CITY OF CAPE CORAL

Utilities Expansion

Managed by:

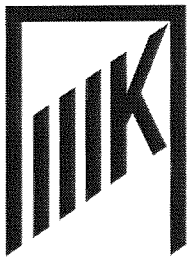
Kellogg Brown & Root, Inc. *(A Division of Halliburton)*

MWH, Inc.

Prepared for:

City of Cape Coral, City Auditor's Office

REPORT PREPARED BY:



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New York, NY

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Notice of Restrictions

This document describes procedures performed by Kessler International ("Kessler") personnel in connection with our engagement to provide consulting services to the City of Cape Coral. Such services do not constitute an engagement to provide audit, compilation, review or attestation services prescribed in pronouncements on Professional Standards issued by the American Institute of Certified Public Accountants. This document has been prepared and is intended solely for the internal use of the City of Cape Coral and its legal counsel. Kessler will not be responsible for any losses suffered by any other party as a result of the use of this report contrary to the provisions of this paragraph.

Background

In 1998, the City of Cape Coral ("City") began planning for the expansion (also referred to as "extension") of public utilities including water and sewer systems. This was due to rapid growth and demand in the southwest Florida region. The Utilities Expansion Program ("UEP") was designed to benefit the citizens and taxpayers of the City by improving communities that were previously served by septic tanks or shallow wells.

The UEP was developed according to a 1996 Utilities Master Plan constructed by Dames & Moore which detailed cost estimates and regional breakdowns for construction. This document served as the basis for future planning of the UEP.

Phase I of the UEP included multiple construction projects that were broken down into individual Work Authorizations. The Work Authorizations detailed one single segment of each construction project. These segments included management, design and construction.

These utility projects have been funded using a combination of bonds and Florida State Revolving Funds. The purpose of the State Revolving Fund program is to provide lower interest rate loans to municipalities or other entities who qualify based upon state guidelines. These funds can be used in conjunction with the design, planning and construction of environmentally beneficial projects.

The City previously determined that the bonds and Florida State Revolving Fund loans would be paid for by the City taxpayers in the form of Assessments. These costs would be allocated to each property owner once the project for their location was completed.

In April 1998, the City solicited proposals for Construction Management Services to include all aspects of design, permitting and construction for the UEP. The City selected one Construction Manager at Risk ("CM") to provide management services for all phases of the projects and to work cooperatively with Public Works personnel.

In April 1999, the City entered into a five year contract, with Kellogg Brown & Root, Inc. ("KBR"), a division of Halliburton, to complete the first phase of the UEP. In August 2002, the contract was assigned to MWH Constructors Inc. ("MWHC"). While we were informed that this was allegedly due to KBR's inability to provide the necessary bonding, a "separate agreement" between KBR and MWHC indicates that KBR declined to provide the "requisite construction performance and payment bonds."

In 2004, the City hired RL Townsend & Associates, Inc. ("Townsend") to conduct an independent audit of the Pine Island Road project, the first completed project within Phase I of the Utilities Expansion Program. Additionally, Townsend was hired to provide recommendations to the City for the revised contract to cover Phase II of the Utilities Expansion Program.

The audit performed by Townsend summarized its conclusions as follows:

"(1) We did not find any material or otherwise significant contract compliance discrepancies in the contact billings or the actual payments made to the Construction Manager.

(2) We found that all required bonds and insurance policies were obtained for the specified amounts for construction contracts that were reviewed.

(3) We found that all significant change orders were priced in accordance with contract documents and no material discrepancies were noted.

(4) We found no evidence that the contractors did not provide the quality materials and services required in the scope of work as defined in the respective contracts.

(5) We found that a quality control process consisting of professional level review by engineers, inspectors and consultants, etc. was functioning in a manner that is generally considered effective.

(6) We did not find any material discrepancies in the billings from the CM's subcontractors or in the related payments to the subcontractors. The billings and related payments were in compliance with the intent of the terms of their contracts as defined by City management representatives in all material respects."

Additionally, Townsend provided several recommendations applicable to a revised contract for Phase II of the UEP. Townsend's "Executive Summary of Construction Cost Control Recommendations" (Exhibit 1) provided a list of all recommendations which would serve to save the City money by re-negotiating the contract with the CM.

In response to Townsend, the Public Works Department ("Public Works") of the City issued a "Response to Audit Consultant Report" (Exhibit 2) which provided justifications for opposing most of the recommendations provided by Townsend.

In January 2006, Kessler was contracted to perform forensic audit services for the City applicable to seventeen projects within Phase I of the UEP. The purpose of this engagement was to identify potential cost exceptions and non-compliance with the terms and conditions of the contracts regarding the UEP.

Utility Expansion Construction Agreement

GMP contracts are agreements to perform a specified project for a maximum sum that is determined before the work commences. The key component of a GMP ensures the owner of a total project cost that will not exceed an agreed upper limit. In the event where the actual project costs are less than anticipated, contractor savings can revert back to the owner.

Lump Sum contracts or lump sum line items, also known as fixed fee contracts or line items, are agreements to perform work for a specified sum that is determined before the work commences. The entire pre-determined amount is ultimately paid regardless of the actual profits or losses incurred by the contractor.

The agreements between the City and CM for Tier Two Design Services were all purported to be Guaranteed Maximum Price ("GMP") agreements. However, Kessler has revealed that these agreements were designed using different methods of funding. The contracts included lump sum line items embedded within the GMP contract billed to the City. This is noteworthy because while GMP agreements are developed as a possible cost savings measure, when a significant portion of a contract is comprised of lump sum line items, the likelihood for any substantial cost savings is diminished. In fact, on all three Tier Two agreements, Kessler has learned that the contingency funds were used.

Additionally, Kessler has found that significant costs were included and paid as lump sum line items in the subcontractor bids including mobilization, surveying, maintenance and bonds.

Key Personnel

The key personnel involved on these projects include the following individuals and subcontractors:

City of Cape Coral

· Charles Pavlos –	Public Works Director
· Wayne Wolfarth –	Utility Extension Manager
· Elizabeth Schultz –	Contract Specialist
· Alberto del Valle –	Procurement Manager (Former Contract Specialist)
· George Chip Kerper –	Former Contract Specialist

MWH Constructors, Inc.

· Larry Laws –	Project Manager (Formerly with KBR)
· Philip Tunnah –	Project Engineer
· Larry Casale –	Cost/Controls Engineer
· George Chip Kerper –	Procurement Manager (Formerly with City)

MWH, Inc. provides engineering design, procurement, construction, technology and program management services to the markets of the Americas, Europe, Middle East, India, Asia and the Pacific Rim. MWH Americas, Inc.(MWHA) and MWH Constructors, Inc.(MWHC) are subsidiaries of this entity.

Kellogg Brown & Root, Inc.

· Larry Laws –	Project Manager (Currently with MWHC)
· Barry Tierce –	Design Manager
· Jake Whicker –	Administration Manager

The UEP project was originally handled by Brown & Root Services, a division of Kellogg Brown & Root, Inc. It was later assigned in 2002 due to an inter-company reorganization to Kellogg Brown & Root, Inc.

Subcontractors

· Denco Construction Inc.
· Forsberg Construction, Inc.
· Guymann Construction of Florida, Inc.
· Mitchell & Stark Construction Company, Inc.
· Southwest Utilities Systems, Inc.
· Westra Construction Corporation

Kessler learned that MWHC utilized the address of 2503 Del Prado Boulevard, Suite 420, Cape Coral, FL 33904 on invoices and supplied it to vendors and has found bills addressed to MWHC at this address. The Halliburton website, www.halliburton.com, indicates Brown and Root Services is located at this same address. The MWH website, www.mwhglobal.com, lists its office at 2503 Del Prado Boulevard, Suite 430, Cape Coral, Fl 33904. It is noteworthy that documentation submitted to the City by MWHC would indicate a mailing address that is actually the address for Brown and Root Services.

Scope & Objectives

The scope of this assignment encompassed a review of program management, design, construction and supplemental projects for years two through five of the agreements between the City and KBR /MWHC in addition to all subcontracts for that period. The projects of focus included the following utility areas and supplemental projects:

- Southwest 1
- Southwest 3
- Southwest 2
- Santa Barbara Force Main
- Headworks/ Aeration Interconnect
- Everest Valves Replacement
- Mariner High School Water Line

Kessler's objectives were to ensure compliance with the agreements and to verify that discrepancies did not exist between the billings and actual payments made by the City, required bonds and insurance were obtained, and change orders were priced in accordance with the contract. Additionally, Kessler was to ensure effective quality controls existed, subcontractor's billings and payments were accurate and all other terms and conditions previously stipulated in the contracts with the City, CM and subcontractors were adhered to.

Obstacles & Delays

During the solicitation of the RFP to award this inquiry, Kessler was informed of the following in regards to the availability of records.

"The original source documents are maintained at the CM offices with a copy of certain items maintained by the City including invoices, project deviation notices (PDN's), purchase orders, etc."

Additionally, it was noted that:

"Documents available for inspection include: all CM and subcontractor records including all assets purchased under the program, Request for Bids, Submitted Bids, Accepted Bids, invoices submitted by the CM and by subcontractors, all materials purchased under the City's purchase order system and verification of CM invoices submitted to the City inclusive of all costs: Personnel, Indirect or Direct expenses, Insurance Certificates and PDN's."

Documentation Provided by Public Works

To accomplish its objectives, Kessler submitted a preliminary list of documents to City personnel on January 10, 2006 that detailed the records which were expected to be compiled prior to the onset of the review (Exhibit 3). The list included items such as subcontractor bids and invoices, applications for payment, vendor invoices, change orders, correspondence, and a list of all subcontractors and the personnel assigned to each project. Kessler also requested access to the CM's records including cancelled checks to subcontractors, payroll records, insurance and bonds. These documents were necessary to facilitate an accurate review of the UEP.

During the engagement, Kessler was supplied thousands of documents by Public Works however; the majority of the records at the onset of field work made available by Public Works were not the documents Kessler requested. After a cursory review, it was

determined that many of the documents provided were not even applicable to projects included within the scope of this engagement.

Restrictions by Public Works

Public Works personnel hindered Kessler's ability to proceed with its assignment by mandating that all document requests and correspondence of the CM must be routed through a Public Works employee. Additionally, Kessler was not given the opportunity to interview key members of KBR and MWHC. This is considered an important protocol of the review that may be used to obtain information and other opinions.

During an initial meeting with Public Works and the City Auditor's Office, it was conveyed to Kessler that Public Works was reluctant to allow Kessler to request documents or speak with the CM directly because two audits were completed during the prior year and the CM indicated to the City that they would charge for the costs associated with time spent relative to the engagement.

Section 13.3 of the "Agreement for Construction Management Services" between the City and KBR states the following:

"Upon completion of the project and receipt of final payment, all designs, drawings, specifications, design calculations, budgets, schedules, notes and all other documents developed or produced in conjunction with CM's performance of the services hereunder shall become the sole property of the City and CM agrees that such information may be used by City for any purpose."

In addition, section 13.4 states:

"CM shall afford, and shall cause its Independent Consultants and Independent Contractors to afford, access to City and/or City designees at all reasonable times to any correspondence, instructions, invoices, receipts, vouchers, memoranda and other records or documents of any kind relating to the Program or any of the services provided by any of them pursuant to this Agreement."

In Kessler's experience, for a CM to charge to comply with audit requests, which they are contractually required to do so, is virtually unheard of especially since all Kessler requested was access to their records. Additionally, Kessler has located an e-mail exchange between two MWHC employees that gives reference to the costs associated with the "reproduction" of turnover books for Kessler's review by indicating the costs were to be charged to the Southeast 1, Phase II project (Exhibit 4), not the projects under review.

Documentation Requests to City Administration / CM

Throughout the course of this engagement, Kessler has made countless written (Exhibit 5) and verbal requests to Public Works and City personnel for the necessary documentation to ensure the CM's compliance with the contracts.

Several response letters have been received from MWHC through Public Works applicable to Kessler's document requests (Exhibit 6). As reflected in these letters, certain documentation was provided to Kessler however; many of Kessler's requests were originally outright denied and other requests were significantly delayed. The MWHC letter dated May 11, 2006 indicated that the City would be charged an estimated $20,000.00 to $30,000.00 for the compilation of the records.

Furthermore, numerous e-mail exchanges took place between Kessler and the City regarding the document requests. These exchanges are enclosed herein for reference (Exhibit 7).

To date, after spending many hours attempting to arrange for the review of certain records; payroll documentation and the cancelled

checks to subcontractors have not adequately been provided. As a result, Kessler's ability to analyze documents has clearly been impeded.

Documentation Requests to Subcontractors

During the preliminary stages of this engagement, Kessler attempted to review the subcontractor's business records as they relate to the scope of this assignment. Two written requests for documentation were sent to the five main subcontractors involved in these projects (Exhibit 8). The aforementioned requests sought copies of contracts, submitted bids, invoices submitted to the CM, correspondence and meeting minutes applicable to the projects and a report of all injuries that may have occurred throughout the duration of the projects.

Kessler discovered that these attempts were stifled by the CM, as reflected in an e-mail exchange (Exhibit 9). As revealed in this exchange, the CM prepared an e-mail (which the City received cc's) to the five subcontractors and instructed them to "disregard" Kessler's requests until the City addressed the need for that request.

This request was not addressed by Public Works until nearly fifteen weeks after the letters were originally sent to the subcontractors. On May 31, 2006, after Kessler had concluded all field work, Public Works informed the City Auditor's Office that there would be no objection to allowing Kessler to review certain subcontractor records. Due to the proposed timeline for Kessler's final report; a review of these records was not feasible and this was explained to Public Works and The City Auditor's Office. During the second week of June, Kessler received boxes of documents but due to time constraints and budgets, Kessler was unable to review the

records. It is unclear why this request went so long without being addressed by the City or CM.

The documents requested of the subcontractors were directly addressed within the scope of this engagement and the instructions to the subcontractors to "disregard" the original request halted Kessler's ability to review the subcontractor billings and subsequent invoices submitted by KBR and MWHC. This matter clearly raises significant concerns.

Lack of Proper Record Keeping

During the course of this engagement, documentation provided to Kessler was found in such disarray causing countless hours to be spent to determine if the documents presented were adequate for review. Kessler also found that many of the supporting documents that should have been included within the monthly invoices were not available at the City however, the payments of these invoices were still approved by Public Works.

Kessler's review of loose leaf binders which contained monthly invoices disclosed that many invoices were out of order and did not include any supporting documentation for charges to the City. Additionally, in an attempt to reconstruct the costs associated with each project, Kessler performed an analysis of each voucher within the binders. Kessler's compilation was inconclusive due to the fact that many of the vouchers were in fact missing. A Public Works employee was provided a list of missing vouchers and when asked for assistance, he stated simply to, "go ask finance." Upon explaining the problem to an employee of the Finance Department, Kessler was provided with a computer listing of payments to KBR/MWHC but was

not provided with the actual missing vouchers thus limiting Kessler's ability to review this information in totality.

Kessler was informed during the engagement that an employee was recently hired to fill the Contract Specialist position. When interviewed as to missing documents the employee stated that the former Contract Specialist "had no idea what he was doing." This employee also stated that they "came into that position and things were already under way so I just went along with the process."

Conference Call with City Administration

After a draft of this report had been issued on April 27, 2006, a conference call was held with Kessler, Public Works, the City Auditor's Office and the City Manager in order to discuss many of the outstanding requests for records. The City Manager explained that he only heard of the problems Kessler encountered earlier that week and that he would do everything in his power to ensure the requested documentation would be provided.

In March 2006, since the documents were not forth coming voluntarily, Kessler filed an open records request (Exhibit 10) for e-mails and other documents in accordance with Florida's Public Records Law, Chapter 119 of the Florida Statutes. In response to this request, Kessler was provided with specified e-mails to and from City employees to employees of KBR/MWHC.

Kessler's review of the City employee e-mails indicates that the City Manager received an e-mail titled "04-04-06- Daily Log-Reference Requests" which included the information requested by Kessler to the City Clerks Office (Exhibit 11). This e-mail, dated Tuesday, April 4, 2006, was subsequently forwarded by the City Manager to two

employees of MWHC and the Public Works Director in which the City Manager states,

"Each day I have the Clerk's Office supply me with information about any public records request that are made to the City. The attached file includes one such notification involving a request from Kessler International for "... detailed records from KBR/MWH regarding their employees as well as subcontractors who worked on our Utility Projects." Just thought you would like to know."

This e-mail was written several weeks before the April 27, 2006 conference call was held in which the City Manager explained to Kessler that he was unaware of the record production problems surrounding this engagement.

Oversight Controls

In order to verify and ensure that the billings submitted monthly to the City are accurate, the Public Works Contract Specialist is responsible for the review of all invoices and supporting documentation. Following the Contract Specialist's approval, the invoice is then submitted to the Utility Extension Manager who Kessler has learned had the sole authority to approve funds. This Public Works employee not only acts as the sole authority to approve these funds, but also controls the use of contingency funds and requested change orders. This is an internal control deficiency.

A review of e-mails received from the City appears to indicate that this individual socializes and has close personal relationships with many of the key personnel of KBR and MWHC involved in the UEP (Sample in Exhibit 12).

Estimating Costs

The City assigned the responsibility of developing cost estimates to the CM. Through an interview with a Public Works employee, Kessler learned that there was no independent review of the estimates performed by the City and that the sole responsibility of developing estimates was assigned to the CM. Kessler was also told that, "estimates were too voluminous" by a Public Works employee. The only justification Kessler received from the City for approving over $142,000,000.00 in spending was purportedly based upon the Utilities Master Plan developed by Dames & Moore in 1996 which projected the costs for Phase I (including Pine Island Road) to be $150,000,000.00. However, Kessler was also told that the estimates developed by Dames & Moore have been inaccurate on at least one occasion.

Kessler has not been provided any documentation reflecting the correlation between the Dames & Moore estimates and those calculated by the CM. While Kessler has been provided the Engineer's estimates, records have not been made available which include supporting documentation to determine how those amounts were derived or any review by Public Works to check for reasonableness.

The review of estimates is an essential and vital aspect of all construction projects. Kessler's review and interviews of City personnel has found that there was a lack of oversight by the Public Works department with regards to the estimates developed by the CM. Since the CM received a fee based upon a percentage of total project costs, it is imperative that the City conduct a more detailed and thorough review of estimates prior to the solicitation of any bids.

Department of Environmental Protection

In order to fund the UEP, the City was provided with State Revolving Loan funds through the Florida Department of Environmental Protection ("FDEP"). This program provides cities and other municipalities with loans at low interest rates. These funds are awarded based upon the City successfully meeting specific federal and state requirements.

Chapter 62-503 (Exhibit 13, specifically Section 700) of the State Revolving Fund Loan Program discusses the Planning, Design, Construction, and Procurement Requirements which parallel federal requirements. According to this section of the law,

"All procurement transactions shall be conducted in a manner providing full and open competition." Additionally, this section states, "construction contractors shall be selected according to a recognized procurement method such as formal advertised competitive bidding, competitive or noncompetitive proposals, design/build agreements or construction manager at risk agreements."

This chapter also contains several references to the required procedures for soliciting competitive bids. It states,

"*the invitation for bids shall be publicly advertised...to assure open competition*" and, "*all bids shall be publicly opened at the time and place prescribed in the invitation for bids.*"

Title XVIII Chapter 255 Section 255.0525 (2) (Exhibit 14) of The Florida Statutes addresses the requirements for advertising competitive bids or proposals for any county, municipality or political subdivision. The Statute states in part:

"The solicitation of competitive bids or proposals for any county, municipality, or other political subdivision construction project that is projected to cost more than $200,000 shall be publicly advertised at least once in a newspaper of general circulation in the county where the project is located at least 21 days prior to the established bid opening and at least 5 days prior to any scheduled pre bid

conference. The solicitation of competitive bids or proposals for any county, municipality, or other political subdivision construction project that is projected to cost more than $500,000 shall be publicly advertised at least once in a newspaper of general circulation in the county where the project is located at least 30 days prior to the established bid opening and at least 5 days prior to any scheduled pre-bid conference. Bids or proposals shall be received and opened at the location, date and time established in the bid or proposal advertisement. In cases of emergency, the procedures required in this section may be altered by the local government entity in any manner that is reasonable under the emergency circumstances."

Title XVIII Chapter 255 Section 255.20 (Exhibit 15) of The Florida Statutes addresses the requirements for Local bids and contracts for public construction works. The Statute states in part:

"A county, municipality, special district as defined in chapter 189, or other political subdivision of the state seeking to construct or improve a public building, structure, or other public construction works must competitively award to an appropriately licensed contractor each project that is estimated in accordance with generally accepted cost-accounting principles to have total construction project costs of more than $200,000..."

The City provided Kessler with two ads that were placed on December 15, 2000 in The Tampa Tribune and the News-Press as documentation of compliance with the Statues (Exhibit 16). The ad read as follows:

UNDERGROUND UTILITIES

"BROWN & ROOT SERVICE, the Construction Manager for the City of Cape Coral's Utility Expansion Project is seeking qualified subcontractors specializing in underground utility work. For consideration, letter of interest must be received at Brown & Root Services office located at 2503 DelPrado Blvd, Suite 420, Cape Coral FL before close of business on 15 January 2001. Brown & Root Services is a drug-free workplace and is an equal opportunity employer."

Documentation provided to Kessler by Public Works appears to not meet the requirements of the Statutes. Furthermore, this advertisement only seeks letters of interest from qualified subcontractors and clearly does not advertise a particular project, request a specific bid on work, nor does it indicate a date, time and location where the bids will be opened.

Interestingly, the City of Cape Coral-Public Works section of the City's website lists what they called "Potential misconceptions" about the UEP (Exhibit 17) and states the following:
"Here are some potential misconceptions (bold) about the utilities expansion program that may arise (followed by the actual facts about the project):

a) The City never put the "utility contract" out for bid. *The selection of Kellogg, Brown & Root as the "Construction Manager at Risk" was done in accordance with Florida Statutes (F.S. 287.055). The statute provides for the competitive selection of an engineering firm based on qualifications, not price. (For example, you probably want the best-qualified engineer to build the Space Shuttle and not the lowest bidder, so you select the most qualified and then negotiate prices.) Eight of the top engineering firms in the country submitted packages. The top three firms were interviewed by the City's Selection Advisory Committee who then ranked them. City Council also interviewed the firms and selected Kellogg, Brown & Root (MWH/KBR).*

b) The City did not bid out the work. *MWH/KBR bids out all construction work related to utilities expansion through the sealed bid process. The bids are reviewed by MWH/KBR and the City, and the work is awarded to the lowest bidder. This bid process is required by the Florida Department of Environmental Protection for the City to receive low-interest, State Revolving Loan Funds."*

During the course of interviews with City personnel, Kessler confirmed that the aforementioned advertisements were the only ones used to solicit subcontractors for the entire UEP to date. Kessler also

secured a document from the Design-Build Institute of America in which MWH or the City lists that the Type of Procurement/Selection Process Used for Southwest area 1 of the Utility Expansion Project was "Sole Source" (Exhibit 18).

Kessler was provided a memo dated December 31, 2001 from Chip Kerper prepared for the Selection Advisory Committee that indicates that the Southwest 1 selection process was not publicly opened (Exhibit 19). Kessler learned this practice continued in the other areas under review. In addition, Kessler also secured a copy of an e-mail exchange dated July 25, 2002 between George Kerper and Marlyn Miller with copies to Charles Pavlos, Jeanne Lady, Steve Neff, and Wayne Wolfarth (Exhibit 20). It is discussed that, "we may need to openly solicit the remaining SW3 and SW2 area construction." This was in response to the Assistant City Attorney stating, "As far as future projects, we may need to open it up and re-bid or do a new request for proposal."

Kessler had a discussion with an official at the FDEP who stated that the CM/City should have advertised for each consecutive work authorization that required the solicitation of bids by subcontractors. This entire situation clearly raises red flags[1].

Documents Received from FDEP

Kessler has also learned during the course of this engagement that problems existed between the City and the FDEP prior to the approval of State Revolving Funds. Kessler secured documentation from the FDEP that indicates serious concerns were raised regarding

[1] For purposes of this report, a "red flag" will indicate potential dangers or questionable areas that warrant additional investigation.

the practices utilized by the CM for soliciting open and competitive bids.

Kessler obtained a letter written by the FDEP on February 25, 2000 to the Finance Director of the City with copies to Steve Daignault, Charles Pavlos and Angie Brewer that indicates that the CM's delivery and bidding practices were a topic of concern for eighteen months (Exhibit 21). This letter details the specific concerns FDEP had over the methodologies used by the City and CM to select bidders.

Angie Brewer & Associates, LC

Kessler's review has disclosed through a series of "Interoffice Memorandum" and "Communication Memorandum" that Angie Brewer & Associates, LC ("Angie Brewer") was retained by the City at a cost of approximately $180,000.00 to work cooperatively on the City's behalf with FDEP to resolve the issues surrounding the City's procurement methods. Many of these correspondences indicated a need to renegotiate the original contract with KBR in order to resolve problems. In addition, one memorandum dated March 10, 2000 indicates that a FDEP employee stated, "I can't imagine one of those guys (or me) defending all such practices to the press or City Commission in the event someone's Ox is gored" (Exhibit 22).

In a document submitted to FDEP on May 9, 2000 (Exhibit 23), Angie Brewer enclosed a sheet that detailed the selection factors used by KBR in evaluating subcontractors. This document states, "The City selection process took nearly 6 months and was open to public scrutiny." Furthermore, this document indicates that KBR evaluated the capacity of subcontractors by considering the "size of relevant projects in evaluating ability to manage large projects." During this engagement, Kessler was informed by a Public Works employee that three of the five subcontractors could only handle one at a time.

Kessler attempted to seek additional information by contacting Angie Brewer directly. A return telephone call was received from Mark Brewer who indicated that all their paperwork was in archives and that he would gather additional information and respond back to Kessler's request. To date, months after Kessler's conversation with Mark Brewer, a further response has not been received.

Pre-qualification and Selection of Subcontractors

In a Communication Memorandum (Exhibit 24) dated March 16, 2000 between an employee of FDEP and the City it is stated that, "the CM's procurement of pre-qualified construction contractors and negotiating practices may not be consistent with our (SRF) philosophy of open competition." This memorandum also indicates that the pre-qualifications were established "without any publicized notice" and "The listing process appears to be closed." Additionally, this document indicates, "preference is intended for the CM's affiliated companies in establishing suppliers."

In a FDEP memorandum dated May 12, 2000 (Exhibit 25) Richard Smith of FDEP advised Angie Brewer, "the prequalification process described is not sufficiently transparent" and that the "simplest way to clarify the process is to publicly notice what construction is contemplated."

An analysis of the documents prepared by Angie Brewer disclosed that two of the five subcontractors used on the projects failed the KBR pre-qualifications process. Kessler also noted a small handwritten note that indicated the requirements were waived for these two vendors. During interviews with Public Works personnel, Kessler

inquired into why the required qualifications were waived but no one Kessler interviewed could provide an explanation.

Additionally, Kessler obtained an Interoffice Memorandum dated June 2, 2000 between two employees of FDEP that references the procurement issues of the City (Exhibit 26). This document indicates that the solutions presented by FDEP were not taken into account and that the response received via Angie Brewer was, "trust me, the procurement is OK." This document also indicates that FDEP personnel tried to deal with "Cape Coral's leadership" and the resulting statement was, "the guys at the top delegate downward and sideways where things are stuck."

As a result of the information provided, it appears FDEP had significant reservations regarding the processes utilized by the City and CM for the pre-qualifications and selection of subcontractors. On February 16, 2001, a letter was sent by Don Berryhill, P.E. Chief of the FDEP formally accepting the subcontractors pre-qualifications based upon blank forms submitted by KBR (Exhibit 27). No basis of acceptance was committed based upon actual data received for the subcontractors which disclosed certain requirements were waived for two of the subcontractors.

Additionally, on November 5, 2002, Mr. Berryhill sent a letter to Terrence Stewart, City Manager, with a cc: to Mark Brewer, Larry Laws, and Chip Kerper indicating he received the bidding information for the contracts attached for Pine Island Road and Southwest 1 (Exhibit 28) and indicated the selection of the bidders was acceptable.

It is questionable why after two years of informing the City that the methodology used was insufficient, that it would suddenly become

acceptable. The fact that the work was awarded years before even leads to greater skepticism. During this engagement, Kessler was informed by an official of FDEP that the funds were simply approved because the State knew that the "money would be repaid."

Subcontractor Selection Process

The "Agreement for Construction Management Services," Section 1.4.2 discusses the responsibilities of the CM and the City applicable to Independent Contractors. This section states that, "All Independent Contractors shall be approved by the City."

Kessler has secured documentation from September 2002 between George Kerper and an employee of the City Clerks Office (Exhibit 29) discussing a citizen request for information on subcontractors in which Kerper indicates that, "the City does not approve nor disapprove any subcontracts." He continues to state that, "this is the responsibility of the Construction Manager" and that the "selection process has been approved by Florida DEP and it is that agency that can disapprove the process [only]." Kessler requested Public Works employees to provide documentation to support these statements but was informed that they could not.

Solicitation of Bids

The practice of soliciting bids from different companies in order to win a contract is theoretically meant to elicit competition. This competition results in lower prices and quickens the delivery of that particular product or service. There must be a reasonable amount of bidders and information must be kept confidential until the bids are revealed in order for this system to work. When the matter involves public funding, it is imperative that these openings are performed in public to ensure that the company with the lowest bid was awarded the contract and that fair competition ensued.

State law mandates, as well as Public Works conceded on their own website, that they were required to bid out each project. Kessler

asked different City employees to provide copies of any advertisements that were used to solicit bids. Kessler was only provided two advertisements which were placed on the same day (see Exhibit 16). During an interview with Public Works personnel, Kessler inquired into procurement methods used by Public Works and was told, "we want local people." This methodology is an example of poor purchasing procedures as competition is limited.

Kessler also learned that KBR was awarded the CM contract with a "team" of subcontractors. The "team" included Guymann Construction of Florida, Inc. ("Guymann"), Forsberg Construction, Inc. ("Forsberg"), Southwest Utilities Systems, Inc. ("SWUSI"), and Westra Construction Corporation ("Westra"). Denco Construction, Inc. ("Denco") was the only company not initially included within the original "team".

Subcontractor Bidding

An analysis of the bidding documentation provided by Public Works has revealed certain transactions that are clearly perplexing. These involve having contractors bidding against one another on projects which were divided into territories and bid out in one week increments. Kessler's review disclosed that Southwest 1, Southwest 2, and Southwest 3 were each broken down into five separate territories and each territory was bid on by the same five contractors. Kessler was apprised by Public Works personnel that only two of these subcontractors had the capabilities to handle more than one area at a time.

Kessler has dissected the bidding documents and has observed a number of trends that raise red flags. During interviews with Public Works personnel, Kessler learned that Guymann and SWUSI were the only companies who had the ability and manpower to handle larger or multiple territories simultaneously. The following table illustrates the contracts awarded to Guymann and SWUSI. Five of these contracts were the largest awarded during Phase I of the UEP.

Guymann / SWUSI Contracts

Southwest #	Section/ Area	Winning Bid	Amount
1	North Central	SWUSI	11,311,648.00*
1	South East	SWUSI	5,135,707.00
1	West Area	Guymann	11,247,949.00*
3	North Central	Guymann	9,680,667.00*
3	South East	SWUSI	7,086,135.00
3	South West	Guymann	8,601,732.00*
2	North East	Guymann	7,938,886.00*
2	South Central	Guymann	6,542,211.00
2	South East	SWUSI	6,807,143.00

* Indicates the five largest contracts awarded for Southwest 1, Southwest 2 and Southwest 3.

During the course of interviews, Kessler inquired into why the "smaller" subcontractors could continue to bid once they had already won a contract and maximized their working capabilities. It was explained by a Public Works employee that the subcontractors were required to submit bids on every territory regardless of their intention to win that contract, and if they did not want to win the contract, they have the option to structure their bid amounts accordingly. This employee also indicated that if the companies could not handle additional work, "they better not win the bid."

Kessler's analysis of the bidding documentation has disclosed that it is a statistical impracticality that the selection process could have been competitive. The analysis indicates that after certain companies received a contract, they would increase or change their unit prices to avoid winning another contract. This could be easily accomplished since the bidding of each area was one week apart. The process used by Public Works and the CM to select subcontractors is dubious at the very least and requires further investigation by an agency capable of compelling testimony and subpoenaing records.

Kessler has also analyzed the bidding activity for the final bid opening on Southwest 1, Southwest 2 and Southwest 3. Kessler disclosed that the subcontractors that allegedly could not handle the work altered unit prices so that they would not win the final bid in each project, thus completely eliminating competition. The following table illustrates the final winning bid for Southwest 1, Southwest 2 and Southwest 3 and again corroborates Kessler's findings relative to SWUSI and Guymann being the only two companies who could handle more than one project at a time.

Final Bid per Project

Bid Opening	Project #	Section/ Area	Winning Bid	Amount
12/18/2001	1	Southeast	SWUSI	5,135,707.00
10/02/2003	2	South Central	Guymann	6,542,211.00
11/01/2002	3	Southeast	SWUSI	7,086,135.00

The practice of adjusting unit prices to avoid winning a contract was further documented in an analysis conducted. Kessler used Denco and Forsberg as a standard of comparison in determining their competitiveness in bids following the award of a contract. Kessler took the detailed line item components of the winning bids and compared them to the subcontractors losing bids.

This analysis disclosed that on Southwest 3 and Southwest 2, Denco was awarded contracts for one territory in each section as the low bidder. The records further indicate that during the bid opening after their award, which occurred the following week, Denco had a significantly higher bid.

Kessler further compared the unit prices for specific items within each bid and found that on the losing bids, unit prices increased for a number of items within that one week period of time. During Southwest 1, the line item called "Remove & Replace Decorative Driveway" was bid at $6.00 per unit for the contract Denco was awarded. The number of units for this line item ranged from 2100 – 7500. During the other four sections which were bid, Denco raised this one line item to as much as $75.00. As a result of the increase to this single line item, the total bids were increased by approximately $500,000.00 and Denco was not awarded the contract for those areas.

An analysis of Forsberg's bids disclosed that on Southwest 3, they received an award for the second territory assigned. Subsequently, Forsberg came in last place twice and fourth place once during the remaining bid openings. For Southwest 2, Forsberg was consistently in third and fourth place until week four when they lowered their unit prices and were awarded the contract.

The use of "local" subcontractors as required by admission of Public Works personnel appears to have created an environment where subcontractors could conspire to adjust their unit prices. Additionally, since Kessler has been informed that three of the subcontractors were unable to handle more than one project at a time, if true, this would allow subcontractors to have the opportunity to manipulate bids. As a result of its review, Kessler recommended to City Auditor's Office that the findings be turned over to the U.S. Attorney's Office, Anti-Trust Division as well as the Federal Bureau of Investigation so that further investigation could be pursued.

Santa Barbara Force Main

During the course of this engagement, Kessler has documented questionable transactions involving Westra and their award of the contract for the Santa Barbara Force Main ("Santa Barbara") project. An analysis of the bidding documents indicates that for most of projects, Westra was the highest bidder because their prices were consistently greater than other subcontractors. As a result, Santa Barbara was the only contract awarded to Westra.

During an interview with a Public Works employee, Kessler inquired as to the bidding practices of Westra and it was explained that the unit prices submitted by Westra were always much higher than the other subcontractors. As a result, Westra did not get awarded any work during Phase I of the UEP except for Santa Barbara.

Kessler received a telephone call from the Vice President of Westra. Kessler inquired into the unit prices submitted to the City and looked for an explanation into why Westra never lowered their prices in an effort to win additional contracts. Kessler was told, "I am not the estimating department." Kessler further asked if any of the projects of which Westra submitted a bid for were too large for them to handle. The individual became defensive and began questioning the scope of this engagement and why the questions were relevant. Kessler never received an answer as to whether or not Westra could handle more than one project for the City.

Kessler performed an analysis of the Westra bids provided for Santa Barbara by comparing the unit prices submitted to those prices submitted for Southwest 1, Southwest 2 and Southwest 3 projects. Using the documents provided by the City (Exhibit 31), this analysis

indicated that Westra raised their unit prices for Santa Barbara in comparison to other bids and in some cases as much as 50% yet they were still awarded the contract.

To determine how this could occur in a competitive environment, additional analysis was performed. Kessler took a sampling of specific line items for Denco, Forsberg, Guymann and SWUSI and compared the unit prices for the Santa Barbara bids to Southwest 1, Southwest 2 and Southwest 3. This sampling disclosed that these four subcontractors significantly increased specific unit prices for specific line items. For example, Kessler compared the unit prices for the 12" Sewer Force Mains and has determined that these four subcontractors increased their unit prices by as much as 80% in comparison to Southwest 1, Southwest 2 and Southwest 3 when the bids were submitted for Santa Barbara. As a result of these four subcontractors dramatically increasing their unit prices, Westra was able to also increase their unit prices while still being the lowest bidder.

Within documentation provided to Kessler by the City, a record called "Santa Barbara Force Main Tier 2 Review" was included (Exhibit 31). This document includes pricing information for the design of Santa Barbara however, the estimated construction costs were indicated on the bottom of the page. While this document indicates that costs for construction were estimated at $460,873.00, the bidding documentation and Work Authorization provided indicate Westra was awarded the subcontract at a price of $1,313,770.00.

Engineer Estimates

As a result of Kessler's analysis of Santa Barbara, further analysis was performed applicable to the engineer estimates. Kessler chose a sample of the engineer estimates that were used as a basis for the subcontractor's bids and then compared them to the final Subcontractor Pay Requests. This analysis has disclosed that for all of the samples reviewed, the engineer estimates contained several line item quantities that at the end of the project were either not utilized or were not accurate when compared to the original estimate.

For example, the Southwest 1 South Central area engineer estimate called for the subcontractors to submit a bid to Remove & Replace Plain Concrete Driveways. While the quantity estimated by the engineer was 9,702, the total completed by the end of the project was only 5,255. Similarly, while the subcontractors submitted bids for installing 3,722 8" Gravity Sewer Pipes (10-12 feet deep), by the end of the project the subcontractor only utilized 1,946 of these items.

For some line items, the quantity originally estimated by the engineer was exceeded by the subcontractors as reflected on the final Subcontractor Request for Payment. For example, during the Santa Barbara project, the engineer estimated the quantity for Restoration to be 3,080 however, at the conclusion of the project, the total quantity was listed as 4,700 by the subcontractor. Similarly, the engineers estimate for Pavement Overlay for the Southwest 3 North Central project was 15,500. At the end of the project, the subcontractor indicated that the quantity for that line item was 19,228.

Kessler's review has disclosed that significant concerns should have been raised over the estimates during the projects. These

deviations clearly raise Red Flags and should be examined by an engineer against the plans to determine what went wrong and how it could be prevented in the future.

Lump Sum Payments

Mobilization

Mobilization refers to the work and resources that must be completed or established prior to the onset of a project. These costs generally include items such as the setting up of physical office locations, arranging for utilities, purchasing pre-construction supplies and safety equipment, signage and the development of contract documents. These costs do not generally include construction materials necessary to complete a project. In typical circumstances involving GMP contracts, these costs are required to be documented and auditable.

Within each of the Work Authorizations reviewed by Kessler, a lump sum cost was included within the bid and within the contract amount (Exhibit 32). From the documentation provided, Kessler was able to calculate the costs for mobilization for all the projects under review to be $2,441,478.00. The mobilization amounts are questionable because the subcontractors were "local" companies with repetitive contracts and therefore, should not have had any significant mobilization costs once they were already established. In so much as the amount was billed as a lump sum with no supporting documents required, Kessler can not review the components that are included in this billing.

During an interview with a Public Works employee, Kessler inquired what types of costs were included in the line item for mobilization. This employee responded by stating, "you can't figure out mobilization." Kessler was told that some companies needed to increase their mobilization line items to have "money up front." Additionally, Kessler was told by a Public Works employee that the

subcontractors sometimes adjusted their unit prices and included greater mobilization costs to purchase materials at the start of the job. In Kessler's experience, including the cost of materials within mobilization charges is rare and extremely questionable.

Kessler has analyzed a judgmental sampling of subcontractor continuation sheets in order to determine the timing of billings when mobilization was invoiced. Kessler's analysis revealed that on a majority of the projects, the lump sum billings to the City for mobilization were within the first two months.

Surveying, Layout & Maintenance of Traffic

Kessler has determined that the costs associated with surveying, layout & maintenance of traffic were also paid to the subcontractors as a lump sum. From the documentation provided, Kessler has calculated the costs associated with these lump sum billings to be $1,926,535.00. Due to the fact it was billed as a lump sum and no supporting documentation is available, Kessler is unable to review the components of these charges.

Performance and Payment Bonds

Kessler has also determined that the costs associated with performance & payment bonds were paid to the subcontractors as a lump sum. From the documentation provided, Kessler has calculated the costs associated with these lump sum billings to be $1,215,500.00. Again, in so much as a lump sum billing does not require documentation, Kessler can not ascertain the components of costs billed to the City.

Other Lump Sum Payments

In addition to the lump sum billings for the items cited above, Kessler has documented several other categories which were included as lump sum line items to subcontractors. On the subcontractors bidding sheets, these items were marked with an "LS" which indicates they were billed as a lump sum. These items included pump stations, sewer testing and pressure tests and thus, no documentation was required to support this cost to the City.

Insurance and Bonding

During the course of this engagement, Kessler reviewed the Subcontractor Agreements between the CM and the subcontractors. According to Section 19 and Special Requirements Section 3 of these agreements, the subcontractors were required to secure and pay for insurance in the specified amounts indicated below.

Workers Compensation Insurance	1 Million Dollars
Comprehensive or Commercial Liability	2 Million Dollars
Automobile Liability Insurance	2 Million Dollars
Excess Liability Insurance	4 Million Dollars

Kessler reviewed each of the subcontractor agreements provided for the projects under review. This review determined that in some instances, the documentation provided to Kessler indicates that the subcontractors failed to secure the minimum requirements for insurance. Furthermore, several of the subcontractor agreements provided to Kessler by the City did not include any evidence of insurance (Exhibit 33).

Documentation found within the Pre-Qualification paperwork submitted to the FDEP indicates that the CM was supposed to specifically address the insurance and bonding qualifications of each subcontractor and if they did not have the required insurance, they did not meet the minimum requirements for pre-qualifications (Exhibit 34). Subcontractors were also required to provide a bonding capacity of five millions dollars as well as the insurance requirements specified above. A bond is in essence the guarantee of a contractor for performance and payments as indicated within the contract.

Kessler's analysis of the vouchers submitted to the City disclosed that the CM charged for performance and payment bonds. A similar analysis of the continuation sheets and bid documents relative to the subcontractors reflects that they were also charging for performance and payment bonds in the form of lump sums thus no review of cost documents could be performed. The previous audit completed by Townsend directly addressed this issue and recommended the elimination of a double layer of bonding as a cost savings measure.

According to the "Response to Audit Consultant Report," the City addressed the double bonding issues raised by Townsend by stating the following.

"State law requires the City to obtain payment and performance bonds from the prime contractor which is MWH under our PM delivery method. The PM requires bonds from their subcontractors the cost of which is included in the sub-contractors bids. We have investigated having the sub-contractors assign their bonds to both the City and the PM and found that they could do that. The City Attorney's Office advised that would not fulfill legal requirements as written in the Statutes."

"The best approach to affect the cost savings from double bonding would be for the City to work with our state representative to initiate a change the state law to allow the scenario mentioned above. The State law was written back in a time that Design-Bid-Build was the only way of delivering projects. It needs to be updated to include all the new delivery methods available in today's world."

Kessler was not provided any evidence that the issue of double bonding was addressed with the legislature by the City since the issuance of the Townsends report. The total costs associated with the CM and subcontractor bonds for these projects were calculated to be $2,197,867.00.

Licensing

As stated in section 1.4.2 of the "Agreement for Construction Management Services", "All construction...shall be performed by qualified contractors and suppliers, properly licensed where required, paid by and under written contracts directly with CM."

Kessler was provided an e-mail (Exhibit 35) that was written to George Kerper in 2002 which indicates that only two of the subcontractors were licensed and the remaining subcontractors were either inactive or not licensed. The e-mail further indicates that the City Licensing Clerks were notifying the companies so that they would be "licensed and legal for the City of Cape Coral."

Kessler also located a quarterly newsletter from 2003 which indicates a "sting operation" was commenced in the City of Cape Coral in an attempt to stop unlicensed contractors due to an increasing number of citizen complaints (Exhibit 36). According to the newsletter, a number of companies held licenses that were clearly outside the scope of the work they were performing.

Additionally, in the documents provided to Kessler, certain records indicated that tier subcontractors were not licensed. In an attempt to confirm the current status of tier subcontractors, Kessler submitted a list to the City Clerks Office to determine if they were licensed with the City of Cape Coral. The City Clerks Office determined that of the twenty two tier subcontractors names provided to Kessler, only eight of them actually held a City license.

Additionally, Kessler contacted the Florida Department of Business & Professional Regulation ("DBPR") and found that the

Construction Qualified Business License for Guymann, one of the five main subcontractors involved in the UEP, has been delinquent since August of 2005 (Exhibit 37). Kessler was informed that any company who performs work in the state of Florida is required to hold an active license. The representative explained that in order to be lawfully licensed to perform work in the state, all fees and licenses must be active.

The DBPR Web Site indicates that among the reasons a company may be unlicensed include that they may not be able to meet the financial requirements, may not be able to pass a background check, may not be able to meet the education or experience required, may not be able to meet worker's compensation requirements, or may not be able to meet liability requirements.

Cancelled Checks to Subcontractors

At the onset of this engagement, Kessler requested copies of cancelled checks to the subcontractors in order to verify that the amounts charged to the City and those paid to the subcontractors were accurate. In response to Kessler's requests, MWHC sent two letters stating that they did not intend on providing Kessler with the cancelled checks payable to subcontractors. These letters further indicated that the close out change orders should have been sufficient to verify the amounts paid to the subcontractors. The close out change orders referred to by MWHC only indicates the amount of funds that are de-obligated from the original project budget and does not reflect the individual payments made to the subcontractors.

One of the aforementioned letters further stated that if Kessler still felt the close out change orders were inadequate, a sample of ten "selected monthly payments" would be provided for review.

In response to this letter, Kessler explained to MWHC that since the projects totaled over 142 million dollars, cancelled checks would have to be provided and that a sampling of only ten "monthly payments" would not be sufficient to test the expenses for subcontractor billings.

Following a May 18, 2006 conference call with the City Manager, Public Works, City Auditor's Office and the CM, Kessler provided the City with a limited sampling of 20 vouchers (Exhibit 38) for testing purposes. Each voucher included approximately five to six checks payable to the subcontractors who performed work for that period. In response, the CM provided Kessler with an example of two checks payable to the subcontractors to determine if they met

Kessler's requirements for testing (Exhibit 39). Kessler was requested to confirm that the two checks met testing requirements prior to the CM securing the remainder of Kessler's requested sample. Additionally, the CM indicated that, "there will be administrative costs involved" with providing copies of the 120 checks. Kessler approved the sample of documentation provided and asked the CM and City to go ahead with preparing the remainder of the sample since certain concerns were noted.

Kessler reviewed the original two sample checks provided by the CM and had found that one of the checks which should have been payable to Southwest Utility Systems Inc. was in fact drawn to "Southwest Utility Systems" and was hand endorsed "For Deposit Only R. Cowart." It is unclear why this vendor would receive checks amounting to millions of dollars not payable to the correct corporate entity and why the check would have been endorsed in an individual's name.

Shortly thereafter, the City Auditor's Office informed Kessler that excessive charges would be billed to the City for the production of the checks. In response to the City Auditor's concerns, Kessler was requested to further limit its request in an attempt to expedite the matter. Following this request by the City Auditor's Office, a limited sample of five vouchers (which contained multiple checks) was then forwarded to the City.

Following the submission of Kessler's five voucher samples, the City Auditor's Office informed Kessler that the CM now stated they would be redacting the bank account and routing number located on the bottom front of the checks. The CM then made copies of

approximately 35 checks which were then routed through Public Works and forwarded to Kessler.

A review of the check copies provided disclosed that a significant portion of the pertinent information contained on the check was also redacted including parts of the endorsements and bank stamps. Examples of these checks and the redacted information are enclosed herein (Exhibit 40). Based on the redactions of critical information on the checks, Kessler is unable to verify the flow of funds to the subcontractors and the accuracy of those payments.

Billing

Kessler performed an analysis of the billing methods in accordance with the "Agreement for Construction Management Services." Based on the agreement, the costs are paid to the CM based upon the project being separated into three tiers. Tier One includes all costs applicable to project management, Tier Two includes the design phases of the project, and Tier Three includes all costs related to construction.

Tier One Billing
KBR until MWHC Assumes CM Role

Billings for Tier One services was for the "management" of the UEP. A majority of these billings to the City was for labor billed based upon hourly rates agreed to in the Work Authorizations for the following positions:

- Administration Manager
- Cost/Schedule Engineer
- Customer Service Manager
- Customer Service Representative
- Construction Manager
- General Superintendent
- Home Office Engineer
- Health/Safety & Environmental Manager
- Project Engineer
- Project Manager
- Manager of Finance & Accounting
- Secretary
- Subcontract Administrator
- Superintendent/Inspector

Also included within Tier One billings were subcontracts for consulting services from MWHA for design consulting and the Lentz Group for Public Relations. Additionally, another component of the billing for Tier One services was the reimbursement of the CM

direct costs. These costs included communication, office equipment, reproduction, transportation, and public information. The final component of these bills was a 6% handling fee which was billed on all subcontracts by the CM.

Tier Two Billing

KBR

Billings to the City applicable to Tier Two services throughout the projects in our scope of examination were billed by KBR even after the assignment of the contract. These billings included management of the design/engineering work, which included the hourly rates of the following positions:

- Deputy Project Manager of Design and Controls
- General Superintendent
- Project Engineer
- Superintendent/ Inspector

In addition, these billings included a lump sum subcontract to MWHA for the actual design/engineering work which included a 6% administrative fee on all MWHA subcontracts and an approximately 10% estimate of direct costs payable whether it is incurred or not. These billings also included a subcontract to Boyle Engineering for modeling and direct costs which included reproduction and permits.

Kessler's analysis has determined that approximately 80% of the Tier Two GMP was comprised of lump sum contracts payable to MHWA. Kessler was not provided any documents that the City ever conducted a review to determine the competitiveness of the costs for these design services. This is a significant concern since KBR accepted MWHA's estimate and added 6% as a "handling fee."

Moreover, since over 8.5 million dollars was paid as a lump sum amount, regardless of the actual costs of labor and materials, no documentation for the expenses is required. Because the City included this amount as a lump sum, Kessler did not have the ability to request detailed records to ascertain the actual costs incurred for their services and for reasonableness.

Furthermore, based on the documents supplied, Kessler's review disclosed that of the lump sum portions of the MWHA contracts, more than half of the costs billed were for secondary subcontractors. It is unknown what percentage of the work these subcontractors actually performed or how much money they actually received for their services since these costs are un-auditable. A document provided by the City (Exhibit 41) labeled "Southwest 1 Tier 2 Review" lists the line items contained within the lump sum billing. Of particular note is the exact same estimate for Montgomery Watson-Design and Avalon-Design.

Tier Three Billing

KBR until MWHC Assumes CM Role

Billings for Tier Three services included all aspects of the project construction including management services. The management services was performed by KBR both pre and post assignment of the contract. KBR billed for employees at hourly rates which included the following positions:

- Construction Manager
- Cost/Schedule Engineer
- Customer Service Manager
- Deputy Project Manager
- Design Manager
- General Superintendent
- Health & Safety Manager

- Procurement/ Subcontract Admin
- Project Engineer
- Project Coordinator
- Secretary
- Subcontract Administrator
- Superintendent-Senior Inspector
- Superintendent-Inspector

Additionally, billings to the City for Tier Three services included the costs of actual construction by subcontractors, materials purchased by the City for the subcontractors through a program known as Direct Purchase Order ("DPO") and a 6% "Handling fee" on all subcontractor billings and DPO amounts charged by the CM (KBR before assignment, MWHC after assignment). The billings also included bonds and insurance, communications, reproduction, safety equipment and transportation.

Other sections of this report address Kessler's concerns regarding these billings.

Hourly Billable Rates

The "Agreement for Construction Management Services" between the CM and the City contains a section listing allowable compensation to be paid for each of the three tiers.

The management compensation for Tier One services is stated in section 4.1 as follows:

"CM's staffing for management, supervisory and clerical personnel directly related to the provision of Program Management Services (Tier One Services) shall be determined on an annual basis and performed pursuant to a Work Authorization. CM shall be paid for Tier One Services in accordance with the rate schedule and the staffing on an annual basis."

Compensation for Tier Two and Tier Three differed from Tier One services in that there was no indication of annual adjustments to the billable rates. Allowable compensation for Tier Two services is stated in sections 4.2 as follows:

"CM's Management, supervisory, and clerical personnel directly related to the Work Authorization shall be compensated in accordance with the specific, mutually agreed to, compensation terms contained within the Work Authorization which is to be issued by City for the design/engineering and pre-construction services (Tier Two Services) for the particular task."

Allowable compensation for Tier Three services is stated in section 4.3 as follows:

"For the full and complete performance by CM of the construction services, the CM shall be compensated in accordance with the specific, mutually agreed to, compensation terms contained within the Work Authorization which is to be issued by City for the particular task."

The Work Authorizations for each project included agreed upon hourly rates for specified timeframes. Kessler's analysis of a sample of invoices has disclosed that for the months following the

expected end dates of the projects, the CM would automatically increase the billing rates to those of the following Work Authorization.

For example, the Deputy Project Manager – Design / Controls agreed upon ending bill rate in Work Authorization 2-2-1 was $123.90 per hour. Beginning in October 2002 with Voucher #162, the City was charged $126.38 without regard that the increase was not authorized.

Another example disclosed that for Work Authorization 4-3-1 the CM increased employee rates beginning on voucher 377 in May 2004 and continued this practice thru October 2004.

The table below outlines these rate increases.

Rate Differences

Title	WA 4-3-1	Invoiced
Manager of Construction	$137.49	$143.70
Customer Service Representative	61.87	63.09
General Superintendent	120.31	122.67
Superintendent/ Senior Inspector	75.62	77.11
Superintendent/ Inspector	$68.75	$70.10

Based on the documentation provided in the Work Authorizations, there was no indication of any attempt by the CM to officially request a change in their rates nor were any documents included in the Work Authorizations that reflected Public Works questioned the practice or that they obtained City Counsel's approval for this change.

Additionally, analysis revealed despite this lack of authorization by the City Council for this increase, Public Works employees approved the changes anyway.

Kessler also found that job titles billed on invoices did not match the approved Work Authorization titles and in some cases, the job title of an individual was changed during the course of the projects under review.

The following table illustrates the job titles that were found to be different when Kessler compared the Work Authorizations, Invoices and Timesheet Summary provided by the City.

Analysis of Position Titles

Work Authorization	Invoice	Per Timesheet Summary
Manager Finance / Accounting	Admin Manager	Admin Manager
Cost/Schedule Controls	Cost/Schedule Engineer	Cost Scheduler
Project Engineer	Project Engineer	Deputy Project Manager
Deputy Proj. Manager - Design / Controls	Design Manager	Design Manager
Deputy Proj. Manager - Construction	Construction Manager	Construction Manager
Superintendent/Senior Inspector	Superintendent/Senior Inspector	Senior Inspector
Superintendent/Inspector	Superintendent/Inspector	Inspector

Kessler was not provided documentation to determine employee gross wages thus, a verification of the billable hourly rates charged for these employees is not feasible. Additionally, Kessler was unable to determine if the job duties of these employees reflect the positions billed.

Cost of Work

According to the "Agreement for Construction Management Services" article 5 outlines what is allowable and not allowable cots of work.

*"5.1 **Costs Included**. The term "Cost Of Work" shall mean all amounts actually and reasonably incurred by CM in the proper performance of this Agreement or, as applicable, any specific Work Authorization. Except to the extent expressly provided for the Work Authorization, such costs shall include only the items set forth*

(a) Wages and fringe benefits paid for labor (as opposed to wages paid to management, supervisory or clerical personnel included in the Work Authorizations) in the direct employ of the CM in the performance of the work under this Agreement.

(b) Cost, including transportation and maintenance, of all materials, supplies, equipment, temporary facilities and hand tools not owned by the workmen which are employed or consumed in the performance of this Agreement.

(c) Payments due to Independent Consultants and Independent Contractors from the CM or made by the CM to Independent Consultants and Independent Contractors for their work performed pursuant to contracts and subcontracts under this Agreement.

(d) Costs associated with setting up, maintaining and removing tool sheds, project field offices, temporary fences, temporary roads, temporary fire protection or any other temporary facilities required for this Agreement.

(e) Rental charges on all necessary machinery and equipment, whether rented from the CM or others, including installation, repairs and replacements, dismantling, removal, costs of lubrication, transportation and delivery costs thereof, which are used in the support of a trade contractor or the CM's own forces in the performance of the work, at rental charges consistent with those prevailing in the area.

(f) Except as provided in Article 9.1.1, cost of the premiums for all insurance and cost of premiums for all bonds which the CM is required to procure by this Agreement, or other insurance or bonds subsequently deemed necessary by the CM, and agreed to by the City. This includes any trade contractor or subcontractor bonds the CM deems appropriate.

(g) Sales, use, gross receipts or similar taxes related to allowable direct costs of the Project imposed by any governmental authority, and for which the CM is liable.

(h) Minor expenses at the site or the project office, such as

telegrams, long distance telephone calls, telephone service, expressage, postage, and similar petty cash items in connection with the project.

(i) Costs of removal and disposal of all debris including cleanup and trash removal from the site.

(j) Costs incurred due to an emergency affecting the safety of persons and property.

(k) Costs to the CM of temporary safety-related protection including barricades and safety equipment, temporary roads and parking, dust control, pest control, installation and operation of temporary hoists, scaffolds, ladders and runways, and temporary project signs and costs of permits and fees pursuant to the Construction Documents.

(l) Project related transportation within 150 miles of the City for those personnel employed directly for the project in accordance with CM's standard personnel policy. Transportation outside of the 150 mile limit must be approved in advance by the City.

(m) Costs of all reproduction used for estimating, bidding or information purposes required by the Project to directly benefit the project.

(n) Costs for watchman and security services for the Project.

(o) Costs for efficient logistical control of the site, including horizontal and vertical transportation of materials and personnel

(p) Cost of surveys, measurements and layout work necessary for the execution of the Project or the requirements of this Agreement.

(q) Cost of preparation of shop drawings, coordination plans, photographs, or as-built documents not included in trade contracts or subcontracts.

(r) Cost of data processing services required in the performance of the services required by this Agreement.

(s) Costs for temporary facilities during construction including temporary water, heat, power, sanitary facilities, telephones, radios, etc.

(t) Costs for independent testing of materials as required in the Construction Documents and or Work Authorizations.

(u) Costs of leasing the Project office and facilities required for the project office including furniture, office equipment, office supplies and computers with software.

(v) Costs for permits of fees paid to federal, state or local government agencies or departments which are required for review or construction of the work,

(w) All costs directly incurred in the performance of the Project for the benefit of the Project and agreed to by both parties and not included in 5.2 below.

*5.2 **Costs Excluded**. Unless otherwise expressly provided for in a specific Work Authorization, the cost of work shall not include any of the following items:*
5.2.1 Any allocation of general overhead expenses of CM's principal office and/or any other offices other than the project office;
5.2.2 General overhead, except as may be expressly included in a Work Authorization;
5.2.3 CM's capital expenses, including interest on CM's capital employed for performing any of the services required of it hereunder;
5.2.4 Any costs not specifically and expressly described or provided for in Article 5.1;
5.2.5 Any costs which would cause any lump sum fixed price or guaranteed maximum price established in any Work Authorization or otherwise agreed to in writing by CM to be exceeded, unless otherwise adjusted by change order.

*5.2.6 **Corrective Costs**. Notwithstanding anything herein to the contrary, CM shall not have a right to seek reimbursement from the City for corrective costs, as a cost of the work, except as may be specifically authorized in a Work Authorization."*

Kessler obtained documents indicating the basis of the labor rates included in the Work Authorizations. These documents have disclosed that the very costs listed as "Cost Excluded unless expressly provided for in a specific work authorization" in the "Agreement for Construction Management Services" were included as a basis of establishing labor rates approved and charged to the City.

Kessler also obtained documents that shed light on how these labor charges were developed. A document labeled "Brown Root Services Utility Extension Labor Rate Analysis" stated that the billable rates charged to the City included direct labor, overhead of 31.5%, General and Administrative costs of 30.3%, Facilities Capital Cost of Money (FCCM) of 1% and a fee/profit of 9% (Exhibit 42).

Furthermore, in a letter dated October 4, 2001 (Exhibit 43) from Chuck Pavlos, Public Works Director, through Howard Kunik, Interim City Manager, to Mayor Kempe and Council Members with copies to Jeanne Landry, Procurement Manager, Wayne Wolfarth, Utility Engineer, and Chip Kerper, Contract Specialist, Pavlos provided a response to Councilmember Asfour's request for additional information on indirect rates.

Pavlos explains that the rates charged to the City were based on Brown & Roots Services indirect costs which include fringe benefits, overhead, G & A, and material handling/ subcontractor administration. Pavlos leaves out the profit ratio that was included in these rates.

The fact that the "Agreement for Construction Management Services" specifically excludes many costs that were in fact billed in labor rates and hidden from the taxpayer, makes it appear as if someone was using smoke and mirrors to hide these costs.

Kessler attempted to reconcile the aforementioned costs associated with labor. Based on the records obtained, for every hour an employee works on the project earning $45 per hour, KBR bills the City as follows:

Direct Labor	$45.00
Overhead	$50.46
G & A	$22.84
Profit	$36.91
Bill Rate	$155.21

Kessler analyzed Exhibit 42 in an attempt to reconcile the multiplier rate of 3.23. The following chart illustrates the calculated multiplier rate using a base billable rate of $45.00 as based on the Direct Labor, Overhead, and General & Administration indicated on the exhibit.

Analysis of
Exhibits 42 and 43

Category	Allocation %	Billable Rate
Direct Labor	100.00%	$45.00
(Salary of Employee)		
Overhead	112.14%	$50.46
Executive Salaries		
Accounting Salaries		
Administration Salaries		
Employee Benefits		
Building Occupancy		
General & Administrative	50.75%	$22.84
Home Office Accounting Salaries		
Home Office Administration		
Home Office Legal Staff		
Bid & Proposal Costs		
Research & Development		
Total Multiplier	262.89%	$118.30
Multiplier per Exhibit 43	323.35%	$155.21
Assumed Profit	**%**	**$36.91**

Kessler's analysis of these documents determined that KBR charges a profit of 82% that is added to every dollar paid to an employee on this project. Additionally, KBR is charging the City 112.14% for every dollar paid to an employee as overhead and 50.75% as general and administrative charges. Based upon

Kessler's analysis, the markup for labor has been calculated to be 223%.

Kessler has not secured documents to ascertain how MWHC arrived at their billable rate.

As pointed out in Townsend's Report, it is unusual when wages are marked up to arrive at a billable labor rate that a 6% handling fee is also charged on construction subcontracts. These costs included in labor are in addition to the 6% fee charged on every dollar subcontracted in this project.

Timesheets

During the course of this engagement, Kessler requested timesheets to verify the labor and hours charged by the CM. After considerable delays and numerous requests Kessler was provided the information.

A sampling of KBR timesheets revealed instances of vacation time and training billed to the city. Additionally, there were occasions where the job code on the timesheets was blank or the timesheets were missing altogether. The number of hours and related charges of these errors do not appear to be material.

Kessler sampled timesheets from MWHC and found that the hours purported on the timesheets reconciled to the corresponding invoices. This analysis however did disclose that the descriptions on a number of them to read "Other Labor Un-billable" and "Other Un-billable Labor". The hours from these timesheets were traced to the invoices and in sixteen of the nineteen instances; they were billed to the City. Kessler calculated the cost to the city for these un-billable hours at $19,494.81 (Exhibit 44).

From the documents provided, Kessler also found numerous timesheets that indicated a temporary staffing agency was used to obtain people which KBR billed to the City as employees.

Based upon an analysis, Kessler determined that six individuals who worked on the projects were under the employment of outside temporary agencies, yet billed as employees of KBR.

As an example, Kessler has revealed that an individual who provided customer support services and billed to the City at $49.08 per hour, actually was billed to Brown & Root Services by the agency at a rate of $18.70 per hour.

The CM's billing of the "temporary staff" for these projects is not consistent with its billing practices with the remainder of the subcontractors it utilizes.

Based upon an analysis of the staff working for the temporary agency, 5,642 hours were charged to the City at a cost of $296,617.26. Kessler calculated the charges to Brown & Root Services for these hours and added a 6% markup and determined the cost to the City should have been $119,001.91, and thus there was a difference of $177,615.35 (Exhibit 45).

Additionally, Kessler has examined the approvals noted on the agency invoices and observed that many of the approval stamps were assigned a work code of "Non-reimb". This code was hand written and signed by Jake Whicker, Administration Manager of KBR. Kessler calculated these non-reimbursable hours billed to the City to equal $57,930.00 (see Exhibit 45).

Payroll

Kessler requested various payroll documents applicable to these projects at the onset of this engagement. In response to Kessler's request, MWHC and KBR only provided timesheets for their employees. As reflected in the March 8, 2006 letter from MWH (see Exhibit 6), they would not provide any additional information. Additionally, another letter dated April 7, 2006 (see Exhibit 6) indicates that MWH "will not be providing payroll information for timesheet verification."

After repeated requests for this documentation, an additional letter was received on May 11, 2006 which indicated the following:

"As identified in our letters dated March 23 and April 7, 2006, we will not be providing raw salary payroll information for timesheet verification. This decision was made for the reasons stated in our response above and was a precedent set on the previous audit conducted on a work authorization under this agreement."

Following two conference calls and several correspondences regarding the necessity of verifying payroll information, Kessler submitted another request to the City on May 31, 2006, limiting its request to a sample size of three months. This sample size was proposed by Kessler as an initial review due to the excessive costs the CM stated it would charge for the production of the documents, if they decided to make them available.

After submitting its final request, Kessler was informed by the City Auditor's Office that the sample was being compiled; however, certain information would be redacted on the documentation including personal information such as social security numbers, payments for child support and taxes.

On June 9, 2006, Kessler received the payroll documentation provided by the CM. A review of these records indicates that almost all of the information on the documents presented was redacted (Exhibit 46) including gross wages, net wages and check direct deposit amounts. The information provided by KBR was also redacted and documents were missing which were required to verify the data presented.

While the documentation provided reflected the hours paid to each employee, there was no information included that allowed Kessler to verify the amounts paid or hourly rates of each individual. As a result, no verification could be made that the base rates used to arrive at the billable labor rates were accurate and reasonable. Based on the lack of detailed cost data, Kessler is unable to evaluate these costs.

KBR/MWHC Separate Agreement

As a result of KBR not being able to or declining to supply the necessary bonding for the UEP, MWHC became the CM at Risk. Kessler has reviewed the amendment entitled "Partial Assignment & Contract Amendment" ("PACA") and "Amendment II" (Exhibit 47) in which KBR relinquishes its role as CM to MWHC in August 2002. The amendment specifies that the responsibility's and compensation structures with the City will remain consistent with the original CM contract and approved Work Authorizations. The agreement was signed by representatives from KBR, MWHC, and the City in August 2002.

Section 1-d of the PACA states,

"In connection herewith, KELLOGG BROWN & ROOT shall further provide for the assignment of all existing subcontracts for Assigned Work, and provide construction management services to MWHC for assigned work under a separate agreement with MWHC."

Furthermore, the PACA indicates in Paragraph 4,

"Costs incurred as a direct result of this Assignment shall be bourn by contract assignment, any costs incurred as a direct result of this assignment shall be bourn by Kellogg Brown & Root Inc. and/or MWHC and shall not be chargeable to, nor reimbursable by City."

Kessler analyzed the "separate agreement" between MWHC and KBR specifically in relation to Paragraph 4 of the PACA (Exhibit 48). The "separate agreement" states,

"MWHC shall provide two additional staff to work with and coordinate activities with CM staff. Initially, MWHC shall provide an Assistant Project Manager (or Project Engineer), and a lead Project Controls representative, and shall have the right, either through necessary additions to staff or through attrition to replace CM personnel, to add two additional staff for the Program. In the event of MWHC adding additional staff in excess of two personnel, CM profit will be adjusted in accordance with section 5.3 herein."

Kessler's analysis indicates that despite the fact that all costs incurred as a direct result of the Assignment was to be bourn by Kellogg Brown & Root and/or MWHC, MWHC added two additional staff to work with and coordinate activities with the CM staff and charged them to the City. Kessler further noted that within 6 months of the agreement, a third part-time employee was billed to the City by MWHC.

In addition to the payroll portion of the agreement, the "separate agreement" also discusses a sharing of the "handling fees" of subcontracts. As stated in section 5.3:

"Fee on subcontract costs shall be calculated based upon MWHC receiving 75.3 percent and CM (KBR) receiving 22.2 percent of the subcontract handling fee as negotiated under Section 4.3.2 of the Prime Contract for each Work Authorization (2.5 percent being non-reimbursed shared ODCs paid pursuant to Section 5.4 of this Agreement). Under SW-1, fee on subcontract costs is based upon MWHC receiving 4.51 percent and CM receiving 1.33 percent of the City's negotiated 6% subcontract handling fee (0.16 percent being non-reimbursed shared ODC's paid pursuant to Section 5.4 of this Agreement). In the event that MWHC's Program staff increases above two positions or the fee on subcontracts varies from 6% the CM and MWHC agree to mutually modify the profit allocation, on subcontracts, to more accurately reflect the intended 51/49 profit allocation. In addition, at the completion of the Program, MWHC and CM agree to modify the above profit allocation in the event that the total subcontract costs varies from the current construction estimate of $118 million for the Program. If required by one of the three trigger events, a review will be performed to asses costs and determine the profit allocation between labor and subcontract costs and an adjustment shall be made to the allocation of profit on subcontract costs. In such an event, the, recalculation costs shall be shared equally by MWHC and CM. MWHC shall bear the risk of the Cost of Work. In the event the established GMP for any Work Authorization is exceeded, then CM's profit shall be reduced accordingly."

Florida Statute 287

Florida Statute Chapter 287 "Procurement of Personal Property and Services (287.050) (Consultants Competitive Negotiation Act) specifically outlines in Paragraph 6 a Prohibition Against Contingent Fees or Fee (Exhibit 49). The Agreement for Construction Manager As Agent ("Separate Agreement") outlines various methods MWH provides KBR for their participation in the contract. Analysis of this area needs a legal review to determine if any violations exist with the State Statute, and if so, should be forwarded to the appropriate agency.

Project Deviation Notices (PDN's)

During the course of the projects, situations arose where the CM or City changed or modified the original agreed upon scope of work. A change in the scope of work can lead to an increase, decrease, or no change to the value of the original contract. Thus GMP is revised based on the net change of the work performed or deleted.

In general, the City initiates the process of costing out charges by requesting an estimate from the CM. The CM then communicates with the Design/Engineering Firm (MWHA) and the subcontractors assigned to that area to prepare cost proposals. After the CM reviews the reasonableness of the proposal, it is submitted to Council for approval. Once approved, the city signs a Project Deviation Notice "PDN" which includes a description and an amount for the change. The CM then prepares a Change Order for the affected subcontractor to begin the work.

Kessler's performed an analysis on a judgmental sample of change orders and supporting documentation contained in the files provided by the City. This analysis disclosed that the CM accepted the subcontractor's full proposal on each occasion without negotiation or inserted the Subcontractor unit prices established during the bidding for the area. This is a concern due to the bidding practices documented earlier in this report. There was also no evidence that the City ever attempted or had the ability to compare or negotiate costs to lower pricing. In so much as, the CM charged a 6% fee based on the value of the change orders; there is a built in incentive to accept a higher estimate.

Additionally, this engagement has disclosed instances of change orders being awarded for work which appears to be large enough or distinctive in scope that it would warrant the public advertising of open competitive bids.

For example, MWHC change order 07 for the Southwest 2 North East area dated December 10, 2004 to Guymann Construction of Florida, Inc., indicates the project as "provide installation, testing, and commissioning of a new 12-inch potable water main entitled Ceitus Parkway Water Main Improvements". This change order was budgeted at $768,864.00 of which $622,296.00 was for construction (Exhibit 51).

MWHC change order 03 for the Southwest 2 North East area dated July 12, 2004 to Guymann Construction of Florida, Inc., indicates the project as "Install sidewalks on both sides of Surfside Blvd". The amount budgeted for this work amounted to $140,259.20 of which $132,320.00 was for construction (Exhibit 50).

Meter Box Installation

As stated in section 2.3.9 of the "Agreement for Construction Management Services" between the City and KBR:

"The CM shall, without additional compensation, revise or correct any errors, omissions or other deficiencies in such data, studies, surveys, designs, specifications, calculations, estimates, plans, drawings, construction documents and instruments, and other services, work and materials resulting from the negligent act, errors or omissions or intentional conduct of CM or any Independent Contractor or Independent Consultant."

Kessler's sample review of change orders revealed an unexplainable trail of documentation related to the installation of meter boxes for residents living in the Southwest 3 area. The documents contained in a change order file disclosed that only 20% of the meter boxes had been installed. Upon realization of this oversight, a change order was issued to all subcontractors who were now working on the subsequent area (Southwest 2). This constitutes a shifting of costs from one project to another. Based on the records provided, Kessler was unable to determine which residents were assessed for these costs.

The PDN for the aforementioned change order indicated an approved encumbered funding of $581,092.00, of which $32,892.00 was included for the 6% CM handling fee. As in many of the analyzed change orders, the documents stated the price was a lump sum (LS). This document was signed by the CM on May 3, 2004 and approved by the City on May 7, 2004.

In conducting a review of the related change orders sent to all of the subcontractors on May 20, 2004, Kessler observed that the change order amounts for the subcontractors were considerably less than the total amount listed on the PDN. Kessler has determined the

total subcontractor change orders amounted to $394,250.00 (Exhibit 52).

Kessler added $23,665.00 to this figure, (6% handling fee) to arrive at a total charge of $417,915.00 to install the remaining meter boxes. According to the documents, $163,177.00 of funding should have been available for future use (Exhibit 53).

According to a letter dated November 16, 2004 and signed by Larry Laws, only $101,045.00 remained available to be un-encumbered (Exhibit 54). Kessler has calculated $62,132.00 is missing funding that can not be explained based on the records provided.

Contingency Funds

When each of the projects were bid out and ready for City Council approval, the CM would submit a detailed sheet breaking down all costs associated with that project. Included within these sheets were percentages for contingency funds.

Contingencies are in essence reserve funds which are to be used for emergencies and any unexpected outlay of funds during the course of a project. The City encumbered these funds with each project Work Authorization and change orders. During a meeting with Public Works personnel, Kessler was told that these funds ranged anywhere from 5 – 10% of the subcontractors estimated project costs. An analysis of these funds has determined that the percentages encumbered by the City ranged anywhere from 5 % to as much as 25%.

During interviews with Public Works personnel, Kessler was told that almost all of these projects under review came in under budget and the City saved a great deal of money. This could be due to faulty estimates.

Kessler has found however, that these funds were used during several of the projects under review. During the design phase of Southwest 1, Southwest 2 and Southwest 3, these funds were consistently used. This is likely the result of significant portions of the design phase being billed as a lump sum.

Kessler has recommended that procedures and guidelines should be put into place that call for more detailed explanations provided to the City when contingency funds are being both developed

and used. This will allow for greater accountability by both the City and CM, especially since a sole employee of Public Works has the authority to approve the use of contingency funds. Since Kessler has found no basis for the assignment of these funds, procedures or guidelines should be put in place to ensure that these funds are objectively assigned in the future.

Direct Purchase Orders

As an intended cost savings measure, the City implemented a Direct Purchase Order program in which they would purchase the necessary materials used in connection to the Utilities Expansion Program. By purchasing the materials for the subcontractors, the City was exempt from paying sales tax. Although this practice took place, the subcontractors were required to include the cost of materials, labor, sales tax, and profits in their bids to the City.

Kessler learned that the City was not paying for 100% of the materials utilized, thus trying to reconcile what was purchased and used by the subcontractors was an impossible task. In fact, Kessler was informed by Public Works that the City only bought 90% of material to defray the costs associated with "wasted" material by the subcontractors and that there was no way to reconcile the purchases to individual subcontractor invoices.

To recoup this outlay by the City, a credit was given to the City based on each subcontractor's alleged actual material usage for the period which including sales tax.

An analysis of the documents provided to Kessler indicates that the City did not receive any credit for the profit and the CM handling fee applied to the profit as included in the bid for the materials by the subcontractors. The CM invoices only credits the material cost and sales tax back to the City. The value of this amount can not be calculated by the documents provided.

Additionally, during an interview with the former Contracts Specialist for Public Works, Kessler was told that the CM actually

provided a list of vendors and instructed the City as to which vendor would be supplying the materials. Upon further inquiry, this employee also stated that the City already had contracts with many of the vendors and could get the materials at a cheaper price, yet they paid the CM's price.

During a telephone interview with a Project Manager from Denco, Kessler inquired into the Direct Purchase Order program and more specifically the crediting procedures used by the subcontractors. The individual confirmed that a profit margin was included in his bids and that the City was only credited for the cost of the actual materials.

Furthermore, this individual indicated that the specifications for each project were provided before the contract was awarded so the subcontractors would know exactly how much material and waste there would be. He confirmed that the City originally bought 100% of the materials but changed their procedures to only purchase 90%.

Savona and Chiquita Intersection

During the course of Kessler's review, documentation was provided relative to intersection improvements at Savona Parkway and Chiquita Boulevard which was not included in UEP. These records indicate that improvements were made to the intersection by Guymann and were included in the Work Authorization 3-3-1, Southwest 2 Construction. This matter is questionable because these intersection improvements were included in the total project costs associated with Southwest 2. Kessler is unable to determine if these costs were included within the assessments paid by the taxpayers.

Kessler's review indicates that this work package which included a GMP contract of $102,174.00 was not bid out and simply awarded to Guymann via a change order so the area could remain, "under one contractor's control." An e-mail exchange (Exhibit 55) indicates that this contract was not bid out in an effort to save time, however, it also indicates that an analysis of proposed competitors pricing was used as a basis to award the contract to Guymann even though two of the estimates were lower than the amount actually proposed by Guymann.

Headworks / Aeration Tank Interconnect

Documentation made available to Kessler applicable to Headworks to Aeration Tank Interconnect ("Headworks"), which totaled $702,893.00, included design management and construction. This lump sum contract was awarded to a subcontractor called Mitchell & Stark Construction Company, Inc. ("Mitchell & Stark") in the amount of $436,212.00. Kessler has not been provided any documentation to determine how this subcontractor became involved in the UEP. No advertisement of the bid request was noted.

Kessler determined that MWHC simply sent letters to five different companies including Mitchell & Stark, requesting a quote for Headworks (Exhibit 56). This appears to violate Florida Statue Chapter 255.0525 (see Exhibit 14).

Everest Valve Replacement

Documentation applicable to the Everest Valve Replacement project ("Everest") was not provided until much of this report had already been prepared. Our review of these documents has revealed questionable items.

According to an Executive Summary submitted to the City by KBR, the Everest project was bid on by six companies and was awarded to SWUSI (Exhibit 57). The only bid information provided reflects a letter from each company which states the price of the lump sum bid. This documentation indicates that the bid proposals ranged anywhere from $38,000.00 to $122,500.00. One bid of $122,500.00 exceeded another by 300%. The KBR estimate for this package is indicated to be $38,893.00. Kessler has already documented questionable bidding practices by subcontractors and the disparity reflected in the documentation provided for Everest is similarly disturbing.

Recommendations

In conducting this inquiry, Kessler encountered issues that it believes require systemic reform within the City. Some of the issues have already been addressed implicitly in this report. These include taking steps to guard against future deception of the taxpayers; diligently monitoring vendors and accurately responding to citizen complaints and inquiries and not discounting them simply because of their source. The fact that certain items at issue in this inquiry -- from questionable bidding practices to obstructing authorized fact-gathering efforts -- pervaded during this engagement suggests serious and systemic management failings. Apart from these concerns, which bear no greater elaboration, Kessler also took note of the following issues requiring more systemic reform.

First, strong signals must be sent by the Council regarding cooperation with the City Auditor's Office. The City must take responsibility for ensuring prompt, complete, and diligent responses to requests for information and evidence. In the future, steps should be taken to ensure that employees rigorously and honestly search their paper files and computer systems, and should have strong administrative action taken against those who do not.

Moreover, Kessler's inquiry discovered grave discrepancies in the Public Works record keeping systems. Inadequacies were found in record retention and a lack of accountability. Particularly, to procurements involving hundreds of millions of taxpayer dollars, these discrepancies pose serious concern. Written policies should immediately be formulated and followed for the handling of records and procurements on behalf of the City.

Additionally, a follow-up check should be made to ensure that appropriate remedies are being implemented and are adequately addressing the problems. Moreover, spot checks should be undertaken to ensure that the same issues found in Phase 1 do not exist in the Pine Island Road project, which was previously audited with no significant findings, and Phase 2 which is on going.

The City should also re-examine its policies relating to allowing vendors complete control of projects without adequate City oversight and determine whether changes need to be made in those policies to ensure that future multi-million dollar contracts are properly supervised and taxpayer funds properly spent. If those policies are deemed adequate, additional training should be provided and additional documentation required ensuring that the incidents Kessler uncovered are not repeated.

The conduct of certain employees in the context of this engagement is also very disturbing, all the more so since the most egregious conduct was committed by persons in positions of substantial responsibility and leadership.

From the point in this engagement when the City Auditor's Office personnel concurred with concerns of questionable bidding activity, Kessler was authorized to refer its findings to the U.S. Attorney's Office – Anti Trust Division and Federal Bureau of Investigation. At their request, Kessler will transmit a copy of our report to them for further evaluation. Regardless of whether any official is prosecuted criminally for actions in connection with this matter, Kessler urges the City Council to contemplate civil and administrative actions concerning these findings and that systemic reforms be implemented.