

STATEMENT BY LESLIE I. TANAKA, CITY AUDITOR
AUDIT OF SELECTED MANAGEMENT ISSUES AT THE
HONOLULU BOARD OF WATER SUPPLY
REPORT NO. 06-07

City Council Committee on Public Works & Energy

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Chair Marshall and Members of the Committee:

My name is Leslie Tanaka, City Auditor, and I appreciate the opportunity to brief you on our *Audit of Selected Management Issues at the Honolulu Board of Water Supply*, Report No. 06-07.

With me today are members of the audit team. I wish to introduce Ms. Susan Hall, audit manager and project supervisor and Ms. Maria Torres-Kitamura, in-charge auditor. Audit team member Roxane Orian is also available here to answer any questions. I would like to thank the board of directors, chief engineer and staff of the Honolulu Board of Water Supply for their cooperation during the conduct of this audit.

This audit was initiated by my office as provided in the Revised Charter of Honolulu. My office selected the Board of Water Supply for review due to significant organization changes that have occurred over the last six years, including the state-authorized Experimental Modernization Project, and the pursuit of business development projects beyond its core mission. In addition,

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reports that BWS has been unable to cover its operational costs, along with the frequency of water main breaks, bring rise to concerns that resources for maintenance and repair of existing drinking water infrastructure may have been compromised by these organization changes.

Susan Hall will now cover the audit's objectives and scope.

The objectives of the audit were to:

1. Review the Honolulu Board of Water Supply's human resource initiatives and practices, and determine the impact of personnel changes on the organization.
2. Evaluate planning and outcome of significant business development projects.
3. Determine the adequacy of resources devoted to the program for maintenance, repair and replacement of water distribution facilities.
4. Make recommendations as appropriate.

Our review focused on management issues related to the human resource initiatives and agency reorganizations for the period of FY1998-99 to FY2004-05. We reviewed personnel counts and personnel costs, particularly for senior staff officers hired on contract under the Experimental Modernization Project. In addition, we assessed the costs and benefits of significant business development projects, and the adequacy of resources allocated to maintenance, repair and replacement of drinking water pipelines.

We reviewed applicable sections of the Hawai'i Revised Statutes, Revised Charter of Honolulu, and the Revised Ordinances of Honolulu. We reviewed policies and procedures pertaining to the Board of Water Supply's board and department, administrative directives, and other applicable departmental documents. We also referred to laws, rules and requirements pertaining to hiring employees in both civil service and non-civil service positions, including employees hired under the Experimental Modernization Project. We reviewed compensation and benefits among executive-level state and city positions for comparisons with Board of Water Supply personnel.

We interviewed board members, the manager, former deputy manager, and other administrators and staff. We conducted site visits to BWS business operations and water distribution system facilities. We examined best practices pertaining to duties and responsibilities of non-profit boards, essential elements of a business plan, and standards for water system infrastructure maintenance and planned replacement. Finally, we conducted Internet, literature and other searches as appropriate to identify best practices regarding the management of municipal water utilities from such organizations as the American Water Works Association, Association of Metropolitan Water Agencies and the Water Infrastructure Network.

At this time I will turn the presentation over to Maria Torres-Kitamura, who will go over the audit's findings and recommendations.

In 1999, Board of Water Supply management attempted to respond to emerging trends in the water utility industry and create a more nimble organization that would be prepared as a workplace for the 21st century. In the process, its leaders awakened an organization that, while

financially healthy, had fallen behind due to outdated tools such as paper-based information systems for everything from financial ledgers to infrastructure maintenance. Reorganization efforts introduced new technology that, when properly implemented, introduced new efficiencies into the organization. In addition, reorganization introduced its staff to the role of BWS in water conservation and stewardship. However, in its eagerness to see results, BWS management initiated wide-ranging, ambitious projects that strained BWS resources and overwhelmed its workforce, resulting in diminishing support and delayed implementation. Our findings are as follows:

Finding 1: Human resource reengineering was costly and failed to deliver anticipated efficiencies.

- Consultant costs for human resource reengineering totaled \$10 million over a five-year period, but the benefits of human resource pilot programs are still uncertain.
- The benefits of the Multi-Skilled Worker pilot facilitated the passage of Experimental Modernization Project (EMP) legislation. BWS' Multi-Skilled Worker pilot project met and exceeded performance goals. However, the full implementation of the multi-skilled pilot has been stymied by disagreements over pay.
- BWS also used EMP to hire contract employees known as EMP chiefs to supervise existing management-level staff.
- Questions on the future role of EMP officers with respect to existing civil service management-level staff remain.

- Although the previous board of directors rewarded BWS managers with substantial bonuses before the reorganization was completed, the lack of a finalized organization chart shows continuing instability.

Finding 2: Costly business development projects were implemented with questionable benefits to ratepayers.

- The business development office was established to generate revenues, but business projects had limited planning and oversight. Over the past six fiscal years, BWS has invested \$78 million of its resources to start up business development projects of questionable value to ratepayers, increasing its financial obligations while justifying these ventures as potential sources of new revenues to potentially defer the need for rate increases. At the same time, incremental water rate increases were delayed, leading to the substantial water rate increases we face today. Such expenses comprise the following projects:
 - \$1.1 million in architectural improvements to redesign a 5,355-square-foot office space for the Asia-Pacific Urban Institute at Kapolei Hale in an effort to draw consulting work from the Asia-Pacific region, and a separate BWS consulting project that generated less than \$10,000 in revenues;
 - \$48 million to purchase the Honouliuli Recycled Water Facility, which had been built by U.S. Filter to help the city meet the requirements of a U.S. Environmental Protection Agency (EPA) consent decree. BWS also has a 20-year agreement to pay the company, now called Veolia, approximately \$400,000 annually to operate and maintain the plant;

- \$13.5 million to purchase the Ewa Shaft from the Estate of James Campbell, rehabilitating the contaminated shaft at a cost of \$4.5 million, absorbing future liabilities and obligating BWS to provide the Estate with 3 million gallons of water per day more than was officially allocated by the state, rather than condemning the property outright; and
 - \$11 million to incorporate and construct a district cooling plant to provide air conditioning at the John A. Burns School of Medicine, plus \$2.3 million over the next 20 years to fully own equipment within the plant.
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- While recycled water and district cooling may pay off over the long run, they have yet to achieve the desired impact of generating new revenues in amounts sufficient to minimize water rate increases.

Finding 3: BWS' limited budgets for pipeline maintenance have been sufficient only for addressing infrastructure in the most critical condition.

- Proactive maintenance management should aim to minimize costs and maximize infrastructure sustainability. BWS has taken steps toward a more proactive system through its infrastructure replacement program.
- New and expanded information system capabilities (i.e. GIS, HONU, CMMS) have resulted in efficiencies for BWS' maintenance activities.
- However, BWS' budgets for repairing and replacing existing drinking water pipelines have declined significantly over the past six years.
- BWS' maintenance management system is still in transition.

We made several recommendations to the Board of Water Supply that we believe will help address these concerns. We recommended that the Board of Directors for the Honolulu Board of Water Supply should:

- establish policies and guidelines for evaluating the manager and chief engineer's performance and refrain from awarding bonuses to the deputy manager;
- conduct annual written performance evaluations of the manager based on the board's overall policy objectives;
- request regular status reports on reengineering efforts, including resources expended, and any process improvements or efficiencies achieved as a result;
- assess the extent to which the BWS has provided the directors necessary and sufficient information before, during and after such activities to carry out its fiduciary responsibilities to the island's ratepayers regarding BWS' business activities;
- establish overall policies pertaining to business activities, investments, analysis, and oversight of business activities;
- require the manager and chief engineer to report on its plans to implement sufficient controls to safeguard the agency's resources and ratepayers' interests in future business activities;
- require the manager and chief engineer to provide status reports on the implementation of the proposed maintenance management system and progress toward proactive repair and replacement of existing water infrastructure; and
- require the manager and chief engineer to report variances between amounts budgeted for repair and replacement compared to actual expenditures, and the estimated impact on the number of water main breaks.

The Manager and Chief Engineer of the Honolulu Board of Water Supply should:

- establish a human resources plan that systematically provides continued feedback on efficiencies resulting from human resource initiatives and innovations to stabilize the organization;
- clarify official position descriptions and responsibilities for EMP chiefs and create specific evaluation criteria to document eligibility for bonuses;
- address potential duplication of official duties and responsibilities between EMP officers and executive-management-level staff;
- finalize official organization charts to reflect actual personnel functions;
- clarify the purpose of the business development office, with respect to the BWS' core responsibilities, develop specific guidelines for evaluating business opportunities and policies for incorporating feasible business activities into the larger organization;
- establish and monitor cost centers for business development projects to facilitate reporting on each business development project and report performance to the board of directors on a regular basis;
- monitor the implementation of the computerized maintenance management system to ensure that it leads to proactive repair and replacement of existing water infrastructure; and
- assess and annually report whether projects included in the Six-Year (FY2005-06 to FY2010-11) Capital Program Prioritization Plan are progressing in efforts to reduce the number of water main breaks.

I will turn it back to Susan who will conclude today's presentation.

In closing, I wish to point out that in its response, the Board of Water Supply provided some clarifying information, and changes to the draft were made in the final report where appropriate. BWS also pointed out that our report contained significant discrepancies between the information contained in the report and its own records. This is puzzling to us, since we had no other source for these figures other than officials at the Board of Water Supply. If updated or finalized information has come to light after our audit was completed, then the Board of Water Supply is certainly free to provide that information at this or any future date. However, it would be unreasonable to expect our office to draw conclusions outside of the evidence that was provided to us at the time of our audit. Despite the assertion of many inaccuracies and misrepresentations, none of the comments provided to us changed the substance of our findings.

For example, the department's response noted that the pipeline budget was understated by \$139 million from FY1998-99 to FY2004-05, and by \$36 million for FY2004-05 alone. However, we specifically stated in the text that our report focuses on budgets to repair and replace existing potable water pipelines. In its response, the department includes budgeted funds for installing new pipelines and non-potable water pipelines, which total \$100 million for FY1998-99 to FY2004-05. While combining amounts budgeted for existing and new potable pipelines with non-potable water pipelines can increase the overall dollar amount, we believe that reporting these elements separately provides clarity for ratepayers. Additionally, the \$36 million budgeted for FY2004-05 reported by the department included 15 deferred projects totaling \$19.3 million and seven deleted projects totaling \$14 million. As we became aware of the magnitude of these

project cancellations, we concluded that reporting only the originally budgeted amount would be misleading as a representation of resources allotted for this purpose.

We also note that BWS management's response did not address the larger issues of accountability with respect to the results obtained from the resources expended over the past six years on human resource reengineering, business development projects, and the sufficiency of resources allotted to pipelines based on their estimated life. Finally, we acknowledge that the BWS management team was in transition at the time of our audit, and have expressed our hope to BWS officials that this report will serve as a guide for them as they make decisions for the future. We look forward to the results of those efforts.

Thank you for this opportunity to brief you on our report. We will be happy to answer any questions.