



Audit Report Number 2005-01
City of Richmond
Department of Public Utilities
Special Investigation – Cast Iron Renewal Contract
April 2001 through April 2004

Prepared by
CITY AUDITOR
Richmond, Virginia

Submitted to
The Honorable Members of City Council
August 26, 2004

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The Honorable Members of City Council
Richmond City Audit Committee
City of Richmond, Virginia 23219

City Auditor's Report

SCOPE

As part of this special investigation, we reviewed the records of work performed and payments issued in the Cast Iron Renewal Contract (gas services) issued by the Department of Public Utilities (DPU) for the period April 2001 through April 2004. We have reviewed and evaluated their system of internal controls for the same period to the extent considered necessary.

OBJECTIVE

Our audit objectives were to determine whether DPU overpaid RTS Construction Company for work performed and if payments were issued for work not performed.

We also identified opportunities for improvement in the internal control structure. Our testing indicated weaknesses in the internal control system that would allow material misstatements in the records processed and maintained by the City to go undetected.

METHODOLOGY

This was not an audit in accordance with Government Auditing Standards for Performance Audits issued by the Comptroller General of the United States. However, during the course of our work, we reviewed supporting documents, evaluated management controls, and conducted other appropriate tests that were in accordance with these Government Auditing Standards. We believe that our work provides a reasonable basis for our conclusions and our recommendations.

CONCLUSIONS

- The Department needs to re-establish internal controls in the New Construction Division, since such controls in this area were extremely weak. These weaknesses led to:
 - Duplicate payments

- Payments for unperformed services
 - Verbal agreements/change orders to the contract among DPU staff and RTS staff
 - Erroneous payments
- The Department needs to implement formal policies and procedures for the operation of the Cast Iron Renewal Contract. These policies and procedures should be similar to any well-managed services contracts.

The management of the City of Richmond, Virginia, is responsible for maintaining financial records. It is also responsible for establishing and maintaining a system of internal accounting controls and management controls. In fulfilling this responsibility, management is required to assess the expected benefits and related costs of control procedures.

We discussed the attached comments and recommendations with management throughout the audit and formally on **August 18, 2004**. We have included management responses from the responsible officials.

We would like to thank the departmental management, staff, and RTS Construction Company for their cooperation and assistance during this audit.

This report is intended for the members of the Richmond City Council, the City Audit Committee, the City and departmental management; it is a matter of public record.

Respectfully submitted,

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July 29, 2004

Executive Summary

Background

The Richmond Police Department's Criminal Investigative Unit contacted the City Auditor's Office to inform the Office that they had received a call alleging that the Department of Public Utilities (DPU) had made payments to RTS Construction Company for work not performed.

The allegation included concerns that the pay items did not match the work performed.

The Cast Iron Renewal Contract covers general contacting services for the replacement of old, existing gas mains within the City of Richmond's gas systems. This includes gas mains in the City of Richmond, Henrico and Chesterfield Counties. It also covers the renewal of any existing gas mains and service lines.

The Contract contains a price listing of 107 items, which specifies allowable charges for each item. Below is a synopsis of some of the pay items in question:

- **Pay item 61:** Gas meter relocation from inside of the home to outside with a length of 15 feet and under. The charge for each pay item is \$300.
- **Pay item 62:** Gas meter relocations from inside of the home to outside with a length of over 15 feet. The charge for each item is \$600.
- **Pay item 85:** Force Account – Foreman. Charge for each hour was \$20. This changed to \$21 per hour in April 2003.
- **Pay item 88:** Force Account – Pipe fitter. Charge for each hour was \$8. This changed to \$8.40 per hour in April 2003.
- **Pay item 89:** Force Account – Laborer. Charge for each hour was \$7. This changed to \$7.35 per hour in April 2003.

Definitions

Tally Sheet – Form filled out by RTS Construction Company when work was performed.

Pay Ticket – Payment form filled out by DPU to record work performed by RTS. This becomes DPU’s basis for paying RTS.

The following below summarizes the financial results of the special investigation:

Summary of over/underpayments

Duplicate payments	\$82,986.06
Erroneous payments – net	24,570.91
Subtotal	107,556.97

Verbal Agreement

Flexible pipes	(41,400.00)*
Grand total (due to the City)	\$66,156.97

*See Recommendation #3 for further details.

Summary of Recommendations

In order to improve operations and better achieve the Department’s objectives, we recommend the following for management’s consideration. Management should:

1. Establish controls to prevent duplicate payments (**Major**). The internal control weaknesses contributed to numerous duplicate payments.
2. Re-establish controls to prevent erroneous payments (**Major**). Lack of supervisory monitoring led to erroneous payments.
3. Follow the proper City Procurement Procedures when making changes to an existing contract (**Major**). DPU staff engaged in a verbal agreement with RTS.
4. Establish formal policies and procedures. The inspectors did not have formal policies and procedures for the Cast Iron Renewal Contract.

FINDINGS AND RECOMMENDATIONS

1. Establish Controls to Prevent Duplicate Payments (Major)

During our review of the Cast Iron Renewal Contract (gas service area), we noted DPU made various duplicate payments to RTS Construction Company for work performed. The Department should have controls in place to prevent such occurrences. DPU made duplicate payments of **\$82,986.06** to RTS as follows:

- \$26,100 for meter relocations (items 61 and 62 in the contract price listing)
- \$56,886.06 for other services, such as renewal services.

We observed that DPU made these duplicate payments because:

- The inspectors were not properly monitored by their supervisor. The Construction Inspector III did not perform his duties as management intended. All pay tickets were to be submitted to him for approval and for random field observations. This did not happen.
- One inspector was responsible for filling out all the pay tickets, even for the work he did not inspect. There was no communication between the other field inspectors who actually inspected the work performed and the inspector who filled out the pay tickets. As a result, payments were approved without verifying the work was actually done and without verifying the propriety of the line items charged (see attachment A). The Inspector relied solely on tally sheets submitted by the Contractor's Foremen. Some of these tally sheets included duplicate services for the same addresses.
- Careless errors by the inspector who filled out the pay tickets. He paid for items that were either crossed out or had lines across them.
- There was a lack of proper training and procedures to follow in regards to reporting their observations.

RECOMMENDATION

We recommend that management ensure that:

- A. The inspectors are properly monitored. The Construction Inspector III should receive all pay tickets written by the inspectors who actually perform the observations.
- B. The Inspector III submits a monthly report of his random observations to his supervisor.
- C. Inspectors are properly trained.

MANAGEMENT RESPONSE

We concur with the recommendations.

- Management has reemphasized basic inspection and documentation procedures.
- All pay tickets are now being prepared by the assigned construction inspector. Pay tickets are now forwarded to the Construction Inspector III for review and approval before submission for payment.
- Construction Inspector III will perform monthly random observations of field staff and document results in a formal written monthly report to management.

Inspectors follow industry standard construction guidelines for inspection purposes. These guidelines, as well as documentation procedures will be incorporated in a training session by October 31, 2004. Periodic refresher training will be conducted on an ongoing basis. These training requirements will be included in work plans and 2004 - 2005 performance agreements for field supervisory staff.



2. Re-establish Controls to Prevent Erroneous Payments (Major)

DPU made payments for work that was:

- a. not performed, or
- b. paid incorrectly.

Erroneous payments were made as follows:

- 72 meters were paid as relocations. However, these meters were not moved. Payments total \$35,400
- 91 meters should have been paid at the hourly rate (outside move, not inside to outside the house). However, they were paid as meter relocations (\$300 or \$600 each). Net payments of \$27,417.90
- 13 meters relocated from inside the house to outside were paid at \$600 instead of \$300. Total over payments of \$3,900
- One meter relocation was paid at \$300 instead of \$600. Underpaid RTS (\$300)

We noted the price listing for the Cast Iron Renewal Contract did not include a specific line item that addressed outside meter relocations or what constituted a relocation. Additionally, the description for inside to outside meter relocations was abbreviated in the RTS tally sheet, making it difficult to determine what work they actually did. For example pay item 61 was abbreviated to "Relocation meter up to 15". However, the contract price listing describes pay item 61 as "Gas meter relocation form inside of home to outside (length of 15 feet and under)."

Other errors noted: the City **overpaid** for some services:

- Payments were issued for two addresses that did not exist. Payments totaled \$2,358.70
- Other computation and coding errors totaled \$6,209.71

Various services performed by RTS were **not paid**:

- 22 meters, that were relocated, were not billed. Total amount not billed \$8,400
- Several addresses were improperly paid at the hourly rate. However, they should have been paid at a flat rate. Total amount not billed \$40,700
- Other errors totaled \$1,315.40

The net effect for the above items was \$24,570.91 due to the City.

The lack of oversight by various levels of management, the lack of training, and the lack of communication among the inspectors contributed to the erroneous payments.

RECOMMENDATION

We recommend that management:

- A. Add a line item to the contract price listing to specifically address different kinds of meter relocations.
- B. Hold a training session for the inspectors to ensure they understand the proper pay items.
- C. Require RTS to change their tally sheet to clearly describe the contract pay items.

MANAGEMENT RESPONSE

We concur with the recommendations

- The contract extract for the current contract period now includes additional pay items for meter relocations.
- The complete list of pay items covered by the contract will be part of the inspector training session to be conducted by August 31, 2004.

RTS has revised their tally sheet to clearly describe the contract pay items.



3. Follow Procurement Procedures when Making Changes to an Existing Contract (Major)

Multiple meter relocations (six or more meters in one location) over-15-feet were paid at the 15-feet-or-under price. According to management there was a verbal agreement between a DPU Supervisor and a RTS Supervisor to use flexible pipes to reduce costs for both DPU and RTS. The City would save money by paying RTS \$300 instead of \$600 (although the flexible pipes were somewhat more expensive) RTS would save money by reducing the labor cost by approximately 50%. The City furnished the required materials.

This verbal agreement bypassed Procurement Services and was not covered by the contract. Verbal agreements between the staffs for the City and RTS broke down the controls in place. According to Procurement Services Policy #36, change orders, supplements and addenda must be approved by the Director of Procurement Services in advance of implementation. Some larger changes must be approved by the City Manager.

Since staff bypassed Procurement Services, this verbal agreement can be revoked. If RTS does not abide by the verbal agreement, DPU will have to pay RTS \$41,400 for the difference of 138 meters paid at \$300 instead of \$600. This only includes payments made as of April 2004.

RECOMMENDATION

We recommend that the DPU administration:

- A. Take corrective action once they determine why middle managers believed they could bypass contractual agreements.
- B. Formally instruct the staff regarding verbal agreements. Emphasize that written approvals should be obtained from Procurement Services prior to making changes to the contract.
- C. Obtain a written change order for flexible pipes before they continue installing them.

MANAGEMENT RESPONSE

We concur with the recommendations

- Management will take appropriate corrective action by September 30, 2004.
- Operations staff was reminded during July, 2004 that agreements with vendors must be processed through Procurement Services and documented with a change order for the benefit of contractors as well as the City of Richmond.
- We are currently in the process of developing departmental procedures which will detail the appropriate steps regarding contract administration. These procedures will be completed and training will have taken place by December 2004.

- The current contract has been revised to include the use of flex pipe and appropriate pay items have been added.



4. Establish Formal Policies and Procedures Guidelines

Formal (i.e., written) policies and procedures did not exist for the operations of the Cast Iron Renewal Contract. Written procedures should be available to enhance the effective operation of any department. Written procedures:

- help ensure management that operations are executed according to its intentions;
- provide guidance whenever a question arises concerning the appropriate way to resolve a problem; and
- facilitate training of new employees.

Management's intentions were not carried out. According to management, each inspector was supposed to fill out the pay tickets as they inspected the work performed by RTS Construction Company. Instead, a single inspector filled out the pay tickets without verifying the work was performed. It was also management's intentions for the pay tickets to be turned in to the Construction Inspector III for approval and for random observations to occur. This did not happen. Instead, they were submitted to the Construction Cost Specialist for payment without verifying the work was actually done and without supervisory approval.

RECOMMENDATION

We recommend that management:

- A. Establish procedures, specific for the Cast Iron Renewal Contract.
- B. Distribute the manual and train the appropriate staff. This manual could then be used as a continuing reference source to promote consistency.

MANAGEMENT RESPONSE

We concur with the recommendations.

- Guidelines for inspection techniques, pay items and documentation of process flows are in separate locations. Procedures and guidelines will be incorporated in one document and distributed by October 31, 2004. The manual will become a permanent part of training for new inspectors as well as refresher training for existing staff.

- The Deputy Director of Gas and Light Utilities is responsible for implementing this recommendation.



Attachment A

**City of Richmond
 DPU - Special Investigation
 Cast Iron Renewal Contract
 April 2001 through April 2004**

