



OFFICE OF THE CITY AUDITOR
COLORADO SPRINGS, COLORADO

12-09
Colorado Springs Utilities
Procurement Audit
Report

May 2012



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12-09 Colorado Springs Utilities Procurement Audit

May 2012

Purpose

The purpose of this audit was to evaluate whether the Colorado Springs Utilities procurement process provided reasonable assurance that best value was obtained for goods and services, determine compliance with Colorado Springs Utilities policies and procedures, and review the adequacy of internal controls.

Highlights

Our audit period included purchase orders and contracts executed from January 1 through December 31, 2010. We concluded that overall, the controls in the procurement process provided reasonable assurance that best value was obtained for goods and services, compliance with internal policies and procedures was achieved, and resources were safeguarded.

Colorado Springs Utilities issued approximately \$22.4 million in standard purchase orders in 2010 and maintained approximately \$968 million in standard contracts. Colorado Springs Utilities issued approximately \$223 million purchase order releases on these contracts. Procurement and Contract Services, which reports to the Financial Services organization, had primary responsibility for procurement of goods and services. Additionally, some procurement duties were performed by Operations personnel in Materials Management. Energy Services negotiated and entered into fuel contracts on behalf of Colorado Springs Utilities.

Our methodology included detail testing of a sample of various types of purchases and contracts to determine compliance with policies and procedures, as follows:

- Reviewed a sample of Contracts and Solicitations to ensure bid solicitations followed policy and selection of best value was documented,

(Continued on page 2)

Management Response

Management was generally in agreement with our recommendations. Responses can be found in the attached report.

Recommendations

1. Contracts and amendments exceeding given terms or dollar amounts should require approval by senior management in addition to the Energy Services Officer.
2. Water Services personnel should review the duties assigned to the inventory specialist in the Water Services Division.
3. Colorado Springs Utilities should review access levels to ensure that dollar limits are in accordance with policy and consistent with limits assigned to supervisors.

Opportunity for Improvement

1. Materials Management should consider reinstating the process to track vendor performance. Procurement and Contract Services should consider the cost benefit of tracking vendor performance data in a standardized format for consideration in future contracting decisions.

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(Highlights continued from page 1)

- Reviewed a sample of change orders to ensure proper documentation and approval,
- Reviewed a sample of sole source justifications for proper documentation and approval, and
- Tested to determine that goods and services were requisitioned and approved in accordance with policy.

Our testing indicated compliance with policies and procedures in place related to procurement.

We noted that Energy Supply contracts did not require review and approval outside the Energy Services Division. Additionally, we noted segregation of duties risks existed for procurement activities performed by Storeroom personnel in the Water Services Division.



OFFICE OF THE CITY AUDITOR PUBLIC REPORT

Date: May 9, 2012

To: President Hente and President Pro-Tem Martin, Members of City Council

Re: 12-09 Colorado Springs Utilities Procurement

We conducted an audit of Colorado Springs Utilities Procurement as part of our regular cycle of audits. Our audit focused on the period from January 1, 2010 through December 31, 2010.

The purpose of this audit was to evaluate whether the Colorado Springs Utilities procurement process provided reasonable assurance that goods and services were obtained at best value for the organization while adequately safeguarding resources. We also evaluated whether Colorado Springs Utilities complied with the internal policies and procedures in place for acquiring goods and services.

We conclude that overall, procurement processes ensure 1) goods and services were acquired at best value for the organization, 2) policies and procedures in place were followed, and 3) controls were adequate to ensure safeguarding of resources. We made three observations related to segregation of duties and internal controls. We have listed our recommendations related to these observations in the attached report.

We would like to thank Colorado Springs Utilities Procurement and Contract Services for their time and help in completing this audit.

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

Sincerely,

Denny Nester, MBA, CPA, CIA, CGFM, CFE, CGAP
City Auditor

Cc: Jerry Forte, Colorado Springs Utilities Chief Executive Officer
Gary Bostrom, Chief Water Services Officer
Bill Cherrier, Chief Planning and Financial Officer
Carl Cruz, Chief Customer and Corporate Services Officer
Bruce McCormick, Chief Energy Services Officer
Leah Ash, General Manager, Distribution, Collection and Treatment
Dede Jones, General Manager, Financial Services
George Luke, General Manager, Energy Supply
Mason Parsaye, General Manager, Energy Construction, Operations and Maintenance
Dawn Roth, General Manager, Information Technology Services

Cc (Continued):

Michele Fujimoto, Manager, Fuel and Materials
William Lopez, Jr., Manager, Resource Technology Services
Greg Mitchell, Manager, Energy Support Services
Eli Novakovich, Manager, Procurement and Contract Services
David Maier, Manager, Enterprise Risk Management Services
Patricia Van Meter, Senior Analyst, Enterprise Risk Management



OFFICE OF THE CITY AUDITOR PUBLIC REPORT

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REPORT DETAILS

PURPOSE

We performed an audit of Colorado Springs Utilities procurement function as part of our regular cycle audits. The purpose of this audit was to evaluate whether the procurement process provided reasonable assurance that best value was obtained for goods and services, and determine compliance with internal policies and procedures. We also reviewed the adequacy of internal controls over procurement.

SCOPE AND METHODOLOGY

The scope of the audit included reviewing the processes used in 1) initiating and approving purchases and contracts, 2) soliciting bids and prices, and 3) processing purchase orders. We assessed controls in place in the Resource Management System (RMS) as well as segregation of duties related to procurement within the organization. Our audit included purchase orders and contracts executed from January 1 through December 31, 2010.

Our methodology included detail testing of a sample of various types of purchases and contracts to determine compliance with policies and procedures. We obtained an understanding of the internal control structure by reviewing procurement policies and conducting interviews with management. Our tests included reviews for compliance with policy and procedures as follows:

- Reviewed a sample of Contracts and Purchase Orders to ensure bid solicitations followed policy and selection of best value bid or proposal to the organization was properly documented,
- Reviewed a sample of change orders to ensure proper documentation and approval,
- Reviewed a sample of sole source justifications for proper documentation and approval, and
- Tested to determine that goods and services were requisitioned and approved in accordance with policy.

Our testing indicated compliance with policies and procedures in place related to procurement.

In addition to procurement activities processed by the Procurement and Contract Services section, we inquired of Colorado Springs Utilities managers throughout the organization to identify any significant procurement activities conducted by other groups in the organization and included these in our scope.

BACKGROUND

The Office of the City Auditor previously performed an audit of Colorado Springs Utilities procurement for the six months ended January 1 to June 30, 2007, which was issued November 12, 2008. Some issues had been resolved when we performed follow-up procedures in 2009. Three recommendations

were to be implemented when the procurement software was upgraded. The City Auditor's Office noted these recommendations had been implemented when follow-up was performed in 2010.

Procurement and Contract Services (PCS), which reports to the Financial Services organization, had primary responsibility to procure goods and services on behalf of Colorado Springs Utilities. Additionally, the Materials Management groups within the Energy Services Division had the authority to procure goods and services under standard (non-blanket) purchase orders up to \$50,000. Storeroom personnel in the Distribution, Collection and Treatment Department within the Water Division also had the authority to create and approve purchase orders for goods and services up to \$50,000.

Fuel and Materials Management personnel within the Energy Services Division negotiated and entered into short and long term contracts for coal and oil on behalf of the organization. The Portfolio Management Department within Energy Services negotiated and executed contracts for natural gas supplies for Colorado Springs Utilities.

Under policy and procedures in place, goods and services could be obtained on a one-time basis or by issuing a release against a blanket order for goods or services. Contract terms were generally for three years, with two one-year renewal options. Contracts or blanket orders could be renewed for an additional term if requested by the Colorado Springs Utilities business unit and approved by Procurement and Contract Services.

Quotations were required for purchases over \$10,000 not covered under blanket purchase orders or contracts. Colorado Springs Utilities policy required that the requestor document and obtain approval for instances in which bids or quotations would not be obtained for purchases of goods or services, known as sole source purchases. According to policy, sole source purchases were allowed when only one source for the product or service existed, or conditions such as a business need to standardize equipment, or when replacement parts were available only from the original equipment manufacturer. These sole source purchases were summarized in a monthly report to Colorado Springs Utilities Officers.

Colorado Springs Utilities issued approximately \$22.4 million in standard purchase orders in 2010 and maintained approximately \$968 million in active contracts. CSU issued close to \$223 million purchase order releases on these contracts.

As stated in the purpose section of the report, this audit was performed as a regular cycle audit of major business processes. The City Auditor's Office also performs on-going audits of procurement activities related to the Southern Delivery System Construction Project. Please refer to Report 11-22 [SDS Project Monitoring Report](#) for procurement-related observations, which were not included here.

CONCLUSION

We conclude that overall, the controls in the procurement process provided reasonable assurance that 1) best value was obtained for goods and services, 2) compliance with internal policies and procedures was achieved, and 3) resources were safeguarded. However, during the course of our audit, we identified areas where improvements could be made to further strengthen controls. These areas are detailed on the pages that follow.

OBSERVATIONS, RECOMMENDATIONS AND RESPONSES

OBSERVATION 1 – ENERGY SUPPLY CONTRACTS DID NOT REQUIRE REVIEW AND APPROVAL OUTSIDE THE ENERGY SERVICES DIVISION

The Fuel and Materials Management Department within the Energy Services Division negotiated and entered into long term coal contracts on behalf of Colorado Springs Utilities. During our audit period, the Energy Supply General Manager was authorized to enter into any contract having a term of two years or less. Contracts with terms over two years could be approved by the Energy Services Officer. We understand that management outside of the Energy Services Division was aware of significant contracting activities through informal processes; however, additional approvals for contracts exceeding a given dollar amount or term were not required. Procurement and Contract Services did not participate in the solicitation or negotiation process for long term fuel contracts.

Requiring reviews and approvals of management outside the Energy Services Division for significant contracts and amendments would help ensure independent and objective evaluation that fully considers potential risks and benefits to the organization.

AUDITOR'S RECOMMENDATION

Contracts and amendments exceeding terms or dollar amounts to be specified by Colorado Springs Utilities' management should require approval by senior management in addition to the Energy Services Officer.

COLORADO SPRINGS UTILITIES RESPONSE

Colorado Springs Utilities, specifically Enterprise Risk Management and Procurement and Contract Services, agrees with this recommendation. However, an Enterprise-wide policy is currently not in place for high-value contracts, which would include coal contracts. A new policy is currently under development that includes provisions relating to authorization levels and execution responsibilities. This policy is expected to be approved and in place during 2012. Until the new policy is finalized, we cannot require individual Divisions with high-value contracts to comply with the City Auditor's recommendation. In the interim, the Energy Services Division will continue to comply with the existing Risk Management Policy, which was developed and approved by the Officer team. Colorado Springs Utilities acknowledges the risks associated with energy commodities purchases, and the Energy Services Division has developed additional policies and procedures to mitigate such risks. However, providing additional transparency on larger value contracts will ensure obligations potentially impacting other areas of the organization are identified and understood.

OBSERVATION 2 - SEGREGATION OF DUTIES RISKS EXISTED IN THE WATER SERVICES DIVISION

Segregation of duties involves separating certain areas of responsibility and duties in an effort to reduce the possibility of fraud and unintended mistakes. Management should establish procedures to separate duties and responsibilities of personnel who create purchase orders, perform a receiving function for goods or services, and authorize payment.

As part of our audit, we examined the processes for requisitioning, ordering, receiving, and processing payments for goods and services. Management should be aware that the lack of segregation of duties increases the risk that employees could purchase goods or services for personal use.

In the Distribution and Collection Treatment Department within the Water Services Division, we noted that the procurement associate had the ability to create and approve a requisition for stock or non-stock goods, create and approve releases against blanket orders, or create and approve standard (non-blanket) purchase orders up to \$50,000, and had the ability to receive these items in the system and issue materials. This employee could perform cycle counts, but could not make inventory adjustments.

We understand that staff is limited in the Water Services Division Storeroom and some system access was assigned to the Procurement Associate to allow backup in the event the Materials Technician was not available. However, the employee had the ability to requisition, procure, receive, and issue materials without involvement from a second person.

AUDITOR'S RECOMMENDATION

Water Services Group Management should review the duties assigned to the procurement associate in the Water Services Division. Segregation of duties would be improved if another employee was required to approve requisitions, approve purchase orders, or acknowledge receipt of goods or services ordered by the Procurement Associate Specialist. Management should evaluate the necessity of allowing the Procurement Associate to create and approve standard purchase orders.

COLORADO SPRINGS UTILITIES RESPONSE

Colorado Springs Utilities agrees with this recommendation. The observations are related to the Las Vegas Warehouse facility which provides storeroom services for the Distribution, Collection and Treatment Department. The following system security authorizations and procedures were changed as of January 12, 2012.

1. The Procurement Associate can no longer receive materials. This authorization was granted several years ago to cover the Materials Technician's duties when out of office. The procedural change will be to train Planner Analysts to perform receiving duties whenever the Materials Technician is out of office for a week or more.

2. The Procurement Associate will not be allowed to perform cycle counts; however, this individual will make the inventory balance adjustments. The Materials Technician will continue to perform the cycle counts, but will no longer make inventory balance adjustments.
3. The Las Vegas Warehouse Procurement Associate's security authorization within the Maximo system for standard purchase orders now matches other Procurement Associates across the organization.
4. The Las Vegas Warehouse Supervisor's Maximo security authorizations now match the other Warehouse Supervisors across the organization. The procedural change will require that when the Warehouse Supervisor is out of office, the General Manager of the Distribution, Collection and Treatment Department will be the next responsible approver as needed. If approvals are required by the General Manager, it will require a security authorization change request to the Maximo security work group.

OBSERVATION 3 – SIX EMPLOYEES HAD HIGHER SYSTEM REQUISITION LIMITS THAN THEIR SUPERVISOR

Six instances were noted during our audit in which an employee's manager had lower requisition limits than one of the employees reporting to the manager. The number of employees with higher limits than their manager had improved since the prior audit, where 21 instances were reported. Requisitions would be subject to supervisory approval, regardless of the manager's approval limits. Although the number of instances was not significant in comparison to the user population, these instances indicated that requisition limits may not be subject to review on a regular basis.

AUDITOR'S RECOMMENDATION

Colorado Springs Utilities should put in place a review of access levels to ensure that requisition dollar limits are in accordance with policy and are consistent with limits assigned to supervisors. Additionally, Colorado Springs Utilities should ensure that requisition limits are reviewed for appropriateness and consistency with the supervisor's limits when an employee changes positions within the organization. This assurance could be accomplished by adding requisition dollar limits to standard documents such as checklists completed for position changes.

COLORADO SPRINGS UTILITIES RESPONSE

Colorado Springs Utilities agrees with this recommendation. Information Technology (IT) has implemented a quarterly review process to verify the system procurement levels for appropriateness. Exception reports developed will identify approval limit anomalies between employee and supervisor levels. Authorized IT personnel will make any corrections or updates needed, based on the established procurement limits which are defined by position/role. These reports will be executed on or before the 15th day prior to the last day of each quarter. Information Technology has also implemented a modification to the Personnel Action process, which now requires IT personnel to evaluate and modify the procurement limits as defined by the employee's new role. The Personnel Action process is a component of the automated Human Resources notification system for personnel changes. Occasionally unique circumstances may require a deviation from the established procurement limits; however, an oversight process is in place to address these situations as documented in QBD #12928, Change Individual Purchase Requisition or Release PO Limits. Expected date for completion is June 30, 2012.

OPPORTUNITY FOR IMPROVEMENT

OPPORTUNITY 1 – VENDOR PERFORMANCE WAS NOT TRACKED AND REPORTED

As noted in the background to this report, most procurement activities for the organization are performed by Procurement and Contract Services. The Materials Management function within Energy Services maintains storerooms and also performs some procurement activities for the Energy Services Division.

Materials Management previously had a process in place to capture vendor performance data related to stock and non-stock items for ten vendors from which the most purchases were made. Data tracked included timeliness of delivery, errors, and customer service issues. This data was utilized in performance improvement discussions with vendors. At the time of our review, Materials Management had not been gathering vendor performance data for approximately one year due to a position vacancy. Vendor performance is currently not documented or tracked on an on-going basis by the Procurement and Contract Services Department within Colorado Springs Utilities. Procurement and Contract Services entered any reports received of vendor performance issues into a database. However, other than the Materials Management tracking noted above, the organization did not have a process to obtain vendor performance data from end users in a standard format for use in future procurement decisions.

AUDITOR'S RECOMMENDATION

The Materials Management group within Energy Services should consider reinstating the previous process to track vendor performance. Procurement and Contract Services should consider the cost benefit of obtaining vendor performance data in a standardized format so that performance can be appropriately considered in future contracting decisions.

COLORADO SPRINGS UTILITIES RESPONSE

Colorado Springs Utilities partially agrees with this recommendation. Management of the Energy Construction, Operations and Maintenance Department (ECOM) is in agreement with the City Auditor's recommendation concerning vendor performance tracking. ECOM's Materials Management employees will reinstate the previous process to track vendor performance beginning in July 2012. This process will be performed on our top eight to ten suppliers by the end of 2012, and repeated with each supplier several times during 2013. Data that will be tracked and shared with these key suppliers will include timeliness of delivery, errors, customer service issues, and discussions concerning how they can improve their services and processes. ECOM's Materials Management will also request input from these suppliers on how Colorado Springs Utilities can improve our communications, forecasting and responses to their questions or needs.

Procurement and Contract Services (PCS) does not believe there would be a benefit in adopting a new process using a standardized format for managing vendor performance. The administrative burden would be significant for Project Managers, as well as Contracting Agents. As a contracting department, PCS manages performance contemporaneously via numerous tools including: cure notices, terminations (both for performance and for convenience), suspensions, disqualifications, bidder prequalification and law suits - all of which were used in 2011. Furthermore, vendor past performance may be considered in the solicitation process. Unique jobs (work scopes) required of vendors make simple standardization difficult. If resources become available, PCS will consider adopting a performance management tool as recommended by the City Auditor.

CITY COUNCIL'S OFFICE OF THE CITY AUDITOR

COLORADO SPRINGS, COLORADO

About our Office

The mission of the Office of the City Auditor is to provide City Council with an independent, objective and comprehensive auditing program for operations of the City. Our auditing program includes:

- Evaluating the adequacy of financial controls, records and operations
- Evaluating the effectiveness and efficiency of organizational operations
- Providing Council, management and employees objective analysis, appraisals, and recommendations for improving systems and activities

The Office of the City Auditor is responsible for auditing the systems used by the City of Colorado Springs and its enterprises, including Colorado Springs Utilities and Memorial Health System. We perform a variety of audits for these entities, including financial audits, performance audits, contract audits, construction audits, and information system audits. We also perform follow-up on a periodic basis to monitor and ensure management actions have been effectively implemented.

Authorization and Organizational Placement

Our audits are conducted under the authority of Chapter 1, Article 2, Part 7 of the Colorado Springs City Code, and more specifically parts 703, 705 and 706 of the Code. 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 the City Council.

Audit Standards

The audit was conducted in a manner that meets or exceeds the International Standards for the Professional Practice of Internal Auditing, a part of the Professional Practices Framework promulgated by the Institute of Internal Auditors, with the exception of the requirements under standards 1312 and 1321 to obtain an external quality assurance review once every five years. We do not believe this non-compliance impacted the quality of our audit.

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.