


September 14, 2018

FOR YOUR INFORMATION

To: Mayor and Members of Council
From: Patrick A. Duhaney, Acting City Manager 
Subject: Special Audit Report of MSD

Today, the State of Ohio Auditor's office released a Special Audit of the Metropolitan Sewer District of Greater Cincinnati (MSD). The audit was initiated in February 2016 at the request of the City of Cincinnati and Hamilton County. It followed on the heels of an internal audit of MSD independently conducted on behalf of the City during the first half of 2016.

The State's audit covered the period of January 1, 2009 through December 31, 2015 and, like the City's internal audit, focused on MSD's use of public funds during that period of time, especially related to its Consent Decree spending. It focused on five separate categories: Master Service Agreements (MSAs), Professional Service Agreements (PSAs), Inter-Departmental (ID) bills, payroll transactions, and select non-payroll disbursements.

The state audit concluded that there were particular instances where public funds were used inappropriately to make illegal purchases. The report also recommended a number of improvements to management practices at MSD, the vast majority of which are already in place.

MSD's Response to the Special Audit

A response to the Special Audit prepared by Interim MSD Director Diana Christy was shared with the State Auditor prior to its release. In her letter, attached, Director Christy highlighted the sweeping procurement reforms made by the City beginning in 2015 to address these allegations of mismanagement and irregular contracting practices at MSD. Based on a review of the draft Special Audit Report, MSD determined that the findings and recommendations were all derivative of past practices that were addressed by the sweeping Procurement Reform and/or by changes in leadership at both MSD and the City between 2015 and 2016.

In total, the State Auditor issued 15 findings for recovery against 7 vendors, the City of Cincinnati and Hamilton County totaling \$779,164. Repayments totaling \$182,476 were made by some of those named after being notified about the findings for recovery. As MSD approaches completion of Phase 1, the projects listed in the Final Wet Weather Improvement Plan (WWIP) are trending at \$1.043 billion (in 2006 dollars). While any finding of potential inappropriate use of ratepayer funds is significant, the amount identified by the Auditor represents one-tenth of 1% of the overall Phase 1 spending program spending on Consent Decree projects.

Additionally, the MSD expenditures at issue date back to 2007 when former City Manager Milton Dohoney gave spending authority to former MSD Executive Director James A. "Tony" Parrott for contracts related to implementation of the Consent Decree. This ultimately led to allegations of mismanagement and irregular contracting practices.

Recognizing the urgent need for reform, former City Manager Harry Black completely revamped and retooled the City's procurement process and Division of Purchasing in March 2015. These changes not only revoked spending authority for the MSD director, but also streamlined and centralized the City's procurement process and improved competition on City contracts. They included:

- Adoption of new Administrative Regulation No. 62. Under this regulation:
 - ✓ All purchases over \$50,000 must be pre-approved by the City Manager.
 - ✓ If the Master Service Agreements process is used, contracts must rotate among vendors in the pool or the vendors must compete for the work based on price or qualifications.
 - ✓ The City Manager signs all contracts or can delegate to the City's Chief Procurement Officer in some situations.
- Establishment of a Procurement Review Committee.
- Designation of a Chief Procurement Officer.
- Reissuance and creation of new manuals on procurement-related processes.
- Updating of Administrative Regulation No. 23 on Policy Guidelines and Minimum Requirements for Professional and Nonstandard Services.
- Enhanced control over Master Service Agreement (MSAs), also known as Master Agreements (MAs).
- Phasing out of contract multipliers, as appropriate.

See the attached FYI memo dated April 6, 2016.

During the audit period, MSD was under the leadership of Mr. Parrott. The City of Cincinnati appointed Gerald Checco as the new director of MSD in August 2015. During his tenure, Director Checco made numerous additional changes, including significantly reducing MSD's use of consultants, instituting new policies related to travel and conflict of interest, and tightening policies and procedures related to consultant work.

MSD is currently taking action to fine tune some of the management practices identified in the state audit, including contractor performance evaluations, invoice review and approvals, records retention, travel, and Hamilton County oversight.

Summary of Audit Findings and Recommendations

The audit focused on five specific objectives:

1. Master Service Agreements (MSAs)
2. Professional Service Agreements (PSAs)

3. Inter-departmental (ID) bills
4. Payroll transactions
5. Select non-payroll disbursements

1. Master Service Agreements

The audit issued seven findings for recovery of money against four vendors and the City of Cincinnati's Planning Department, for a total of \$367,456. The vendors include Ribway Engineering Group, Inc., Focus Solutions, RA Consultants, and Ellington Management Services.

The finding against the City's Planning Department was related to activities performed by an MSD consultant working within the Planning Department. The planning consultant was hired by MSD for the purpose of representing and integrating the interests of MSD into City Planning practices. The mere fact that staff performed some functions that also provided a benefit to Planning did not diminish that overall purpose. While the City agreed to resolve this finding with full payment, it takes exception with the Auditor's finding. This amount, \$47,071, was fully repaid by the City.

The other findings were related to overbilling, unsupported expenses, or expenses not related to the operations of MSD.

The audit issued 12 management recommendations related to competitive procurement practices, application of multipliers on contracts, ambiguous task orders, performance evaluations, use of consultants, invoice approvals, and conflict of interest.

Resolution: The City of Cincinnati has put in place a number of checks and balances to regulate the use of Master Service Agreements, including the adoption of Administrative Regulation #62. In addition, several policy and internal process changes were made that addressed the use of multipliers, task orders, and the performance of work prior to the execution of a task order.

In addition, during his tenure, former MSD Director Gerald Checco reduced the number of consultants working as staff supplements at MSD by nearly 60% and prohibited consultants who work as staff supplements from requesting work to be performed by a consultant or approving work to be performed by a consultant.

MSD is currently working to strengthen its procedures related to performance evaluations and invoice approvals.

2. Professional Service Agreements (PSAs)

The audit issued three findings for recovery of money against three vendors for a total of \$318,339. The vendors include Urban Strategies & Solutions, Early Morning Software, and Crabbe, Brown and James. The largest finding was against Urban Strategies & Solutions for \$294,000 for services for which no documentation existed to support the work performed.

The audit issued four management recommendations related to documentation of PSAs, use of sub-consultants, payments related to PSAs and execution of direct awards.

Resolution: As noted above, the City of Cincinnati adopted Administrative Regulation #62, which also regulated the use of PSAs, sub-consultants, compensation and direct awards.

3. Inter-Departmental (ID) Billings

The audit issued four findings for recovery of money against the City of Cincinnati totaling \$90,671. The findings against the City were related to various mathematical errors that resulted in overbilling on ID bills. ID bills are the method used by the City of Cincinnati to pay other City departments for services rendered. The amount has been fully repaid by the City.

The audit issued one management recommendation related to Memorandums of Understanding (MOUs) on ID bills.

Resolution: MSD will coordinate with the City's Law Department to determine if any additional MOUs are needed for services provided between MSD and another City department.

4. Payroll Expenses

The audit did not identify any improper expenses.

5. Non-Payroll Expenses

The audit issued one finding for recovery of money against Hamilton County totaling \$9,072. This finding was related to the County's submittal of invoices to MSD from Plante Moran, the County's consultant, that were duplicates, reimbursements for alcohol, or overbillings. The amount has been fully repaid by the County.

The audit issued two management recommendations related to Hamilton County oversight expenses and MSD travel expenses.

Resolution: Employees responsible for contracts will receive additional training on invoice review. MSD will also evaluate its travel approval process to ensure consistency and adherence to the City's policy. The City will require that Hamilton County provide all supporting documentation related to their oversight and program monitoring services so that it may evaluate proper expenditures.

Conclusion

With the City's new procurement policies and internal controls in place for several years now, MSD's process is much more equitable, transparent, competitive, and regulated than it was during the time period covered in this audit. MSD will use this Special Audit Report to fine tune its policies and management and implement process enhancement strategies as necessary.

Attachments

September 12, 2018

VIA EMAIL AND REGULAR MAIL

Richard Blakesley, CFE
Senior Forensic Audit Manager
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RE: Special Audit of MSD – Response to Draft Report

Dear Mr. Blakesley:

This letter is in response to the draft Special Audit Report of the Metropolitan Sewer District of Greater Cincinnati (MSD), received on September 5, 2018. The State's audit was initiated in February 2016 at the request of the City of Cincinnati and Hamilton County.

The State's audit of MSD consisted of two components: (1) the Performance Audit, which assessed current MSD practices and efficiencies and was completed in February 2017; and (2) the Special Audit, which evaluated expenses related to the Consent Decree during the period of January 1, 2009 through December 31, 2015.

First, I want to express our appreciation to the State Auditor's staff for their professionalism and courtesy while working with us over the past two-and-a-half years. We view the audit process as an important tool in evaluating proper use of ratepayer dollars and assessing our operational performance. Last year, the Performance Audit concluded that MSD is a solidly performing organization that provides a competitive return on investment to its ratepayers. Our response to the Performance Audit is enclosed in Appendix A.

Next, the following response to the draft Special Audit Report is provided on behalf of the City of Cincinnati in its role as the operator and manager of MSD:

Response to Special Audit Report

The State's Special Audit followed on the heels of an internal audit of MSD independently conducted on behalf of the City of Cincinnati and covers the same past practices that the City investigated and reported on in 2016. In 2015, even prior to that investigation, the City began taking action to address the allegations of mismanagement and irregular contracting practices at MSD. Recognizing the urgent need for reform, then City Manager Harry Black completely revamped and retooled the City's procurement process and Division of Purchasing. These changes were comprehensive and included:

- New Administrative Regulation No. 62 to streamline and centralize procurement
- Procurement Review Committee
- Designation of Chief Procurement Officer
- Reissuance and Creation of New Policies and Manuals
- Updated Administrative Regulation No. 23

- Enhanced Control over Master Agreements
- Phasing out use of Contract Multipliers as Appropriate

More information on the City's Procurement Reform is provided in the April 6, 2016 FYI Memo enclosed as Appendix B.

Based on our review of the draft Special Audit Report, the findings and recommendations are all derivative of past practices that were addressed by the sweeping Procurement Reform and/or by changes in leadership at both MSD and the City. For example:

- During the audit period, MSD was under the leadership of James A. "Tony" Parrott. The City of Cincinnati appointed Gerald Checco as the new director of MSD in August 2015. During his tenure, Director Checco made numerous additional changes, including significantly reducing MSD's use of consultants, instituting new policies related to travel and conflict of interest, and tightening policies and procedures related to consultant work.
- Much of the concern over MSD expenditures dates back to 2007 when former City Manager Milton Dohoney gave spending authority to former MSD Executive Director James A. "Tony" Parrott for contracts related to implementation of the Consent Decree on behalf of the City of Cincinnati. In March 2015, more than a year before the release of the City's internal audit, Administration Regulation #62 was approved. This regulation not only revoked spending authority for the MSD director but also streamlined and centralized the City's procurement process and improved competition on City contracts.

With respect to the "Findings for Recovery," the State Auditor identified particular instances where it determined that District funds were inappropriately used to make illegal purchases and sought recovery of money against seven vendors, the City of Cincinnati, and Hamilton County totaling \$785,538. As MSD approaches the final year of Phase 1, the projects listed in the Final Wet Weather Improvement Plan (WWIP) are trending at \$1.043 billion (in 2006 dollars) as compared to and below the original \$1.14 billion estimated cost of the Phase 1 program. While significant, the findings identified in the draft Special Audit Report amount to one-tenth of 1% of the overall Phase 1 spending on Consent Decree projects.

In addition, in some instances, the Auditor's findings are based on what the Auditor determined to be an improper public purpose. Generally speaking, the determination of what constitutes a proper public purpose rests with the judgement of the governmental entity, unless such determination is arbitrary or unreasonable. In the draft report, the Auditor included two findings for recovery where it failed to show that the determination made by the City and/or County declaring a public purpose was arbitrary or unreasonable.

First, the Auditor included a potential finding against the City of Cincinnati for what it determined was the shared use of a consultant by MSD and the Planning Department. The planning consultant was hired by MSD for the purpose of representing and integrating the interests of MSD into City Planning practices. The mere fact that staff performed some functions that also provided a benefit to Planning did not diminish that

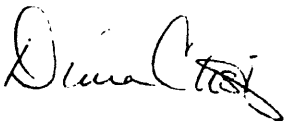
overall purpose. While the City agreed to resolve this finding with full payment, it takes exception with the Auditor's finding. The City's complete response to the potential finding is enclosed as Appendix C.

Second, the City takes exception with the finding against Ribway Engineering for Project Rebuild Expenses, to the extent that the determination of public purpose for the scope of work performed under this task order was made by the Hamilton County Board of County Commissioners as MSD capital project 10290021, Program Risk Mitigation and Communication, which was legislated and funded in the 2009 and 2010 Capital Improvement Plan budgets.

Like the findings for recovery, the vast majority of the management recommendations are related to procurement procedures that were addressed through the aforementioned Procurement Reform. The City and MSD continue to fine tune management improvements and control, including the ongoing reduction of staff supplementation contracts, enhanced invoice control, and revamped records management. A response to each of the management recommendations is provided in Appendix D.

With the City's new procurement policies and internal controls in place for several years now, MSD's process is much more equitable, transparent, competitive, and regulated than it was during the time period covered in this audit. Again, we appreciate the time and attention provided by the State Auditor in this matter and thank you for the professional courtesy shared with our staff.

Sincerely,



Diana R. Christy
Interim Director, MSD

Enclosures

April 6, 2016

FOR YOUR INFORMATION MEMO

TO: Mayor and Members of Council
FROM: Harry Black, City Manager **HB**
SUBJECT: Procurement Reform Update

As a means of providing additional clarification related to Master Service Agreements and Multipliers, I am providing this procurement reform update.

Since my arrival, the Administration has worked at an urgent pace to revamp and improve the City's procurement process with the goal of creating transparent and uniformed standards and practices, enhancing command and control over process, and increasing competition and opportunities for inclusion in contracting. We have made significant headway toward these goals, including insuring that appropriate checks and balances and controls are in place with respect to the utilization of all contract vehicles, including Master Agreements (MA).

We quickly realized that the City's procurement process and its Division of Purchasing were in need of significant retooling. The Division of Purchasing was understaffed. There were only three professional buyers employed in the Division. These three employees were charged with procuring all of the City's needs and managing the thousands of contracts and purchase orders in the financial system. In addition, the procurement process was extremely decentralized. Hundreds of employees of varying classifications and skill sets were making procurement transactions with little to no oversight of a central authority nor requisite skill sets.

This reality is not unique to Cincinnati. It was quite common in the early and mid-2000s for municipalities to abandon centralized purchasing and reduce the staff of its procurement function when faced with tough budget decisions. The result of these actions is a lack of procurement accountability and oversight, reduced ability to purchase proactively and strategically, and a loss of transparency and professionalism with regards to the procurement process.

Changes to the City's Procurement Process

The Administration has put in place greater controls and checks and balances to regulate utilization of Master Agreements (MA) that weren't in place prior to my arrival. What follows is a detailed, comprehensive list of these efforts.

Administrative Regulation No. 62

Administrative Regulation No. 62 was issued in February of 2015 with the purpose of streamlining and centralizing the City's procurement process in order to establish a unified procurement policy with

associated procurement best practices. It has been revised periodically throughout the year. Some of the key points of Administrative Regulation No. 62 are as follows:

- Requires all procurements and contracts, including MAs and transactions against MAs, in excess of \$50,000 to be reviewed and approved by the City Manager;
- Requires City Manager approval of all evaluation and/or selection committees for procurements in excess of \$50,000;
- Requires that orders against multiple award MAs undergo competition prior to issuing any orders against the MA;
- Brought MSD procurement staff, activities, and processes under the authority of the City's Chief Procurement Officer;
- Clarifies that only the City Manager, or in specific situations, as delineated in the Cincinnati Municipal and Administrative Code, the Chief Procurement Officer/City Purchasing Agent, may sign procurement contracts that bind the City; and
- Requires City Manager approval of all subcontractors proposed to work on a City contract for professional services prior to commencing any work.

Procurement Review Committee

I formed the Procurement Review Committee (PRC) in April 2015. Membership of the PRC is comprised of the City Manager, both Assistant City Managers, one Assistant to the City Manager, the Director of Economic Inclusion, and the Chief Procurement Officer. The PRC is charged with reviewing and approving the City's procurement transactions and activities, including orders against MAs, in accordance with Administrative Regulation No. 62. The PRC has met at least weekly since inception. The PRC also gives the Chief Procurement Officer direct and regular access to the City Manager to discuss and receive guidance on procurement and contracting related issues.

The Chief Procurement Officer and Improvements to the Division of Purchasing

In May of 2015, I changed the title of the head of the Division of Purchasing from City Purchasing Agent to Chief Procurement Officer. The title change was to signify a change from the decentralization of the procurement process to a more centralized process governed by one responsible authority that reports to the City Manager. With your leadership, Chapter 321 of the City's Municipal Code was revised to reflect that the person designated this position by the City Manager is the person to whom the City's procurement authority has been delegated. I appointed Patrick A. Duhaney to the position of Chief Procurement Officer in May of 2015. He has done an impressive job to date.

In addition, to ensure that the Chief Procurement Officer had the resources to accomplish the important tasks of centralization, the City Manager's Office hired a government process improvement consultant to analyze the City's procurement process, benchmark, and create a plan to implement improvements. In addition, the Administration increased the Division of Purchasing's staff from 8 to 17. (This was achieved through budget neutral means.) The Division is also in the process of hiring 2 more employees which would bring its total complement to 19 employees. Twelve of those employees are professional buyers. All City buyers now report to one central authority.

The additional staff has allowed the Division of Purchasing to focus resources on implementing the full scope of the electronic procurement module of the City's financial system. The City had previously paid for this module several years ago. However, the Division never had the resources to implement the system to its full capability. Full activation of this module will allow the Division to place greater controls on and more effectively manage all contracts, including MAs and the orders issued against them.

The City Manager's Office worked with the Division of Purchasing to institute a Department Purchasing Liaison Program. The Program is designed to assist in ensuring uniformed procurement standards and

practices are applied throughout the City. Buyers are now assigned and responsible for specific departments and to work with their assigned Purchasing Liaisons to ensure that appropriate procurement standards and practices are applied to each purchase. Purchasing liaisons are required to go through mandatory procurement training and are held accountable to upholding procurement standards via their annual performance review.

Reissuance and the Creation of New Policies and Manuals

The Administration has reissued and created a host of new policies and manuals (e.g., Administrative Regulation Nos. 23 and 62, the Procurement Manual, the RFP Process Manual, the Multiple Award Contracting Manual, etc.). The new policies and manuals require that City employees conduct procurement tasks in a responsible, ethical, accountable, disciplined, professional, competitive, and inclusive manner.

On January 28, 2016, the City Manager and Chief Procurement Officer issued the Multiple-Award Contracting (MAC) Policy which was the first in the City's history, to govern the ordering process against Multiple-Award Contracts (MACs), which are typically referred to as Master Agreements (MAs) or Master Service Agreements (MSAs). The aforementioned agreements are the ones referenced in the media in relation to the Smale Park Project and MSD. The MAC policy addresses the following:

- Charges the Chief Procurement Officer with oversight of the ordering procedures against MACs;
- Delineates ordering procedures that afford each awardee under a MAC a fair opportunity to compete and to be considered for task/work/delivery orders issued during the life of the contract.
 - This ensures that the City take continuous advantage of the competitive forces of the commercial marketplace which results in lower prices, better quality, reduced time from identification of need to award, and improved contractor performance in satisfying requirements.
- Requires that orders above certain dollar value are subject to M/WBE or SBE participation goals; and
- Requires that all construction and professional services orders against a MAC that exceed \$50,000 in value are subject to the City Manager's review and approval process as described in Administrative Regulation No. 62.

The policy is a more detailed representation of the intent first penned in Administrative Regulation No. 62 that orders against multiple-award MAs undergo competition prior to the issuance of any order. The competitive processes delineated in the MAC policy are the result of a pilot that started in the summer of 2015 using MAs for MSD and DOTE. Codified in the MAC Policy are the best practices gained from that pilot. The MAC policy sets clear standards and makes the process for ordering against these contracts more competitive, equitable, inclusive, and transparent.

We are currently training all City employees who touch the procurement process on the MAC Policy and all of the other new or reissued manuals and policies. To date, over eight procurement training sessions have been held covering various procurement topics. Another eight sessions are scheduled in the month of May. The training is required for any employee that touches the City's procurement process.

How are MAs Currently Controlled and Monitored?

Several policy and internal process changes are in effect that have improved "checks and balances" with respect to utilization of MAs. The following improved policies and internal processes should prevent the misuse of MAs:

- The City Manager procurement review and approval process delineated in Administrative Regulation No. 62;

- Delegated authority to Directors to sign procurement contracts on behalf of the City has been revoked (effective January 2015). Only the City Manager, or in specific situations as delineated in the Cincinnati Municipal and Administrative Code, the Chief Procurement Officer, may sign contracts, including orders against MAs, that bind the City;
- The MAC policy which requires that orders against MAs be issued competitively, equitably, inclusively, and transparently;
- Employees are trained on the appropriate use of contracts, conflicts of interest and contracting ethics, and on the new policies, manuals, and procedures;
- Implemented policy to transition MSD from reliance and heavy use of expensive consultant contractors to full time employees in MSD to control costs and save ratepayers money;
- New professional and design services for MSD projects are procured via a project specific RFQ or RFP that is publicly let by the Division of Purchasing;
- Increased staff and resources for the Division of Purchasing means they have increased capacity to provide oversight of MAs; and
- Full activation of the procurement module which allows the Division of Purchasing to place greater controls on and more effectively manage all contracts, including MAs and the orders issued against them. These tools have equipped the Division of Purchasing with the capability to approve all orders against MAs and place additional electronic backstops to prevent unauthorized spend.

MSD Contract Multipliers

In that there has been some discussion regarding contract multipliers, I am providing the below brief insight for context purposes. Any discussion of multipliers can be complex and confusing. Also referred to as the direct labor "multiplier," it is a fully burdened labor rate – the rate at which an organization must bill out its direct labor units to cover its direct and indirect costs before any profit is made. For an organization to break even on a total cost basis, each unit of direct labor must cover the direct costs of that labor plus a proportionate share of the organization's indirects – fringe, overhead, general and administrative, etc. So the multiplier for \$1 of direct labor is the burdened rate that effectively covers all the direct and indirect costs necessary to support that labor, it could typically be anywhere from \$1.50 to \$2.25.

In the case of MSD, the multipliers themselves are not necessarily unusual. What is unusual is that in cases where there are multiple task/delivery orders associated with one contract, the same multiplier is applied across the board, regardless of the scope of work and associated labor categories. For example, you might have a task order to perform low level administrative work and another task order for high end engineering work, but the same multiplier is applied to both. High multipliers are appropriate for specific labor categories and not necessarily appropriate for other labor categories. As a means of ensuring the reasonableness and realism of contract prices, we will be re-competing these contracts over a year to year and a half period, with an eye toward having multipliers more realistically and reasonably applied. The magnitude of contracts supporting MSD will require that we phase in our re-competition efforts. We will also need to further develop our in-house capacity to conduct high level cost/price analysis.

In closing, it is important to note that, as a contracting mechanism, the Master Agreement (MA) is a useful and essential tool that is utilized by all forms of governments (i.e., the state, local, and federal levels). However, if left unchecked and unregulated, which was the case prior to our reform efforts, MAs can expose the City to risk, create an appearance of impropriety, create inequities as evidenced by the findings of the disparity study, and raise doubts as to whether best value for taxpayer dollars was achieved. The Administration is putting appropriate measures in place to address the use of these agreements. We have set new policies and implemented internal controls that have made the process for ordering against these contracts more equitable, transparent, competitive, and regulated.

We look forward to continuing to keep you up to date on our procurement reform efforts.