



City of Seattle

Office of City Auditor
Susan Cohen, City Auditor

Memorandum

To: Norine Grace, Project Funding and Agreements Coordinator
Seattle Public Utilities

CC: Faith Fogarty, Grants & Contracts Unit Supervisor, Seattle Public Utilities
Susan Cohen, City Auditor
Eileen Norton, Assistant City Auditor

From: Patti Jones, CDR Consultants, Inc. *AKR PJ*

Date: 11/30/00

Re: Review of HDR Overhead Rates

This memo memorializes the November 22, 2000 teleconference with Mike Dingwell, Vice President, HDR Corporate. The teleconference was intended to accomplish the following objectives:

1. Reconcile the "allocated expenses" applied to HDR's Washington office
2. Verify that non-allowed items, per the City of Seattle contract, were not included in the calculation of the Washington overhead rate,
3. Reconcile HDR's corporate and Washington state overhead rate, and
4. Validate HDR's cost accounting procedures for computer costs charged back to the City.

Allocated Expenses

HDR's total allocated expenses amount to \$31,375,341. This is comprised of the following:

007-Corporate Admin	\$21,213,209
039-Omaha Tech Directors	\$5,145,468
108-HDR Engineering Marketing	\$4,791,179
117-HDR Engineering Computer Grp	\$528,290
Disallow Goodwill (Dept 007)	(\$297,745)
Audit Adjustment (Spread CEO Salary)	(5,060)
Total Allocated Expenses	\$31,375,341

HDR's Washington office contributes 6.8% of the Net Fees Earned (NFE). Thus, the Washington share of allocated expenses amounts to \$2,133,573. Due to additional reallocations, the Washington share of the allocated expenses is adjusted to **\$1,956,400**.



Office of City Auditor, 1100 Municipal Building, 600 Fourth Avenue, Seattle, WA 98104-1876
Tel: (206) 233-3801, Fax: (206) 684-0900, TTY: (206) 233-0025,

E-Mail: auditor@ci.seattle.wa.us, Website: <http://www.pan.ci.seattle.wa.us/seattle/audit>

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Non-allowed Items

HDR Engineering is a large firm with a complex accounting system. The complexities of the system are due to the subsidiaries contributions and expenses that must be re-apportioned and allocated to derive the net revenues earned by each subsidiary.

Initially, it was HDR's position that they did not have to provide the City of Seattle the FAR audited overhead rate but they were doing so as a goodwill gesture. HDR has agreed and did provide a listing that compares the items disallowed by the City of Seattle's contract with the items disallowed by FAR. HDR agrees that they are obliged to offer the City the FAR audited overhead rate. As of 1999 that rate is 161.67%.

HDR has proven that disallowed items have been removed from HDR's corporate numbers that make up the allocated expenses that are apportioned to the Washington office. The credit share that the Washington office is entitled to receive of the disallowed items is based on its percentage of NFE (6.8%).

Washington Office Overhead Rate

As indicated above, HDR's corporate overhead rate for 1999 is 161.68%. The overhead rate is adjusted for Washington State to include the B&O taxes. The adjusted rate is 168.63%. HDR believes that by using a percentage increase to the overhead rate works out to be the same as direct expensing the taxes on a client-by-client basis. Because the B&O tax is based on HDR's revenues earned and the overhead percentage markup is derived based on that, it becomes a proportional increase based on the City's portion of revenues contributed to the overall revenues earned each year.

Computer Charges

Each year HDR estimates its PC Recovery costs based on the number of direct labor hours times \$10/hr for computer and \$15/hr for CAD. For 1999, HDR Inc claimed \$7,344,013 for PC Cost Recovery. This amount is backed out of the corporate overhead rate because these costs are direct expensed to clients (some but not all). This is also done for HDR's Washington office. In 1999, the PC Cost Recovery deduction from the overhead rate amounted to \$484,638.

When the City requested the direct computer expenses for Washington, local accounting staff contrived expenses based on what they thought made up the expenses rather than based on the manner by which HDR handles these expenses on a company-wide basis. To derive a computer percentage markup for the overhead rate, HDR divides the Washington PC Cost Recovery (\$484,638) by the Direct Labor Costs (\$3,604,562). This equates to 13.45%.

So, if the City did not want to pay computer costs as a direct expense (employee computer charged hours times \$10/hr) but rather as part of the overhead rate, the City would have to add 13.45% to the Washington overhead rate of 168.63%. The new overhead rate would be 182.08%. The City should disregard the initial overhead rate for inclusion of computers that was reported to be 190.13% as that number is incorrect.

HDR indicated that they have clients who refuse to pay for computers. This is an issue that is typically negotiated at the local level (i.e. Gary Bleeker) and depends on the amount of revenue the City of Seattle contributes to the total Washington office revenues.

In addition, HDR stated that PC charges can be adjusted. Because PCs are logged onto with project numbers there is the opportunity for human error (i.e. forgetting to log off when working on another project or going to lunch, etc.). OCA did not review any of HDR's invoices to see if computer hours are charged by employee or are a lump sum amount added to the invoice. In any case, these charges are supposed to be reviewed by a supervisor to ensure that only the hours worked on City of Seattle projects are being charged. HDR indicated that adjustments are made when it appears that an employee forgot and left the computer logged onto a project inappropriately.

Summary

HDR Corporate Overhead Rate	161.67%
Washington State Overhead Rate	168.63%
WA Overhead Rate w/Computers	180.08%

OCA Recommendations

- 1) It does not seem to be in the City's best interests, based on the manner by which HDR handles costing its computers, to pay for computers as a part of the overhead rate. This is because the City has a better chance of monitoring computer charges based on what is reasonable computer usage for the work effort undertaken.
 - a) The City should ensure that computer hours are reported by employee and not on a lump sum basis.
 - b) The City should meet with HDR's project manager to ensure that the engineers assigned to the City's projects have been reminded to be diligent in how computer time is charged to City projects.
 - c) The City may want to request computer documentation to determine if HDR has ever adjusted the City's computer charges.
- 2) The City should consider negotiating the elimination of PC charges in future contracts/amendments. HDR states that it has calculated the computer charges (ie. \$10/hr) and found them to be representative of their costs. This has been the rate for many years. The problem is that because the PC Cost Recovery is based on the \$10/hour charge and not actual expenses, the City would never get the benefit of computers expenses decreasing when the computers are paid off.

If you have any questions, please feel free to contact me directly via telephone at 760-602-9709 or via email at PJonesCDR@aol.com. You may also contact me through Eileen Norton at 233-1092 or via email.