



**CITY OF COLORADO SPRINGS
OFFICE OF THE CITY AUDITOR**

**08-20 - COLORADO SPRINGS UTILITIES
PROCUREMENT AND CONTRACT SERVICES**

PUBLIC REPORT

NOVEMBER 12, 2008

Jeff Litchfield
City Auditor

Denny Nester, CPA CIA CGFM
Assistant City Auditor

Jacqueline Rowland, CPA
Senior Auditor





Office of the City Auditor Public Report

Date: November 12, 2008
To: Honorable Mayor and Members of City Council
Re: 08-20 – Colorado Springs Utilities Procurement and Contract Services

We performed an audit of Colorado Springs Utilities (Springs Utilities) Procurement and Contract Services Organizational Unit for the six months ended June 30, 2007. From January 1, 2007 to June 30, 2007, a total of 8,533 Purchase Orders were issued for a total cost of \$98,068,949. This represents 15% of the total operations and maintenance expense budget for 2007.

The purpose of our audit was to evaluate whether Procurement and Contract Services efficiently acquired goods and services while adequately safeguarding resources. We also evaluated whether Springs Utilities, as an entity, abided by the internal policies and procedures established for acquiring and safeguarding resources. The areas reviewed included processes used in purchasing, contracting, and receiving. Our scope included Resource Management System (RMS) controls and limited Lawson controls over invoicing for purposes of matching to the purchase and receiving data.

We concluded that overall, goods and services were acquired in an efficient manner, assets were adequately safeguarded, and the policies and procedures established for acquiring and safeguarding of resources were followed. During the course of our audit, we did identify areas where we believe internal controls can be strengthened.

As always, feel free to contact me if you have any questions.

Sincerely,

A handwritten signature in purple ink that reads "Jeff Litchfield".

Jeff Litchfield
City Auditor

cc: Jerry Forte, Chief Executive Officer
Edward Easterlin, Officer, Planning & Finance Division
Bill Cherrier, General Manager, Financial Services
Eli Novakovich, Manager, Procurement and Contract Services

Dawn Roth, General Manager, Information Technology Services Department
William Lopez, Manager, Resource Technology Services
David Maier, Manager, Enterprise Risk Management Services
Debbie Griffin, Analyst Senior, Strategic Planning & Monitoring
Luann Wagar, Analyst Senior, Strategic Planning & Monitoring

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Abbreviations and Acronyms used in this Report

PCS	Procurement and Contract Services
PO	Purchase Order
PR	Purchase Requisition
QBD	Quality by Design Approved Process Documents
RMS	Resource Management System
SCM	Supply Chain Management
SSJ	Sole Source Justification
Springs Utilities	Colorado Springs Utilities

Introduction

AUTHORIZATION

We performed an audit of Colorado Springs Utilities (Springs Utilities) Procurement and Contract Services (PCS) Organizational Unit. We conducted this audit under the authority of Chapter 1, Article 2, Part 7 of the Colorado Springs City Code, and more specifically parts 703, 705, and 706, which state:

1.2.703: ENSURE PUBLIC ACCOUNTABILITY:

The City Auditor shall ensure that administrative officials are held publicly accountable for their use of public funds and the other resources at their disposal. The City Auditor shall investigate whether or not laws are being administered in the public interest, determine if there have been abuses of discretion, arbitrary actions or errors of judgment, and shall encourage diligence on the part of administrative officials.

1.2.705: DETERMINE EFFECTIVENESS AND EFFICIENCY OF PROGRAMS:

The City Auditor shall determine the extent to which legislative policies are being efficiently and effectively implemented by administrative officials. The City Auditor shall determine whether City programs are achieving desired objectives. The City Auditor shall review the administrative control systems established by the enterprises, department, or group managers and by the City Manager, Utilities Executive Director, and Memorial Hospital Executive Director and determine whether these control systems are adequate and effective in accomplishing their objectives.

1.2.706: EXAMINE BOOKS, RECORDS:

The City Auditor shall examine and inspect all books, records, files, papers, documents, and information stored on computer records or in other files or records relating to all financial affairs of every office, department, group, enterprise, political subdivision, and organization which receives funds from the City or under the direct or indirect control of the City Council. The Auditor may require any person to appear at any time upon proper notice and to produce any accounts, books, records, files, and other papers pertaining to the receipt or expenditure of City funds, whether general or special. If that person fails to produce the papers, then the Auditor may request Council approval to search for and take any book, paper, or record in the custody of that person or public official.

ORGANIZATIONAL PLACEMENT

The Office of the City Auditor is structured in a manner to provide organizational independence from the entities it audits. This independence is accomplished by the City Auditor being appointed by and reporting directly to City Council. The audited entity in this audit was the Procurement and Contract Services Organizational Unit of Springs Utilities, which is under the reporting structure of their Chief Executive Officer. Springs Utilities Chief Executive Officer is also a City Council Appointee.

Introduction

SCOPE AND METHODOLOGY

The purpose of our audit was to evaluate whether PCS efficiently acquired goods and services while adequately safeguarding resources. We also evaluated whether Springs Utilities, as an entity, abided by the internal policies and procedures established for acquiring and safeguarding resources. The areas reviewed included processes used in purchasing, contracting, and receiving. Our scope included Resource Management System (RMS) controls and limited Lawson controls over invoicing for purposes of matching to the purchase and receiving data.

The audit was conducted in accordance with the *International Standards for the Professional Practice of Internal Auditing*, a part of the Professional Practices Framework promulgated by the Institute of Internal Auditors. The audit included interviews with appropriate personnel and included such tests of records and other supporting documentation as deemed necessary in the circumstances. We reviewed the internal control structure and compliance tests were performed. Sufficient competent evidential matter was gathered to support our conclusions.

BACKGROUND

The mission of Springs Utilities is to provide safe, reliable, competitively-priced electric, natural gas, water, and wastewater services to the citizen owners and customers of Springs Utilities. The goal of PCS is to provide Springs Utilities with the timely acquisition of cost-effective goods and services.

From January 1, 2007 to June 30, 2007, a total of 8,533 Purchase Orders (PO) were issued for a total cost of \$98,068,949. This represents 15% of the total operations and maintenance expense budget for 2007. Purchasing is conducted by the PCS group, as well as by employees located at various plant and warehouse locations. Purchases over \$50,000 are handled exclusively by PCS.

OVERALL OPINION

We conclude that overall, goods and services were acquired in an efficient manner, assets were adequately safeguarded, and the policies and procedures established for acquiring and safeguarding resources were followed. However, during the course of our audit, we did identify areas where we believe internal controls can be strengthened. These areas are listed on the pages that follow.

We have made no determination as to which findings are more important than others. Therefore, the findings are not necessarily listed in order of importance.

Findings, Recommendations, and Responses

1. Twenty-one employees were identified with a higher PO approval limit than their manager/supervisor.

Each manager was responsible for assigning approval limits for designated employees in the RMS and for ensuring the employee's approval levels did not exceed that of the manager. We reviewed all employees with an approval level greater than \$0, and identified 21 individuals with a higher approval level than their respective manager. This was caused in part by various entity reorganizations and staff reassignments where purchase approval levels were not reviewed.

Prior to issuing this report, we confirmed that Springs Utilities corrected the assigned approval limits and implemented additional controls to prevent future occurrences.

Auditor's Recommendation:

We recommend controls be implemented to ensure approval levels are within policy guidelines and updated whenever employee job status changes.

Springs Utilities Response:

Colorado Springs Utilities agrees with the Office of the City Auditor's recommendation that internal controls be implemented to ensure approval levels are within policy guidelines. Approval limits were reviewed and corrected in RMS version 4.1.1 in the fourth quarter of 2007.

Additionally, Colorado Springs Utilities is currently embarking on a signatory authority project where role-based limits are being established and will be maintained in RMS version 4.1.1. Another update to RMS version 4.1.1 is expected to occur by December 31, 2008. Automated updating capability is anticipated to be implemented during the RMS Phase II project which will follow the release of RMS version 6.22.

Findings, Recommendations, and Responses

2. POs were created on the system with a negative total cost.

Seven negative POs were created during 2007 to solicit vendor reimbursement for billing errors. This was not the proper method for seeking vendor reimbursements. Billing errors and adjustments should be handled through Accounts Payable.

We noted that steps were taken during the course of the audit to prevent future occurrences of negative total cost POs.

Auditor's Recommendation:

We recommend implementation of a system control to prevent creation of negative total cost POs. Management should ensure proper processes are followed to seek reimbursement from vendors. Additional training may be needed to ensure understanding and compliance.

Springs Utilities Response:

Colorado Springs Utilities agrees with the Office of the City Auditor's recommendation that system controls be implemented to prevent the creation of negative total cost POs. Training to prevent this situation from occurring has occurred. In addition, RMS version 6.22, due to be released in the first quarter of 2009, will include controls which disallow POs from having a total cost of less than zero.

Findings, Recommendations, and Responses

3. Approved procedures as outlined in the Quality By Design (QBD) were not consistently followed.

Through test work, interviews, and observations, we found published QBDs were not consistently followed as noted in the three areas mentioned below. At the beginning of the audit, we were provided a list of 33 primary QBDs for purchasing procedures. Many of these are almost identical to one another with only one or two sections being different. The large number of policies may contribute to the lack of employee understanding and compliance with the purchase process.

- a. Purchase requisitions (PRs) were approved by the creator in two of 25 PRs reviewed.

RMS allows a PR to be approved by the creator, which is contrary to the approved QBD procedure. Out of 25 selected POs, we found two attached PRs that were requested and approved by the same individual. An exception report listing all PRs with the same creator and approver is generated weekly and emailed to the creator/approver's supervisor. The absence of a response from the supervisor is deemed to be approval for the PR. There are no consequences or follow up to prevent repeat offenses.

- b. Sole Source Justification (SSJ) forms were not being completed for all goods/services where a bid was not solicited.

SSJ forms should be completed for acquisition of any good or service with an estimated value greater than \$5,000 where bids are not solicited and the award is made to a single source per policy. Supply Chain Management (SCM) representatives are responsible for evaluating the requestor's SSJ and obtaining approval for the total estimated value. We tested 25 POs and found ten instances where competitive bids were not sought and SSJ forms were not completed. For items where the SSJ was present, four were missing signatures indicating SCM approval.

Many exceptions to the QBD were assumed by the Inventory Specialists that were not specifically listed in the QBD. For instance, when a motor was shipped to a vendor for repair, multiple bids were not collected. However, the SSJ was not completed either.

- c. The purchasing process was not followed for PO 200703735 and we found no evidence the incident was reported to management.

In the QBDs, a defined process flow outlines the steps to be taken in precise order to complete the purchasing process. The QBDs also specify the process and possible consequences for an unauthorized purchase. During test work, an incident was identified where a bid was solicited from a vendor in September 2006. The PR should have been created and submitted to PCS at that time along with support documents and the SSJ. The PR was not submitted to PCS until January 2007, and the SSJ wasn't created until February 15, 2007. Proper procedures were not followed. Work was authorized and completed outside of the stated Springs Utilities processes. We found no evidence the incident was reported to the employees' manager.

Findings, Recommendations, and Responses

Auditor's Recommendation:

We recommend Springs Utilities review purchase related QBDs for accuracy, clarity, and elimination of duplication. Additional training to those performing the purchasing function may be warranted to ensure compliance.

Specific recommendations for the three areas mentioned above are as follows.

- a. We recommend the system programming prevent the approval of a PR by the creator. Until this can be implemented, we recommend a response be required from the supervisor in the above mentioned report, in order for the purchase to proceed. Lack of a response should not equal approval.
- b. We recommend training be provided to all who complete and approve SSJs to ensure consistency and understanding in completion and use of the form. Additionally, controls should be implemented to ensure policies are followed and specific exceptions are approved in writing.
- c. We recommend management ensure procurement processes are followed. If specified processes are not followed, management should document the incident and corrective action taken.

Springs Utilities Response:

Colorado Springs Utilities agrees with the Office of the City Auditor's recommendation that purchase related QBDs be reviewed for accuracy, clarity, and elimination of unnecessary duplication. Per QBD #00002 – Document Control, version 07, section 6.10, "Documents are scheduled for evaluation every three years after the last approval date." Purchase related QBDs will be reviewed for accuracy, clarity, and elimination of unnecessary duplication during their required evaluation period and updated as appropriate.

- a. Colorado Springs Utilities agrees with the Office of the City Auditor's recommendation that system programming be implemented to prevent the approval of a PR by the creator. RMS version 6.22, due to be released in the first quarter of 2009, will include controls which prevent the approval of a PR by the creator. Until the release, exception reports are being generated on a regular basis and reviewed for compliance by the appropriate supervisors or managers.
- b. Colorado Springs Utilities agrees with the Office of the City Auditor's recommendation that training be provided to all who complete and approve SSJs to ensure consistency and understanding in completion and use of the form. QBD #09921 – Sole Source Procurement version 03 was recently updated and approved on September 22, 2008. Training on the newly updated process is planned for completion by December 31, 2008.

Findings, Recommendations, and Responses

- c. Colorado Springs Utilities agrees with the Office of the City Auditor's recommendation that management ensure procurement processes are followed. Per QBD #11298 – Unauthorized Purchase Approval Request, version 02, section 5.2.3, the authorized Procurement Agent is responsible for "... and escalate any concerns involving requestors that repeatedly violate approved procurement regulations and underlying processes to the Sourcing & Contracts Manager." Therefore, if such serious or chronic situations occur, it is expected that, when identified, they would be reported to the appropriate level of supervision.

Findings, Recommendations, and Responses

4. Exception reports should be utilized to maintain and strengthen purchase process controls.

Some exception reports were available on the system but not adequately utilized by PCS. For example, a report identifying employees' approval limits was available on the system. We used this report to identify employees with a higher approval limit than their manager or supervisor. A report of those approving their own PRs was created and distributed monthly; however, no action or response was required to ensure corrective action occurred. Other reports could be obtained and utilized to strengthen the purchase process. Reports could be run to verify authorization limits by employee, to identify PRs entered and approved by the same employee, to identify POs created without PRs, and to track blanket releases on contracts as the current system does not limit employee authorization amounts. These same reports and queries along with others could be used by management to identify and report exceptions to policy for corrective action.

Auditor's Recommendation:

We recommend management identify key information to track for internal control and policy compliance. If reports containing the key information are not readily available, management should cause such reports to be created. The reports should be regularly reviewed to ensure policies and controls are working as designed.

Springs Utilities Response:

Colorado Springs Utilities agrees with the Office of the City Auditor's recommendation that management identify key information to track for internal control and policy compliance. As previously stated in the response for Finding #1, assigned approval limits were reviewed and corrected in RMS version 4.1.1 in the fourth quarter of 2007. RMS version 6.22, due to be released in the first quarter of 2009, will also include controls with established role-based PR and PO approval limits. Reports generated in RMS version 6.22 for management review will be evaluated for usefulness and adjusted as necessary.

Findings, Recommendations, and Responses

5. Internal controls surrounding Blanket Purchase Orders or Contracts and related Blanket Releases should be strengthened.

A Blanket Purchase Order or Contract is a term commitment to a supplier for certain materials or services at predetermined prices, terms, and conditions. Blanket Release is an individual purchase order release that is generated from a blanket purchase document.

Blanket agreements did not indicate a maximum amount authorized. When blanket contracts were issued, a dollar amount was assigned in the system based on the procurement specialist's best guess as to the potential total dollar amount that would be used for the life of the contract, including any renewable options. This amount could be increased as needed by the procurement specialist.

We tested 25 blanket releases over \$25,000. For blanket releases, the creator and the approver are the same employee. We found 15 releases had been entered and approved in the system by employees who were acting in excess of their assigned approval limits. Of the 15 releases, eight were created by employees with zero purchase approval authority. The system did not check to see approved dollar limits for requestors as was done for purchase orders. There was no system check in place to limit the amount of a purchase order release created off a blanket contract. Any amount up to the total dollar limit of the blanket agreement could be entered and approved by employees, even employees with no purchase authority.

Auditor's Recommendation:

We recommend:

- A system control to limit blanket release authority to employee's assigned approval amounts.
- Blanket releases should not be created and approved by the same employee.
- Blanket Purchase Orders and Contracts should state a total maximum amount allowable as well as maximum per occurrence amounts.
- Until system controls can be strengthened, activity should be monitored through review of reported activity or other such means.

Springs Utilities Response:

Colorado Springs Utilities agrees with the Office of the City Auditor's recommendation that system controls should be implemented to limit blanket release authority. RMS version 6.22, due to be released in the first quarter of 2009, will include controls which will limit blanket releases based on employee's assigned approval amounts. The new release will also include total maximum allowable amounts and maximum per occurrence amounts for blanket releases and contracts.

Findings, Recommendations, and Responses

Colorado Springs Utilities partially agrees with the Office of the City Auditor's recommendation that blanket releases should not be created and approved by the same employee. Exceptions do exist where it is necessary for an employee to have the ability to create and approve blanket releases. RMS version 6.22 will include controls that will allow the employee to take appropriate action without subsequent approval only if the release amount does not exceed the employee's approval limits. If the release amount exceeds the employee's approval limits, subsequent approval will be required.

Because the release of RMS version 6.22 is near, and because the risk of not doing so is minimal, it was determined that it is not practicable at this time to divert the efforts of the resources needed from the RMS project to create additional reports for review of blanket releases.