Architect and Engineering Consultant Negotiations and Contracting Recommendations

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Office of the County Auditor
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Executive Summary

The purpose of this report is to provide recommendations to the Board to improve the process by which the County negotiates hourly rates with architect and engineering consultants.

The basis for the recommendations within this report include, among other things; 1) our observations of negotiations over several years, 2) billing rate reviews of consultants' contracts with the Aviation Department (BCAD) and several Public Works Department (PW) divisions including: Seaport Engineering and Construction, Highway Construction and Engineering, and Water and Wastewater Engineering, and 3) focus group discussions with County staff, consultants and subconsultants.

As discussed more fully in this report, the culmination of our observations, reviews and discussions indicate opportunities to:

- Reduce administrative burden for County staff, consultants and their subconsultants
- Reduce the time needed for negotiations
- Reduce the risk of overpayment by the County
- Reduce future audit costs of the County, consultants and subconsultants
- Provide greater consistency in the negotiation process

Our recommendations include:

1) Adoption of a Safe Harbor rate option for overhead and fringe benefit costs.

2) Formalizing the County’s general practice of limiting the maximum contract multiplier to 3.0, but permitting exceptions, when justified, on a case by case basis.

3) Adoption by the County of the Florida Department of Transportation model for negotiating consultant operating margins.

4) Creation and maintenance of a County-wide database of negotiated consultant rates as a tool to assist County staff in the review and negotiation of future billing rates.

5) Development of formalized guidelines and staff training for consultant contract negotiations, incorporating the above recommendations and Board policies.
Purpose and Scope

The purpose of this report is to provide recommendations to the Board to improve the process by which the County negotiates hourly rates with architect and engineering consultants. This report is prompted based upon challenges observed during contract negotiations, as well as the results of overhead rate reviews completed by my Office for 17 consultants contracting with various County agencies.

To further assist our Office in developing these recommendations we:

- Conducted focus groups with Public Works Department (PW) and Aviation Department (BCAD) Contract Administrators
- Conducted focus groups with contracted consultants and subconsultants
- Provided PW Project Managers an opportunity to comment on the concepts presented herein during a quarterly Project Manager Workshop conducted by PW
- Met with members of the Small Business Development Advisory Board
- Met with Finance and Administrative Services Department staff, including Purchasing Division Director and Chief Negotiator
- Interviewed peer entities, including Miami-Dade, Palm Beach, Fairfax, and Maricopa counties regarding their consultant contracting practices
- Interviewed a representative from the Federal Highway Administration regarding the Safe Harbor rate pilot program
- Reviewed Federal Highway Administration and Florida Department of Transportation consultant contracting practices
- Performed other relevant research

Background

Broward County, like many other government entities, enters into contracts with consultant firms to provide engineering, design and surveying services. Agreements may be for known services, related to the design or renovation of a specific building or facility, or agreements may be of a continuing term nature, where work authorizations are issued on an as-needed basis for various ongoing projects, such as repairs and improvements.

In Florida, the award of these agreements is subject to the Consultants’ Competitive Negotiation Act, section 287.055, Florida Statutes. In summary, this Act requires that consultants are selected based upon qualifications, not price. Typically, firms responding to County solicitations are ranked according to their qualifications and experience. Once the top ranked firm is identified, negotiations are initiated with the goal of establishing a price the agency considers to be fair, competitive and reasonable.

Broward County relies heavily on the services of contracted consultants to meet its operational needs. In 2014 the County entered into 15 new consulting services
agreements. These contracts, plus amendments to four existing agreements, have awarded almost $43 million in funding to consultants, and represent the negotiation of over 100 hourly rates schedules.

**Negotiation of Consultant Fees and Rates**

The negotiation of consultant agreements can be a complex and lengthy process. The general terms and conditions of the agreement are detailed in the standard County contract forms (BCF 202 and 403), which are made available to consultants for review as part of the solicitation. As part of their response, consultants identify whether they take exception to any of the standard terms which can then be addressed during the selection process, or during negotiations. Project specific details such as the Scope of Services, project deliverables, project schedule, and fees are negotiated between the consultant and the contracting Division, with assistance from Purchasing. Fees are typically based upon the required level of effort to complete the work and negotiated hourly rates for the consultant’s professional staff working directly on the project.

Hourly billing rates are developed based upon the consulting firm’s actual salary costs for their employees, and a negotiated ‘multiplier’. The multiplier has three components: the firm’s overhead\(^1\) cost rate, the firm’s fringe benefit\(^2\) cost rate, plus a profit percentage.\(^3\) Once negotiated, the multiplier is applied to consultant’s employee’s actual salary cost to develop a billable rate per hour. For example, if a firm pays an Engineer $40/hour and has a negotiated multiplier of 2.9, the billable rate for the Engineer would be $116/hour (2.9 x $40). Maximum billing rates for the prime consultant’s and subconsultants’ various staff classifications are identified in an Exhibit contained in each agreement.

Overhead and fringe benefit rates represent a significant portion of the billable rate. As such, these rates are contractually required to be certified by an independent Certified Public Accountant (CPA), in accordance with Federal Acquisition Regulation (FAR) guidelines. Presently, subconsultants who do not have a certified FAR audit, may, through the prime consultant, apply for a waiver of this requirement from my Office. Waivers are typically granted, so that smaller firms are not precluded from participating in County contract opportunities. However, it is important to note that even if the requirement for a CPA certified audit has been waived by my Office, all contract rates,

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\(^1\) Examples of allowable overhead expenses include rent, utilities, office equipment, and indirect staff expenses, such as payroll, purchasing or management personnel in accordance with Federal Acquisition Regulation guidelines.

\(^2\) Examples of allowable fringe benefit expenses include paid vacation and holidays, health and retirement benefits, and required taxes and insurances in accordance with Federal Acquisition Regulation guidelines.

\(^3\) Profit is applied to raw salary costs as well as overhead and fringe rates.
collectively referred to as ‘salary costs’, are considered provisional, and remain subject to verification through audit.\(^4\)

**Overview of Observations**

My Office has extensive knowledge and experience regarding the development, negotiation and administration of consultant agreements, including: attendance at negotiation meetings; coordination and collaboration with staff in developing hourly rates; review of FAR waiver requests; coordination with Office of the County Attorney in developing salary cost language for county contracts; responding to Contract Administrator questions and concerns regarding invoicing; and the review and audit of consultant agreements.

Throughout the course of these interactions, several challenges in the negotiation and subsequent administration of these agreements have been observed, including:

- Contract negotiations may be lengthy, requiring several meetings.
- Several subconsultant firms, and occasionally prime Consultant firms, do not have current FAR audits in support of their proposed rates. As a result, the negotiation process then includes the additional step of a developing FAR waiver request, or in the case of a prime consultant, a modification to the standard terms within the contract.
- Smaller, less sophisticated entities have difficulty compiling adequate support for their proposed overhead and fringe benefit rates.
- Some consultants have incorrectly interpreted the FAR waiver as a waiver of the contractual requirements to develop rates based upon actual cost, instead of its actual purpose as an exemption of the requirement to have such costs by certified by a CPA.
- Recent reviews conducted by my Office indicate a significant level of errors in non-certified support of overhead rates (i.e. FAR waiver documentation) used in contracts.
- Our reviews disclosed that some subconsultant services have been invoiced to County using the prime consultant’s overhead and fringe factors; a practice that is clearly contrary to the contractual requirement to use a firm’s ‘actual’ cost factors.
- Repayment of overbilled amounts can create a financial challenge for both the prime and subconsultants, and affect CBE goal attainment, especially for services overbilled across multi-year projects.

\(^4\) Article 5.2.2 of the BCF 202 and BCF 404 states “Salary Costs for the Consultant and subconsultants as shown in Exhibit B are the Maximum Billing Rates which are provisional, subject to audit of actual costs, and if the audit discloses that the actual costs are less than the costs set forth on Exhibit B for the Consultant or any subconsultant, the Consultant shall reimburse the County based on the actual costs determined by the audit.”
• There are inconsistent practices across Divisions in the review and establishment of hourly salary costs for consultant staff classifications, maximum allowable multipliers and profit percentages.

It is recognized that the above challenges do not apply to every contract negotiation, and every contract is different; however, these observations, when considered in their totality, indicate that there are opportunities for improvement within the current practices.

**Recommendations**

The following section details the basis for our recommendations, inclusive of an overview of our observations, assessment of the area for improvement, and feedback from focus groups.

1) **Adopting a “Safe Harbor” rate program similar to the program developed by the Federal Highway Administration may streamline negotiations of overhead rates, reduce audit costs and reduce risk of overpayment**

When negotiating contracts with consulting firms, many governmental entities (including the federal government and the County), require the submission of an independently certified FAR audit to substantiate the consultant’s actual costs of doing business (i.e. the firm’s overhead or indirect cost rates). However, it is generally recognized this requirement can create difficulties for new or smaller firms that may not have the sophistication to provide an accurate cost proposal or the financial means to engage a CPA firm to complete an audit. As a result, it is common to provide alternatives for small firms.

The County’s FAR waiver process was envisioned as one such alternative. The waiver process was designed to enable small consulting firms to participate in County contracts without the expense of a FAR audit. In lieu of a FAR audit, firms instead provide the County, through the prime consultant, their own supporting calculations of their proposed overhead and fringe benefit expense rates. The waiver has generally been approved for all who request it; however, consistent with the County’s contract, all rates “are provisional, subject to audit of actual costs.” Therefore, while the waiver process allows subconsultants to avoid the cost of an audit, it does not alleviate the necessity for calculating a firm’s cost rates in accordance with the FAR.

Based on our observations during negotiations, many subconsultants have difficulty in developing their rates. Errors in ‘self-calculations’ by consultants could potentially result in overpayments by the County. In follow-up to these concerns, we conducted of a review of unaudited rates for a selection of eleven subconsultants. Our review revealed that the unaudited support submitted for ten were inconsistent with FAR principles. Discrepancies such as the inclusion of direct, unallowable, and/or unsupported costs in their overhead amounts were noted.
A “Safe Harbor” rate program similar to the program developed by the Federal Highway Administration may help address concerns with the existing FAR waiver process

The Federal Highway Administration (FHWA) has recently initiated a ‘Safe Harbor’ rate pilot program across ten states. Under this program, consulting firms without a FAR audit, or a history of FAR audits, may elect to use a pre-established Safe Harbor rate of 110% (combined overhead and fringe expense rate) in their state Department of Transportation (DOT) contract. Firms that do not opt to use this rate can still participate in contract opportunities if they obtain a certified FAR audit.

To learn more about this program, we contacted the FHWA’s Office of the Chief Financial Officer, whose representative provided additional information. The pilot program was created to allow small or new firms without a cost history an opportunity to participate in DOT contracts, and to encourage competition. The 110% rate utilized by the program was developed by auditors from the American Association of State Highway and Transportation Officials (AASHTO) task force. At 110%, the rate is considered fair to consultants, as it is high enough to allow recovery of their expenses. However, the rate is low enough to encourage firms to work towards obtaining a FAR audit in the future. Once a Safe Harbor rate is in a contract, it remains in effect for the entire term of the agreement. Use of the Safe Harbor rate also provides a ‘free pass’ to the firm from a review of overhead (audit relief). After the first year of the pilot program, FHWA notes that a significant number of new firms are now participating in DOT contracts, and the FHWA is considering expanding the program to additional states.

To assess if consultant contract stakeholders would be interested in having a similar option available in Broward County, we presented this concept to focus groups of Contract Administrators, Project Managers, prime consultants, and subconsultants. All groups were supportive overall. Some potential benefits identified include: simplifying negotiations and invoicing; saving time in negotiations; removing subconsultant barriers and burdens; eliminating business risk and threat of future audits; and reducing risk for prime consultants. Although some concern was expressed that the 110% combined overhead and fringe rate is low, it was recommended that the rate be offered as an option, not a mandate, and firms can obtain a FAR if they do not wish to participate in the program.

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5 FWHA does not allow program participation if a consultant has had a FAR audit in the past, and in order to be accepted into Safe Harbor pilot program, firms must agree to develop their internal financial and accounting systems and obtain a FAR audit within three years.

6 Notice of, and invitation to, the Subconsultant focus group was provided to members of the Small Business Development Advisory Board.
Implementing a Safe Harbor Rate in Broward County

Based upon the initial success of the FHWA program, and the positive response to the Safe Harbor rate concept by focus group attendees, it appears that implementing a similar program in Broward County would be a positive change. We suggest that the Safe Harbor rate of 110% combined overhead and fringe (consistent with the FHWA program) be utilized as this rate is high enough to ensure recovery of most overhead costs of small firms, yet is low enough to minimize risk of overpayment for services by County. As requested by focus group attendees, the option should be made available to all interested firms, whether prime or subconsultant. For consistency, it is recommended that once a contract is approved by the Board, the Safe Harbor rates employed would remain in effect for the entire term of the agreement (subject to formal amendment), and would be exempt from an audit of actual overhead costs.

To enact a Safe Harbor rate alternative, consultant contract form language would require minor modification, to be coordinated with and approved by the Office of the County Attorney. As a link to the form contract is included with each solicitation, all interested firms would have the opportunity to review such language prior to responding, and would have an opportunity to cite an exception with their response, or seek a FAR audit if preferred.

2) To enhance consistency in contracting, the County should formalize its policy regarding maximum multipliers within consultant agreements

The formal establishment of a County-wide maximum multiplier will provide clear direction to Contract Administrators when negotiating agreements, as well as promote consistency across County agencies.

Present application of ‘maximum’ allowable amounts is inconsistent

Currently, the majority of County agencies employ the use of multiplier ‘caps’ when negotiating consultant agreements; however, this concept is not applied consistently. For example, during negotiation sessions, consultants are commonly instructed not to submit rate proposals with multipliers in excess of a particular threshold; however, this directive varies across Divisions with 3.0, 2.99 and 2.9 used most commonly as a ‘maximum’ multiplier. This is sometimes, but not always, combined with a second directive to consultants prohibiting proposals with a profit in excess of 10%. Meanwhile, other agencies may allow higher profit percentages (up to 12% and 15%) in their contracts, particularly if the overall multiplier is below the maximum proscribed.

Based upon observations during negotiation meetings, it is noted that these differences create a perception of unfairness to consultants, who when contracting with one County agency are able, or unable, to negotiate more favorable agreements than their peers contracting with another County agency. Consultants have also voiced concern that this process creates a ‘one size fit all’ multiplier concept which may not be appropriate, given the variety of contracted firms and project scopes.
A formal, yet flexible, policy regarding maximum thresholds for multipliers could improve actual and perceived consistency in contracting

Peer research conducted in this area indicates that use of a maximum allowable multiplier is a common practice, and that the majority have established 3.0 as such a cap. Therefore, we recommend the Board formally adopt a policy establishing a maximum multiplier, and consider 3.0 as the threshold amount. Additionally, we recommend that a process be created which would allow exceptions to be presented to the Board, for approval on a case-by-case basis, when the Contract Administrator presents a valid business case stating why the exception is in the best interest of the County.

The concept of such a policy was presented to our focus groups, and was well received by Contract Administrators, and generally supported by consultants and subconsultants. Most attendees favored the consistency of the approach, and the ability to have flexibility to seek exceptions when justified. Some consultants expressed concern about individual Divisions’ willingness to go before the Board, while another consultant opined that 3.0 multiplier should not be exceeded under any circumstance.

3) Establishing criteria for the negotiation of profit (i.e. operating margin) will enhance current practices

Presently, the profit percentage within the multiplier is typically established based upon (1) a maximum percentage, for example 10%, as established by a Contract Administrator, or (2) whatever percentage mathematically yields the maximum overall multiplier as established by the Contract Administrator, such as 2.9, or (3) allowing a higher percentage (most commonly observed when the overall multiplier is low). As such, it is often the case that profit percentages, are typically ‘assigned’ rather than thoughtfully negotiated. As observed with the establishment of the multiplier, practices across Divisions may vary, and this inconsistency may be creating a perception of unfairness.

Current profit negotiation practices do not regularly consider the specific work to be performed

It is recognized that the present approach generally achieves some measure of cost control, through the award of a higher or lower profit percentage based upon the overall efficiency (or inefficiency) of a consultant’s overhead rates. However, it has been observed that other factors, such as project scope, risk or complexity, or the specific nature of the work to be performed by individual consultants, are less frequently considered. These factors may also be worthy of consideration when negotiating a fair profit amount with a consultant.
FDOT model considers various factors when establishing operating margin

In researching models used by peers, it was found that different practices are employed when negotiating profit with consultants. It is common to use 10% as a maximum, with some entities allowing slightly higher percentages when the work is particularly complex.

Over the years, several consultants expressed a preference for the FDOT model for negotiating agreements, and suggested the County employ a similar approach. This feedback was considered, and more research was conducted on this model. FDOT publishes an extensive negotiation manual, which includes guidelines for establishing profit. These guidelines consider criteria such as complexity of the project, degree of risk, project schedule and rate each category ‘low’, ‘medium’ and ‘high’, for the work to be completed for each consultant. Therefore, a consultant performing services with a complex scope, requiring a high level of coordination with other entities and demanding/accelerated project schedule, would be awarded a higher profit percentage than a consultant completing work on a routine, simple project. FDOT’s model also places significant weight on a consultant’s cost control efforts, considering not only the efficiency of the overhead rates, but the fee proposal overall, including salary rates and distribution of staffing across a project.

Implementing a formalized approach to negotiating operating margin would enhance consistency and fairness across consultant agreements

Each of our focus groups was presented with the idea of Broward County establishing a profit negotiation scale similar in concept to FDOT. All groups were supportive of such a model. Contract Administrators appreciated the ability to have more consistency and more flexibility in negotiations, and that such a model would recognize consultants with low-cost overhead and incentivize the potential ‘safe harbor’ overhead rate. Contract Administrators also noted that a scale which awarded profit based on project-specific work would necessitate thoughtful discussions of the scope between Project Managers and consultants during negotiations, and create a quantifiable record of the elements considered. Consultants and subconsultants also provided positive comments, similar to that of Contract Administrators, noting that this would incentivize and reward more efficient business practices, deterring manipulations of overhead costs. It was also felt that this would create fuller discussions of the scope, bringing more subconsultants into the process. Further, this would provide considerations for complexity, while allowing for flexibility.

Therefore, it is recommended that the County implement more formalized approach to the negotiation of profit percentages, or operating margin (terminology preference by many consultants). This could be accomplished by establishing a workgroup, representative of all stakeholder Divisions, to develop guidelines, identifying key factors for consideration, and a weighable scale, with specific criteria that can be employed by all Contract Administrators and/or Project Managers during negotiations. Once developed and tested, such guidelines can be shared with the consultant community for
increased transparency during negotiations. As in the recommendation for developing maximum multiplier policy, policies regarding the establishment of operating margin should include a maximum threshold, as well as a means by which exceptions can be identified and presented to the Board for approval.

4) **A County-wide database of negotiated consultant rates would be a useful tool during negotiations**

Another key element in the negotiation of consultant fees is the establishment of maximum hourly rates, i.e. raw salary amounts paid to consultant employees and billable to the County. These rates are multiplied by the ‘multiplier’ to establish the maximum billing rate. Therefore, it is important that these rates are negotiated consistent with market value for the specific classifications, disciplines, and key personnel included in each contract.

We have observed that in some instances, an individual consultant has proposed and been awarded different salary costs for their staff across multiple County agreements. While this may be appropriate in some circumstances, there does not appear to be sufficient cause in other cases.

According to peer research regarding other counties’ practices, the majority reviewed have an organization-wide database of rates that they use as a tool to consider proposed base salary costs. Some have implemented practices requiring newly negotiated rates not to exceed certain thresholds (i.e. one standard deviation from the mean) when compared against existing contract rates.

In conducting focus groups of County staff, it was learned that several Divisions maintain their own databases, but do not have access to, or maintain records of salary costs negotiated by other Divisions. All agreed that having access to County-wide information would be a useful tool during negotiations. To achieve the most value from this endeavor, the database would ideally include position titles, along with raw and loaded rates, identifiable by consultant and agreement. The database should be maintained on an ongoing basis, with all Contract Administrators and Project Managers having the ability to view information. Users of the database should be aware that different contracts may have differing staffing needs.

**Summary of Recommendations**

To enact the proposed solutions discussed in this report, we recommend:

1) Adoption of a Safe Harbor rate option for overhead and fringe benefit costs.

2) Formalizing the County’s general practice of limiting the maximum contract multiplier to 3.0, but permitting exceptions, when justified, on a case by case basis.
3) Adoption by the County of the Florida Department of Transportation model for negotiating consultant operating margins.

4) Creation and maintenance of a County-wide database of negotiated consultant rates as a tool to assist County staff in the review and negotiation of future billing rates.

5) Development of formalized guidelines and staff training for consultant contract negotiations, incorporating the above recommendations and Board policies.