



Dave Yost • Auditor of State



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To the Customers, Board and Administration the Northeast Ohio Regional Sewer District:

In October 2010, the Northeast Ohio Regional Sewer District engaged the Auditor of State's Office to conduct a performance audit of internal controls over the procurement and contracting process for capital projects. Based on the contract with the District, this included reviews of policies and procedures, compliance, change orders, and management.

The performance audit contains recommendations which identify the potential for improvements to the Sewer District's capital contracting process. While the recommendations contained in the audit report are resources intended to assist in improvement efforts, the Sewer District is encouraged to assess overall operations and develop additional alternatives.

An executive summary has been prepared which includes background information; the methodology and scope for the performance audit; assessments not yielding recommendations; a summary of the recommendations; issues for further study; other observations; and the audit objectives. This report has been provided to the Sewer District and its contents discussed with the Board and Administration. The Sewer District has been encouraged to use the results of the performance audit as a resource for further improving the capital contracting process.

Additional copies of this report can be requested by calling the Clerk of the Bureau's office at (614) 466-2310 or toll free at (800) 282-0370. In addition, this performance audit can be accessed online through the Auditor of State of Ohio website at <http://www.auditor.state.oh.us/> by choosing the "Search" option.

Sincerely,

A handwritten signature in black ink that reads "Dave Yost".

Dave Yost
Auditor of State

July 28, 2011

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Executive Summary

Background

In October 2010, the Northeast Ohio Regional Sewer District (NEORSO or the District) engaged the Auditor of State's Office (AOS) to conduct a performance audit of internal controls over the procurement and contracting process for capital projects. Based on the contract with the District, the following areas were reviewed in this performance audit:

- Policies and Procedures;
- Compliance;
- Change Orders; and
- Management.

District Overview

NEORSO was created by a court order in 1972 and is governed by Chapter 6119 of the Ohio Revised Code (ORC). The District has a Board of Trustees (the Board) comprised of seven members. Two members are appointed by the City of Cleveland, two by the Suburban Council of Governments, one by Cuyahoga County, one by the appointing authority of the sub-district with the greatest sewage overflow (currently Cleveland), and one by the appointing authority of the sub-district with the greatest population (currently the Suburban Council of Governments). The Board appoints the Executive Director, Deputy Executive Director, Finance Director, and Law Director to manage and administer the District's operations.

NEORSO's mission is to serve its customers by providing effective wastewater and stormwater management that protects the health and environment of the region while enhancing quality of life. The District is responsible for treating wastewater and stormwater for all or portions of 61 communities in northeast Ohio (Cleveland region). To aid in this effort, the District is responsible for addressing capital improvements, monitoring and enforcing industrial discharge limits, sampling water quality, and addressing combined sewer overflow (CSO). The District owns and operates three wastewater treatment plants: Easterly, Southerly and Westerly. The District also operates the Environmental and Maintenance Services Center (EMSC), housing maintenance, laboratory, and industrial surveillance departments. Public meetings are held at the George J. McMonagle (GJM) administration building, located in Cleveland.

The Engineering and Construction Department is responsible for the planning, design, construction, and management of NEORSO's capital improvements program. As a result, the

Engineering and Construction Department administers the District's engineering and construction contracts, including procurement, cost negotiations, contractual changes, review and approval of invoices, and delivery and acceptance of final projects. The Purchasing Department is also responsible for performing certain activities related to capital procurement.

According to the District's 2010 Budget Report, costs related to construction in progress will range from \$164 to \$302 million per year from 2010 to 2014. The District's 2010 Budget Report also shows that NEORSD spent approximately \$19.9 million in both 2008 and 2009 on contractual and professional services. These costs are budgeted to increase to approximately \$27.2 million in 2010. These amounts comprised 20.7 percent of total operating expenses in both 2008 and 2009, increasing to 25.2 percent in 2010.

In addition to this performance audit, NEORSD has previously contracted for two external studies of certain aspects of its capital procurement process. One external study reviewed more than 500 contracts from 1998 to 2007. The other external study reviewed whether the change orders and settlements were justified for 20 projects selected by the District, with respect to entitlement, process, and amount. All 20 contracts were initiated prior to 2008. The second external study also included a review for any evidence that the District's prior General Counsel (i.e., Law Director) had improperly influenced the change order and settlement process and outcome. Both external studies were conducted in response to crimes committed by the previous General Counsel. Specifically, the *Plain Dealer* reported in October 2010 that the previous General Counsel was sentenced to nearly six years in prison after pleading guilty in May 2010 to bribery, theft, and five counts of filing false tax returns. The *Plain Dealer* also reported the previous General Counsel accepted more than \$800,000 in bribes and stolen checks.

Audit Methodology and Scope

Performance audits are defined as engagements that provide assurance or conclusions based on evaluations of sufficient, appropriate evidence against stated criteria, such as specific requirements, measures, or defined business practices. Performance audits provide objective analysis so that management and those charged with governance and oversight can use the information to improve program performance and operations, reduce costs, facilitate decision-making by parties with responsibility to oversee or initiate corrective action, and contribute to public accountability.

AOS conducted the performance audit of the Northeast Ohio Regional Sewer District in accordance with Generally Accepted Government Auditing Standards (GAGAS). These standards require that AOS plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for findings and conclusions based on audit objectives. AOS believes that the evidence obtained provides a reasonable basis for the findings and conclusions presented in this report based on the audit objectives.

The scope of this performance audit entailed reviewing and analyzing internal controls over the procurement and contracting process for capital projects, in relation to District policies, statutory and regulatory compliance, industry standards, and recommended or leading practices. This scope required a sample review of the District's contracts. Due to the high risk¹ related to the District's capital contracting process, the performance audit drew a relatively large sample for review. Specifically, the performance audit reviewed 53 of 104 contracts² that were authorized from 2008 to October 2010, using a systematic random sample method. The 53 contracts reviewed account for approximately 73 percent of the total contract costs. In addition, the sample was based on contracts authorized from 2008 to October 2010 because the District requested the review to focus on its procurement process since the previous General Counsel left employment at NEORSD. The following attributes were reviewed in these 53 contracts:

- Declaration of Material Assistance (DMA) forms for contracts over \$100,000;
- Certificate of available resources, including approvals;
- Attainment of advertising requirements;
- Receipt of required information from bidders;
- Selection of the lowest/best bidder;
- Board approval for contracts;
- Difference between these figures: purchase order and original contract award, purchase order and invoice amounts, invoice amount and amount paid, total contract award and actual amount paid, and contract allowances and actual allowances (i.e., change orders);
- Contract language pertaining to, and evidence of completing: notice to proceed, inspections, materials testing, regular performance reporting, consequences for unsatisfactory performance, and change orders (including frequency and approvals); and
- Final inspection, review and approval.

Furthermore, the District's policies and procedures for the key aspects of the capital procurement process were reviewed, including change orders, management and technology use.

Audit work was conducted between October 2010 and April 2011, and data was drawn from fiscal years 2008 to 2011. To complete this report, the auditors conducted interviews with District personnel, and reviewed and assessed information from NEORSD and other relevant sources. Data from other sources used for comparison purposes was not tested for reliability. These sources include the American Public Works Association (APWA), Ohio Revised Code (ORC), and Ohio Department of Transportation (ODOT).

¹ The high risk determination is based on the crimes committed by the previous General Counsel, subsequent increased scrutiny, and the significant financial resources devoted to capital projects.

² The District did not provide requested documentation for two additional contracts, which would have increased the sample to 55.

The performance audit process involved significant information sharing with the District, including preliminary drafts of findings and proposed recommendations related to the identified audit areas. Furthermore, periodic status meetings were held throughout the engagement to inform the District of key issues impacting selected areas, and share proposed recommendations for improving or enhancing operations. Throughout the audit process, input from the District was solicited and considered when assessing the selected areas and framing recommendations. Finally, the District provided verbal and written comments in response to various recommendations, which were taken into consideration during the reporting process. Where warranted, AOS modified the report based on these comments.

The Auditor of State and staff express appreciation to NEORS D for its cooperation and assistance throughout this audit.

Assessments Not Yielding Recommendations

The following summarizes the assessments that did not yield a recommendation.

Certain Attributes in Sample Review: The sample review of 53 contracts did not reveal significant or systematic deficiencies for the following attributes:³

- Certificate of available resources, including approvals;
- Attainment of advertising requirements;
- Receipt of required information from bidders;
- Board approval for contracts;
- Difference between the previously mentioned figures (see **Audit Methodology and Scope**):
- Contract language for inspections;
- Notice to proceed for regular construction contracts; and
- Change orders.

In addition, the sample review did not identify any compliance issues related to selecting the lowest/best bidder for regular construction contracts, although the District can develop policies and procedures to ensure the selection of the “best” bidder (see **R1.3**) and for consultant engineer contracts (see **R1.2**). The sample review also did not find indication of poor contractor performance that would necessitate action (i.e., consequences) by the District.

Policy Compliance With Statutes: The District’s policies⁴ comply with the key ORC sections.

³ The performance audit did identify six anomalies during the sample review that did not include a specific corresponding recommendation, due to significance and the general testing results (see **Other Observations**).

⁴ During the course of this performance audit, the District developed a policy intended to address ORC 2909.32 and 2909.33 (see **R1.5**).

Change Orders: The audit identified no significant issues involving change orders in the sample of 53 contracts.⁵ Further, the Board has bylaws that govern the use of change orders. Specifically, the Executive Director has authority to approve all change orders that do not involve a contract modification. Further, the general allowance (i.e., contingency), which drives the use of change orders, is not to exceed 10 percent of the base contract including specific allowances, unless otherwise approved by the Board. This is consistent with information from the American Institute of Architects (AIA), which indicates that 5 to 10 percent is a common contingency amount for contractors. Lastly, the District has multiple approval levels to ensure the use of a change orders is justified.

Technology: NEORSD developed and is using an automated system to manage the work of contractors and consultants. The District is working on including the close-out process in the automated system, which will fully automate the management system.

Emergency Projects: The District has a formal and competitive process for selecting contractors to perform emergency repairs through its request for qualifications process. This enables NEORSD to respond to emergencies in a timely manner.

Operating Manual: The District developed a Construction Standards Operating Procedure Manual and trained staff on its use during late 2010. The Construction Process Manager is responsible for maintaining and overseeing changes or revisions to the District's construction process and forms. Given the stage of development, the District has not yet formalized a process for making revisions. However, the Construction Process Manager envisions both an annual review and the collection of issues or recommended changes during the year. The Director of Engineering and Construction will approve all changes.

Segregation of Duties: The District has established adequate segregation of duties in the capital project procurement process.

Conclusions and Recommendations

This section of the audit report presents recommendations that are intended to provide the District with options for improving its capital contracting process. In order to obtain a full understanding of the assessed areas, the reader is encouraged to review the recommendations in their entirety. The following summarizes the recommendations from the performance audit report.

⁵ See **Other Observations** for the anomalies related to change orders.

- Evaluate contractor and consultant performance.
- Develop consultant selection policy and procedures.
- Specify allowable per-diem costs, unallowable costs, and the requirement to provide itemized receipts. Carefully review invoices for compliance.
- Comply with ORC 2909.32 and 2909.33.
- Include and issue “notice to proceed” directives for all contracts.
- Develop a policy addressing best value procurement.
- Ensure compliance with Sunshine law and Board’s Code of Conduct and Decorum.

Issues for Further Study

Auditing standards require the disclosure of significant issues identified during an audit that were not reviewed in depth. These issues may not be directly related to the audit objectives or may be issues that the auditors do not have the time or resources to pursue. The following presents issues requiring further study:

- The District has strong internal controls over the change order and vendor payment processes because they require multiple approvals, as was evident in the sample review of contracts. For example, two respective change orders show approvals from five and six employees. In addition, the Director of Engineering and Construction indicated nine employees approve vendor payments. Requiring multiple approval levels reduces the potential for fraud and abuse. However, the District should consider reviewing the impact of the various approval levels and the overall internal controls on the efficiency of its processes. Doing so would help ensure that the District appropriately balances the competing requirements of control and efficiency.

Other Observations

In addition to the assessments resulting in recommendations, the sample review of the District’s contracts revealed the following issues that were not further investigated due to their material insignificance and the general testing results:

- The purchase order amount did not match the total contract amount in two instances. Specifically, the purchase order was less than the total contract amount. For one contract,

this may have been due to the purchase order not being generated when the contract was executed, considering that the purchase order amount matched the invoice amount. The variance in the purchase order and total contract amounts for the other contract was less than one dollar.

- The District did not provide all remittances to document payments for one contract.
- Although the sample review showed proof of advertising for the original bid, it also showed a lack of evidence of advertising for revised bids in three cases. According to the District, it now advertises for rebids.
- The certificate of available resources for one contract was valued at the base contract amount, rather than the purchase order amount which reflected the base contract plus allowance amount.
- The contracts that did not include provisions regarding change orders also lacked a budgeted allowance, with one exception. Since this contract has a budgeted allowance, it should have contained language in the contract regarding change orders. However, at the time of the sample review, this project had not incurred any change orders.
- The sample review found that less than four percent of the reviewed change orders lacked all of the appropriate approvals. This may have been due to the District's failure to maintain the final approved change order documents.

Audit Objectives

The following audit objectives were used to conduct the performance audit of the Northeast Ohio Regional Sewer District. According to *Government Auditing Standards*, “the objectives are what the audit is intended to accomplish. They identify the audit subject matter and performance aspects to be included, and may also include the potential findings and reporting elements that the auditors expect to develop. Audit objectives can be thought of as questions about the program that the auditors seek to answer based on evidence obtained and assessed against criteria.”

- Does the District have appropriate policies and procedures that govern the construction procurement process?
- Is the District complying with key aspects of the ORC, its policies and procedures, and leading practices for its construction procurement process?
- Is the District using an objective and competitive process to award contracts?
- Is the District’s use of change orders consistent with leading practices?
- Do the District’s competitive bids, requests for proposals (RFPs), contracts and related processes contain essential elements?
- Does the District effectively use technology to manage the construction procurement process?

Recommendations

R1.1 Evaluate contractor and consultant performance.

NEORSD should formally evaluate the performance of its contractors and consultants as part of the close-out process. This process should begin with development of related policies and procedures. The performance evaluations should be kept with the contractor and consultant file and used as a part of the selection process for future work in the District (see R1.3). Furthermore, the District should require each contractor and consultant to regularly report on performance throughout the project, and include related language in each contract. Similarly, the District should ensure that inspections and material testing are completed during projects when required by contracts. However, the District should exclude these requirements from contracts if they are not necessary based on the nature of the services. Lastly, the District should include language in each contract that addresses unsatisfactory performance, complete the close-out process for each project, and develop a related policy to ensure consistency.

NEORSD takes certain steps to close out projects, such as developing final pay estimates and certifying final completion. NEORSD also has mechanisms in place to oversee the work of consultants and contractors to help mitigate project failures and prevent monetary loss, including inspections and monitoring of progress on a monthly basis via a formal report. NEORSD also requires a performance bond from the contractor in an amount equal to 100 percent of the contract price. Furthermore, the general terms and conditions in the contracts protect NEORSD from poor contractor performance and related monetary loss, including payment withholding and contract termination.

While the District has oversight procedures, it does not evaluate the overall performance of the consultant or contractor at the end of a project. NEORSD's project engineer does develop a "lessons learned" document that reflects on work performance or issues at the end of the project. However, there are no steps taken from the "lessons learned" document to make improvements or to formally evaluate the performance of the contractor or consultant. In addition, 7 of the 53 contracts reviewed by AOS did not require regular performance reporting through daily inspections or monthly status meetings. Furthermore, 5 of the 8 projects that lacked documentation of regular performance reporting had language in the contracts that required such reporting. Likewise, 5 projects lacked evidence of inspections and 8 lacked evidence of material testing, despite related requirements in the contracts. In some instances, the nature of the service may not have required material testing. In these cases, the respective contracts should not have included this requirement. Moreover, 8 contracts did not contain language addressing unsatisfactory performance. However, 4 of these 8 contracts were for professional services to help the District develop a management plan. The nature of the service appears to mitigate the

need for such language. Finally, NEORSD's procedure for closing out construction projects is not formalized in a policy and is not used consistently. This is apparent in the sample review that showed evidence of the District conducting final inspections and reviews in only 3 of the 20 completed projects, and completing final approvals of work in only 4 of the 20 completed projects.

The Ohio Department of Transportation (ODOT) policy number 411-001(P) states that it must perform contractor performance evaluations for each contractor and subcontractor on every project, as required by the Ohio Administrative Code. The policy also indicates that evaluations need to be objective, well-documented, performed in a timely manner and consistent in the application of rating guidelines. In addition, the policy states “the contractor’s average scores for the previous calendar year will be used in the calculation of the contractor’s bidding capacity. Utilizing the average scores in this calculation will provide incentive for the contractor to provide quality construction services.” The policy further indicates that at the pre-construction conference, a blank copy of the Contractor Performance Evaluation form and a copy of the rating guidelines should be provided to, and reviewed with, the contractor. Moreover, the Office of Contracts, Qualifications Section, is charged with monitoring compliance with this policy by measuring completion, timeliness and consistency of contractor evaluations.

Formal evaluation of the performance of the consultants or contractors would better ensure quality services and the selection of the “best” consultants and contractors. This is particularly important because the District has used the same consultants and contractors for multiple projects. In addition, requiring consultants and contractors to regularly report on performance and ensuring that inspections and material testing are performed during the projects would allow the District to identify and correct problems prior to project completion. Likewise, conducting final inspections and reviews, and completing the steps during the closeout process would ensure that all activities have been sufficiently addressed by the contractor prior to officially closing the project. Lastly, including language in the contracts that addresses unsatisfactory performance would help to ensure quality services.

R1.2 Develop consultant selection policy and procedures.

NEORSD should develop policies and procedures for the consultant selection process. Policies and procedures should include the rating system and related criteria (e.g., qualifications), advertising and solicitation steps, staff responsibilities, and involvement of stakeholders (where practical and possible). Subsequently, the District should maintain documentation that shows compliance with the policies and procedures, including the rating system. Taking these steps would help ensure the District selects the most qualified consultants via a competitive and objective process.

The District has procedures to guide the request for proposal (RFP) process, including a checklist and template to ensure RFPs contain essential elements, as well as a rating system to evaluate

and select the “best” applicants. NEORSD provided documentation of the selection process via its rating system for 10 of the 12 consultant engineer contracts requested by AOS. However, no documentation was provided to show how the other 2 consultant engineers were selected. Further, while documentation shows the District evaluated multiple proposals in 8 of the 12 contracts, there is no direct evidence that it advertised for proposals to ensure and foster competition. Furthermore, NEORSD does not have formal policies and procedures for consultant selection. The District’s rating document is prepared by the selection committee made up of five to six staff members. Ratings are performed using a weighted scoring system from 1 to 10 on elements that include personnel, methods used in scoping the project, consultant written and oral presentation, and experience.

According to the *Selection and Use of Engineers, Architects, and Professional Consultants* (APWA, 1997), selection policies can include a wide variety of steps and criteria, but most good policies do the following:

- Establish qualifications as the basis for selection;
- Specify criteria by which qualifications will be judged;
- Provide for effectively publicizing the availability of the work;
- Correlate the number of consultants to be interviewed with the sizes and kinds of projects or other service needs anticipated by the agency;
- State the procedure(s) for screening proposals;
- Require that a comprehensive agreed-upon scope of services be the basis for consultant compensation and contract finalization;
- Identify departmental responsibility for administering the process;
- Specify who makes recommendation(s) and who makes (which) final decisions; and
- Assign responsibility for conflict negotiations with the selected consultant and state whether the contract is to be executed by a designated official or presented to the governing body for final decision. In the latter case, negotiation with another candidate firm should occur only in the event the first contract is disapproved.

APWA also notes that policy details should relate well to variations in magnitude of projects and studies, and should allow flexibility for unusual situations. Designating an administrative lead department is essential, but detailing staff and organization is unnecessary. The agency's selection criteria should specify that qualifications are the final determinant. APWA further indicates that the following are important objectives in developing an effective consultant selection process:

- Participation by a sufficient number of qualified consultants to ensure the agency's ability to secure a truly qualified firm;
- Fair competition between available firms while narrowing the final group under consideration to avoid undue imposition on the consultant community;

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- Involvement of stakeholders whose satisfaction with the selection process and the eventual accomplishment of the consultant's work is vital to final success, although some may be impractical to read and involve as individuals (e.g., motorists who use a highway);
 - Formulation and thoughtful administration of policies and procedures to ensure fair, thorough, and objective comparison of agency needs and goals with the capabilities, concepts, time frames, and other relevant capabilities offered by each firm under consideration; and
 - Flexible selection procedures to keep the degree of agency and consultant effort in reasonable proportion to the magnitude of the work to be done.

The absence of policies and procedures, coupled with the lack of documentation to support the rationale for selecting consultants increases the risk of not selecting the most qualified consultant based on a competitive and objective process.

R1.3 Develop a policy addressing best value procurement.

NEORSD should develop a policy that addresses the concept of best value, including factors other than direct cost to consider in awarding construction contracts. In doing so, the District should review the applicable information from its training manual, its process for evaluating and selecting consultant engineers, and industry resources. Subsequently, the District should determine whether there is a feasible and practical method for scoring all of the factors when evaluating bids.

ORC 6119.10 authorizes the District to let contracts to the lowest and best bidder who meets the requirements of ORC 153.54 that addresses bid guaranty. Although the Board's bylaws state that all purchases authorized by the Board shall conform with ORC 6119.10, the District does not have a formal policy or procedures regarding how it meets the "best" component. However, the District developed a training manual, dated December 2010, which contains the following information under "Designer Bid Evaluation/Recommended Elements:"

- Name and size of projects worked on;
- Types of work involved on these projects;
- Record of completing projects on time;
- Record for seeking unwarranted change orders, unsubstantiated claims;
- Contractor's project manager and/or foreman on these projects;
- Contractor's strong and weak points;
- Recommendation for future work with interviewer;
- Record of litigation with contractor;
- Rating on a scale from 1 to 10;
- Contractor's current financial information;

- Contractor's reputation for making prompt payments; and
- Any known cash flow problems.

The Ohio Department of Transportation (ODOT) has a policy for the use of a value-based selection process for specific design-build contracts. The policy is designed to ensure that when used, the process is transparent and contracts are procured in a fair, equitable, and competitive manner. The value-based selection process combines technical qualifications and competitive bidding elements, including technical, quality, scheduling, operating, and pricing factors. Additionally, ODOT may assess the project risks, project complexity, size, traffic management, and project schedule requirements in determining whether a value-based selection process should be used for a particular design-build project.

The sample review of 53 contracts did not reveal any instances where the District did not comply with the lowest and best requirement. However, focusing additional attention on the concept of “best” can help the District ensure it receives the highest quality construction services. Furthermore, NEORSRSD considers and rates non-cost factors when selecting consultant engineers.

R1.4 Specify allowable per-diem costs, unallowable costs, and the requirement to provide itemized receipts. Carefully review invoices for compliance.

NEORSRSD should specify the allowable per-diem costs related to travel (lodging, meals, etc.), unallowable costs, and the requirement to submit itemized receipts in its contracts. It should also specify the ramifications for routine violation. Furthermore, staff should carefully review all invoices and supporting documentation to avoid inappropriate payments.

During the review of NEORSRSD’s contracts, AOS found instances of consultants’ failure to itemize invoices and the provision of inappropriate reimbursements. For example, the District reimbursed a consultant for alcoholic beverages in one instance and over-reimbursed for taxi services in another. The invoice issues identified during the performance audit relate to three consultant contracts. However, AOS did find evidence of the District correcting invoices prior to reimbursement, including the exclusion of alcohol beverages in one instance. Furthermore, AOS found evidence of the District’s project engineers approving invoices for reimbursement.

The Deputy Executive Director stated that all consultants are required to submit itemized receipts or they will not be paid. However, the project invoice standards that are used as a part of the contracts do not specifically require travel receipts to be itemized. The Deputy Executive Director also noted that consultants are aware that they will not be reimbursed for alcohol, must abide by standard tipping requirements, and have a per diem food cost requirement. However, the per diem allowable costs for food are not listed in the contracts. Although one of the three consultant contracts indicates that lodging and meal expenses may not exceed the maximum per

diem rates set for Cleveland, OH by Title 48, Part 31.205.46 (Travel Costs) of the Code of Federal Regulations, this Part does not actually detail the per diem maximums. The actual per diem rates are available at the U.S. Department of General Services Administration's website (<http://www.gsa.gov/portal/category/100120>). Additionally, the District's project invoice standards require conformance with Title 48, Part 31, and indicate that alcohol is an unallowable cost and gratuities are reimbursed at a maximum of 15 percent.

According to *Selection and Use of Engineers, Architects and Professional Consultants* (APWA, 1997), disputes with contractors about meal costs can be partially avoided by specifying per diem rates for food and lodging. Requiring itemized receipts and carefully reviewing invoices, would help ensure the District reimburses contractors for appropriate costs.

R1.5 Comply with ORC 2909.32 and 2909.33.

NEORS D should comply with ORC 2909.32 and 2909.33 by requiring all contractors and consultants doing work valued at over \$100,000 to complete the declarations regarding material assistance/non-assistance to a terrorist organization (DMA) questionnaire to certify that they have not provided material assistance to a terrorist organization. In addition, the District should review the recently created questionnaire and policy to ensure they comply with the relevant statutes.

During the fieldwork phase of the performance audit, NEORS D lacked a policy that addresses declarations regarding material assistance/non-assistance to a terrorist organization (DMA) as required in ORC 2909.32 and 2909.33. As a result, none of the contracts reviewed in this performance audit showed evidence of compliance with these ORC sections. However, during the course of this performance audit, NEORS D established a questionnaire and a policy regarding DMA for all contractors and consultants doing future work valued at over \$100,000.

ORC 2909.33 (C) states the following:

"Prior to entering into a contract to conduct business or receive funding, any person, company, affiliated group, or organization, and any person who holds, owns, or otherwise has a controlling interest in a company, affiliated group, or organization that conducts any business with or receives funding in an aggregate amount greater than one hundred thousand dollars annually from the state, any instrumentality of the state, and any political subdivision of the state, excluding the amount of any personal benefit, shall certify that it does not provide material assistance to any organization on the United States department of state terrorist exclusion list. The certification shall be made by completing the declaration of material assistance/non-assistance."

In accordance with ORC 2909.32, DMA should address the following questions:

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- Are you a member of an organization on the U.S. Department of State Terrorist Exclusion List?
 - Have you used any position of prominence you have within any country to persuade others to support an organization on the U.S. Department of State Terrorist Exclusion List?
 - Have you knowingly solicited funds or other things of value for an organization on the U.S. Department of State Terrorist Exclusion List?
 - Have you solicited any individual for membership in an organization on the U.S. Department of State Terrorist Exclusion List?
 - Have you committed an act that you know, or reasonably should have known, affords “material support or resources” (further defined by ORC) to an organization on the U.S. Department of State Terrorist Exclusion List?
 - Have you hired or compensated a person you knew to be a member of an organization on the U.S. Department of State Terrorist Exclusion List or a person you knew to be engaged in planning, assisting, or carrying out an act of terrorism?

According to the Ohio Homeland Security Declaration of Material Assistance at the Ohio Department of Public Safety, the agency or entity issuing a license, hiring an employee, entering into a business contract or providing funding subject to the DMA shall retain the completed form along with the application for its records. If the applicant has answered “no” to each of the questions, no further action is necessary by the agency or entity.

R1.6 Include and issue “notice to proceed” directives for all contracts.

NEORSRD should include a "notice to proceed" directive in all contracts, including consultant engineer services, as a means of officially communicating its readiness to commence with the project. Subsequently, the District should issue the “notice to proceed” directives for all contractors. Doing so would allow the District to accurately track project start times to ensure compliance with timeline requirements in the contract. NEORSRD should also educate affected staff members on the “notice to proceed” requirements.

NEORSRD does not always issue "notice to proceed" directives to consultant engineers, despite the requirement in its standard contract language. Specifically, 11 out of the 19 consultant engineer contracts reviewed in this performance audit required a “notice to proceed.” However, 7 of these 11 contracts lacked evidence that a "notice to proceed" was issued. In addition, three consultant engineer contracts and one regular construction contract did not contain a “notice to proceed” requirement. Furthermore, District employees are not fully aware of the “notice to proceed” requirement, indicating the notice is only issued for construction projects and not for consultant engineering projects.

According to the *Public Works Management Practices Manual, 4th Edition* (APWA, 2001), "a notice to proceed is required prior to construction and includes special instructions or revisions to

the construction schedule. The notice to proceed includes any revisions to the schedule or special instructions that resulted from the preconstruction conference. The notice advises the contractor that any time restrictions required of the contract are now in effect."

By failing to include and issue a "notice to proceed" for each contract, the District increases the risk of starting projects before all issues related to scope and timelines have been addressed.

R1.7 Ensure compliance with Sunshine law and Board's Code of Conduct and Decorum.

NEORS D should review the activities undertaken during the luncheons prior to Board meetings to ensure compliance with the Sunshine Law, ORC 122.22, and its own Code of Conduct and Decorum. Specifically, the District should not discuss or undertake Board business at the luncheons.

NEORS D's Board meetings are held twice each month at 12:30 p.m. in the Public Meeting Room located at the District headquarters. Various committee meetings, such as the Governance Committee, the Audit Committee, and Finance Committee, are also held at the District during regular business hours. Meeting times are also posted on the District's website.

Prior to each regular Board meeting, the District holds luncheons for executive staff and Board members. The media is not notified of these luncheons and they are not open to the public. In addition, two Board members indicated that some District matters are discussed at these luncheons, while another Board member indicated that certain documents are signed at these luncheons. The luncheons have been the practice of the District for many years to promote good will between the staff and the Board, and to use the Board members' time more efficiently. For example, by signing documents related to decisions made at the prior meeting ahead of time, Board members can leave immediately after the current meeting and return to their regular jobs sooner.

According to Rule 9 of the Board's Code of Conduct and Decorum, "the Board will discuss Northeast Ohio Regional Sewer District business in an open forum or in Executive Session." Likewise, Ohio's Sunshine Law, ORC 121.22, requires public officials to take official action and conduct all public deliberations only in open meetings, unless the matter is specifically excepted by law. All meetings of any public body are declared to be public meetings open to the public at all times. A member of a public body is required to be present in person at a meeting open to the public to be considered present or to vote at the meeting and for purposes of determining whether a quorum is present at the meeting. A meeting is defined as "any prearranged discussion of the public business of the public body by a majority of its members." As a result, the luncheons would need to be open to the public if Board members are in fact performing the previously mentioned activities.

District Response

The letter that follows is the District's official response to the performance audit. Throughout the audit process, staff met with District officials to ensure substantial agreement on the factual information presented in the report. When District officials disagreed with information contained in the report and provided supporting documentation, the audit report was revised. The official response did not require any modifications to the performance audit report. However, readers of the audit report should refer to **R1.7** to understand the basis for this recommendation.

June 29, 2011

Mr. Dave Yost
Auditor of State
88 East Broad Street
Fifth Floor
Columbus, Ohio 43215-3506

Dear Mr. Yost:

The Northeast Ohio Regional Sewer District would like to thank the entire performance audit team for their time and effort towards the completion of our Performance Audit. We appreciate the thorough review and the recommendations that were provided.

The staff and board of the Northeast Ohio Regional Sewer District understand the importance of delivering our services to our customers with efficiency, fairness and transparency. Towards that end, we have carefully reviewed each of the recommendations you provided and prepared the following response:

R1.1 Evaluate contractor and consultant performance

The District is currently implementing major improvements to the administrative procedures for managing both professional services/design and construction contracts. Separate procedures and policies are being developed for the close-out and performance monitoring for each type of contract, which generally ascribe to the following:

- **Professional Services/Design Contracts:** The District follows Ohio's Design Professional Selection Law (ORC §§ 153.65-71) in its selection of professional engineering services. The District has standardized its process for Qualifications-Based Selection (QBS), including our Request for Proposal (RFP) requirements.
- **Ability to assess Overall Performance in Consultant Selection:** As part of the revised RFP requirements, the District solicits disclosure of consultant performance on both previous projects at the District, as well as, with other clients. The RFP requires disclosure of deviations from budget or cost and a summary of construction change orders that are attributable to the designer's errors and/or omissions. We believe that these RFP requirements bring the designer's overall

performance into consideration and give them appropriate weighting in the selection process for professional services contracts.

- **Regular Performance Reporting:** Recent professional services contracts for design projects include the identification of Key Performance Indicators (KPIs) for consultants, against which a portion of their fee is placed at risk. KPIs are linked to both achievement of milestones and performance of the design during construction, as measured through change orders. The administration of the KPIs will be defined as part of the new design contract administration policies being developed. In addition to measuring and reporting of performance on the KPIs, the consultants do provide monthly performance reporting and status reporting as part of the District's professional services invoicing standards.
- **Construction Contracts:** The District bids construction contracts under Ohio's Competitive Bidding laws and selects based upon "lowest and best" bid per the requirements of ORC §§ 6119.10 and 153.54. While there are no formalized procedures for documenting a contractor's performance on previous projects, the District's bidding documents allow determination of "best" on a project-by-project basis. A Contractor's Qualifications Questionnaire (CQQ) is part of every construction bidding package that is issued by the District. For complex projects (e.g., the Euclid Creek Tunnel), the CQQ can be customized to the specific needs and require the contractor to demonstrate its qualifications and successful track record in delivering similar projects. The CQQ also requires the listing of client references. For the unique and complex project types that are bid by the District, we believe that the project-specific CQQ is a more valuable tool in the District's determination of Lowest and *Best*, in lieu of a formal performance tracking system.

R1.2 Develop consultant selection policy and procedures

The District is currently implementing major improvements to the selection and administrative procedures for professional services/design contracts. The bulk of the consultant contracts reviewed by Auditor of State, including those that were lacking evidence of advertising and/or had missing scoring sheets, were for Construction Administration (CA) and Resident Engineering (RE) Services during Construction. These contracts were part of a legacy procurement system at the District where professional services for design were initially selected through a competitive process which included evaluation and scoring. Once the design was completed, and a clearer picture of the required level of assistance needed during construction from the designer was known, a new and separate contract would be entered into with the Design consultant for CA/RE services. The legacy CA/RE contracts were modifications to the original design contract, not the result of new solicitations or advertisement.

This practice was discontinued beginning with new design contracts awarded in 2008. Professional Services contracts for design now include a complete cradle-to-grave scope of work and include the full suite of CA/RE services anticipated. In addition, the District currently follows Ohio's Design Professional Selection Law (ORC §§ 153.65-71) in its selection of professional engineering services. The notification for RFPs is communicated via email to all engineering firms registered on the District's vendor list, including Minority Business Enterprise, Women Business Enterprise and Small Business Enterprise firms. In addition, the RFP is advertised on the internet.

R1.3 Develop a policy addressing best value procurement

The District is currently implementing major improvements to the administrative procedures for managing both professional services/design and construction contracts. The policies and procedures for determination of best value must be treated separately for design services and construction contracts since they are governed under different State statutes. The District's current practices for each type of contract generally ascribe to the following:

- **Professional Services/Design Contracts:** The District follows Ohio's Design Professional Selection Law (ORC §§ 153.65-71) in its selection of professional engineering services. While the *Selection and Use of Engineers, Architects, and Professional Consultants* (APWA, 1997) provides general guidance for a selection processes, the District follows Ohio's Design Professional Selection Law (ORC §§ 153.65-71) in its selection of professional engineering services. The District has standardized its process for the Qualifications Based Selection (QBS), including our Request For Proposal (RFP) in accordance with those requirements which state:

“No public authority planning to contract for professional design services pursuant to R.C. § 153.69, shall require any form of fee estimate, fee proposal, or other estimate or other measure of compensation prior to selecting and ranking professional design firms except for instances where firms are selected and ranked from a pre-qualified list.”

- **Construction Contracts:** The District bids construction contracts under Ohio's Competitive Bidding laws and selects based upon “lowest and best” bid per the requirements of ORC §§ 6119.10 and 153.54. While there are no formalized procedures for documenting a contractor's performance on previous projects, the District's bidding documents allow determination of “best” on a project-by-project basis. A Contractor's Qualifications Questionnaire (CQQ) is part of every

construction bidding package that is issued by the District. For complex projects (e.g., the Euclid Creek Tunnel), the CQQ can be customized to the specific needs and require the contractor to demonstrate its qualifications and successful track record in delivering similar projects. The CQQ also requires the listing of client references. For the unique and complex project types that are bid by the District, we believe that the project-specific CQQ is a more valuable tool in the District's determination of lowest and *best* bidder, in lieu of a formal performance tracking system.

R1.4 Specify allowable per-diem costs, and the requirements to provide itemized receipts. Carefully review invoices for compliance

- We will review the District's invoicing standards and make any required changes to avoid any misunderstandings about meal and lodging costs.
- Language will be addressed in the contracts and proper oversight will be put in place to avoid any potential reimbursement for unallowable costs.

R1.5 Comply with ORC §§ 2909.32 and 2909.33

Based upon this finding by the AOS, the District has modified our standard construction bid documents to include the requirements as described in R1.5 which states:

“Prior to entering into a contract to conduct business or receive funding, any person, company, affiliated group, or organization, and any person who holds, owns, or otherwise has a controlling interest in a company, affiliated group, or organization that conducts any business with or receives funding in an aggregate amount greater than one hundred thousand dollars annually from the state, any instrumentality of the state, and any political subdivision of the state, excluding the amount of any personal benefit, shall certify that it does not provide material assistance to any organization on the United States department of state terrorist exclusion list. The certification shall be made by completing the declaration of material assistance/non-assistance.”

R1.6 Include and issue “notice to proceed” directives for all contracts.

The District is currently implementing major improvements to the administrative procedures for managing both professional services/design and construction contracts. The policies and procedures are being developed separately for design services and

construction contracts since they are governed under different State statutes. The District's current practices for commencing each type of contract generally ascribe to the following:

- **Professional Services/Design Contracts:** Though not a legal requirement, the District agrees that the practice of issuing a Notice to Proceed (NTP) for professional services contracts is good practice. The lack of NTP letters on four of the seven professional services contracts is attributable to legacy CA/RE contracts. As previously discussed, this legacy practice was essentially a continuation of design contracts, and accordingly, the District's policy at that time was not to issue NTP letters when modifying the design contracts to include CA/RE services. The District will further evaluate the terms and conditions of our professional services contracts regarding the requirement for an NTP and reconcile with our current practices for professional services.
- **Construction Contracts:** It is the District's current and on-going practice to issue NTPs for Construction projects in accordance with the requirements of our Construction Contracts.

R1.7 Ensure compliance with Sunshine Law and Board's Code of Conduct and Decorum

In 2008, the Board of Trustees adopted a Code of Ethics and a Code of Conduct and Decorum which incorporate specific provisions for compliance with the Ohio Sunshine Laws. Currently, the Board is considering revisions to the Code of Ethics to update the Code in Compliance with the Ohio Open Meetings Act and to further clarify the District's policies regarding confidential information and privileged communications.

The District provides an optional lunch to District staff and Board Members on Board meeting days. The Code of Conduct and Decorum for the Board of Trustees states in Rule 9 that "[T]he Board will discuss Northeast Ohio Regional Sewer District business in an open forum or in Executive Session. After Board discussion, information discussed in Executive Session may be released to the public only if not identified as confidential or privileged." The practice of not discussing District business at lunch will continue and be strictly enforced.

To further reinforce the requirements of open meetings laws with Board members, a copy of the State of Ohio Sunshine Law will be downloaded to each Board member's electronic Board packet for easy reference both during the Board meeting and in preparation for the meetings.

Sunshine Law training schedules provided by the Ohio Attorney General's Office and the Auditor of the State's Office will be made available to each Board member. In addition, Sunshine Law review will be made a part of the training of all new Board members, as well as, the annual training of all Board members.

Thank you again for your time and effort in service to our organization and the citizens of our state.

Sincerely,

A handwritten signature in blue ink, appearing to read 'JC', is positioned above the printed name.

Julius Ciaccia
Executive Director