



Office of the Public Auditor
Commonwealth of the Northern Mariana Islands

Commonwealth Utilities Corporation
Audit of Small Purchases
October 1, 1999 through March 31, 2001



Audit Report
AR-02-01

EXECUTIVE SUMMARY

Commonwealth Utilities Corporation

Audit of Small Purchases

From October 1, 1999 through March 31, 2001

Report No. AR-02-01, August 27, 2002

Summary

This report presents the results of an audit of small purchases made by Commonwealth Utilities Corporation (CUC) from October 1, 1999 through March 31, 2001. In Fiscal Year 2001, OPA surveyed selected CUC operations and decided to conduct four separate audits: travel, personnel hiring, compensation practices and small purchases. Burger & Comer, P.C., an independent Certified Public Accounting firm, was contracted to assist OPA in its audit of CUC's small purchases using agreed-upon procedures¹. These procedures were conducted in accordance with standards established by the American Institute of Certified Public Accountants.

The objectives of this audit were to determine whether CUC: (1) complied with its Procurement Regulations regarding small purchases, and (2) has adequate systems and procedures in place to ensure proper planning and budgeting for procurement of goods and services.

Results of the Audit

The audit showed that CUC did not always comply with its Procurement Regulations. The audit also noted certain internal control weaknesses. Out of 225 purchase orders (POs) examined, the audit found: (a) POs that appear to have been artificially divided in order to avoid competition requirements, (b) POs that did not have three quotations from vendors as required, (c) a CUC official² had a conflict of interest with a particular vendor, (d) a PO that was not supported by an invoice, (e) POs that were issued after the goods or services had already been delivered ("after-the-fact" POs), and (f) POs that were not adequately justified.

CUC officials and employees involved in the procurement process have not strictly complied with CUC's Procurement Regulations applicable to small purchases. CUC's failure to obtain three quotations may have resulted from a misunderstanding of its procurement regulations which seem to imply that 3 quotations should be requested but not necessarily received. CUC needs to provide new guidance for determining split purchases because it is not adequately addressed in CUC's existing Procurement Regulations, policies and procedures.

¹ Agreed-upon procedures may include clerical testing, confirmations, analytical review, cut-off testing, reconciliations, and any other procedure, provided the specific procedures are performed and specific findings are communicated through a report to the intended recipients. Reports using agreed-upon procedures do not require a specific format.

² In accordance with statutory restrictions in the Auditing and Ethics Acts, names of individuals and corporations are not disclosed in this report.



Some purchases discussed above involve special procurement situations, such as urgently needed goods or services, which are not addressed by CUC's Procurement Regulations. Although Burger & Comer's report stated that the design of the system is sufficient to allow for proper planning, budgeting and procurement of goods and services, they believe that there is considerable need and room for improvement in the process. OPA agrees that CUC needs to improve controls on small purchases to ensure that: (1) goods and services are procured at the lowest available price and with the best possible quality, (2) purchases of goods or services are actually needed, (3) payments are supported by vendors' invoices, and (4) conflict of interest provisions are complied with.

We recommended that the CUC Board:

1. Amend its Procurement Regulations to address: split purchases, the proper procurement method to be followed in special circumstances, and its inability to obtain required three quotations when the number of available suppliers is limited; and
2. Adopt policies and procedures that provide adequate guidance on determining split purchases, define emergency procurement under the "after-the-fact" procurement method specified in the CUC Comptroller's memorandum dated October 24, 2001, and provide for identifying and documenting actual or potential conflicts of interest.

We recommended that the Executive Director:

3. Direct the Procurement and Supply Manager to consolidate related purchase requests into one PO that is competitively procured if it exceeds the small purchase threshold, prepare periodic procurement plans covering anticipated needs for goods and services, ensure that the requirement for three quotations is complied with and properly documented, and ensure that small purchases are issued with an adequately supported PO; and
4. Remind CUC officials and employees involved in the procurement process of the requirement to comply with the conflict of interest provision in CUC's Procurement Regulations.

In its letter response, CUC generally agreed with Recommendations 1 to 3 and partially disagreed with Recommendation 4. Although they were not responsive to all the recommendations, CUC did acknowledge that the report will be considered in strengthening and streamlining its procurement functions. Since most of the recommendations involve modifications to CUC's existing procurement regulations, CUC stated that responsible officials have already begun reviewing pertinent provisions of existing procurement regulations with an aim to make them more applicable to the unique nature of CUC operations as a utility company while retaining and/or strengthening safeguards to maintain public confidence in CUC's procurement system.



A copy of this report is available at the Office of the Public Auditor

Michael S. Sablan, CPA
Public Auditor
Commonwealth of the Northern Mariana Islands
Web Site: www.opacnmi.com

P.O. Box 501399
Saipan, MP 96950
Tel. No. (670) 234-6481
Fax No. (670) 234-7812



Office of the Public Auditor

Commonwealth of the Northern Mariana Islands

World Wide Web Site: <http://opacnmi.com>

2nd Floor J. E. Tenorio Building, Chalan Pale Arnold
Gualo Rai, Saipan, MP 96950

Mailing Address:
P.O. Box 501399
Saipan, MP 96950

E-mail Address:
mail@opacnmi.com

Phone: (670) 234-6481
Fax: (670) 234-7812

August 27, 2002

Mr. Francisco Q. Guerrero
Chairman, Board of Directors
Commonwealth Utilities Corporation
Saipan, MP 96950

Mr. Bernard P. Villagomez
Acting Executive Director
Commonwealth Utilities Corporation
Saipan, MP 96950

Dear Messrs. Guerrero and Villagomez:

Subject: Final Audit Report - Commonwealth Utilities Corporation - Audit of Small Purchases from October 1, 1999 through March 31, 2001 (Report No. AR-02-01)

This report presents the results of an audit of small purchases made by Commonwealth Utilities Corporation (CUC) from October 1, 1999 through March 31, 2001. The Office of the Public Auditor (OPA) conducted this audit with assistance from the independent CPA firm of Burger & Comer. The objectives of this audit were to determine whether CUC: (1) complied with its Procurement Regulations regarding small purchases, and (2) has adequate systems and procedures in place to ensure proper planning and budgeting for procurement of goods and services.

The audit showed that CUC did not always comply with its Procurement Regulations. The audit also noted certain internal control weaknesses. Out of 225 purchase orders (POs) examined, the audit found that: (a) 54 POs totaling \$1.1 million appeared to have been artificially divided in order to avoid competition requirements, (b) 54¹ POs valued at \$1.4 million did not have three quotations from vendors as required, (c) a CUC official² had a conflict of interest with a particular vendor, (d) 1 PO was not supported by an invoice, (e) 26 POs were issued after

¹ Number of POs and their corresponding values were revised in the final report to reflect items that were resolved during the 30-day response period.

² In accordance with statutory restrictions in the Auditing and Ethics Acts, names of individuals and corporations are not disclosed in this report.

the goods or services had already been delivered (“after-the-fact” POs), and (f) 21 POs amounting to \$258,970 were not adequately justified. These occurred because CUC officials and personnel did not adhere to CUC Procurement Regulations. As a result, CUC has no assurance that (1) it obtained the best available price as well as quality for the goods or services purchased, (2) the integrity of the procurement system was maintained, and (3) the goods or services procured were necessary.

We recommended that the CUC Board:

1. Amend its Procurement Regulations to address: split purchases, the proper procurement method to be followed in special circumstances, and its inability to obtain required three quotations when the number of available suppliers is limited; and
2. Adopt policies and procedures that provide adequate guidance on determining split purchases, define emergency procurement under the “after-the-fact” procurement method specified in the CUC Comptroller’s memorandum dated October 24, 2001, and provide for identifying and documenting actual or potential conflicts of interest.

We recommended that the Executive Director:

3. Direct the Procurement and Supply Manager to consolidate related purchase requests into one PO that is competitively procured if it exceeds the small purchase threshold, prepare periodic procurement plans covering anticipated needs for goods and services, ensure that its requirement for three quotations is complied with and properly documented, and ensure that small purchases are issued with an adequately supported PO; and
4. Remind CUC officials and employees involved in the procurement process of the need to comply with the conflict of interest provision in CUC’s Procurement Regulations. Also, he should remind accounting personnel to process vendors’ payments only if supported with invoices.

In CUC’s letter response of June 22, 2002 (**Appendix A**), the Board Chairman and the Acting Executive Director generally agreed with Recommendations 1 to 3 and partially disagreed with Recommendation 4. Since most of the recommendations involve modifications to CUC’s existing procurement regulations, they stated that responsible officials have already begun reviewing pertinent provisions of existing procurement regulations with an aim to make them more applicable to the unique nature of CUC operations as a utility company while retaining and/or strengthening safeguards to maintain public confidence in CUC’s procurement system.

With regard to that portion of Recommendation No. 4 requiring payments to vendors only if supported by invoices, CUC emphasized that it has been complying with this requirement. They stated that the cases cited in the report were exceptions to the norm. CUC attributes this problem to the limited understanding on the part of the vendor as to the purposes and uses of

business forms. They did add, however, that they do require vendors' billings be accompanied by certificates of completion of services.

Although they were not responsive to all the recommendations, CUC did acknowledge that the report will be considered in strengthening and streamlining its procurement functions.

Based on the response we received from CUC, we consider Recommendations 1, 2, 3 and 4 open. The information or action required to close the recommendations is presented in **Appendix B**.

BACKGROUND

In Fiscal Year 2001, OPA surveyed selected CUC operations and decided to conduct four separate audits: travel, personnel hiring, compensation practices and small purchases. Burger & Comer, P.C., an independent Certified Public Accounting firm, was contracted to assist OPA in its audit of CUC's small purchases using agreed-upon procedures³. These procedures were conducted in accordance with standards established by the American Institute of Certified Public Accountants.

Commonwealth Utilities Corporation

CNMI Public Law 4-47 (4 CMC §8111, et seq.) established the Commonwealth Utilities Corporation, a component of the Commonwealth of the Northern Mariana Islands Government(CNMI), as a public corporation on October 1, 1985. CUC is responsible for supervising the construction, maintenance, operation, and regulation of all CNMI utility services, including power, sewage, and water. Since it began operations on October 1, 1987, it has been governed by an eight-member Board appointed by the Governor, with the advice and consent of the CNMI Senate. The Board appoints an Executive Director who administers CUC operations on behalf of the Board.

OBJECTIVES, SCOPE AND METHODOLOGY

The objectives of the audit were to determine whether CUC: (1) complied with its Procurement Regulations regarding small purchases, and (2) has adequate systems and procedures in place to ensure proper planning and budgeting for procurement of goods and services.

Government Auditing Standards require a report format or presentation containing the five elements of an audit finding: criteria, condition, cause, effect, and recommendation. In the "agreed-upon procedures" engagement contracted by OPA, Burger & Comer was not required to identify the cause(s) of the findings nor propose any recommendation(s).

³ Agreed-upon procedures may include clerical testing, confirmations, analytical review, cut-off testing, reconciliations, and any other procedure, provided the specific procedures are performed and specific findings are communicated through a report to the intended recipients. Reports using agreed-upon procedures do not require a specific format.

After Burger & Comer submitted the results of its work on February 28, 2002, OPA verified the audit findings, identified the causes, and formulated recommendations. We also identified items needing further review and investigation, as well as matters to be referred to the Attorney General's office. On March 13, 2002, OPA received CUC's responses to the results of Burger & Comer's work.

OPA conducted fieldwork at CUC's main office from July to August 2001. To accomplish our objectives, we: (1) reviewed CUC's Procurement Regulations, (2) obtained a list of all POs showing vendors, invoices, and goods or services purchased, (3) interviewed knowledgeable CUC employees and officials, and (4) obtained relevant information on selected vendors.

OPA initially selected all individual POs over \$25,000 consisting of 109 valid⁴ POs and 22 POs that were eventually cancelled. Our tests covered 109 POs with a total of value of \$4M. Of the 1,088 POs valued at less than \$25,000 each, OPA tested 116 with a total value of \$1.4M. Overall, our sample covered 60 percent of the total value of all valid POs as indicated in the following table:

Particulars	Number of Purchase Orders (POs)	Value of POs Generated	Number of POs Tested	Value of POs Tested	Percentage Tested
<i>Purchase Orders Above \$25K</i>					
Valid POs	109	\$4,040,340	109	\$4,040,340	100
Cancelled POs	22	814,869			
Subtotal	131	4,855,209			
<i>Purchase Orders Below \$25K</i>					
Valid POs	1,088	4,984,129	116	1,398,429	28
Cancelled POs	27	453,992			
Subtotal	1,115	5,438,121			
Grand Total for Valid POs	1,197	\$9,024,469	225	\$5,438,769	60

This audit was made, where applicable, in accordance with Government Auditing Standards issued by the Comptroller General of the United States. Accordingly, we included such tests of records and other auditing procedures as we considered necessary in the circumstances.

⁴ Valid POs refer to purchase orders that were processed and issued or awaiting issuance to vendors. Valid POs were segregated in this report to distinguish the issued and completed POs from cancelled POs.

PRIOR AUDIT COVERAGE

This was OPA's first audit of CUC procurement. In 1998, an independent accountant issued a single audit report on CUC's internal controls and compliance, stating that CUC had not followed prescribed procurement procedures. The report noted that CUC had approved POs after receipt of goods or services, and they had acquired fixed assets prior to contract approval. The independent accountant recommended that CUC management strictly adhere to procurement policies and procedures. CUC partially agreed.

FINDINGS AND RECOMMENDATIONS

Purchases Appear to Have Been Artificially Divided

On purchases greater than \$50,000, CUC must issue contracts through competitive sealed bidding as set forth in CUC's Procurement Regulations. For small purchases, (those not exceeding \$50,000), Section 3-103 of CUC's Procurement Regulations allows CUC to use purchase orders without any bidding, but it prohibits CUC from artificially dividing a procurement to make small purchases. Of the 225 POs tested, a considerable number appear to have been artificially divided, namely:

- goods and services totaling \$929,077 on 39 POs of less than \$50,001 each,
- goods and services totaling \$138,424 on 15 POs of less than \$25,000 each.

If these POs had been combined, CUC would have had to follow competitive procurement practices on goods or services with aggregate value exceeding \$50,000. These POs were for similar goods purchased only a few days apart (if not on the same day), recurring services that were frequently extended, and recurring orders for goods needed in CUC operations. Use of split purchases is not a good practice as it: (1) allows the award of a procurement to selected vendors without competition; (2) does not maintain the public's confidence in the integrity of the procurement process; and (3) may not result in the lowest possible price.

CUC stated that the issue of artificial subdivision needs to be clarified since CUC Procurement Regulations do not define this term. OPA agrees that the CUC Procurement Regulations do not define "artificial division."

CUC gave various reasons for why small purchases appeared to be artificially divided.

- CUC explained that it issued POs for short-term periods in anticipation of technical changes, more convenient alternatives, and uncertainties in funding a long-term agreement. However, OPA believes that by projecting needs, CUC would be in a better position to competitively bid for goods or services. Also, with proper procurement, planning and budgeting, CUC need not issue numerous POs to the same vendor in anticipation of requirements and subsequent modifications.

- CUC explained that it issued separate POs to a vendor in order to extend their services without a long-term commitment. OPA believes that CUC cannot continue to extend contracts indefinitely. Rather, they must decide which particular type of goods or service best fits their needs.
- CUC explained that on some power division purchases, it based vendor selection on the lowest quote per line item. This resulted in several POs being issued to the same vendor even though they were for similar parts on the same projects. In order to obtain greater efficiency, OPA believes that CUC should consider consolidating related requests into one PO instead of using the lowest quote per line item.
- Finally, CUC stated that it is not their policy to consolidate into one PO requisitions generated by different divisions.

Purchases Made Without Obtaining Required Three Quotations

According to Section 3-103(3) of CUC's Procurement Regulations, CUC must obtain price quotations from at least three vendors, and select a vendor based on the most competitive price and quality, for purchases valued between \$25,000 and \$50,000. Our audit showed that CUC had issued 54 POs amounting to \$1,409,475⁵ without receiving three quotations as required. As a result, CUC had no assurance that its small purchases were of the best quality and price.

CUC stressed that in selecting a vendor it attempts to: 1) make procurement as competitive as possible and considers premium quality as well as price in selecting vendors, and (2) enforce the three-quotation requirement. CUC explained that:

- Only a few island vendors carry the stock that CUC needs. To save on freight cost and delivery time, CUC attempts to select from these available vendors. When CUC attempted to include mainland vendors, most demanded prepayments and considered CUC a credit risk because of its location. OPA believes that since very few off-island vendors carry the stock that CUC needs while also accepting CUC trade terms, CUC should continue to search for a broader base of suppliers who offer premium quality goods and services at the most competitive price at terms acceptable to such suppliers. Accordingly, OPA believes this is a valid reason for not obtaining three quotations.
- In several cases, the goods and services that CUC needs are specialized and highly technical in nature, limiting CUC to the manufacturer and the authorized service center. This was the situation for repair and replacement of parts for power plant engines, heavy equipment and drill rigs obtained from two suppliers under 11 POs valued at \$373,302. OPA agrees that CUC's purchase of goods and services that are technical in nature should comply with

⁵ This amount includes purchases below \$25,000 for related POs (on manpower services and degreasers) issued to the same vendor. These purchases when consolidated into one PO amounted to at least \$25,000.

sole-source procurement requirements to justify limiting the procurement to the manufacturer, licensed entity or authorized service center.

- In the case of 26 POs amounting to \$861,324, CUC explained that most CUC procurement personnel believe that faxing three requests for quotation regardless of the response met the requirements. They indicated that the number of responses received was dependent on factors beyond their control. OPA believes that CUC needs to establish procedures to ensure that they fax requests for quotations to legitimate vendors and obtain at least three quotations.
- In the case of two vendors who had been issued 16 POs valued at \$169,089, CUC no longer solicits from other vendors because these POs are merely an extension of previous agreements. OPA believes that CUC's practice of issuing POs to extend previous contracts does not ensure competition for goods or services. With proper evaluation and budgeting, CUC would be able to determine whether it needs to bid the contracts anew or require that any modifications be competitively bid.
- In the case of 3 POs amounting to \$98,205, CUC accepted a vendor who had possession of the engine needing repair and had previously overhauled a similar engine at a lower price than others. OPA also believes that CUC's practice of shipping out power plant engines to be estimated by an off-island vendor prior to actual repair or overhauling must be clearly documented. CUC should also document how it chooses the shipper for the items delivered. Although CUC gets quotes from other vendors, it eventually ends up selecting the vendor making the initial estimate. Furthermore, CUC needs to reassess whether it saves cost in the long run by having these engines overhauled or repaired instead of buying a new one.
- CUC selected the only vendor who could deliver the volume desired on short notice with flexible payment terms. This was the case for recurring urgent requests involving three POs valued at \$47,960. OPA cautions, however, that suppliers who accept short notice and flexible payment terms may actually be charging additional fees for expediting CUC orders and accepting longer payment terms.
- Four sole-source POs valued at \$138,823 were justified by the P&S Manager.

OPA believes CUC needs to amend its Procurement Regulations to address the above recurring concerns.

Former CUC Official Participated in Procurement Action Despite Conflict of Interest

According to Section 6-204(1) of CUC's Procurement Regulations, it is a breach of CUC's ethical standards if any CUC employee participates directly or indirectly in a procurement action when the employee knows that:

- he or she or any member of his/her immediate family has a financial interest in the procurement, and
- a business or organization in which he or she, or any member of the employee's immediate family, has a financial interest in the procurement.

CUC's Procurement Regulations provide that, upon discovery of an actual or potential conflict of interest⁶, an employee shall promptly file a written statement of disqualification and withdraw from further participation, or request the Public Auditor to advise him or her on any further participation.

Our audit, however, showed that a CUC official approved a \$49,000 PO for supplies from his brother-in-law. The CUC official did not file a statement of disqualification nor withdraw from the procurement process as required. As a result, the integrity of the system was not upheld, possibly leading to loss of public confidence.

CUC explained that because of the special nature of this chemical, only one vendor responded. He was awarded the PO. CUC proposed in its March 13, 2002 reply to the Burger & Comer report that it needs to develop a form for employees to list business entities where they or any member of their immediate family may have financial interest. The form would also contain a sworn declaration that in the event CUC employees or officials conduct business transactions with any of the organizations on the list or with any of the related-parties, they will automatically withdraw themselves from the procurement process. It would include a statement acknowledging the employee's understanding of the conflict of interest provisions in the Procurement Regulations. In addition, CUC would educate its employees on the ethics provisions in the Procurement Regulations.

OPA believes that avoiding conflicts of interest is necessary to preserve public confidence in the government's procurement process. The proposed plan of action appears to adequately address CUC employee conflict of interest situations. We encourage CUC to finalize the proposed action plan. OPA will refer this matter to the Attorney General's Office.

⁶ Conflicts of interest may either be apparent, potential or actual. An apparent conflict of interest is one in which a reasonable person would think that the person's judgment is likely to be compromised. A potential conflict of interest involves a situation that may develop into an actual conflict of interest.

Purchase Not Supported by an Invoice

CUC's policies require that it compare vendor invoices with POs and receiving reports, and that vendor invoices be verified for accuracy. Our audit showed that one PO was not satisfactorily documented. CUC paid the PO despite the absence of an invoice. As a result, CUC had no assurance that it paid valid CUC obligations.

OPA believes that CUC should ensure that payments are made based on valid supporting documentation, such as vendor's invoices. Accordingly, CUC should follow-up if it fails to receive an invoice. Also, they should only authorize payment on the basis of vendor invoices.

POs Issued After Purchase of Goods or Services

CUC issued 26 POs, amounting to \$324,232, only after it had received an invoice. CUC Procurement Regulations require that POs be issued before goods and services purchased. Our audit showed that CUC issued the 26 POs only after it received a corresponding invoice indicating that the goods or service had already been received. In doing so, these vendors faced the risk of not getting paid since goods or services delivered may have not been properly approved.

CUC explained that 5 of the POs for rental equipment were issued monthly while the contract was being renewed. Overall, the POs were issued for payment purposes rather than for authorization. CUC indicated that on the other 21 POs, it had issued POs monthly since 1996 to extend vendor's ground maintenance services at the power plant; procure cleaners, washers and other materials in an urgent manner so as to provide preventive maintenance for power plant engines; and purchase emergency parts, materials, and labor for vehicles and equipment needing repair.

POs should be issued to encumber funds and authorize the purchase of goods and services pursuant to requisitions submitted. The purpose of a PO is defeated when it merely ratifies a procurement action, and is issued "after-the-fact." We agree that most purchases cited above were exceptions to CUC's normal procurement process where proper planning, budgeting and approval process are part of the system. While CUC's Procurement Regulations provide for an emergency procurement method to be used when an emergency exists, they do not address urgently needed goods or services.

The CNMI Procurement Regulations address such situations through use of an expedited procurement method. Under this method, the Director of Procurement and Supply may approve expedited procurement without soliciting bids or proposals, after considering the urgency of the need, the comparative costs of goods or services not to exceed \$25,000, and the availability and timeliness in acquiring goods and services. CUC should consider amending its Procurement Regulations to include expedited purchasing in special circumstances.

POs Issued Without Requisition Vouchers Justifying Purchase

Sound internal control requires that a purchase requisition voucher (RV) be prepared before issuance of a PO. However, our audit showed that 21 POs totaling \$258,970 had no RVs. As a result, CUC had no assurance that the goods or services purchased were actually needed.

In lieu of a voucher, CUC explained that its Procurement Office instead supported some POs with an acquisition justification. According to CUC, the 21 POs were generally emergencies involving sewer backflow, power outages, and equipment malfunctions that needed immediate repair thereby taking precedence over procedural requirements. Likewise, vehicles needed to be repaired immediately to comply with public safety requirements. In the case of heavy equipment and trucks, CUC dispensed with preparing an RV because it needed to get the equipment back into operations immediately. Also, these were relatively low cost repairs. Furthermore, they explained that RVs were not needed when processing contract renewals or extensions, or when the only vendor responding already had possession of the item to be repaired.

OPA believes that CUC's policies do not address the procedures for requisitioning emergency or highly urgent goods or services, such as spare parts and other goods or services needed during power outages. For expediency, we understand that some procedures need not apply during such situations. However, expediency should also be balanced with the need to ensure that proper goods or services are procured, to prevent waste or abuse. This and other aspects of emergency or expedited purchases need to be addressed in CUC's policies and procedures. While CUC previously had no standard purchase requisition form, its Controller recently issued a revised requisition voucher form to be used for all POs. It addresses approvals and documentation needed as well as documentation for emergency and "after-the-fact" procurement, but does not define emergency purchases. It is also not clear whether an emergency is limited to situations where public health, safety or welfare is threatened or whether it also covers the procurement of urgently needed goods or services.

Conclusion and Recommendations

CUC officials and employees involved in the procurement process have not strictly complied with CUC's Procurement Regulations applicable to small purchases. CUC's failure to obtain three quotations may have resulted from a misunderstanding of its procurement regulations which seem to imply that 3 quotations should be requested but not necessarily received. CUC needs to provide new guidance for determining split purchases because it is not adequately addressed in CUC's existing Procurement Regulations, policies and procedures. Some purchases discussed above involve special procurement situations, such as urgently needed goods or services, which are not addressed by CUC's Procurement Regulations. Although Burger & Comer's report stated that the design of the system is sufficient to allow for proper planning, budgeting and procurement of goods and services, they believe that there is considerable need and room for improvement in the process. OPA agrees that CUC needs to improve controls on small purchases to ensure that: (1) goods and services are procured at the lowest available price and with the best possible quality, (2) purchases of goods or services are actually needed, (3)

payments are supported by vendors' invoices, and (4) conflict of interest provisions are complied with. Accordingly, we recommend that:

1. The CUC Board amend CUC's Procurement Regulations to include:
 - a. a clear definition of artificial division of purchases or split purchases.
 - b. the procurement method to be followed in special circumstances, such as for urgently needed goods or services.
 - c. an exception to the required three quotations when the number of available suppliers is very limited.
2. The CUC Board adopt policies and procedures for small purchases that:
 - a. provide adequate guidance on determining split purchases or artificially divided purchases.
 - b. define the coverage of emergency procurement under the after-the-fact procurement method specified in the CUC Comptroller's memorandum dated October 24, 2001.
 - c. provide procedures for identifying and documenting actual or potential conflict of interest, including procedures for ensuring that conflicted employees recuse themselves from participating in the procurement process.
3. The Executive Director direct the Procurement and Supply Manager to:
 - a. consolidate related purchase requests into one PO that is competitively procured if it exceeds the small purchase threshold;
 - b. prepare periodic procurement plans covering anticipated needs for goods and services, useful in budgeting for CUC's needs;
 - c. ensure that the requirement for three quotations is complied with and properly documented. (Toward this end, a form showing vendors contacted, description of goods or service requested, vendors' prices and responses, and other pertinent information would be useful.); and
 - d. ensure that small purchases are issued with a PO including a requisition voucher as provided in the Comptroller's memorandum dated October 24, 2001, before the corresponding goods or services are delivered.
4. The Executive Director remind CUC officials and employees involved in the procurement process of the need to comply with the conflict of interest provision in CUC's Procurement

Regulations. Also, he should remind accounting personnel to process vendors' payments supported with invoices.

CUC Response

In its letter response dated June 22, 2002 (**Appendix A**), CUC generally agreed with Recommendations 1 to 3 and partially disagreed with Recommendation 4. Furthermore, they recognize that most of the recommendations involve modifications to existing procurement regulations. Accordingly, they have begun reviewing pertinent provisions to make them more applicable to the unique nature of CUC operations while retaining or strengthening safeguards to maintain public confidence in CUC's procurement. Their justification or additional comments on specific audit findings are as follows:

Purchases Appear to Have Been Artificially Divided

- POs that fell under the \$50,000 threshold were properly procured using the small purchase method.
- The cost of additional work was below the \$25,000 threshold. Hence, the requirement for obtaining quotations or competitive bidding was not applicable.
- CUC issued several POs to a vendor who is the sole distributor of a particular product in the entire Micronesian region. While it is more appropriate to enter into a long-term supply contract with the vendor, CUC opted not to because of the very high initial deposit requirement.
- As to OPA's suggestion that CUC should project its needs, its inventory system provides the needed information for CUC to estimate its material requirements. However, entering into a long-term supply or a bulk purchase agreement, which requires competitive bidding because of the materiality of amount involved, necessitates steady cash flow. The period audited was characterized by dwindling revenues due to the economic slump and increase in fuel prices. Accordingly, CUC resorted to buying only the quantity that its cash flow could afford, mostly through PO issuance.
- As to consolidating requisitions from different divisions, this is not feasible because CUC's departments have their own requirements with varying technical specifications. However, on common items, they do consolidate requisitions generated by different divisions.
- The use of POs was the fastest procurement mode in critical situations. Although CUC conducted bidding for annual supply of certain items, there were delays in processing contracts. As the stock reached critical levels, CUC resorted to solicitation of quotes to expedite the procurement process.

- CUC did not extend any of its contracts for an indefinite period. Although it retained ground maintenance services after contract expiration, such services were procured through issuance of a monthly PO and not by extending the contract indefinitely. CUC's ground maintenance service was terminated in October 2001.

Purchases Made Without Obtaining Required Three Quotations

CUC partially agreed with our recommendations on the three vendor quote requirement. Although it admitted that some services could have been procured more appropriately by contracts, they gave the following reasons why obtaining three quotations for certain goods or services was not applicable.

- Each PO valued below the \$25,000 threshold did not require quotations. Products or services for which these POs were issued were originally intended for short-term use.
- There were only two vendors on island who could provide goods and services. Accordingly, CUC always ordered from the vendor who provided the lowest quote.
- The goods or services could only be provided by one vendor.
- In procuring engine parts, CUC always settled for the lowest price.
- While buying new engines is desirable, CUC resorted to overhauling its engines due to financial constraints.
- One purchase was preceded by solicitation of four quotations; it should be deleted as a finding.

Additionally, CUC provided the following comments:

- As to ensuring that requests for quotations are sent only to valid vendors, CUC first obtains the vendor's business license or financial statement. In other instances, it makes inquiries with other business firms, to ensure that CUC is dealing only with legitimate and reliable vendors.
- As to the claim that suppliers who accept short notice and flexible payment terms may actually be charging more, CUC believes the amount paid was at market price. No hidden cost was charged just because the vendor delivered the items on short notice.
- The statement requiring CUC to clearly document the rationale for shipping engine parts off-island for vendor estimates needs clarification.

Former CUC Official Participated in Procurement Action Despite Conflict of Interest

CUC agreed with our recommendation on conflict of interest. CUC recognizes that it must make procurement regulation changes to address situations where the approving official is in conflict. CUC stated that its procurement regulation is undergoing a review to strengthen the conflict of interest provisions. CUC also reiterated that the signature of the cited officer in the PO was merely to comply with procedural requirements, and that such purchase underwent the required procurement procedures.

Purchase Not Supported by an Invoice

CUC disagreed with this finding by citing the following:

- Small firms may not understand the purposes of business forms in the way that more established or bigger firms do.
- The PO was a one-time transaction with a seller who was not in the business of supplying parts or equipment. His letter describing the item and his selling price served as his invoice. This was documented by a receiving report.

POs Issued After Purchase of Goods or Services

- CUC admitted that the POs covered by the finding were issued “after-the-fact” but stated that justifications were made explaining the reason for the departure from the prescribed procedures, while affirming the need for goods or services as well as the validity of the work done. Additionally, CUC responded to certain POs included in the finding.
- Five POs resulted from CUC’s decision to continue renting a power generator from a vendor despite the expiration of the original contract. CUC does not see any internal control lapses since it was done out of operational exigencies and for the welfare of the public in general. CUC mentioned that ending the existing rental contract without readily available power supply sources would have been detrimental to CUC operations. Rota would have faced severe power outages because of inadequate power supply.
- Two POs were for major repairs of leased vehicles. The lease agreement required CUC to promptly refer damages or malfunction to the lessor as the only authorized party to handle repairs and maintenance. The repairs involved a bucket truck which was mistakenly refueled with gasoline instead of diesel. The other was an auger truck that figured in a major accident due to the fault of an employee. CUC issued “after-the-fact” POs because of the urgency of the situation.

POs Issued Without Requisition Vouchers Justifying Purchase

- CUC did not see the need for issuing RVs for the power generator because the rental agreement provided for a term extension.
- CUC's not coming up with RVs was a result of operational exigencies taking precedence over procedural requirements. Unfortunately, these situations are not addressed by its existing procurement regulations "putting in surface" (sic) the need for CUC to evaluate them.

OPA Comments

CUC's letter response primarily provided explanations or rebuttals to the audit findings and did not specifically address the audit recommendations. The response did not indicate a specific course of action, the official responsible for the action, and the implementation date; hence we consider all recommendations open. The information or action required to close the recommendations is presented in **Appendix B**. OPA has made the necessary changes to the report to address the valid arguments raised in the CUC response. Presented below are OPA's comments on the rest of CUC's response.

1. CUC needs to amend its Procurement Regulations in order to address or clarify:
 - (a) artificially split POs;
 - (b) recurring concerns, such as maintenance or repairs of leased equipment and services limited to a specific manufacturer, licensed entity or authorized service center;
 - (c) urgent procurement; and
 - (d) expedited procurement in special circumstances.

Although CUC provided valid justifications on some POs covered in the audit findings, the fact remains that there were departures from required policies and procedures. CUC's need to amend its Procurement Regulations was demonstrated throughout the discussion of audit findings. The audit exceptions remain despite the decrease in the magnitude of the findings.

2. Even if POs for similar items were generated on different dates, artificially splitting purchases may still occur when CUC:
 - (a) generates one PO for each division's request, instead of looking at the feasibility of consolidating them; and
 - (b) bases vendor selection on the lowest price quotation per line item.

Since split purchases do not ensure fair and open competition, CUC needs to make it a policy to consolidate similar purchases whenever feasible, and clarify unallowable division of purchases in its regulations, policies or procedures.

3. As to funding requirements, funds are always certified prior to issuance of a PO and awarding of a contract. Contract extensions, like PO issuances, are not approved unless funds are available. If CUC was eventually able to issue several POs valued at \$1.1 million through the small purchase method, regardless of any funding problem, we see no reason why goods and services exceeding \$50,000 could not be solicited through competitive bidding or proposals.

Since CUC Procurement Regulations do not have regulations on recurring and continuing requirements, CUC may choose to adopt Section 5-103 (3) of the Revised CNMI Procurement Regulations, which state that:

“Extension of services, award of contracts for recurring and continuing service requirements are often delayed due to circumstances beyond the control of contracting offices. In order to avoid negotiation of short extensions to existing contracts, the P & S Director may include an option clause in solicitations and contracts which will enable the Government to require continued performance of any services within the limits and at the rates specified in the contract. The option provision may be exercised more than once, but the total extension of performance thereunder shall not exceed 6 months.”

While CUC’s contracts may provide for a term extension, CUC’s Procurement Regulations do not address extension of service contracts. Nevertheless, as a good procurement practice, the extension should not go beyond the contract term unless there is a valid change order. In the following cases, CUC exceeded the maximum allowable contract period without a corresponding change order.

- a. For one vendor, CUC extended its ground maintenance services from 1996 to 2001 through issuance of monthly POs. CUC paid \$49,299 for ground maintenance services from November 1999 through September 2000 alone. During this period, CUC did not issue contract change orders. Also, it could have bid out the vendor’s services and issued new contracts, instead of issuing monthly POs.
- b. CUC’s equipment rental agreement with a vendor indicated a contract period beginning May 22, 1999 and ending in October 1999. The agreement stated that if CUC provided a written notice to the vendor by October 1, 1999, CUC could extend the rental agreement for up to an additional 6 months using the same rates and terms stated in the contract. CUC issued 5 “after-the-fact” POs throughout 2000 amounting to \$73,620 to renew the rental agreement.

Repeated extensions of contracts generally does not foster competition since awards of goods or services are limited to few vendors. One of the purposes and policies in the CUC Procurement Regulations is to foster effective and broad-based competition within the free enterprise system.

4. While it is true that individual purchases below the \$25,000 threshold do not require three vendor quotes, we found related purchases for which POs issued to the same vendor accumulated to more than \$138,424. This practice did not foster free and open competition.
5. On vendors' non-accommodation of CUC's urgent requests and longer payment terms, OPA maintains its recommendation for CUC to prepare periodic procurement plans covering anticipated needs for goods and services. Failure to plan does not justify an urgent procurement.
6. Four quotations supporting a PO pertained to a bidding process that was cancelled. CUC should not use the original four quotations to satisfy the competition requirement. Instead, it should have obtained new quotes for the revised requirement.
7. CUC records should identify POs issued on a sole-source basis and provide justification as required in the Procurement Regulations.
8. CUC should request quotations only from legitimate vendors and ensure that procurement of goods and services is done through open and free competition.
9. Since CUC's Procurement Regulations do not address a situation where there is no adequate local source, it may choose to adopt Section 3-102(6) of the CNMI Procurement Regulations, which states:
 - (a) before advertising the invitation for bids, the expenditure authority shall certify to the P&S Director whether there is adequate local competition for the solicited goods or services based on experience, or on a survey of available local vendors. If there is adequate local competition, the advertisement shall be made only within the Commonwealth;
 - (b) if there is no adequate local competition, the invitation for bids shall be advertised in at least one regional newspaper or at least one national publication or on the internet; in such case, the P&S Director shall consider extending the bidding period.
10. CUC should also ensure that items shipped out (like power engine repair to be estimated by an off-island vendor) are properly documented for proper authorization and monitoring of assets. This should be included in its written policies and procedures.
11. The finding on conflict of interest will be referred to the Attorney General's Office. In order to close the recommendation, CUC should finalize its action plan, indicate the official responsible for the action and the implementation date. CUC mentioned its action plan through a previous discussion with Burger & Comer.
12. While we acknowledge CUC's efforts to verify the accuracy and validity of vendors' charges, OPA maintains its position that if CUC does not receive an invoice, it should follow up on

the required document with the vendor. CUC officials should only authorize payment on the basis of vendor invoices.

13. Vendors who were issued “after-the-fact” POs faced the risk of not getting paid since goods and services were obtained without following the required approval process. CUC should issue RVs for all CUC required goods and services.

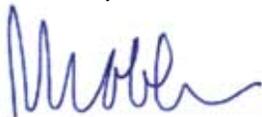
The information or action required to close Recommendations 1, 2, 3 and 4 is presented in **Appendix B**.

★ ★ ★

Our office has implemented an audit recommendation tracking system. All audit recommendations will be included in the tracking system as open or resolved until we have received evidence that the recommendations have been implemented. An *open* recommendation is one where no action or plan of action has been made by the client (department or agency). A *resolved* recommendation is one in which the auditors are satisfied that the client cannot take immediate action, but has established a reasonable plan and time frame of action. A *closed* recommendation is one in which the client has taken sufficient action to meet the intent of the recommendation or we have withdrawn it.

Please provide to us the status of recommendation implementation within 30 days along with documentation showing the specific actions that were taken. If corrective actions will take longer than 30 days, please provide us additional information every 60 days until we notify you that the recommendation has been closed.

Sincerely,



Michael S. Sablan, CPA
Public Auditor

cc: Governor
Lt. Governor
Thirteenth CNMI Legislature (27 copies)
Attorney General
Secretary of Finance
Special Assistant for Management and Budget
Press Secretary
Media



Commonwealth Utilities Corporation



June 22, 2002

Mr. Michael S. Sablan
CNMI Public Auditor
2nd Floor, J. E. Tenorio Building
Saipan, MP 96950

6/24/02
RECEIVED

Dear Mr. Sablan:

Subject: Draft Letter Report – Commonwealth Utilities Corporation
Audit of Small Purchases from October 1, 1999 through
March 31, 2002

Enclosed is our response to your draft letter report on the subject audit.

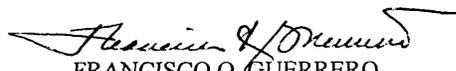
The report allowed us to evaluate our procedures and controls as regards to small purchases. We are thankful on the recommendations in areas where improvements can be instituted or enhanced. We shall certainly consider them in strengthening and streamlining our procurement functions.

We would like to thank the officers and staff of the independent accountant and those of your office for a thorough audit of our small purchases and for allowing us the chance to respond to their findings.

Let us know if you need additional information regarding our response.

Sincerely yours,


BERNARD P. VILLAGOMEZ
Acting Executive Director


FRANCISCO Q. GUERRERO
Board Chairman

P.O. Box 501220 CE • Third Floor, Joeten Bandan Building
Saipan, MP 96950-1220
Telephone (670) 235-7025 • Facsimile (670) 235-6145

**REPLY TO DRAFT LETTER REPORT
COMMONWEALTH UTILITIES CORPORATION
AUDIT OF SMALL PURCHASES
FROM OCTOBER 1, 1999 THROUGH MARCH 31, 2001**

54 POs for \$1.1M Appears to Have Been Artificially Divided

Please reconsider the inclusion of the following POs, which the report considered as having the appearance of artificial division:

- a) POs 2166 and 2195 when combined would only amount to \$41,400.00; hence, they are still under the \$50,000 threshold for procurement using the small purchase method.
- b) POs 1918, 1922, and 1924 totaled to only \$47,725.44 and rightfully procured using small purchase procedures.
- c) POs 837, 856, 1870, and 2521, all for \$23,250 were dated far apart from each other to be considered artificially divided. Furthermore, these were for services that were beyond the original janitorial services scope for which this vendor was hired. Therefore, we deemed it necessary to issue them separate POs for these additional works. In addition, because the cost of additional work was below the \$25,000 threshold, the requirement for obtaining quotation or for competitive bidding was not applicable.
- d) POs 615 and 617 for a total of \$68,168.00 were dated (effective date and not the date when they were generated by the system) far apart from each other to be considered as split purchase. The first was signed by the final signatory on December 20, 1999 while the other was on February 3, 2000.

The nine POs totaling \$55,485 were for monthly refill of chlorine from the cited vendor who is the sole distributor of this product in the entire Micronesian region. We tried inquiring from some mainland suppliers but the shipment cost makes the price higher or they do not make delivery to this area because of some exclusive agreements with the subject vendor. There is no reason therefore in splitting the POs. While it is more appropriate to enter into a long-term supply contract with them, we found the initial deposit requirement for empty cylinders quite steep, which we can use in more pressing requisitions.

For the other POs amounting to \$524,474, these were for needed materials by Power Distribution like cable wires and poles. Although we conducted bidding for annual material supply covering these items, the processing of the resulting contracts suffered delay. As the stock level then for these materials was already critical, we tapped from our typhoon stock to meet our operational requirements. However, we did not want to be caught off-guard during typhoon season when the availability of these power distribution

materials is most needed. As a result, we decided to procure cables and poles through solicitation of quotes as a stopgap measure. In addition, materials of these types require a certain lead time (from three to six months), as they still need to be manufactured and shipped from the mainland. The use of PO of then was the fastest mode given the critical situation.

We would like to stress above POs were awarded to the respective vendors based on competition (solicitation of quotes) and our records support this assertion.

The report supports our contention that CUC Procurement Regulations do not define “artificial division.” It is our opinion that the focus in interpreting “artificial division” must be on the artificial nature of a division. Where, for instance, CUC requires at one time numerous smaller items, obtains quotations for each item, and awards several POs to a vendor, it cannot be considered artificial division even if the resulting purchase orders exceed \$50,000.00. While it may be true that CUC could combine items in a solicitation and procure them through a competitive bidding to achieve an economy of scale, the failure to combine is not an “artificial division.”

To clarify this issue and to and provide guidance on what constitutes artificial division we are evaluating our procurement regulations for needed amendments.

On the other hand, we would like to clarify certain matters brought out in this finding:

- As regards the suggestion that CUC should project needs, our inventory system provides the needed information for us to estimate our material requirements. However, entering into a long-term supply or a bulk purchase agreement, which requires competitive bidding because of the materiality of amount involved, necessitates steady stream of positive cash flow. We did not have that scenario during the period covered by this audit as that time was characterized by dwindling revenues due to a depressed economy and exacerbated by a regime of increasing fuel prices. As a result, we resorted to buying only the quantity that our existing cash flow could afford, which most of the time was through issuance of POs. (Pertinent to first bulleted paragraph, page 4.)
- Relative to the statement that CUC cannot continue to extend contract indefinitely, our records will show that we did not make extension to any of our contracts for an indeterminate period. The exception cited in the report was for a ground maintenance services rendered by a firm whose contract already expired. Although we retained their services for a certain period after the expiration of their contract, such services were procured through the issuance of monthly PO and not by extending their contract indefinitely. Their services were terminated in October 2001. (Pertinent to second bulleted paragraph, page 4.)
- Regarding the manner of selecting the vendor based on the lowest cost quoted per line item (on the requisition voucher), we believe that there is more advantageous to us because we always obtained the best price. The awarding of

POs to the same vendor was never for the same parts but for the same project. (Pertinent to third bulleted paragraph, page 5.)

- About consolidating requisitions by different divisions, this is infeasible as each of our department has its own requirement in varying technical specifications (e.g. power poles for Power Distribution, engines parts for Power Generation, pipes for Water, and motor pumps for Wastewater). In addition, even the market has its own specific suppliers for each of the example items because of technology ownership. Only for common items like computers and office supplies can we consolidate the requisitions generated by different divisions and we are doing this. Nevertheless, we do consolidation if the procurement is for bulk supply like annual material requirement wherein we combine all material requisitions for the year for a division into one request for bid. We then based the selection depending on the lowest bid for each commodity group (e.g., transformers, cables, poles, etc.). However, this is not applicable to small purchases. (Pertinent to fourth bulleted paragraph, page 5.)

55 POs for \$1.4 Million Do Not Have Three Quotations

Because the report accepted our justifications on why obtaining three quotations is not applicable in certain instances, we believe that the above heading does not present a true accounting for this finding. We request that the number of exceptions cited and the corresponding amount should be adjusted downward due to the validity of our justifications.

Aside from the 11 POs for \$373,302, which the report considered justifiable despite the absence of three quotations because of specialized and highly technical nature of requirements or exclusivity arrangement, we are seeking the inclusion of the following:

- PO no. 282 for \$36,900.50 – As explained further on page 7, this represents major repairs of an auger truck that we are leasing from the cited vendor. Our lease agreement specifically provided that only them could carry out any maintenance or repairs for the leased equipment.
- PO no. 676 for \$32,598.00 – The vendor is the manufacturer of the parts purchased. Despite of this, we obtained quotation from another vendor for price comparison purposes. The manufacturer quoted a better price hence awarded the PO.
- PO no. 10307 for \$37,192.72 – This is the only vendor on the island that can provide servicing and certification of the safety and worthiness of overhead cranes.

For those 14 POs valued at \$72,549, we disagree that three quotations were required for these purchases. Each of these 14 POs amounted to no more than \$25,000. In accordance

with our procurement regulations, purchases below this threshold amount do not require quotations. Moreover, the products or services required from these vendors were originally contemplated on short-term basis.

The issue, we believe, is the propriety of procurement method we employed rather than our compliance with the three-quotation requirement. Admittedly, these services should have been procured more appropriately by contracts, as they became recurring needs.

PO number 149 for \$47,040.00 was preceded by solicitation of four quotations; it should be deleted from this finding.

Likewise, PO nos. 10809, 2741, 2155, and 10111 for a total of \$167,570 should not be included in this finding. It is widely known that there are only two vendors on the island selling trucks. Hence, we could only solicit quotations from these two. Although buying from off-island is an option, the shipping cost involved would make the item more expensive than the prices offered by the two on-island vendors and there is the concern about services and warranties.

PO no. 717 for \$33,189.24 was canceled and should likewise be deleted from this finding.

As regards the other comments and suggestions disclosed in this particular finding, we want to clarify the following matters:

- We did not say that very few island vendors were willing to accept CUC trade terms. On the contrary, this matter was attributed to off-island vendors. Because of our location, they considered us a credit risk and thus normally required prepayments, which heavily impact our cash flow. Our problem of sourcing from local vendors was that they do not normally carry the stock we need. Because of the technical nature of our material requirements and the high cost of carrying them on stock, we can only source our inventory from mostly big companies abroad. Hence, the suggestion of evaluating if on-island purchases are more cost-efficient and effective than off-island purchases is not applicable. In most cases, sourcing of items from either on-island or off-island vendor is dictated by availability of stock. (In reference to first bulleted paragraph, page 5.)
- The report suggested that for purchase of goods and services that are technical in nature, CUC should comply with sole-source procurement requirement to justify that the procurement needs to be limited to the manufacturer, licensed entity or authorized service center. We agreed with this suggestion but relative to the POs concerning purchase of parts for the power plant engines, we always have two licensed suppliers and we order from either depending on the price quoted. (In reference to second to the last sentence, second bulleted paragraph, page 5.)

- As regards ensuring that we fax requests for quotations only to valid vendors, we stress that before we transact with any business entity, we first obtain their business license, financial statement, or we inquire from other business firms to ensure that we are dealing only with legitimate and reliable vendors. (In reference to last sentence, third bulleted paragraph, page 6.)
- The statement requiring us to clearly document shipping out of engine parts for estimate by off-island vendor needs clarification. We do not know the basis for this claim, as it was not in any report provided to us. In addition, we do not know the reason why must we document the basis for selecting shipper for the items delivered. The selection of the shipper for our purchases is at the discretion of the vendor as we normally buy “FOB” or “CIF.” (In reference to fifth bulleted paragraph, second to the last sentence, page 6.)

As far as our finances are concerned, overhauling engines is the only option. While buying new engines is desirable, it is a major capital expenditure considering the cost alone. The last time it was done, all the branches of the government including the federal government were involved. (In reference to fifth bulleted paragraph, last sentence, page 6.)

- As regards the claim that suppliers who accept short notice and flexible payment terms may actually charging CUC more, as far as the excepted POs were concerned, the amount we paid was at market price and we ensured that no hidden cost was charged just because the vendor delivered the items on short notice. (In reference to sixth bulleted paragraph, page 6.)

Conflict of Interest on a Former CUC Official

Although the signature of the cited officer was on the PO, his signing was to comply with procedural requirement because POs are given effect only upon his or his appointed designee’s approval. Our records show that subject purchase underwent the required procurement procedures. A solicitation of quotation ensued after a duly approved requisition voucher was received from the requisitioning department. Because of the special nature of the chemical that we needed, only the subject vendor was able to respond and thus awarded the PO. The subject officer had no participation in the solicitation process.

CUC recognizes that it must make procurement regulatory changes to address situations where the approving official is in conflict. Again, the procurement regulation is undergoing a review to strengthen the conflict of interest issues.

Purchases Not Supported by Invoices

We disagree with this finding. Our records show that on PO nos. 2521, 856, and 01762, the respective payments totaling \$54,295 were supported either by a letter from the proprietor (in her letterhead) or by billing statements (not statements of account) requesting payment for services rendered. We must understand that small firms may not have the understanding of the purposes of business forms in the way that more established or bigger firms are. As far as the subject vendor was concerned, the billing statements served as her invoices as each statement showed the services rendered, the period covered, and the amount. Nevertheless, we supported the cited POs with certifications of services rendered signed by the department concerned to ensure that the work authorized and required by the corresponding PO was completed to our satisfaction prior to making payments. Hence, we were assured that we paid only for valid obligations.

PO 2495 for \$1,400.00 was a one-time transaction with a seller who was not actually into trading business. He happened to have an item we needed, which he was willing to sell. His letter describing the item and his selling price served as his invoice. We then documented our receipt of the item through a receiving report before we paid this vendor. Likewise, we believe that we paid a valid obligation.

26 "After-the-Fact" POs for \$324,232

We admit that the POs were issued "after-the-fact" but it should be mentioned that justifications were made explaining the reason for the departure from the prescribed procedures and affirming the need for goods or services and validity of work done or items covered by these POs.

As regards the five POs for the rental of power generator totaling to \$73,620, we take exception to the report's statement that CUC had no approved budget for equipment rental. On the contrary, our approved budget for fiscal year 2000 showed an amount allocated for the rental of this generator.

Nevertheless, the five POs resulted from our decision to continue renting a power generator from a vendor despite the expiration of the original contract. Such extension of rental period, which both parties agreed to, was provided for in the contract. We do not see any internal control lapses in this regard because CUC, out of operational exigencies and for the welfare of the public in general, had decided to continue renting the generator (while the CUC-owned main generator was still undergoing rehabilitation). Otherwise, Rota would have faced severe power outages because of inadequate power supply. At the same time, we were then in the process of procuring an engine after obtaining financial support from the Rota delegation. To end the existing rental contract without a readily available power supply sources would have been detrimental to our operations.

The arrangement with the vendor as regards billing called for its submission of monthly invoice for the kilowatt-hours usage of the preceding month. Upon our receipt of their

billing, we then issued a PO for the amount billed. The issuance of PO in this case is similar to expenditure for utilities in which the amount payable is known only upon the determination of actual usage.

Both PO nos. 11087 and 11032 totaling \$63,238.07 were for major repairs of vehicles that we leased from the cited vendor. In accordance with the leased agreement, we have to promptly refer to lessor all incidents of damage or malfunction of the leased equipment as only they are authorized to handle all repairs and maintenance. The first repair was for a bucket truck that was mistakenly refueled with a gasoline instead of diesel causing major damage to its engine assembly. Expectedly, the truck abruptly stopped at a major road causing traffic obstruction. To avoid further inconvenience to the public and to place the critical equipment back to operation, we had this vendor perform the necessary repairs at once although an estimated cost was provided to us beforehand. The second repair was for an auger truck that figured in a major accident at the fault of our employee. This equipment was also critical to our operations and because of the damages it sustained from the accident we promptly brought it to this vendor for repair. Likewise, we were provided an estimate of the cost in advance. Certainly, the urgency of the situations, the requirement of the lease agreement, and our prior knowledge of the cost the repairs made us decide to issue the corresponding PO after the repairs were completed.

PO no. 838 for \$13,836.50 represents accumulated charges for minor repairs of CUC heavy equipment and trucks. Because of the urgency of situations, the need for these equipment to be placed back to operations, and the relatively small cost of charges (less than \$100.00, expenses that could not be accommodated by our petty cash) the prior preparation of RVs and PO was dispensed with.

We recognized that our existing procurement regulations do not address a number of situations pertinent to the uniqueness of our operations as a utility company. In this regard, we have started evaluating certain provisions to make them more attune to our operations while retaining or strengthening internal controls and public confidence in our procurement processes.

24 POs for \$315,470 Do Not Have Requisition Vouchers

As explained in the previous finding, POs 1997 and 1017 for \$36,585 represent rental of power engine. We did not see the need for issuing RVs because the extension of the term for the rental of said equipment was provided for in the contract.

PO 10762, 837, and 856 for \$56,500 had supporting requisition vouchers. (These were deleted from the finding by Burger and Comer during our exit conference with their representative.)

As stated previously, the absence of RVs was a result of operational exigencies taking precedence over procedural requirements. Unfortunately, these situations are not

addressed by our existing procurement regulations putting in surface the need for us to evaluate them.

Recommendations

We recognize that most of the recommendations involve modifications to our existing procurement regulations. We have began the task of reviewing provisions to make them more applicable to the unique nature of our operations as a utility company while retaining or strengthening safeguards to maintain public confidence in our procurements.

We shall inform your office of the specific actions that will be implemented after our evaluation is completed.

As regards your suggestion that we remind our accounting personnel to process only vendor's payment supported with invoices, we would like to stress that this is a long standing requirement that we have been observing. The findings you cited were exception to the norm but this is because of the limited understanding of the cited vendor as to the purposes and uses of business forms. As a compensating control, we supported their billing with certificate of completion of services to validate their billings.

**AUDIT OF COMMONWEALTH UTILITIES CORPORATION'S
SMALL PURCHASES
FROM OCTOBER 1, 1999 THROUGH MARCH 31, 2001**

STATUS OF RECOMMENDATIONS

Recommendations	Agency to Act	Status	Agency Response/ Action Required
<p>1. The CUC Board should amend CUC's Procurement Regulations to include:</p> <ul style="list-style-type: none"> a) a clear definition of artificial division of purchases or split purchases; b) the procurement method to be followed in special circumstances, such as for urgently needed goods or services; c) An exception to the required 3 quotations when the number of available suppliers is very limited. 	CUC	Open	<p>CUC generally agreed with recommendations 1 to 3. However, in its letter response of June 22, 2002, it did not specifically address each recommendation.</p> <p>CUC recognized that most of the recommendations involved modifications to its existing procurement regulations. Accordingly, CUC began reviewing pertinent provisions to make them more applicable to the unique nature of CUC operations while retaining or strengthening safeguards to maintain public confidence in CUC's procurement.</p> <p>To close recommendation 1, CUC needs to submit a duly adopted amendment to its Procurement Regulations addressing split purchases, the procurement method in special circumstances, and CUC's inability to obtain 3 quotations where the number of available suppliers is very limited.</p>
<p>2. The CUC Board should adopt policies and procedures for small purchases that:</p> <ul style="list-style-type: none"> a) provide adequate guidance to CUC employees on determining split purchases or artificially divided purchases; b) define the coverage of emergency procurement under the after-the-fact procurement method specified in the CUC Comptroller's memorandum dated October 24, 2001; c) provide procedures for identifying and documenting actual or potential conflicts of interest, including procedures for ensuring that conflicted employees recuse themselves from participating in the procurement process. 	CUC	Open	<p>To close recommendation 2, the CUC Board needs to submit written policies and procedures for small purchases that provide adequate guidance to CUC employees in determining split purchases, defining the coverage of emergency procurement under the "after-the-fact" procurement method, and identifying and documenting conflicts of interest.</p>

Recommendations	Agency to Act	Status	Agency Response/ Action Required
<p>3. The Executive Director should direct the Procurement and Supply Manager to:</p> <p>a) consolidate related purchase requests into one PO that is competitively procured if it exceeds the small purchase threshold;</p> <p>b) prepare periodic procurement plans covering anticipated needs for goods and services, useful in budgeting for CUC's needs;</p> <p>c) ensure that the requirement for 3 quotations is complied with and properly documented. Toward this end, a form showing vendors contacted, description of goods or service requested, vendors' prices and responses, as well as other pertinent information, would be useful;</p> <p>d) ensure that small purchases are issued with a PO including a requisition voucher as provided in the Comptroller's memorandum dated October 24, 2001, before the corresponding goods or services are delivered.</p>	CUC	Open	<p>To close recommendation 3, the Executive Director must direct the P&S Manager to consolidate related purchase requests into one PO that is competitively procured if it exceeds the small purchase threshold, prepare periodic procurement plans for anticipated needs, ensure that its requirement for 3 quotations is complied with and properly documented, and ensure that small purchases are issued with a PO and covered by a requisition voucher, before goods or services are delivered.</p>
<p>4. The Executive Director should remind CUC officials and employees involved in the procurement process of the need to comply with the conflict of interest provision in CUC's Procurement Regulations. Also, he should remind accounting personnel to process vendors' payments supported with invoices.</p>	CUC	Open	<p>CUC agreed with the recommendation on conflict of interest. It also has the following plan of action, previously discussed with Burger & Comer.</p> <p>(a) Develop a form for employees to list business entities where they or any member of their immediate family may have financial interest. The form would contain the following:</p> <ul style="list-style-type: none"> a sworn declaration that in the event CUC employees or officials conduct business transactions with any of the organizations on the list or with any of the related parties, they will automatically withdraw from the procurement process; and

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			<ul style="list-style-type: none"> • a statement acknowledging the employee’s understanding of the conflict of interest provisions in the Procurement Regulations. <p>(b) Educate CUC employees on the ethics provisions of the Procurement Regulations.</p> <p>To close the recommendation on conflict of interest, the Executive Director must remind CUC officials and employees involved in the procurement process to comply with the provision on conflict of interest, including required procedures and copies of the forms discussed in (a).</p> <p>CUC must furnish OPA with pertinent documents and provide a time frame in which the action will be implemented.</p> <p>CUC disagreed with the recommendation on payments without vendors’ invoices. However, OPA maintains that CUC officials should only authorize payments on the basis of vendor invoices.</p>