



**Auditor of State
Betty Montgomery**

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**OHIO DEPARTMENT OF ADMINISTRATIVE SERVICES - IQ SOLUTIONS
FRANKLIN COUNTY**

**SCHEDULE OF RELEVANT PERSONNEL
As of January 31, 2003**

Ohio Department of Administrative Services

Matt Westerman, Legal Counsel
Jeff Westhoven, Chief Administrator, Energy Services
Jerry Orth, Energy Specialist

IQ Solutions

Robert Kendall, Owner
Bill Sprow, Controller
Denise Dunn, President

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**Auditor of State
Betty Montgomery**

INDEPENDENT ACCOUNTANTS' REPORT

Scott Johnson, Director
Ohio Department of Administrative Services
30 East Broad Street, 40th Floor
Columbus, OH 43266-0401

Based upon your request, we have conducted a special audit by performing the procedures described in the attached Supplement to the Special Audit Report for the period September 1, 2001 through January 31, 2003 (the Period), solely to identify the amounts owed to natural gas suppliers in conjunction with the State of Ohio's Contract with IQ Solutions, LLC; to determine, if possible, the disposition of funds paid to IQ Solutions by the State of Ohio and members of the cooperative agreement; and evaluate the process used by the Ohio Department of Administrative Services (DAS or the Department) to manage the contract with IQ Solutions.

This engagement was conducted in accordance with consulting standards established by the American Institute of Certified Public Accountants. The procedures and associated findings are detailed in the attached Supplement to the Special Audit Report. A summary of our procedures and significant results is as follows:

1. We compared the amount payable to each supplier based on documentation provided by IQ Solutions to the amount owed based on information from the suppliers provided by the Department of Administrative Services to identify any differences between these amounts.

Significant Results:

We calculated a total payable amount of \$5,771,302 per the suppliers' invoices and other support, and \$5,775,774 based on the internal records of IQ Solutions. The total variance of \$4,472 related to only two suppliers; there were no differences identified for five of the seven suppliers. The first of the two variances (\$621 for FirstEnergy) was determined to be related to a credit which was not recorded in the records of IQ Solutions. The second variance (\$3,851 for Noble Gas) was narrowed down to one invoice. IQ Solutions showed this invoice as outstanding; the supplier did not include this amount in the outstanding payables.

The amounts IQ Solutions owed as of January 31, 2003, are identified, by supplier, in the table on the following page. These amounts include a \$2.1 million error made by Columbia Gas when electronically debiting the IQ Solutions bank account for payments. Additional amounts may have been incurred subsequent to this date, including late fees or other similar charges, and/or subsequent payments made by IQ Solutions which have not been included in this report.

IQ Solutions
Comparison of Past Due Balances
As of January 31, 2003

| Supplier Name | Balances per IQ Records | Balances per Suppliers ³ | Variance |
|---|----------------------------|--|----------------------|
| EnergyUSA – TPC | \$266,257 | \$266,257 | \$0 |
| Exelon Energy – Gas | \$187,005 | \$187,005 | \$0 |
| FirstEnergy Solutions⁴ | \$1,613,136 | \$1,612,515 | (\$621) ¹ |
| Interstate Gas Supply | \$724,328 | \$724,328 | \$0 |
| Marathon Oil Company | \$572,568 | \$572,568 | \$0 |
| Noble Gas Marketing | \$312,480 | \$308,629 | \$3,851 ² |
| Subtotal | \$3,675,774 | \$3,671,302 | (\$4,472) |
| Columbia Gas/FirstEnergy⁴ | \$2,100,000 | \$2,100,000 | \$0 |
| Total | \$5,775,774 | \$5,771,302 | (\$4,472) |

1 – Credit amount not shown on IQ records.

2 – IQ's records show invoice 2090126FC for \$3,851; Noble did not show this amount as outstanding.

3 – Based on copies of invoices and other documents provided by DAS.

4 – The \$2.1 million relates to an error on the part of Columbia Gas. IQ Solutions' records indicate the amount is payable to Columbia Gas. This amount may, however, be payable to FirstEnergy in conjunction with agreements they had with DAS and Columbia Gas. See the Supplement to the Special Audit Report on page 9 for more details.

IQ Solutions did not pay the suppliers all the amounts owed; therefore, a finding for recovery is being issued in the amount of \$5,771,302 against IQ Solutions, LLC in favor of the State of Ohio in accordance with Ohio Revised Code Section 117.28.

- We evaluated the transactions recorded in the IQ Solutions billing system and general ledger, and other relevant documentation to determine, if possible, the disposition of monies paid by the State of Ohio and the local government members of the cooperative agreement to IQ Solutions in conjunction with their contract.

Significant Results:

Because the financial transactions of IQ Solutions were commingled with other related companies of CPS Holding, we were not able to determine with any degree of certainty the disposition of the monies paid by the State and cooperative agreement members in conjunction with the contract. However, since all amounts paid to IQ Solutions for natural gas were deposited in their bank account, it would appear the amounts not forwarded to the suppliers were used to pay other obligations or operating losses of IQ Solutions or one of the related companies of CPS Holding. We did identify 22 payments totaling \$316,046 which were made directly to other companies owned by or associated with Mr. Kendall, to officers of those companies, to Mr. Kendall himself, or to his wife.

3. We documented the process used by DAS to manage the contract with IQ Solutions and identify any significant weaknesses and/or recommendations for improvement in the process.

Significant Results:

We met with representatives from DAS and documented the process used to award and monitor the contract with IQ Solutions. Based on our review of this documentation and information gathered throughout our testing, we identified 7 weaknesses related to the bid award/evaluation and the monitoring process for advanced payment contracts or where the contractor has control over state funds. In addition, we made 10 recommendations for improvements in the process.

4. On October 28, 2003, we held an exit conference with the following individuals from DAS:

Rick Hickman, Deputy Director of General Services
Jeff Westhoven, Chief Administrator, Energy Services
Beth Stalnaker, Acquisitions Management
Curtis Brooks, Acquisitions Management
Matt Westerman, Legal Counsel
Chris Kinworthy, Legal Counsel

The attendees were informed that they had five business days to respond to this Special Audit Report. A response was received on October 31, 2003, evaluated, and modifications were made to the attached Supplement to the Special Audit Report as we deemed appropriate.

This report is intended solely for the information and use of the Ohio Department of Administrative Services and is not intended to be and should not be used by anyone other than these specified parties. However, reports by the Auditor of State are a matter of public record and use by other components of state government or local government officials is not limited.



BETTY MONTGOMERY
Auditor of State

October 16, 2003

Supplement to the Special Audit Report Ohio Department of Administrative Services – IQ Solutions

Background

The State of Ohio had a contract with IQ Solutions to act as a third-party administrator for contracts the State had with various natural gas suppliers to provide natural gas to the State of Ohio and local government members of a cooperative agreement who purchase natural gas through State term contract. Under the terms of the agreement, IQ Solutions was to use their expertise to obtain the best price for the natural gas through volume discounts, receive the invoices from the suppliers, allocate and bill these costs to the users, receive payments from the users, and remit the amounts owed to the suppliers. For this service, IQ Solutions was paid an administrative fee by the users based on the quantity of gas delivered. See Chart 1 on page 7 which depicts the intended flow of activities.

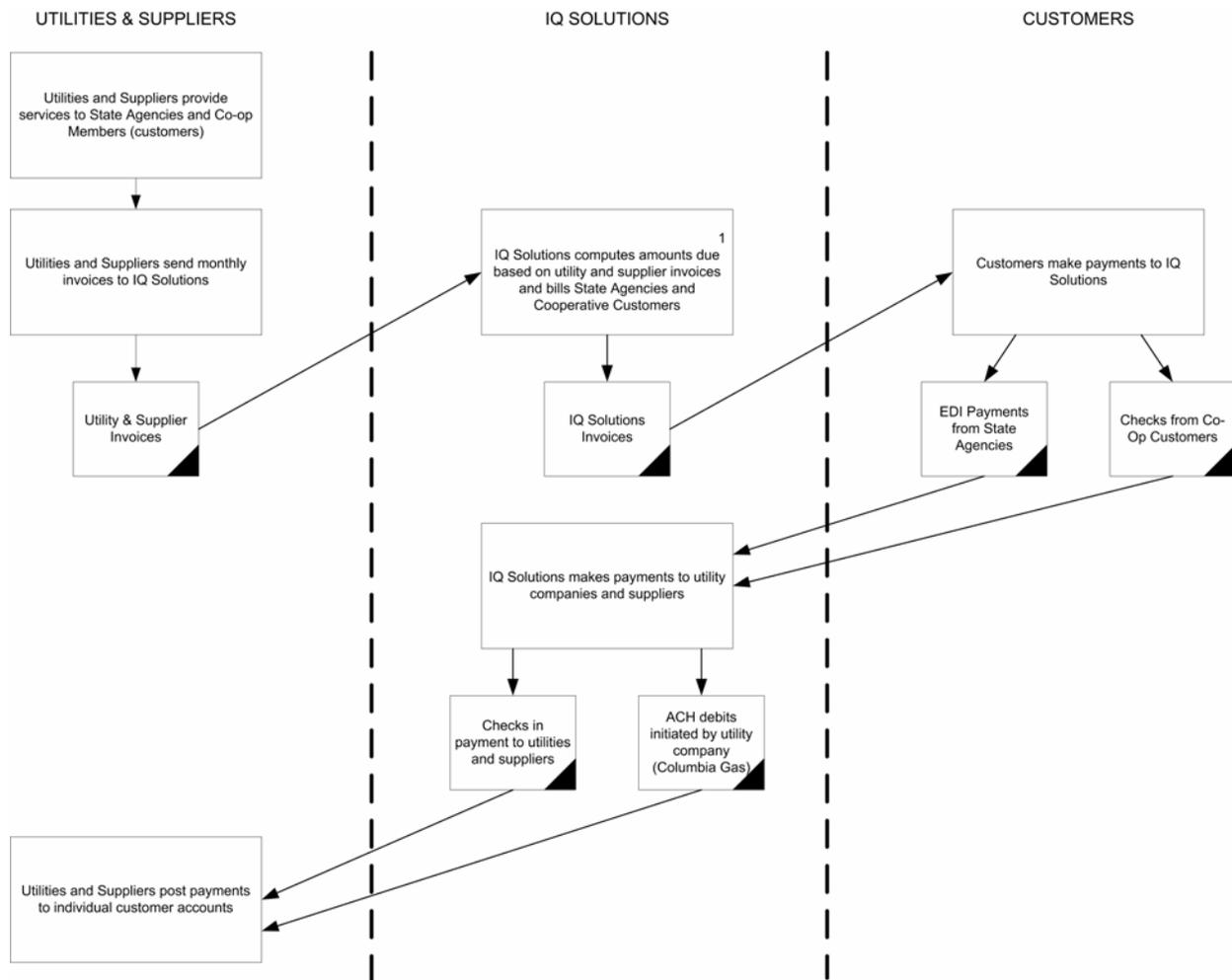
IQ Solutions had served as the third-party administrator since December 1995 through three consecutive three-year contracts awarded through competitive bid. In March 2002, the Ohio Department of Administrative Services and other customers began receiving complaints from suppliers indicating the suppliers were not receiving payment, although the State and other customers indicated they were regularly remitting payments to IQ Solutions. In late December 2002, the responsibilities of IQ Solutions were reduced to preparing the billings to the customers. DAS personnel took over the functions of purchasing the natural gas, receiving and reviewing the invoices produced by IQ Solutions and paying the suppliers. DAS did not, however, pay any outstanding amounts to suppliers which occurred during the time period IQ Solutions was providing the natural gas utility services. Although the third contract was not set to expire until June 30, 2003, DAS terminated the contract on March 27, 2003, as a result of the payment issues.

Following preliminary contacts between representatives of DAS, the Attorney General, and the Auditor of State, DAS requested that we perform a special audit of this matter in a letter dated March 19, 2003, from the Director of DAS. The above information was presented to the Auditor of State's Special Audit Task Force and on March 21, 2003, the Auditor of State initiated a special audit of this matter.

In March 2003, DAS entered into a contract with FirstEnergy Solutions to act as the new third-party administrator of this program. On May 30, 2003, the Attorney General filed a court action on behalf of the State to attempt to recover the monies paid to IQ Solutions which were not forwarded to the natural gas suppliers.

Supplement to the Special Audit Report Ohio Department of Administrative Services – IQ Solutions

Chart 1: Intended Flow of Activity



1 – IQ Solutions added an administrative fee to each customers invoice based on the volume of natural gas delivered. However, the transporter, supplier, and administrative fees were not separately identified on the customer invoices.

Note: This chart was prepared by DAS and recreated by Auditor of State personnel for this report.

Supplement to the Special Audit Report Ohio Department of Administrative Services – IQ Solutions

| |
|----------------------------------|
| Objective 1: Amounts Owed |
|----------------------------------|

We compared the amount payable to each supplier based on documentation provided by IQ Solutions to the amount owed based on information from the suppliers provided by the Department of Administrative Services to identify any differences between these amounts.

PROCEDURES

1. We obtained all transactions maintained in IQ Solutions' accounts payable ledger electronically and determined the amount owed to the suppliers as of January 31, 2003.
2. We obtained supplier invoices received and maintained by DAS which detail amounts owed to the suppliers and summarized this information by supplier.
3. We compared the amounts owed to the suppliers per IQ Solutions' internal records to the amounts owed per supplier invoices and determined the disposition of variances, if any.

RESULTS

1. On May 14, 2003, we met with Robert Kendall and Bill Sprow of IQ Solutions and obtained the electronic data from their general ledger including the accounts payable activity with the suppliers. Using Audit Command Language (ACL) software, we quantified the accounts payable to each supplier as of January 31, 2003, per the IQ Solutions accounts payable ledger. As noted in the table on page 9, the records of IQ Solutions indicated it owed six suppliers at January 31, 2003 amounts ranging from \$187,005 to \$1,613,136, for a total of \$3,675,774.
2. On May 16, 2003, we obtained from DAS copies of various invoices and other supporting detail provided to them by the suppliers. We reviewed these documents, identified those items which were outstanding and quantified the amounts owed per the suppliers. As noted in the table on page 9, the information provided by DAS indicated IQ Solutions owed six suppliers at January 31, 2003, amounts ranging from \$187,005 to \$1,612,515, for a total of \$3,671,302.
3. We compared the accounts payable amounts as of January 31, 2003, per the records of IQ Solutions to the invoices and other support from the suppliers provided by DAS, and identified and researched all noted variances as detailed in the table below. The payable amount for four of the six suppliers agreed without exception; variances were identified for two suppliers. The first variance (\$621 for FirstEnergy) was determined to be related to a credit which was not recorded in the records of IQ Solutions. The second variance (\$3,851 for Noble Gas) was narrowed down to one invoice. IQ Solutions showed this invoice as outstanding; the supplier did not include it in the outstanding payables.

**Supplement to the Special Audit Report
Ohio Department of Administrative Services – IQ Solutions**

**IQ Solutions
Comparison of Past Due Balances
As of January 31, 2003**

| Supplier Name | Balances per IQ Records | Balances per Suppliers ³ | Variance |
|------------------------------|----------------------------|--|------------------------|
| EnergyUSA – TPC | \$266,257 | \$266,257 | \$0 |
| Exelon Energy – Gas | \$187,005 | \$187,005 | \$0 |
| FirstEnergy Solutions | \$1,613,136 | \$1,612,515 | (\$621) ¹ |
| Interstate Gas Supply | \$724,328 | \$724,328 | \$0 |
| Marathon Oil Company | \$572,568 | \$572,568 | \$0 |
| Noble Gas Marketing | \$312,480 | \$308,629 | (\$3,851) ² |
| Total | \$3,675,774 | \$3,671,302 | (\$4,472) |

1 – Credit amount not shown on IQ records.

2 – IQ's records show invoice 2090126FC for \$3,851; Noble did not show this amount as outstanding.

3 – Based on copies of invoices and other documents provided by DAS.

We obtained a worksheet and other support from IQ Solutions regarding an Automated Clearing House (ACH) debit error caused by Columbia Gas which resulted in an additional outstanding payable of \$2.1 million, bringing the total payable amount to \$5,771,302 per the suppliers. We also obtained all bank statements and other documentation necessary to support the accuracy of the errors reported.

The supporting worksheet provided by IQ Solutions identified 14 Columbia Gas transactions from January 2001 to October 2001. Apparently, there was a problem in Columbia's systems which caused any digits in the 100,000 place and higher to be deleted (e.g. \$215,000 was debited as \$15,000). The worksheet included the transaction number, date, marketer, the amount which should have been swept from the Provident bank account by Columbia Gas, the difference from the actual amount transacted, and other data related to the transactions. The total amount of the difference was \$2.1 million. We verified the actual amounts paid to the Provident bank statements; however, we did not agree the amounts which should have been paid to any records at IQ Solutions. Based on correspondence provided by IQ Solutions between the parties involved, there does not seem to be any contention about this issue.

Additional correspondence provided by DAS indicated FirstEnergy Solutions believes the \$2.1 million is actually payable to them. It appears FirstEnergy had an agreement with Columbia that allowed Columbia to collect a portion of the costs associated with FirstEnergy services via the ACH debit, and then remit this amount to FirstEnergy by check. FirstEnergy claims this amount was withheld from them by Columbia. Discussions are ongoing between Columbia and FirstEnergy regarding this issue.

FINDING FOR RECOVERY

IQ Solutions, LLC entered into a Contract with the Department of Administrative Services to act as the administrator of the State's Natural Gas Administration Services contract, which required IQ Solutions to receive funds from the State of Ohio and members of the cooperative agreements and to forward these monies to the suppliers as payment for natural gas delivered. IQ Solutions did not pay the suppliers all the amounts owed. IQ Solutions, LLC received public money under the contract to be used for the specific purposes related to the purchase of natural gas, and co-mingled those funds such that the public funds cannot be accounted for. In addition, IQ Solutions, LLC acting on behalf of the Department of Administrative Services as its agent in the purchase of natural gas, received public money for payment of natural gas, yet converted those funds to pay for other purposes. Therefore, a finding for recovery is being issued in the amount of \$5,771,302 against IQ Solutions, in favor of the State of Ohio, in accordance with Ohio Revised Code Section 117.28.

Supplement to the Special Audit Report Ohio Department of Administrative Services – IQ Solutions

Objective 2: Disposition of Payments

We evaluated the transactions recorded in the IQ Solutions billing system and general ledger, and other relevant documentation to determine, if possible, the disposition of monies paid by the State of Ohio and the local government members of the cooperative agreement to IQ Solutions in conjunction with their contract.

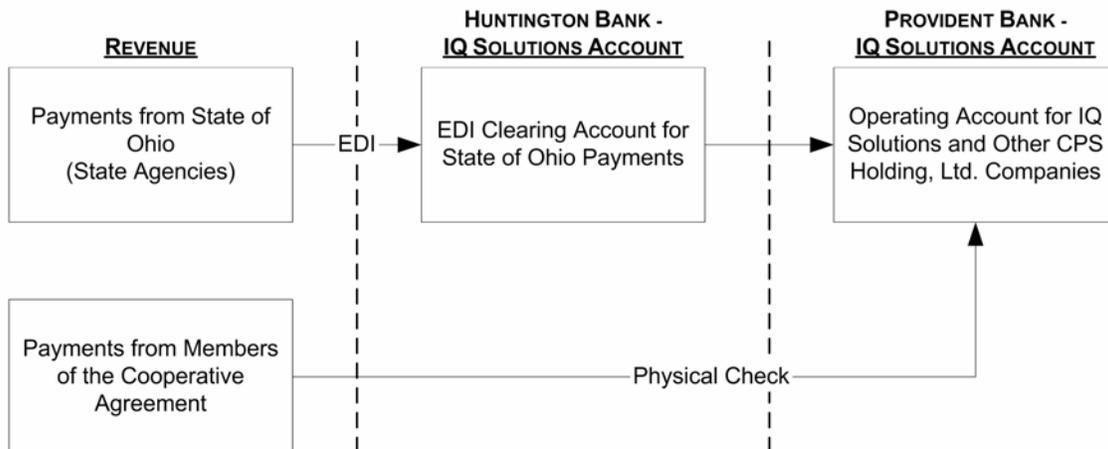
PROCEDURES

1. We obtained all transactions maintained in IQ Solutions' billing system/accounts receivable ledger and determined the amount received by IQ Solutions from the State of Ohio and the local government members of the cooperative agreement.
2. We obtained the State of Ohio general ledger (CAS), for the periods July 1, 2001 through March 31, 2003, electronically and determined amounts paid by the State of Ohio to IQ Solutions.
3. We agreed amounts disbursed and deposited, as recorded in IQ Solutions' internal records, to the IQ Solutions' operating account.
4. We agreed amounts paid by the State of Ohio to the IQ Solutions' operating account.
5. Based on the results of procedures No. 1 through No. 4 above, we attempted to determine the disposition of funds received by IQ Solutions from the State of Ohio and the local government members of the cooperative agreement which were not used to pay supplier invoices.

RESULTS

The procedures related to objective 2 involved the internal records of IQ Solutions, as well as the various bank accounts they used. Chart 2 below provides an overview of the cash flow of these accounts.

Chart 2: Cash Flow from State of Ohio Contract



**Supplement to the Special Audit Report
Ohio Department of Administrative Services – IQ Solutions**

1. On May 14, 2003, we met with Robert Kendall and Bill Sprow of IQ Solutions and obtained the electronic data from their general ledger, including their billing system regarding charges to the State of Ohio and other customers/users in the cooperative agreement. We also obtained record counts which were compared to the electronic data received to ensure completeness. These files indicated IQ Solutions had received \$25,252,811 from the State of Ohio and \$10,212,221 from the members of the cooperative agreement between September 1, 2001 and January 31, 2003 (see the table in results No. 3 below), for a total of \$35,465,032.

2. On May 8, 2003, we obtained an electronic copy of the disbursement activity in CAS from the Auditor of State Information System division for the following periods: July 1, 2000 – June 30, 2001, July 1, 2001 – June 30, 2002, and July 1, 2002 – March 31, 2003. The Information System division also provided record counts and amount totals which we used to ensure completeness of the files received. We used ACL to identify and quantify the amount paid by the State of Ohio to IQ Solutions for the period September 1, 2001 through January 31, 2003 to be \$25,468,541 (see the table in results No. 4 on the following page).

3. We obtained copies of the bank statements for the Provident account used as the operating account for IQ Solutions. We traced the transactions recorded in the IQ Solutions billing system (from results No. 1 above) to the activity recorded in the Provident account, as depicted in the following table. \$49,429 of the variances identified appeared to be the result of timing differences and were traceable to subsequent postings in the ledger or the bank. \$2,575 of the variance related to 25 transactions with members of the cooperative agreement which appeared to be the result of mis-postings in the records of IQ Solutions. The remaining \$11,456 of the variance could not be identified.

**Analysis of Receipt Variance Between
IQ Solution and Provident Bank**

| | |
|------------------------------|--------------|
| Receipts per IQ Solutions | |
| State of Ohio | \$25,252,811 |
| Members of the Coop. | 10,212,221 |
| Total | \$35,465,032 |
| | |
| Receipts per Provident Bank | \$35,505,580 |
| | |
| Variance | (40,548) |
| Timing Differences | 49,429 |
| Mis-postings by IQ Solutions | 2,575 |
| Unknown Variance | (\$11,456) |

**Supplement to the Special Audit Report
Ohio Department of Administrative Services – IQ Solutions**

4. We obtained copies of the bank statements for the Provident account used as the operating account for IQ Solutions, and for the Huntington account used to pass through the Electronic Data Interchange (EDI) payments from the State of Ohio to IQ Solutions. We traced the payments recorded in CAS to IQ Solution (from results No. 2 above) to the activity recorded in the Huntington account, as depicted in the following tables. The variance of \$7,480 was related to payments made by state agencies via state warrants and not through the EDI process. These transactions were traced to CAS and to the Provident bank statements. We also traced the amounts processed through the Huntington account to activity recorded in the Provident account, as depicted in the following table. The variance of \$86,898 was related to timing difference.

**Analysis of Variance Between
CAS and Huntington Bank**

| | |
|--------------------------------|--------------|
| Amounts Paid per CAS | \$25,468,541 |
| | |
| Amount Received per Huntington | \$25,155,018 |
| Variance | \$313,523 |
| Timing Differences | 306,043 |
| Non-EDI State Warrant | 7,480 |
| Unknown Variance | \$0 |

**Analysis of Variance Between
Huntington Bank and Provident Bank**

| | |
|--------------------------------|--------------|
| Amount Received per Huntington | \$25,155,018 |
| Less Huntington Bank Charges | (3,395) |
| Amount Paid per Huntington | 25,151,623 |
| | |
| Amount Received per Provident | \$25,241,916 |
| Variance | (86,898) |
| Timing Differences | 86,898 |
| Unknown Variance | \$0 |

**Supplement to the Special Audit Report
Ohio Department of Administrative Services – IQ Solutions**

5. Before we could determine the disposition of monies, we first had to determine whether the State of Ohio reasonably met its obligations to IQ Solutions as of January 31, 2003. We used the following data in this analysis:

- The IQ Solutions Accounts Receivable (from Objective No. 2, Procedure No. 1).
- An estimate of the administrative fee. The administrative fee was to be calculated based on the volume of gas delivered. However, this amount was not separately tracked by DAS or IQ Solutions. We, therefore, had to estimate this amount based on the Gas Purchases File (SiteGas File) provided by DAS in electronic form.
- The IQ Solutions Accounts Payable (from Objective No. 1, Procedure No. 1).

Using this information, we calculated the gross receipts from the State of Ohio and local cooperatives and subtracted IQ Solutions' estimated administrative fee to estimate the net receipts which should have been used for payments to natural gas suppliers. We subtracted the gross payments to suppliers from the net receipts and added the calculated outstanding balance at August 31, 2001. Based on our evaluation of this information, it appears the State of Ohio reasonably met its obligations to IQ Solutions as of January 31, 2003. This analysis is depicted in the table below.

**Estimated State of Ohio Payments to IQ Solutions Not Paid to Suppliers
Net of Administrative Fees as of January 1, 2003**

| | | |
|--|---------------------|------------------------|
| <i>Receipts</i> | | |
| Gross Receipts from the State of Ohio and Cooperatives | \$35,465,032 | |
| IQ Solutions Administration Fees (estimated) | <u>(498,378)</u> | |
| Net Receipts | | \$34,966,654 |
| <i>Payments</i> | | |
| ACH Debits, Debited from Provident Account by Suppliers | (17,122,082) | |
| Payments to Suppliers via Checks issued by IQ Solutions | <u>(15,515,075)</u> | |
| Total Payments to Natural Gas Suppliers | | (32,637,157) |
| Outstanding Balance at August 31, 2001 ¹ | | <u>2,832,916</u> |
| Estimated State of Ohio Payments to IQ Solutions Not Paid to Suppliers | | <u>\$5,162,413</u> |

1 – Total Receipts from the State of Ohio per IQ Solutions records net of estimated administrative fee less total payments to Suppliers per IQ Solutions records as of August 31, 2001. Note: ACH Debits prior to September 1, 2001 are estimated based on ACH Debits from the period September 1, 2001 through January 31, 2003.

We then evaluated the disbursement transactions recorded in the accounts payable ledger of IQ Solutions and the ACH payments reported on the Provident Bank statements since the ACH payments were not recorded in the accounts payable ledger. According to these records, IQ Solutions paid a total of \$36,158,950 to various vendors during the period September 1, 2001 through January 31, 2003, as detailed in the table on the following page. \$3,230,510 of this amount was paid to vendors other than suppliers. The payments to these vendors were further analyzed and categorized by major type of expenditure based on the company name and/or the nature of their business. Since this data is based on the activity reported by the bank, the total payments to suppliers on the following page (\$15,806,358) varies from the amount recorded in the records of IQ Solutions, as reported in the table above (\$15,515,075), due to timing differences.

**Supplement to the Special Audit Report
Ohio Department of Administrative Services – IQ Solutions**

**Disbursements
For the Audit Period September 2001 to January 2003**

| | | <u># of Transactions</u> |
|--|-------------------------|------------------------------|
| <u>Gas & Related Payments</u> | | |
| Columbia Gas Debits | \$17,122,082 | 12,426 |
| Gas Suppliers / Vendors | <u>15,806,358</u> | 189 |
| Total Gas Expenses | \$32,928,440 | |
| <u>Other Disbursements</u> | | |
| General Administrative | | |
| Payroll Related | 1,245,356 | 191 |
| Banks | 549,858 | 495 |
| Property Leasing | 241,926 | 48 |
| Computer, Telephone, and Technology | 232,658 | 123 |
| Insurance | 175,089 | 38 |
| Professional Fees | 170,652 | 41 |
| Government Fees/Taxes | 60,330 | 32 |
| Freight & Delivery | 26,071 | 39 |
| Miscellaneous | <u>212,524</u> | <u>159</u> |
| Total General Administrative | 2,914,465 | 1,166 |
| Related Items | | |
| Regency Technologies, Ltd. | 130,000 | 3 |
| Sentex Inc. | 124,500 | 5 |
| Robert S. Kendall, IQ Solutions Owner | 30,269 | 3 |
| Julius Hess, Sentex Vice President | 25,462 | 5 |
| Denise M. Dunn, IQ Solutions President | 3,516 | 5 |
| Linda R. Kendall, Wife of Owner | <u>2,299</u> | <u>1</u> |
| Total Related Items | 316,046 | <u>22</u> |
| Total Other Disbursements | <u>3,230,510</u> | <u>1,188</u> |
| Total Disbursements | <u>\$36,158,950</u> | <u>13,803</u> |

Supplement to the Special Audit Report Ohio Department of Administrative Services – IQ Solutions

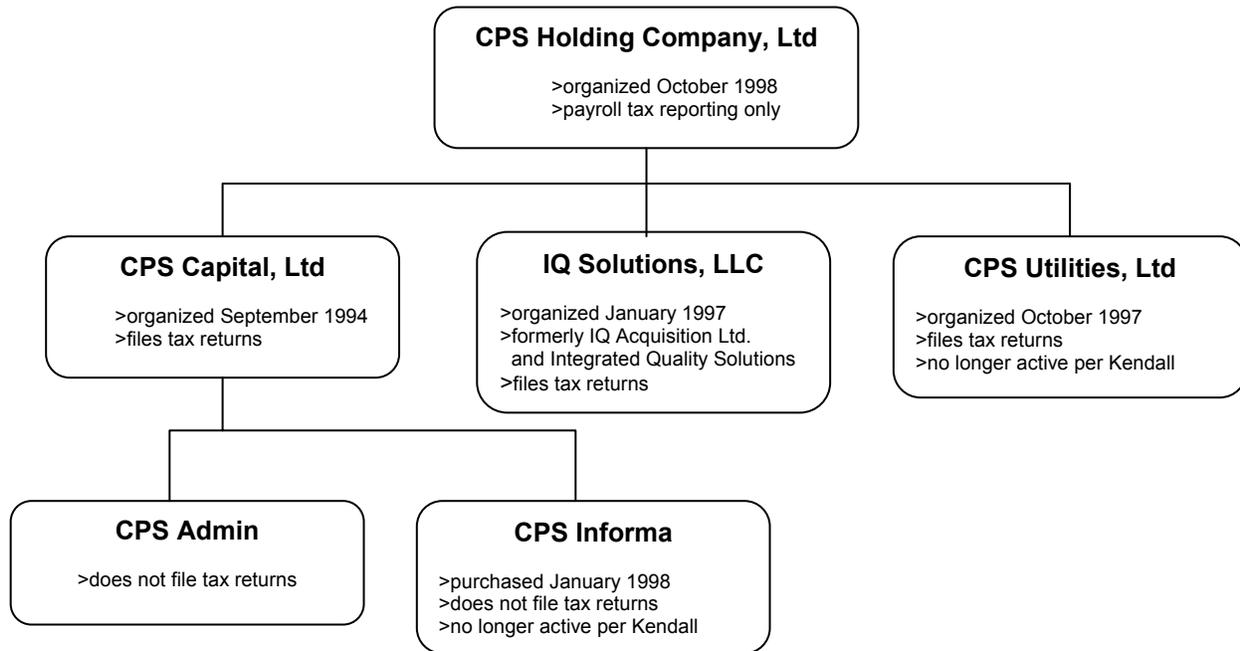
\$2,914,465 of the payments to non-gas vendors from the table on the previous page appeared to relate to normal operating expenses of any business. However, we were not able to determine what portion, if any, of these costs were attributable to the activities of IQ Solutions and/or the administration of their agreement with the State of Ohio because IQ Solutions, LLC is one of several companies owned and operated by Robert Kendall under CPS Holding. All the companies within CPS Holding appear to operate using one joint bank account at Provident Bank. Mr. Kendall also is currently or was previously the principal party in and/or affiliated with several other companies. See Chart 3 on page 16 for CPS Holding's table of organization and a listing of the related companies. Mr. Kendall purchased IQ Solutions (formerly Integrated Quality Solutions) in 1997 during the third year of the first three-year contract with the State.

\$316,046 of the payments to non-gas vendors from the table on the previous page appeared to relate to companies or individuals with whom Mr. Kendall had a relationship. However, we were not able to determine if any of these payments were inappropriate based on the information available.

Based on our testing, we were not able to determine with any degree of certainty the disposition of the monies paid by the State and cooperative agreement members in conjunction with the contract because the financial transactions of IQ Solutions were commingled with the other companies of CPS Holding. However, since all amounts paid to IQ Solutions for natural gas were deposited in their bank account, it would appear the amounts not forwarded to the suppliers were used to pay other obligations or operating losses of IQ Solutions or one of the related companies.

**Supplement to the Special Audit Report
Ohio Department of Administrative Services – IQ Solutions**

Chart 3: CPS Table of Organization



Related Companies

Leasing Dynamics, Inc. or LDI Corp
Sentex Sensing Technology, Inc.
Regency Technologies, Ltd.
Monitek, Inc.; Monitek Technologies, Inc.; Monitek International, Inc.
Cypress Instruments, Inc.
NCP Limited Partnership
NCP Acquisition Corp.

Note: This information was obtained from Robert Kendall and from research of the Secretary of State's web site.

**Supplement to the Special Audit Report
Ohio Department of Administrative Services – IQ Solutions**

Objective 3: Contract Management

We documented the process used by DAS to manage the contract with IQ Solutions and identified any significant weaknesses and/or recommendations for improvement in the process.

PROCEDURES

1. We interviewed all DAS employees involved in the monitoring of the IQ Solutions contract and obtained DAS policies and procedures and related documents associated with contract monitoring.
2. We documented the contract monitoring process which was in place for the monitoring of the IQ Solutions contract.
3. We examined the documented contract monitoring process and determined any significant control weaknesses and/or recommendations for improvement.

RESULTS

1. On August 28, 2003, we met with Jeff Westhoven, Chief Administrator of Energy Services within DAS. He described the process used to award and monitor the contract with IQ Solutions and provided copies of available documentation related to the process. We also requested copies of various other documents listed below with the date the information was provided by DAS.

| REQUESTED INFORMATION | DATE RECEIVED |
|---|--|
| Copies of the Request for Proposal for each of the three contracts (1995, 1998, & 2001) | 1995 – not received * 1998 – September 5, 2003 2001 – September 18, 2003 |
| Copies of IQ Solutions’ responses to these three RFPs | 1995 – not received * 1998 - September 5, 2003 2001 – October 10, 2003 |
| Copies of the DAS score sheets and evaluations of these bids | 1995 – not received * 1998 – September 5, 2003 2001 – October 9, 2003 |
| Notes from quarterly meeting with IQ Solutions | Not Documented |
| Notes from the March 2, 1999 visit to CPS/IQ Solutions | Not Documented |

* DAS personnel indicated these documents were destroyed in accordance with their records retention policy.

2. We prepared a narrative documenting the process used by DAS based on the information obtained from procedure No. 1. We provided a copy of this document to Jeff Westhoven and Jerry Orth to verify that our understanding of the process was correct.

Supplement to the Special Audit Report Ohio Department of Administrative Services – IQ Solutions

3. We evaluated the contract monitoring process and identified the following control weaknesses and recommendations for improvement.

The weaknesses below relate specifically to the contract with IQ Solutions. The recommendations relate the IQ Solutions contract and other similar agreements where the contractor is paid prior to fulfillment of the requirements and/or the contractor has control over the timing of payments and the disposition of State funds. DAS should determine whether these items would apply to other types of contracts they administer based on the nature of services provided, dollar amounts involved, and other pertinent factors.

- The 2001 RFP did not require audited financial statements be submitted by the respondents. Although the 1998 RFP did require audited financial statements for the preceding three years, the proposal submitted by IQ Solutions only included compiled, unaudited statements for IQ Solutions for one year and audited statements for CPS Holding for two years. All three sets of statements identified operating losses ranging from (\$229,146) to (\$1,140,507) and deficits in members equity ranging from (\$67,642) to (\$1,668,577). It did not appear from the evaluation sheets that DAS considered this to be an issue.
- The contract specifically required IQ Solutions to establish a separate account for the contract activity (the "Work Account"). All payments made from the Work Account were to be only for obligations incurred in the performance of the Contract and were to be supported by contracts, invoices, vouchers, and any other data needed to audit and verify the payments. DAS did not have any procedures in place to verify a separate account had been established or to monitor the activity of this account.
- DAS did not have formal documented policies and/or procedures addressing contract monitoring for advanced-payment type contracts, such as the one entered into with IQ Solutions; nor were there written policies regarding the evaluation process to define the number of individuals required to review the proposals or the required documentation.
- DAS required specific information and reports from IQ Solutions which were reviewed by DAS personnel to monitor the contracts. DAS did not obtain any corroborating information from independent parties (such as banks, suppliers, and gas users/customers) to reasonably ensure IQ Solutions was meeting the contract's requirements.
- DAS did not maintain or was not able to locate documentation related to the following:
 - Verification of references for all contracts with IQ Solutions. DAS personnel indicated they only conducted reference checks for the 1995 RFP, which were destroyed in accordance with their records retention policy.
 - Minutes or other documentation regarding the information discussed during quarterly meetings with IQ Solutions personnel, any problems identified, and/or any required actions by the parties. Although some follow-up letters were provided which noted certain actions required by the contractor, this information did not provide a complete representation of all the activities of the meetings and actions required by the parties.
 - A site visit DAS personnel indicated they conducted at IQ Solutions in March 1999 as a result of the company's change in ownership.
- The contract provided DAS, or their designee, the right to audit the records of IQ Solutions. DAS personnel indicate no such audits were conducted.
- The invoices submitted by IQ Solutions and paid by the State did not provide a breakdown of the charges to separately identify gas costs, transportation costs, and administrative fees.

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MANAGEMENT RECOMMENDATIONS

Contracts are created to document an agreement between two or more parties. It is management's responsibility to select the best contractor through competitive bidding or other appropriate methods, and to monitor and oversee adherence to contract requirements to reasonably ensure each party is complying with the agreement. This is of particular importance when the contractor has control over the timing of payments and the disposition of funds. This type of contract requires management to implement more stringent controls to monitor performance and ensure all payments are made pursuant to the contract.

We recommend DAS develop, document, and implement policies and procedures related to contracted services requiring payment to a contractor prior to contract fulfillment (advanced-payment contracts) and/or where the contractor has control over State funds. These policies and procedures should encompass requirements related to bidding/evaluating, awarding, and monitoring of the contract including, but not limited to, the following.

Request for Proposal/Bid Evaluation Requirements

- DAS should require audited financial statements be submitted with every bid proposal related to advanced payment contracts or where the contractor has control over state funds.
 - For contracts valued over a pre-determined amount, require each respondent to provide at least the three most recent years of audited financial statements.
 - The statements should be reviewed by a knowledgeable individual to determine the financial stability of the respondent, to identify financial trends or concerns, and to evaluate the respondent's overall ability to fulfill the contract requirements. This review should be documented in the bid evaluation files. It may be necessary for DAS to seek training related to financial statement analysis for the key individuals responsible for reviewing this documentation.
- DAS should determine, document, and evaluate the respondent's organizational structure.
 - Respondents should be required to submit copies of their Articles of Incorporation or other creating documents filed with the Secretary of State and Ohio registrations for foreign corporations located out of Ohio.
 - Respondents should be required to submit information on all changes to their organizational structure (such as a change from a partnership to a corporation or new ownership) that may have occurred in the last three years.
 - DAS personnel should verify the documents are current by checking the Secretary of State's web site or contacting the Office directly. DAS should review these documents for potential related party activities.
 - DAS should perform thorough reference checks of the respondent's current and prior customers, vendors, and/or other key contacts to obtain information regarding the respondent's ability to fulfill the contract requirements. DAS should consider performing background checks on all principal parties and key staff within the respondent's organization if the contract is an advanced payment type agreement or requires them to handle significant amounts of State funds. These reviews should be documented in the bid proposal evaluation files.

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- DAS should ensure thorough and complete evaluations are performed for all proposals submitted so the most appropriate respondent will be selected using fair and impartial criteria. Such reviews must be performed by the appropriate number of evaluators based on the nature of the contract and other key factors. The evaluations should be thoroughly documented to depict the scores of the evaluators/evaluation committee, any concerns or deficiencies related to the respondent's proposal, and any actions taken by DAS regarding the proposal (additional information requested, evaluations not used for any reason, etc.)
- Prior to awarding a contract of this type, DAS should ensure sufficient mechanisms are in place to reduce the State's risk of loss if the contractor fails to fulfill its responsibilities. These mechanisms could include, but not be limited to:
 - Requiring a performance bond be obtained and maintained in effect throughout the course of the contract. The bond should provide coverage for the State and for any person (such as a third party customer or vendor) who may have a cause of action against the contractor for any liability arising out of a violation by the contractor of any provision of the contract. The contract should provide a list of violations and remedies for each.
 - Requiring an escrow account be opened and maintained in effect throughout the course of the contract. Payment for services should be placed into this account by the State and released to the contractor upon verification that all payments to third party vendors have been made timely, and other key requirements have been met.

Contract Monitoring

- DAS should require audited financial statements be submitted annually for contracts lasting more than one year. The statements should be reviewed by a knowledgeable individual to determine the financial stability of the contractor, to identify financial trends or concerns, and to evaluate the contractor's ongoing ability to fulfill the contract requirements. This review should be documented in the contract files. It may be necessary for DAS to seek training related to financial statement analysis for the key individuals responsible for reviewing this documentation.
- DAS should require any changes to the organization's structure or ownership interest occurring during the course of the contract be fully and timely disclosed. DAS personnel should evaluate the impact of the changes on the contractor's ability to continue to fulfill the contract requirements. Such information and reviews should be documented in the contract files.
- DAS should document all significant meetings or interactions with the contractor, along with all status reports or other written documents required to be submitted by the contractor. DAS should periodically obtain information from third parties or otherwise corroborate critical information submitted by the contractor. This independent verifications could include:
 - Obtaining status reports or otherwise communicating with the suppliers/vendors being paid by the contractor to determine if the contractor is making full and timely payments related to the contract.
 - Obtaining information from the customers involved in the contract to verify they are receiving the necessary services from the contractor.
 - Performing unannounced site visits to the contractor to inspect records and accounts.
 - Obtaining copies of bank statements for any accounts required to be established to fulfill the obligations of the contract. These statements should be reviewed on a regular basis to verify the transactions processed through the accounts are reasonable and appropriate.

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- DAS personnel should perform regular reconciliations of the escrow account and any other accounts set up to receive payments of State funds. All significant reconciling items should be investigated and the resolution documented.
- DAS should require invoices submitted by the contractor include a breakdown of the charges by category (products, transportation, administration, etc.). DAS should track the payments, by category, using an internally prepared spreadsheet or by coding these items using distinct object codes on the voucher processed in CAS. DAS personnel should review each category of expense, paying particular attention to the administrative fees, to verify they are in compliance with the contract.
- DAS should implement penalties, including percentage reductions in the administrative fee, for any late payments on the part of the contractor or other deficiencies identified as a result of the monitoring procedures performed.



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OHIO DEPARTMENT OF ADMINISTRATIVE SERVICES - IQ SOLUTIONS

FRANKLIN COUNTY

CLERK'S CERTIFICATION

This is a true and correct copy of the report which is required to be filed in the Office of the Auditor of State pursuant to Section 117.26, Revised Code, and which is filed in Columbus, Ohio.

Susan Babbitt

CLERK OF THE BUREAU

**CERTIFIED
NOVEMBER 12, 2003**