

August 14, 2015

Audit Committee Members  
Power Board Members  
Mayor Kim McMillan and City Council Members  
City of Clarksville  
Clarksville, Tennessee 37040

Executive Summary of the CDE Contracting Audit #1401

The following is an executive summary of the objectives, findings and recommendations related to the Internal Audit report on CDE's Contracting Process. The full audit report is attached and contains additional details about the audit results as well as management's responses. The full report also describes the audit methodology and provides more background and statistical information.

Objectives of the Audit

The objectives of the audit were to:

- Determine if the internal control system related to the contracting process provides reasonable assurance of achieving operational goals and reliable financial reporting;
- Assess the contracting process for compliance with City Code and other regulations;
- Assess the safeguarding of assets associated with the contracting process;
- Evaluate the contracting process for opportunities to add value and improve operations.

Brief Background

Both the electric and broadband divisions of CDE exist to provide reliable and affordable services that also foster strong economic growth. In meeting this goal, both divisions enter contractual agreements for goods and services, allowing CDE to combine in-house resources with outside business partnerships.

Effective July 1, 2011, CDE began utilizing the City of Clarksville's purchasing department and city purchasing policies and procedures. The beginning of this audit period coincides with the transition, and provides a 2 ½ year (30 month) assessment ending December 31, 2013, of the contracting process during the transition period.

Conclusions of Report

Our audit of CDE's contracting process for the period from July 1, 2011 to December 31, 2013 identified findings and other information related to each audit objective.

The following areas of weakness were identified in the internal control system of the contracting process in providing reasonable assurance of achieving operational goals and reliable financial reporting:

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- The contract management process is not formalized into comprehensive policies and procedures with assigned responsibilities.
- External communications in bid solicitations and internal documentation in bid files lacked clarity and consistency.
- The process for approval and file documentation of contract modifications, particularly extensions and rate increases, did not consistently adhere to that required for original contracts.
- Inconsistencies were also identified in purchase approval methods, payable approvals, vendor payment tracking, and non-competitive bid justifications.
- A process for accruing construction contract retainage in accordance with generally accepted accounting principles (GAAP) was not formalized.

Instances of noncompliance with City Code and other laws and regulations were found related to the contracting process as follows:

- Vendor and employee conflict of interest acknowledgements were not obtained in all instances in accordance with the City Ethics policies and other City procedures.
- Contract approval documentation did not consistently indicate compliance with City Code.
- Construction contract retainages did not comply with two requirements of State law.

Safeguarding of assets associated with the contracting process was lacking based on results of audit testing in the following areas:

- Contractor insurance, bonds and licensing verifications were not monitored effectively, particularly in instances where contract durations exceeded initial contractor expirations.
- Documentation of policies and procedures related to IT controls were limited.
- Contract and work order closeout was not timely.
- Monitoring of older agreements for compliance with current City procedures was not evident.

The following recommendations are included in our audit report related to the internal control system to improve the effectiveness and efficiency of operations goals and financial reporting:

- Due to the number of departments, divisions, and people involved in the contracting process, establish more structured procedures for contract management and administration at the City and at CDE. State which employees are responsible for which functions to be performed in which manner. State objectives and the ordered control activities to meet objectives. Address risk management and monitoring controls. An integrated approach to internal control design should consider the differences in accounting software used by the City and CDE.
- Improve bid communications and documentation to proactively strengthen contracts and the integrity of the contracting process.
- Strengthen existing policies and procedures to control approval authority, oversight and process flow for all contract modifications.
- Document appropriate oversight and accountability in approving purchases and payments.
- Record construction retainage in accordance with generally accepted accounting principles (GAAP).

The following recommendations are made to strengthen compliance with City Code and other regulations:

- Reinforce the process for obtaining employee and vendor conflict of interest acknowledgements.

- Document consistent compliance with City Code and other City procedures pertaining to contract approval by the Power Board, signature by the Mayor, and approval by the City Attorney as to legal form.
- Implement procedures to ensure that construction retainage withholdings comply with state law.

Recommendations to improve safeguarding of assets are as follows:

- Assign responsibility for monitoring insurance, bonds and licensing, particularly when contract durations exceed original expirations.
- Assess, document and monitor cybersecurity controls, including segregation of duties, for all vendor relationships.
- Establish procedures to facilitate and monitor timely contract and work order closeouts.
- Inventory older agreements and determine whether current requirements are being met. Perform Power Board review of all master service agreements periodically.

In order to add value and improve operations of the contracting process, the following recommendations are made in addition to those noted above:

- Consider adding a contract management position to the existing organizational structure to improve efficiencies and increase oversight of the complete process.
- Consider contract management software, or utilize existing software and other tools to improve completeness and consistency in the process.
- Pursue training initiatives and certification programs to enhance skills in purchasing and contracting.

Additional recommendations:

- Communicate “right to audit” language consistently when possible, particularly where purchases are exempt from competitive bidding.
- Clarify vendor expectations where contract provisions give vendors the right to audit CDE data.

Management of CDE, City Purchasing and the Legal Department agree with the findings in the report as applicable to their respective departments and are working toward correcting the identified weaknesses.

If you have any questions about the audit, the findings, or the recommendations please contact me at 931-648-6106.

Respectfully,



Lynn Stokes  
Director of Internal Audit

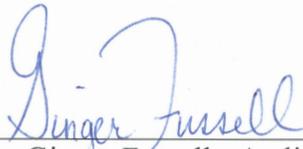
cc: Charlie Gentry, Chief of Administration  
Laurie Matta, Chief Financial Officer  
Brian Taylor, Superintendent, CDE Lightband  
David Johns, Chief Financial Officer, CDE Lightband  
Sean Newman, Purchasing Manager, CDE Lightband  
Camille Thomas, Purchasing Supervisor, City of Clarksville  
Lance Baker, City Attorney, City of Clarksville



## INTERNAL AUDIT REPORT

}	<b>AUDIT TITLE:</b>	<b>CONTRACTING AUDIT #1401</b>
	<b>DEPARTMENT:</b>	<b>CDE LIGHTBAND</b>
	<b>AUDIT PERIOD:</b>	<b>JULY 1, 2011 TO DECEMBER 31, 2013</b>

**CITY OF CLARKSVILLE**  
**CDE Lightband**  
**Contracting Audit**  
**AUDIT # 1401**



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Ginger Fussell - Auditor



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Lynn Stokes – Director of Internal Audit

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*August 14, 2015*

Date

**CITY OF CLARKSVILLE  
INTERNAL AUDIT REPORT**

**CDE Lightband Contracting Audit**

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# Internal Audit Report

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## Origin of the Audit

This audit was conducted as a part of the annual audit plan approved by the Audit Committee for the fiscal years 2014 and 2015.

## Audit Objectives

The specific audit objectives were:

- To determine if the internal control system related to the contracting process provides reasonable assurance of achieving operational goals and reliable financial reporting;
- To assess the contracting process for compliance with City Code and other regulations;
- To assess the safeguarding of assets associated with the contracting process;
- To evaluate the contracting process for opportunities to add value and improve operations.

## Scope and Methodology of the Audit

The audit period was from July 1, 2011 to December 31, 2013. Evidence to support our conclusions was gathered from inquiries of management and staff as well as observations of source documentation and tests of key controls surrounding the contracting process.

The audit included an evaluation of the five components of internal control related to the contracting process: the control environment, risk assessments, control activities, information and communication and monitoring activities. We also reviewed related laws, regulations, policies and procedures.

Contracts were judgmentally selected from a listing of vendor payments made during the audit period that were charged to Construction Work in Progress (CWIP), Fixed Assets or selected Operating Expense accounts, and that were determined upon audit selection to have been paid under a contractual agreement.

For purposes of this audit, contractual agreement refers to a separate, written agreement that has terms above and beyond those stated in a purchase order. The scope of this audit does not include payments to or contracts with TVA for cost of power or other expenses, or payments made to taxing authorities. Our audit objectives focused on the performance of

the contracting process as a whole, and not the advisability of individual contracts or performance of the related contractors under individual contracts.

We used both judgmental and random sample techniques. We included both capital construction contracts (from the top eight work orders based on dollars charged in the audit period), as well as routine operating contracts in our sample. A total of 28 contracts involving 23 vendors were tested. In order to achieve audit coverage primarily among high dollar contracts, statistical sampling was not used. Therefore, the results of this audit cannot be projected to the entire population of contracts. See Tables 2, 3 and 4 in the Statistical Information section of this report for further information.

## **Statement of Auditing Standards**

We conducted this performance 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 findings and conclusions based on our audit objectives.

## **Background**

Established in 1938, the Clarksville Department of Electricity (CDE) is a non-profit, municipal electric power distributor servicing customers within Clarksville, Tennessee with a mission to provide reliable and affordable delivery of electricity. In fulfilling that mission, a fiber infrastructure was constructed beginning in 2007 and completed in 2009 to provide a foundation for future enhancements in electric management. The fiber structure provided benefit for the electric division by increasing efficiencies and effectiveness in system reliability and power restoration.

To take advantage of unused bandwidth provided by the electric system's fiber infrastructure, CDE entered the broadband business as CDE Lightband (CDE throughout this report refers to electric and broadband divisions). In response to a favorable referendum vote in 2006 by the Clarksville community, as well as regulatory approval by TVA in 2007, CDE expanded services providing broadband as a Fiber to the Home (FTTH) provider offering video, internet and telephone services.

Just as electricity was considered an economic driver when CDE was established in 1938, high speed internet is currently considered a key economic driver and incentive for progressive community development. In 2013, Clarksville became one of only a few cities in the United States to be considered a "Gig City" with internet speeds of one gigabit per second.

CDE currently has 12 substations with miles of overhead and underground lines, fiber optic cable and fiber optic hub sites. CDE services over 65,000 electric and over 17,000

broadband customers.<sup>1</sup> The American Public Power Association ranked CDE at 47th among the 100 largest Public Power Utilities based on electric customers served.<sup>2</sup>

## **The Contracting Process within CDE's Mission**

Both the electric and broadband divisions exist to provide reliable and affordable services to foster strong economic growth. In meeting this goal, both divisions enter contractual agreements for goods and services. The contracting process facilitates reliable electric and broadband services by combining in-house resources with outside business partnerships.

According to City of Clarksville Ordinance, a board of five local business people (the Power Board), appointed by the City of Clarksville Mayor and approved by city council, governs the policies of CDE. One member of the Power Board is a current member of the city council. Members serve three year staggering terms.

City Code (Section 13-108d and Article IV, Section 3) requires all contracts pertaining to CDE to be:

- 1) In the name of the City of Clarksville
- 2) Approved by the Power Board
- 3) Signed by the Mayor in the manner required by City Charter
- 4) Approved as to form by City Attorney's office.

## **Transition in the Purchasing Process**

Effective July 1, 2011, CDE began utilizing the City of Clarksville's purchasing department for obtaining goods and services and operating under city purchasing policies and procedures set forth in City Code. The beginning of the audit period coincides with the date of this transition.

Prior to that date, CDE operated under its own purchasing policies and procedures and its own purchasing manager. CDE continues to staff an internal purchasing manager who works closely with CDE management and the City of Clarksville's purchasing department to facilitate both the purchasing and the contracting processes.

Contracts tested in this audit were selected based on vendor payments made during the audit period. Therefore, contracts may have originated under either set of policies and procedures depending on the contract execution date. Eleven of the 28 contracts tested were entered into prior to the date of transition; 17 contracts were entered into after that date. Test criteria was developed taking the transition into account.

The audit period provides a 2½ year (30 month) span of activity, beginning at the point of transition and ending December 31, 2013. The audit provides an assessment of the overall contracting process during a time of conversion to a more centralized purchasing process.

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<sup>1</sup> CDE Lightband Audited Financial Statements and Other Information June 30, 2014, Schedule of Statistical Data – Electric Division and Broadband Division (Unaudited)

<sup>2</sup> American Public Power Association 2014-2015 Annual Directory & Statistical Report, [www.PublicPower.org](http://www.PublicPower.org)

Therefore the audit addresses matters for which both departments, CDE and City Purchasing, are responsible.

### **Internal Control Objectives in the Contracting Process**

Internal control is a process affected by people, expected to provide reasonable, but not absolute, assurance geared to the achievement of entity-wide objectives classified in four broad categories:

- Operational
- Financial Reporting
- Compliance
- Safeguarding of Assets

Within those broad categories, activity-level objectives specific to CDE’s contracting process were not formally stated, but were derived by internal audit through discussions with CDE personnel and review of various policies, procedures, and mission statements of the department and city purchasing to be as follows:

**Table 1**

<b>Entity-Wide Objective</b>	<b>Activity-Level Objectives of the Contracting Process</b>
<b>Operational</b>	<b>Allow for fair and equal opportunity competition among qualified suppliers to the maximum extent reasonably practicable in contracting for needed goods and services to bring the greatest value to CDE, the ratepayer and the Clarksville community.</b>
<b>Financial Reporting</b>	<b>Develop and maintain a system of internal control that fosters reasonable assurance that internal and external reporting of contracted goods and services is presented fairly in all material respects, and facilitates the achievement of operational goals.</b>
<b>Compliance</b>	<b>Comply with city code, laws and other regulations in the contracting process.</b>
<b>Safeguarding of Assets</b>	<b>Provide protection and preservation of CDE resources.</b>

### **Key Personnel in the Contracting Process**

Currently, there is no single position within CDE or the City of Clarksville that is responsible for CDE’s contract management function.

Instead, separate aspects of the purchasing and contracting process are handled by various CDE and City personnel requiring interaction and collaboration to complete the process, as described at Appendix 1.

Most personnel involved in the contracting process have had longevity in their positions through the audit period, with the exception of turnover in the following two positions:

- CDE internal purchasing manager position – Held by two people during audit period with one training at end of audit period.
- CDE IT manager position – Held by two people during the audit period with a new manager hired after the end of the audit period.

### Outside Assistance in the Contracting Process

For capital projects, outside engineers and/or architects are engaged as necessary to provide technical professional services in facilitating procurement, purchasing and contracting activities. One firm specializing in comprehensive electric utility engineering services was used for six out of eight work orders tested, and was involved in the contracting process for 15 out of 19 capital contracts tested. A local architect was engaged to provide services for building renovation for one out of eight work orders and was involved with one out of 19 capital contracts tested. The remaining capital work order and contracts tested were managed without the assistance of outside engineers or architects. (Work orders are listed in the Statistical section at Table 4)

### Contracting Process Cycle

For purposes of this audit, the contracting process refers to the entire cycle of contract development, management and administration. The complete contracting process is an interactive effort. CDE must obtain needed goods and services in order to fulfill its mission. City Purchasing facilitates CDE’s task in obtaining those goods and services, while at the same time protecting the public and promoting fairness in contracting with the business community. The end result is that needed goods and services are available on a timely basis so that CDE can deliver reliable and affordable services.



Contracts are executed after going through either

1. A competitive procurement process, or
2. A non-competitive procurement process meeting certain city and legal requirements for competitive exemption.

City Purchasing policies and procedures define the general framework for both processes.

The contracting process is summarized in five phases for the more comprehensive competitive process at Appendix 1. The non-competitive process, which is less extensive, involves only a portion of the more comprehensive competitive process and must be adequately justified according to City purchasing requirements.

Both the electric division and the broadband division of CDE utilize the described contracting process, however each division operates in unique industry and contracting environments.

## **Statistical Information**

The exact number of open contracts during the audit period could not be determined. During the audit period, CDE maintained a listing of contracts, but the listing did not provide a historical trail of contract activity for the full 30 month period under audit.

In order to identify active contracts during the audit period, the auditor reviewed vendor payments debited to CWIP, Fixed Assets and selected Operating Expense accounts, as described in the Scope and Methodology section of this audit report. The audit population included only vendors paid more than \$10,000 in aggregate during the audit period. Vendors meeting both the scope of dollars paid and selected accounts charged, totaled 214, with payments totaling over \$65M.

The vendors/contracts tested during the conduct of this audit represent 75% of the payments made to vendors who received over \$1M during the audit period, and 53% of payments made to all vendors meeting the scope of testing, as indicated in Table 2:

**Table 2**

Vendors/Contracts Tested to Vendor Payments - Selected Accounts *						
During 2 1/2 Year Audit Period Ending 12/31/13						
All Vendors (contract and non-contract) paid >\$10,000		\$ Range of Vendor Payments in scope	Vendors/Contracts Tested			
A	B		C	D	E	%
# of Vendors	\$ Paid Vendors Selected Accts		Vendors Tested	Contracts Tested	\$ Paid to Selected Vendors in Selected Accts	Column E divided by Column B
3	21,529,200.80	> \$5,000,000	2	2	14,887,024.79	75%
11	20,717,091.80	\$1,000,000 to \$4,999,999	9	12	16,762,578.26	
14	42,246,292.60	<b>Subtotal &gt; \$1,000,000</b>	11	14	31,649,603.05	
28	12,846,081.72	\$275,000 to \$999,999	4	6	1,920,814.69	
30	4,823,251.25	\$100,000 to \$274,999	4	4	609,116.52	
142	5,496,980.93	\$10,000 to \$99,999	4	4	184,342.23	12%
200	23,166,313.90	<b>Subtotal \$10,000 - \$999,999</b>	12	14	2,714,273.44	
214	65,412,606.50	<b>Total</b>	23	28	34,363,876.49	

\* Selected Accounts are defined at the Scope and Methodology section of this Audit Report as CWIP, fixed assets and selected operating expense accounts which do not include cost of power, taxes or depreciation.

**The types of goods and services obtained through vendors selected for contract testing were as indicated in Table 3:**

**Table 3**

Goods and Services Obtained			
Vendor Payments - Selected Accounts*, 2 1/2 Year Audit Period Ending 12/31/13			
# of Vendors	# of Contracts	Goods and Services Obtained	Vendor \$ Amount Paid
13	18	CWIP Construction	8,473,336.87
1	1	CWIP Construction & Operating Maintenance	5,795,277.05
3	3	Video Provider, Phone Provider and Network Services	11,699,974.19
3	3	Tree Trimming, Fiber to the Home, Premise Installations	8,263,522.61
3	3	Customer Support, Equipment Rental, Safety Testing and Other Services	131,765.77
23	28	<b>Payments Charged to Selected Accts - Vendors Tested</b>	34,363,876.49

\* Selected Accounts are defined at the Scope and Methodology section of this Audit Report as CWIP, fixed assets and selected operating expense accounts which do not include cost of power, taxes or depreciation.

Tested capital construction (CWIP) contracts were selected from among the top eight work orders during the audit period based on dollar amount paid. Each work order exceeded \$275,000 in charges. All vendors receiving payments greater than \$50,000 within those respective work orders were selected for testing. Information regarding the eight work orders is presented in Table 4 summarized as follows.

Four work orders were in progress at the start of the audit period, and four were started during the audit period. Five of the eight work orders remained open at December 31, 2013, two of which originated prior to July 1, 2011.

The months of inactivity at the end of the audit period for the five work orders still open ranged from zero to 14 months, and the months to complete the three work orders closed during the audit period ranged from nine to 62 months, as noted in Table 4.

**Table 4**

Work Order Summary						
In Progress at Start of Audit Period (7/1/11)	Start Date	Closed During Audit Period (7/1/11 to 12/31/13)	Open at End of Audit Period (12/31/13)	Months Duration at Close Out	Months Duration at 12/31/13	Months of Inactivity at 12/31/13
West Creek Substation	11/30/2007	Closed 2/28/13		62		
Gibbs Substation	2/28/2010	Closed 2/28/13		36		
Primary Bank 1 Substation	8/31/2010		Open		40	14 (See Finding 8)
District Substation	8/31/2010		Open		40	5
Started During Audit Period (7/1/11 to 12/31/13)	Start Date	Closed During Audit Period (7/1/11 to 12/31/13)	Open at End of Audit Period (12/31/13)	Months Duration at Close Out	Months Duration at 12/31/13	Months of Inactivity at 12/31/13
Circuit Breaker Replacement	12/8/2011		Open		24	8
Madison Street Renovation	6/30/2012	Closed 3/31/13		9		
Primary Substation	7/31/2012		Open		17	0
Trenton Rd - Kennedy to Gibbs Line Relocation	10/24/2012		Open		14	0

## Noteworthy Accomplishments

As of April 2014, CDE was among 184 public power utilities awarded the Reliable Public Power Provider (RP3) designation by the American Public Power Association. The RP3 designation recognizes public power utilities that demonstrate proficiency in four key disciplines: reliability, safety, workforce development, and system improvement.<sup>3</sup> Strong vendor/contractor partnerships play an important role in CDE meeting its mission.

CDE's external financial audit reports for fiscal years ended June 30, 2013 and 2014 received unmodified (clean) opinions, with no findings in either year.<sup>4</sup> This indicates CDE's commitment to improvements which strengthen financial reporting.

<sup>3</sup> <http://www.publicpower.org/Media/daily/ArticleDetail.cfm?ItemNumber=41066>

<sup>4</sup> CDE Lightband Audited Financial Statements and Other Information June 30, 2013 and June 30, 2014

## Results of Audit

Inherently, a contracting process bears risk, not only in fact but also in appearance, that control objectives may not be met. Several controls to manage this risk were tested or observed during the audit without significant exception. However, the following findings represent significant deficiencies related to the contracting process. Opportunities for improvement in internal control design or operation exist in eight general areas:

1. Bid/Proposal Packages
2. Contract Modifications (including extensions and rate increases)
3. Conflict of Interest Acknowledgements
4. Contract Approvals
5. Construction Contract Retainage
6. Purchase Approvals (PO's and AP's)
7. Contract Management and Administration
8. Safeguarding of Assets

## Findings and Recommendations

### 1. Bid package documentation lacks clarity and consistency

#### Criteria:

Bid/proposal documents should be well designed, clear and concise to achieve desired purchasing objectives of integrity, efficiency and added value when obtaining needed goods and services.

Bid/proposal files, contracts and contract attachments should include adequate documentation to clearly support the integrity and consistency of the purchasing process, as well as the overall contracting process.

Competitive sealed bidding and competitive sealed proposals are two distinct purchasing methods for vendor selection. Both methods are intended to achieve open competition. However, there are important procedural distinctions in the two methods that should be clearly communicated and consistently applied in bid solicitations, bid forms and through the complete bid process.

#### Condition:

For one bid tested the following was noted:

- a) Bid forms prepared by CDE required both detailed hourly-rate schedules and a summary page to be completed by the bidder. The purpose of the summary page was to obtain an estimate of the annual cost, based on the underlying hourly-rate schedules.

At bid opening, base bids were recorded from the summary page. However, bidders appeared to have interpreted instructions differently when calculating annual totals from the detailed hourly rate schedules, and entering totals on the summary page.

As a result of the differing interpretations, CDE re-calculated the bidders' estimated annual cost by applying a consistent mathematical method to their hourly-rate schedules. The results were then used to evaluate the cost component of the bid.

Based on the design and instructions of the summary page, the ranking of high to low bids at bid opening differed from the ranking achieved when CDE applied the alternative, more consistent methodology. In the case of the successful bidder, the difference was significant and could have caused vendors to question the integrity of the resulting bid award.

- b) Bid documents contained bid terminology and proposal terminology which appeared to have been used and applied interchangeably.
- c) Bid file documentation included detailed mathematical calculations, as well as narrative explanation supporting the selection team's recommendation of bid award. However, the bid file, contract and contract attachments contained inconsistencies in estimated annual costs, which should have been more adequately reconciled or explained.
- d) Additionally, file documentation did not identify the team participants involved in determining the recommendation for bid award.

**Cause:**

- a) **Unclear bid form design** – This bid involved a rate-based contract. The summary page was included as a bid form in an effort to streamline the bid opening process. Summary pages are routinely used by City Purchasing as a basis to record opening bids, and CDE was attempting to provide bid forms that facilitated the city process.
- b) **Inconsistent purchase method terminology and application** – City Purchasing policies and procedures provide general framework for various procurement methods, however, standardized templates specific to each method have not been developed for guidance.
- c) **Inconsistency in bid file documentation** – The unclear format of the bid forms and instructions appear to have caused some of the inconsistencies in file documentation of estimated annual costs.
- d) **Unidentified selection team participants** – Current procedures do not require documentation in the bid file to specify those who participate in the bid award selection process.

**Effect:**

Unclear bid solicitations and unnecessary complication of bid forms can result in bidding inefficiency, ineffectiveness and potential noncompliance. More importantly,

these issues can raise questions among vendors regarding the integrity of the contracting process.

**Recommendation:**

Since contracts are based on bid packages, improved bid documents will proactively strengthen contractual agreements as well. The following recommendations are made to enhance the existing process:

- a) Draft bid documents allowing ample time to provide clear bid forms and related instructions, particularly with rate-based contracts.
- b) Continue to enhance City Purchasing policies and procedures. Develop additional guidance to assist CDE and other city departments in selecting, applying and documenting appropriate procurement methodology. Consider the following tools and resources:
  - Decision tree or flowchart for method selection
  - Invitation to Bid (ITB) and Request for Proposal (RFP) templates
  - Competitive bid and competitive proposal checklists
  - External and inter-departmental training specific to procurement and contracting
- c) Implement process flow checklists and other tools to ensure consistency and completeness in bid file and contract file documentation. Contract documents should mirror the underlying bid documents, complementing one another.
- d) Document the names of all team members involved in bid award recommendation to demonstrate fairness, objectivity and segregation of duties.

**City Purchasing Management Comments:**

Agree \_\_\_\_\_ YES \_\_\_\_\_ Disagree \_\_\_\_\_

**Corrective Action Plan:** Purchasing is already working closely with the department to come up with more clear and concise bid/proposal documents. Purchasing will also ensure that the words bid and proposal are not used in the same document as it relates to the process for CDE. We will continue to use our checklist to ensure all bid documents/information is included in the file. The names (shall be 2 or more persons) of the evaluation team will be either kept on file in the using department or the Purchasing Department. It is my intent to update the Purchasing Policies and Procedures. We will consider adding various tools to guide departments on the bid and proposal process. The bid in question has been revised and sent to vendors as an RFP with an Engineering firm writing the specifications.

**Projected Completion Date:** Much of the above is being implemented now. For the names on the evaluation team, we will implement immediately. For the updating of the Purchasing policies and procedures, I hope to have a completion date of December 31, 2015. This will need to go through many eyes and departments before the policy is completely updated.

**Responsible Manager:** Camille Thomas, Purchasing Supervisor

**CDE Management Comments:**

Agree \_\_\_\_\_ X \_\_\_\_\_

Disagree \_\_\_\_\_

**Corrective Action Plan:** a) The finding of confusion relates to CDE's first attempt to bid out its line work under the "new" City process. While it could have confused bidders, that was not the intent, and CDE corrected the process when recently bidding out its line work again (May 2015). Management notes that the City's process did and does allow a period of time for questions and answers for bidders should they have any.

b) CDE will work with City Purchasing to enhance and follow policies and procedures.

c) CDE continues to work to make contracts and bids mirror each other, as seen with the recent line work bid and contract.

d) CDE will document in board packets all team members involved in bid recommendation.

**Projected Completion Date:** In place and ongoing.

**Responsible Manager:** Sean Newman, Purchasing Manager; Bruce Walker, Operations Manager (Electric Division Manager)

**2. Contract modifications and extensions are not carried out in a consistent manner**

**Criteria:**

City purchasing policies state that all procurements should be carried out in a manner that provides for maximum free and open competition.

As noted at page three of this report, City Code requires all contracts pertaining to the department of electricity to be

- a) in the name of the city
- b) approved by the Clarksville Power Board
- c) executed by the Mayor, and
- d) approved as to legal form by City Attorney's office

**Condition:**

Ten operating contracts were sampled. One was entered in 2009 and expired during the audit period. The contract was extended three times for a total of 17 months before rebidding. One extension included a rate increase of 4%. Payments made to the contractor during the extended 17 month period totaled \$3,090,413. Of that amount, \$118,862 was attributable to the 4% rate increase.

The extensions and the rate increase related to this contract did not go before the Power Board for approval and were not signed by the Mayor or initialed by the City Attorney's office. Instead, the extensions and rate increases were handled as change

orders signed by either the operations manager (electric division manager) or the superintendent of CDE.

While the change orders were retained with the original contract at CDE, the contract on file with City Purchasing was not updated. The auditor found no indication of an established process to ensure that City Purchasing is notified, and files updated, in all situations where contract modifications are made.

When comparing the contract modification process for this vendor to other vendor contracts, the auditor noted that the process of approving and executing rate increases was inconsistent among vendors. Additionally, the process for contract modification was described inconsistently from one vendor contract to the next.

**Cause:**

a) **Multiple contract extensions with rate increase** – The first twelve month extension was requested to provide continuity in six major projects in which the contracted crews were involved. These on-going projects were estimated to take six to twelve additional months to complete. The first extension included a rate increase deemed by management to be reasonable related to the US Department of Labor Consumer Price Index - Urban considering the fact that there had been no rate increase during the three year contract period.

The second and third extensions were requested to allow CDE engineering and operations time to develop a new Request for Bid (RFB). However, the resulting new bid form was unclear and inconsistently interpreted by bidders, as discussed in Finding 1a above.

b) **Inconsistent contract modification process** – City policies and procedures do not define a consistent process for managing contract modifications or extensions.

c) **City contract files not up to date** – Contracts and contract modifications are not numbered or tracked, and a routing process for modified documents is not defined.

**Effect:**

Multiple contract extensions could indicate inefficiency in planning, ineffectiveness in pursuing price competition, and could reflect an appearance of vendor favoritism.

Inconsistencies in the contract modification process among different vendors could result in unauthorized spending, noncompliance and/or the appearance of vendor favoritism.

Established internal controls could be circumvented, and noncompliance with underlying bid/proposal stipulations could result where contract modifications do not follow the same process as the initial contract award process. Additionally, City Purchasing's contract documentation could become outdated if modifications are not added to the contract file upon agreement. This, in turn, could result in internal



**Projected Completion Date:** In place and ongoing.

**Responsible Manager:** Sean Newman, Purchasing Manager; Brian Taylor, Superintendent.

**City Attorney's Office Management Comments:**

Agree  Disagree

**Corrective Action Plan:** The legal department will work with CDE and City Purchasing to create and implement a contract tracking process to include parameters pertaining to extensions and modifications of contracts.

**Projected Completion Date:** Initial discussions will begin by October 31, 2015, with a December 31, 2015 completion.

**Responsible Manager:** Lance Baker, City Attorney

### **3. Conflict of interest acknowledgments vary in wording and compliance**

**Criteria:**

City purchasing procedures require vendors to sign conflict of interest statements prior to a competitive bid/proposal award.

CDE Operating Policy 3-28 and Title 1, Chapter 6 of the City Code provide policy related to ethics and conflicts of interest. Employees are required to review the policy annually and to sign an acknowledgment to be retained in employee records.

**Condition:**

- a) Conflict of interest acknowledgments were obtained for 16 vendors as required for competitive bid/proposal awards. However, three out of 16 vendor acknowledgements contained wording contrary to the objectives of the ethics policy, because an old form was used. Improvement was noted during the latter part of the audit period tested.
- b) Acknowledgements were not required under current city policies and procedures for two vendors, as the contracts were exempt from competitive bidding. Payments to one of the two vendors totaled in excess of \$9M during the 30 month audit period.
- c) One employee conflict of interest statement was not on file out of ten employees tested. This employee was a purchasing manager for a period of 27 months within the 30 month audit period.
- d) CDE's employee conflict of interest statements are in the form of a one-time acknowledgement of the following:

- Understanding of policy,
- Agreement to abide by policy, and
- Agreement to inform the immediate supervisor or department head if violations occur.

City Code, however, requires annual review and acknowledgement of the ethics policy, rather than one-time review and acknowledgement.

**Cause:**

- Outdated conflict of interest form** – The vendor conflict of interest form was updated, and old forms were not properly discarded.
- Conflict of interest forms not obtained in non-competitive process** – Current City Purchasing procedures are to obtain conflict of interest forms before awarding a competitive bid or proposal, and do not address vendor purchases of services exempt from the competitive process.
- Conflict of interest form not obtained for purchasing manager** – The missing employee conflict of interest statement was due to the fact that the employee was on a leave of absence during the employee acknowledgement period.
- One-time acknowledgments rather than annual acknowledgements** – The annual process had not been implemented by CDE during the audit period.

**Effect:**

Conflicts of interest are inherent risks in any contracting process. Inconsistencies in documentation related to the ethics policy could potentially hinder achievement of the policy's objective, which is to provide a high standard of honesty, integrity, impartiality and conduct.

Acknowledgements of the City's conflict of interest policies might not be obtained for sole-source vendor relationships, which inherently bear heightened risk in any contracting environment.

**Recommendation:**

Continue to enhance policies, procedures and documentation to demonstrate compliance with the Code of Ethics policy.

Specifically,

- Ensure that vendor acknowledgement forms obtained are consistent with current policy.
- Establish a method to ensure vendor notifications and acknowledgements are appropriately documented in both competitive and non-competitive purchasing processes.
- Obtain conflict of interest acknowledgements for all employees.
- Obtain acknowledgements annually in accordance with the City Ethics Policy.



**4. Procedures related to contract approval documentation do not assure City Code compliance**

**Criteria:**

As previously stated, City Code requires all contracts pertaining to the department of electricity to be

- a) in the name of the city
- b) approved by the Clarksville Power Board
- c) executed by the Mayor, and
- d) approved as to legal form by City Attorney’s office

**Condition:**

- a) CDE’s departmental contract procedures state that contracts should come before the Power Board for review. However, City Code requires Power Board approval (voting action), not just review (non-voting action), for all contracts.
- b) Sixteen contracts were tested for compliance with City Code and internal procedures. Results from this testing correspond with the columns in Table 5 to follow.

<b>TABLE 5</b>	<b>Test 1</b>	<b>Test 2</b>	<b>Test 3</b>	<b>Test 4</b>
<b>Contracts Entered in Audit Period</b>	<b>Power Board Action As Recorded in Minutes</b>	<b>Signature On Contract</b>	<b>Attorney Approval On Contract</b>	<b>Dept. Head Approval On Contract</b>
<b>Contract Tested</b>	<b>Approval of Contract</b>	<b>Signed by Mayor</b>	<b>Approval As to Legal Form</b>	<b>Superint. Initials</b>
1	N - Info Rev	Y	N	Y
2	N - Appr Pur	Y	Y	Y
3	Y	Y	Y	Y
4	N - Info Rev	Y	Y	Y
5	N - Info Rev	Y	Y	Y
6	N - Info Rev	Y	Y	Y
7	N - Info Rev	Y	Y	Y
8	N - Info Rev	Y	Y	Y
9	Y	Y	Y	Y
10	Y	Y	Y	Y
11	Y	Y	Y	N
12	Y	Y	N	N
13	Y	Y	N	Y
14	Y	Y	N	Y
15	NOT NOTED	Y	Y	Y
16	N - Info Rev **	N **	N **	N **
<b>In Compliance</b>	<b>7</b>	<b>15</b>	<b>11</b>	<b>13</b>
<b>Not In Compliance</b>	<b>9</b>	<b>1</b>	<b>5</b>	<b>3</b>
<b>Total Tested</b>	<b>16</b>	<b>16</b>	<b>16</b>	<b>16</b>

Key to Table 5	
N - Info Rev	Power Board action stated as informational review (non-voting) versus contract approval (voting) in minutes.
N - Appr Pur	Power Board action stated as approval of purchase versus contract approval in minutes.
NOT NOTED	No mention of action related to this contract was noted in the Power Board minutes.
**	Rental agreement signed by CDE electric division manager. See Finding 6.b.2 for additional details.

**Test 1:** Power Board minutes indicated some form of oversight related to the purchase and/or the vendor contract for 15 out of 16 contracts tested. However, minutes did not clearly and consistently state that action taken related to each contract represented “contract approval” per City Code. Alternative wording most often indicated “informational review” which is usually not a voting action of the Power Board.

Power Board minutes did not indicate any form of oversight action related to 1 out of 16 contracts tested.

**Test 2:** Fifteen out of 16 contracts were signed by the Mayor. One of 16 contracts (a rental agreement) was signed by the electric division manager. See Finding 6.b.2 for further details related to this agreement.

**Test 3:** Five out of 16 contracts did not bear evidence of approval as to legal form by the City Attorney’s office.

**Test 4:** Three out of 16 contracts did not bear evidence of CDE’s superintendent initials per internal policy.

- c) A bandwidth order was signed by CDE’s superintendent. There was no underlying master service agreement at the time of the order.
- d) One RFP for call overflow services was noted to have called for a separate contract; however no separate, written contract was negotiated.

**Cause:**

- a) Power Board approval action not consistently stated in the minutes – Based on the fact that CDE’s departmental policies and procedures refer to “Board review” rather than “Board approval”, there may be a perception that Board review of the bid also implies approval of the contract.
- b) Approvals inconsistently documented; Agreements entered under inconsistent process Regarding Power Board action, bid review is routinely documented in Power Board minutes as an informational item after bids are awarded. However, contracts

related to those bids are not always completed and ready for approval at the same meeting. When the contract is subsequently finalized, it may be perceived that the Power Board's informational review was sufficient as approval.

A truck rental, originally expected to be a temporary arrangement, was later determined necessary for a longer term. This was brought before the Power Board as an informational review item, but the original agreement was not re-negotiated.

Initials documenting attorney approval (as to legal form), and department head approval (as to subject matter) may be inconsistent due to the process flow and timing of finalized contract documents, or simply oversight.

- c) *Bandwidth agreement approval not consistent with City requirements* – The same process was followed that was in place before the transition to City purchasing policies and procedures. Determination of what constitutes a contract is sometimes unclear.
- d) *Separate, written contract not obtained where stated in the RFP* - It appears that another RFP may have been used for drafting the new RFP; therefore the intent for a separate, written contract may have been miscommunicated. Determination as to when a separate, written contract is necessary may sometimes be unclear.

**Effect:**

Contract agreements do not consistently bear evidence of compliance with requirements stated in City Code. These requirements are designed to ensure proper oversight, manage risk and prevent unauthorized expenditures. As a result, contract file documentation does not evidence that the prescribed steps were completed to meet these objectives, even though the steps may have been performed.

**Recommendation:**

- a) Ensure that all policies and procedures, as well as contracts, are in compliance with City Code as noted under Criteria above.
- b) Implement checklists to ensure that requirements are consistently addressed and documented. Checklists should also be designed to facilitate optimal process flow in meeting objectives.
- c) Document general guidance, based on collective input from City Purchasing, CDE and the City Attorney's office, for determining what constitutes a contract and under what circumstances a separate, written contract should be negotiated. While it is understood that decisions are made on a contract by contract basis, general guidelines could improve overall compliance and file documentation.



**City Attorney's Office Management Comments:**

Agree  \_\_\_\_\_

Disagree \_\_\_\_\_

**Corrective Action Plan:** The legal department will work with City purchasing to create a policy on the contracting process and a checklist to ensure that contracts are processed in accordance with City Charter and Code requirements.

**Projected Completion Date:** Initial discussions will begin by October 31, 2015, with a December 31, 2015 completion.

**Responsible Manager:** Lance Baker, City Attorney

**5. Contract retainage procedures do not consistently comply with State law and accruals are not recorded in conformity with generally accepted accounting principles**

**Criteria:**

- a) Contract retainage should be accrued as a liability when services are performed and goods are received according to generally accepted accounting principles (GAAP).
- b) TCA §66-34-103 provides for withholding of retainage on construction contracts in amounts not to exceed five percent of the amount of the contract.
- c) For construction projects where prime contracts are \$500,000 or greater, TCA §66-34-104 requires that retained funds be deposited in a separate, interest-bearing, escrow account with a third party.

**Condition:**

- a) Construction contract retainage was not accrued for some vendors tested.
- b) For one construction contract out of seven tested, retainage was withheld at 10%, in excess of a 5% maximum allowable by TCA §66-34-103.
- c) For five construction contracts meeting criteria for compliance with TCA §66-34-104, CDE did not deposit construction retainage into a separate, interest-bearing, escrow account with a third party for any of the five.

**Cause:**

- a) **Unaccrued retainage** - Controls exist to accrue unpaid invoice amounts. However, a process for accruing contract retainage had not been formalized during the audit period.
- b) **Retainage percentage in excess of that allowed** - For the specific contract with the increased withholding percentage, the vendor requested the higher percentage to match their billing software.



Purchase approval authority is defined by city purchasing policy as well as CDE’s internal department procedures, requiring additional levels of approvals based on monetary spending levels.

To ensure a fair and competitive procurement process, city policy requires adequate documentation when purchases are exempt from the competitive process, (i.e. sole-source, proprietary or emergency) or when bid awards do not go to the lowest bidder.

**Condition:**

- a) Purchase approval is documented and communicated at CDE by one of two methods, depending upon the nature of the purchase:
- Purchase order (PO), used generally for purchases of materials
  - Authorizations to Purchase (AP), used generally for purchases other than materials to be received

Audit testing indicated the following results related to the effectiveness of purchase approval documents (PO’s vs AP’s):

Matters Noted	Examples
Choice of purchase approval method (PO vs AP) was not always consistent for the same good or service.	For three capital contracts with the same vendor: A PO was used for two of the contracts; an AP was used for one contract, while all three were for the same type of service.
The level of signature obtained differed based on the choice of purchase approval method. (PO vs AP)	For nine PO’s tested, superintendent approval was evident on all nine. For 13 AP’s tested, superintendent approval was evident on one; not evident on 12.  An annual listing of all AP’s was distributed to department heads prior to the beginning of a fiscal year; however, this listing was not signed by the superintendent.
Documentation of the amount approved differed based on the choice of purchase approval method. (PO vs AP)	For nine PO’s tested, nine stated the approved amount. For 13 AP’s tested, only three stated the approved or “not to exceed” amount, ten did not.  The annual listing noted in the previous block does not list estimated amounts.
Tracking of cumulative payments charged to PO’s or AP’s performed manually.	For one contract, cumulative payments were understated in manual tracking by the amount of one invoice totaling \$36,013, resulting in a potential for vendor overpayment.
Timeliness of PO/AP approval did not always meet control objectives.	One PO and three AP’s were dated after goods were received or services were performed.

- b) Audit test results demonstrate weaknesses in purchasing control documentation for two specific contracts:

### **1. Broadband Vendor Contract**

Appropriate non-competitive justification was not on file for a vendor receiving payments in excess of \$9M during the 30-month audit period. For one fiscal year tested, an authorization to purchase (AP) was issued as discussed in Finding 6a. As a result, superintendent approval was not evident on the AP, nor was an approved amount or “not-to-exceed” amount (as explained in 6a above). The highest level of documented approval on the AP was the broadband division manager, who was the approver of all invoices as well.

### **2. Truck Rental Agreement**

A truck rental agreement, originally expected to be a temporary arrangement, was entered and signed by the electric division manager for two trucks, one of which was tested in this audit. The agreement was open ended in duration according to the signed agreement.

It was later determined that the truck rental would be necessary for a longer term and a request for proposal (RFP) was issued. The active vendor was among those responding and was awarded the contract at the same price. This was brought before the Power Board as an informational review item (discussed in Finding 4). The original agreement was not re-negotiated.

Similar to the contract discussed in Finding 1, the RFP also contained bid terminology, rather than consistent terminology specific to the RFP source selection method, and the selection team participants were not identified.

The contract amount stated 11/15/12 in the City Purchasing bid file was “Max Total \$19,875” for the truck tested with a contract expiration date of 6/14/13. This was the amount approved for budgetary sufficiency.

On July 18, 2013, subsequent to the stated expiration date, an authorization to purchase (AP) was issued for the new fiscal year (13-14). Since an AP was used, there was no indication of superintendent approval and no approval amount stated as explained in 6a above. The highest level of documented approval was the electric division manager who approved all invoices as well.

Payments through the end of the audit period (12/31/13) totaled \$46,575, exceeding the “Max Total” and expiration date in the bid file. Payments continued subsequently through September 2014 after which the truck was purchased.

c) Audit testing indicated the following related to vendor invoice approvals:

Matters Noted	Examples
Evidence of invoice approval was inconsistent.	Invoice approvals were not indicated on seven out of 81 invoices tested.

**Cause:**

Causes may include but are not limited to the following:

- a) **Different purchase approval methods, manual tracking and approval timeliness** - Lack of defined policies and procedures, difficulty in estimating amounts, as well as and computer input challenges may all play a role in the use of two different purchase approval methods. Many of the services that AP's are issued for are recurring in nature and covered by signed contract. While rates may be established by contract, quantities vary making it difficult to estimate dollar amounts. The manual tracking error was made in oversight. The timeliness of PO's or AP's most likely related to vendors with whom CDE has a recurring relationship.
- b) 1. **Non-competitive justification and approval documentation for broadband vendor** - The contract for the broadband vendor was entered prior to the transition to city purchasing procedures, therefore the city's required documentation was not on file. Longer terms are negotiated with this vendor in an attempt to get the best programming for customers for the lowest prices.  
  
2. **Truck rental agreement approval and oversight documentation** – The change in the original intent of the truck rental agreement contributed to the process followed.
- c) **Invoice approval documentation** - Lack of obtaining invoice approval was oversight.

**Effect:**

The effects of the noted conditions are as follows:

- a) Inconsistent or untimely documentation of approvals or amounts could create potential for unauthorized spending and/or budget overruns. Manual tracking of payments made toward a PO or AP may be inefficient, and could result in payments exceeding approved amounts should computation errors occur.
- b) 1. Lack of appropriate documentation of the reason for non-competitive bid does not demonstrate commitment to fair purchasing practices.  
2. Failure to comply with policies and procedures related to approval and oversight can lead to abuse.
- c) Lack of invoice approval does not demonstrate oversight of the expenditure, or the appropriateness of the purchase.



**CDE Management Comments:**

Agree \_\_\_\_\_ X \_\_\_\_\_

Disagree \_\_\_\_\_

**Corrective Action Plan:** a) CDE's criteria for PO vs. AP basically boils down to whether the goods and services are received at a CDE warehouse location (so that the warehouse and accounting can verify and track amounts) or not. While some items may not clearly fit either category, CDE will ensure that the same level of control and documentation is maintained. To that end, management has developed a new AP form, implemented in July 2015 to ensure this.

The software used does track PO amounts, but not AP amounts. CDE has investigated automated AP tracking with the accounting software vendor, but it is not currently cost effective.

CDE will educate those who make purchases on the importance of obtaining proper approvals before goods are received and services performed.

b) For current contracts, CDE will continue to comply with City Policies for competitive exemption, which consist mostly of obtaining sole source letters, etc. Where expenditures may exceed stated expirations or ceiling amounts, CDE will obtain further approvals.

c) CDE will educate those involved in approving purchases and expenditures of the importance of documenting invoice approval. CDE has modified its AP structure to help stress this importance.

**Projected Completion Date:** In place and ongoing.

**Responsible Manager:** David Johns, CFO; Sean Newman, Purchasing Manager; Gina Wilbur, Accounting Manager

**7. The contract management process is not formalized into comprehensive policies and procedures with assigned responsibilities**

**Criteria:**

Comprehensive contracting policies and procedures should be formalized to define authority, assign responsibilities and establish guidelines to ensure that the contracting process provides for the most effective, compliant and efficient procurement and delivery of goods and services.

**Condition:**

Current policies and procedures address only a few basic areas of the contracting process, and do not formally document its comprehensive structure, all key controls, or the administrative organization of pertinent documentation.

Other findings noted in this report highlight areas needing improved contract administration or management. Additional matters and examples are noted as follows:

Matters Noted	Examples
Contract masters and related attachments were not consistently filed together.	Contract attachments, exhibits, rate schedules, and other pertinent notices were not consistently attached to contract masters for current or historical reference.
Contract terms not mirroring those in the underlying bid/proposal documents or bid files	The percentages of the total contract price to be paid, and the milestones to trigger each payment were negotiated prior to a contract being signed. The negotiation was documented; however the resulting contract did not reflect the documented clarification in milestones or in the percentages to pay at each. In fact, the percentages stated in the contract did not total 100%.
Signature and date lines left blank.	Date lines on contracts were not completed in several instances. A vendor signature was missing from one proposal form.
Process flow of contracting activities is not streamlined	Delay was noted in the awarding of one proposal. Several discussions took place regarding the applicability of bonding and licensing requirements for the service. The procurement would have progressed more efficiently if these discussions had taken place earlier in the process.

**Cause:**

Currently, there is no single department or individual responsible for managing the contracting process. Instead, the process is a collective effort among several individuals to perform certain duties of the overall process. This is achieved primarily through the experience of involved personnel without the aid of comprehensive contracting policies and procedures or control checklists to ensure seamless and consistent completion of necessary steps.

**Effect:**

The potential effects of not having formalized policies and procedures and assigned responsibilities in contract management include, but are not limited to:

- Risk of contract arrangements which do not meet objectives or provide optimal value
- Risk of contract arrangements without proper oversight
- Risk of delay in executing contracts
- Risk of misunderstandings which weaken vendor relations
- Hindrance to continuity of the process during personnel turnover

**Recommendation:**

Recommendations regarding contract management include the following:

- a) Expand City Purchasing policies and procedures related to the contracting process, as well as CDE's, to provide additional structure, guidance and oversight for staff with contracting responsibilities.
  - State *which employees* are responsible for performing *which functions* in *which manner*. State specific *objectives* and the ordered *control activities* necessary to meet those objectives.
  - Integrate risk assessment and monitoring of controls, including IT controls into the process.
  - Re-align the timeliness of steps for optimal control.
  - Utilize a central contract filing system, accessible to appropriate staff. Include all contract documents and related attachments, notices to proceed, notices of award, correspondence, and performance reports for efficient access and effective contract monitoring.
  - The filing system should not only maintain active contract information, but retain historical contract documentation as well.
  - A listing should be maintained to indicate the contract population at current, as well as historical points in time.
- b) Utilize control checklists with the following objectives.
  - Ensure compliance with policies and procedures
  - Include pertinent contract clauses
  - Address optimal risk management
  - Ensure contract file completeness, including signatures and dates
  - Monitor contractor performance
  - Document receipt of contract closeout documentation.
- c) Consider implementing contract management software, or expanding the use of existing software applications to improve the contracting process.
- d) Consider adding a contract management position to the existing organizational structure of the City, of CDE or both, to strengthen contract development, management and monitoring. This would allow City Purchasing and CDE management and personnel to devote more attention to the operational success of the procurement, and less time in the administrative and compliance aspects of contract management. It would also allow for more consistency in the contracting function, and allow for stronger internal controls.

Contracting controls should not be an impediment to effective operations, but rather should be a planned, defined activity to improve efficiency in the process, demonstrate good stewardship and ensure that resources are in place when needed.





Performance bonds, payment bonds, proof of insurance and verification of contractor licenses are all methods of safeguarding assets.

**Condition:**

The following conditions were noted:

- a) A process exists for obtaining proof of insurance and licensing information before a contract is awarded. However, there is no formal process or person assigned responsibility to ensure that renewal certificates of insurance are obtained, or that contractor licensing is re-verified, where contract durations exceed initial expiration dates.
- b) For seven contracts tested, certificates of insurance were obtained upon contract award for all seven. However the following was noted:
  - For three out of seven, the insurance amounts recorded on City Purchasing's Required Forms checklist were less than those required by the bid, proposal or contract documents. Variances ranged from \$1M to \$3M.
  - In two out of seven instances, insurance certificates did not name CDE or the City specifically.
  - Three out of seven insurance certificates were not dated timely in comparison to contract dates.
- c) Formal policies and procedures related to IT internal controls are limited. Accounting duties are segregated where practical; however, access to accounting software functions is not equally segregated. While this is not uncommon with software, there is no documented historical trail of security settings for software access, which could provide a compensating control. Due to the underlying importance of IT as an infrastructure to internal control, the lack of formal IT policies and procedures, risk assessment and monitoring, is considered a weakness.
- d) The auditor noted one work order had a 14 month period of inactivity as noted at Table 4. One construction contract within the work order had an original price of \$167,590. The last processed invoice during the audit period was dated June 30, 2012 and reflected project activity at 84% completion as of that date. No further invoice activity was noted through the end of the audit period (December 31, 2013).

In response to audit inquiry, a change order decreasing the original contract price by \$25,000 was provided to the auditor. The change order was dated August 7, 2012 and was signed by the contractor however there was no approval by CDE or the outside engineer. Additional contract documentation and audit inquiry indicated that contractor releases had not been obtained. No documented resolution to this contract was provided to the auditor.

- e) Performance and payment bonds were not obtained consistently where stated in requests for bids (RFB's) or proposals (RFP's). Of 13 contracts tested, it was noted that two performance bonds and four payment bonds were not obtained where required in the bid/proposal documents.
- f) The master service agreement with the current electric utility engineer dates back to 2005, with no indication of periodic Power Board review. The agreement requires the engineer to maintain professional liability insurance, but does not specify minimum limits of coverage to be maintained as recommended by City insurance requirements.

**Cause:**

- a) **No assigned responsibility for insurance and licensing follow-up** - No one at the City, or at CDE has been specifically assigned responsibility for insurance or licensing follow-up, as it is believed to be a contract management function.
- b) **Insurance coverages less than required** - Underlying bid documents are sometimes prepared in collaboration with outside engineers. Depending on the project, insurance requirements sometime exceed the City's general insurance requirements. Coverages indicated on the City Purchasing Required Form checklist are recorded from the certificates once obtained, and may be compared to the City's general requirements, rather than those stated for the particular project.
- c) **Limited IT policies and procedures, and historical access documentation** - Limited IT resources hinder efforts for formalized documentation of policies and procedures. Control access can be examined on a current basis, but no process was developed for access tracking historically.
- d) **Untimely contract and project closeout** - Once projects and contract services are physically complete and resulting projects are operational, final paperwork completion may not be a priority.
- e) **Bonds not obtained where required by bid documents** - Lack of contract control checklists could contribute to incomplete follow-up.
- f) **Lack of review of older agreements** - No need for master service agreement modification was deemed necessary by CDE management.

**Effect:**

- a) Potential exists for uninsured projects or assets.
- b) Potential exists for underinsured assets.
- c) Unauthorized access, internally or externally, could lead to misappropriated assets.
- d) When work orders remain open past construction completion dates, capital asset accounts and depreciation understatements could result, as well as additional charges to the work order. Where the cause relates to underlying contracts that remain open, lack of obtaining final releases could lead to unnecessary exposure to risk. Misclassification of project costs could result in understated assets or associated depreciation.
- e) Potential exposure exists for liability, noncompliance or underinsured assets. Additionally, the integrity of the procurement process could be questioned when vendors are not required to provide stated protections.
- f) Older agreements can contain outdated terms, language or contact information, and can hold CDE and the City accountable to contract terms that rotating Power Board members or City officials have not been made aware of.

**Recommendation:**

- a) Strengthen risk management to ensure that all projects and assets are properly insured and that all vendors meet licensing requirements throughout the entire life of contracts.
- b) Same as above.
- c) Enhance existing policies and procedures to evidence clear separation of duties for authorization, recordkeeping (posting), custodianship, and review (reconciliation). Where IT access boundaries do not coincide with manual processes, include compensating or mitigating controls. As computing environments in business relationships become more interconnected, cybersecurity controls should be assessed and monitored for all vendor relationships.
- d) Establish a milestone in the latter stages of construction completion for aggressive follow-up of contract closeout documentation, as well as work order closeout. Perform a final review of work orders before closing to ensure that all project costs are included based on initial project budgets.
- e) Secure and maintain all bonding to properly safeguard assets and reduce risk exposure for projects and contracts. Additionally, implement controls to ensure that all protections required of the vendors are obtained on a timely and consistent basis as stated in procurement documents and state requirements.
- f) Power Board review of older agreements should be performed at periodic intervals to ensure adherence to current objectives, as well as compliance with applicable rules, regulations and policies. Ensure that all updated vendor correspondence and acknowledgements are on file.



three to six months from completion to allow all invoices to be paid associated with the project. CDE's Plant accountant discusses the project with the engineer to be sure of closing. Substations are generally the most extensive projects. The work order is established to capture all of the cost from the purchase and preparation of the site through the energizing of the station. Normal procedure would have been for the work to be closed by June 2013 year end, which would have allowed for all invoices to be presented for payment. However, due to an oversight this did not happen. Plant accounting position changed late 2013 and the work order was not closed until year end of June 2014.

To avoid this from occurring in the future, the plant accountant will review hold opens in depth quarterly (at a minimum) with notation as to the reason it will be held open if it is not to be closed at that time. IT Department is developing a query of the last transaction date of the hold open work orders.

e) CDE would expect to handle additional controls over bonding in much the same way insurance and licensing items, as noted above.

f) CDE had operated under the guidance that older contracts will be brought into compliance with the "new" requirements as they are renewed, extended, or re-bid. CDE's purchasing manager does do a periodic review of older agreements, at least annually. CDE will communicate the results of these reviews (which contain very few older agreements still in place) to the Board at least annually.

**Projected Completion Date: 12/31/2015**

**Responsible Manager: a) and b) Sean Newman, Purchasing Manager; c) Steve Pennington, IT Manager; d) Gina Wilbur, Accounting Manager; e) Sean Newman, Purchasing Manager; f) Sean Newman, Purchasing Manager**

## **Other Recommendations**

Looking forward, the Internal Audit department strongly encourages communication between departments to develop an integrated approach to internal controls over the contracting process. City Purchasing and CDE are on two separate accounting systems and this fact needs to be considered when assessing the overall process. Each department's control structure is designed to work with its own accounting system; therefore the differences should be understood when evaluating the process taken as a whole.

Internal Audit also recommends consistency where possible in communicating "right to audit" language in accordance with city-approved wording. This wording is included in vendor applications, as well as forms distributed by City Purchasing for competitive awards. It is preferred that this language be incorporated into contracts as well, particularly for those exempt from competitive bidding.





Safeguarding of assets associated with the contracting process was lacking based on results of audit testing in the following areas:

- Contractor insurance, bonds and licensing verifications were not monitored effectively, particularly in instances where contract durations exceeded initial contractor expirations.
- Documentation of policies and procedures related to IT controls were limited.
- Contract and work order closeout was not timely.
- Monitoring of older agreements for compliance with current City procedures was not evident.

The following recommendations are included in our audit report related to the internal control system to improve the effectiveness and efficiency of operations goals and financial reporting:

- Due to the number of departments, divisions, and people involved in the contracting process, establish more structured procedures for contract management and administration at the City and at CDE. State which employees are responsible for which functions to be performed in which manner. State objectives and the ordered control activities to meet objectives. Address risk management and monitoring controls. An integrated approach to internal control design should consider the differences in accounting software used by the City and CDE.
- Improve bid communications and documentation to proactively strengthen contracts and the integrity of the contracting process.
- Strengthen existing policies and procedures to control approval authority, oversight and process flow for all contract modifications.
- Document appropriate oversight and accountability in approving purchases and payments.
- Record construction retainage in accordance with generally accepted accounting principles (GAAP).

The following recommendations are made to strengthen compliance with City Code and other regulations:

- Reinforce the process for obtaining employee and vendor conflict of interest acknowledgements.
- Document consistent compliance with City Code and other City procedures pertaining to contract approval by the Power Board, signature by the Mayor, and approval by the City Attorney as to legal form.
- Implement procedures to ensure that construction retainage withholdings comply with state law.

Recommendations to improve safeguarding of assets are as follows:

- Assign responsibility for monitoring insurance, bonds and licensing, particularly when contract durations exceed original expirations.
- Assess, document and monitor cybersecurity controls, including segregation of duties, for all vendor relationships.
- Establish procedures to facilitate and monitor timely contract and work order closeouts.

- **Inventory older agreements and determine whether current requirements are being met. Perform Power Board review of all master service agreements periodically.**

**In order to add value and improve operations of the contracting process, the following recommendations are made in addition to those noted above:**

- **Consider adding a contract management position to the existing organizational structure to improve efficiencies and increase oversight of the complete process.**
- **Consider contract management software, or utilize existing software and other tools to improve completeness and consistency in the process.**
- **Pursue training initiatives and certification programs to enhance skills in purchasing and contracting.**

**Additional recommendations:**

- **Communicate “right to audit” language consistently when possible, particularly where purchases are exempt from competitive bidding.**
- **Clarify vendor expectations where contract provisions give vendors the right to audit CDE data.**

**The auditor would like to thank CDE’s staff and management, as well as the City Purchasing department, and the City Attorney’s office for their help and support during the performance of this audit. Their positive attitude facilitated the conduct of the audit and provides the necessary environment for process improvements to take place.**

**If further information about this audit is desired please contact Internal Audit at 931-648-6106.**

# APPENDIX 1

## CONTRACTING PROCESS CYCLE (Competitive Procurement Process)

### PLANNING PHASE

- Procurement need is determined
- CDE operations managers & engineering (& outside engineers if engaged) determine design and specifications
- CDE purchasing manager performs procurement planning
- City of Clarksville purchasing department prepares for solicitation
- Collective collaboration to determine appropriate procurement method
- Collective collaboration to refine scope, specifications, contract draft, evaluation criteria and procurement timeline

### SOLICITATION PHASE

- City purchasing develops/issues solicitation packages to vendors (RFB, RFP, RFQs); advertising by city code
- Collaboration with outside engineering firm, if engaged
- Pre-bid conferences, addendums, question and answer period conducted if applicable
- Vendors respond to solicitation requests
- City purchasing receives bid/proposal, conducts bid openings, verifies validity of bid submissions including receipt of required forms, bond, licenses & insurance certificates, as applicable

### EVALUATION PHASE

- CDE performs evaluation of bids/proposals based on stated criteria
- Where outside engineering firm is used, firm performs evaluation and makes recommendations
- Collaboration with city purchasing and/or city legal department as necessary
- Vendor decision for pending award is made, (vendor application must be on file before award granted)
- City bid summary/recommendation sheet is approved by CDE superintendent, op mgrs, CFO and city purchasing
- CDE superintendent reviews contract, collaborates with city legal department as necessary
- CDE Power Board reviews award, approves contract, city legal approves for legal form, Mayor signs contract

### AWARD PHASE

- CDE notifies vendors of successful, unsuccessful outcomes
- Vendor signs and returns 4 copies of contract distributed to CDE purchasing, CDE executive assistant, city purchasing and vendor
- CDE purchasing issues purchase order (PO) or authorization to purchase (AP) and adds contract to master list
- CDE managers approve PO's or AP's, CDE purchasing manager initials, board minutes are attached to indicate review and/or approvals

### CONTRACT LIFE

- Vendor provides goods/services and invoices CDE. Where outside engineers are used, firm reviews, certifies, recommends for payment
- CDE financial accounting department processes invoices and generates payments under accounting policies and procedures through life of contract until closeout. Contract performance is monitored by CDE.
- Where outside engineering firm is engaged, assistance is provided in obtaining required close out documentation
- 3 months prior to expiration, CDE purchasing notifies operations managers who repeat process if to be renewed.