

# INTERNAL AUDIT REPORT

2016-07

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Vendor Contracts: Payments

Anchorage Water and Wastewater Utility

December 6, 2016

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# Municipality of Anchorage

Ethan Berkowitz, Mayor

Internal Audit Department

December 6, 2016

Honorable Mayor and Members of the Assembly:

I am pleased to present for your review **Internal Audit Report 2016-07, Vendor Contracts: Payments, Anchorage Water and Wastewater Utility**. A brief summary of the report is presented below.

In accordance with the 2016 Audit Plan, we have completed an audit of Vendor Contracts: Payments at the Anchorage Water and Wastewater Utility. The objective of this audit was to determine whether payments under vendor contracts were appropriate. To accomplish this objective, we judgmentally selected six vendor contracts and reviewed 145 invoices that were issued under 48 Notices to Proceed from mid-2013 through mid-2016. In addition, we evaluated the Notice to Proceed process and the adequacy of the associated documentation.

Our audit revealed Anchorage Water and Wastewater Utility needs to improve its oversight of vendor payments. Specifically, during our review, we identified a payment for services not performed for one contract and labor overcharges for two of the six vendor contracts. In addition, billing backup for some of the invoices was inadequate and the Notice to Proceed process lacked transparency due to insufficient documentation or documentation that was not produced in a timely manner during the Notice to Proceed process. Finally, Anchorage Water and Wastewater Utility had no internal standard operating procedure regarding the allowability of charges to the project before the Scope of Work was created.

There were five findings in connection with this audit. Management was responsive to the findings and recommendations.

Michael Chadwick, CICA  
Acting Director, Internal Audit



# Municipality of Anchorage

Ethan Berkowitz, Mayor

Internal Audit Department

December 6, 2016

**Internal Audit Report 2016-07**  
**Vendor Contracts: Payments**  
**Anchorage Water and Wastewater Utility**

**Introduction.** Anchorage Water and Wastewater Utility (AWWU) is the largest water and wastewater utility in Alaska. To sustain and improve its operations, AWWU procures a variety of goods and services using various purchasing methods, such as vendor (term) contracts, purchase orders, and procurement cards. While subjected to the same initial procurement and approval procedures as purchase orders, vendor contracts provide for greater speed and flexibility because individual Contract Task Orders (CTO) and Notices to Proceed (NTP) can be readily issued for specific projects that respond to changing conditions and emerging demands. In 2016, AWWU utilized about 70 vendor contracts that authorized about \$25.9 million in goods and services.

**Objective and Scope.** The objective of this audit was to determine whether payments under vendor contracts were appropriate. Specifically, we judgmentally selected six vendor contracts and reviewed 145 invoices that were issued under 48 NTPs from mid-2013 through mid-2016. In addition, we evaluated the NTP process and the adequacy of the associated documentation.

The audit was conducted in accordance with generally accepted government auditing standards, except for the requirement of an external quality control review. 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. The audit was requested by the Administration.

**Overall Evaluation.** AWWU needs to improve its oversight of vendor payments. Specifically, during our review, we identified a payment for services not performed for one contract and labor overcharges for two of the six vendor contracts. In addition, billing backup for some of the invoices was inadequate and the NTP process lacked transparency due to insufficient documentation or documentation that was not produced in a timely manner during the NTP process. Finally, AWWU had no internal standard operating procedure regarding the allowability of charges to the project before the Scope of Work (SOW) was created.

## **FINDINGS AND RECOMMENDATIONS**

### **1. Payments For Services Not Performed.**

- a. Finding.** During our review, we identified a payment for services not performed. Specifically, a December 30, 2015, NTP authorized transferring the remaining amount from a previously authorized not-to-exceed amount under a time-and-materials agreement into a lump-sum payment of \$10,976 for services not performed. To “justify” this action, a December 29, 2015, e-mail from the contractor to AWWU Engineering stated, “Since we are not meeting the initial deadline for the submittal of the final condition assessment report with [subcontractor name] in 2015, we propose transferring the remaining funds from the time and materials phases (T&M) into a final lump sum phase and prebilling those efforts.”

Accordingly, on January 3, 2016, the contractor submitted to AWWU a \$48,575 invoice without timesheets. The invoice contained a payment line indicating the phase “Final Reporting & Closeout” as 100 percent complete and the amount of \$10,976 as “Total Earned”. Per the requested additional billing backup directly from the contractor, the invoice amount of only \$37,599 had proper support for payment, but there was no support for the remaining “prebilled” amount of \$10,976.

Per Policy and Procedure (P&P) 24-7, *Authorization of Accounting Transactions*, the responsibilities of an agency head are to “Ensure that every request for payment, journal entry, work authorization, voucher . . . or other accounting document input or submitted to be processed against his/her accounts is supported by documentation adequate to indicate to a reasonable person that the transaction is valid and proper.”

- b. **Recommendation.** The AWWU General Manager should enforce controls to ensure that payments are made for only services that are performed and that the Finance Division is provided with adequate supporting documentation to be able to make such verifications.
  
- c. **Management Comments.** Management stated, “AWWU agrees with this finding. AWWU will review all payments to ensure they are made in accordance with the stated contract terms. Any changes to contract payment terms and deliverables will be clearly documented in a contract change order.”
  
- d. **Evaluation of Management Comments.** Management comments were responsive to the audit finding and recommendation.

2. **Incorrect Labor Rates Charged.**

- a. **Finding.** Our review revealed labor overcharges for two of the six vendor contracts. For example, invoices under one vendor contract contained 13 labor charge entries resulting in a total overcharge of \$547 because labor rates charged were higher than the contract rates. In addition, the invoices under this vendor contract contained 17 labor charge entries that could not be verified because the employees or their labor categories in the invoices were not listed in either the contract or the supporting NTP schedule.

- b. **Recommendation.** The AWWU General Manager should enforce controls to ensure that payments for services performed are correct and that the Finance Division is provided with adequate supporting documentation to be able to make such verifications.
  
- c. **Management Comments.** Management stated, “AWWU agrees with this finding. AWWU currently does a review on a sample of contract invoices to verify billing rates. AWWU will implement procedures to ensure that all invoices are billed at correct rates.”
  
- d. **Evaluation of Management Comments.** Management comments were responsive to the audit finding and recommendation.

3. **Inadequate Billing Backup.**

- a. **Finding.** Billing backup for some of the invoices was inadequate. For example, seven invoices for one contractor did not contain timesheets for labor charges under time and material agreements. When the timesheets were obtained from the contractor, we noticed that one invoice stated that the billing was for professional services performed from February 28, 2016, through April 2, 2016. However, the timesheets indicated that the services were performed in 2015, mostly in November.

In two other invoices by another contractor, reimbursable contractor expenses contained a boat rental from its own employee for \$500 per day, totaling \$1,500 for three days, with an additional ten percent markup (\$150). The only support supplied for the reimbursable was a short personal note by the contractor’s employee stating that he agreed to rent his own boat to his employer. No boat license number and registration, type of boat, justification for the rental price, contact information, or any other relevant information was provided.

Per P&P 24-7, an agency head should implement procedures that “. . . ensure that requests for payment and other transactions are audited and properly authorized by the agency head, verifying that the transactions are valid and proper based on attached documentation . . .”. This P&P defines audit to mean “. . . examine to determine authority, validity and correctness of vouchers for the purpose of certifying that: The supporting documents are adequate and in due form, Accounting and payment information is correct . . .”.

- b. **Recommendation.** The AWWU General Manager should enforce controls to ensure that payments for services performed have adequate supporting documentation.
- c. **Management Comments.** Management stated, “AWWU agrees with this finding. AWWU review all invoices for adequate backup and require vendors to supply sufficient documentation prior to processing payments.”
- d. **Evaluation of Management Comments.** Management comments were responsive to the audit finding and recommendation.

4. **Lack of Process Transparency.**

- a. **Finding.** The NTP process lacked transparency due to insufficient documentation or documentation that was not produced in a timely manner during the NTP process. Specifically, after reviewing 48 NTPs, we identified the following issues that contributed to the lack of process transparency:
  - *Missing SOW* – Five NTPs/CTOs had no corresponding SOW drafted, even though the NTPs stated that “AWWU has reviewed and approves your scope and fee proposal . . .”. Instead, there sometimes were unofficial e-mails informally discussing the projects without specifying the details. Therefore, it

was difficult to determine what exactly was to be performed under these NTPs/CTOs. However, the *Scope of Services* section of each vendor contract stated that individual CTOs must set forth the tasks for specific projects. It also stated that “The Contractor shall respond to each CTO with a proposal detailing cost and time required to complete the work. AWWU and the Contractor may refine the proposal for clarification of the scope of services prior to issuing Notice to Proceed for the CTO.”

- *Work Performed Before NTPs Issued* – Three NTPs were issued after work was either started or already performed. The vendor contracts state that work should be performed only after the NTP has been issued.
- *NTP Time Extensions Not Amended* – Thirteen NTP time extensions were not amended. Instead, sometimes there were e-mails mentioning an extension of the time period without formal documentation or any explanation of the project time extension.
- *NTP Amount Increases Not Properly Documented* – Five amendments to increase authorized amounts did not contain proper documentation or were amended after the authorized amounts were already exceeded.

b. **Recommendation.** The AWWU General Manager should ensure that adequate and timely documentation is generated to make the NTP more transparent.

c. **Management Comments.** Management stated, “AWWU agrees with this finding. AWWU will issue task orders and NTPs in accordance with contract terms and scope of work.”



- d. **Evaluation of Management Comments.** Management comments were responsive to the audit finding and recommendation.

5. **Treatment of Pre-Project Costs Needs Standardization.**

- a. **Finding.** AWWU had no internal standard operating procedure regarding the allowability of charges to the project before the SOW was created. As a result, during our review we noticed questionable treatment of pre-project costs incurred by contractors. For example, one NTP (called NTP #0) was issued to authorize a not-to-exceed amount of \$10,000 specifically to establish a SOW of an upcoming project. Per AWWU Engineering Management, it is not an acceptable AWWU practice for contractors to charge costs incurred before or while establishing the project scope. Per explanation, such pre-project costs represent project overhead that contractors should absorb.

On the other hand, the contractors are allowed to charge project management costs after the SOW is established and the NTP authorizing to start the work is issued. For example, once the SOW was established, the next NTP (NTP#1) was issued that, in addition to the actual project costs, authorized project management costs of \$6,459. By the end of the project, all of the authorized amounts were disbursed.

Authorization to charge pre-project costs in addition to the project management costs to some contractors but not to others creates a risk of discriminatory practices. Especially due to the fact that the example above relates to a large contractor, small contractors may feel discriminated against if not treated the same way.

- b. **Recommendation.** The AWWU General Manager should ensure that treatment of pre-project and project management costs are standardized and documented in an internal standard operating procedure.

- c. **Management Comments.** Management stated, “AWWU agrees with this finding. AWWU will implement a Standard Operating Procedure (SOP) regarding pre-project costs. The SOP will be communicated to all staff to ensure consistency in process.”
  
- d. **Evaluation of Management Comments.** Management comments were responsive to the audit finding and recommendation.

**Discussion With Responsible Officials.** The results of this audit were discussed with appropriate Municipal officials on October 14, 2016.

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