CITY OF CHARLOTTE
CITY MANAGER'S OFFICE – INTERNAL AUDIT DIVISION

MEMORANDUM

To: W. Curtis Walton, Jr., City Manager February 7, 2012

From: Greg McDowell, City Auditor

Re: Fiscal Year 2012 Mid-Year Audit Summary

The Internal Audit Division has completed a number of performance audits during the first half of fiscal year 2012. We continue to support the City's efforts to properly report and manage American Recovery and Reinvestment Act (ARRA), or Stimulus Act funds. In addition, we completed a follow-up procurement audit, which was expanded to include contracting issues at Utilities. With the issuance of one CATS-related report, along with a separate draft report in late 2011, we are nearing completion of our review of contracts associated with the South Corridor Rail Line.

At calendar year-end, significant audits in progress include the final CATS South Corridor contract audit (STV-Direct Labor, Overhead and Fees), Business Tax Collections, and the Police Uniforms unit price contract. A report of Recommendations Cleared during the period is attached to the end of this report.

Nearly ninety percent of Internal Audit staff project time was allocated to non-competition performance audits with the remainder focused on Managed Competition. The following audits were completed during the first half of the fiscal year, while additional audits in progress are detailed further below:

- Procurement Follow-Up: Utilities (October 2011)
- ARRA: Stimulus Reporting in FY11 (September 2011); ARRA-COPS (November 2011)
- Managed Competition: completed one semi-annual audit and one budget review
- CATS: Bus Imprest (October 2011); STV-ODC Billings (December 2011)

PROCUREMENT FOLLOW-UP

Utilities Procurement and Contract Audit (October 2011) – The audit was designed to determine how effectively Charlotte-Mecklenburg Utilities (Utilities) had addressed procurement issues identified in the audit report issued July 2009, and to conduct a limited review of contracting processes. Some GIS-related contracts were specifically reviewed.

Since our report in July 2009, Charlotte-Mecklenburg Utilities made considerable efforts to address previous non-compliance with City procurement policies. While a few contracts remain to be executed, steady progress was made through fiscal years 2010 and 2011 to bring 16 of 20 vendors under contract. Each of these contracts required a significant commitment of resources

to complete an RFP and evaluation process. An additional two vendors were brought under contract in early FY2012, and two are expected to be addressed in the next few months.

During this follow-up audit, we expanded our scope to perform a limited review of contract management. We focused on GIS-related contracts because we received allegations of improprieties with specific contracts. The information was received in November 2010, along with a request from the City Manager's Office to perform a review. After an initial review of documentation and some preliminary interviews, we concluded that the allegations appeared to have merit and required a more detailed review. For efficiency, we combined that review with the scheduled procurement follow-up and conducted both efforts between March and September 2011.

With respect to the GIS-related contracts, we concluded that Utilities violated City policies and did not follow best practices. Our detailed findings and recommendations address a number of actions taken between the years 2003 and 2009, including the following: excess usage of direct pay processing, unjustified sole sourcing, poor documentation of contractor selection process, and an ill-advised positioning of a subcontractor/contractor relationship.

In the past, the City's accepted practices included a significant number of direct pay relationships with vendors, in lieu of full contracting processes. Some of these practices had been tolerated because the City's limited information systems capabilities did not facilitate best practices. That is, a vendor's aggregate payments, purchase orders and contracts within a KBU or throughout the City could not be readily obtained.

Several years ago, KBUs began working together with assistance from BSS – Procurement Services Division to identify vendors the City annually paid $100,000 or more, in aggregate. For example, five KBUs might each purchase $50,000 from the same vendor, without the benefit of competitive pricing which could be derived by pooling information and conducting one RFP. Many City-wide procurements have been facilitated by BSS-PSD and completed in the past few years.

While direct pays had become accepted throughout the City, our 2008 and 2009 KBU-specific audits found that the approach was most pronounced at Utilities and one other KBU. At Utilities, this was not limited to the GIS contracts. However, a now-former employee reported that the direct pays to GIS contractors, and other actions appeared suspicious. Audit staff investigated each allegation but could not corroborate the charges. Nevertheless, a number of recommendations have been made to improve operations and avoid the appearance of favoritism in the contracting process. The remaining issues are addressed in detail in the full report. We are satisfied with Utilities' responses and will monitor management's action plans to ensure the issues have been resolved.

> *Update:* Utilities provided a formal response to the City Manager's Office in mid-November 2011. Utilities indicated its intent to continue to formalize purchasing agreements where necessary and to work with applicable City divisions to implement consistent City purchasing policies and business practices. Internal Audit will schedule a follow-up to review Utilities' progress in 2012.

AMERICAN RECOVERY AND REINVESTMENT ACT

Stimulus (ARRA) Reporting FY11 (September 2011) – To comply with Federal guidelines, a quarterly report (known as the "1512" report) detailing the costs and jobs associated with the grant must be completed. Internal Audit has completed a review of Stimulus 1512 reporting for the fourth quarter of FY2011.

During fiscal year 2011, grants to the City of Charlotte from Federal agencies increased from $50.2 million to $112.4 million. In addition, the City was sub-recipient to grants totaling $11.2 million, an increase of $1.8 million from the prior year.

Although minor adjustments were required in subcategories, controls helped ensure accurate reporting of total expenses. We have recommended that a log of all errors be maintained and reviewed regularly by the Economic Stimulus Team (EST). In addition, Project Managers (PMs) should provide written verification to the EST coordinator that the GEAC reconciliation has been completed timely.

As grants near completion, PMs should expect additional review from Federal and State auditors, especially related to debarment documentation and subrecipient monitoring. We have recommended that PMs review, and as needed, update the required documentation to comply with federal guidelines.

> *Update:* The EST coordinator accepted the Audit recommendations and implemented the necessary steps to improve controls.

COPS ARRA Grant (November 2011) – Internal Audit reviewed the COPS Hiring Recovery Program Grant funded by the American Recovery and Reinvestment Act of 2009 (ARRA).

The audit focused on the project from inception through June 30, 2011. The purpose of the audit was to evaluate internal controls, compliance with ARRA requirements and the accuracy of ARRA reporting. Overall, internal controls are in place as:

- Project costs were reported accurately,
- Agency reports filed timely, and
- Monitoring was satisfactory.

However, minor variances in payroll costs were found. We were satisfied with CMPD's response to the audit recommendations.

MANAGED COMPETITION AUDITS

Internal Audit staff completed one quarterly audit of Solid Waste Services, plus one benchmark budget review. Also completed were final gainsharing payout reviews for Charlotte Mecklenburg Utilities. Specifically:

- *SWS City-wide Services:* The SWS residential model has transitioned from a managed competition and optimization in FY10 to city-wide service in FY11. Prior to FY11, the North, South and East Districts of the City were serviced by SWS staff and the West District was contracted out. Since July 2010, refuse, yard waste and bulky collection services have been performed by SWS City-wide; while recycling is being performed by an outside contractor.

  The final quarterly audit for the first fiscal year of services under the reorganization was completed and the results for the first year of operations under the new plan were positive. Fiscal year-to-date operations were under budget $789,073, or 4% of revenues. While gainsharing has ceased, the PCAC-approved plan includes periodic auditing semi annually for FY12 under the new operating model.

  The optimized budget for the reorganized SWS operations was developed and reviewed at the beginning of the FY 2012 operating period. In our opinion, the SWS benchmark proposal for FY12 is reasonable and conforms to the Council's "Guidelines for Services Contracting" policy statement adopted in 1994 and revised in 1997.

- *Charlotte Mecklenburg Utilities:* The final gainsharing payments were reviewed by Internal Audit for CMU Wastewater Optimization (WWO) years ended June 30, 2009 and June 30, 2010 as well as CMU Irwin Creek WWTP for the year ended June 30, 2010. Currently, CMU has no services under managed competition or optimization.

CATS-RELATED

CATS Bus Operations Division Imprest FY11 (October 2011) – The purpose of this audit was to determine whether the City has reimbursed the bus operations management company accurately and the funds have been disbursed properly. The City's outside auditor, Cherry, Bekaert & Holland, L.L.P. (CB&H), performs agreed-upon procedures related to the Bus Operations Division (BOD) that cover the inventory of buses, bus parts and payroll. The work performed by Internal Audit is provided to CB&H auditors for their review.

Overall, the system of controls used by Bus Operations Division is satisfactory. The wire transfers are accurately recorded, and the reimbursement requests are adequately supported. In response to audit recommendations for FY10, revised procedures ensured the timeliness of deposits. Also, necessary changes have been made to comply with the federal and state laws for garnishment.

However, even though procedural changes were made in FY08 and FY11 to ensure there are adequate funds to cover outstanding checks, the Bus Operations Imprest Fund had a negative balance one day during FY11. Due to a banking error, a wire transfer was posted to the account on the day that the call was made to request the transfer, rather than the date the transfer was due to be paid. Errors can and do occur, and the BOD should closely monitor the balance in the imprest account to assure that a negative balance does not occur as a result of one of these errors. New procedures have been implemented to monitor the account online on a daily basis.

N.C. General Statute §95-25.8 states that in order for employees' wages to be withheld, the employer must obtain a written authorization from the employee signed before the applicable payday. The authorization must indicate the reason for the deduction and the actual dollar amount or percentage of the wages of the deduction. A valid authorization could not be located for 55 (8%) of the 733 deductions reviewed during the audit. In response, changes for the current fiscal year have been made to deal with concerns with the authorizations addressed in the findings of this report. Satisfactory plans have been made to address each audit recommendation. This audit is performed annually and includes a follow-up of previous recommendations.

CATS-STV Project Billings FY08 and FY09 (December 2011) – We have completed another in a series of audits related to the South Corridor Light Rail construction. This audit addresses the other direct costs (ODCs) portion of STV North Carolina, Inc.'s (STV) billings (for itself and two of its subcontractors, WPC Engineering and Stewart Engineering) from July 2007 through February 2009.

For the period audited, STV submitted invoices totaling about $5.2 million, of which $1.6 million was for ODC charges. The STV and WPC other direct cost charges of $731,000 and the administrative charges billed by Stewart of $250,873 totaled $981,873 or about 19% of the total billings. We propose disallowing about $72,000 or 10% of the other direct costs reviewed. It is possible that STV will supply additional documentation to support some of these charges after CATS addresses our report findings with them. In addition, we continue to question the $250,873 in administrative charges billed by Stewart. In an audit report issued in April 2010, auditors recommended that CATS review similar charges for propriety since the costs were not supported by adequate documentation. CATS subsequently indicated to Internal Audit that it had deemed the charges appropriate but did not provide documentation to support the basis for its conclusion. Internal Audit also noted that STV had not submitted charges to CATS within the timeframe stipulated in the contract.

> *Update:* CATS provided a written response to the City Manager's Office in early January 2012. This is the third and final ODC audit related to STV and its subcontractors on the South Corridor Rail Line. STV has responded to past audit reports by providing documentation that had been requested during the audit. It is likely that STV will respond similarly to this report. We will follow-up with CATS to address the administrative charges first noted in our April 2010 report. We noted positively that CATS' response included a plan to dedicate more resources to FAR-related issues in the future.

CATS CONSTRUCTION FOLLOW-UP

From 2006 through 2011, we conducted several audits of PTG and its subcontractors. Some audits noted that CATS had disallowed certain expenses during the initial review of invoices. Internal Audit reviewed and supported those disallowances, but also encouraged CATS staff to conduct more rigorous reviews. Most of the audits questioned a small percentage of charges and recommended various recoveries. Occasionally, recommended recoveries were substantial. In

some instances, contractors resolved the questioned costs by submitting appropriate documentation which had not been provided during the audits.

CATS has collected on the following recommended disallowances: $83,011 from PTG and STV (Other Direct Costs through 2004); $174,145 from PBS&J (Labor, Overhead and Fees, 2003-2006). We understand that CATS Legal is in discussions with PTG to resolve a number of contractual claims, including issues raised in past audits. Based upon our discussions with CATS Legal, we are satisfied that the following audit findings are being appropriately addressed.

- *FWA Direct Labor, Overhead and Fees (January 2009):* This audit focused on the direct labor, overhead, and fee charges billed by The FWA Group (FWA), one of Parsons Transportation Group's (Parsons) subcontractors for the South and Northeast Corridor Light Rail Transit System projects.

  For the audit period May 2004 through October 2005, FWA submitted 24 project-related invoices to Parsons totaling $1,318,899. We reviewed direct labor charges of $422,543 and overhead and fees of $271,253, and proposed disallowing $50,676 in questioned costs, or 7% of direct labor, overhead, and fee charges reviewed.

- *Odell Direct Labor, Overhead and Fees through October 2005 (January 2010):* This audit focused on the direct labor, overhead, and fee charges billed by Odell Associates Inc. (Odell), one of Parsons Transportation Group's (Parsons) subcontractors for the South and Northeast Corridor Light Rail Transit System projects.

  For the audit period May 2003 through October 2005, Odell submitted 69 project-related invoices to Parsons totaling $2,256,550. We reviewed direct labor charges of $524,968 and overhead and fees of $1,209,387. During its initial review of invoices presented by Parsons, CATS disallowed and deducted direct labor, overhead, and fee charges of $82,503. We agreed with those deductions and propose disallowing an additional $181,819 or about 10% of the direct labor, overhead, and fees. This amount is net of a $101,963 credit which was issued by Odell in September 2005 to reflect a reduction in the provisional overhead rate.

- *Neighboring Concepts (August 2010):* Auditors completed a review of payments made by CATS to Neighboring Concepts from May 2003 through October 2005. For the period audited, Neighboring Concepts submitted 73 project-related invoices to Parsons totaling $1,809,412. We reviewed direct labor charges of $398,593 and overhead and fees of $866,196. We proposed disallowing $443,141 or about 35% of the direct labor, overhead, and fees previously paid by CATS.

  Our audit did not find any purposeful misrepresentation of costs by Neighboring Concepts. In retrospect, both CATS and Parsons should have recognized Neighboring Concepts' lack of previous experience with Federal contracting, which requires specific costing methodologies prescribed by the Federal Acquisition Regulations (FAR). During our audit, Neighboring Concepts was cooperative and forthcoming, and appeared to take

steps to obtain accounting and technical support to better position itself for future contracting which is covered by the FAR.

CATS requested a refund in October 2010 and discussed a repayment plan with Neighboring Concepts' principal. N.C.'s initial proposal was not accepted by CATS.

AUDITS IN PROGRESS @ December 31, 2011

- Business Taxes – These taxes include Prepared Food and Beverage; Occupancy; Privilege License; Vehicle Rental; and other business taxes collected by the County for the City. Included in our audit was a comparison of independent databases to the County tax listings. That step produced exceptions which are being evaluated. Among the exceptions are some ARRA contractors. As local tax compliance is required by the grantor, a letter has been sent to the contractors who are presently non-compliant, informing them of the requirement and directing them to the County tax office website. A draft report was discussed with City Finance in December. Further discussion of possible recommendations is warranted before final report issuance in January or February.

- Quarterly Stimulus Audit Work – Program managers must submit ARRA reports to FederalReporting.gov by January 14, 2012. Internal Audit will begin the quarterly review soon after that date.

- CMPD Uniform Unit Price Testing – Subsequent to our June 2010 audit related to the continued purchase of uniforms after the contract expired, we are reviewing the accuracy of pricing. In November 2010, we discussed preliminary findings with CMPD and inquired with the uniform vendor about unit price discrepancies noted during our review. In January 2011, Best Uniforms presented its response, which required additional follow-up on the part of Internal Audit staff. Completion of this review was delayed due to other audit priorities. In August, Internal Audit staff resumed fieldwork for this review and sent additional inquiries to Best Uniforms. A draft report was discussed with CMPD in December. Final report issuance is expected in January.

- STV Direct Labor, Overhead and Fees – A review of the Direct Labor, Overhead and Fees for STV North Carolina Inc.'s (STV) billings from September 1, 2003 through January 30, 2009, related to the South Corridor Light Rail Line is underway. A draft report for CATS' review was provided in December. We expect to issue the final report in early 2012.

- CATS Follow-up Recommendations – We have issued several audit reports over the past few years which require follow-up. After discussing this with CATS management, the issues noted by Internal Audit were referred to CATS Legal. We plan to follow-up previous recommendations to obtain an understanding of their resolution process.

Recommendations Cleared July-December 2011
Related to Select Audits Completed 2009-2011

KBU	Report and Date	Audit Recommendation or Actions Planned/Taken	Resolution Status
County Finance; City Finance; B&E	Property Taxes Received December 2009 (Audit Follow-up Concluded August 2011)	1. Post Implementation Review (PIR) of new property tax system 2. Losses of interest; consider in Joint Undertaking Agreement (B&E) 3. Controls over exception payments 4. Internal controls require follow-up	1. The County contracted with KPMG to conduct the PIR during the fall of 2010; KPMG's final presentation to staff was made January 31, 2011. Subsequently, County Finance provided an implementation schedule for the KPMG findings. 2. County Finance responded that steps to expedite mortgage company tax remittances are continuing. 3. Reconciliation received; exception payments now better controlled; backlog reduced considerably; County Finance responded that reconciliation will be done at least annually. 4. County Finance responded that County Internal Audit has the tax office on its FY'12 schedule.
BSS	Procurement September 2010 (Completed August 2011)	1. Procurements lacked proper approval 2. Contracts expired without renewal in place 3. BSS plans to improve contract monitoring	1 and 2 - Numerous competitive solicitations have been performed, decreasing unsupported direct payments and implementing proper renewals. 3. Monitoring has improved through use of the Contracts Digital Archive.
CMU	Utilities Billing September 2010 (Completed August 2011)	1. Recommended collection of additional data 2. Implement additional data control 3. Prioritize billing exceptions for resolution	1. CMU reports that it has developed a more refined inventory control process. 2. CMU completed a batch control process. 3. CMU reports that improved criteria and a new workflow have been implemented.
BSS	City-wide P-card Compliance March 2011 (Completed August 2011)	1. P-card Manual modifications 2. Additional training will be provided to improve compliance 3. Compliance should be improved 4. A lower single transaction limit should be implemented	1. BSS completed a revised P-card Manual. 2. Online training modules were made available to all KBUs by September 1, 2011. 3. Several changes have been put in place. 4. April 2011, BSS implemented a reduction to $2,500.

OCIO	Pre-ERP Implementation Review June 2011 (Completed December 2011)	Audit concluded that the effort to develop a new ERP program has started well and is equipped with qualified people and good planning tools as of June 2011. The ERP program aligns with the City priority for "One Business." Significantly, the ERP program integrates the required elements to implement successful project management. Although poised for success (through alignment and project management), the required changes leading up to an ERP implementation are so critical, a number of steps are recommended to help ensure fulfillment of the plan. Audit recommendations are organized into three sections: • Greater definition of “transformation” should be communicated, • The ERP schedule should address the time and effort for people to process change, and • Acceptance of the (Program Charter) levels of decision making needs greater transparency.	The OCIO responded to the City Manager in a several page memo dated August 26, 2011. Two tasks mentioned in the memo were (1) to complete the first iteration of the decision model and (2) add initial change management tasks to the integrated program plan. Both of these tasks have been accomplished. The Organizational Readiness Assessment and Change Management Strategy was forwarded to Internal Audit in December 2011. In addition, the ERP Communications plan has been finalized. With these documents, all the recommendations have been addressed.