



Office of the City Auditor

**Report to the City Council
City of San José**

**AUDIT OF THE SAN JOSÉ
CONSERVATION CORPS**

**The City Paid More Than Actual Cost
Through Its Agreements With the San José
Conservation Corps**

**The City Is Paying For Indirect Costs Not
Anticipated Through Its Agreements With
the San José Conservation Corps**

**There Are Several Other Areas Where the
City Can Strengthen Controls Over
Administration of These Agreements**

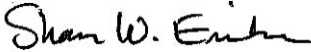
**Report 09-05
May 2009**

May 13, 2009

Honorable Mayor and Members
of the City Council
200 East Santa Clara Street
San Jose, CA 95113

Transmitted herewith is the report *Audit of the San José Conservation Corps*. This report is in accordance with City Charter Section 805. An Executive Summary is presented on the blue pages in the front of this report. Responses from the City Administration and the San Jose Conservation Corps are shown on the yellow pages before Appendix A.

This report will be presented at the May 21, 2009 meeting of the *Public Safety, Finance & Strategic Support Committee*. If you need any additional information, please let me know. The City Auditor's staff members who participated in the preparation of this report are Steve Hendrickson, Chris Constantin and Avichai Yotam.

Respectfully submitted,

Sharon W. Erickson
City Auditor

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Executive Summary

In accordance with the City Auditor's 2008-09 Workplan, we performed an audit of the San José Conservation Corps' (Corps) compliance with its agreements with the City of San José. We conducted this audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our finding and conclusions based on our audit objectives. We limited our work to those areas specified in the Objectives, Scope and Methodology section of this report.

The City Auditor's Office thanks the management and staff of the Corps, the City Manager's Office, the Finance Department, the Housing Department, the Environmental Services Department, the San José Fire Department, the Parks, Recreation and Neighborhood Services Department, the Planning, Building and Code Enforcement Department, the General Services Department, and the City Attorney's Office for their cooperation during the audit process.

Finding I The City Paid More Than Actual Cost Through Its Agreements With the San José Conservation Corps

The Master Agreement between the City and the San José Conservation Corps (Corps) requires the Corps to invoice the City for actual costs. However, we found the Corps invoiced and the City paid \$276,802 more than the costs reflected in Corps accounting records for recycling and construction services. City staff did not question these over-billings because they often approved payment for the full amount of a contract, or a pro-rated portion of the contract without requiring the Corps to demonstrate the actual cost. Additionally, we found the Corps had already been reimbursed \$133,140 by the State of California for recycling services provided under contracts with the City. We noted that a few departments have taken steps to ensure payment of only actual cost, but on one occasion, the City did not fully address a prior finding of unsubstantiated costs. We found that the Master Agreement does not stipulate sufficient detail regarding what type of expenses are allowable or unallowable, nor does the Master Agreement require the Corps to account for City funds independently from non-City funds. The City can improve controls by establishing and enforcing specific guidelines for reporting, justifying, and accounting for actual costs. We found that:

- The Corps recouped more costs than were reflected in its accounting records for recycling services and was already reimbursed for some expenses by other sources including the California Department of Conservation;
- The City paid \$76,117 more than the actual cost for construction services;
- The City should establish and enforce specific guidelines for reporting and justifying actual costs under the Master Agreement;
- The Housing Department; Planning, Building and Code Enforcement Department; and General Services Department took action to ensure the City paid only for actual costs; and
- The Office of Economic Development identified prior findings of unsubstantiated personnel costs, yet irregular billing practices persisted.

We made five recommendations to recover excessive payments and to strengthen controls. In total, the City should attempt to recover \$276,802 we found to be overpayments and \$133,140 already reimbursed by the State.

RECOMMENDATIONS

We recommend that the City:

- Recommendation #1** **Attempt to recover the \$200,685 that was not reflected in Corps accounting records for services provided under ESD contracts. In addition, the City should attempt to recover the \$133,140 in City-related expenditures that were already reimbursed by the California Department of Conservation. If within 60 days the Corps provides additional documentation supporting expenditures on City projects that were not reimbursed by others, we agree to reevaluate the amount that the City should attempt to recover from the Corps. (Priority 2)**
- Recommendation #2** **Attempt to recover the \$76,117 it overpaid for services provided under Fire Department contracts. If within 60 days the Corps provides additional documentation supporting expenditures on City projects that were not reimbursed by others, we agree to reevaluate the amount that the City should attempt to recover from the Corps. (Priority 2)**
- Recommendation #3** **Establish and enforce specific guidelines for reporting and justifying actual costs under the current Master Agreement. (Priority 3)**

We recommend that the City:

Recommendation #4 **Require the Corps to account for City activities separately from non-City activities. (Priority 3)**

We also recommend that the Office of Economic Development (OED):

Recommendation #5 **Follow up and resolve the personnel billing issue we identified. In the future, OED should require the Corps to provide substantiating documentation regarding the total activity and cost for Corps employees whose salaries are funded by Workforce Investment Act contracts. (Priority 3)**

Finding II The City Is Paying For Indirect Costs Not Anticipated Through Its Agreements With the San José Conservation Corps

The City's Master Agreement allows the Corps to invoice the City for actual costs, but does not provide guidance on indirect costs. We found the City paid for activity not anticipated through many of its agreements during 2005-06 through 2007-08. Specifically, the City's lack of sufficient guidance defining allowable and unallowable indirect costs, and lack of guidance detailing restrictions on how indirect costs can be allocated to specific City projects led to excessive indirect costs rates. We found that:

- The City paid \$98,325 for expenses unrelated to City projects; and
- The City must ensure the Corps bills for reasonable and actual costs by providing more detailed guidance or revise and simplify the Master Agreement.

By providing sufficient guidance and working with the Corps to identify allowable and exclude unallowable expenses, we believe that the City may achieve cost-savings of \$70,000 per year while maintaining existing Corps service levels. We made two recommendations to recover excess payments and to strengthen controls.

RECOMMENDATIONS

We recommend that the City:

Recommendation #6 **Attempt to recover the \$98,325 paid in indirect costs for work not described in City contracts. If within 60 days the Corps provides additional documentation supporting expenditures on City projects that were not reimbursed by others, we agree to reevaluate the amount that the City should attempt to recover from the Corps. (Priority 2)**

Recommendation #7 **Revise and simplify the Master Agreement to:**

- 1. Establish guidance defining what costs are allowable and unallowable for inclusion in an indirect cost pool. Further, the guidance should detail restrictions of how indirect costs can be allocated to specific City projects;**
- 2. Annually require the Corps to develop and justify an indirect cost rate proposal and/or an hourly billing rate. (Priority 3)**

Finding III There Are Several Other Areas Where the City Can Strengthen Controls Over Administration of These Agreements

During our review, we found several other areas where the City can strengthen controls over the Master Agreement and contract administration. First, the City can strengthen controls in the Master Agreement between the City and the Corps to ensure the Corps maintains the desired balance between work and education. Second, the City should ensure there are controls in place to restrict projects from exceeding estimated costs. Finally, we communicated our concerns to the Corps regarding its practice of providing loans to employees.

RECOMMENDATIONS

We recommend that the City:

Recommendation #8 **Clarify and amend the Master Agreement to include performance standards to ensure the Corps maintains the desired balance between work and education. (Priority 3)**

We recommend that the City:

- Recommendation #9** **Ensure that there are controls in place to ensure that the Corps does not exceed estimated costs for contracts under the Master Agreement. (Priority 3)**
- Recommendation #10** **Consider providing guidance to the Corps regarding the practice of providing loans to key individuals responsible for accountability and reporting. (Priority 2)**

Introduction

In accordance with the City Auditor's 2008-09 Workplan, we performed an audit of the San José Conservation Corps' (Corps) compliance with its agreements with the City of San José. We conducted this audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our finding and conclusions based on our audit objectives. We limited our work to those areas specified in the Objectives, Scope and Methodology section of this report.

The City Auditor's Office thanks the management and staff of the Corps, the City Manager's Office, the Finance Department, the Housing Department, the Environmental Services Department, the San José Fire Department, the Parks, Recreation and Neighborhood Services Department, the Planning, Building and Code Enforcement Department, the General Services Department, and the City Attorney's Office for their cooperation during the audit process.

Background

The Corps incorporated in May 1987 as an independent nonprofit organization formed to provide disadvantaged young men and women with the academic education, hands-on learning, and development of basic skills needed to enter and succeed in the Silicon Valley workforce. The organization offers secondary education courses through its on-site Charter High School, and vocational education and job training through its Projects and Recycling divisions. Another program, YouthBuild San José, combines mandatory academics with paid on-site job training in the construction trades. The mission of the Corps is to provide youth with a quality high school education and teach valuable work and life skills that empower them to become responsible, productive, and caring citizens.

The Corps is one of twelve private, nonprofit certified local conservation corps in California. The California Conservation Corps certifies local conservation corps annually in accordance with the Public Resources Code, which requires local conservation corps to engage in recycling and litter abatement projects, to conduct an educational component, and to have at least 50 corpsmembers enrolled, among other things. Because of its status as a certified local conservation corps, the Corps can access state grant funds.

Programs

The Corps has the following five main programs:

- **Environmental and Community Projects Division:** provides entry-level jobs throughout Santa Clara County for students enrolled in the Corps.
- **Recycling and Eco-Academy Division:** gives students paid job training, vocational instruction, and skills. As a certified local conservation corps, the Corps receives significant funding annually from the California Department of Conservation's Division of Recycling to provide beverage container recycling programs in the community.
- **Youth Corps Division:** provides underserved and minority youth at select public high schools an after-school intervention program, homework assistance, leadership development, and paid after-school jobs performing community service, environmental conservation, and neighborhood beautification projects. In July 2008, the Corps informed the City that it eliminated the division because of a lack of sufficient funding to sustain the costs of operation.
- **YouthBuild San José:** teaches students trade skills in the construction industry while building housing for low-income families. In 2007, the division completed the construction of single-family homes on Hennessy Place in the Blossom Hill area of San José.
- **Charter High School:** serves as the hub of the Corps' programs where students earn credits for a high school diploma or prepare for the General Education Development (GED) exam, and learn vocational and leadership skills. Established in July 2002, the Charter High School derives its separate income from state block grants (attendance and categorical programs), other federal and foundation grants, as well as from independent donor contributions. The Charter High School is overseen by the Corps' Board of Directors and the East Side Union High School District. In the fall of 2006, the Corps began operating a full-time school with a focus on enabling high school dropouts to graduate by placing them on the fast track to pass the California High School Exit Exam.

Financials

In 2007-08, as shown in Exhibit 1, the Corps received about \$6.5 million in revenue, mostly through government grants and contracts. For 2007-08, Corps accounting data show the City provided more than \$1.6 million of the \$5.1 million (32 percent) in revenue to the Corps, excluding the Charter High School. The Charter High School generated an additional \$1.4 million.

Exhibit 1: San José Conservation Corps Operational Revenue and Expenses

	2005-06	2006-07	2007-08
Revenue			
Government grant income	\$6,094,191	\$5,657,519	\$6,120,986
Contributions	1,899,558	1,004,556	372,130
Other	36,654	202,463	54,080
Total revenue	8,030,403	6,864,538	6,547,196
Expenses			
Personnel costs	4,846,301	4,525,291	4,644,149
Corpsmember development	20,790	162,010	711,539
Depreciation	326,112	293,168	265,485
Professional services	276,594	318,935	223,407
Conferences, meetings, and training	35,809	148,910	167,049
Other	1,059,421	918,684	725,270
Total expenses	6,565,027	6,366,998	6,736,899
Change in net assets before other revenue (loss)	1,465,376	497,500	(189,703)
Other revenue (loss)			
Capital grants	-	-	245,928
Loss from discontinued project	-	-	(132,634)
Net income (loss)	\$1,465,376	\$497,500	\$(76,409)
Cash on Hand, June 30	\$885,431	\$923,636	\$799,454

Source: San José Conservation Corps audited financial statements for 2005-06, 2006-07, and 2007-08.

The Corps' 2007-08 audited financial statements note that the Corps receives a substantial amount of support from federal, state, city and county governments and that a significant reduction in the level of this support, if this were to occur, might have an effect on the Corps' program and activities.

The City's Relationship With the San José Conservation Corps

The City has numerous contractual arrangements with the Corps. In 1987, the City provided a lease to the Corps for property housing its headquarters. The current lease agreement executed in November 2000 and scheduled to

expire in March 2030, requires the Corps to pay rent of \$1 per month. As shown in Appendix B, in fiscal year 2007-08, the Corps had 8 major agreements with the City, including federal grants and a Master Agreement with 40 individual service contracts.

The City justified entering into a **sole-source** Master Agreement with the Corps to provide community improvement activities because the City has determined that the Corps provides a unique service. Specifically, in approving a new Master Agreement for up to five years in August 2007, the City Council found that the Corps provides programs to at-risk youth with essential job training and development opportunities and that this unique service presents an unusual or unique situation that makes applying the requirements for competitive procurement of a services agreement contrary to the public interest.

Under the Master Agreement with the Corps, the City Manager has the authority to approve special projects—often for neighborhood beautification, parks maintenance, graffiti abatement, and recycling at City sites—that do not exceed \$250,000 without obtaining competitive bids or seeking City Council approval. Under the terms of the Master Agreement, the City and Corps mutually agree to projects using a Special Project Approval Form. The form includes the project name, location, start/stop dates, description, and estimated labor and materials costs. City and Corps representatives sign approval of the service contract prior to the start of each project. The Master Agreement states that each service project shall be undertaken at Corps' sole cost and expense on a reimbursement basis for actual costs, except for those projects where City materials and supplies are to be used as specified in the Special Project Approval Form. Once work has begun, the Corps must invoice the City on a per project basis monthly. The agreement further states that the City is not responsible for paying costs in excess of the estimated costs for a project, unless they are due to a written addition to or change to the scope of services requested.

In addition to the Master Agreement, the City has awarded competitive grants to the Corps. These grants, which include grants of federal funds, have different terms, but generally require that the Corps demonstrate its actual costs when requesting reimbursement through invoices.

Objectives, Scope, and Methodology

Our audit objective was to review contract compliance and oversight of the agreements between the San José Conservation Corps (Corps) and the City. We reviewed contracts between 2005-06 through 2007-08 with a particular focus on 2007-08. We also reviewed some recycling contracts in 2004-05.

During our review, we analyzed Corps financial information, indirect cost calculations and payroll transactions from electronic data sources such as financial and employee timekeeping as well as other internal spreadsheet data sets. We also reviewed City Financial Management System records, City Clerk's Council History and Documents database records, and other City department files. We interviewed officials and staff from various City departments, the Corps, and other external organizations.

We did not audit the Corps' Charter High School and relied upon attendance reports for comparison to Corps data. Our audit of the Corps was focused on activity funded by the City of San José. We did not audit activity of other jurisdictions. We conducted some electronic data reliability tests by comparing financial transactions for cash asset accounts with official bank statements and we compared financial and payroll transactions against internal sources and third-party payroll information. Our testing indicated the data sources available are sufficient to conduct our analysis.

Our conclusions are based on testing of select City agreements with the Corps and we have noted exceptions as documented in this report. We did not compare electronic records to a visual inspection of ongoing work, nor did we complete 100 percent testing of transactions.

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Finding I The City Paid More Than Actual Cost Through Its Agreements With the San José Conservation Corps

The Master Agreement between the City and the San José Conservation Corps (Corps) requires the Corps to invoice the City for actual costs. However, we found the Corps invoiced and the City paid \$276,802 more than the costs reflected in Corps accounting records for recycling and construction services. City staff did not question these over-billings because they often approved payment for the full amount of a contract, or a pro-rated portion of the contract without requiring the Corps to demonstrate the actual cost. Additionally, we found the Corps had already been reimbursed \$133,140 by the State of California for recycling services provided under contracts with the City. We noted that a few departments have taken steps to ensure payment of only actual cost, but on one occasion, the City did not fully address a prior finding of unsubstantiated costs. We found that the Master Agreement does not stipulate sufficient detail regarding what type of expenses are allowable or unallowable, nor does the Master Agreement require the Corps to account for City funds independently from non-City funds. The City can improve controls by establishing and enforcing specific guidelines for reporting, justifying, and accounting for actual costs. We found that:

- The Corps recouped more costs than were reflected in its accounting records for recycling services and was already reimbursed for some expenses by other sources including the California Department of Conservation;
- The City paid \$76,117 more than the actual cost for construction services;
- The City should establish and enforce specific guidelines for reporting and justifying actual costs under the Master Agreement;
- The Housing Department; Planning, Building and Code Enforcement Department; and General Services Department took action to ensure the City paid only for actual costs; and
- The Office of Economic Development identified prior findings of unsubstantiated personnel costs, yet irregular billing practices persisted.

We made five recommendations to recover excessive payments and to strengthen controls. In total, the City should attempt to recover \$276,802 we found to be overpayments and \$133,140 already reimbursed by the State.

The Corps Recouped More Costs Than Were Reflected In Its Accounting Records For Recycling Services and Was Already Reimbursed For Some Expenses By Other Sources Including the California Department of Conservation

The Environmental Services Department (ESD) paid the Corps about \$1 million for providing recycling services at City facilities, parks, and public recycling and litter cans from July 2004 to June 2008. However, we did not find evidence to justify \$200,685 the City paid for recycling services at City sites.

ESD entered into service contracts with the Corps under the City's Master Agreement. According to ESD, since 2000 the City has received approximately \$255,000 annually for beverage container recycling and litter abatement activities from the California Department of Conservation's Division of Recycling, which it uses to pay for Corps collection services. The Corps submits monthly invoices to ESD for one-twelfth of each contract's amount. However, this practice is not consistent with the Master Agreement which requires the Corps to invoice only the actual costs of providing the service.

As shown in exhibits 2 and 3, our review of the Corps' accounting records raised questions that the Corps' actual expenses did not justify all City payments. For one of the four years we reviewed, the Corps incurred only \$23,091 in expenses, including indirect costs, to pick up recycled materials from City facilities but received \$48,750 from ESD. In this single case, the Corps invoiced and the City paid \$25,659 in expenses that were not documented in the Corps' accounts for City activity and therefore should not have been paid by the City.

The Corps states that it incurred expenses that justify the City payments, but inadvertently charged a portion of those costs to a California Department of Conservation grant. Nonetheless, because the California Department of Conservation reimbursed the Corps for those costs, the City should recoup the overpayments.

Exhibit 2: The San José Conservation Corps Received Payment For Costs Not Documented In Accounts For City Activity

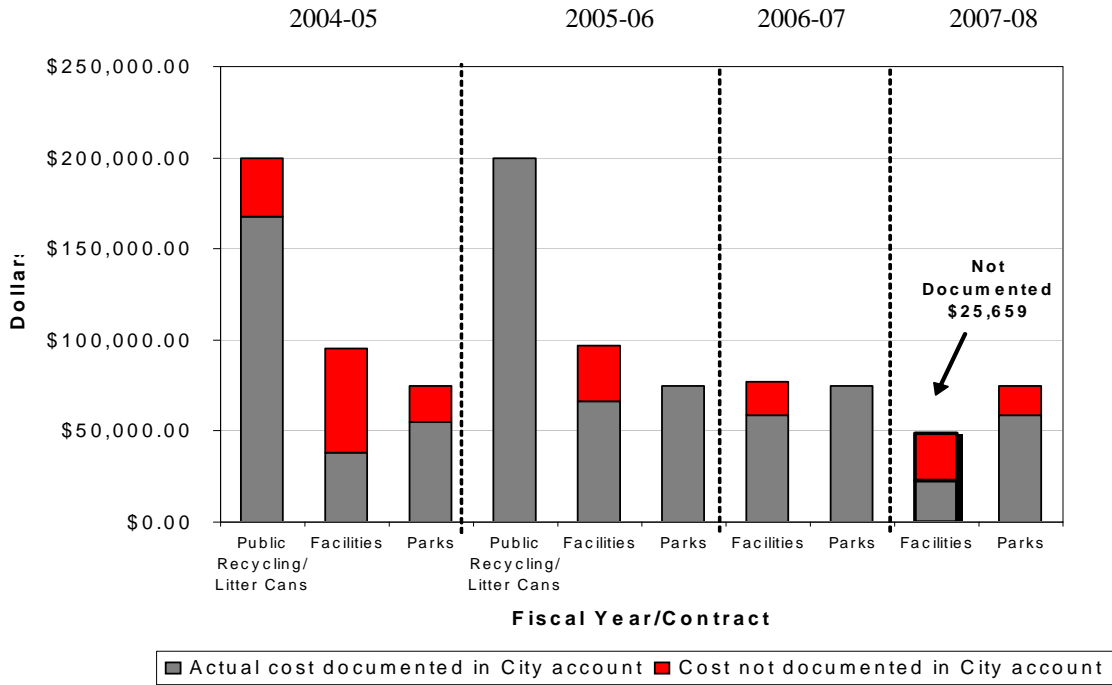


Exhibit 3: Revenue and Expenses For Recycling Contracts

(in thousands)

	2004-05			2005-06			2006-07		2007-08		Total
	Public Recycling/ Litter Cans	Facilities	Parks	Public Recycling/ Litter Cans	Facilities	Parks	Facilities	Parks	Facilities	Parks	
Revenue	\$200	\$95	\$75	\$200	\$97	\$75	\$77	\$75	\$49	\$75	\$1,018
Expenses											
Staff payroll	27	10	27	43	20	30	20	17	0	0	194
Corpsmembers payroll	102	5	0	105	14	29	16	45	15	37	368
Non-personnel costs	11	15	18	26	24	5	14	3	4	6	126
Indirect costs ¹	28	8	10	27	9	12	8	19	4	15	140
Total expenses	168	38	55	201	67	76	58	84	23	58	828
Net income²	\$32	\$57	\$20	\$(1)	\$30	\$(1)	\$19	\$(9)	\$26	\$17	\$201

Sources: City Auditor's analysis of San José Conservation Corps and City Finance Department accounting records as of April 2009.

According to ESD staff, ESD approves monthly Corps invoices for one-twelfth of the contract amount upon receipt of a report documenting the past month's activity. However, ESD does not request documentation to substantiate the cost of the activities, nor does ESD require detailed reporting or supporting materials for monthly expenses. Staff indicate they hold the Corps accountable for correcting any deficiencies in its services prior to the release of City funds.

Further complicating the issue, for fiscal year 2005-06, the Corps had already been reimbursed \$133,140 by other sources including the California Department of Conservation for a portion of corpsmembers salaries for City recycling services.

¹ Indirect costs are expenses associated with activity that cannot be directly charged to a specific project. To recover indirect costs, the Corps pools and allocates indirect costs across multiple activities based on the number of hours of service performed by each activity. Although there is no provision for indirect costs in the City's Master Agreement, this practice is normal and customary. We did not exclude the indirect costs we question in Finding 2; rather, we included all indirect costs that the Corps allocated to the recycling contracts.

² We do not deduct net losses (where net income is less than zero) from the total net income because the Master Agreement does not require the City to pay for costs in excess of the original estimated costs for a project, unless they are due to a written addition to or change to the scope of services requested. Additionally, we found that the Corps billed the California Department of Conservation to cover most of the net losses.

We recommend that the City:

Recommendation #1

Attempt to recover the \$200,685 that was not reflected in Corps accounting records for services provided under ESD contracts. In addition, the City should attempt to recover the \$133,140 in City-related expenditures that were already reimbursed by the California Department of Conservation. If within 60 days the Corps provides additional documentation supporting expenditures on City projects that were not reimbursed by others, we agree to reevaluate the amount that the City should attempt to recover from the Corps. (Priority 2)

The City Paid \$76,117 More Than the Actual Cost For Construction Services

We also found the Fire Department paid \$76,117 more than actual cost for services it received from the Corps under the Master Agreement. In March 2002, San José voters approved the Public Safety Bond Act, which provided funds for upgrading fire department facilities. From June 2007 to June 2008, the Fire Department contracted with the Corps for a portion of this work on six facilities. According to Fire Department staff, the Fire Department paid the invoices in full but did not request documentation to support the actual cost of the services provided.³

In a number of projects, the Corps subcontracted the entire scope of work to private businesses and invoiced the City the cost plus a substantial premium above the subcontractors' invoiced costs. We found in at least one case the Corps did not receive prior written consent from the City for the use of subcontractors in violation of the Master Agreement. Additionally, Corps records show a breakdown of subcontractor cost elements including a cost labeled "profit." The "profit" amounts do not correspond to an actual expense. As shown in Exhibit 4, Corps' documentation indicates the Corps made at least \$58,000 in "profit" on the sale of subcontracted services. Subcontracted services accounted for more than \$328,000 of the \$426,000 in direct costs (77 percent) associated with Fire Department contracts.

³ We should also note the City did not execute contracts for several of these projects until after the Corps had completed its work and invoiced the City.

Exhibit 4: Some San José Conservation Corps Back-up Documents Showed “Profit”

Facility⁴	Subcontracted work	Cost to Corps	“Profit” Charged to City
Fire Station 16	Windows.	\$8,065	\$1,613
Fire Station 22	Trusses, plumbing, lighting and electrical work, stucco, sheetrock, soil testing, fire-rated paneling, insulation, sheet metal work, air conditioning, windows and skylights.	48,603	5,068
Fire Station 26	Windows, lighting and electrical work, bathroom renovation, sheet metal work, heating and air conditioning, and floor refinishing.	123,888	16,708
Fire Station 34	Repaving parking lot.	6,000	2,400
Fire Department Training Center	Air conditioning, lighting and electrical work, repaving parking lot, and ductwork.	142,288	32,666
	<i>Heating and air conditioning (included in Fire Department Training Center totals above)</i>	26,835	10,000
Total		\$328,844	\$58,455

Source: City Auditor’s analysis of San José Conservation Corps project and accounting files.

One of the contracts shown in Exhibit 4 was for the replacement of two roof-mounted air conditioning units at the Fire Department Training Center in May 2008. In May 2008, the Corps submitted a good faith estimate prior to entering into a Master Agreement contract. The Corps reported it could provide the requested services at a cost of \$36,835. However on the same day, the Corps received a subcontractor proposal for the same scope of work at a cost of \$26,835 – \$10,000 less than it quoted the City. We found no evidence to support a \$10,000 markup which the Corps requested and the City later reimbursed.

City staff did not identify the “profit” cost element because they approved Corps invoices without reviewing documentation that should have identified the Corps’ actual cost of providing its services. Had they requested such evidence, they also may have identified two instances we found where the Corps billed the City twice for the same cost in separate invoices. All together from June 2007 to June 2008, we found no justification for \$76,117 of the \$533,813 paid by the City. The City should attempt to recover the unsubstantiated portion of payments for construction at Fire Department facilities.

⁴ The data for Fire Station 22, Fire Station 26, and the Fire Department Training Center span multiple service contracts.

We recommend that the City:

Recommendation #2

Attempt to recover the \$76,117 it overpaid for services provided under Fire Department contracts. If within 60 days the Corps provides additional documentation supporting expenditures on City projects that were not reimbursed by others, we agree to reevaluate the amount that the City should attempt to recover from the Corps. (Priority 2)

The City Should Establish and Enforce Specific Guidelines For Reporting and Justifying Actual Costs Under the Master Agreement

In fiscal year 2007-08, ESD contracted with the Corps for recycling services at major events and paid for those services without receiving a detailed accounting of the costs. Consequently, City staff likely had no knowledge of the costs the Corps attributed to events recycling services prior to approving payments to the organization. Moreover, because the Corps accounted for City and non-City events recycling revenue and expenses together, the Corps may have used City funds to pay for employees who worked at a political campaign event.

Prior to entering into the contract, ESD staff informed the City Council that one of the agreement's benefits was that City funds would be used only if the Corps did not receive enough revenue from the California Department of Conservation to cover costs. However, according to ESD staff, staff did not believe it needed to require the Corps to demonstrate that City funds would serve as a supplement to state funds because staff understood the Corps needed all the state funds for other projects.

Although the Corps incurred expenses that could justify its request for City funds associated with event recycling services, it appears the City did not know or ask about all these costs. Specifically, the Corps staffed one event in part with full-time employees working 14- to 17-hour shifts on three consecutive days resulting in double-time wages between \$45 and \$52 per hour for several individuals. According to the Corps, the City provided the Corps short notice which required the Corps to staff with full-time staff in addition to less expensive corpsmembers. The Corps states it had to assign an appropriate level of supervising staff to oversee the large number of corpsmembers at the event, and that these staff provided their expertise to facilitate the overall successful operation of the event and to satisfy the City's recycling and clean-up goals. However, it appears the City did not know or ask about such costs when entering into a sole-source Master Agreement.

ESD staff indicated that staff did not believe verifying the Corps' use of City funds was needed based on staff's understanding that the Corps' cost of providing recycling services at major events greatly exceeded the \$30,000 paid. Nonetheless, service contracts into which the City enters into under the Master Agreement are on a reimbursement basis for actual and demonstrable costs, and ESD needs to manage these projects accordingly.

We are also concerned by the Corps' payment for staff to work at a political campaign event from an account that commingles City and non-City funds. Corps timekeeping and payroll records indicate two corpsmembers were paid about \$40 each for time attributed to a political campaign event in early August 2007. The Corps' accounting supervisors explained to us that the Corps generally pays staff who work at events like the political campaign event using funds it receives from the California Department of Conservation. Nonetheless, the practice of commingling funds raises concerns.

The City can improve controls to ensure it pays for only reasonable and actual expenses. The Master Agreement does not stipulate sufficient detail regarding what type of expenses are allowable or unallowable, nor does the Master Agreement require the Corps to account for City funds independently from non-City funds. By establishing guidelines for reporting, justifying, and accounting for actual costs, the Corps can more appropriately determine costs for reimbursement purposes. Additionally, guidelines would allow the City to communicate the level of detail, form, and other requirements necessary to improve the monitoring process. Such added guidance will enhance City staff's ability to evaluate the reasonableness of claimed expenses.

We recommend that the City:

Recommendation #3

Establish and enforce specific guidelines for reporting and justifying actual costs under the current Master Agreement. (Priority 3)

Recommendation #4

Require the Corps to account for City activities separately from non-City activities. (Priority 3)

The Housing Department; Planning, Building and Code Enforcement Department; and General Services Department Took Action to Ensure the City Paid Only For Actual Costs

During our review, we noted that several departments took steps to prevent payments beyond actual costs. The Code Enforcement Division of the Planning, Building and Code Enforcement Department (Code Enforcement) and the General Services Department (General Services) identified and addressed concerns about payment for services received from the Corps. The Housing Department also attempted to address concerns over Corps invoices. We believe other departments can benefit from consistently applying similar monitoring and evaluation practices as well as developing guidelines for the reporting, justifying, and accounting of actual expenses.

According to Code Enforcement, some past Corps invoices appeared to claim more hours of service than Code Enforcement's inspectors noted at the project sites. Additionally, the Corps billed the City for 1.5 hours for every hour of weekend work, which further complicated Code Enforcement's invoice reconciliation between Code Enforcement records and timesheets the Corps submitted. Code Enforcement addressed these problems by establishing more rigorous service contracts with the Corps and using sign-in sheets at project sites as an added control.

According to General Services, the Corps submitted invoices that did not match City records. Moreover, General Services stated the Corps would send more corpsmembers than necessary to provide the requested services, and City supplies were sometimes lost or damaged under the care of the Corps. General Services ensured greater accountability and better treatment of City supplies by charging the Corps for damaged and lost items, and specifying in its service contract that the Corps provide only a two-person crew on a daily basis.

The Housing Department took action to ensure payment for actual costs only. During fiscal year 2007-08, the Housing Department provided technical assistance to help the Corps better justify the cost-basis—and therefore expedite payment—of invoices. Since that time, the Housing Department has noted an “ongoing concern with the lack of adequate supporting documentation required with activity reports and reimbursement requests.”

Learning from the example of these departments, the City should establish guidelines of how to report and how to demonstrate actual costs in order to reduce any ambiguity of what is an actual cost. However, as we discuss in greater detail in the following section, the City also has not resolved an outstanding issue with the Corps' problematic billing practices.

The Office of Economic Development Identified Prior Findings of Unsubstantiated Personnel Costs, Yet Irregular Billing Practices Persisted

The City Manager's Office of Economic Development (OED) has found occasions the Corps submitted invoices for unsubstantiated personnel costs. OED administers the City's federal Workforce Investment Act (WIA) program, which in recent years has awarded grants to the Corps to provide development activities for youth. Under the WIA grants, the Corps employs case managers, a vocational education instructor, program administrators, and a recruiter. In an August 2005 monitoring report, OED raised several concerns about the Corps' administration of WIA grants. One concern was the Corps lacked personnel activity reports to support the amount of time it claimed staff worked on WIA activities. According to OED, this finding was considered resolved after a subsequent monitoring visit. In an August 2007 monitoring report, OED noted that the same finding had occurred again. That year OED noted that in January 2007, a Corps staff person charged 70 of 176 total hours (40 percent) of his time to WIA activities, yet the Corps billed OED for 60 percent of the personnel expenses. According to OED, OED noted that this specific finding was resolved after reviewing additional Corps documentation.

However, our review of Corps accounting records suggests that there are systemic issues with the Corps' billing practice which warrant City attention. Specifically, we found the Corps maintains two sets of personnel activity records for the vocational education instructor—a record that it submits to OED as evidence of time spent on WIA activities, and an internal record it uses to track the employee's activity for payroll and non-WIA billing purposes. For example, from April to June 2008, OED paid the Corps \$6,687 for 45 percent of the employee's salary and benefits, yet the internal Corps records show the employee charging all but 32 hours during those 3 months to a service contract with the City of Cupertino. In another example, in October 2007 the Corps billed 8.0 hours of the employee's time to a City parks maintenance project and an additional 3.6 hours to the WIA contract. Altogether, the Corps received reimbursement for 123 percent of the vocational education instructor's salary and benefits for those days. The Corps' billing of more than 100 percent of the employee's time does not appear to be isolated to these instances.

We also recommend that the Office of Economic Development (OED):

Recommendation #5

Follow up and resolve the personnel billing issue we identified. In the future, OED should require the Corps to provide substantiating documentation regarding the total activity and cost for Corps employees whose salaries are funded by Workforce Investment Act contracts. (Priority 3)

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Finding II The City Is Paying For Indirect Costs Not Anticipated Through Its Agreements With the San José Conservation Corps

The City's Master Agreement allows the Corps to invoice the City for actual costs, but does not provide guidance on indirect costs. We found the City paid for activity not anticipated through many of its agreements during 2005-06 through 2007-08. Specifically, the City's lack of sufficient guidance defining allowable and unallowable indirect costs, and lack of guidance detailing restrictions on how indirect costs can be allocated to specific City projects led to excessive indirect costs rates. We found that:

- The City paid \$98,325 for expenses unrelated to City projects; and
- The City must ensure the Corps bills for reasonable and actual costs by providing more detailed guidance or revise and simplify the Master Agreement.

By providing sufficient guidance and working with the Corps to identify allowable and exclude unallowable expenses, we believe that the City may achieve cost-savings of \$70,000 per year while maintaining existing Corps service levels. We made two recommendations to recover excess payments and to strengthen controls.

The City Paid \$98,325 For Expenses Unrelated to City Projects

From 2005-06 through 2007-08, we found the City paid \$98,325 to the Corps for indirect costs unrelated to City projects. The Corps incurs expenses associated with activity that cannot be directly charged to a specific project. These expenses are called indirect costs. To recover its indirect costs, the Corps pools and allocates these indirect costs across multiple activities based on the number of hours of service performed by activity. Although there is no provision for indirect costs in the City's Master Agreement, this practice is normal and customary. Additionally, the Corps has other non-Master agreements with the City which include allocated indirect costs. However, the Corps' existing methodology for allocating indirect costs allocates more administrative indirect costs to the City than appears reasonable.

Specifically, we identified expenses related to administrative personnel, facilities, and other non-personnel expenses which do not relate to City activity which the Corps had added to the indirect costs that were allocated back to the City. The Master Agreement does not provide guidance to the Corps regarding what indirect costs are allowable for inclusion in the pool

of indirect costs or how indirect costs could or should be allocated to specific City projects. Further, unlike federal grants which require grantees to establish an indirect cost rate plan, the City does not require an indirect cost rate plan from the Corps. An indirect cost rate proposal allows the granting agency to evaluate the reasonableness of an indirect cost rate prior to payment for activity. As a result, the Corps billed activity to the City for which the City derived little to no benefit under a service contract.

Personnel Indirect Expenses

The Corps allocated \$53,012 in Charter High School administrative personnel expenses to City projects. The Corps operates a Charter High School which derives revenue from the State. The Corps' accounting personnel maintain separate financial records for the Charter High School. Additionally, Corps senior management oversees both the Corps and Charter High School. However, from 2005-06 through 2007-08, we found the Corps allocated about 90 percent of all accounting staff and senior management personnel costs to the City and other governmental agencies. Based on our analysis of its expenses, we believe the Corps should not have included about 20 percent of these costs in the pool of indirect costs allocated to the City. A more reasonable allocation would have reduced the total pool of indirect expenses, which would have yielded a sizable reduction in the billing rate charged on City contracts.⁵

Facilities Expenses

The Corps allocated about \$43,571 in facilities expenses to City projects even though the Corps received sufficient revenue from the Charter High School to cover nearly all such costs with state funds. The City leases the property housing some of the Charter High School to the Corps for \$12 per year. Additionally, the Corps owns other property housing the Recycling Division and the remaining portions of the Charter High School. From 2005-06 through 2007-08, the Corps allocated nearly \$244,000 of a total \$393,000 in facilities expenses, including the \$12 per year in rent for the City's lease, as indirect cost to the City and other governmental entities. During the same time period, the Charter High School's State revenue provided \$345,000 in funding for facilities. In other words, the Corps effectively billed facilities expenses to the City, without consideration for the facilities revenue received from the Charter School.

⁵ It should be noted that in February 2008, the Charter High School funded 50 percent and 75 percent of the salaries for the Corps' information systems administrator and information systems specialist, respectively. This is a reasonable approach to sharing administrative personnel costs across the Corps' funding sources.

Other Expenses

The Corps allocated to City projects about \$1,742 out of a total \$9,275 in meal expenses which appear unrelated to City contracts. Specifically, we found the Corps purchased tickets to political fundraising events in August 2005 for the Corps senior management. The Corps assigned the cost for these meals to an administrative account classification, which were allocated back to the City and other government entities.⁶ Further, we found the Corps spent \$1,500 in March 2006 and March 2007 to purchase tickets “for important guests” to special community events, and that it spent more than \$4,000 on meal expenses that it allocated through indirect costs to the City and other governmental entities.⁷ The expenses do not appear to fall within the scope of City projects and should not be supported using City funds.

We recommend that the City:

Recommendation #6

Attempt to recover the \$98,325 paid in indirect costs for work not described in City contracts. If within 60 days the Corps provides additional documentation supporting expenditures on City projects that were not reimbursed by others, we agree to reevaluate the amount that the City should attempt to recover from the Corps. (Priority 2)

The City Must Ensure the Corps Bills For Reasonable and Actual Costs By Providing More Detailed Guidance or Revise and Simplify the Master Agreement

Currently, costs other than wages and benefits account for a large portion of the costs the City reimburses under the Master Agreement. Exhibit 5 shows that for three contracts, these costs are a substantial percentage of the City’s payment for services received.

⁶ According to the Internal Revenue Service, these contributions may violate tax restrictions governing nonprofit organizations.

⁷ According to the Corps, the meals were for staff and students; committee meetings with Board Members and Advisory Board Members; and donors, potential donors, and educators. The Corps added that it was actively involved in its Capital Campaign during the time frame in which these meetings were held and that the meals also included meetings with agency directors in which numerous fee-for-service projects were discussed. We have cautioned City staff and the Corps that, if City staff received meals at the Corps’ expense, those City staff may have violated the City’s Code of Ethics, Gift Policy and conflict of interest policy.

Exhibit 5: Costs Other Than Wages and Benefits Represent a Significant Percentage of City Payments

Contract	Team	Actual hours charged	Billed hourly rate	Total payment (a)	Actual wages and benefits (b)	Other costs⁸ (a) – (b)	Other costs as a percentage of wages and benefits
Graffiti Eradication	2 corpsmembers (CM)	8 each	\$21.00	\$336	\$159	\$177	111%
Neighborhood Clean-up	4 CM, 2 supervisors	5 each	\$28.50	\$855	\$389	\$466	120%
Parks Maintenance	8 CM, 2 supervisors	8 each	\$21.00	\$1,680	\$968	\$712	74%

Source: City Auditor’s analysis of San José Conservation Corps accounting files and City Finance Department data.

One reason other costs are so great is that the Corps may have unintentionally inflated costs to the City by attributing direct costs of non-Master Agreement projects to the Master Agreement through indirect overhead. For example, in January 2008, we found that the Corps charged 61 percent of a project supervisor to the Housing Department’s Community Development Block Grant, yet he received his salary payment through a different account within the Corps Projects Division. The Corp’s Project Division includes much of the City’s activity related to the Master Agreement. This improper expense to the Project Division increased the expenses which would be subsequently included in indirect cost to the City. As a result, this expense artificially inflated City costs in the Project Division. The Corps should not include those expenses in any calculations of actual costs under the Master Agreement as the expense should have been directly charged to the CDBG project.

However, the City has not provided guidance defining allowable and unallowable indirect costs, nor how indirect costs can be allocated to specific City projects. We examined the Corps’ costs for fiscal year 2007-08 and determined that if we excluded unreasonable expenses discussed on the previous three pages, the City could have paid \$57,750 to \$70,000 less. The City can achieve such cost-savings in future years while maintaining existing service levels by ensuring that it pays the Corps for the direct costs associated with the services provided and only those indirect costs to which it has agreed.

One way the City can better ensure it pays for reasonable and allowable costs is for the City to provide additional guidance to the Corps regarding indirect costs. The federal government requires nonprofit organizations receiving federal funds to follow the Office of Management and Budget’s

⁸ “Other costs” include vehicle expenses such as insurance, maintenance, and fuel; field expenses such as tools, project supplies, uniforms and safety equipment; and indirect costs.

Circular A-122. The circular requires nonprofit organizations provide an indirect cost plan for the awarding agency's review and approval. The circular further stipulates that for an expense to be allowable, it must not be included as a cost or used to meet cost sharing or matching requirements of any other federally-financed program. We believe that this circular may serve as a good starting point for the City in the development of guidance for allowable/unallowable costs and how indirect costs can be allocated to specific City projects. The City should require the Corps provide a similar proposal to ensure the Corps bills only for direct costs and those indirect costs to which the City has agreed.

We also found the current Master Agreement billing rate set by the Corps results in the City paying more than the actual cost to provide the services. The Master Agreement between the City and Corps specifies service contracts are undertaken at the Corps' sole cost and expense on a reimbursement basis for actual costs. In 2007-08, the Corps billed the City at a rate of \$21 per hour for many services it provided under the Master Agreement. By excluding unreasonable and unrelated expenses, we estimate actual costs for City projects undertaken by the Projects Division were between \$17.04 and \$17.63 per hour, significantly less than the \$21 per hour invoiced. An annual review of billing rates would help ensure rates were reasonable and conformed to the terms of the Master Agreement.

We recommend that the City:

Recommendation #7

Revise and simplify the Master Agreement to:

- 1. Establish guidance defining what costs are allowable and unallowable for inclusion in an indirect cost pool. Further, the guidance should detail restrictions of how indirect costs can be allocated to specific City projects;**
- 2. Annually require the Corps to develop and justify an indirect cost rate proposal and/or an hourly billing rate. (Priority 3)**

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Finding III There Are Several Other Areas Where the City Can Strengthen Controls Over Administration of These Agreements

During our review, we found several other areas where the City can strengthen controls over the Master Agreement and contract administration. First, the City can strengthen controls in the Master Agreement between the City and the Corps to ensure the Corps maintains the desired balance between work and education. Second, the City should ensure there are controls in place to restrict projects from exceeding estimated costs. Finally, we communicated our concerns to the Corps regarding its practice of providing loans to employees.

The City Should Amend the Master Agreement Between the City and the Corps to Ensure the Corps Maintains the Desired Balance Between Work and Education

The City entered into a Master Agreement with the Corps to provide paid on-the-job training to at-risk Charter High School students. The City Council designated the activity a unique service thereby exempting projects from City bidding requirements. The Charter High School's 2007-08 independent audit report states the school's operations are classroom based with no full-time independent study program. According to Corps and some City staff, the Charter High School places students one week in the classroom and one week in the field. Additionally, we found the Corps' most recent submission for the Community Development Block Grant, a non-Master Agreement activity, specifies students alternate by spending one week taking academic classes and the other receiving eight hours job skills training.

However, we found students who worked a significant amount of time on projects while Charter High School attendance records indicate they were in school. For example, we found one student who is shown in school for 131 days during 2007-08. The Corps payroll records show the student worked for 125 days of the 131 school days (95 percent), and the student worked eight or more hours for 108 of those days. We identified other students working in excess of 75 percent of the school year while being claimed for attendance in the Charter High School. School days range from six hours and 45 minutes for minimum days to six hours 55 minutes for regular days.

The high percentage of time that students work on projects while they are claimed as fully attending the Charter High School increases the risk these students do not receive the level of educational service which the City contemplated when entering into a Master Agreement. We found the

Master Agreement does not include any requirements or standards regarding the level of educational or job training necessary for students participating on City projects. Consequently, the City's significant Master Agreement activity may increase the demands on Corps staff to utilize charter school students to perform City work to the detriment of their education. Since the Corps performs most of City activities under the Master Agreement, we recommend adding clarifying language to provide balance between work and education.

We recommend that the City:

Recommendation #8

Clarify and amend the Master Agreement to include performance standards to ensure the Corps maintains the desired balance between work and education. (Priority 3)

The City Should Ensure There Are Controls In Place to Ensure the Corps Does Not Exceed Estimated Costs For Contracts Under the Master Agreement

The City's Master Agreement with the Corps requires all projects to be undertaken at the Corps' sole cost and expense on a reimbursement basis. The agreement further states the City is not responsible for paying costs in excess of the estimated costs for a project, unless they are due to a written addition to or change to the scope of services requested.

PRNS contracts with the Corps for basic maintenance in neighborhood and regional parks. PRNS pays for these services with Construction Tax and Real Property Conveyance Tax (C&C) funds the City Council appropriates for parks maintenance in each Council district. In 2006-07 and 2007-08, the Corps requested reimbursements for services rendered in certain Council districts in excess of the estimates PRNS used in Special Project Approval forms to initiate the service contracts. According to PRNS staff, although service contracts for certain districts were exhausted, staff felt obliged to pay the Corps for the services provided.

According to PRNS staff, the lack of coordination and communication between the staff requesting work and those tracking available budgeted funds allowed the Corps to exceed the expected costs. PRNS has since adjusted its administration of Corps contracts to designate one individual to coordinate its many service contracts with the Corps and to require more information in Corps invoices. In addition, not-to-exceed amounts were

added to the Special Project Approval forms in use. Since the Corps provides estimates for many projects, the City should ensure all departments maintain adequate controls over the estimates and actual costs.

We recommend that the City:

Recommendation #9

Ensure that there are controls in place to ensure that the Corps does not exceed estimated costs for contracts under the Master Agreement. (Priority 3)

Corps Practice of Providing Loans

During the course of our review, we noted that the Corps provides loans, or payroll advances, to numerous key staff members responsible for financial internal controls. Specifically, Corps financial information for 2007-08 indicates the Corps provided about \$46,000 in loans to employees. The Corps maintains a loan policy which states staff or corpsmembers should pay off the first loan before receiving a second loan which is granted only during serious hardship. We found individuals in key areas of accountability and reporting to have taken out multiple loans. Further, during the past three years we found individuals receiving multiple loans in amounts of up to \$5,000, which are being repaid in small increments.⁹ This practice indicates individuals in key areas of accountability and reporting may be under serious financial hardship, which increases internal control risk. We informed Corps management and City staff of our concerns, and believe the City should take steps to reduce the risk the loan practice poses.

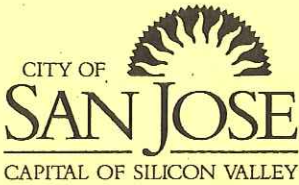
We recommend that the City:

Recommendation #10

Consider providing guidance to the Corps regarding the practice of providing loans to key individuals responsible for accountability and reporting. (Priority 2)

⁹ We should note that Corps financial records did not indicate any collection of interest on these loans.

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Memorandum

TO: Sharon Erickson
City Auditor

FROM: Debra Figone
City Manager

SUBJECT: ADMINISTRATION'S RESPONSE TO "AN AUDIT OF THE SAN JOSE CONSERVATION CORPS" **DATE:** May 8, 2009

Since 1998 the City of San Jose has contracted with the Conservations Corps to provide a wide range of service projects to City Departments. These projects include work to beautify and improve neighborhoods, maintain parks, plant trees, abate graffiti, rehabilitate housing, and recycle. The City's partnership with the Conservation Corps has provided a valuable service to our community by supporting job training opportunities for at-risk youth, and at the same, time deliver core City services.

The Administration has reviewed "*An Audit of the San Jose Conservation Corps*" (the Audit) and overall is in agreement with the recommendations. The Audit disclosed several opportunities for improving contract management and oversight of the City's agreements with the San Jose Conservation Corps (Corps). A majority of the issues raised relate to the City's Master Agreement with the Corps, originally established in January 1988 to perform various community improvement and conservation activities.

The Administration takes very seriously the findings made in this report. Prior to exercising the City's most recent option to extend the City's Master Agreement (June 2008) with the San Jose Conservation Corps (Corps), action was taken to solicit feedback from departments and the Corps on the agreement. A few issues were identified related to work quality and scope which have since been clarified in consultation with the Attorney's Office. A quarterly meeting with all parties has also been initiated to identify and resolve new issues. While the City Auditor's Office worked on this audit, action was also taken to require under the City's Master Agreement with the Corps additional information on project approval forms, documentation on direct costs and timekeeping records with invoices, and to provide guidance to Departments for approving new projects and processing payment of invoices.

The Administration acknowledges that there are several areas where improvements to the Master Agreement with the Corps should be pursued, ranging from guidelines for accounting for direct and indirect costs to consistent application of best practices among departments. The current agreement is set to expire June 30, 2009. In some cases individual agreements specific to department needs may also be pursued. The Administration will

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ensure that improvements are understood and followed by staff that process agreement and payment documents, as well as staff who work in the field with the Corps crewmembers.

There are also important applications as noted in the Administration's response, of the work underway by the City's Non-profit Strategic Engagement Committee including new policies and procedures of the Grants Manual, enhanced oversight including financial review, and utilization of the QLBS assessment tool.

Provided below are responses to the audit recommendations specific to the Administration:

Recommendation #1

The City should attempt to recover the \$200,685 that was not reflected in Corps accounting records for services provided under ESD contracts. In addition, the City should attempt to recover the \$133,140 in City-related expenditures that were already reimbursed by the California Department of Conservation. If within 60 days the Corps provides additional documentation supporting expenditures on City projects that were not reimbursed by others, we agree to reevaluate the amount that the City should attempt to recover from the Corps. (Priority 2)

The Administration agrees with this recommendation. City staff, in conjunction with the City Attorney's Office, will work with the Corps and the Auditor's Office to review the actual costs of recycling services from 2004 to 2008 and the services reimbursed by others, determine the amount that the City should attempt to recover, and pursue a repayment plan as appropriate. It is important to note the Environmental Services Department (ESD) project for providing recycling services at City facilities was established as a performance-based fixed fee project, based on estimated service needs for the program over the course of a year. This method of payment places the majority of the risk on the service provider, and allows them to allocate their expenses over the course of the year, while program demands may fluctuate significantly from month to month.

Performance was monitored to ensure the corps met its requirements, and that service was provided in a consistent and professional manner. Performance requirements detailed in the Project Services Approval Form between ESD and the Corps include condition and cleanliness of collection containers, cleanliness of collection sites, timeliness and frequency of pick-ups, condition of vehicles, security of container lids and locks, and reports of the total amount of recyclable materials collected each month. Quarterly reports with activity and performance measures were submitted, and ESD worked with the corps to ensure their obligations were met. ESD recognizes that this does not fit within the parameters of the master agreement, and intends to establish a separate, fixed-fee based agreement with the Corps for city recycling services beginning 2009-2010. The State of California, Department of Conservation advised ESD staff that "fee for service" contracts like that ESD has set up

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with the Corps are the most common form of payment arrangement between local governments and State certified conservation corps.

ESD is not familiar with the Corps contractual obligations to the State nor has detailed knowledge of income and expenses related to their state grant funding. Notwithstanding this audit, such findings would not have otherwise been available to the City through the normal course of business.

Recommendation #2 The City should attempt to recover the \$ 76,117 it overpaid for services provided under Fire Department contracts. If within 60 days the Corps provides additional documentation supporting expenditures on City projects that were not reimbursed by others, we agree to reevaluate the amount that the City should attempt to recover from the Corps. (Priority 2)

The Administration agrees with this recommendation. City staff, in conjunction with the City Attorney's Office, will work with the Corps and the Auditor's Office to review the actual costs of services for upgrading fire departmental facilities from June 2007- June 2008 and pursue a repayment plan. The Administration will provide training to Departments on reviewing documentation to verify actual costs of providing services prior to approving payment and provide guidance on the use of subcontractors.

The Administration further acknowledges that the work under the agreements to upgrade fire department facilities is considered public works projects while the master agreement excludes this type of work. The Administration will evaluate the review and approval process for considering projects under the Master Agreement and identify procedures to improve accountability that public works projects are not completed under the City Master Agreement.

To ensure Departments are aware that the Corps will be utilizing a subcontractor, the City's project approval form, under the Master Agreement has been revised to require designation of proposed use of subcontractors in advance of project approval.

Recommendation #3

The City should establish and enforce specific guidelines for reporting and justifying actual costs under the Master Agreement. (Priority 3)

The Administration agrees with this recommendation and will work with the Corps and the City Attorney's Office to ensure adequate guidance is provided on what types of expenses are allowed. The Administration will ensure that Departments are aware of allowable expenses and reviewing payment requests.

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Further evaluation of the audit finding revealed the event referenced whereby full-time Corpsmembers worked 14 to 17 hour shifts on three consecutive days resulting in double-time wages was the 2007 San Jose Grand Prix. It is important to note that this was the first year the Corps provided recycling services for the City at this event and the program was put into place two weeks prior to the start of the Grand Prix. Given the short time frame and the uncertainty of service level needs, the Environmental Services Department believed it was important to allocate appropriate resources for the successful coverage of the event and communicated to the Corps that any additional expenses over existing project funding would be the responsibility of the corps. Given these circumstances, the Administration believes that the expenses allocated to the Grand Prix were justified.

Recommendation #4

The City should require the Corps to account for City activities separately from non-City activities. (Priority 3)

The Administration agrees with this recommendation and will amend the Master Agreement to require the Corps to provide clear documentation for direct and indirect costs and to require the Corps to account for City funds independently from non-City funds.

Recommendation #5

OED should follow-up and resolve the two additional personnel billing issues we identified. In the future, OED should require the Corps to provide substantiating documentation regarding the total activity and cost for Corps employees whose salaries are funded by WIA contracts. (Priority 3)

The Administration agrees with this recommendation and will follow-up to resolve the personnel billing issue as follows. Work2future will review internal personnel activity sheets to further investigate the discrepancy of the personnel activity records. If the discrepancy is confirmed, the Administration will pursue repayment for services or provision of service of equal value to be channeled back to the Youth program.

In the future, work2future will require the Corps to provide additional back-up documentation to account for total activity and cost for employees whose salaries are not 100% funded from the WIA program.

Recommendation #6

The City should attempt to recover the \$98,325 paid in indirect costs for work not described in City contracts. If within 60 days the Corps provides additional documentation supporting expenditures on City projects that were not reimbursed by others, we agree to reevaluate the amount that the City should attempt to recover from the Corps. (Priority 2)

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The Administration agrees with this recommendation. City staff, in conjunction with the City Attorney's Office, will work with the Corps and the Auditor's Office to review the indirect costs that were allocated to the City and evaluate the reasonableness of the costs based on the benefit derived, and pursue a repayment plan.

Recommendation #7

The City should revise and simplify the Master Agreement to:

1. Establish guidance defining what costs are allowable and unallowable for inclusion in an indirect cost pool. Further the guidance should detail restrictions of how indirect costs can be allocated to specific City projects;
2. Annually require the Corps to develop and justify an indirect cost rate proposal and/or an hourly billing rate. (Priority 3)

The Administration agrees with this recommendation. The Administration agrees that the Corps' indirect costs represent a significant percentage of the City's payments. However, it is important to note that these rates are comparable to rates charged for most projects under the master agreement, as well as, other grant agreements between the City and Corps. For example, the graffiti eradication work referenced in the report as a project under the master agreement, is also performed under separate grant agreement between the City and the Department of Parks, Recreation and Neighborhood Services. The grant agreement stipulates the compensation rate agreed to by the City and the Corps is \$21.00 for Corps members and \$32.00 for Saturday Supervisors. The rates include the Corps overhead expenses associated with vehicle use provided by the Corps. This rate is a relatively standard rate that the City has historically reimbursed the Corps for services under the master agreement.

The Administration, in conjunction with the Attorney's Office will work with the Corps to identify an indirect cost allocation methodology. The Administration will revise the Master Agreement to identify an hourly rate to be paid for crewmembers and supervisors including direct and indirect costs to facilitate consistent billing among department. Provisions for developing and justifying an indirect cost rate proposal will also be incorporated.

Recommendation #8

The City should clarify and amend the Master Agreement to include performance standards to ensure the Corps maintains the desired balance between work and education. (Priority 3)

The Administration agrees with this recommendation. As noted in the draft Audit, the City's Master Agreement does not include a requirement or standard for the level of educational or job training necessary for students participating on projects. However, to the

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extent that the Corps' educational work is a consideration in the establishment and continuation of the Master Agreement, the Administration agrees that such expectations should be clarified. The Master Agreement will be revised to incorporate expectations for the desired balance between work and education for students working on projects. This may be accomplished by reference, such as to the Corps maintaining its charter school standing.

Recommendation #9

The City should ensure that there are controls in place to ensure that the Corps does not exceed estimated costs for service contracts under the Master Agreement. (Priority 3)

The Administration agrees with this recommendation. Parks, Recreation and Neighborhood Services (PRNS) has taken significant steps to ensure that the Corps does not exceed estimated costs for services under the Master Agreement. PRNS has revised its information requirements to designate the number of on-site crew members that may not be exceeded for projects, require crewmember sign in/out sheets with Corps invoices, designated one individual to coordinate its many service contracts with the Corps, and provided guidance and training to staff on reviewing invoices. In addition, not-to-exceed amounts, hourly rate for crewmembers were added to the Special Project Approval forms in use. The Administration will integrate necessary controls into the Master Agreement as appropriate, and provide guidelines and training to staff to ensure that the Corps does not exceed estimated costs for service contracts.

Recommendation #10

The City should consider providing guidance to the Corps regarding the practice of providing loans to key individuals responsible for accountability and reporting. (Priority 2)

While the Administration agrees that this is an important issue, we believe that the City's involvement is best addressed more comprehensively related to financial management capacity rather than specifically engaging on this specific practice.

Overall, given the longstanding and interdependent relationship between the City and the Corps, the Administration will reinforce the criticality of strengthening its fiscal management capacity. Prior to amending the City's Master Agreement with the Corps, the Administration will work with the Corps to engage a business planning consultant, such as SCORE (a local non-profit association dedicated to providing free, confidential business planning consultation), and maintain services of a chief financial officer knowledgeable in the management of federal, State, and local funding sources. The Administration will also work with the Corps to perform a structured organizational assessment using the nonprofit capacity assessment tool QLBS provided through the Office of Economic Development. QLBS is a software platform that provides a nonprofit with a questionnaire-based

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assessment of strengths and areas for improvement in a variety of critical business functions such as governance structure, management capacity, and financial condition. The City purchased a license for the QLBS software as a capacity building tool for non-profits as part of the City's non-profit strategic engagement platform. The assessment involves a 4-6 hour commitment of the Corps Board Chair, Executive Director, Chief Operating Officer and other key individuals to participate in a facilitated organizational assessment. City staff will organize and facilitate the QLBS effort.

The Audit has surfaced concerns with internal controls and other management and administrative functions where the Administration did not meet its desired standard. While we have already begun to amend the City's process for monitoring service agreements with the Corps additional action will be taken to thoroughly address the above recommendations over the coming months. The City's Master Agreement with the Corps is set to expire June 30, 2009. This will present a timely opportunity to incorporate related provision into a new Master Agreement. The Administration would like to thank the City Auditor's Office for conducting this audit.



Debra Figone
City Manager

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**SAN JOSE CONSERVATION CORPS AND CHARTER SCHOOL
RESPONSE TO AUDIT**

From: Bob Hennessy [mailto:bob@sjcccharterschool.org]

Sent: Friday, May 08, 2009 4:11 PM

To: Erickson, Sharon; Constantin, Chris; Yotam, Avichai; Hendrickson, Steve; Shikada, Ed; Tucker, Sheila
Cc: Figone, Debra; MayorEmail; District1; Kalra, Ash; District3; District4; District5; Oliverio, Pierluigi; District7; Herrera, Rose; Chirco, Judy; Office of Councilmember Nancy Pyle; Ann Draper; nunezb@esuhsd.org; CSouthwa@aol.com; hamidsaadat@comcast.net; Jim Stoch; mak5836@yahoo.com; marjorie.matthews@ceo.sccgov.org; mlazzarini@dalpropertiesllc.com; De La Rosa, Rich; Scott Yoo; Tim Quigley, Jr.; tmk54@sbcglobal.net; Doyle, Richard; Krutko, Leslye; Dan Moors; Neil Kozuma; Alex Torres; BETH.Copeland@tenethealth.com; Chuck Toeniskoetter; Peg Wyn; Doyle, Richard; Stufflebean, John; Von Raesfeld, Darryl; Balagso, Albert; joehorwedel@sanjoseca.gov; Leslie Murdock; Larry Kuechler; Gina Garcia

Subject: SAN JOSE CONSERVATION CORPS RESPONSE TO AUDIT

The San Jose Conservation Corps and Charter School, Board of Directors, Advisory Board, Audit Committee, Staff and Students wish to thank the Mayor, City Council, City Managers Office and all the Department heads for your support over the past 21 years. Together we have enabled 17,000 high school dropouts and at risk youth change their lives and become successful members in this community. We wish to share with you our response to the City Audit as we move forward to implementing a corrective action plan in the rewrite and approval of our City Master Agreement.

We sincerely thank each and every one of you for the tremendous support you have for the young men and women of the City of San Jose and the San Jose Conservation Corps and Charter School; we look forward to twenty more years of serving the young people of this city.

With warmest regards,

Robert J. Hennessy
Founder and Executive Director
San Jose Conservation Corps & Charter School
408 515-4254 cell

Mission Statement

"The San Jose Conservation Corps & Charter School is a non-profit organization that provides youth with a quality high school education and teaches valuable work and life skills that empower them to become responsible, productive and caring citizens."

Relationship between the City of San Jose and the San Jose Conservation Corps & Charter School

The Master Agreement between the San Jose Conservation Corps and the City of San Jose is very similar to the original agreement signed some twenty years ago. The Master Agreement enables the City of San Jose to utilize crews of the San Jose Conservation Corps to accomplish significant project work for a number of City Departments. The City Council finds that the Corps provides programs to at-risk youth with essential job training and development opportunities. The Corps is appreciative that the City of San Jose is supportive of helping at-risk youth change their lives.

The Master Agreement states that each service project shall be undertaken at the Corps' sole cost and expense. Since the beginning of the partnership between the City and the Corps, the Corps has operated under the belief that charging an hourly rate and/or performance agreement that included indirect costs was the established business practice.

Finding 1 - The City Paid More Than Actual Cost Through Its Agreements With the San Jose Conservation Corps (pages 6-14)

The Corps Recouped More Costs Than Were Reflected In Its Accounting Records For Recycling Services And was Already Reimbursed For Some Expenses By The California Department of Conservation (pages 6-8)

The Corps' 21-year old Master Agreement stipulates the Corps is to invoice the actual costs of providing services. In addition, throughout the year the Corps completes "Project Services Approval Form" for each project performed for the City (see attached example). We have consistently billed 1/12th of the "Project Services Approval Form" each month since the year 2000 for our recycling contracts with the City. We have never been told otherwise and assumed this was acceptable. Neither the Master Agreement nor the "Project Services Approval Form" provides sufficient detail regarding what type of expenses are allowable or unallowable. There is no provision for indirect costs in the Master Agreement or the "Project Services Approval Form".

While the Corps' QuickBooks cost center accounting shows a net income over expenses in 2007-08 for Recycling Contracts, in fact, actual costs exceed revenues. In Exhibit 1, the Corps has detailed the actual costs associated with this 2007-08 recycling income, including costs that had been incorrectly coded to other cost centers.

For example, for the 2007-08 year, our "Cost Center" financial statements for the "Facilities" contract showed revenue of \$48,750, expenses of only \$23,091 and a "net income" of \$25,659. This major discrepancy was due to staff turnover which resulted in staff not correctly coding corpmember time spent on this contract. When reviewing corpmember hours in our Kronos time keeping system, less than one corpmember was charged to this project when in fact two corpmembers actually worked on this project daily excluding weekends. Miscommunication on our part contributed to this error which resulted in showing "net income" for this contract. At SJCC, no driver operates without the assistance of a helper for safety reasons.

SJCC has daily Route Crew logs to serve as evidence that two corpmembers were sent out each day on this project. We have re-calculated corpmember wages based on the Route Crew logs, allocated supervisor wages, and included actual operating costs such as vehicle insurance, vehicle maintenance, fuel, vehicle tracking system costs, corpmember uniforms, project radios, safety

equipment, and project supplies for our 2007-08 year "Facilities" and "Parks" contracts in Exhibit 1 for your reference. These costs do not include any of allocation of "administrative costs".

Exhibit 1
SJCC Calculation on 2007-08 Facilities and Parks Contracts Actual Costs

True Costs of Recycling Services (excluding "administrative costs")	Facilities	Parks
Corpsmember Wages (including FICA and workers compensation insurance)	\$ 38,767	\$ 49,762
Supervisor Wages (including FICA and workers compensation insurance)	2,379	2,855
Vehicle Insurance	3,371	3,220
Vehicle Maintenance	1,345	2,689
Fuel (Vehicle)	7,344	11,383
Vehicle Tracking System	370	740
Uniforms	439	439
Radio Communications	539	1,078
Safety Equipment	396	476
Project Supplies	2,415	2,899
Totals	\$ 57,365	\$ 75,541
Contract Amounts	\$ 48,750	\$ 75,000

FURTHERMORE, WE WISH TO CORRECT THE STATEMENT THAT "Further complicating the issue, for fiscal year 2005-06, the Corps had already been reimbursed \$133,140 for the California Department of Conservation for a portion of corpsmembers salaries for City Corps recycling services". **WE BELIEVE THIS NOT TO BE THE CASE. PLEASE REVIEW THE SUPPORTING DOCUMENTATION AGAIN. THIS ISSUE SHOULD BE REMOVED ENTIRELY FROM THE AUDIT REPORT.**

Recommendation #1- Management's Response

We believe that this priority should be changed from a Priority 2 to a Priority 3.

While the Corps' QuickBooks cost center accounting shows a net income over expense in 2007-08 for Recycling Contracts, in fact, actual costs exceed revenues. In Exhibit 1, the Corps has detailed the actual costs associated with this 2007-08 recycling income, including costs that had been incorrectly coded to other cost centers.

We are in the process of correcting the original recycling cost center figures for the years ended June 30, 2007, 2006 and 2005.

From a global perspective, we would point out that total recycling expenditures for the four years (June 30, 2008, 2007, 2006 and 2005) is roughly equivalent to recycling grant and contract income for those same four years.

However, we agree that we need to modify our grant and contract accounting systems in order to improve to completeness and accuracy of our accounting by "Cost Center" for each individual contract and grant. Our corrective action plan for this process improvement is as follows:

Recommendation #1

Operational/Administrative Process Improvement Corrective Action Plan

Cost Center Accounting

SJCC is currently in the process of modifying its accounting system to enable us to produce complete and accurate grant/contact accounting by "Cost Center" ("Class") for each individual grant and contract.

Grant and contract accounting "Cost Centers" for each individual grant and contract will enable better monitoring of costs charged to specific program grants and contracts. Grant accounting by "Cost Center" will also allow SJCC to utilize its accounting software system to more easily request expense reimbursements and/or track remaining unspent restricted grant and contract balances based on actual allowable costs incurred for each individual grant and contract.

Since the expenses will be allocated by "Cost Center" this will virtually eliminate the risk that the same expense will be claimed on more than one grant. In addition, the process will provide a clear audit trail from the income statement by "Cost Center" to the general ledger to the actual cash disbursement and related supporting documentation (approved invoice or to the ADP payroll report by "Cost Center" and related approved employee timesheets).

The key to the system is that each applicable employee tracks and submits their actual time by "Cost Center". Actual time spent by "Cost Center" is communicated to ADP Payroll Service who prepares "Cost Center" salary summary and detail reports. SJCC will then utilize the ADP reports by "Cost Center" to generate its semi-monthly payroll entry. This process will allow SJCC to utilize its accounting software system to track and request payroll reimbursement based on actual cost incurred and/or calculate an "hourly rate" based on actual historical costs. Again, the process will provide a clear audit trail from the income statement by "Cost Center" to the general ledger to the ADP report by "Cost Center" to the approved employee timesheets.

Indirect Cost and Hourly Billing Rate Proposal

In addition to the Corrective Action Plan listed above, SJCC is currently in the process of developing an "indirect cost rate" and "hourly billing rate" proposal for and in collaboration with the City of San Jose. To date, an SJCC consultant has met with and discussed clarification issues relating to "direct" vs. "indirect" costs and "allowable" vs. "unallowable" costs as well as the "indirect cost rate" proposal methodology and approach with two members of the City Auditor's Office and has scheduled a series of collaborative meetings with SJCC's Finance Director and a member of the City Manager's Office to work through the proposal process.

The City Paid \$76,117 More Than The Actual Cost for Construction Services (pages 9-11)

It is clear that these projects do not fall under our master agreement. They are solely Public Works projects on a design build basis. We operated as the General Contractor and provided good faith estimates which included cost of material, cost of labor, cost of equipment and cost of disposal thus, the San Jose YouthBuild Program does not owe the City of San Jose \$76,117.

Recommendation #2 - Management's Response

This should definitely be listed as a Priority 3.

We do not dispute the City Auditor's calculations *if* the amount received from the City is to be determined under the Master Agreement. However, the Corps operated as a General Contractor and not under the Master Agreement cost reimbursement guidelines. Rather, the Corps operated by providing a bid for each job which is the accepted process that involved costs for material, labor and a contingency component.

It should be further noted that the City accepted the bids from the San Jose Conservation Corps and paid all invoices submitted.

Our staff worked on a daily basis with a representative from the Fire Department and we assumed we were in compliance with all of the City's requirements and those of the Conservation Corps.

However, we agree that we need to modify our grant and contract accounting systems in order to produce complete and accurate accounting by "Cost Center" for each individual contract and grant. Our corrective action plan for this process improvement is as follows:

Recommendation #2

**Operational/Administrative Process Improvement
Corrective Action Plan**

See Recommendation #1 - Corrective Action Plan

In addition to the Corrective Action Plans listed above in Recommendation #1, SJCC is in the process of developing and documenting "best practice" bidding and contracting procedures for its construction contracts. In addition, SJCC is in the process of revising its current accounting policies and procedures manual to include "best practices" in government grant/contract accounting and compliance. One of the documented government grant/contract accounting policies includes the requirement to produce complete and accurate grant/contact accounting by "Cost Center" ("Class") for each individual grant and contract as further outlined in Recommendation #1 Corrective Action Plan.

The City Should Establish and Enforce Specific Guidelines for Reporting and Justifying Actual Costs Under the Master Agreement (pages 11-12)

According to the Memorandum addressed to the Mayor and City Council on May 29, 2007, the cost implication clause states "any costs for the proposed contract between the City and SJCC that result from SJCC expenses exceeding the amount of their available State funding for Special Event Recycling will be funded from City funds received from the California Department of Conservation....The total compensation for this agreement will not exceed \$30,000 per year." SJCC strongly believes that the Corps did not bill the City excessively for events recycling. In fact, SJCC believes that its recycling events services were delivered, at no or very low cost to the City. SJCC also believes that the Corps delivered on all of its promises for this contract and that ESD was pleased with the Corps' performance. SJCC reallocated budgeted funds from the Department of Conservation to cover total costs of special events recycling. The actual cost of wages, payroll taxes and workers compensation for City's of San Jose's eleven special events including the City's portion of the Grand Prix for 2007-08 totaled \$71,611.

SJCC had attempted to secure the San Jose Grand Prix (SJGP) contract in 2005 and 2006. In 2007, SJCC entered into contract with the SJGP. Our contract stipulated that on each event day, SJCC provide a staff of 50 from 7 am to 6 pm and 20 corpsmembers scheduled each evening from 6 pm to 12 am. SJCC sent a staff of seventy to work SJGP and successfully fulfilled its contractual obligations to SJGP in hopes of securing the contract for the remaining years that SJGP was in San Jose. The City of San Jose was disappointed in the two prior years with recycling efforts and overall cleanliness of the grounds after the SJGP event was finished. SJCC demonstrated an effective and efficient recycling campaign and debris cleanup for SJGP and the City of San Jose.

SJCC designated key veteran staff to oversee the SJGP project which accounts for wages in amounts of \$45 to \$52 per hour (overtime wages). The overtime wages are not typical wages for staff supervising special events. In order to satisfy the City's recycling and cleanup goals as well as the SJGP requirements, senior directors (including one who has been employed with the Corps for over 17 years), provided their expertise to facilitate the overall successful operation of the SJGP event. Because our SJGP contract required a great number of corpsmember coverage, it was necessary to have the right amount of supervising staff to oversee the large number of corpsmembers. Program Managers accounted for only 7.5% of the total wages paid to all staff and corpsmembers.

In order to make the SJGP recycle/cleanup event a success, it was a burden upon SJCC to have the appropriate number of corpsmembers, supervisors and managers. Our decision to keep key staff on the clock upwards to 14-17 hours per day was to adhere to pressure from the City and SJGP to make certain that the SJGP project ran smoothly. City staffers were looking at the Corps to see if it could handle such a large event. SJCC received great reviews from ESD and the City Manager and even other cities and countries were calling SJCC to ask "how we did it." Our actual cost for the Grand Prix was \$130,483.

On July 11, 2007, SJCC received a call from the office of an elected official asking for help to provide recycling bins and to collect the cans and bottles for an event on August 5, 2007. The event was held at Kelley Park, one of SJCC's City of San Jose Recycling Accounts. SJCC scheduled two corpsmembers from 11:30 am until 4:30 pm to collect cans and bottles from the event. The corpsmembers had no affiliation with the event and were strictly there to collect all the cans and bottles generated from the event. The Corps does not turn away any opportunity to

collect cans and bottles. The hours charged to this account were clearly billed to the Department of Conservation, Division of Recycling and not to the City of San Jose. The Department of Conservation does not stipulate in our contract that we cannot recycle at certain events. Therefore, we recycle at as many venues as we can to reach our target tonnage goal for the State. In addition, the \$92.20 paid in wages does not constitute endangering the nonprofit status of the San Jose Conservation Corps & Charter School.

SJCC does not invoice any events that are not stipulated in our scope of work signed by the City of San Jose and the Executive Director (October of 2007) or assigned by the City of San Jose's Project Supervisor for events recycling. For the month of August 2007, SJCC billed the City of San Jose 928.75 hours solely for recycling services performed for the San Jose Comcast Jazz Festival. The actual totals reflect 1,007.75 hours expended on this project during 3-days. The dollar amount billed for that month totaled \$5,941.46 (invoice # 4786) which when interpreted into an hourly rate is \$6.40 per hour, less than the current minimum wage paid to corpsmembers (not including overtime).

For the Special Events contract of 2007-08, SJCC did not bill for actual costs as stipulated in the Master Agreement. SJCC expended 4,689 hours on the City of San Jose's 11 major events. SJCC billed the City through two invoices (# 4786 and #4899) for a total of \$30,000. The hours billed to the City were not actual costs but rather costs below what SJCC paid staff to work the events. When using the hours expended on the total project season against the \$30,000 the hourly rate the City paid to SJCC was \$6.40 per hour. If SJCC billed the City for actual expenses (an hourly rate of \$22.76) City funding would have expired at approximately 1,318 hours. However, City Council approved SJCC to provide event services free to event organizers at no or little cost to the City on May 29, 2007 (signed off on 6/3/07). It was assumed the SJCC would cover the remaining costs through SJCC's Department of Conservation Grant (which has been done).

Recommendation #3 - Management's Response

SJCC agrees with the recommendation that the City and Corps should establish guidelines to justify a reasonable cost in doing business together. SJCC further agrees that the Master Agreement does not stipulate sufficient detail regarding what type of expenses are allowable or unallowable. By establishing guidelines for reporting, justifying and accounting for actual costs, the Corps can more appropriately determine costs for reimbursement purposes. Our corrective action plan for this process improvement is as follows:

Recommendation #3

Operational/Administrative Process Improvement Corrective Action Plan

See Recommendation #1 - Corrective Action Plan

In addition to the Corrective Action Plan listed above in Recommendation #1, SJCC proposes to work with the City to revise its Master Agreement and related Project Services Approval Forms to include sufficient detail regarding what type of expenses are allowable or unallowable and to include to the extent possible line item budgets for each Project Services Approval Form.

Recommendation #4 - Management's Response

Our corrective action plan for this process improvement is as follows:
The Corps will setup a separate account for City funds.

Recommendation #4

**Operational/Administrative Process Improvement
Corrective Action Plan**

See Recommendation #1 - Corrective Action Plan

**The Housing Department, Planning, Building and Code Enforcement Department,
and General Services Department Took Action to Ensure the City Paid Only for
Actual Costs** (page 12)

In regard to Code Enforcement, the Corps has an agreement to bill weekend work at an overtime rate of \$28.50 each hour (see project # 08-016) as our corpsmembers have already worked a 40 hour week. The Corps follows the staffing request from Code Enforcement and has not experienced an issue with internal timekeeping. The Corps on this situation provides daily rosters to Code Enforcement which is signed by the City Coordinator the actual day the work is performed. The process has assisted the Corps and Code Enforcement with issues on invoice reconciliation.

In regard to General Services, the Corps' previous Projects Director would send a three-person crew out in one work vehicle (pickup truck) to provide greater job training for corpsmembers to take over when a corpsmember graduated from our program. The Projects Director was unaware that the General Services' budget only allowed for one two-person crew and failed to communicate with General Services on invoices and concerns. The Corps' new Projects Director and the Corps' park graffiti crew have corrected errors in communications with General Services and the program now runs efficiently. In addition, the General Services' power washer (wheels) was damaged by the Corps. The Corps takes responsibility in replacing this equipment. In addition, SJCC experienced theft on its premises, a paint spraying rig was stolen along with many 5-gallon paint containers and landscaping equipment. SJCC has filed several police reports on lost of property. SJCC has installed surveillance cameras to combat the activities of theft.

**Regarding the Corps Received Less Than Half of Federal CDBG Funds the City
Awarded Because of the Corps' Difficulty in Demonstrating Actual Costs (page 12
of previous report)**

This audit statement is in error and it is not the reason why SJCC used less than one-half of the CDBG funds in 2007-08. The City's SNI department did not provide sufficient neighborhood cleanup sites to the Corps. After several e-mail correspondences (dating back to March 2008) over a period of many months, SNI was slow to deliver neighborhood cleanup sites. Additional sites were also requested from SNI neighborhood managers at two separate meetings in 2008 and during the CDBG audit in 2008. The 2007-08 CDBG agreement between the City and the Corps was not signed until November 27, 2007. The first and second quarters of 2007 (July through December) were effected because of the delay in presenting a signed CDBG agreement. This

delay resulted in no work being performed on neighborhood revitalization until the agreement was signed.

In addition, there was a delay with the 2008-09 CDBG agreement with the Corps. The 2008-09 agreement was not presented by the City to SJCC until October 23, 2008. This meant that the contract was four months late and SJCC was instantly behind in providing CDBG neighborhood revitalization services. Currently, this issue still persists, SJCC foresees unused CDBG funds because SNI has still not provided sufficient neighborhood cleanup sites to use the remaining 2008-09 CDBG transferred funds (transferred from 07-08).

The San Jose Conservation Corps & Charter School has been providing CDBG community service projects for over fifteen years. We have met the City's requirements and performed community service projects that benefit local neighborhoods, its residents and at-risk young women and men. We have always subsidized our CDBG work with other funding providers, as CDBG does not pay indirect costs. In order for us to provide a supervisor for this project, his or her salary has to be picked up by other funding sources with the exception of this year. **When SJCC is not provided additional sites for cleanup, supervisors and crews sit idle which contributes to a tremendous cost to SJCC on a daily basis.**

Regarding the audit statement "lack of adequate supporting documentation", we provide two inches of hard copy documents each month (time sheets of staff and corpsmembers) to CDBG. In addition, the accounting department works closely with the CDBG Analyst to provide every requested document. The CDBG Analyst has not informed the Corps that problems existed with this issue. In fact, we are surprised that this issue of "lack of adequate supporting documentation" came up in the audit when this has never come up in any means of communication from the City to the Corps during our many years of CDBG funding.

In addition the audit states that when it came time to award grants (CDBG) for fiscal year 2008-09 funds, the Housing Department denied the Corps' application because the proposed project did not meet an established funding priority. The Corps had previously been informed by the City's CDBG department in 2008 that CDBG funds would no longer be used for neighborhood cleanups and that we should apply for regular program funding during the 2009-10 CDBG grant application period.

The Office of Economic Development Identified Prior Findings of Unsubstantiated Personnel Costs, Yet Irregular Billing Practices Persisted (pages 13-14)

The audit indicates that the Corps maintains two sets of personnel activity records (for OED and internal) on the vocational education instructor. The record submitted to OED as evidence of time spent on WIA activities show an employee spent 3.6 of 8.0 hours each business day (45%) on WIA activities. The same employee was charged 8 hours to the City of San Jose parks maintenance contract and there is also a charge to the City of Cupertino.

The issue at hand is of duplicative billing for the activities of a vocational education instructor. The Corps maintains two sets of personnel activity records for the vocational education instructor because of the required reports to WIA. The WIA program manager submits reports on the services provided to WIA funded students. The WIA program manager and WIA case managers maintain WIA program data separate from non-WIA corpsmembers. Although the vocational education instructor provided WIA services to WIA participants, a review of the Corps' records indicate that during the month of October 2007, the Corps mistakenly billed for 8 and 3.6 hours, a total of 123%

salary and benefits. However from April to June 2008, the Corps correctly allocated 45% of the activity hours of the vocational education instructor while working 3 months on a bid contract with the City of Cupertino. To correct this problem from reoccurring, the Corps has developed a process to cross-check time sheets for WIA allocation between the WIA program manager and the accounting department.

Recommendation #5 - Management's Response

We have reviewed the hours of the vocational instructor. A mistake was made when reporting his hours for two days while working for City Parks. The hours worked for the City of Cupertino were correctly recorded in the correct cost center in the QuickBooks accounting records. We have put in place a process so as not to duplicate billing in the future by cross checking time sheets. Our corrective action plan for this process improvement is as follows:

Recommendation #5 Operational/Administrative Process Improvement Corrective Action Plan

See Recommendation #1 - Corrective Action Plan

In addition to the Corrective Action Plan listed above in Recommendation #1, SJCC has put in place a process so as not to duplicate billing in the future by cross checking time sheets.

Finding 2 – The City Auditor States the City is Paying for Indirect Costs Not Anticipated Through Its Agreements With the San Jose Conservation Corps (pages 15-22)

We agree with the Auditors that there is no provision for indirect costs in the City's Master Agreement, yet this practice is normal and customary. The Master Agreement does not stipulate sufficient detail regarding what type of expenses are allowable or unallowable.

The City Auditor States the City Paid \$98,325 For Expenses Unrelated To City Projects (pages 15-17)

Personnel Indirect Expenses

The San Jose Conservation Corps incorporated on June 1, 1987 with a mission of providing at-risk youth an academic and job training program that will enable them to become responsible, productive and caring citizens. SJCC's education program was operated by Excelsior Charter School. The Conservation Corps provided paid job training skills through on-the-job work projects. The operation of SJCC's education and job training was managed separately.

SJCC started its own charter school in 2002 under the direction and approval of the East Side Union High School District. The Charter School continues to be operated as a separate component from the Conservation Corps. The SJCC Charter School has a unique federal employer identification number (30-0093157). The Conservation Corps has a unique federal employer identification number (77-0155997). The SJCC Charter School maintains a separate

bank account, payroll, personnel procedures, audit, Board of Directors, and bylaws from the Conservation Corps. The operation of the Conservation Corps and the Charter School continues to be managed and operated separately.

SJCC's has already allocated a percentage of the Executive Director's salary, accounting staff salary, and the IT administrator's salary to the Charter School for the 2008-09 fiscal year. The Charter School pays the salaries of all the teachers' and their benefits.

The auditor's suggestion that a higher percentage of staff salaries, who are not involved with the Charter School, should be paid by the Charter School is not possible. Charter Schools are assigned an indirect cost rate that represents a statewide average, for the 2008-09 fiscal year the San Jose Conservation Corps' Charter School has been given a rate of 4.96% (see attached). In addition, Charter Schools are required by law to finish the fiscal year with more than 3% reserve.

SJCC feels it is important to calculate an indirect cost with guidance from the City. For the past twenty years, SJCC has operated with full transparency and relies on the independent annual audits to guide SJCC on proper accounting procedures. Recently, because SJCC has received federal grant funding, the federal government has a method of approving an indirect cost. SJCC will review the requirements of obtaining an approved federal indirect cost rate.

Facilities Expenses

The California Department of Education provides funds for the SJCC charter school. The SJCC Charter School is considered as a separate component of the Conservation Corps. The SJCC Charter School has its own federal identification number, payroll, bank account and accounting process. The SJCC Charter School pays the Conservation Corps rent for facility space usage. The SJCC Charter School and Conservation Corps' independent audited financial statements note the expense and revenue of the facility rent. SJCC is reviewing the comments from the auditor regarding allowable indirect costs that billed facilities expenses to the City and facilities rent revenue received from state funds. SJCC believes that working with the City auditors to clarify allowable and unallowable direct and indirect cost will benefit both the City and SJCC.

Other Expenses

The audit states the Corps purchased tickets to political fundraising in 2005. SJCC is careful in protecting its nonprofit status. SJCC does not come close to the guidelines of Lautze and Lautze that allows up to 5% of our total budget on political events. We believe that this was not a violation of the IRS rules governing nonprofits. The Corps' expenses of \$1500 in March 2006 and March 2007 were not for a political event. The San Jose Dublin Sister City Program is a non-political and a nonprofit 501(c)(3) with a mission to develop civic, cultural, economic and educational ties between San Jose and Dublin as well as the Silicon Valley and Ireland.

In regard to \$4,000 spent by the Corps from July 2005 to June 2007 for meals, SJCC believes this was acceptable as the costs went toward food for staff and students at committee meetings with Board Members and Advisory Board members, funders, potential funders, and educators. In the time frame which these meetings were held, SJCC was actively involved in its Capital Campaign. SJCC also met with agency directors in which we discussed numerous fee-for-service projects. SJCC has considered the comments from the auditors and changed its practice to hold all meetings in our conference room (1534 Berger Drive) which saves costs and enables guests to meet students and learn about their struggles, hardships and aspirations.

Because of the restriction imposed on us by the State of California's Department of Education, we are unable to allocate additional indirect costs to the Charter School. We have followed the same procedure for the past 20 years. Now, we need to work with the City in developing an indirect cost rate. It is not true that the Corps billed the City for activities which the City derived little or no benefit from. Everyday the Corps with its enrollment of 300 young men and women, all high school dropouts saves the City of San Jose millions of dollars by having this at-risk population off the streets in an education and training program. The residents of this City are much safer with much less home invasions, gang activities, and a lot less of drugs and alcohol being consumed thus a safer city for us all.

Recommendation #6 - Management's Response

We believe this Priority 2 should be downgraded to a Priority 3

The Master Agreement is ambiguous at best in defining "direct" and "indirect costs". We plan to work with the City Attorney's Office and the City Manager's Office to fine tuning our existing Master Agreement.

We are in the process of developing a formal "indirect cost rate" proposal which will be prepared and submitted to the City of San Jose for their approval and ultimately be used in our contract agreements. Our corrective action plan for this process improvement is as follows:

Recommendation #6 Operational/Administrative Process Improvement Corrective Action Plan

See Recommendation #1 - Corrective Action Plan

The City Must Ensure The Corps Bills for Reasonable And Actual Costs By Providing More Detailed Guidance or Revise and Simplify the Master Agreement (pages 17-19)

Page 17, Regarding Exhibit 5

Exhibit 5 lists three contracts with an analysis of "other costs" as a percentage of "actual wages and benefits". Additionally "other costs" listed in footnote 8 of the auditors report (vehicle insurance, maintenance, and fuel; field expenses such as tools, project supplies, uniforms, and safety equipment and indirect costs) should include equipment, first aid supplies, first aid clinic visits, radio communication and GPS vehicle tracking, vehicle replacement and supervision. SJCC strongly feels that a \$22.76 hourly rate is justifiable when all project direct expenses are included in the cost of the project work. This rate is the best in the State for any local conservation corps or YouthBuild program.

Recommendation #7 - Management's Response

We agree that the City and the Corps should work together to revise and simplify the Master Agreement.

We also agree that the City and Corps should work together to develop and justify an indirect cost rate and/or an hour billing rate.

In addition, SJCC agrees with this recommendation and will work with the City of San Jose to develop an understanding of reasonable and allowable costs. SJCC will use the Office of Management and Budget's Circular A-122 to establish a clear agreement and understanding with the City of San Jose in regard to allowable and unallowable cost. Our corrective action plan for this process improvement is as follows:

Recommendation #7

Operational/Administrative Process Improvement Corrective Action Plan

See Recommendation #1 - Corrective Action Plan

Finding 3 – There Are Several Other Areas Where the City Can Strengthen Controls Over Administration of These Agreements

The City Should Amend The Master Agreement Between The City And The Corps To Ensure The Corps Maintains The Desired Balance Between Work And Education (pages 20-21)

SJCC does not discriminate against students who apply for admittance with or without a high school diploma. SJCC offers at-risk youth a second chance at life. Students without a diploma are required to attend academic courses in order to earn credits toward their graduation and to pass the California High School Exit Exam. Students who attend classes may elect to stay in school fulltime or they may elect to apply for SJCC's paid job training program. Students electing to learn and earn are placed in either SJCC's Projects, Recycling or YouthBuild job training programs. Students spend one week on-the-job and one week in the classroom. SJCC's charter school petition prescribes vocational education through on-the-job training and academic performance in the classrooms. SJCC's students are members of the Charter School every day of the year until they get their high school diploma.

After a student graduates with a diploma, SJCC does not terminate its services to that graduate. SJCC helps graduates find a job and/or continue with college. It is not unusual to have high school graduates working fulltime in the SJCC job training program while they are looking for another job. In addition, for those students who have earned all of their high school credits and passed one of the two high school exit exams, it is not unusual for them to be working more hours, while they are studying to pass the second high school exam or waiting for the results of their second and final high school exit exam; which is the case for most of the students on the list furnished by the auditor. SJCC's work and school day is from 8:00 am to 4:25 pm, five days per

week. SJCC has the best record in the nation for its type of education program. Last year, SJCC turned 172 former high school dropouts into high school graduates. January 2009, SJCC graduated 106 students and current plans are to graduate over 100 students in June 2009.

Students performing work for the city are not doing so in detriment to their education. The partnership SJCC has with the city departments enables SJCC to train disadvantaged and at-risk students in numerous hard skills that will serve them well during their working careers (please review attached Charter School Petition).

Recommendation #8 - Management's Response

SJCC believes this recommendation should not be part of the Master Agreement as the structure is already in place to provide the best vocational and academic education program in the country which is reviewed by the County Board of Education, the State of California, and oversight by East Side Union High School District. However, San Jose Conservation Corps and Charter School will provide the City its accomplishments on an annual basis.

The City Should Ensure There Are Controls In Place to Ensure the Corps Does Not Exceed Estimated Costs for Contracts Under the Master Agreement (page 21)

SJCC is aware that there have been occasions when a council park district expended their budget and PRNS transferred funds from another council district park to cover the expended council district's park shortage. This transfer of funds would not be because of SJCC exceeding estimated costs. This circumstance would occur because PRNS requested SJCC to perform work for a council district park that did not have full funding in its budget. Each council district park project is not the same, project costs will fluctuate based on the type of work to be performed and the number of days to complete the tasks.

Recommendation #9 - Management's Response

This has been an ongoing practice for 20 years and we have always had the approval of City staff to reallocate funding from one council district to another with the assurance that the combined Council District Funds will not be overspent.

We believe our new formula for indirect costs and/or hourly rate will cover the type of expenditures that are allowable or unallowable.

Our corrective action plan for this process improvement is as follows:

**Recommendation #9
Operational/Administrative Process Improvement
Corrective Action Plan**

See Recommendation #3 - Corrective Action Plan

Corps Practice of Providing Loans (page 22)

SJCC developed a staff and student loan policy in September 1998 because staff and students (very low income to middle income earners) experienced hardship situations which required payment for medical expenses, funerals, child birth, food, shelter and other emergency needs. SJCC is a compassionate social service organization whose mission is to help others. When SJCC is in a position to help staff and students with a loan, SJCC may provide a loan if certain conditions are met, such as repayment ability and immediate need.

On a recent loan agreement, a key staff member had to fly to Vietnam for her mother's funeral. Another staff member needed a loan to pay for property taxes or face possible foreclosure. SJCC students are very low-income earners and some of the students have requested loans to pay for their parent's hospital bill, or to purchase formula for their baby, or to pay rent (or face eviction). SJCC does not charge interest on these loans because SJCC wants to help staff and students, not hurt them through finance charges. SJCC collects loan repayment through payroll deduction. SJCC has reviewed its 1998 loan policy and has set repayment guidelines and eliminated approval of multiple loans for a single staff member or student.

Recommendation #10 - Management's Response

Definitely, a priority 3.

Our Board of Directors unanimously agreed that the City of San Jose should leave the management of the providing loans to staff and students as the responsibility of the San Jose Conservation Corps which has a very clear policy as to the practice how staff and corpsmembers are loaned monies in severe emergency situations.

APPENDIX A

DEFINITIONS OF PRIORITY 1, 2, AND 3 AUDIT RECOMMENDATIONS

The City of San Jose's City Policy Manual (6.1.2) defines the classification scheme applicable to audit recommendations and the appropriate corrective actions as follows:

Priority Class¹	Description	Implementation Category	Implementation Action³
1	Fraud or serious violations are being committed, significant fiscal or equivalent non-fiscal losses are occurring. ²	Priority	Immediate
2	A potential for incurring significant fiscal or equivalent fiscal or equivalent non-fiscal losses exists. ²	Priority	Within 60 days
3	Operation or administrative process will be improved.	General	60 days to one year

¹ The City Auditor is responsible for assigning audit recommendation priority class numbers. A recommendation which clearly fits the description for more than one priority class shall be assigned the higher number.

² For an audit recommendation to be considered related to a significant fiscal loss, it will usually be necessary for an actual loss of \$50,000 or more to be involved or for a potential loss (including unrealized revenue increases) of \$100,000 to be involved. Equivalent non-fiscal losses would include, but not be limited to, omission or commission of acts by or on behalf of the City which would be likely to expose the City to adverse criticism in the eyes of its citizens.

³ The implementation time frame indicated for each priority class is intended as a guideline for establishing implementation target dates. While prioritizing recommendations is the responsibility of the City Auditor, determining implementation dates is the responsibility of the City Administration.

APPENDIX B

The below table lists the contracts the City executed with the San José Conservation Corps for activity in fiscal year 2007-08.¹ Because contracts may span multiple years and because the City did not fully expend the funds available for all contracts, the Not-to-Exceed amount differs from the \$1.6 million paid to the San José Conservation Corps during that year as reported in the Background.

Contract		Department	Not-to-Exceed Amount ²
1	Workforce Investment Act—Younger Youth	City Manager's Office of Economic Development (OED)	\$80,100
2	Workforce Investment Act—Older Youth	OED	240,000
3	Community Development Block Grant	Housing	225,241
4	Anti-Graffiti Program	Parks, Recreation and Neighborhood Services (PRNS)	123,529
5	Healthy Neighborhoods Venture Fund—Youth Corps	PRNS	42,704
6	Healthy Neighborhoods Venture Fund—YouthBuild	PRNS	57,565
7	Youth Employment Program	PRNS	43,579
8	<i>Master Agreement service contracts</i>	<i>City Manager's Office</i>	
	Recycling Services at City Facilities	Environmental Services Department (ESD)	
1	(Recycle@Work)	ESD	\$48,750
2	Recycling Services at City Parks	ESD	75,000
3	Event Recycling Services	ESD	30,000
4	Graffiti Eradication (Parks, Trails, and City Facilities)	General Services Department	75,000
5	Citywide Parks	PRNS	60,000
6	Citywide-Regional Parks	PRNS	30,000
7	Council District 1—Parks	PRNS	15,000
8	Council District 2—Parks	PRNS	12,000
9	Council District 3—Parks	PRNS	17,000
10	Council District 4—Parks	PRNS	12,000
11	Council District 5—Parks	PRNS	17,000
12	Council District 6—Parks	PRNS	15,000
13	Council District 7—Parks	PRNS	37,000
14	Council District 8—Parks	PRNS	40,000
15	Council District 9—Parks	PRNS	12,000
16	Council District 10—Parks	PRNS	12,000
17	Guadalupe River Park	PRNS	10,000
18	Guadalupe Gardens	PRNS	10,000
19	Emma Prusch Memorial Park	PRNS	6,720
20	Overfelt Gardens	PRNS	2,838
21	Lake Cunningham Regional Parks	PRNS	20,000
22	Amgen Tour of California	OED	500
23	Fire Station 26 Phase 1	Fire Department	34,155
24	Fire Station 26 Phase 2	Fire Department	66,761
25	Fire Station 26 Phase 3	Fire Department	4,823

¹ Table does not include contracts for activity that took place mainly in fiscal year 2006-07 or 2008-09, such as the San José BEST grant of \$48,360 from Parks, Recreation and Neighborhood Services that began September 1, 2006 and ended September 30, 2007.

² Not-to-exceed amounts do not necessarily reflect actual disbursements of City funds. As discussed, the City did not fully expend each contract's available funding.

	Contract	Department	Not-to-Exceed Amount
26	Fire Station 26 Additional Work (1 of 5)	Fire Department	5,740
27	Fire Station 26 Additional Work (2 of 5)	Fire Department	20,518
28	Fire Station 26 Additional Work (3 of 5)	Fire Department	30,946
29	Fire Station 26 Additional Work (4 of 5)	Fire Department	10,003
30	Fire Station 26 Additional Work (5 of 5)	Fire Department	9,492
31	Fire Station 22	Fire Department	109,584
32	Fire Station 22 Additional Work	Fire Department	2,904
33	Fire Department Training Center Phase 1	Fire Department	44,373
34	Fire Department Training Center Phase 2	Fire Department	51,812
35	Fire Department Training Center Additional Work (1 of 2)	Fire Department	56,040
36	Fire Department Training Center Additional Work (2 of 2)	Fire Department	34,288
37	Fire Department Training Center HVAC Phase 2	Fire Department	36,835
38	Fire Station 34	Fire Department	8,400
39	Fire Station 35	Fire Department	931
40	Neighborhood Clean-up	Planning, Building and Code Enforcement	84,000
	Total Master Agreement		1,169,413
	Grand Total		\$1,982,131

Source: City Clerk's Office.