

Staff Report

Auditor of State's Report on Ames Electric Services

March 10, 2009

Background

In October 2007, the City received a letter from the Office of the Auditor of State providing notice that citizen concerns regarding certain transactions in the Ames Electric Services Department had been brought to their attention. Based on this information, a review of transactions was planned.

In January 2008, two representatives from the State Auditor's office conducted two days of field work in City offices. The auditors did not provide City staff with information on the nature of their concerns, but through the course of the review it became clear that the primary focus was a contract with Sega, Inc. for engineering services related to design, installation, and controls for the Gas Turbine 2 (GT2) peaking unit and a related upgrade of Gas Turbine 1 (GT 1) controls over the period of 2003 to 2005. Though the Sega contract was the primary focus, requests were made for information related to the coal contract, the 161kV tie-line, software upgrades to the SCADA system, the HPI controls contract, the Distributive Control System (DCS) sequence of events time stamping process, and OSI controls software support. The auditor reviewed Comprehensive Annual Financial Reports to evaluate the overall financial condition of the electric utility. The auditor also indicated that citizen concerns included the existence of an improper personal relationship between Electric Department employees and vendors used by the City. As part of an additional day of field work in December 2008, City staff provided a listing of all recent professional services contracts for the Electric Department, and provided documentation for an auditor review of a sample of the contracts. The overall review covered electric transactions from July 1, 2003 to January 7, 2008.

On February 5, 2009, State Auditor representatives met with City staff to discuss a draft of their findings and also held a phone conference on February 26, 2009. A draft of the report was not provided to City staff for either meeting.

Report Summary

The State Auditor's report indicates, and we agree, that improvements could have been made in the documentation and processes related to project and contract management, including the timing and process for change orders for engineering services for the Sega contract. There were additional transactions with Sega during the timeframe that the auditor concluded should have been part of the GT2/GT1 contract and should have been processed as change orders rather than stand alone transactions. The contractor was also directed by staff to shift work efforts from one area of the contract (GT1) to another (GT2) due to problems with commissioning of GT2. This resulted in additional costs for GT2 and a reduction in services provided for GT1. Though the total amount of the contract and change orders was not exceeded, City staff should have taken a change order to Council to report the shifting of resources.

The auditor review of a sample of more recent professional services contracts did not find similar issues, with one exception; the auditors indicated, and we agree, that additional detail should be required on invoices for professional services to better identify the specific work being billed.

The auditors did not indicate any concerns with information they reviewed related to the coal contract, the 161kV tie-line, software upgrades to the SCADA system, the HPI controls contract, the DCS sequence of events time stamping process, OSI controls software support, and the overall financial condition of the electric utility. The auditors also noted that there was no evidence to indicate an improper relationship existed between electric department employees and vendors.

All expenditures reviewed were supported by properly executed invoices and purchase orders and all expenditures were approved as required by the Council approved purchasing policy. All funds were and continue to be properly accounted for, no unauthorized payments were made, and none were noted by the auditor. There was one change order in the amount of \$41,162 to Sega in which work was begun prior to approval by the City Council, though no payments were made until Council had approved the change order.

The report included recommendations for improvements to control procedures that City Staff agrees with, for the most part, and has already implemented or will implement in the near future.

Report Details/Audit Process

Normally in the process of an audit, both parties are aware of the assertions being tested and work together to test the assertions with the auditor providing an opinion on the tests when work is concluded. For example, every year for the annual audit, management of the City asserts to the auditors among other things, that the reports we provide fairly represent the financial position of the City of Ames. The auditors test this assertion, work with City staff on their tests, review findings with City staff, and report an opinion and findings to the Mayor and Council. The process with the State Auditor was much different. The auditors did not provide City staff with the assertions or concerns that prompted the audit, nor did they share the report or findings other than in discussions prior to the release of the report. Because of the method used in conducting the audit and lack of review by the City prior to release, there are several errors included in the report. City staff does not believe that the errors in the report would impact the auditor's findings or the recommendations made for improvement.

Recommended Control Procedures

The audit report made recommendation for five improvements to internal control procedures. A summary of recommendations and City staff response is provided below.

1. Recommendation. Vendor invoices for professional services should provide sufficient detail to determine specific services provided and that services are within the scope of the contract.

City Response. *City staff has developed standards to be included in contracts for professional services to include requirements that vendor invoices provide sufficient detail to determine specific work being billed and within the scope of the contract. The Purchasing Policies and Procedures Manual will be updated to reflect this change and brought to the City Council for approval. (See Attachment 1 for details.)*

2. Recommendation. Change orders should be approved in accordance with City Council policy and supported by adequate documentation.

City Response. *Updates to the City Purchasing Policies and Procedures Manual since the time of this finding have substantially improved change order policies and procedures. We believe that no additional action is necessary other than to ensure compliance with current policy. (See Attachment 2 for details.)*

3. Recommendation. Modification of use of funding authorized by a change order should be supported by another change order and invoices should include adequate detail to demonstrate compliance with work authorized with change order.

City Response. *Improvement to the change order process has been included in changes to the Purchasing Policies and Procedures Manual including that the change orders only authorize additional work specified by the approved change order. As noted in response to recommendation number 1, additional detail will be required on vendor invoices. The City has also taken action to improve compliance with Purchasing Policies and Procedures by providing training through the Employee Development Center. Six classes on contract management, including a class specifically on contract administration with an emphasis on change orders, are included in the training offered. (See Attachment 3 for details.)*

4. Recommendation. Single purchase orders should be used for a single project or contract and the purchase order not closed until the project or contract is complete. Change orders should be reflected in changes to the purchase order.

City Response. *City staff believes that each case should be evaluated and a decision made on whether a single purchase order or multiple purchase orders will provide the best level of internal control. For projects with distinct divisions of work, it can provide a better progress and expense tracking record to have a separate purchase order for each division. For example, the engineering services contract for the 161-kV Interconnect project now has one purchase order for the in-town portion and one purchase order for the out-of-town portion of the work. With the out-of-town portion of the project delayed, the original purchase order issued for the entire project was closed and the two purchase orders issued totaling the balance of the contract. This will improve the detail documentation for the two divisions of the work. Staff agrees with the recommendation that for many projects, a single purchase order should be used. (See Attachment 4 for details.)*

5. Recommendation. The City should establish a policy for retention of documents related to contractual requirements.

City Response. City staff will establish a record retention policy that includes retention of records by the user department to demonstrate contract compliance. The City has a team currently reviewing the records retention policy and will include the addition of this policy as part of their review. City staff will also review the retention policy for Requests for Proposal (RFP), responses to RFPs, and documentation of evaluation and selection. (See Attachment 5 for details.)

We will continue to review and update our Purchasing Policies and Procedures Manual with the intent to provide a balance of cost effective controls and the ability to deliver goods and services to Ames citizens on a timely basis. Since the GT2/GT1 project began in 2003, the City Council has approved six updates of the Purchasing Policies and Procedures Manual. Included in these updates were improvements to the change order policies and processes that directly address some of the needed improvements identified by the auditors. Additionally, all major projects for Electric Services now go through Purchasing, and since August 2007, a Procurement Specialist has been dedicated to large projects in Electric Services. (See Attachment 6 for details.)