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OFFICE OF THE CITY AUDITOR
City and County of Honolulu

**Audit of the Department of
Environmental Services'
H-POWER Contracts and Procurement
Practices**

BACKGROUND

- Department of Environmental Services (ENV) plans, directs, operates and administers the city's solid waste and other environmental sustainability programs.
- ENV 25-year integrated solid waste management plan updated in 2008.
- To reduce the need for landfill, plan called for H-POWER waste to energy facility (i.e. converted solid waste into electricity).
- In FY 2014, H-POWER facility produced and sold 379,438 megawatt hours of electricity and generated \$65.6 million in electric revenues.

City Council Resolution 12-150, CD1

- Requested audit of the Department of Environmental Services' (ENV) contracts, including its procurement practices to ensure that it is operating efficiently, effectively and in compliance with all applicable laws and policies.
- Audit done according to generally accepted government auditing standards from November 2013 to November 2015.
- Audit focused on the H-POWER project. (Beachwalk and Synagro projects will be the focus of other planned audits).

BACKGROUND

ENV executed two H-POWER contracts.

- ENV awarded 20 year operating contract to Honolulu Resource Recovery Venture (HRRV) (July 1985; \$163,764,130).
- ENV awarded a second contract (July 1985, \$149,975,660) to HRRV to design, construct, and test the H-POWER facility.
- Original contracts totaled \$313.7 million.
- Covanta acquired the operating contract from HRRV in 1993.
- In FY 2014-15, ENV paid Covanta a \$52.9 million service fee to operate and maintain the H-POWER facility.

Photo of H-POWER Plant



BACKGROUND

- After the contracts were awarded, ENV initiated three major capital projects and used 79 contract modifications (amendments, change orders, and task orders) to construct, improve, expand, and refurbish the H-POWER facility.
- Contract changes increased the overall project costs to \$993.3 million (including contractor, construction, and operating costs) as of FY 2013.
- Consultant contracts (\$14.7 million) are not included in the \$993.3 million total.
- Despite State of Hawai'i Procurement Code and city policies that restricted the use of sole source contracts, cost-plus, and time and materials contracts, ENV used de facto sole source, cost plus, and time and materials contracts to construct, improve, expand, and refurbish the H-POWER facility, and to hire consultants.

AUDIT RESULTS

We found ENV needs to improve its procurement practices. ENV:

- Did not fully comply with sole source contract requirements, particularly for consultants.
- Used cost-plus and time and materials contracts although resources needed to administer the contracts were not assigned.
- Approved contract terms that were not in the best interests of the city, and
- Approved contract modifications without realizing the contractor's right to operate the H-POWER facility was extended from 20 years to 47 years.

CONTRACT ADMINISTRATION

- City's current *General Terms and Conditions* not used in contracts.
- Contract required city to issue general obligation bonds to ensure contractor and subcontractors are paid.
- Cost-plus and time and materials contracts used although city resources not assigned to administer the contracts.
- Contract limits city's right to audit, access to records, records retention.
- ENV and BFS approved contract modifications that automatically extended operating contract from 20 to 47 years without soliciting competitive bids.

AUDIT RESULTS

We found ENV needs to improve its contract administration practices.

- Payments prior to FY 2013 reviewed.
- ENV approved payments that were excessive, questionable, and not fully supported.
- A small sample of invoices indicate payments for invoices have improved since FY 2013.
- ENV can still improve its contract administration by assigning the resources needed to properly administer the complex H-POWER contracts.

CONTRACTOR PAYMENTS

- ENV payment for contractor's legal fees (\$585,000) related to contract negotiations to increase payments from the city.
- ENV approved excessive subcontractor billings (\$78,600/month vs \$5,000/month), rates that exceeded contract hourly rates (\$207/hour vs \$146/hour), and out-of-scope consultant work.
- ENV approved payments for first class and business class airfares, and unallowable travel costs.
- ENV approved intern rates (\$40 - \$59/hour) that exceeded full time city engineer rates (\$19 - \$29 /hour).

PROCUREMENT PRACTICES

- 2008 city plan identified future projects.
- ENV used cost-plus, time and materials, and *de facto* sole source contracts for projects.
- Contracts were to construct, improve, expand, and refurbish H-Power facilities. Projects included:
 - ✓ Air pollution control system improvements
 - ✓ 3rd boiler expansion and refurbishment projects
 - ✓ Consultants(HDR Engineering and Mele Associates)
- ENV reliance on the contract terms resulted in non-compliance with the State Procurement Code and city policies.

CONTRACTOR PAYMENTS

- Consultants used to purchase items for ENV staff.
- ENV used project funds to pay expenses for another project (\$1 million).
- Costs were inadequately supported before approving payments.

RECOMMENDATIONS

- 1. Maximize the use of fixed price contracts. ENV must assign the resources needed to properly administer the contract, scrutinize the contract scope, and minimize costs if ENV needs to use cost-reimbursement type contracts (including cost-plus service fee, and time and materials type contracts),
- 2. ENV should pay particularly close attention to contracts that are vague, do not cap or limit city liabilities, and do not provide an explicit expiration date, particularly if the contractor or consultant write the contracts.
- 3. Document justifications for approving long term, sole source, cost-plus, and time and materials contracts, operating contracts and similar contracts.

RECOMMENDATIONS

- 10. Develop formal policies and procedures for administering cost-plus and time and materials, H-POWER, and other contracts.
- 11. Re-compete contractor and consultant professional services contracts as required by the state procurement code and city policies.
- 12. Provide written justifications for any contract modifications (including amendments, change orders, and task orders) as required by the state procurement code and city policies before extending any contract or expanding the scope of work.

RECOMMENDATIONS

- 4. Require the city's current standard *General Terms and Conditions* to be inserted in all ENV contracts and contract modifications.
- 5. Collaborate with BFS to develop formal guidance on contract negotiations, required terms and conditions, and prohibited items.
- 6. Develop formal guidance on good contract administration practices and require that proper resources and staff (including accounting, auditing, and administrative personnel with the expertise and skill sets needed) are assigned to administer cost-plus and time and materials contracts.

RECOMMENDATIONS

- 13. Maximize the use of competitive bids; solicit open competition whenever possible; and solicit competitive bids or proposals before extending long term contracts.
- 14. Follow State Procurement Office guidelines that recommend long term contracts should not exceed 5 years and should contain options to renew the contract for specific periods of time.
- 15. Follow State Procurement Office guidelines for construction and professional services contracts. Suspend ENV's contracting authority if it continues to violate city contracting policies and state procurement code rules.

RECOMMENDATIONS

- 7. Assign adequate resources and knowledgeable staff (including contract accounting, auditing, and administrative staff) with the expertise needed to administer the complex and costly contracts. Provide the oversight needed to ensure the contractor costs are minimized when cost-plus and time and materials contracts are used.
- 8. Expedite filling the H-POWER contract administration position (the Energy Recovery Administrator) to ensure invoices and payments are accurate, valid, substantiated, and justified.
- 9. Improve contract administration and management practices by ensuring only valid, reasonable, and accurate payments are made to ENV contractors and consultants.

AUDIT RESULTS

- ENV disagreed with our findings, but agreed with most of our recommendations.
- Despite the shortcomings, ENV and BFS managers claim the contracts were justified; in the best interests of the city, and the existing contract is a good contract.
- We respectfully disagree and stand by our findings.

THANKS

- We thank the managers and staffs of the Office of the Managing Director, ENV, BFS, and the many others who assisted us during the audit.
- Questions and answers?

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