



City of Cape Coral City Auditor's Office

TO: Mayor and Council Members
FROM: Dona J. Newman, City Auditor *DJN*
DATE: July 17, 2006
SUBJECT: Issuance of the Utility Expansion Contract Audit Report

This Utility Expansion Contract compliance audit report prepared by Kessler International (Kessler) was scheduled to be issued July 18, 2006, to be included in the agenda package for the July 21st Committee of the Whole meeting. Since the News-Press has published an unauthorized copy of the Consultant's Report, this office will issue the report today and include the customary attachment, Management Response, when it is available. This office is actively working with Management to identify the person that released the unauthorized copy of the report and will let you know if we are successful.

The report contains some disconcerting elements and implied conclusions. There are actions this office and the City can take to prevent repetition of these concerns. These are discussed in the remainder of this transmittal letter.

As the City Auditor, I have issues with this audit in that it was not done in accordance with audit standards. Although audit services were clearly requested in the RFP, Kessler's report contains a disclaimer that an audit was performed. In Kessler's response to the RFP assertions were made that the firm was well qualified to perform an audit and had CPA's on staff as well as affiliation with the Institute of Internal Auditors. As a result of not following normal audit reporting procedures, the report does not present the situation in specific finding and recommendation format. This leaves interpretation of the findings up to the reader when the City contracted with an expert in the field of construction contracts to analyze the findings, state them and their ramifications to the City, and recommend specific actions for correction or improvement.

To prevent such miscommunication in the future, compliance audit RFP's will contain more specific wording as to audit standards that must be met and the format of the written report.

Certain sections of the report state that there are red flags and possible illegal activity involved in the bidding of the construction projects between the Construction Manager at Risk (CM) and the sub-contractors. It is to be noted that these alleged illegal activities have not been proven. The Department of Justice (DOJ) has been notified and provided with the information Kessler found

Issuance of the Utility Expansion Contract Audit Report

July 17, 2006

Page 2 of 3

during their review of documents related to this audit. The DOJ has opened a case to follow through on these allegations and as of this week the case is still open. The City is not involved in this investigation; however, I will continue to keep you apprised of any information shared with me. This will probably be limited to whether or not the case is still open.

Certain sections of the report refer to indications that billings from the CM to the City may not be in compliance with the contract terms. MWH Constructors, Inc. (MWH), the CM, has indicated that they have retained the services of one of the "big four" accounting firms to provide an independent review of the issues addressed in Kessler's report. In addition, they indicate they have retained independent outside counsel to provide an opinion on their compliance with Florida Statutes. Both reports will be made available to the City Auditor's office and City Council when available.

Weaknesses in the City's control environment were discussed in the report. Controls are designed to prevent errors in contract compliance and payment of invoices. A strong control environment protects the City and the public from overpayments and contains such features as documented review, double authorization, reconciliations, and orderly documentation files.

The control environment over the utility extension contract would be improved by the recommendations developed by the City Auditor's office for each of the findings listed in the Highlights section of Kessler's report. The schedule of findings and recommendations, along with Management's Response, can be found behind the "Management Response" tab of this document.

Finally, much space in the report and time during the audit process was devoted to accessing documents. There have been audit issues with accessing records for this major construction effort in the past as well. It seems that some of the difficulty arises from auditing completed projects. The CM and subcontractors have closed their books on these projects and are involved in current projects. In addition, staff turnover occurred with the City, the CM, and subcontractors between the time the projects were completed and the audit fieldwork begun.

To prevent this type of barrier to review of documents in the future, I recommend discontinuing outsourcing the utility expansion audits and hiring a full time Contracts Auditor in the City Auditor's Office. The annual salary of the auditor would be less than the cost of outsourcing a utility expansion audit each year. This auditor could work with management to improve the control environment, as well as, conduct audit tests of bids, purchases, invoices, and payments throughout the life of the project. This would ensure proper documentation is on hand and discrepancies are reconciled before payments are made by the City.

Issuance of the Utility Expansion Contract Audit Report

July 17, 2006

Page 3 of 3

In addition, this same level of review could be applied to other construction projects the City is involved in such as the Public Safety Complex, the Utility plant construction, and any further charter schools that are built.

In the following pages in this binder, you will find an executive summary by Kessler, management's response (when available) as well as a response from the CM in the same section, followed by the 80 page Kessler report and 57 exhibits.

Attachments

xc: Terry Stewart, City Manager
Dolores Menendez, City Attorney
Chuck Pavlos, Public Works Director
Bonnie Vent, City Clerk