 ^b	
Employee Bid	\$39,974,644	\$41,295,550	\$41,601,250	
Actuals	\$34,073,834	\$35,459,046	\$37,686,999	
Savings	\$ 5,900,810	\$ 5,836,504	\$ 3,914,251	
Wastewater				
Private Sector Benchmark				\$219,596,075 ^c
Employee Bid				\$207,157,305
Actuals				\$181,866,945
Savings				\$ 25,290,360
Water Operations				
Private Sector Benchmark	\$55,238,000 ^d			
Employee Bid	\$60,489,478	\$62,272,175	\$63,724,000	\$65,809,348
Actuals	\$51,341,755	\$52,412,193	\$53,851,907	\$56,014,991
Savings	\$ 9,147,723	\$ 9,859,982	\$ 9,872,093	\$ 9,794,357
Water Customer Support				
Private Sector Benchmark			\$23,294,000 ^e	\$24,329,000 ^e
Employee Bid			\$22,040,744	\$22,294,020
Actuals			\$21,072,708	\$20,684,068
Savings			\$ 968,036	\$ 1,609,952

Source: Office of the City Auditor’s analysis of Water and Wastewater Department data.

Notes: Shaded areas represent years not applicable for B2G, for example, Water Customer Support started its B2G program in fiscal year 2007 and Wastewater combined its two B2G programs into one department-wide program in fiscal year 2007.

We calculated the “Actuals” by subtracting the audited savings amounts from the Employee Bid.

^a The document with private sector benchmark for the Wastewater Operations and Maintenance Division was done in fiscal year 2002. This is the only available data for comparison purposes.

^b Industry benchmarks were included in the B2G memorandum of understanding for the Wastewater Collection Division for fiscal years 2002 through 2007.

^c The private market proposal for the Wastewater Department was done in fiscal year 2007.

^d The Private market proposal for Water Department’s Operations Division was done in fiscal year 2003 and included a private sector benchmark for 1 year. Note that this figure was not adjusted for inflation or operational changes as was the employee bid. This is the only available data for comparison purposes.

^e The Private market proposal for Water Department’s Customer Support Division was done in fiscal year 2006.

Department officials told us that, as is the case with a true competition, the department does not obtain a private sector benchmark every year, but only for the year the contract is competed. Although it has not been the case in the past, officials told us that, based on lessons learned, the three most recent B2G contracts have required obtaining a private sector benchmark every five years. Without obtaining a private sector benchmark at least every five years, the Department is less likely to ensure that its bids are competitive with the private sector and benefit from new technologies in the industry—which is the intent of the B2G program.

Department Lacks Accurate and Complete B2G Documentation Making it Challenging to Assess Program

Throughout this audit, we faced challenges in obtaining accurate and complete data and documentation on the B2G program, because (1) there has been no central source within the Department with this information and (2) the departments/divisions generally have not maintained updated and complete historical information on the program. The departments'/divisions' memorandums of understanding establish a timeframe for reporting B2G performance results to the Mayor's office and requires that the annual reports include operational and financial standards and actual performance results; explanations for instances where budget or performance goals are not met; and a summary of savings resulting from efficiency gains to be deposited into the employee assurance fund. We reviewed annual performance reports for fiscal years 2005 through 2008 and found that they met the November 30th date for issuing annual performance reports for fiscal year 2008 and include information on core performance and explanations for instances when goals are not met. However, the annual reports do not consistently provide core performance standards, either summaries or details of goal achievement, or information on the status of the assurance fund. More importantly, the reports do not include updated or reconciled financial information following the external audits of cost savings and goal achievement which made it challenging for us to identify audited financial data, such as actual costs. We had difficulty obtaining the annual reports for the program, because the department lacks a centralized source for documents and information on B2G. We recognize that the Water and Wastewater Departments are newly combined into the Public Utilities Department (in July 2009) and previously B2G programs have been managed separately and that several employees with knowledge of the program retired last summer when retirement rules were changed. However, AKT has recommended that the departments/divisions reconcile financial information in their annual reports or establish a system to ensure the accuracy of annual performance reports and supporting schedules in each fiscal year since its audit of the B2G savings for fiscal year 2005.²⁴ Federal guidance on annual performance reports specifies that reports include an assessment by the head of the agency of the completeness and reliability of the data included in it and a table or chart showing historical performance trends for at least five fiscal years.²⁵ Further, we faced challenges in assessing the program because the department does not track or keep accurate records on several aspects of the program, such as administrative costs and payouts, which are addressed throughout

²⁴ This includes nine recommendations for audits of fiscal years 2004 through 2008 made to at least one participating departments/divisions in each year. Later in this report, we discuss the issue of repeat findings identified by the external auditor because the departments/divisions lack a system for implementing recommendations.

²⁵ Office of Management and Budget, *Circular A-136* (Washington, D.C.: Aug. 23, 2005).

this report. Department officials told us that they are establishing a central office for B2G documentation which will improve the accuracy of financial data. Without accurate and consistent information on B2G, the transparency, reliability, and auditability of program results are affected. In addition, Department managers and other stakeholders are deprived of a key source of accurate historical data upon which to base future assessments of the program.

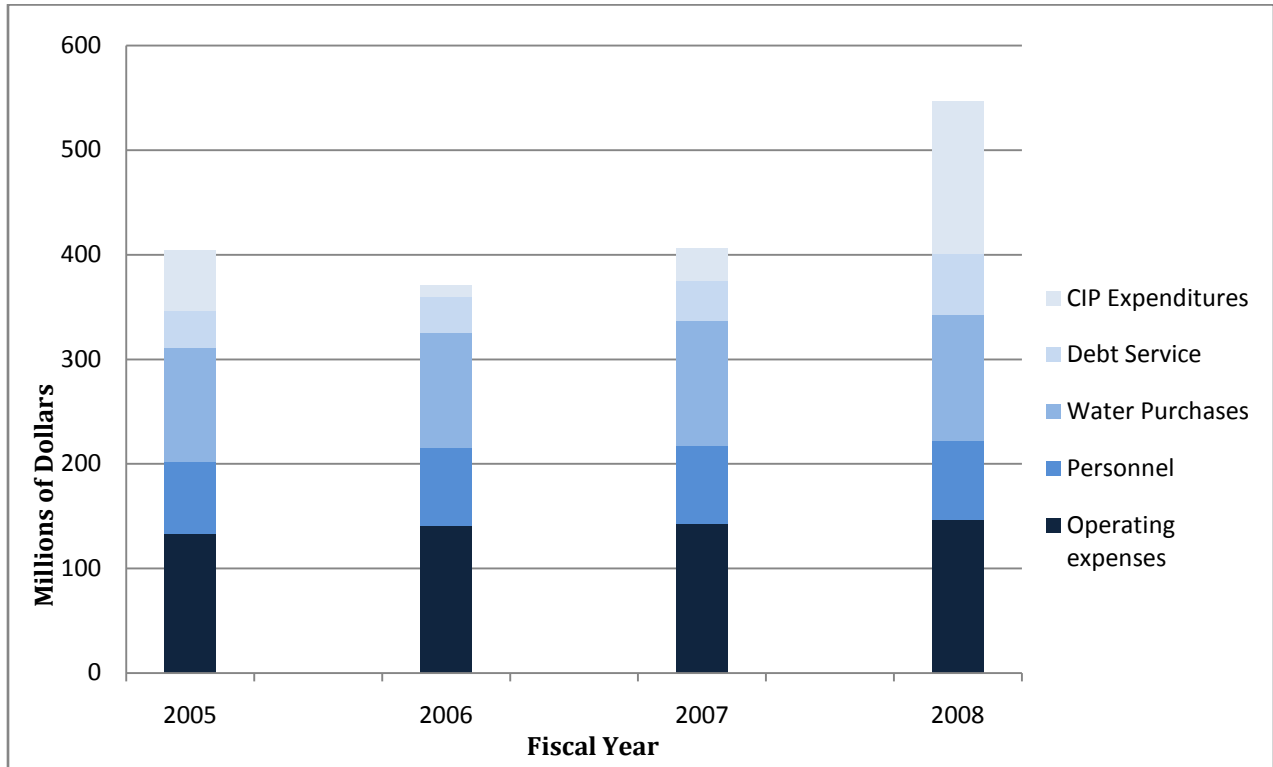
EFFICIENCIES HAVE BEEN ACHIEVED, BUT ARE ALSO ATTRIBUTABLE TO OTHER FACTORS AND IMPROVEMENTS ARE NEEDED TO BETTER MANAGE PROGRAM

Efficiencies Have Been Achieved

The intent of the B2G program is to motivate employees to operate water and wastewater systems more efficiently, effectively, and competitively while providing economic benefits to the ratepayers.²⁶ The Department defines savings as being achieved when the departments'/divisions' actual costs are less than the employee bid amount. For each applicable year for fiscal years 2005 through 2008, all participating departments/divisions have achieved actual costs below the employee bid with audited total savings of about \$116.2 million. The Water and Wastewater Departments' operating expenses remained relatively constant through this time period, despite increases in the cost of imported water and chemicals for treating wastewater (see figures 1 and 2).

²⁶ Metropolitan Wastewater Department, *Memorandum of Understanding: Labor-Management Partnership Bid to Goal Public Contract Operations Agreement* (San Diego, CA: Oct. 29, 2007); Water Customer Support Division, *Bid to Goal Memorandum of Understanding* (San Diego, CA: June 26, 2006); Public Utilities Department, *Draft Memorandum of Understanding: Water Enterprise Fund Bid to Goal Public Contract Operations Agreement* (San Diego, CA: Dec. 27, 2009).

Figure 1: Water Department Budget, Fiscal Years 2005-2008

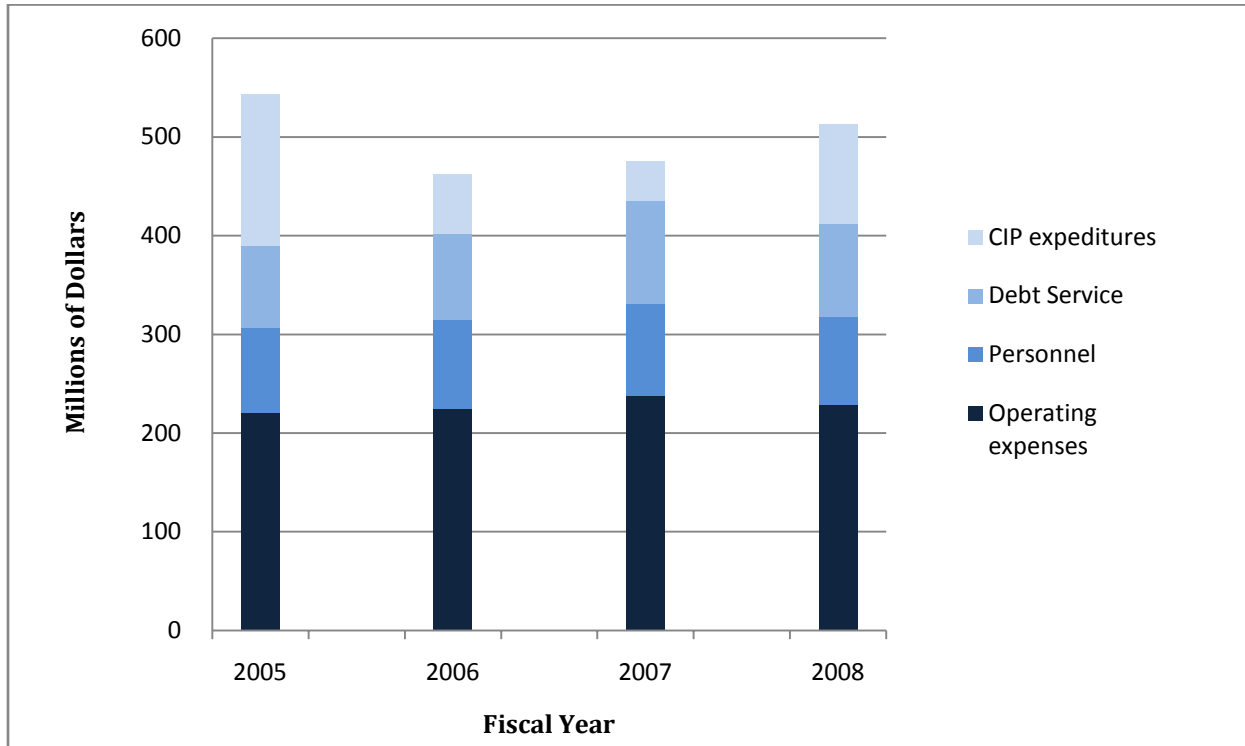


Source: Office of the City Auditor’s analysis of Water Department data.

Notes: Figure excludes certain budget line items such as unallocated reserves and transfers to other funds.

Although debt service is classified as an operating expense in financial statements, we present it separately here.

Figure 2: Wastewater Budget, Fiscal Years 2005-2008



Source: Office of the City Auditor’s analysis of Wastewater Department data.

Note: Figure excludes certain budget line items such as unallocated reserves and transfers to other funds.

Although debt service is classified as an operating expense in financial statements, we present it separately here.

Total staffing levels decreased for both water and wastewater by about eight percent from fiscal years 2005 through 2008. The number of Water and Wastewater Department employees decreased by about one percent and 14 percent, respectively (see table 2).

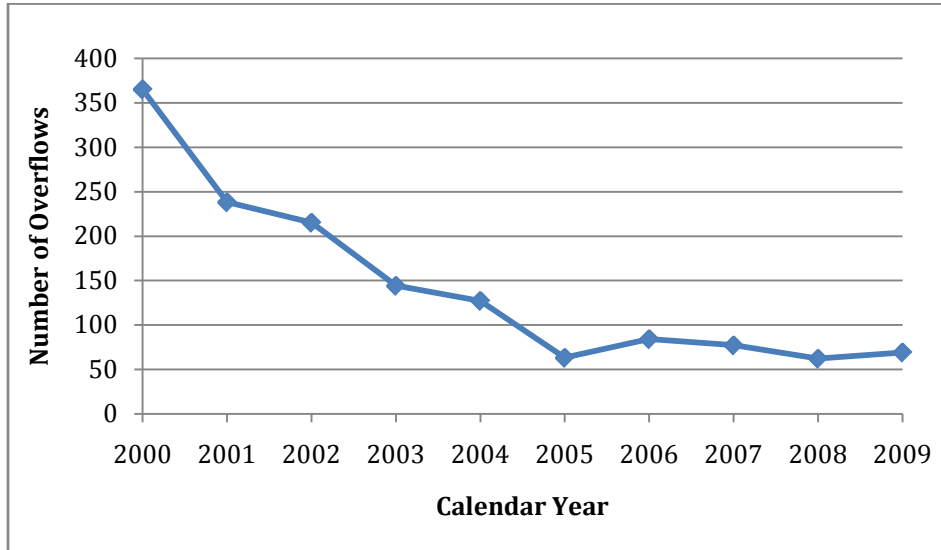
Table 2: Number of Water and Wastewater Budgeted Positions, Fiscal Years 2005-2008

	Fiscal Year			
	2005	2006	2007	2008
Water	858	889	914	851
Wastewater	1,066	1,055	1,052	916
Total	1,924	1,944	1,966	1,767

Source: Office of the City Auditor’s analysis of Water and Wastewater Department data.

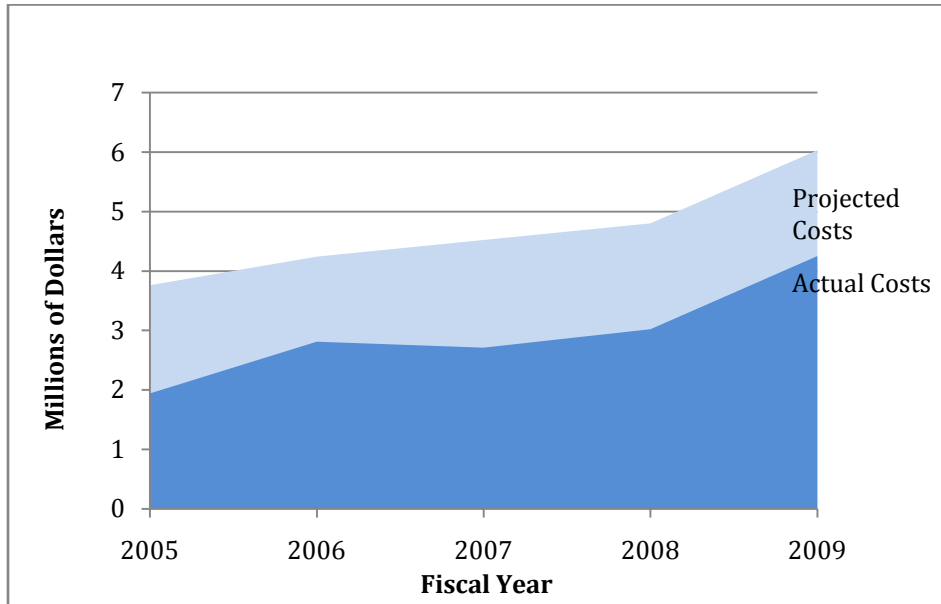
The divisions have generally improved performance since the program was established. For example, the Wastewater Department reduced sanitary sewer overflows by 81 percent from 365 in calendar year 2000 to 69 overflows in calendar year 2009 (see figure 3). In addition, by optimizing the water system so that treated water is used only where it is the most cost-effective option, the Water Department saved \$8.6 million in treated water costs from calendar years 2005 through 2009 (see figure 4).

Figure 3: Reduction in Sanitary Sewer Overflows, Calendar Years 2000-2009



Source: Office of the City Auditor’s analysis of Wastewater Department data.

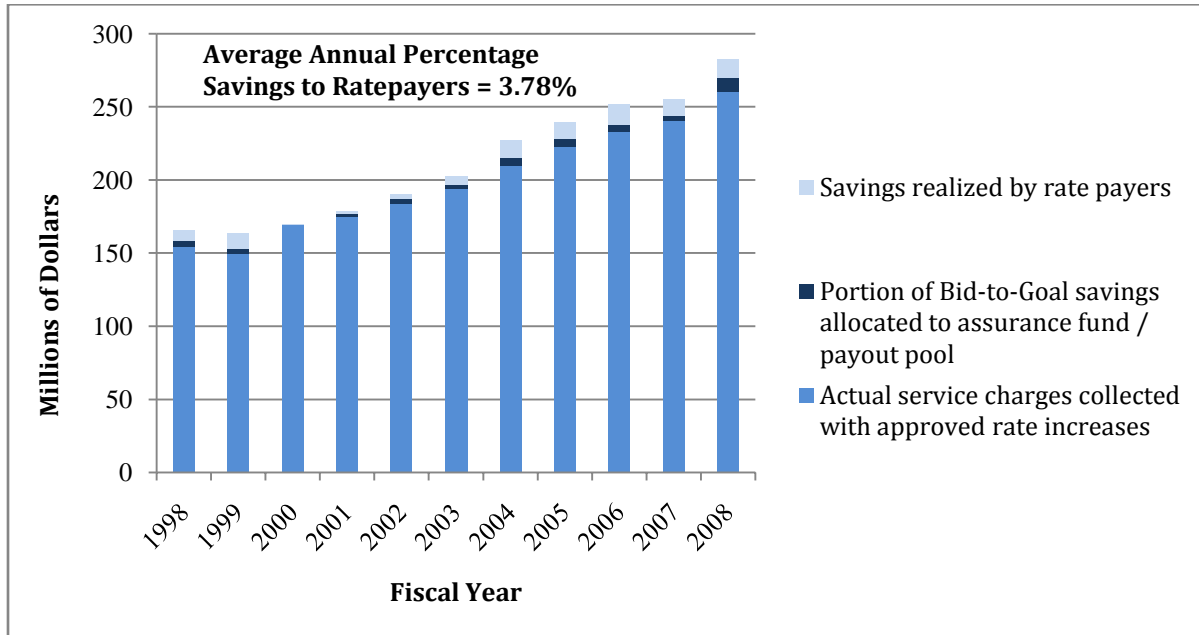
Figure 4: Savings in Treated Water Costs, Fiscal Years 2005-2009



Source: Office of the City Auditor’s analysis of Water Department data.

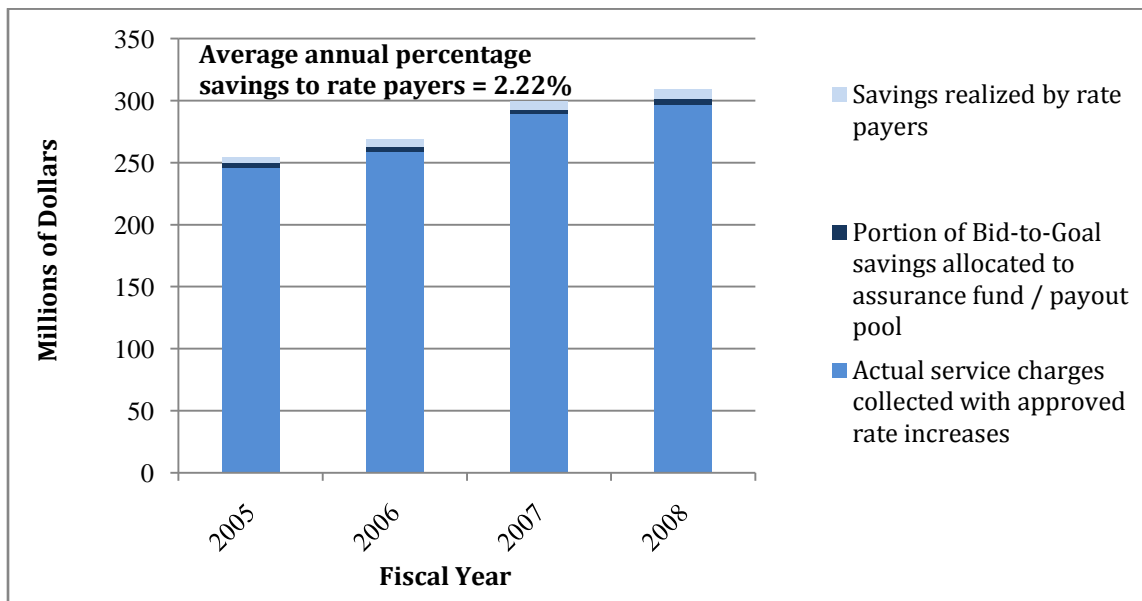
The intent of the B2G program is to achieve efficiencies while providing economic benefits to the ratepayers. According to Department officials, the major benefit to the ratepayers is difficult to measure, because it includes the efficiencies the Department makes to achieve the initial employee bid target. Another, more measurable benefit to the ratepayers is that half of the savings realized (the difference between the employee bid amount and actual costs) remain in the respective water or wastewater fund. While the measurable benefits from B2G to rate payers are small, Department officials told us that the savings and efficiencies achieved by the B2G program have helped to offset larger issues affecting rates, such as the Capital Improvement Program debt service. Based on the Department’s analysis of the impact of the program’s savings on customer rates from fiscal years 1998 through 2008, the average annual savings for wastewater ratepayers was 3.78 percent of the total amount charged to ratepayers (see figure 5). Water ratepayers saved 2.22 percent of the total amount charged from fiscal years 2005 through 2008 (see figure 6). All other savings realized by B2G were allocated to the employee assurance funds.

Figure 5: Wastewater Department: Average Annual Percentage of Savings to Ratepayers, Fiscal Years 1998-2008



Source: Office of the City Auditor’s analysis of Wastewater Department data.

Figure 6: Water Department: Average Annual Percentage of Savings to Ratepayers, Fiscal Years 2005-2008



Source: Office of the City Auditor’s analysis of Water Department data.

Efficiency Improvements Are Also Attributable to Other Factors

B2G has been closely linked with other systems and efforts and gainsharing goals have reflected mandatory requirements which would potentially have yielded significant efficiencies without B2G. (See figure 7.) For example, based on the Wastewater Department's longstanding legal issues with the EPA largely due to violations of the Clean Water Act, EPA issued an Administrative Order in 2002 and a Consent Decree began in 2005 and was finalized in 2007 requiring the cleaning and replacement, rehabilitation, or permanent repair of the city's sewer pipe system. As was EPA's intention, the required cleaning and replacement of the sewer pipes would have reduced sanitary sewer overflows. In addition, throughout this time, the divisions developed standard operating procedures that became formal Environmental Management Systems with International Standards Organization (ISO 14001) Certification.²⁷ These systems encourage employees to find new and better ways to perform tasks and have resulted in measurable benefits. For example, in an Assessment of its ISO 14001 Certification Program, the Wastewater Department reported the measurable and tangible benefits of increasing regulatory compliance and reducing potable water use, solid waste, chemical use, and energy use.²⁸ A former wastewater official told us that B2G was used to motivate employees to achieve these challenging requirements. However, we conclude that efficiencies are likely to have occurred through the new operating procedures adopted for Environmental Management Systems and ISO 14001 Certification and cannot be solely attributed to B2G.

²⁷ Within the Wastewater Department, the Operations and Maintenance Division was the first publically owned wastewater treatment operation in the United States to receive ISO 14001 certification in 1999. The Environmental and Technical Services and the Collection Divisions were ISO 14001 certified in 2002 and 2004, respectively. Metropolitan Wastewater Department, *Assessment of ISO 14001 Certification Program* (San Diego, CA: Sept. 1, 2006). Environmental Protection Agency (prepared by Ross and Associates Environmental Consulting, Ltd.), *Managing for Excellence: Analysis of Water and Wastewater Utility Management Systems* (Washington, D.C.: Aug. 2005), 60-61.

²⁸ Metropolitan Wastewater Department, *Assessment of ISO 14001 Certification Program* (San Diego, CA: Sept. 1, 2006), 4-6.

Figure 7: Major Events and Milestones for Water, Wastewater, and B2G, Calendar Years 1995-2009

Year	Month	Event
1995	November	National Pollutant and Discharge Elimination System permit issued by EPA and California Regional Quality Control Board regulating the operation and maintenance of San Diego's Point Loma Wastewater Treatment Plant.
1996	May	California Regional Water Quality Control Board issues order prohibiting sanitary sewer overflows and establishes reporting requirements.
	June	Zero-Based Management Review of Water Department finds lax management and cost controls and urges the deployment of a strong management team with a finite period for improving management of the department.
1997	January	California Department of Health Services issues compliance order to ensure that the water supplied is at all times pure, wholesome, healthful, and potable.
	June	Zero-Based Management Review of the Wastewater Department finds that process improvements and cost reductions of the clean water program are necessary and suggests improvements to administrative divisions and a reduction in the use of private consultants.
1998	May	Wastewater Department initiates B2G program in its Treatment and Disposal (formerly Operations and Maintenance) Division.
1999	May	Wastewater Operations and Maintenance Division implements Environmental Management System and achieves ISO 14001 certification.
2001	July	Wastewater Department initiates B2G Program in its Wastewater Collection Division.
2002	April	EPA issues Finding of Violation of Clean Water Act and Administrative Order setting forth a comprehensive set of requirements to be met by the City to reduce and eliminate sewage spills.
	June	Wastewater Environmental and Technical Services Division implements Environmental Management System and achieves ISO 14001 certification.
2003	December	Wastewater Collection Division implements Environmental Management System and achieves ISO 14001 certification.
2004	July	Water Department initiates B2G program in its Operations Division.
2005	May	First Partial Consent Decree (EPA, Baykeeper, and Surfrider v. City of San Diego) requires the City to inspect, rehabilitate, and replace portions of the sewer system; control root problems; clean a specific amount of pipe; and implement a grease blockage control program.

Year	Month	Event
2006	December	Mayor Sanders initiates first Business Process Reengineering study, leading to Citywide program.
	May	California Water Resources Control Board issues Order on general waste discharge and requires consistent statewide approach for reduction of sanitary sewer overflows.
	June	Wastewater Department incorporates citywide Business Process Reengineering with B2G program.
	July	Water Department initiates B2G Program in its Customer Support Division.
	August	Second Partial Consent Decree (EPA, Baykeeper, and Surfrider v. City of San Diego) requires the City to inspect, rehabilitate, and replace portions of the sewer system; control root problems; clean a specific amount of pipe; and implement a grease blockage control program.
2007	July	Final Consent Decree (EPA, Baykeeper, and Surfrider v. City of San Diego) requires the City to inspect, rehabilitate, and replace portions of the sewer system; control root problems; clean a specific amount of pipe; and implement a grease blockage control program.
		Wastewater Department incorporates existing B2G programs (Treatment and Disposal and Collection) into a department-wide Wastewater B2G Program.
2008	September	Water Department initiates successor Water Fund B2G proposal.
2009	July	Water and Wastewater Department are merged into the Public Utilities Department.

Source: Office of the City Auditor's analysis of regulations, requirements, and Department documents.

Further, in 2006 the Wastewater Department incorporated the Mayor's Business Process Reengineering efforts into its existing B2G program, resulting in a reduction of 158.8 full-time equivalent (FTE) positions and about \$20 million in savings. A former wastewater official told us that, while all city departments were required to make FTE reductions due to business process reengineering, the Wastewater Department used B2G to make more informed decisions regarding which positions to cut. We conclude that efficiencies would have occurred to some extent through other efforts. Further, the close linkage between B2G and the other efforts made it difficult to directly and solely attribute efficiencies to any one specific program.

Improvements for Managing the Program Are Needed in Four Areas

Bid Process Roles and Responsibilities Are Not Clear and Distinct

The B2G program is unique because it represents a benchmark competition rather a true competitive process; therefore, we faced challenges in identifying criteria for its structure and procedures. However, we believe that following some of the best practices for competitive bidding will improve the transparency of the program and allow the City to conduct a managed competition for water and wastewater operations if this becomes an option in the future. Office of Management and Budget *Circular A-76* provides a structured process for the competition of public services that defines tasks and deliverables, identifies clear roles and specific responsibilities, and creates a communications firewall between employees involved in preparing contract specifications and those preparing an employee bid.²⁹ We found that the B2G program includes the development of several of the tasks and deliverables outlined in this guidance, such as a statement of work to identify the work requirements for providing services. An HDR Engineering representative told us that B2G has evolved to include the development of separate deliverables, such as the private market proposal and employee bid, to ensure that the bid process is transparent and auditable. However, roles and responsibilities for the Department and the contractor, HDR Engineering, are not clearly defined and distinct. For example, in addition to providing a private market proposal or industry benchmark, the Wastewater Department used HDR Engineering to assist in tasks that would be performed within the department during a competitive process, such as developing the statement of work, employee bid, and calculating savings.³⁰ In addition, HDR Engineering developed a methodology for calculating savings for the Wastewater Collection Division in fiscal year 2005 and performed savings calculations for three years through fiscal year 2007. The Wastewater Department has used HDR Engineering to this extent in order to take advantage of the company's expertise and knowledge, much in the same way that a consultant would be used. Without a clear definition of roles and responsibilities to provide structure to the bid process, it will be less transparent, understandable, and credible to stakeholders outside of the Department.

Administrative Costs Are Not Being Tracked

Organizations need to evaluate resource requirements to ensure that they are allocating resources effectively and to increase the probability of a program's success.³¹ We found that the Wastewater Fund does not have a system in place for tracking the administrative costs for its B2G program, such as employee time spent on developing a statement of work and setting gainsharing goals.³² While the Water Operations Division has a job order number for employees to charge when they spent time on B2G

²⁹ Federal contracting of services currently performed by public employees is carried out in accordance with procedures set forth in the Office of Management and Budget's *Circular A-76*, which establishes federal policy for the competition of commercial activities. Office of Management and Budget, *Circular A-76: Performance of Commercial Activities* (Washington, D.C.: May 29, 2003). Various government groups have examined competitive sourcing practices, such as the Commercial Activities Panel, which issued its report in April 2002. Commercial Activities Panel, *Improving the Sourcing Decisions of the Government* (Washington, D.C. April 2002).

³⁰ According to an HDR Engineering representative, the Water Department did not use HDR Engineering to the same extent as the Wastewater Department.

³¹ Government Accountability Office, *Cost Estimates and Assessment Guide* (Washington, D.C.: March 2009), 6.

³² Note that the third party contractor costs are subtracted from the savings calculation.

activities, officials told us that use of the job order number is not enforced and, therefore the existing data will not be accurate. Department officials had a great deal of difficulty providing administrative cost estimates for the program, largely because employees have other duties not related to B2G. At our request, the Department developed estimates for the total number of staff hours spent on (1) annual program activities—such as setting gainsharing goals, and (2) activities done on a five-year basis—such as developing the statement of work and employee bid for the proposed Water Fund B2G Program. The Department spent 7,203 staff hours or 3.46 FTEs on annual B2G activities for both water and wastewater in fiscal year 2009 (see table 3). During the development of the fiscal year 2010 Water Fund B2G proposal, the Department has spent an estimated 8,485 staff hours or 4.08 FTEs.³³ In addition, the Department will spend an estimated 4,325 hours annually or 2.08 FTEs to administer the program. For the entire five-year contract for the new Water Fund B2G Program, the total administrative time spent will be 29,660 staff hours.³⁴ Wastewater did not provide an estimate for activities done on a 5-year basis, because Department management felt the most recent Water estimate for the 5-year basis would be representative for Wastewater. Note that the most recent wastewater private market proposal and employee bid were done in fiscal year 2007 and 2008, respectively.

Table 3: Administrative Time Spent on the B2G Program, Fiscal Year 2009

	Annual Basis		5-Year Basis	
	Staff hours	FTEs	Staff hours	FTEs
Wastewater	2,878	1.38	<i>Not available</i>	
Water	4,325	2.08	8,485	4.08
Total	7,203	3.46	8,485	4.08

Source: Office of the City Auditor’s analysis of Public Utilities Department data.

According to the U.S. Government Accountability Office, when agencies lack a realistic and objective system for estimating costs, these estimates tend to be too low.³⁵ However, Department officials told us that time expended on B2G in future years is likely to be less due to (1) economies of scale based on the consolidation of the Water and Wastewater Departments, (2) the establishment of program rules and procedures, and (3) no fulltime staff assigned to administer the program.³⁶ A Department official told us that requirements for tracking administrative costs are included in the draft memorandum of understanding for the new Water Fund B2G Program, but the department has not developed a method for effectively tracking these costs. We recognized that the labor costs for employees is an in-scope cost included in the employee bid; however, the time employees spend on B2G activities rather than on their regular duties represents a loss in productivity that is not currently tracked. Without a system for tracking

³³ This includes time spent on the bid process for the Water Fund B2G proposal. Because the Water Customer Support Division’s B2G Program was first adopted for FY2007 and its bid was not duplicated for the FY2010 Program, the staff time spent developing this contract was added to the Water Fund B2G proposal estimation.

³⁴ This includes 4,235 staff hours per year for each of the five years of the contract plus 8,485 staff hours for tasks conducted on a five-year basis.

³⁵ Government Accountability Office, *Cost Estimates and Assessment Guide* (Washington, D.C.: March 2009), 6.

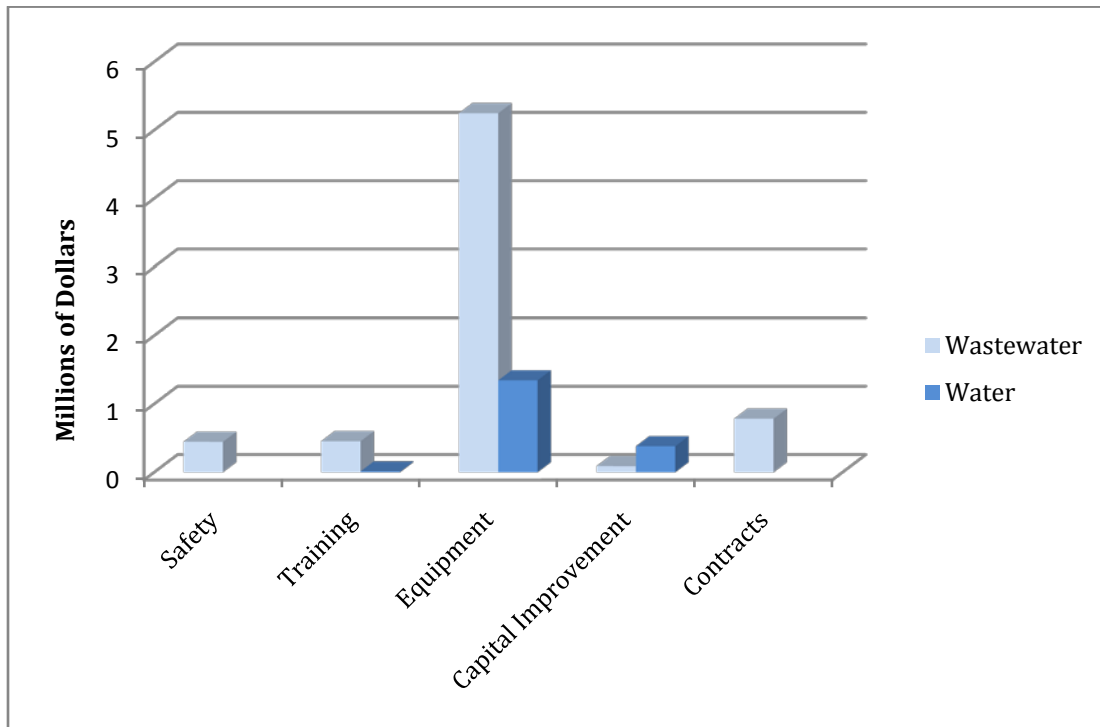
³⁶ According to Department officials, employees involved in B2G administration have ongoing, full-time workloads outside of the program.

all administrative time and costs associated with B2G, the Department cannot fully assess the resources needed or benefits of the program.

EEIR Expenditures Are Consistent with Guidance, but Actual Expenditures Are Not Tracked

The employee assurance fund or EEIR monies have been used (1) for division-wide employee payouts or bonuses to eligible employees in sections that achieve their gainsharing goals; (2) for new technologies, equipment, and training; and (3) as credits in subsequent years when savings are not sufficient. Payouts for employees will be discussed in the following section. The B2G memorandums of understanding provide guidance on allowable expenditures for the EEIR—such as funding purchases of new technology, equipment, training, consultant services—and require that expenditures are recommended by the Labor-Management Committee and authorized by the Department Director. We reviewed a sample of EEIR expenditures for B2G programs for appropriate fiscal years 2005 through 2008 and found that they were properly authorized. The majority of funds, about 77.3 percent for Water (Operations and Customer Support) and 74.7 percent for Wastewater, were spent on the purchase or replacement of equipment (see figure 8). For example, based on employee suggestions, \$17,000 of the Water Operations Division's EEIR was authorized for installing a metering device to provide accurate measures of the effect of chemical treatments on raw water at the Otay Water Treatment Plant. Other expenditures included providing new construction and improvements to buildings, roads, and fixtures; technical training, seminars, and instructional materials for employees; and protective gear and safety training. We believe these expenditures have resulted in increased efficiencies within the departments/divisions.

Figure 8: Total Water and Wastewater EEIR Expenditures (excluding payouts) by Type, Fiscal Years 2005-2008



Source: Office of the City Auditor's analysis of water and wastewater data.

However, we identified two issues with tracking these expenditures. First of all, the departments/divisions lack a dedicated fund in the City's accounting system for the EEIR. EEIR monies remain in the wastewater or water fund until expenditures are recommended by the Labor-Management Committee and authorized by the Department Director. Once authorized, the departments/divisions transfer funds to the appropriate section that will make the purchase. The departments/divisions have attempted to track EEIR expenditures on a general ledger account with a transfer out of monies to cover expenses or purchases. The Wastewater Department used job orders to track these expenditures, but discontinued this practice in fiscal year 2009. Officials told us that they had requested a dedicated fund number, but that the City was limiting the number of new funds at the time. Secondly, although the Wastewater Department has tracked the approval dates and authorized amounts of EEIR expenditures, it has not tracked dates or specific amounts for actual expenditures. Although this information is recorded in the City's financial system, it is not being collected or analyzed by the Department. This is occurring because the department lacks an effective system for tracking these expenditures. Without such a system, the Department will not have a transparent and accurate record of what is being spent on new technologies and efficiencies.

B2G and Pay for Performance Payouts Are Not Externally Audited and Records Are Not Maintained by the Department

Departmental guidance establishes a standard of 2,080 compensated hours worked for employees to be eligible for full payouts, excludes employees from eligibility who have received a less than satisfactory performance evaluation or are facing disciplinary action, and sets net of taxes payout caps for employees—\$3,000 for B2G and \$1,000 for Pay for Performance.³⁷ We found that 1,463 employees or about 91 percent of all employees covered by the programs received payouts for fiscal year 2008 for the Water and Wastewater Departments (see table 4).³⁸ The Department did not provide complete records to us on the number of employees who received payouts, such as certification and employee ineligibility reports, until after reviewing our draft report. We found it challenging to identify accurate data from these records. For example, we found that certification reports listed some employees more than once which inflated the total by more than 15 percent in some cases. In addition, the departments’/divisions’ methodology for identifying employees who are eligible to receive payouts made it challenging to verify this information. Payroll specialists within the Department review payroll certification reports, identify employees working fewer than the standard 2,080 hours, and manually adjusts hours worked, for example based on termination or retirement. Manual adjustments are required due to limitations with the payroll system, which is currently being replaced. Adjustment certification reports are reviewed and approved by the appropriate manager, forwarded to the City Comptroller Payroll Section, and processed with a subsequent biweekly payroll. Prior to fiscal year 2005, the City Auditor and Comptroller’s Office conducted audits of the departments’/divisions’ payouts in addition to auditing B2G savings and Pay for Performance goal achievement. For example, the Office identified that the Wastewater Department overstated calculated B2G payouts by \$42,343.08 for fiscal year 2002. This represents the amount that the Department would have overpaid employees if the payouts had not been audited. In addition, the Auditor and Comptroller’s Office included post-audit data on the total gross amounts and numbers of employees who received payouts in their audit report to the departments. AKT has not conducted audits of payouts because the Department has not included this in its contract. Without external audits of payouts, the Department cannot ensure that all employees who received payouts were eligible and resulting payout amounts are accurate.

³⁷ A minimum of 480 compensated hours of work is required for employees to be eligible for payouts, which are prorated as a ratio of a 2,080 hour work year. As mentioned earlier in the report, B2G and Pay for Performance are now combined into one program and the cap for fiscal year 2009 is \$4,000 (net of taxes) for both. Metropolitan Wastewater Department, *draft Gainsharing Guidebook* (San Diego, CA: 2010); Metropolitan Wastewater Department, *Bid to Goal Guidebook* (San Diego, CA: 2009).

³⁸ This data does not include payouts to employees outside the departments/divisions who were identified by the Labor-Management Committee as making a significant contribution to meeting the department’s/division’s mission and goals. For example, awards have been provided from the Water Operations assurance fund to employees in the Department of General Services Street Division for trench restoration. About 41 City employees were awarded these special gainsharing bonuses in fiscal year 2008.

Table 4: Number of Employees Receiving and Not Eligible to Receive B2G and Pay for Performance Payouts, Fiscal Years 2005-2008

Department/ Division	Fiscal Year							
	2005		2006		2007		2008	
	Received payout	Not eligible	Received payout	Not eligible	Received payout	Not eligible	Received payout	Not eligible
Wastewater Collection	292	19	304	20	272	18		
Wastewater Treatment and Disposal ^a	303	17	307	22	286	18		
Wastewater Department							843	74
Water Operations	414	71	456	64	394 ^b	63	429	59
Water Customer Support					195	19	191	18
Total	1009	107	1,067	106	1,147	118	1,463	151

Source: Office of the City Auditor’s analysis of water and wastewater data.

Notes: NA represents data that was not provided to us by the applicable department/division. Totals exclude this missing data.

Shaded areas represent years not applicable for B2G, for example, Water Customer Support started its B2G program in fiscal year 2007 and Wastewater combined its two B2G program into one department-wide program in fiscal year 2008.

This data does not include payouts to employees outside the department/division who were identified by the Labor-Management Committee as making a significant contribution to meeting the department’s/division’s mission and goals.

^a The Treatment and Disposal Divisions was formerly Operations and Maintenance.

^b This figure includes an estimate for duplicates that we were unable to resolve.

The Department does not maintain a record of final payouts made, because officials believe that the City’s accounting system constitutes the City record; however, we found it challenging to identify accurate payout amounts. The Department did not provide accurate total amounts of payouts to us until after they reviewed our draft report. Prior to the Department providing this information, we obtained the data from the City’s Accounting Management Resource Information System (AMRIS) reports and analyzed this information using a web-based reporting tool—SIMPLER. We found that total payouts for fiscal years 2005 through 2008 for the B2G and Pay for Performance programs were about \$28 million, which includes payouts for fiscal year 2004 based on a re-audit of the Wastewater Department’s B2G

results by AKT in 2008 (see table 5).³⁹ Note that no payouts have been made for fiscal year 2009, because the external audit has not yet been conducted. One reason that we found it challenging to identify accurate payouts amounts is because payroll data does not provide specific definitions or descriptions of dates for payouts. As a result, we are reporting the total amounts paid out for B2G and Pay for Performance in each fiscal year rather than providing the amounts of payouts for each fiscal year. While payouts are generally paid in the successive fiscal year following the external audit, we identified several fiscal years where more than one payout was made. For example, fiscal year 2009 includes three payouts that we were not able to separate. In addition, there were four payout dates for B2G in fiscal year 2008—November and December 2007 and April and May 2008. Department officials told us these were for wastewater and water employees respectively. Another reason that we found it challenging to identify accurate information is because the total payouts amounts included accruals for fiscal years 2008 and 2009 which we had to identify and subtract from the total. Department officials told us that the accruals are estimates of what the employees will be paid in the following year for efforts made in the current year and are used to ensure that the expense shows in the correct year in the financial statements. Payout data provided to us by the Department after reviewing our draft report was also obtained using SIMPLER and was generally consistent with our data, except that the Department excluded the fiscal year 2004 payouts in the total paid in fiscal year 2009. By expanding the scope of its contract with AKT to include an audit of payouts, the Department will obtain an accurate source of total gross payouts and the number of employees receiving payouts which will assist in maintaining accurate, transparent records. Without maintaining a record of total payout amounts each year, the total and accurate payout costs to the City are not transparent, particularly for stakeholders who cannot easily access the City's payroll system and overcome the challenges that we faced in obtaining this information.

³⁹ The results of B2G for fiscal year 2004 were originally audited by the City Auditor and Comptroller's Office, which found a budget shortfall of \$1.8 million. In 2008, the Wastewater Department determined that some out-of-scope expenses had been improperly recorded as in-scope, and engaged AKT to re-audit the savings. AKT reported a savings amount of \$ 5.85 million, and payouts were subsequently made in fiscal year 2009.

Table 5: Total B2G and Pay for Performance Payouts Made in Fiscal Years 2006-2009

Department/Division	Fiscal Year				Total
	2006	2007	2008	2009	
B2G Payouts					
Wastewater Collection	\$0	\$1,133,059	\$1,309,263	\$ 3,610,980 ^a	\$ 6,053,302
Wastewater Treatment and Disposal	\$1,369,671	\$1,363,866	\$1,353,461	\$ 2,275,187	\$ 6,362,185
Wastewater Other Divisions ^b				\$ 1,766,534	\$ 1,766,534
Water Operations	\$1,385,132	\$1,307,464	\$1,999,079	\$ 1,927,487	\$ 6,619,162
Water Customer Support			\$ 458,036	\$ 591,797	\$ 1,049,833
Subtotal B2G	\$2,754,803	\$3,804,389	\$5,119,839	\$10,171,985	\$21,851,016
Pay for Performance Payouts					
Wastewater Collection	\$ 432,111	\$ 363,506	\$ 317,644	^d	\$ 1,113,261
Wastewater Treatment and Disposal	\$ 426,578	\$ 356,426	\$ 358,652	^d	\$ 1,141,656
Wastewater Other Divisions ^c	\$ 457,448	\$ 428,991	\$ 361,559	^d	\$1,247,998
Water Operations	\$ 581,650	\$ 565,000	\$ 640,127	\$ 428,458	\$ 2,215,235
Water Customer Support			\$ 200,294	\$ 210,101	\$ 410,395
Subtotal Pay for Performance	\$1,897,787	\$1,713,923	\$1,878,276	\$ 638,559	\$ 6,128,545
Total	\$4,652,590	\$5,518,312	\$6,998,115	\$10,810,544	\$27,979,561

Source: Office of the City Auditor’s analysis of SIMPLER data.

Note: Shaded areas represent years not applicable for B2G, for example, Water Customer Support started its B2G program in fiscal year 2007 and Wastewater combined its two B2G program into one depart-wide program in fiscal year 2008.

^a This figure includes payouts for fiscal year 2004 which were reaudited (see footnote 39) and for fiscal year 2008. Payouts for fiscal year 2009 will not be made until AKT completes its external audit of B2G savings and goal achievement.

^b The Wastewater Department combined its two existing B2G programs and expanded to department-wide in fiscal year 2008. This category includes the Wastewater Department’s Environmental Monitoring and Technical Services, Administrative Services, and Program Management Divisions.

^c This category includes Wastewater divisions that did not have a B2G program (until 2008), but had pay for performance programs—Environmental Monitoring and Technical Services, Information and Organizational Support, Program Management, Services and Contracts, and Administrative Services (for fiscal year 2008 only).

^d The Wastewater Department combined its B2G and Pay for Performance programs in fiscal year 2008.

Departmental guidance also establishes that payouts will be funded from the EEIR and sets net of taxes payout caps for employees--\$3,000 for B2G and \$1,000 for Pay for Performance.⁴⁰ We reviewed payout data and found that employee payouts are under the established net of taxes caps. However, we identified a differential of about 56 percent between the net amount the employee receives and the gross amount that the City pays out which includes federal and state taxes. For example, a maximum B2G award of \$3,000 and Pay for Performance award of \$1,000 will actually cost the City about \$4,669 and \$1,556, respectively. We believe that tracking, reconciliation, and review of payments to employees are importance management practices. As indicated earlier in this report, payouts are funded through the EEIR, which is not a separate fund in the accounting system and represent authorized rather than actual expenditures. Without external audits of payouts and maintaining an accurate record of the total and gross costs of payouts, the Department cannot fully assess the benefits of the program, the resulting payouts may be unreliable, and the actual costs to the City may be understated.

GOALS HAVE IMPROVED AND ADMINISTRATIVE PROVISIONS FOR GAINSHARING HAVE BEEN MET, BUT DEPARTMENT LACKS A SYSTEM FOR INVOLVING ALL LEVELS OF EMPLOYEES

Measurability of Gainsharing Goals Have Improved in Fiscal Year 2010

Departmental guidance establishes that gainsharing goals should incentivize performance above and beyond core service levels—stretch goals—and be measurable and auditable. We reviewed a sample of Water Operations and the Wastewater Divisions gainsharing goals from fiscal years 2008 through 2010 and found that the goals description for fiscal year 2010 has become more readable, specific, and nontechnical. This is particularly true for Water Operations, which had a very basic format for goal descriptions in the previous two years. For example, Water Operations goals for fiscal years 2008 and 2009 lacked a sufficiently detailed description and benchmark for determining whether it was a stretch goal and required a calculation to determine the actual goal requirement. We identified several goals in these prior years that were not stretch goals, for example, goals for hiring a consultant and for completing the annual B2G performance report. The measurability of fiscal year 2010 goals also improved, for example, the goal summaries contain specific measures and source documentation and, in some cases, a timeline for completion. In addition, the goal summaries contained more robust and detailed information in the Relevance and Justification sections which provided links to regulatory requirements and benchmark information to help us determine whether it was a stretch goal. Improvements in fiscal year 2010 goals are largely due to specific guidance and coaching provided to management prior to and throughout the goal development process. We believe that the Department should continue to strive to develop goals that are measurable and auditable and provide the justification and relevance for the goal to improve the credibility and transparency of the program.

⁴⁰ The departments/divisions established the net limits on payouts based on the City's Merit Program. As mentioned earlier in the report, B2G and Pay for Performance are now combined into one program and the cap for fiscal year 2009 is \$4,000 (net of taxes) for both. Metropolitan Wastewater Department, *draft Gainsharing Guidebook* (San Diego, CA: 2010); Metropolitan Wastewater Department, *Bid to Goal Guidebook* (San Diego, CA: 2009);

Administrative Provisions for Gainsharing Have Been Met

Best practices for performance measurement systems and gainsharing programs include operating and administrative provisions for gainsharing.⁴¹ We found that the most recent B2G memorandums of understanding generally contain such provisions (see table 6). For example, the B2G memorandums of understanding develop eligibility requirements for employees based on the number or hours worked and establish an adjustment provision allowing changes to the contract due to uncontrollable events such as catastrophic breakdowns of major equipment and changes in the law that have a material effect on operating costs or performance.

Table 6: Public Utilities Department Divisions Have Met Best Practices for Operating and Administrative Provisions of Gainsharing

Operating and Administrating Gainsharing Provisions	Meets Best Practices	Does Not Meet Best Practices
Establish a gainsharing task force	√	
Develop implementation timeline	√	
Establish specific objectives of program		√
Determine who will participate	√	
Develop eligibility requirements	√	
Determine allocation basis (method of payment, payout period, payout calculation)	√	
Establish performance period	√	
Establish a holdback provision	√	
Establish a sunset provision	√	
Establish an adjustment provision	√	
Establish a buyback provision	√	
Establish ceiling for bonuses	√	
Develop a sharing ratio	√	
Cover administrative details	√	

Source: Office of the City Auditor’s analysis of B2G contractual documents against best practices for performance measurement.

We identified one area where the Department does not meet best practices. Gainsharing objectives should satisfy multiple and sometimes competing interests including those of employees, managers, ratepayers, and other stakeholders.⁴² Current B2G program objectives include yielding economic benefits to ratepayers while maintaining the integrity and soundness of capital investment, infrastructure, and

⁴¹ National Performance Review, *Best Practices in Performance Management* (Washington, D.C.: June 1997) and Boyett, *The Gainsharing Design Manual* (Lincoln, NE: 2004).

⁴² National Performance Review, *Best Practices in Performance Management* (Washington, D.C.: June 1997) and Boyett and Boyett, *The Gainsharing Design Manual* (Lincoln, NE: 2004).

safeguarding the environment; meeting commitments to employees and promoting cooperative labor-management relations; achieving continual improvements through benchmarking. Some of these objectives are consistent with best practices, such as improving competitiveness and productivity. However, the Department lacks employee-focused objectives, such as improving communication, increasing employee involvement, and improving teamwork and cooperation. We believe establishing employee focused objectives is a foundation for an employee involvement system which best practices ascertain as vital to the success of gainsharing. Further, without measuring the achievement through employee surveys and other methods, the Department cannot assess whether B2G is improving in its organizational culture and employee attitudes.

Department Lacks Process for Involving All Levels of Employees

Best practices for performance measurement systems and gainsharing programs ascertain that a structured method for involving employees at all levels is critical to the success of a gainsharing program.⁴³ Department guidelines for developing gainsharing goals encourage managers to ask employees in each section for input. We surveyed the Department's deputy directors to identify their processes for developing gainsharing goals and found that they generally rely on supervisors and senior staff to solicit employee input and ideas for gainsharing goals. Five of the 11 deputy directors said that input from employees below this level is limited and largely a function of (1) individual initiative and interest and (2) how proactive senior staff are at soliciting input. They also told us that employee involvement is voluntary. According to a deputy director, employees have rarely volunteered ideas for gainsharing goals. Further, the deputy directors reported challenges in getting all employees engaged in the gainsharing process, ensuring that employees take their responsibility for submitting goals seriously, and avoiding "come to work" goals. Employee representatives who work in the field told us that they would like to be more involved in setting goals because they have the first hand knowledge and expertise on the work to be performed, but that they do not provide input on goals because their ideas have not been implemented in the past. In contrast, supervisory level employee representatives told us that B2G has motivated employees at all levels to work together as a team to achieve goals. Success with employee participation and the establishment of effective goals has varied across divisions and sections, because the department does not have guidance and a structured process for ensuring that employees at all levels are involved and employee participation for employees below the senior or supervisory level is voluntary.⁴⁴ Department managers told us that a top-down management system is more appropriate for goal setting, because managers have a broader view of the organization's needs and are better equipped to develop stretch goals. However, gainsharing programs are generally based on a more inclusive approach where ideas for improving efficiency and effectiveness from front line employees are solicited and valued. Employees are more likely to meet or exceed goals when they are empowered with the authority to make decisions and solve problems related to the results for which they are accountable.⁴⁵ Further, management buy in for

⁴³ National Performance Review, *Best Practices in Performance Management* (Washington, D.C.: June 1997) and Boyett and Boyett, *The Gainsharing Design Manual* (Lincoln, NE: 2004).

⁴⁴ Employees are providing suggestions to the Labor Management Committee for new technologies, equipment, and training for the EEIR. In addition, the department recently established the Suggestions to Achieve Results--STAR Program, which gives employees the opportunity to identify issues of concern to the Labor Management Committee.

⁴⁵ National Performance Review, *Best Practices in Performance Management* (Washington, D.C.: June 1997), 11.

this approach is required for the program to be successful. The performance goals of an organization are a shared responsibility for all employees—each of whom has a stake in the success of the organization.⁴⁶ Without a structured system for involving all levels of employees in the goalsetting process, the Department is missing an opportunity to obtain ideas and input from employees for improving the efficiency and effectiveness of operations and hold these employees accountable and responsible for each performance measure. We conclude that additional benefits could be obtained from implementing the gainsharing incentive program as it was intended.

DISCREPANCIES HAVE OCCURRED IN SAVINGS CALCUATIONS AND GOAL ACHIEVEMENT DUE TO DEPARTMENT’S LACK OF DETAILED GUIDANCE AND INTERNAL CONTROLS

Discrepancies Have Been Made Calculating B2G Savings

The Department calculates B2G savings by subtracting actual costs from the employee bid amount. For the purposes of B2G, costs are limited to those associated with core operations and maintenance and direct-support functions and exclude out-of-scope expenditures such as those associated with Capital Improvement Projects. HDR Engineering developed steps for calculating savings for the Wastewater Collection Division in fiscal year 2005, and the Wastewater Department provided general guidance in fiscal year 2008 on financial reporting procedures, such as posting the division’s approved budget and expenditures, calculating encumbrances, and procedures for out-of-scope expenses.⁴⁷ (See figure 9.)

⁴⁶ National Performance Review, *Best Practices in Performance Management* (Washington, D.C. : June 1997).

⁴⁷ Metropolitan Wastewater Department, *Bid to Goal Financial Reporting Procedures* (San Diego, CA: 2008) and HDR Consulting, *Technical Memorandum: Fiscal Year 2005 Bid to Goal Report Calculation Methodology* (San Diego, CA: Jan. 2006).

Figure 9: Steps for Calculating B2G Savings

Step 1	Calculation of B2G budget
Step 2	Subtraction of nonpersonnel expenses
Step 3	Documentation of council mandated additions and deletions
Step 4	Calculation of materiality adjustments
Step 5	Calculation of final employee B2G budget
Step 6	Calculation of actual expenditures
Step 7	Calculation of prior year expenses
Step 8	Calculation of all expenses for current fiscal year
Step 9	Calculation of out of scope expenses Organizations Job order numbers Units Salaries Overtime Limited Employees
Step 10	Subtraction of total out of scope expenses
Step 11	Subtraction of in-scope expenditures from B2G budget

Source: Office of the City Auditor’s analysis of HDR Engineering information.

Based on our review of findings identified during external audits of B2G cost savings,⁴⁸ we found that program savings were overstated by \$10,696,448 or about 8.4 percent from fiscal years 2005 through 2008.⁴⁹ (See table 7 and figure 10.) Discrepancies in reported savings were primarily due to the errors with encumbrances, such as including expenditures incurred and recorded subsequent to the year’s end, and the overstatement or improper inclusion of out-of-scope expenditures.⁵⁰ For example, the Wastewater Department included \$2,753,461 of B2G payments made in fiscal year 2008 in its total out-of-scope expenditures; however, these payments are already identified as a separate line item in the annual report. Overstatements in savings also occurred due to the Water Operations Division’s inclusion of the Division’s Contingency Fund in fiscal years 2005 through 2007. According to the external auditor, the contingency—a budgetary tool designed to cover unanticipated costs which would be out of scope for B2G—should not be included in a program that’s purpose is to reward employees for efficiencies and resultant savings. This issue was resolved in fiscal year 2008 when the division removed the contingency from its memorandum of understanding.

⁴⁸ AKT audit work includes sampling and testing transactions to determine the accuracy of the reported savings amount. Sample sizes typically range from 1-100, depending on the complexity of the calculation.

⁴⁹ Note that payouts do not occur until after the external audit of savings and goal achievement.

⁵⁰ Encumbrances represent commitments related to unfilled purchase orders or unfilled contracts and serve as a placeholder so that budgeted funds are not spent elsewhere.

Table 7: Differences in Calculated and External Audited Savings by Department/Division, Fiscal Years 2005-2008

Fiscal Year	Department/Division	Calculated Savings	Audited Savings	Difference
2005	Wastewater Collection	\$ 6,382,198	\$ 5,900,810	\$ 481,388
	Wastewater Operations and Maintenance	\$ 12,267,360	\$ 10,774,060	\$ 1,493,300
	Water Operations	\$ 10,813,191	\$ 9,147,723	\$ 1,665,468
	Total for 2005	\$ 29,462,749	\$ 25,822,593	\$3,640,156
2006	Wastewater Collection	\$ 5,844,324	\$ 5,836,504	\$ 7,820
	Wastewater Operations and Maintenance	\$ 12,645,845	\$ 12,456,035	\$ 189,810
	Water Operations	\$ 10,246,437	\$ 9,859,982	\$ 386,455
	Total for 2006	\$ 28,736,606	\$ 28,152,521	\$ 584,085
2007	Wastewater Collection	\$ 4,712,912	\$ 3,914,251	\$ 798,697
	Wastewater Treatment and Disposal ^a	\$ 10,813,491	\$ 10,791,002	\$ 22,489
	Water Operations	\$ 11,429,509	\$ 9,872,093	\$ 1,557,416
	Water Customer Support	\$ 1,001,464	\$ 968,036	\$ 33,428
Total for 2007	\$ 27,957,376	\$ 25,545,346	\$ 2,412,030	
2008	Wastewater Department ^b	\$ 29,157,670 ^c	\$ 25,290,360	\$ 3,867,310
	Water Operations	\$ 9,801,652	\$ 9,794,357	\$ 7,295
	Water Customer Support	\$ 1,795,524	\$ 1,609,952	\$ 185,572
	Total for 2008	\$ 40,754,846	\$ 36,694,669	\$ 4,060,177
Total		\$126,911,577	\$116,215,165	\$10,696,448

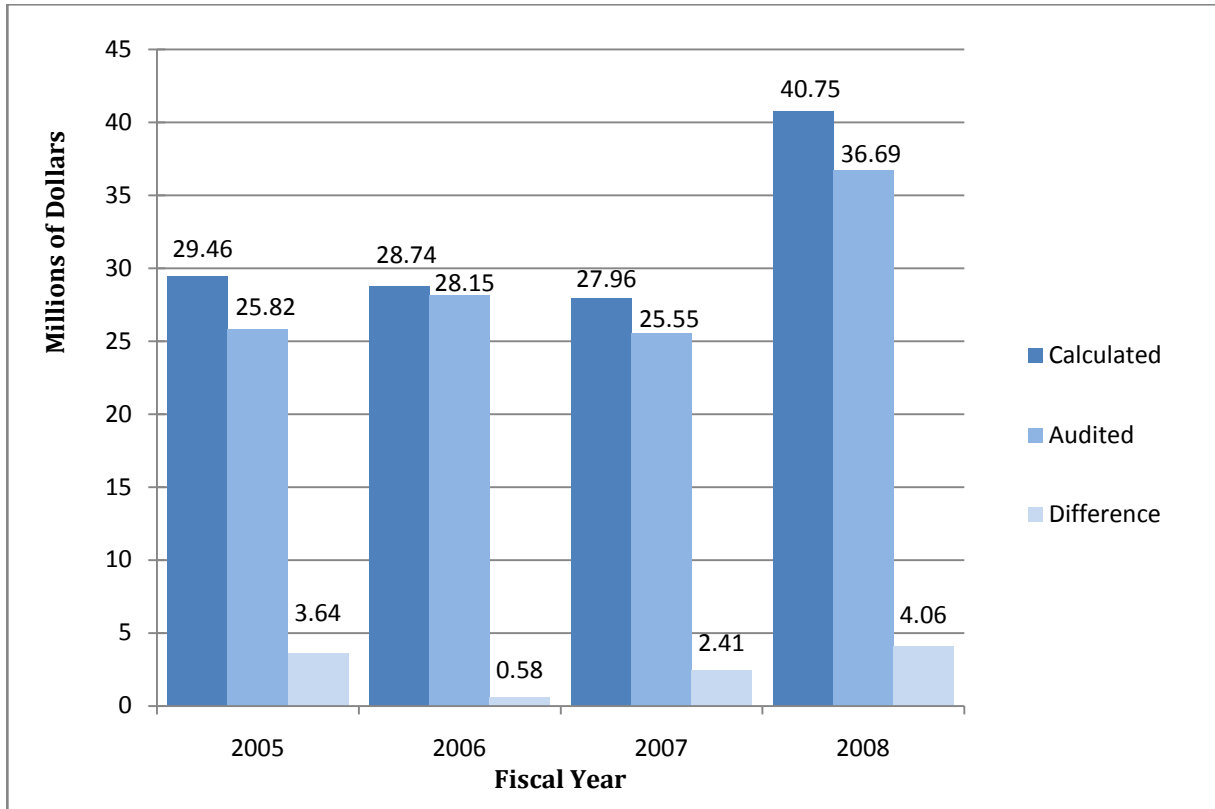
Source: Office of the City Auditor's analysis of external audit results.

^a The Wastewater Operations and Maintenance Division became the Treatment and Disposal Division in fiscal year 2007.

^b The Wastewater Department established a department-wide B2G program effective July 1, 2007, which combined the Wastewater Collection and Treatment and Disposal programs.

^c The Wastewater Department initially reported savings of \$33,839,309 on the annual report, but subsequent to the submission of the report, Department management made the decision to exclude the Director's contingency fund from the savings calculation, decreasing savings by \$4,681,639.

Figure 10: Total Differences in Calculated and Audited Savings for all B2G Programs, Applicable Fiscal Years 2005-2008



Source: Office of the City Auditor’s analysis of external audit results.

We found that the potential for errors in financial reporting is also increased because the savings calculations are performed on spreadsheets and rely on importing data from AMRIS—the City’s accounting management system. For example, HDR Engineering’s methodology for savings calculations indicated that data was downloaded from OARS—the Department’s online reporting system; however, more recent guidance indicates that this report should not be used to run expenditure balances because they do not pick up some types of expenditures and encumbrances. In fact, AKT identified this as a finding in both fiscal years 2004 and 2005 and made the recommendation to the Wastewater Department to use AMRIS reports to prepare total expenditures and encumbrances for the annual report, because they are more reliable in identifying expenditures and encumbrances.

Incorrect Reporting of Gainsharing Goals Being Met

Based on our review of external audit findings, we also found that the water and wastewater departments/divisions incorrectly reported on gainsharing goal performance in 56 out of 140 goals tested or 40 percent from fiscal years 2005 through 2008 (see table 8). About 48 percent of these discrepancies

were due to calculation errors, reporting discrepancies, and reliability and measurement issues. The departments/divisions did not provide sufficient or appropriate supporting documentation in 14 percent of the discrepancies. We identified 21 of these cases or about 38 percent as goal not met, because the external auditor did not agree with the status of goal achievement, but no specific errors were identified in these cases. For example, in fiscal year 2005, the Water Operations Division’s stormwater section reported that it had achieved its goal of completing tasks identified in the revised contract with the State Water Resources Control Board for development of the San Dieguito Watershed Management Plan. However, the Quarterly Progress Report provided to the auditor as supporting documentation indicated that none of the specific tasks were accomplished and no additional documentation could be provided. We believe that there is an inherent risk in having employees verify and report out on their own goals when they have a vested interest in the outcome and, for this reason, internal controls are necessary. This inherent conflict of interest also makes it important that Department managers who will provide internal controls in the future continue to not be eligible to receive payouts.

Table 8: Discrepancies in Water and Wastewater Departments/Divisions Achievement of Performance Goals, Fiscal Years 2005-2008

Type of Finding	Fiscal Year				
	2005	2006	2007	2008	Total
Goal not met	5	5	4	7	21
Calculation errors	1	3	3	0	7
Reporting discrepancies	2	0	2	4	8
Missing supporting documentation	0	2	6	0	8
Data reliability issues	1	0	5	1	7
Measurement issues	0	1	3	1	5
Totals	9	11	23	13	56

Source: Office of the City Auditor’s analysis of external audit findings.

Note: This includes all Water and Wastewater B2G programs in applicable fiscal years.

We also identified cases where management granted administrative relief for a performance goal after the external auditor determined that it had not been met, and the employees involved received payouts. For example, in fiscal year 2008 the Water Operations Division did not achieve one of its performance goals, primarily because certain operational reports were not appropriately signed by management. Subsequent to the audit, the section was granted administrative relief for this goal at 75 percent of goal achievement. Management told us that such adjustments are made to goals due to unforeseen events. However, without proper authorization and well-documented justification, the credibility of the program will be undermined.

Discrepancies are occurring in part because the Department lacks specific guidance and procedures for preparing savings calculations, including out-of-scope expenditures and the release of encumbrances. This is particularly important for the Department because accurately identifying out-of-scope expenses

can be subjective and require management's judgment. For example, overtime charges can be excluded as out of scope if they result from additional work mandates that occur subsequent to the memorandum of understanding, but overtime charges resulting from ordinary fluctuations in regular workloads should not be excluded. Department officials told us that they recognize that more specific guidance is required and provided a list of out-of-scope expenditures which they plan to incorporate into the employee bid that is currently being developed for the proposed Water Fund B2G Program (see appendix II). Discrepancies are also reoccurring because the department lacks a process for ensuring that recommendations made by the external auditor are implemented. For example, the audit report for fiscal year 2004 noted that 7 of the 16 prior year recommendations were not implemented. If these recommendations had been implemented it would have minimized the risk of clerical errors and incorrectly claiming expenditures as out of scope more than once. By not implementing and sharing these recommendations across divisions, the department is losing an opportunity for lessons learned, risks the continued reoccurrence of these issues, and is not maximizing the benefit of the external auditor's knowledge and experience.

Incorrect reporting of performance goal achievement and discrepancies in savings calculations are also occurring because the department lacks an internal control and review process and instead relies on the external auditor to provide that function. Reliance on the external auditor results in a lag time of more than six months before discrepancies are identified. Internal control is an integral component of an organization's management and provides reasonable assurance that operations are effective and efficient, financial reporting is reliable, and the organization is complying with applicable laws and regulations.⁵¹ The adequate segregation of duties between the performance, review, and documentation of a task is necessary for effective internal controls.⁵² According to Department officials, the Wastewater Department established a B2G team that performed an internal review of savings in fiscal year 2008; however, the variance in savings for that year was \$3,867,310.⁵³ Recognizing that internal controls are needed, the Department established the Employee Services and Internal Controls Section within the Business Support Branch. While the Department has not developed a plan or processes for specific internal controls for the B2G program, the intent is to use this office to provide internal review and oversight of the program. Without specific and detailed procedures and an effective system of internal review and oversight, managers cannot ensure that B2G results are reliable and safeguard the integrity of the program.

⁵¹ Office of Management and Budget, *Circular Number A-123 revised* (Washington, D.C: Dec. 21, 2004), 7.

⁵² Office of Management and Budget, *Circular Number A-133 Compliance Supplement* (Washington, D.C: March 2004), 6-3.

⁵³ The total difference was initially \$8,548,949; however, Department management made the decision to adjust the employee bid by removing the Director's Contingency of \$4,681,639 from the savings calculation prior to the submission of the annual report. The contingency had been disallowed by the external auditor for Water Operations for fiscal years 2005 through 2007.

Conclusions

Providing clean and safe drinking water and treating and removing wastewater for residents are essential services provided by the City. As San Diego continues to face budgetary and resource pressures, Department managers and employees are challenged to meet increasing requirements and demands with fewer resources. The B2G program was envisioned to help managers motivate employees to identify opportunities for increasing efficiency and become the most effective and efficient organization possible. This ideal and the efficiencies achieved by the departments/divisions have been recognized by awards, such as receiving the Gold Award for Exceptional Utility Performance from the Association of Metropolitan Water Agencies in 2009 and becoming a finalist in 2003 for the Harvard Kennedy School of Government's Innovation in American Government Award. However, effective implementation and management of the B2G program is crucial to its success, not only to ensure that the full benefits are derived but also due to the political sensitivity of a program that awards payouts to employees while the City is reducing salaries and cutting costs. Recent steps taken by the Department to centralize the program and establish internal controls are a move in the right direction. However, effective implementation includes providing standardized guidance, processes, or systems for all aspects of the program; ensuring that accurate and reliable data are maintained and easily accessible; involving all levels of employees in setting gainsharing goals and holding them accountable for the results; and providing internal review and oversight to ensure that B2G results are reliable and credible. Without effective management, documentation, and internal controls, the program will continue to lack transparency and auditability and the integrity of B2G will be compromised.

Recommendations

To improve the accuracy of B2G documentation and transparency of the program and ensure that managers and other stakeholders have a key source of information upon which to base future assessments of the program, we recommend that the Department

1. solicit the development of a private sector benchmark at least every five years and ensure that the benchmark is comparable with the employee bid for at least the first year of the contract;
2. establish a central location for B2G documentation and core of employees with knowledge about the program;
3. ensure that accurate and updated B2G records, such as the annual performance reports, are maintained;
4. develop guidance with specific criteria for B2G annual reports, including the format and content and required updates to be included in such reports that will allow the results to be easily reviewed and compared; and

5. maintain a public, historical record of B2G results by including previous years' annual reports on the department's website.

To improve the transparency, management, and credibility of the bid process and ensure that management can fully assess the benefits of B2G, we recommend that the Department

6. identify clear and distinct roles and responsibilities for the department and contractor and provide structure for the bid process;
7. develop a system for accurately tracking the administrative costs of the program;
8. develop a system for accurately tracking EEIR actual expenditures and report these in annual performance reports; and
9. require an external audit of payouts, maintain an accurate record of the audited total gross payout amounts and number of employees receiving payouts, and evaluate whether setting net rather than gross payout caps is the most equitable and appropriate limit.

To ensure to that gainsharing goals continue to improve and employees of all levels are involved in developing these goals, we recommend that the Department

10. ensure that gainsharing goals continue to be measurable, auditable, and stretch goals; and
11. establish a structured system for involving all levels of employees in the goalsetting process, such as encouraging participation on goalsetting teams on a rotational basis to obtain ideas and input for improving the efficiency and effectiveness of operations and hold these employees accountable and responsible for each performance measure.

To improve the accuracy of B2G savings calculations and ensure that program results are reliable, we recommend that the Department

12. develop detailed and specific guidance for standardized savings calculations, including instructions for sources of data, out-of-scope and in-scope expenditures, encumbrances, and justifications for administrative relief when goals are not met;
13. develop procedures for ensuring that recommendations from external audits are implemented; and
14. establish processes for making internal controls an integral part of planning, budgeting, management, accounting, and auditing the B2G program, including reviewing savings calculations and goal achievement and segregating duties between performing, reviewing, and documenting a task.

Office of the City Auditor

Survey of Public Utilities Department Deputy Directors

The City Auditor's Office is conducting a review of the Bid to Goal (B2G) Program within the various divisions of the Public Utilities Department (PUD). We are conducting this survey to find out more about your experiences with the B2G (1) bid process and (2) gainsharing incentive program. If you have not had experience with these processes, please obtain the relevant information from appropriate employees within your division and note this in your responses.

Your expeditious, considered, and complete responses will help us to fully review this program and complete our audit report in a timely manner. Your responses may be presented in larger groupings for summary purposes and may be used individually as illustrative examples in our report.

Note that when we are asking "to what extent" questions we would like to know whether something is being done and, if so, please explain how it is being done. If you have questions, please contact [REDACTED]. Provide your complete responses to [REDACTED] via email by Wednesday, November 18, 2009.

Contact Information

Please provide the following contact information about the person completing this survey and with whom we can follow up, if needed:

Name:

Title: Deputy Director

Division:

Phone #:

Email:

Note that when we are asking “to what extent” questions we would like to know whether something is being done and, if so, please explain how it is being done.

Section 1: Bid Process

Developing the Statement of Work

1. To what extent are you involved in developing the Statement of Work?
2. To what extent do you involve employees within your division in this process?

Developing the Memorandum of Understanding

3. To what extent are you involved in developing the Memorandum of Understanding?

Developing the Employee Bid

4. To what extent are you involved in developing the Employee Bid?
5. To what extent are employees within your division involved in this process?
6. Please provide examples of improvements or changes that have been made within your division in order to (1) meet the budget established by the employee bid and (2) achieve further savings less than the bid.
7. What are the benefits and challenges associated with the bid process?

Section 2: Gainsharing Incentive Program

Developing Gainsharing Goals

8. What, if any, guidance has the department provided to you for developing gainsharing goals?
9. What is the process that you use to develop gainsharing goals for your division?
10. What is the basis for your division’s gainsharing goals, for example, the Strategic/Tactical Plan, regulatory requirements such as the Consent Decree, or the recent Independent Rates Oversight Committee Report?

11. How could this process be improved? For example, would the use of HDR Engineering to assist in the development of gainsharing goals be beneficial due to their knowledge and expertise on departmental operations?

Involving Employees

12. What, if any, requirements or guidance does PUD have for including employees in the goal development process?
13. To what extent do you involve employees in this process?
14. To what extent do your employees readily provide ideas for gainsharing goals?
15. What percentage of your goals have been provided by employees for fiscal years 2009 and 2010? Please provide examples.

Communicating Goals with Employees

16. How do you communicate goals with employees?
17. To what extent do you communicate linkages between gainsharing goals and organizational goals?
18. To what extent do you motivate employees to work as a team to meet goals?

Monitoring and Tracking Performance

19. How frequently do you measure performance toward goal achievement (e.g. quarterly)?
20. To what extent do you use performance information to manage your division, such as determining whether your division is accomplishing its mission and making decisions about areas that need to be addressed?

Reviewing Goal Achievement

21. To what extent do you review gainsharing goals at the end of the year verify that they (1) meet criteria for achievement and (2) have sufficient supporting evidence?
22. To what extent do you prepare for the external audit of gainsharing goal achievement?
23. What are the benefits and challenges associated with the gainsharing incentive program?
24. Please provide any additional comments.

APPENDIX II: PUBLIC UTILITIES DEPARTMENT’S RECOMMENDED OUT-OF-SCOPE AND IN-SCOPE ITEMS

Recommended Out-of-Scope and In-Scope Items

The following re the list of items that have been agreed to be either out-of-scope or in-scope for the Water Department’s Bid to Goal Agreement.

I. **Out-of-Scope Costs** are not competed/benchmarked. These items are uncontrollable and/or unanticipated, and/or are not part of the O&M Budget.

1. CIP Project Costs: The costs of CIP projects are not included in the Operating budget, are viewed as having too many unknowns and as a result, are out-of-scope. However, planning efforts associated with developing projects through the planning package phase are considered in scope and are included in the Bid and PMP.
2. Raw Water Purchases: Water usage by customers is largely uncontrollable, so the cost of purchased water is considered out-of-scope.
3. Regulatory Change-related Costs: Regulatory changes are viewed as out-of-scope, as the Water Department has no control over changes in regulations that could result increase operating costs.
4. State-mandated Drought and Conservation Measure-related Costs: These are viewed as out-of-scope, as the Water Department has no control over these mandates and their associated costs.
5. Gainsharing Payouts to Employees and other EEIR Fund Purchases (e.g. Defibulators, etc.): These are out of scope, as the Department will have earned/saved money, deposited it into the EEIR, and it is appropriate to utilize these funds for employee payouts and/or other EEIR Fund purchases.

II. **In-Scope**

1. San Diego Data Processing Costs: HDR Engineering will include this in the PMP, using the Cost-history Analysis method, and include CPI escalators.

2. Service Level Agreements (SLA's): HDR Engineering will include this in the PMP, using the Cost-history Analysis method, and include CPI escalators.
3. General Government Services: Examples of these included costs for City overhead for the print shop, risk management, equipment, central stores, etc. HDR Engineering will include this in the PMP, using the Cost-history Analysis method, and include CPI escalators. Costs that fluctuate greater than or less than 5% may be considered out-of-scope
4. Real Estate Costs (e.g. Easements, ROW, Appraisals, etc.): HDR Engineering will include this in the PMP, using the Cost-history Analysis method, and include CPI escalators.
5. Treated Water Purchase: This is in-scope, as we have the ability to control it. The plants are then incentivized to treat as much as possible and control costs by limiting treated water purchased.
6. Fuel*: Costs associated with fuel purchases are in-scope unless the price escalates over the CPI. HDR Engineering will include this in the PMP, using the Cost-history Analysis method, and include CPI escalators. *Note: Steps are in place to determine how we capture this cost, since the majority of fuel costs are rolled-up into vehicle usage fees. The appropriate CPI will be selected. In addition to identifying the CPI to use, a baseline for consumption is being developed for each of these categories.
7. Energy*: Costs associated with energy purchases are in-scope unless the price escalates over the CPI. HDR Engineering will include this in the PMP, using the Cost-history Analysis method, and include CPI escalators. *Note: The appropriate CPI will be selected. In addition to identifying the CPI to use, a baseline for consumption is being developed for each of these categories.
8. Chemicals*: Costs associated with chemical purchases are in-scope. These costs are in-scope, unless the price escalates over the CPI. HDR Engineering will include this in the PMP, using the Cost-history Analysis method, and include CPI escalators. *Note: The appropriate CPI will be selected. In addition to identifying the CPI to use, a baseline for consumption is being developed for each of these categories.
9. Water Legislative analysis: HDR Engineering will include this in the PMP, using the "Organization Benchmark Analysis method," and include CPI escalators.
10. City Building/Lease Costs: HDR Engineering will include this in the PMP, using the Cost-history Analysis method, and include CPI escalators.

11. Insurance costs (e.g. Injuries, damages, claims, etc.): HDR Engineering will include this in the PMP, using the Cost-history Analysis method, and include CPI escalators.

12. Expenditures from Discretionary Revenue-generating Services provided to other Agencies: Joe Harris and Rod Greek will develop mechanisms for : a) tracking expenditures, and b) tracking revenues. This will ensure that revenues cover or exceed the cost of providing the service. All revenues will be deposited in the EEIR and/or the DRES. Note: This issue occurs very infrequently, and is potentially a non-issue for the Water Dept. The rationale for inclusion as an in-scope item is that it incentivizes the entrepreneurial practice of being “best in class” so that others desire our services, and so that employees are motivated to raise revenues and off-set rates.



THE CITY OF SAN DIEGO

M E M O R A N D U M

DATE: February 1, 2010
TO: Eduardo Luna, City Auditor
FROM: Jim Barrett, Director of Public Utilities
SUBJECT: Departmental Response to the OCA Bid to Goal Audit Report of January 2010

Attached and forwarded herewith is the Public Utilities Department's response to the OCA Audit Report on Bid to Goal. Our comments are reflective of the content within the version of the Report that we received on January 29, 2010.

While the Department agrees that improvements could have been made in documenting the program's earlier achievements, it should be recognized that progress towards those improvements has been underway since the outset of the FY2008 Wastewater program. Additionally, the consolidation that formed the Public Utilities Department effective July 1, 2009, has already started centralizing the documentation, management and internal control aspects of the Bid to Goal program so that it will be more consistent as progressive improvements continue.

The Department acknowledges the OCA Report's documentation of over \$116 million in savings to the ratepayers over a four year period (FY2005-2008) and would agree that it is difficult to quantify how much of the savings come as a direct result of the program because it is only one among many initiatives designed to deliver more efficient and effective operations. In support of the programs underpinnings, the Report (table 6) notes that the current program meets 13 of 14 best practices for operating and administrative provisions of gainsharing. Finally, the Department notes that through the entire review of the program, for almost 12 years, the Report finds no evidence of fraud, waste, abuse or willful misconduct.

It is our intent, upon publication of this Report, to proceed with a request for approval of AKT to perform the third party review of the FY2009 Bid to Goal results (this has been discussed with your staff and they have recommended the continued use of AKT) and, when appropriate, audit the FY2010 program results.


J. M. Barrett

Attachment

Page 2
Eduardo Luna, City Auditor
February 1, 2010

cc: City Council Members
Audit Committee Members
Jan Goldsmith, City Attorney
Jay Goldstone, Chief Operating Officer
Wally Hill, Assistant Chief Operating Officer
Mary Lewis, Chief Financial Officer
Ken Whitfield, City Comptroller
Andrea Tevlin, Independent Budget Analyst

Management's Response to Report Recommendations

The Public Utilities Department would like to thank the Office of the City Auditor for its review of the Bid to Goal (B2G) program and for offering recommendations to continue the improvement efforts that have been at the heart of the program since FY1998.

Established originally in the Operations and Maintenance (O&M) Division in the former Metropolitan Wastewater Department (MWWD), the aim of the program from the outset has been to implement and sustain productivity optimization measures determined by independent assessment and employee involvement. Created in support of Council Policy 000-30, whose stated goal was “to insure that the City of San Diego is competitive and provides and maintains the highest quality of service for the optimum cost to the residents, businesses, tourists, and visitors”¹, it was also in response to a Zero-Based Management Review (ZBMR) review of the MWWD, conducted in 1997, and has focused and fostered optimized service delivery through a commitment to multi-year budget targets.² These budgets are reflective of the competitive benchmark and the submission of detailed plans (or bids) to attain the goal. Employee incentives incorporated within the program are designed to encourage continuous improvement over the program's lifetime and deliver benefits to ratepayers *beyond* the substantial savings provided by achieving the initial competitive goals.³ As demonstrated in the Office of the City Auditor (OCA) Report, over the last four years, these savings have reached \$116 million.

Because there was no single template for these agreements, but more of an evolutionary approach as each Division and Department fashioned their own approach, improvements to the B2G program have occurred somewhat unevenly over the years. From an initial start in the O&M Division, the program's budgetary success in achieving savings led to its adoption within a second MWWD Division.⁴ B2G was subsequently approved by Council to be adopted in the Operations Division of the Water Department, expanded to the Water Department's Customer Support Division, and finally was expanded to an MWWD-wide program in FY2008 in conjunction with the City's larger Business Process Reengineering initiative. At each step through this evolution, changes were made to increase the effectiveness of the program and the probability of achieving business goals and objectives. For example, initial programs with the MWWD B2G agreements were for six years. Starting with the Water Operations Division B2G in FY2005 (and consistent with the OCA Report's current recommendations) the contract length was reduced to five years to provide more frequent recalibration of program effectiveness.⁵ Similarly, in the most recent version of the contract, centralized oversight and document management was provided to ensure standardization of B2G administration and quality control. The consolidation of all prior MWWD B2G programs into a single department-wide effort for FY2008 provided a focused and consolidated labor-management partnership in

¹ Council Policy 000-30 Competition Program (1994)

² The ZBMR process, as well as the B2G program's success within this efficiency effort, is amply laid out in Manager's Report 03-058 Manager's Proposal on the Blue Ribbon Committee's Recommendations on the City Pursuing Operational Efficiencies (March 2003)

³ Manager's Report 98-33 Pilot “Bid to Goal” Methodology to Achieve the Purpose of the Competition Program (1998)

⁴ Manager's Report 01-069 Public Contract Operations (Bid to Goal) Agreement for the Wastewater Collection Division of the Metropolitan Wastewater Department. (2001)

⁵ MWWD Operations and Maintenance Division Bid To Goal Memorandum of Understanding (July 1997); and Water Operations Division Bid to Goal Memorandum of Understanding (July 2004).

attaining creditable, measureable, and meaningful business objects throughout the organization.⁶ The evolutionary nature of the changes, with each new B2G program modifying the prior one, has indeed led to inconsistencies when all programs are compared side by side rather than historically in their own context.

Throughout the program's development, external review has ensured that each new B2G agreement met the goals identified in an objective and transparent manner. At its inception, the program sought and obtained endorsement from the City's then-existing Competition Sub-Committee of the Select Committee on Government Efficiency and Fiscal Reform, which was chaired by the Deputy Mayor and joined by two other Council members of the Rules Committee.⁷ The Select Committee charter was to ensure identified programs met the objectives outlined in Council Policy 000-30. The initial program in 1998 was endorsed by the Rules Committee, and subsequently approved by the City Council. Each subsequent program went through the external scrutiny afforded by Competition Sub-Committee review and each program was approved by City Council prior to implementation. These programs were also extensively reviewed by the Government Efficiency and Openness Committee at its October 31, 2005 meeting, where a detailed report on the overall efficiency of City operations, including the B2G programs then in existence, was provided.⁸

While the 2007 Customer Support Division and 2008 department-wide MWWD B2G contract were not reviewed by the Competition Sub-Committee as other efforts had been, the programs were reviewed by the Office of the Independent Budget Analyst in 2007. In the MWWD review, recognizing the achievements stemming from a reduction of 158.8 positions and an approximate \$20 million in savings, the IBA's June report concluded that the program "has been very successful in identifying efficiencies and optimizing business practices in order to keep MWWD competitive with the private market place."⁹ The IBA fully supported the adoption of the MWWD B2G.¹⁰

In addition to endorsement and approval within the City, the program also received awards from a number of organizations, including the San Diego County Taxpayers Association, the International City/County Managers Association, and the Ash Institute for Democratic Governance and Innovation at Harvard University's John F Kennedy's School of Government. Most recently, the Public Utilities Department received the 2009 Association of Metropolitan Water Agencies (AMWA) Gold Award for Exceptional Utility Performance. As noted by AMWA, "through programs such as Bid to Goal, the utility continually pursues initiatives that drive performance to optimum levels and improve labor-management relationships by encouraging all employees to work together to achieve shared goals."¹¹

In pointing to the programs' successes, the Department also acknowledges that problems described in this review by the OCA did exist in the earliest versions of B2G but does not believe that they continue to exist in the current 2008 Wastewater fund agreement nor within the draft 2010 Water fund agreement. The Department has continued to improve the program annually in response to internal priorities and to the annual audits received from a third party review. Concerns over a consistent approach to goal establishment, program management and centralized documentation are valid as they existed in the past but are deficiencies

⁶ Metropolitan Wastewater Department Labor-Management Partnership FY2008 Annual Performance Report

⁷ There were an additional 16 citizens on the Committee, (two from each Council District) and two additional members from the City's CHANGE2 task force, itself a citizen task force created in 1993 to examine municipal government and identify areas where the City could improve its performance.

⁸ Manager's Report 05-212 Efficiency and Productivity of City Operations (October 2005)

⁹ Office of the Independent Budget Analyst Report 07-65 (June 2007)

¹⁰ Ibid.

¹¹ Association of Metropolitan Water Agencies 2009 Award Announcement

that are already being corrected under the recently consolidated leadership team. For example, concerns over the OCA's recommendation to "identify clear and distinct roles and responsibilities for the department and contractor"¹² were addressed prior to the beginning of the OCA work effort (see response to recommendation #6, below).

The OCA report acknowledges that "efficiencies have been achieved" and the reader should be able to conclude that with improved administrative procedures, which consolidate core knowledge of B2G oversight and goal/savings review, the B2G program will continue to effectively serve the ratepayer. The Department would agree that it is difficult to quantify how much of the savings come as a direct result of the program because it is only one among many initiatives designed to deliver more efficient and effective operations. Suffice it to say, that this program, with its Gainsharing goals (GSGs), incentivizes all classified personnel to provide continuous process improvement, save money, and achieve faster program success with observable achievements on an annual basis .

It is clear that this Report contains no findings of fraud, waste, abuse or willful misconduct. Furthermore, it is clear that no employee was rewarded as a result of this program before the completion of an external 3rd-party audit. It is the Department's understanding that these external audits, historically performed by *AKT*, were reviewed as part of the OCA report and no negative findings related to these audits have been presented by the OCA.

While the *AKT* audits have recommended corrective action as part of their yearly reports, they also confirmed the continual progress referenced above. In fact, in the *AKT* auditor's report dated March 19, 2009 for the FY2008 MWWD-wide program, the following comment was made: "It should also be noted that in FY2008, MWWD put in place a Bid-to-Goal Implementation Team that has improved upon readiness and program checks and balances from what has been observed in prior program years."¹³ In their detail testing of Key Performance Service Levels and Division Performance Goals, the external auditors noted no discrepancies between Department reported results and audited results. MWWD indicated all 8 of the Key Performance Levels as defined in the MOU for FY2008 were met and the external auditors tested all 8 and agreed with the results reported.¹⁴ MWWD indicated 20 of the 24 goals that comprised FY2008 Division specific Gainsharing Performance Goals were met or partially met. The external auditors tested 13 of 20 goals and agreed that all had been met as reported. There were 2 findings noted in the audit report. Finding 1 noted errors in the savings calculation process related to how MWWD treated post-close adjustments, CIP costs and out of scope expenditures and encumbrances. Recommendations to address these errors were noted and management has implemented all such recommendations. Specifically, the following actions have been taken in response to the auditor's recommendations:

1. Financial data is exported after all post-close adjustments that impact in-scope expenditures are posted.
2. Each Division reviews the savings calculation to ensure that all financial data is correct, including the out of scope items. Division sign off is now required.
3. Staff actively reviews encumbrances during the year end close-out period to ensure documentation submitted to the auditor is complete.

¹² Office of the City Auditor Draft Bid to Goal Audit Report, *Bid Process Roles and Responsibilities Are Not Clear and Distinct*,

¹³ *AKT* MWWD Bid to Goal Public Contract Operations Agreement Audit for FY2008 (March 2009)

¹⁴ *AKT* MWWD Bid to Goal Public Contract Operations Agreement Audit for FY2008 (March 2009)

4. Staff has implemented a second review for potential re-encumbering of funds.
5. MWWD now retains electronic and paper copies of all reports used in the financial savings calculation. Final figures will be reconciled and traced before being provided to the outside auditor for their review.

Finding 2 related to the treatment of the Director's Contingency Reserve within the savings calculation. *AKT* recommended that management consider amending the MOU and/or Bid to define the Director's Contingency, including the total amount allowed, its purpose and how it is to be used. MWWD agreed with this recommendation¹⁵ and the MWWD Bid-to-Goal MOU will be amended and presented to Council in conjunction with the draft Water Bid-to-Goal Agreement.

The external auditor's reports dated March 17, 2009 for the Customer Support Division's FY2008 program contained only one finding related to the savings calculation and recommended additional review by the Division. Division management agreed with this recommendation and it has been implemented. The external auditor selected for review 7 goals that had been reported as met by the Division and confirmed that all 7 were met as was initially reported by the Division.¹⁶

The external auditor's reports dated March 17, 2009 for the Water Operations Division's FY2008 program contained only one finding related to the savings calculation and recommended additional review by the Division. Division management agreed with this recommendation and it has been implemented. Additionally, the external auditor did find issues with the goals as reported by the Division and made several recommendations for improvement. Water Operations agreed with these recommendations and has taken steps to implement them, including internal review of goal criteria and goal attainment results by the Internal Controls team of the Employee Services and Internal Controls Division.¹⁷

The B2G program has been in a constant state of evolution and is now very different from the earlier versions. This thorough program review by the OCA is timely and will help further refine improved program management efforts. These modifications will be institutionalized for any new agreements that will cover all classified Public Utilities Department employees with the same rules and potential for gaining additional efficiencies and savings. Now that this review is complete, the Public Utilities Department will proceed with a request for audit of the FY2009 program results as required under existing contracts, and, when appropriate, the FY2010 results.

OCA Recommendations Related to Record Keeping:

To improve the accuracy of B2G documentation and transparency of the program and ensure that managers and other stakeholders have a key source of information upon which to base future assessments of the program, we recommend that the Department:

1. *solicit the development of a private sector benchmark at least every 5 years and ensure that the benchmark is comparable with the employee bid for at least the first year of the contract;*

Response: Concur. Action complete.

¹⁵ MWWD Audit Response (April 2009)

¹⁶ *AKT* Pay for Performance Verification of Goals Audit (March 2009)

¹⁷ Water Operations Response Letter (March 2009)

While there were delays in starting two of the agreements back in FY2002 and FY2003 and the inflationary increases to the benchmark were not made, over the course of the past 4 years, two B2G program MOUs have been ratified by the City Council and a third, for Water Fund classified employees, is pending review. In each of these three cases, a new private market benchmark has been obtained from HDR and a bid was developed which was lower than the benchmark as follows:

FY2007	Customer Support Division (CSD) ¹⁸	
	Private Market Benchmark	\$23,294,000
	Employee Bid	\$22,040,744
FY2008	Wastewater Fund ¹⁹	
	Private Market Benchmark	\$219,596,075
	Employee Bid	\$207,157,305
FY2010	Water Fund draft proposal ²⁰	
	Private Market Proposal	\$138,924,326
	Employee Bid	\$138,763,168

This comparison does not reflect the “one time” savings that result when the initial year department/division budget is reduced to match the Employee Bid. For the FY2008 Wastewater agreement, the savings were approximately 159 Full-time Equivalents (FTE); for the proposed FY2010 Water agreement, the savings are expected to be approximately 78 FTE. The FY2013-2017 Wastewater Fund B2G program will require a new Statement of Work and an independent private market benchmark.

2. *establish a central location for B2G documentation and core of employees with knowledge about the program;*

Response: Concur.

In FY2008, MWWD implemented a department-wide B2G program, combining the Wastewater Treatment and Disposal Division and Wastewater Collection Division programs. This was also the first time collaboration amongst Divisions occurred in the development of a B2G agreement. As part of this consolidation, MWWD created a B2G Implementation Team with the following **responsibilities:**

- Program Administration
- Facilitate the creation of clear and measurable goals

¹⁸ San Diego Water Department Customer Support Division Assessment Report (November 30, 2005); CSD Employee Bid (June 26, 2006); and Water Customer Support Division Bid to Goal FY2007 Annual Report

¹⁹ MWWD Private Market Proposal for Management, Operations and Maintenance Services (October 27, 2006); and MWWD Labor-Management Partnership Bid (February 21, 2006); and AKT MWWD Bid to Goal Contracts Operation Agreement Audit (March 2009)

²⁰ Private Market Proposal for Water System Management, Operations and Maintenance Services (September 25, 2009); and Draft Water Fund Bid (December 20, 2009)

- Conduct quarterly audits of goal attainment support documentation
- Annual pre-audit of the savings calculation
- Annual pre-audit of the annual report
- Centralized filing of goal attainment and financial support documentation
- Program communications.

By instituting the Implementation Team business model, the program dedicated resources that successfully initiated program standardization while monitoring program performance on a quarterly basis across the entire Department.

Prior to the consolidation which created the Public Utilities Department (effective July 1, 2009), the Water Department administered their Water Operation Division and CSD programs independently under Divisional management due to the distinct nature and timing of each Division's B2G agreement. As a result, all documentation was retained in those separate Divisions, not in a centralized location. This process was understood by the independent auditor and not questioned. Once the decision was made to consolidate the Water Department and MWWD, it was determined that the MWWD department-wide agreement was a better approach and actions were taken to develop a Water Fund program. This also highlighted the need for centralized management of all B2G programs and consolidated document management.

As part of the formation of the Public Utilities Department, two new sections were created to provide improved administrative oversight and to continue to implement the Department-wide enhancements started in MWWD to both the Water and Wastewater funds. The Strategic Support Services section employees have begun the consolidation of core knowledge for the Water and Wastewater Fund B2G programs and the Internal Controls section has the responsibility to review the goals and savings. (See response to Item #14.)

3. *ensure that accurate and updated B2G records, such as the annual performance reports, are maintained;*

Response: Concur.

As noted in response 2 above, effective July 1, 2009, all B2G programs came under the single management of the Public Utilities Department and responsibilities for record keeping (Strategic Support Services section) and review (Internal Controls section) have been consolidated. This centralization will ensure accurate, consistent, and updated B2G records are maintained for all active and future programs. However, a retroactive review and modification of records associated with past programs in order to revalidate findings will not be performed given limitation in resources.

4. *develop guidance with specific criteria for B2G annual reports, including the format and content and required updates to be included in such reports that will allow the results to be easily reviewed and compared; and*

Response: Concur.

While the historically separated B2G programs produced year-end annual reports detailing the achievements and accomplishments of their respective Divisions,²¹ the Department agrees that uniform guidance should be developed for all programs. As a result, the guidance containing specific criteria for Final Annual B2G Reports has been developed and disseminated to all program administrators. The Department is committed to developing a Department Instruction (DI) that will include these specific criteria, procedures developed for the FY2008 Wastewater Fund and the draft FY2010 Water Fund, and incorporate the best practices included in the recommendations of this Report. The DI will be available for internal routing before the end of the fiscal year.

5. *maintain a public, historical record of B2G results by including previous years' annual reports on the Department's website.*

Response: Concur.

The Department recognizes that improved access to program reports, including information on the attainment of goals, efficiency and savings achieved, and incentive awards approved would enhance the confidence of the public and stakeholders in the program. The Department will ensure that the FY2008 Final B2G Reports and those of succeeding years will be available to the public through the Department website. In addition, existing reports and summaries will likewise be made available for past years.

OCA Recommendations Related to Program Benefits:

To improve the transparency, management and credibility of the bid process and ensure that management can fully assess the benefits of B2G, we recommend that the Department:

6. *identify clear and distinct roles and responsibilities for the Department and contractor and provide structure for the bid process;*

Response: Concur.

The Department has already implemented the recommended separation of roles regarding the development of the statement of work and responsibility for the private market benchmark. For the draft FY2010 Water Fund agreement, the Department separated these roles, began working on the Statement of Work (SOW) in August 2008, and separately engaged an expert consultant in February 2009 solely for the purpose of deriving the private market benchmark. At the outset, the Water Fund staff understood their clear and distinct responsibility to develop a SOW and delivered the *Statement of Work for Management, Operations and Maintenance Services dated July 1, 2009*. The selected consultant worked independently to develop the private market proposal (benchmark) and delivered the final report entitled *Private Market Proposal for Water System Management, Operations and Maintenance Services dated September 25, 2009*. This is the process that has been identified for use in all future programs and which will be codified in the new DI governing all processes within the B2G program.

²¹ For example, see Water Customer Support Division Bid To Goal FY2008 Annual Report

In addition, since the inception of the B2G program, all contracts have been developed under the oversight of the City Manager and/or Mayor, and ultimately approved by the City Council. This oversight has been provided through various groups, such as the Optimization Program, the Competition Sub-Committee and/or the Business Office. The goal of this oversight is to improve the Department's effectiveness of service delivery and business operations, maintain high quality service at an optimum cost to ratepayers, and promote accountability.

7. *develop a system for accurately tracking the administrative costs of the program;*

Response: Concur.

The Department agrees that procedures and guidelines are needed for separately tracking the administrative costs as well as the cost for the preparation of the savings calculation under the various agreements. In the past, all internal program costs were included as part of the overall administrative costs of the various Divisions or Department. Now, the Public Utilities Department has created separate accounting within the City's system to track internal costs spent specifically on the yearly administration of B2G programs. An SAP internal order number has been established to capture program costs and was announced by email to all program administrators on January 21, 2010, to be used on time cards submitted for the pay period ending January 22, 2010. While this was planned to occur sooner, it was dependent upon the roll-out of the City's new Human Capital Management (HCM) system. The Department will also update current guidance used in the Wastewater Fund B2G savings calculations to incorporate the recommendations from this Report.

8. *develop a system for accurately tracking EEIR actual expenditures and report these in annual performance reports; and*

Response: Concur.

The Department agrees that procedures and guidelines are needed for tracking EEIR actual expenditures separately from other Departmental expenditures and with the need to report these in the Annual Performance Report. The Department will enhance these changes by incorporating the procedures into a DI for all future B2G agreements.

9. *require an external audit of payouts, maintain an accurate record of the audited total gross payout amounts and number of employees receiving payouts, and evaluate whether setting net rather than gross payout caps is the most equitable and appropriate limit.*

Response: Concur.

The Department has relied on information maintained in the City's accounting systems (AMRIS and CAPPS) and believes that the information is accurate, reliable, and provides the detailed information needed to effectively manage the B2G program. The Department expects SAP to provide the same functionality and will be monitoring this.

The Department contracted with AKT to complete a third party review of the payouts from all three programs for FY2008 and that review was completed January 29, 2010. From a total population of

2,221 gross payouts totaling \$7,173,194.33, one hundred employee records were randomly selected and only one discrepancy was noted (a retired employee was paid \$398 when he should have been ineligible). This represents a total payout error rate of 1.19%. The Department will add this task to the scope of the contract for all three programs for FY2009, and include this information in the Final Annual B2G reports for those programs.

The Department has evaluated the recommendation on modifying payouts to reflect gross, rather than net, pay to the employees. At this time, continued payouts on a net-pay basis are recommended as the most equitable method of ensuring the same value of the award to all who earn them. In addition, cash awards made by the City have historically been based on *net* pay, as outlined in Administrative Regulation 95.91 Employee Recognition and Award Programs²², not *gross pay*. It should be noted that the fully burdened *gross* payout amounts are charged to the savings amounts in the established Employee Earned Incentive Reserve (EEIR), and thus are fully accounted for within the program.

OCA Recommendations Related to Goals:

To ensure to that gainsharing goals continue to improve and employees of all levels are involved in developing these goals, we recommend that the Department:

- 10. ensure that gainsharing goals continue to be measurable, auditable, and stretch goals; and*

Response: Concur.

The Department recognizes that goals should consistently improve in quality. As noted in the OCA report, the measurability of goals as well as the level of detailed linkage to regulatory and benchmark information has improved for FY2010. In FY2010, as a result of Utility consolidation, the Department initiated additional review steps in which all GSGs were recommended by the responsible Assistant Director, presented and reviewed by the Department Executive Team, and approved by the Director. The intent of this new process is to ensure that all established goals are consistently developed and in alignment with the goals and objectives of the newly consolidated Department. Starting with the FY2011 GSGs, the newly consolidated Employee Services & Internal Controls Division will be responsible for a pre-audit of all future GSGs before they are presented to the Executive Team.

- 11. establish a structured system for involving all levels of employees in the goal-setting process, such as encouraging participation on goal-setting teams on a rotational basis to obtain ideas and input for improving the efficiency and effectiveness of operations and hold these employees accountable and responsible for each performance measure.*

Response: Concur.

Since the inception of the B2G program, the Department has solicited input for the development of operational improvement and GSGs from employees at all levels in the organization. Each Program

²² Administrative Regulation 95.91. Section 6 (1989)

has accomplished this in different ways and with varied levels of success. One common aspect of all prior programs was that, given the independent nature of each contract, Division management review and approval were required for all GSGs to ensure that selected goals were challenging and achievable, and that they were consistent with the mission and goals of the Department. Goals were developed to encourage communication and cooperation throughout the Department. When insufficient goals were obtained from employees, Division management established goals with input from senior staff in the Division. In addition to soliciting input from employees, all goals are shared with each Labor Management Committee for input prior to finalizing. The Labor Management Committee consists of staff and representation from both MEA and Local 127.

It should be noted that the Department's commitment to employee involvement has extended not solely to the development of the yearly Gainsharing goals, but has been a fundamental element in deriving the optimal level of performance and bid targets for the first year of the bid contracts. For example, in the Customer Support Division's (CSD) FY2007 agreement, in preparation for B2G implementation, employees from each CSD Section and their supervisors worked together as Process Improvement Teams (PITs) to review their sections' work-flow activities, recommended operational changes for improvements, and developed the performance measures necessary to track achievements and improvements over time.

The PITs began their work by looking at their workloads objectively, from the customer's perspective, debating where improvements needed to be made, and then developing performance metrics that are measurable given available technology and the Division's service level requirements. For example, employees in CSD/Field Services & Investigations evaluated the amount of time it took to complete a field investigation; vigorously debated how to improve their work processes in order to complete investigations faster; and recommended a performance measure that will help focus employees on completing investigations in an incrementally less number of days every year. Employees looked in detail at the process of completing investigations, including factors such as reducing travel time, more efficient scheduling and planning, reducing down time, improving communication within the billing and field sections, and changing existent processes and procedures all with the goal of completing their work not only faster, but also without losing accuracy. The result: while in 2006 investigations had taken up to 25 days to resolve, in FY2007, 82% of investigations were completed in 21 days and by FY2008 86% of investigations were completed in 15 business days.²³

The Department is committed to trying different techniques to increase employee involvement. We have seen through the years that the lion's share of good ideas come from those doing the job. Any new, effective guidelines used in setting future goals will be incorporated in the new DI.

The B2G Gainsharing Guidebook codifies the Department's past and current system for goal setting. The Department has also implemented the Suggestions To Achieve Results (STAR) program in FY2010. This program provides the opportunity for any employee to make recommendations or suggestions to improve Department operations. It has already proven to be a very successful vehicle for receiving employee input on the program and continuous improvement efforts. Many of these

²³ Field Services and Investigations and Customer Support Office Accountability Tables

suggestions could be inspirations for future (FY2011 and beyond) GSGs. The Department will detail this process in the new DI.

To ensure that the Department has a consistent and inclusive approach, in the development of GSGs across both the Water and Wastewater Fund programs, the Department will create a process to obtain employee input (including the Report recommendation of using a rotational team of employees or the LMC to develop goals to be presented to management). This process will also be captured in the DI governing the B2G programs.

OCA Recommendations Related to Savings:

To improve the accuracy of B2G savings calculations and ensure that program results are reliable, we recommend that the Department:

12. *develop detailed and specific guidance for standardized savings calculations, including instructions for sources of data, out of scope and in scope expenditures, encumbrances, and justifications for administrative relief when goals are not met;*

Response: Concur.

The Divisions within the B2G program developed procedures for calculating savings, utilization of source data, and the determination of in-scope versus out-of-scope expenditures. Due to the separate and distinct provisions of each Divisional agreement, these procedures were not standardized across all B2G programs, though communication between staff helped improve uniformity in data interpretation and calculation.²⁴ In order to codify standardization across the entire Department, a draft manual was developed in FY2008 for the MWWD B2G department wide program. This will be further developed and become a part of the new Department Instruction (DI) for the B2G programs spanning the consolidated Public Utilities Department.

The new DI will specifically address the development of the complete Statement of Work and Private Market Proposal; creation of the employee Bid targets; the formulation and scope of the Labor Management Committee; present detailed outlines of the Gainsharing program and incentive award process; delineate the Annual Performance Report and Final B2G Annual Report; outline the scope of review of the Internal Controls section; and specify communications, document retention, and annual program schedule of key milestones and deliverables.

13. *develop procedures for ensuring that recommendations from external audits are implemented; and*

Response: Concur.

As noted, the Department has historically documented its response to external audit findings. (See prior discussion above regarding Departmental response to AKT findings.) Post-finding implementation has not specifically been documented, though the effect of the implementation is

²⁴ For example, while governed by separate agreements, staff within the Water Operations Division and Customer Support Division continually met to achieve greater consistency in factors such as savings calculations, administrative relief criteria, and source document control.

reflected in annual reports produced by the Divisions.²⁵ The Department will continue to document its audit responses. In addition to this, each successive year's Annual Report will specifically include details regarding the degree to which prior year audit findings have been implemented. In this manner, all audit findings will be addressed twice: first as part of the Department's direct response to the external audit report, and then as part of the subsequent year-end summary of performance measure and goal attainment, and cost savings on each B2G program.

14. *establish processes for making internal controls an integral part of planning, budgeting, management, accounting, and auditing the B2G program, including reviewing savings calculations and goal achievement and segregating duties between performing, reviewing, and documenting a task.*

Response: Concur. Action complete.

The establishment of these processes has been completed for the Department's draft FY2010 programs. The Internal Controls and Strategic Support Services sections were established effective July 1, 2009 to provide internal control and auditing of the now-centralized B2G administration. The completion of annual reports outlining program savings, goal and performance measure achievement, and overall contract administration, as well as the yearly planning and integration of the B2G program within the overall City budget is centralized in the Strategic Support Services (SSS) section of the unified department. Auditing of yearly savings and goal attainment reports is coordinated by the Internal Controls section, which performs this function independent of the SSS section and serves as an internal quality assurance and quality control check.²⁶ The Department will have a fully integrated Internal Controls Section review of program results prior to each step of the program and this process will be detailed as part of the new DI. The review will include verification of measure and goal attainment through detailed examination of source documents, process control, data integrity, and performance measure validity on a randomized sample from each Division within the program. In addition, verification of financial savings, appropriate bid escalation factors, and employee bid payout eligibility will also be included as part of the review. Subsequent to this internal review, the Department will engage an independent 3rd party auditor to perform a second audit of the program.

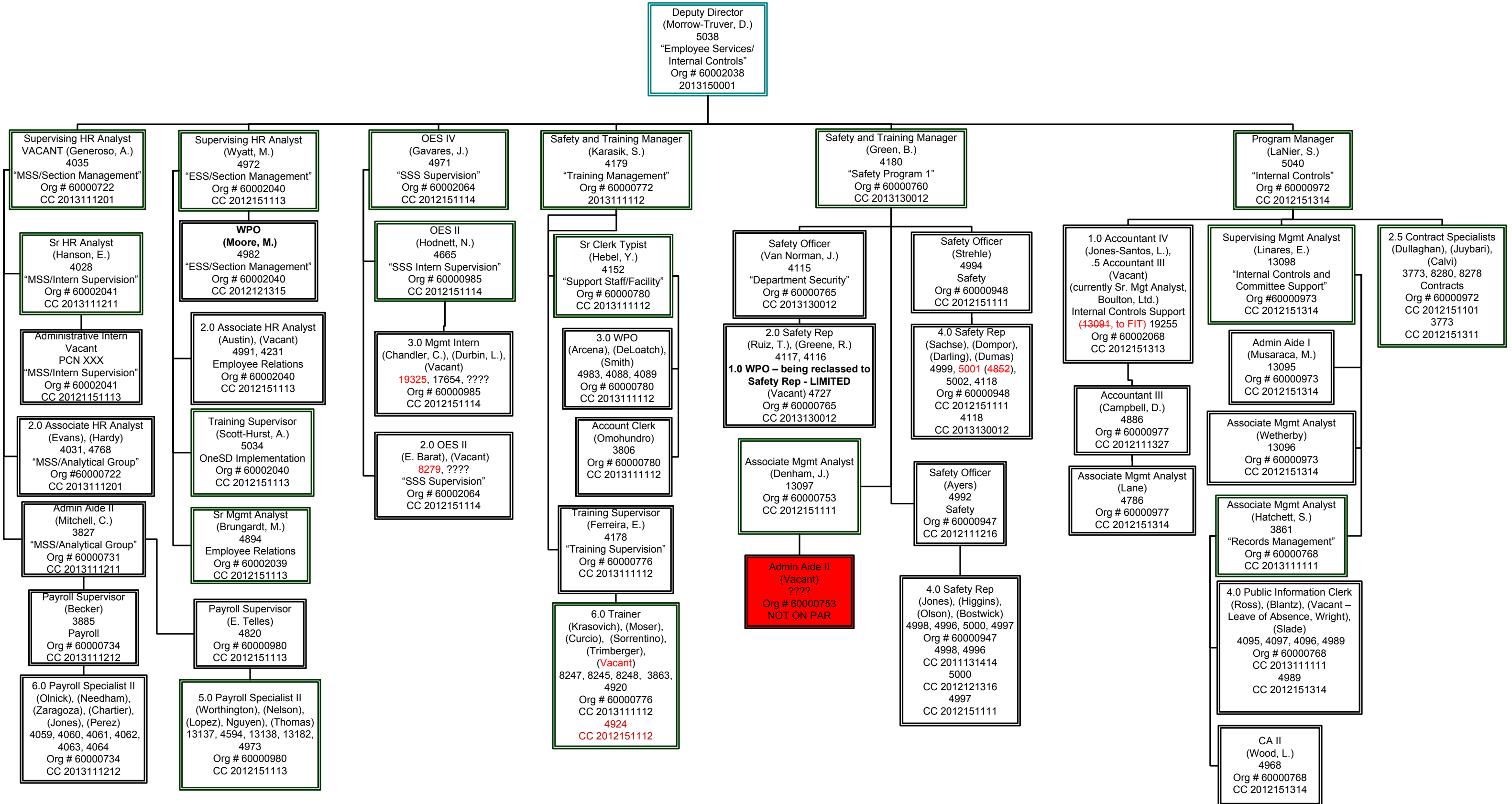
²⁵ Water Customer Support Division Bid To Goal FY2008 Annual Report

²⁶ See attached FY2010 organization chart showing these relationships.

Fiscal Year 2010 Public Utilities Organizational Chart

Employee Services/Internal Controls

1 21 2010



Contacts

On the Web

<http://www.sandiego.gov/auditor/>

Contact

Eduardo Luna, City Auditor

cityauditor@sandiego.gov

(619) 533-3165

1010 Second Avenue, Suite 1400

San Diego, CA 92101
