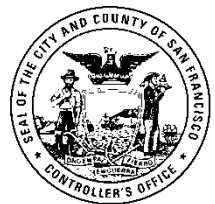


City and County of San Francisco

Office of the Controller – City Services Auditor

SAN FRANCISCO PUBLIC UTILITIES COMMISSION:

The Department Appropriately Categorized Program Management Costs, but Should Improve Its Method of Allocating Those Costs to Projects



February 13, 2012

**OFFICE OF THE CONTROLLER
CITY SERVICES AUDITOR**

The City Services Auditor (CSA) was created in the Office of the Controller through an amendment to the Charter of the City and County of San Francisco (City) that was approved by voters in November 2003. Under charter Appendix F, CSA has broad authority to:

- Report on the level and effectiveness of San Francisco's public services and benchmark the City to other public agencies and jurisdictions.
- Conduct financial and performance audits of city departments, contractors, and functions to assess efficiency and effectiveness of processes and services.
- Operate a whistleblower hotline and website and investigate reports of waste, fraud, and abuse of city resources.
- Ensure the financial integrity and improve the overall performance and efficiency of city government.

CSA may conduct financial audits, attestation engagements, and performance audits. Financial audits address the financial integrity of both city departments and contractors and provide reasonable assurance about whether financial statements are presented fairly in all material aspects in conformity with generally accepted accounting principles. Attestation engagements examine, review, or perform procedures on a broad range of subjects such as internal controls; compliance with requirements of specified laws, regulations, rules, contracts, or grants; and the reliability of performance measures. Performance audits focus primarily on assessment of city services and processes, providing recommendations to improve department operations.

CSA conducts its audits in accordance with the Government Auditing Standards published by the U.S. Government Accountability Office. These standards require:

- Independence of audit staff and the audit organization.
- Objectivity of the auditors performing the work.
- Competent staff, including continuing professional education.
- Quality control procedures to provide reasonable assurance of compliance with the auditing standards.

Audit Team: Irella Blackwood, Audit Manager
Kat Scoggin, Associate Auditor
Chris Trenchel, Associate Auditor



City and County of San Francisco

Office of the Controller - City Services Auditor

San Francisco Public Utilities Commission:

February 13, 2012

The Department Appropriately Categorized Program Management Costs, but Should Improve Its Method of Allocating Those Costs to Projects

Purpose of the Audit

The objective of the audit was to determine if best practices are being followed in the allocation of program management costs for two projects of the San Francisco Public Utilities Commission's (SFPUC) Water System Improvement Program (WSIP): long-term improvements at the Harry Tracy Water Treatment Plant and modifications to the dechloramination facility at the Pulgas Balancing Reservoir.

Highlights

- SFPUC's categorization of expenditures as program management costs appears appropriate. A high-level review of expenditure data from July 2006 through June 2011 found that the majority of program management costs were paid to construction management consultants. The audit selected \$1.1 million of expenditures for in-depth review and found them to be correctly categorized as program management costs.
- Although SFPUC takes a unique approach to allocating program management costs compared to four other jurisdictions, its decisions to allocate costs to individual WSIP projects and use each project's share of total WSIP costs as a basis for allocations comply with relevant accounting standards and are logically sound.
- SFPUC should improve the way it calculates its annual allocation of program management costs to WSIP projects. The audit found that:
 1. SFPUC does not reconcile its budget-based allocations of program management costs when actual costs become available, resulting in misallocations.
 2. SFPUC's allocation process causes some projects' program management costs to be recognized before they are incurred, resulting in less accurate interim reports.
 3. SFPUC does not have procedures for identifying and correcting significant misallocations of program management costs.
 4. The WSIP quarterly reports do not always reflect program management costs.

Recommendations

The audit report includes four recommendations for SFPUC to improve its allocation of program management costs to WSIP projects. Specifically, SFPUC should:

- Develop a method of adjusting program management costs to reflect actual costs before projects are capitalized.
- Cease recognizing future expenses in the current fiscal year.
- Develop procedures to identify and resolve material misallocations of program management costs to projects.
- Ensure that WSIP quarterly reports reflect program management costs either as part of the expenditures of the individual projects or as a separate expenditure category.

Copies of the full report may be obtained at:

*Office of the Controller • City Hall, Room 316 • 1 Dr. Carlton B. Goodlett Place • San Francisco, CA 94102 • 415.554.7500
or on the Internet at <http://www.sfgov.org/controller>*

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CITY AND COUNTY OF SAN FRANCISCO
OFFICE OF THE CONTROLLER

Ben Rosenfield
Controller

Monique Zmuda
Deputy Controller

February 13, 2011

Ms. Aimee Brown, Chair
San Francisco's Public Utilities Revenue Bond Oversight Committee
City Hall, Room 244
1 Dr. Carlton B. Goodlett Place
San Francisco, CA 94102

Dear Chair Brown and Members:

The Office of the Controller, City Services Auditor Division, presents its audit report on the allocation of program management costs for two projects of the San Francisco Public Utilities Commission's (SFPUC) Water System Improvement Program (WSIP):

- Project CUW367.1 - Harry Tracy Long-Term Improvements
- Project CUW361.5 - Pulgas Balancing Reservoir: Modifications to Existing Dechlor Facility

The audit objective was to determine if program management costs are being allocated according to best practices.

The audit found that SFPUC appropriately categorized expenditures as program management costs for WSIP. The audit also found no evidence that SFPUC's accounting for program management costs was out of compliance with state law or professional standards such as those of the Governmental Accounting Standards Board. By allocating program management costs to individual WSIP projects, SFPUC provides more transparency than is required. However, SFPUC's allocation methodology should be improved to better achieve its goal of providing a more complete picture of each project's total costs.

SFPUC's response to the audit report is attached as Appendix B. CSA will follow-up with SFPUC on the recommendations made in the report.

We appreciate the assistance and cooperation that SFPUC staff provided to us during the audit.

Respectfully,

A handwritten signature in black ink, appearing to read "Tonia Lediju".

Tonia Lediju
Director of Audits

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LIST OF ABBREVIATIONS AND ACRONYMS

City	City and County of San Francisco
CMU	Charlotte-Mecklenburg Utilities
commission	San Francisco Public Utilities Commission's governing body
CSA	City Services Auditor Division, Office of the Controller
FAMIS	Financial Accounting and Management Information System
Harry Tracy projects	Project CUW367.1 - Harry Tracy Long-Term Improvements project Harry Tracy and Pulgas projects
Pulgas	Project CUW361.5 - Pulgas Balancing Reservoir: Modifications to Existing Dechlor Facility
RBOC	San Francisco's Public Utilities Revenue Bond Oversight Committee
SFPUC	San Francisco Public Utilities Commission (a city department)
WSIP	Water System Improvement Program

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INTRODUCTION

Audit Authority

This audit was conducted under the authority of the Charter of the City and County of San Francisco (City), which requires that the Controller, as the City Services Auditor (CSA), conduct periodic, comprehensive financial and performance audits of city departments, services, and activities.

CSA established an agreement with San Francisco's Public Utilities Revenue Bond Oversight Committee (RBOC) to perform a series of five audits. As authorized by voters in 2002, RBOC was formed the following year to monitor the bond expenditures of the San Francisco Public Utilities Commission (SFPUC). At the request of RBOC, CSA determined if program management costs for SFPUC's Water System Improvement Program (WSIP) were allocated for two WSIP projects according to best practices:

- Project CUW367.1 - Harry Tracy Long-Term Improvements (Harry Tracy)
- Project CUW361.5 - Pulgas Balancing Reservoir: Modifications to Existing Dechlor Facility (Pulgas)

Background on the Water System Improvement Program

WSIP is a \$4.6 billion dollar construction program funded through revenue bonds issued as a result of a November 2002 voter-approved bond measure. WSIP is intended to repair, replace, and seismically upgrade the system's deteriorating pipelines, tunnels, reservoirs, pump stations, storage tanks, and dams. WSIP projects are either local or regional, with the regional projects being further divided into five large regions (San Joaquin, Sunol Valley, Bay Division, Peninsula, and San Francisco).

Background on Harry Tracy and Pulgas Projects

Harry Tracy and Pulgas (the projects) are regional projects in the Peninsula region. The Harry Tracy Water Treatment Plant, in conjunction with the Crystal Springs Reservoir System (Upper and Lower Crystal Springs reservoirs) and San Andreas Lake, serves as the emergency back-up and supplementary water supply system for the entire San Francisco Peninsula. The Harry Tracy project is intended to improve delivery reliability and provide seismic upgrades at this regional water treatment plant.

Office of the Controller, City Services Auditor

The Department Appropriately Categorized Program Management Costs, but Should Improve Its Method of Allocating Those Costs to Projects

The Pulgas Balancing Reservoir helps the water transmission system meet daily peak demands. The reservoir is seismically vulnerable, requires improvements to sanitary protections, and requires general rehabilitation of miscellaneous structural, mechanical, and electrical systems. The Pulgas project is improving the dechloramination (dechlor) and pH control facilities to address immediate compliance issues.

Background on program management costs

SFPUC includes as program management costs all expenditures associated with program-level development and implementation benefitting WSIP as a whole and not attributable to a specific project. Major program management costs include those associated with the following functions or activities:

- General oversight and coordination among the various SFPUC or city organizations and consultants involved in WSIP
- Construction management planning
- Risk management
- Program controls and reporting
- Program communication and public outreach
- Legal services at the program level
- Cost estimating and scheduling at the program level
- Contract management
- All consulting services for program support

Each WSIP project has its own code in the City's accounting system, Financial Accounting and Management Information System (FAMIS). Because WSIP program management is tracked as a separate project in FAMIS, all WSIP program management expenditures can be identified by one code. At the end of the fiscal year, SFPUC allocates the year's WSIP program management costs to each WSIP project based on its share of total WSIP costs (Appendix A provides an overview of the allocation process). Program management costs of \$110.5 million were budgeted for WSIP as of the July 25, 2009, budget realignment.

Exhibit 1 shows the Harry Tracy and Pulgas projects' expenditures and allocation of program management costs for fiscal years 2007-08 through 2010-11.

EXHIBIT 1 **Harry Tracy and Pulgas Budgets, Expenditures, and Allocations of Program Management Costs**
Fiscal Years 2007-08 through 2010-11

	Harry Tracy		Pulgas	
	Expenditures	Program Management Costs Allocation	Expenditures	Program Management Costs Allocation
July 2007 through June 2008	\$ 4,793,509	\$1,693,751	\$ 692,192	\$ 46,840
July 2008 through June 2009	7,865,224	423,534	591,468	33,148
July 2009 through June 2010	12,922,417	686,215	724,818	45,323
July 2010 through June 2011	12,269,913	345,536	1,979,928	10,951
Total	\$37,851,063	\$3,149,035	\$3,988,406	\$136,262

Sources: Expenditures from FAMIS as of June 30, 2011; program management costs from SFPUC's annual program management worksheet for fiscal year 2010-11.

Objective

The objective of the audit was to determine whether WSIP program management costs are being allocated according to best practices. Specifically, the audit sought to:

- Identify the types of expenditures included in program management costs.
- Evaluate whether program management costs are allocated reasonably and within industry norms.
- Verify that program management costs are reflected in project and program expenditure reports.

Scope and Methodology

The scope of the audit included program management expenditures for two selected WSIP projects during fiscal year 2010-11.

The audit team:

- Interviewed SFPUC staff and managers to understand SFPUC's program management processes and expenditure approval processes.
- Assessed the projects' internal controls for expenditure processing and review.
- Compared SFPUC's overhead policies to those of four other jurisdictions.
- Tested, on a sample basis, expenditures allocated to program management.

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The Department Appropriately Categorized Program Management Costs, but Should Improve Its Method of Allocating Those Costs to Projects

- Assessed whether the frequency and timing of SFPUC's allocation of program management costs to WSIP projects is appropriate.

Statement of Auditing Standards

This performance audit was conducted in accordance with generally accepted government auditing standards. These standards require planning and performing the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for the findings and conclusions based on the audit objectives. We believe that the evidence obtained provides a reasonable basis for the findings and conclusions based on the audit objectives.

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AUDIT RESULTS

Summary

SFPUC's categorization of expenditures as WSIP program management costs appears reasonable. However, its methodology for allocating those costs to individual WSIP projects needs improvement. Although SFPUC's allocation methodology differs from other jurisdictions', decisions to allocate the costs to the smaller WSIP projects and to use budget as a basis for this allocation comply with accounting standards and represent a logical approach. However, the department does not adjust its budget-based allocations to match actual costs, recognized some projects' share of program management costs in incorrect fiscal years, does not have procedures for correcting overallocations, and does not always reflect program management costs in its quarterly reports.

Finding 1

SFPUC's categorization of expenditures as program management costs appears reasonable.

SFPUC's program management expenditures adhere to its criteria of what constitutes program management

Of the \$1.1 million in program management expenditures examined by the audit, no exceptions were found. All program management expenditures appear within SFPUC program management guidelines, and, therefore, properly categorized as program management costs. Exhibit 2 summarizes the expenditures and the results of the review.

EXHIBIT 2

Program Management Costs for WSIP by Category July 1, 2006, through June 30, 2011

Category	Costs	Dollars Tested	Results of Review
Construction management planning	\$39,154,411	\$1,066,431	No exceptions
SFPUC Infrastructure Division overhead ^a	6,433,833	9,571	No exceptions
SFPUC labor ^b	5,381,824	31,190	No exceptions
Legal services at the program level including permits and rights of way	3,163,375	0	Not applicable
Other	2,023,354	0	Not applicable
Total	\$56,156,797	\$1,107,192	No exceptions

^a Includes expenses like office supplies and salaries of division support staff.

^b Includes expenses like salaries of staff performing contract management, program controls, public outreach, and program communication duties.

Source: Auditor's evaluation of FAMIS data for July 1, 2006, through June 30, 2011.

Finding 2

SFPUC's allocation of program management costs to projects based on their share of total costs differs from other jurisdictions' methods, but complies with best practices and is a logical approach.

Although SFPUC's allocation methodology is different than those of four other jurisdictions contacted, it is reasonable (Appendix A summarizes SFPUC's allocation method). The audit team interviewed four U.S. jurisdictions with large infrastructure construction programs about their accounting of nonproject-specific overhead expenditures.

SFPUC's approach differs in three primary ways: the frequency and timing of allocation, the allocation to smaller projects in the construction program, and the cost basis for allocations. Problems related to the timing and frequency of allocations is addressed in findings 3 and 4 below.

SFPUC allocates program management costs to individual WSIP projects.

Unlike three of the four other jurisdictions contacted, SFPUC allocates the WSIP's program management costs to the program's projects. According to SFPUC, tracking program management costs by project allows the department to more precisely determine the actual cost of each project. This, in turn, allows the department to better budget for projects in the future and provides stakeholders with a complete depiction of project costs.

SFPUC bases its allocations on each project's share of overall WSIP costs.

SFPUC's allocation is based on each project's proportional share of the total WSIP costs. For example, a project with expenditures that amount to 10 percent of WSIP's overall costs should be allocated 10 percent of the total WSIP program management costs over the life of the project.

Only one other jurisdiction contacted, Charlotte-Mecklenburg Utilities (CMU), allocates program overhead to individual projects. CMU allocates its overhead by multiplying the direct labor hours its employees charge to the project by an overhead rate. Similar to SFPUC, at the end of the fiscal year, CMU allocates any differences between its expected overhead and actual overhead expenditures to projects based on each project's share of the total direct expenditures for that fiscal year. According to the program's business manager, the amount CMU

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allocates based on budget is an insignificant portion of the total overhead costs.

SFPUC's cost basis for allocating program management costs to projects complies with best practices.

The Cost Accounting Standards Board (CASB) has established guidelines that, while specifically directed at entities that contract with the federal government, can be considered best practices. CASB standard 418 indicates that pooled costs could be allocated based on resource consumption. Using share of budget, or share of resources, as the basis of allocating program management costs complies with this standard.

The allocation methodologies of SFPUC and the other jurisdictions are summarized in Exhibit 3.

EXHIBIT 3		Comparison of Utility Construction Programs in Five Jurisdictions	
Jurisdiction	Program Scope	Allocation Methodology	Allocation Frequency
San Francisco Public Utilities Commission (San Francisco, CA)	\$4.6 billion program encompassing 46 projects to upgrade regional and local water systems	Allocated to individual projects, based on share of total costs	Annually
Los Angeles Department of Water and Power (Los Angeles, CA)	\$3.4 billion project to improve reliability and quality of water supply for 3.8 million residents	Projects are not differentiated; charged as direct expenditures	As Direct Expenditures
Orange County Sanitation District (Orange Co., CA)	\$2.9 billion program encompassing 125 projects to improve sanitation system	Projects are not differentiated; separate cost to the program	Monthly
Charlotte-Mecklenburg Utilities (Charlotte, NC)	\$200 million expended annually to improve water and sewer systems	Allocated to projects, based on labor multiplier and share of total costs*	Monthly
Eugene Water and Electric (Eugene, OR)	\$130 million program to repair and maintain water system	Projects are not differentiated; separate cost to the program	Monthly
*Program management costs are generally allocated monthly using a labor multiplier that is based on a total budget for program management for that fiscal year. At the end of the fiscal year, any difference between the budgeted total and actual total is allocated to projects based on their relative share of the year's total expenditures.			

Source: Auditor survey of other jurisdictions.

Finding 3

SFPUC does not reconcile its budget-based allocations of program management costs when actual costs become available, resulting in misallocations.

The SFPUC Commission does not update the approved budget annually.

WSIP operates under the most recent budget approved by the SFPUC Commission, which may not be the most recent information available. SFPUC stated that it can only make decisions based on the approved budget because of a state law, the Wholesale Regional Water System Security and Reliability Act.¹ The law requires improvements to the San Francisco Bay regional water system to ensure emergency preparedness and includes requirements for planning, financing, and reporting, as well as a specific process for adjusting the plan. According to SFPUC, this law's requirements result in SFPUC having to use only the approved budget when managing WSIP, including when calculating the program management costs allocations, even if it has more current cost information available.

The baseline WSIP budget was first approved in 2005 and the SFPUC Commission has updated that baseline budget every two years to account for adjustments in project scope or fluctuation in prices. Program management cost allocations for fiscal year 2010-11 were based on a WSIP budget approved by the commission in June 2009. Because project budgets have continued to change since 2009, the 2009 realignment does not reflect SFPUC's most current estimate of some projects' total costs. As a result, program management costs were misallocated.

The Commission-approved budget can differ significantly from current cost estimates.

SFPUC continually monitors the status of each project, including its past expenditures and projections of final cost. The department produces quarterly WSIP reports that provide updates on the projects' status. Some of the updated project budgets shown in quarterly WSIP reports differ significantly from the official budget approved by the commission in 2009.

Exhibit 4 shows the differences between the 2009 commission-approved budget used to allocate fiscal year 2010-11 program management costs and the July, 1, 2011, quarterly WSIP report for the Harry Tracy and Pulgas projects that reflects the estimated budget at the end of fiscal year 2010-11.

¹ California Water Code §73500-7314.

EXHIBIT 4		Comparison of 2009 Commission-Approved Budget and Estimated Project Budgets in 2011 Quarterly WSIP Report			
Project	2009 Project Budgets Used in Calculation	Project Budget in July 2011 WSIP Quarterly Report	Difference from 2009 Budget		
			Dollars	Percent of Project Budget^a	Percent of WSIP Budget^b
Harry Tracy	\$359,063	\$276,896	\$82,167	22.9%	1.8%
Pulgas	6,158	5,790	368	6.0%	0.0%
Note: Dollar amounts are in thousands.					
^a Percent the dollar difference is of the budgets for the projects in the 2009 approved budget.					
^b Percent the dollar difference is of the budget for WSIP of \$4,585,556,000 in the 2009 approved budget.					

Source: June 2009 commission-approved budget and July 1, 2011, SFPUC WSIP Quarterly Report budgets for Harry Tracy and Pulgas projects. Percentages calculated.

SFPUC is aware that the changes in project estimates as compared to previously adopted budgets may cause variances in allocating program management costs. Specifically, when a project's estimated costs decrease, SFPUC often allocates too much program management costs to the project.

SFPUC takes steps to compensate for these variances. During the annual allocation process, the department identifies projects that have already been overallocated and ensures that they receive no further allocation. However, SFPUC does not make any adjustments to remove the overallocated costs from those projects. Consequently, some program management costs are shifted away from projects that will ultimately be underallocated and left in other projects that remain overallocated.

Recommendation

1. The San Francisco Public Utilities Commission should develop a method of adjusting program management costs before each project is capitalized to reflect actual costs.

Finding 4

SFPUC's allocation process causes some projects' program management costs to be recognized before they are incurred, resulting in less accurate interim reports

Although SFPUC's process aims to ensure that each project receives its full allocation of program management

Office of the Controller, City Services Auditor

The Department Appropriately Categorized Program Management Costs, but Should Improve Its Method of Allocating Those Costs to Projects

costs, the timing of the allocations and capitalization of the projects results in some of those costs being recognized too soon. Consequently, some projects' costs may be misstated in interim reports.

SFPUC recognizes future costs in the current year, contrary to best practices.

According to SFPUC, there is no opportunity to allocate to a project any program management costs that may be incurred during the year it is completed. This is because the allocation happens at year end, but projects are capitalized upon completion. Once a project is capitalized, SFPUC does not retroactively adjust the capitalized amount.

To account for the anticipated completions, SFPUC weights its program management allocations to assign more costs to projects nearing completion. Essentially, SFPUC is projecting the next year's expenses and recognizing them in the current year.

For instance, in the fiscal year 2010-11 allocation, SFPUC allocated all remaining program management costs anticipated for the life of the local water project grouping although several projects in it were not yet completed. In fact, of the \$600 million budgeted for local water projects, \$284 million (47 percent) was for projects that were less than 25 percent complete when the allocation was made.

Best practices require expenses to be recorded in the fiscal period in which they occur and be based on actual rather than estimated expenses when possible.

Best practices require expenses to be recorded in the fiscal period in which they occur. Best practices also require that cost allocations be made on actual data whenever possible; estimates should be used only when actual expenses cannot be reasonably determined. Consequently, SFPUC's allocation of program management costs based on projections of what it anticipates to occur in the subsequent year does not comply with best practices. Recognizing costs in the incorrect fiscal year also results in WSIP reports misstating the projects' actual costs incurred to date. For instance, WSIP quarterly reports regarding the local water projects mentioned above will show a sharp increase in costs due to recognizing future program management costs in fiscal year 2010-11.

To comply with best practices and standards, SFPUC could allocate program management costs an additional time, upon a project's completion. This would reconcile budget-based allocations to the project's actual final costs. An

alternative would be to allocate the program management costs more frequently.

Recommendation

2. The San Francisco Public Utilities Commission should cease recognizing future expenses in the current fiscal year.

Finding 5

SFPUC does not have procedures for identifying and correcting significant overallocations of program management costs.

As stated in Finding 3, SFPUC's program management cost allocation process results in misallocations to individual projects. Although the department identifies projects that are overallocated and adjusts to ensure that they are not allocated any further program management costs, it does not evaluate whether the overallocations are large enough to warrant further adjustment.

Overallocations of program management costs can distort the actual cost of a project, negating the benefits of allocating program management costs to projects. Exhibit 5 includes a breakdown of the five WSIP projects with the greatest program management cost overallocations as of June 30, 2011.

EXHIBIT 5

**Examples of Program Management Cost Overallocations^a
As of June 30, 2011**

Project	Region	Amount of Overallocation	Overallocation as Percentage of Project Budget
SVWTP Calaveras Road Improvements	Sunol Valley	\$10,922	31.52%
Recycled Water Project – Pacifica ^b	Local Water	70,366	20.21%
Pulgas Balancing - Laguna Creek Sedimentation	Peninsula	13,480	2.72%
Cross Connection Controls	Peninsula	64,130	1.69%
Calaveras Reservoir Upgrades	Sunol Valley	22,584	1.34%

^a These projects were allocated a greater proportion of the program management costs expected for all of WSIP than their share of the total WSIP budget. Projects in this exhibit were not chosen for audit but are included to illustrate the effect of overallocating program management costs.

^b This project is no longer in WSIP and will be completed using funds from the Water Enterprise capital budget.

Source: Auditor's analysis of SFPUC's program management allocation worksheet.

SFPUC does not have procedures to determine when an overallocation of program management costs materially affects the overall cost of a project. The overallocations of these costs to two of the projects in Exhibit 5 exceed 20 percent of the projects' budgets. The dollar value of the overallocations is small compared to WSIP's overall budget, but, as a percentage of a project's overall budget, overallocations can significantly distort a project's cost.

Recommendation

3. The San Francisco Public Utilities Commission should develop procedures for determining when allocations of program management costs are materially misallocated. The guidelines should be based on the misallocation as a ratio to total project costs and should include procedures for adjusting significant misallocations.

Finding 6

The WSIP quarterly reports do not always reflect program management costs.

SFPUC's infrequent allocations also cause the program management costs that accrue throughout the year not to be reflected in the expenditures included in interim reports. SFPUC issues quarterly WSIP reports that detail important project information such as timelines and budgets. Only the program management costs that have already been allocated are reflected in the quarterly reports as part of each project's expenditures. Because program management costs are only allocated annually, the expenditures shown in the quarterly reports throughout the fiscal year do not reflect projects' total costs to date.

Recommendation

4. The San Francisco Public Utilities Commission should ensure that Water System Improvement Program quarterly reports reflect program management costs either as part of the expenditures of the individual projects, or as a separate expenditure category.

APPENDIX A: OVERVIEW OF WSIP PROGRAM MANAGEMENT COSTS ALLOCATION PROCESS

1. Divide WSIP into project groupings (local, regional, and systemwide).
2. Calculate the distribution percentage. This is each project's budget as a percentage of the total budget for the project grouping.
3. Adjust the distribution percentage to compensate for projects allocated too much in program management costs in prior years.
 - Overallocation occurs when a project is assigned program management costs based on a budget that turns out to be higher than the project's actual expenditures. See findings 3 and 4 in this report.
4. Weight the distribution percentage in favor of projects that are nearing completion.
 - Once completed, a project is capitalized as a fixed asset. SFPUC will then no longer allocate any costs to it. Because projects are allocated program management costs only once a year, all such costs must be allocated in the year before the project is finished. To help ensure that this happens, SFPUC allocates more program management costs to projects that are at or near completion when it makes its annual allocations. See finding 5 in this report.
5. Allocate the current year program management expenditures to the remaining open projects according to the adjusted, weighted distribution percentages.

	Harry Tracy	Pulgas	Because Pulgas was closer to completion, its adjusted, weighted distribution percentage was higher than its original distribution percentage.
2009 re-aligned project budget	\$359,063,409	\$6,158,246	
Original distribution percentage ^a	9.15%	0.16%	
Total program management costs that should be allocated over the life of the project ^b	\$10,113,927	\$125,311	
June 30, 2011, project completion status	14.40%	69.30%	Conversely, because Harry Tracy was only 14 percent complete, its adjusted, weighted distribution was less than its original distribution.
Fiscal year 2010-11 adjusted, weighted distribution percentage	6.72%	0.21%	
Actual fiscal year 2010-11 allocation of program management costs to the project ^b	\$345,536	\$10,951	
^a Based on the 2009 total WSIP budget for all regional and local projects of \$3,924,098,350. ^b Based on the total budgeted program management costs for all of WSIP of \$110,525,250.			

APPENDIX B: SAN FRANCISCO PUBLIC UTILITIES COMMISSION RESPONSE



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February 3, 2012

Tonia Lediju, Audit Director
Office of the Controller, City Services Auditor Division
City Hall, Room 476
1 Dr. Carlton B. Goodlett Place
San Francisco, CA 94102

Subject: Management's Responses to The Department Appropriately
Categorized Program Management Costs, but Should Improve Its
Method of Allocating Those Costs to Projects Audit.

Dear Ms. Lediju,

Thank you for providing us the opportunity to review the audit report entitled,
'The Department Appropriately Categorized Program Management Costs, but
Should Improve Its Method of Allocating Those Costs to Projects Audit',
prepared by the Controller's Office, City Services Auditor.

Attached for your review and consideration are SFPUC Management's
responses to the recommendations detailed in the audit report, dated 2/13/12.

If you have any questions or need additional information, please do not hesitate
to contact me at (415) 554-1600.

Sincerely,

A handwritten signature in blue ink, appearing to read "Ed Harrington".

ED HARRINGTON
General Manager

cc: Michael Carlin, Deputy General Manager
Todd L. Rydstrom, AGM Business Services & Chief Financial Officer
Harlan Kelly, Jr., AGM, Infrastructure
Nancy L. Hom, Director, Assurance & Internal Controls

Edwin M. Lee
Mayor
Anson Maras
President
Art Torres
Vice President
Ann Miller Case
Commissioner
Francesca Vietor
Commissioner
Wesley Courtney
Commissioner
Ed Harrington
General Manager



AUDIT RECOMMENDATIONS AND RESPONSES

Recommendation	Response
1. The San Francisco Public Utilities Commission should develop a method of adjusting program management costs before each project is capitalized to reflect actual costs.	The SFPUC will revisit the method and frequency of cost allocation, and decide on a process and frequency that provides for more accurate allocations based on current actual expenses, which would not anticipate future year project expenses, and which would include controls to determine when costs are materially misallocated, along with proper resolution for reallocating the misallocation. Ensure that these costs are appropriately reflected in both the project management and accounting systems. Estimated timeline: Quarter 4 – FY 11-12
2. The San Francisco Public Utilities Commission should cease recognizing future expenses in the current fiscal year.	
3. The San Francisco Public Utilities Commission should develop procedures for determining when allocations of program management costs are materially misallocated. The guidelines should be based on the misallocation as a ratio to total project costs and should include procedures for adjusting significant misallocations.	
4. The San Francisco Public Utilities Commission should ensure that Water System Improvement Program quarterly reports reflect program management costs either as part of the expenditures of the individual projects, or as a separate expenditure category.	The SFPUC will display an expense category in its WSIP Quarterly Report to identify the expended Program Management costs. Estimated timeline: Quarter 3 – FY 11-12