



Communication to Those Charged with  
Governance and Internal Control Related Matters

**Eugene Water & Electric Board**

December 31, 2013

**2014 Q2 Updates – September 9, 2014**

**MOSS ADAMS** LLP

Certified Public Accountants | Business Consultants

*Acumen. Agility. Answers.*



## COMMUNICATION TO THOSE CHARGED WITH GOVERNANCE AND INTERNAL CONTROL RELATED MATTERS

To the Board of Commissioners  
Eugene Water & Electric Board

Dear Commissioners:

We have audited the financial statements of Eugene Water & Electric Board (EWEB or the Board) as of and for the year ended December 31, 2013 and have issued our report thereon dated March 7, 2014. Professional standards require that we provide you with the following information related to our audit.

### **OUR RESPONSIBILITY UNDER AUDITING STANDARDS GENERALLY ACCEPTED IN THE UNITED STATES OF AMERICA**

As stated in our engagement letter dated February 5, 2014, our responsibility, as described by professional standards, is to form and express an opinion about whether the financial statements prepared by management with your oversight are fairly presented, in all material respects, in conformity with U.S. generally accepted accounting principles. Our audit of the financial statements does not relieve you or management of your responsibilities.

Our responsibility is to plan and perform the audit in accordance with generally accepted auditing standards and to design the audit to obtain reasonable, rather than absolute, assurance about whether the financial statements are free of material misstatement. An audit of financial statements includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Board's internal control over financial reporting. Accordingly, we considered the Board's internal control solely for the purposes of determining our audit procedures and not to provide assurance concerning such internal control.

We are also responsible for communicating significant matters related to the financial statement audit that, in our professional judgment, are relevant to your responsibilities in overseeing the financial reporting process. However, we are not required to design procedures for the purpose of identifying other matters to communicate to you.

### ***Planned Scope and Timing of the Audit***

We performed the audit according to the planned scope and timing previously communicated to you in our planning meeting held during our interim fieldwork.

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### ***Significant Accounting Policies***

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by the Board are described in Note 1 to the financial statements. The following new accounting policy was adopted in the current year:

Effective January 1, 2013, the Board adopted GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities*. The Statement requires reclassification of certain items previously reported as assets or liabilities to deferred outflows of resources or deferred inflows of resources. In addition, certain items previously reported as assets and liabilities are now recognized as outflows of resources (expenses) or inflows of resources (revenues). GASB Concepts Statement No. 4, *Elements of Financial Statements*, specifies recognition of deferred outflows and deferred inflows should be limited to instances specifically identified in authoritative GASB pronouncements. Statement No. 65 amends items previously classified as assets and liabilities to be consistent with GASB Concept Statement No. 4. Statement No. 65 also limits the use of the term deferred in financial statement presentations.

Implementation of Statement No. 65 resulted in the reclassification of unamortized bond issuance costs from an asset to a regulatory asset (recorded within other assets on the Statement of Net Position). Unamortized losses on bond refunding were reclassified from a liability to a deferred outflow of resources. Also, deferred sick leave and net pension obligation were reclassified from regulatory liabilities to deferred inflows of resources at December 31 for the two years presented. There was no effect on income for 2013 or net position at the beginning of 2013.

Other than the policy adopted and described above, there were no additional policies adopted in the current year and no changes in the application of existing policies during 2013. We noted no transactions entered into by the Board during the year for which there is a lack of authoritative guidance or consensus. There are no significant transactions that have been recognized in the financial statements in a different period than when the transaction occurred.

### ***Accounting Estimates***

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. The most significant estimates affecting the financial statements are as follows:

**Unbilled Revenue** – Unbilled revenue is a measure of revenue earned through the end of the reporting period that has yet to be billed. This generally represents accounts with billing cycles that start in the reporting year and end in the subsequent year. We have evaluated the key factors and assumptions used to develop unbilled revenue in determining that it is reasonable in relation to the financial statements taken as a whole.

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**Allowance for Doubtful Accounts** – This represents an estimate of the amount of accounts receivable that will not be collected. We have evaluated the key factors and assumptions used to develop the allowance in determining that it is reasonable in relation to the financial statements taken as a whole.

**Recovery Periods for the Cost of Plant** – This represents the depreciation of plant assets. Management’s estimate of the recovery periods for the cost of plant is based on regulatory-prescribed depreciation recovery periods. We have evaluated the key factors and assumptions used to develop the recovery periods in determining that they are reasonable in relation to the financial statements taken as a whole.

**Other Post-employment Benefit Obligations** – This represents the amount of annual expense recognized for post-employment benefits. The amount is actuarially determined, with management input. No liability is recognized in EWEB’s financial statements because the annual required contribution, as actuarially determined, is transferred to an external trust. We have evaluated the key factors and assumptions used to develop the annual expense in determining that it is reasonable in relation to the financial statements taken as a whole.

**Mark-to-Market Adjustment** – Certain derivative instruments are marked to market at year end. However, the impact to the statement of revenues, expenses, and changes in net assets is deferred in accordance with GAAP. We have evaluated the key factors and assumptions used to develop year-end amounts and have determined that they are reasonable in relation to the financial statements taken as a whole.

### ***Financial Statement Disclosures***

The disclosures in the financial statements are consistent, clear, and understandable. Certain financial statement disclosures are particularly sensitive because of their significance to financial statement users. Significant disclosures include: Note 2 – Power Risk Management and Note 17 – Commitments and Contingencies.

### ***Audit Adjustments/Passed Adjustments***

**Audit Adjustments** – For purposes of this letter, professional standards define an audit adjustment as a proposed correction of the financial statements made subsequent to the start of audit final fieldwork. An audit adjustment may or may not indicate matters that could have a significant effect on the Board’s financial reporting process (that is, cause future financial statements to be materially misstated).

No audit adjustments were noted on the electric or water systems in the current year.

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**Passed Adjustments** – Passed adjustments are those entries found during the course of the audit that management has decided to not post to the financial statements of the Board. It has been concluded by management, and agreed upon by Moss Adams, that the adjustments are immaterial to the financial statements as a whole.

Passed adjustments are as follows:

- Electric Passed Adjustments –
  - To gross up derivative assets and liabilities for the fair values of option premiums that were previously netted with the fair values of the associated derivative instruments: \$661,758. This is a Statement of Net Position reclassification entry only.
  - To close out jobs in commercial operation at year end: \$530,914. This is a Statement of Net Position reclassification entry only.
  - To true up beginning net position for prior year Harvest Wind audit adjustment: \$1,518,116. This amount has been posted to the 2013 financial statements. This passed entry is the difference between the estimate made for Harvest Wind and the audited financial statements which were received after issuance of EWEB's 2012 financial statements.
  
- Water Passed Adjustments –
  - To reclassify the SDC liability on the Statements of Net Position: \$282,849. This is a Statement of Net Position reclassification entry only.
  - To close work orders in commercial operation at year end: \$63,795. This is a Statement of Net Position reclassification entry only.
  - To correct over-accrual of invoice posted at year end: \$84,500. Adjustment will be posted in the 2014 financial statements.
  - To true up beginning net position for incorrect unbilled revenue amount at 12/31/12: \$283,154. This correction has been posted to the 2013 financial statements. This passed adjustment reflects the fact that this adjustment should have been posted to the 2012 financial statements.

### ***Significant Difficulties Encountered in Performing the Audit***

We encountered no significant difficulties in dealing with management in performing and completing our audit.

### ***Disagreements with Management***

For purposes of this letter, professional standards define a disagreement with management as a financial accounting, reporting, or auditing matter, whether or not resolved to our satisfaction, concerning a financial accounting, reporting, or auditing matter that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

***Management Representations***

We have requested certain representations from management that are included in the management representation letter dated March 7, 2014.

***Consultation with Other Accountants***

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a “second opinion” on certain situations. If a consultation involves application of an accounting principle to the Board’s financial statements or a determination of the type of auditor’s opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

***Independence***

Moss Adams is independent in appearance and fact with respect to Eugene Water & Electric Board.

**COMMUNICATION OF INTERNAL CONTROL RELATED MATTERS**

In planning and performing our audit of the financial statements of EWEB as of and for the year ended December 31, 2013, in accordance with auditing standards generally accepted in the United States of America, we considered the Board’s internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Board’s internal control. Accordingly, we do not express an opinion on the effectiveness of the Board’s internal control.

Our consideration of internal control was for the limited purpose described in the first paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses and therefore, material weaknesses may exist that were not identified. However, as discussed below, we identified certain deficiencies in internal control that we consider to be a material weakness.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity’s financial statements will not be prevented, or detected and corrected on a timely basis.

***We consider the following deficiencies in the Board's internal control to be a material weakness:***

***Circumvention of controls***

During the current and prior year procedures, we have noted a several instances where employees have been able to circumvent the control structure in place, whether knowledgeable of the implications of their actions or not. Some of the specific items noted that prompted this comment are as follows:

- 1) Ability for IT employees to make unauthorized changes to the purchasing system database, thus bypassing the normal requisitioning approval process. We noted an instance where this occurred in the current year. See additional details related to this in our comment labeled, "IT circumvention of controls," below.
- 2) Ability for employees to purchase and maintain significant amounts of inventory items, via the use of a EWEB credit card. This allows the employee to avoid the normal inventory controls that are attached to items that are purchased through the warehouse. These controls include required physical inventories of the warehouse, security of the warehouse, and purchasing controls that help identify significant purchases that would require informal or formal bidding procedures per EWEB policy and State of Oregon statute. As a result of this process, management has recorded an adjustment of \$2.1 million in the current year once all the various offsite inventory items were identified and recorded on EWEB's records.
- 3) Ability for employees to receive wage increases without any written documentation maintained in the employee file to authorize the increase. See additional details related to this in our comment labeled, "Approval of pay rate changes," below.
- 4) Significant purchases being made on employee credit cards that seem more appropriate for EWEB's standard PO process. Some of these items include purchases for computers, computer equipment and specialized, high-cost office chairs for employees.

We analyzed the impact of the accumulation of these items, along with the control deficiencies noted below and have concluded that they rise to the level of a material weakness. In 2014, EWEB is implementing a significant Workorder Asset Management System (WAM). In order for the implementation of this system to be successful, it is vital that appropriate internal controls are not only put in place, but followed consistently.

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As such, we recommend management consider creating a position for an Internal Audit Manager. This position would report directly to the General Manager and/or the Board of Commissioners and would provide several key roles for the Board. First, this position could provide risk assessment on internal controls and testing to ensure controls are designed and implemented. Second, this role could provide an outlet for employees to report any concerns. We also recommend considering contracting out with an experienced third party who could provide IT-specialized internal audit services. This would allow for additional support for the IT department and all of its employees as the concerns raised in this department, as mentioned in the instance noted above, may require an auditor with special knowledge and experience. We also recommend that management continue to educate employees about the importance of internal controls and require periodic ethics training to key employees involved with internal controls.

***Management Response – Roger Gray, General Manager:*** Improving internal processes, controls and systems has been an on-going effort. We take past audit findings and continue to make improvements. Management initiated the WAM project which created a thorough review of many operational and controls processes. The WAM work was what led to Management finding the inventory issue which was quickly disclosed and reported to Moss Adams. In 2014 we will ensure increased focus and use of proper internal controls by:

- 1) Implementation of the WAM project which will result in more modern and standard business processes and tightening of internal controls. This system impacts our plant, procurement and inventory processes. These modern business processes will be reviewed by Baker Tilly and Moss Adams before the system goes live in the fall to ensure proper adherence to internal controls.
- 2) We will provide training to all Managers & Supervisors regarding internal controls and their role in ensuring adherence and support.
- 3) Training for IT regarding their unique role in supporting IT systems and the related internal controls.

EWEB had an Internal Audit Department up until December 31, 1996. That department consisted of an internal audit manager and two staff positions. In the 2012 budgeting process, Management proposed reestablishment of an internal auditor position and it was not approved because of increasing budget constraints. In the past 3 budget cycles (2012, 13 and 14), EWEB has continued to reduce positions and personnel to meet increasing budget and rate pressures. Adding an internal auditor position without incremental funds will result in reduction of another position to offset the cost.

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This may improve performance with respect to internal controls, but it will reduce operational performance. EWEB has already experienced several minor operational performance issues due to the reductions made in the past 3 years. Nonetheless, the General Manager (GM) appreciates the recommendation by our Moss-Adams (EWEB's external auditor) and will take the following actions during 2014 in light of the Moss-Adams recommendation.

- 1) For the 2015 Budget, the GM will again include an internal auditor position with proposed incremental funding to cover the cost of the position. This has already been included in the 2015 financial plan that is currently being produced by EWEB staff and will be introduced to the Board under the normal financial planning process (i.e. typically introduced in July and approved in November/December of the current year for the following year's budget).
- 2) As an alternative to a "pure" internal auditor position which the GM does not believe is necessarily a full-time position on its own, the GM will propose a "hybrid" position of internal/performance auditor. This position hypothetically could pay for itself because part of a performance auditor's role is to look for performance and cost savings opportunities. Due to the fact that the GM and Leadership team have already been cutting costs across the board for several years, there is unlikely to be low hanging fruit so the likelihood of immediate offsetting cost savings is low; therefore, the GM will still make a partial funding increase for the 2015 budget for the hybrid position.
- 3) With respect to the reporting recommendations, EWEB's current governance structure is not conducive to adding additional EWEB employees that literally report to the Board. Under present Board-approved policy only 1 EWEB employee (the GM) reports to the Board. However, the General Manager has already discussed with Board members in the past possible modifications to this policy to conform to better governance practices. Some of these modifications (not requiring Board approval) have already been put in place by the GM. For example, the Risk Management Committee (RMC) votes are recorded and the Chief Financial Officer has been instructed to make her dissenting vote known to the Board if she believes the issue is material enough to raise to the Board. The GM has also instructed the CFO and HR Manager to take certain matters to the Board President (bypassing the GM) under certain circumstances. In light of Moss Adams' recommendation and the GM's modified practices described above the GM will make the following recommendations for policy changes (that are subject to Board approval).

- a. All applicable policies will be modified so that the proposed position of Internal Auditor (or Internal/Performance Auditor) may communicate directly with the Board President as necessary to perform his/her position effectively. Although the position will administratively report to the GM, the GM will only hire or terminate the person in this position (or eliminate the position) with the concurrence of the Board President. The Board President may seek approval from the entire Board.
- b. The GM has already instructed the CFO and HR-Manager to communicate certain matters with the Board President under certain circumstances in order for them to effectively perform their roles. The GM will also propose policy changes so that these positions will continue to report administratively to the GM, but will be treated similarly to the proposed Internal Auditor (Internal/Performance Auditor) for governance review purposes.
- c. Because the recommendation by Moss Adams eliminates the current concept of unity of control built in to EWEB's present governance structure there also needs to be an appropriate rebalance of accountability in the event that the Board accepts a business recommendation by the Internal Auditor that the GM disagrees with. In the event that the recommendation of the Internal Auditor creates an adverse financial or operational impact the Internal Auditor and not the GM will be accountable for the result. The GM will propose appropriate modifications to the Unity of Control policies as well.

**2014 Update - Roger Gray, General Manager:** The position Internal Audit Manager has not been included in the current Long-Term Financial Plan (LTFP) because there is already a \$2 million budget gap (electric) to close and incremental funding would only increase this gap. However, it is recognized and accepted that the issue needs to be addressed. The current course of action is to establish an "Enterprise Risk and Internal Controls Manager" that will report directly to the GM with a possible independent relationship with the Board. This position will focus on 3 major areas: (i) Enterprise Risk Management, (ii) Business Process Improvement and (iii) Internal Audit. This position is broader perhaps than the recommendation by Moss Adams, but the judgment of the GM is that the position needs to be broader. A position description (PD) has been completed based on benchmarking similar positions from other utilities and the goal is to have this position filled by mid-September. The PD has been reviewed, market-priced and approved by HR. In addition to a manager dedicated to this function, the GM and CFO have discussed possible use of one-time funds to supplement the new function with consultants to get this effort fully up and running by the end of 2014.

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With respect to the policies that would need to be changed to accommodate changes in unity of control and reporting, these matters have been discussed between staff, 2 assigned Board members and the GM. These policy modifications will be presented to the Board (along with others) later this year for consideration by the full Board.

In addition to the required communications, we have identified the following matters for your consideration. Our recommendations are based on observations and testing during the course of our audit. These recommendations should be evaluated by management and the Commissioners for implementation and EWEB should conduct a cost benefit analysis including consideration of the risks for the recommended action.

### Control Deficiencies

#### ***Timely reconciliation of bank reconciliations***

At the time we performed our interim fieldwork testing in December 2013, we noted that bank reconciliations had only been completed through June 2013. Timely reconciliation of all cash accounts is important to ensure that this detective control is able to identify errors or suspicious activity in a timely manner. We recommend that a policy be established to require monthly bank reconciliations to be completed within a month of the month end close.

***Management Response - Susan Eicher, Accounting and Treasury Supervisor:*** Accounting has a procedure to complete timely bank reconciliations as mentioned above. However, due to the 80% turnover in the Accounting staff and staffing shortages in Cash Accounting, the bank reconciliations were not performed as timely as normal. Over the next year Accounting will work closely with Cash Accounting to ensure cash receipt information is timely and Accounting reconciles the activity according to policy.

***2014 Update - Susan Eicher, Accounting and Treasury Supervisor:*** General accounting and Cash accounting have been working together to get current on bank reconciliation and improve the reconciliation process. We anticipate being current as of the end of September and will implement process improvements as identified.

#### ***Inventory purchases outside of the inventory system***

During our discussions with management, we noted that employees have the ability to purchase and maintain significant amounts of inventory items via the use of a EWEB credit cards or through purchase orders. This may allow the employee to avoid the normal inventory controls that are attached to items that are purchased through the warehouse and items may not be recorded correctly in the inventory system, resulting in overstatement of operating expenses and capital assets. Normal inventory controls include required physical inventories of the warehouse, security of the warehouse, and purchasing controls that help identify significant purchases that would require informal or formal bidding procedures per EWEB policy and State of Oregon statute. As a result of this process, management has recorded an adjustment of \$2.1 million in the current year once all the various offsite inventory items were identified and recorded on EWEB's records. We recommend that management discuss inventory held outside of the warehouse to determine 1) whether the inventory would be better held and secured

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within the warehouse, 2) if inventory is to be held outside of the warehouse, what controls will be implemented to ensure the security of the inventory, 3) what procedures will be established to ensure periodic physical counts of the inventory held outside of the warehouse will be performed, 4) whether inventory purchases should be purchased strictly through PO to ensure State purchasing laws are consistently followed.

**Management Response – Todd Simmons, Transmission and Distribution Operations Manager:** In the fourth quarter of 2013, as part of the Work and Asset Management(WAM) project, EWEB staff, along with our WAM consultants, began to map the inventory system in order to create the “as is” and “should be” conditions with the new system. In addition to the inventory in the warehouse at the Roosevelt Operations Center (ROC) and in EWEB work vehicles, staff was tasked to account for any additional material and supplies in their respective work groups. Materials were counted and values estimated at the ROC, Substations, Pump Stations, Headquarters, Hayden Bridge Filter Plant, Walterville Hydroelectric Plant, Leaburg Hydroelectric Plant, and Carmen Smith Hydroelectric Plant. This information was shared with Moss Adams in the fourth quarter of 2013 prior to the 2013 audit and an accounting entry was made to recognize the value of the materials as of December 31, 2013.

The material in all locations were either consumables and therefore not considered inventory, inventory materials purchased for O&M or capital work, materials and equipment that was accounted for correctly and included in plant, or materials that no longer had any value other than to EWEB (outdated or antiquated equipment and materials still on hand as replacement parts). This material was acquired over the course of business over years or decades by various purchasing policies, practices, and procedures. Some of the material was purchased and immediately put into plant upon receipt. In some cases this material should have been accounted for as inventory items since it has yet to be installed in the system or used for O&M work. Some equipment; meters, transformers, pumps, and breakers, are properly accounted for as part of the plant since this equipment moves in and out of service. With respect to the recommendations regarding physical storage of materials (i.e. inside warehouse or not), it is not physically possible or operationally prudent to attempt to store all such materials in the warehouse. However, it is possible through proper controls and procedures to create a distributed warehouse where inventory is properly controlled and monitored. At this time there is an inventory control task force determining in which category each piece of material belongs. This inventory control task force, made up of staff from Finance, Operations, Purchasing, Facilities, and Engineering will determine how inventory is purchased, accounted for, controlled, and cycle counted within the new WAM system that is expected to go live in September 2014.

**2014 Update – Todd Simmons, Transmission and Distribution Operations Manager:** The WAM Inventory Implementation Summary is in its second draft and will be completed by the end of the third quarter. All inventory currently in the warehouse, including transformers and meters, will be included in the WAM launch which is still scheduled to go live in September 2014. All other sites with inventory will be included

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in the system in the fourth quarter of 2014 or will have a plan for implementation in some remote site locations (Hayden Bridge, Leaburg/Waltermville, Carmen Smith). The BC/DR and Operations Support Services Supervisor will lead the team to implement the new Consumables Program and WAM Inventory Control program in each location outside of the main warehouse.

### ***Approval of pay rate changes***

During our internal control testing over payroll, we noted that several employee personnel files did not include signed personnel action forms for the employees' most recent pay adjustments. We recommend that an approved and signed personnel action form be included in each employee's personnel file for each pay change implemented. In addition, we identified several errors in the updated wage rate spreadsheet including incorrect wage rates for a number of employees. We recommend that a detailed review of all wage increases be performed with a final review by the payroll department prior to inputting the updated rates into the system.

***Management Response - Lena Kostopulos, Human Resources Manager:*** In 2013, EWEB conducted a comprehensive study and redesign of the compensation system for its Management, Professional, Technical and Administrative (MAPT) workers. The project entailed a complete redesign of EWEB's compensation architecture, detailed evaluation of the duties and market comparison of the pay for each position and finally, the placement of each incumbent into the appropriate performance-based pay designation within their assigned pay range.

The evaluation and final assignment of pay was conducted in partnership with HR and the supervisor and manager of each job. The placement of each of individual in their subject pay range was made by the supervisor/manager with the guidance of the assigned HR representative for the purpose of organization-wide calibration.

- The project was a full replacement of the previous system and resulted in a large number of changes. The approach was to review entire groupings of employees (by section or function) at the same time with the final outcome being an individual pay assignment agreed upon by the supervisor, manager and HR representative.
  - The HR representative recorded the final decision in a master spreadsheet.
  - Prior to implementation, the spreadsheet was sent to the supervisor/manager of each of the subject groups. While there was verbal agreement and an exchange of e-mail surrounding each change, there was no explicit statement of approval in all cases.
  - Importantly, an independent process and determination review of the market matches and salary level disposition for each position was conducted by Milliman Consulting.

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- Now that the project has been completed, it is unlikely that EWEB will undertake another mass review in the foreseeable future. However, in the event that does occur or if similar adjustments to an entire group were to be done, EWEB will include a step requiring a documented approval for each individual transaction.
- EWEB will update procedural documents in the Salary Setting Practices Policy to ensure any future pay changes are appropriately documented.

EWEB acknowledges there were errors as cited by the auditors. Errors were brought to HR's attention and through additional auditing and reconciliation a formula error in the wage rate spreadsheet and an incorrect wage range mid-point factor were discovered. The supervisor/managers of affected employees were notified, with the supervisor validating the corrections and communicating the changes to their respective employees. In the event of another large scale change affecting wage rates, the process will include an audit with review by Payroll, HR's Senior Business Analyst, the Project manager and data entry personnel.

**2014 Update** - *Lena Kostopulos, Human Resources Manager*: For standard pay changes, a Personnel Action Request (PAR) form and approval process has been in place since 2011. Going forward, any bulk pay changes will be accompanied by a transmittal document including an explanation of the changes and approvals by the supervisor, department manager and HR manager.

### ***Breach of \$5,000 procurement threshold***

During our internal control testing over disbursements, we noted a breach of EWEB's \$5,000 threshold for small procurements. The original purchase order was under the \$5,000 threshold, however, the purchase order was amended with a change order which brought the total PO amount up above EWEB's small procurements threshold.

Per EWEB's small procurements rule 3-0265(1), amendments to small procurements which will cause breach of the \$5,000 threshold may not increase the total contract price to greater than \$6,000. Therefore, this was outside of EWEB's policies, and once it was clear that the \$5,000 threshold was in danger of being breached, 3 quotes should have been sought in order to comply with EWEB policy. We recommend that employees be educated on how to comply with EWEB's procurement rules.

We also recommend that EWEB implement procedures to evaluate disbursements throughout the year for compliance with the procurement thresholds.

**Management Response** - *Gail Murray, Purchasing and Risk Manager*: During the year, the Purchasing staff became aware of the above breach. When the breach was detected the department staff was asked to complete a Findings to Support Breach of \$5,000, which is the Small Procurement Threshold. The breach was then approved by

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the Leadership Team member for that department. After further investigation by purchasing staff, this instance was determined to be unfounded since the purchase was Personal Services work, which does not require solicitation of bids unless the scope of work exceeds \$150,000. However, in the course of investigating the breach cited, purchasing staff discovered a purchase of goods that that was determined to be a breach of the Small Procurement threshold.

Over the next year Purchasing will provide additional training to help educate staff regarding thresholds and purchasing policies. In addition, future breaches of procurement thresholds will be noted and included on the Board's quarterly contract report.

**2014 Update – Gail Murray, Purchasing and Risk Manager:** The Purchasing and Risk Manger has conducted training sessions with each Leadership Team Manager and their supervisors on the procurement thresholds and purchasing policies. Staff has been instructed to contact the Purchasing Dept prior to making purchases to insure the adherence to the limits and policy. The one page Purchasing and Contract Quick Reference Guide is in the process of being revised to assist staff in determining the Procurement threshold for their purchases.

To date, there has not been a breach of procurement thresholds to include on the Board quarterly contract report.

### ***Timeliness of conservation loan receivable reconciliation***

During the process of auditing conservation loans receivable, we noted that although the account had been reconciled to the conservation loans system at year end, it hadn't been reconciled prior to that since February 2013. Through the year end reconciliation process, accounting personnel noted that there were loans that were assigned incorrectly to expense FERC accounts rather than receivables. As a best practice, we recommend that loan detail be reconciled to the general ledger on a monthly basis by the personnel responsible for maintaining the conservation loan system so that all errors may be reconciled in a timely manner.

***Management Response – Mark Freeman, Customer Service and Energy Management Services Manager:*** Per recommendations from Moss Adams, loan reconciliation will occur on a monthly basis by the personnel responsible for maintaining and administering EWEB's loan program. Currently, that person is EWEB's Loan Administrator. A new process will be developed to review the loan program to ensure all of EWEB's loans conform to EWEB program requirements.

**2014 Update** – Mark Freeman, Customer Service and Energy Management Services Manager:

- Complete
- Reconciliations will occur at a minimum of every other month.
- This will be a team effort of GA running the reports and sending to the loan administrator for reconciliation if there is an out of balance situation.

***IT circumvention of controls***

It was noted that there was an issue where internal controls were circumvented by IT personnel based on requests from users. A Requisition was altered after it was initially entered, without the appropriate approval. The value of the requisition was changed directly in the database based on a request made in passing without thought about the issue with circumvention of controls. In most cases it is not appropriate to address issues in this manner, however, there may be times when business needs may necessitate a quick or emergency fix. In such cases, documentation of the actions taken and the formal approval of those actions should be retained. In addition to making sure that all requests get documented and approved, consideration should be given to generating reports on a regular basis that shows activity performed within the systems by IT personnel with respect to transactions.

**Management Response – Matt Sayre, Information Technology Manager and Roger Gray, General Manager:** EWEB acknowledges there was a circumvention of controls. The document changed was a requisition which had not yet been processed to the Purchase Order stage. The change was to a ‘unit price’ value. The ‘unit price’ default value is 0; this value was change to a 1. The effect was to change a requisition that had been approved with a \$0 value to a \$9,000 value.

The IS Department will work with Financial Services to ensure all necessary internal controls are documented and understood by staff. In addition, in 2014 Staff will develop a report that supports Internal Controls and details any administrative changes to the financial systems, to the Finance Department. IS personnel have been coached and counseled on this matter as to the importance and implications of modifying financial systems outside of proper procedures and the importance of controls.

**2014 Update** – Matt Sayre, Information Technology Manager: 100% of Information Services staff whose work relates to financial systems are registered for Internal Controls training. The Internal Controls report that details any administrative changes to financial systems is currently in the discovery phase, aligning with EWEB’s active WAM & Financial System changes.

***IT opportunities for business process improvements – part 1***

During the audit period, EWEB underwent a significant project to replace the hardware underlying the Oracle systems. The project brought to light some issues that should be assessed. First, there was turnover in the Linux Administrator position midway through the project which

highlighted issues related to the position experiencing a good deal of turnover. EWEB should determine whether there are issues related to compensation or other factors that have resulted in the turnover which should be addressed. Second, the departure of the administrator brought to light the lack of documentation around the functions performed by the position. EWEB should develop adequate documentation of the functions performed by the Linux Administrator to act as an insurance policy against ongoing turnover.

**Management Response – Matt Sayre, Information Technology Manager:** There has been high turnover specifically with regard to the Linux Administrator position. In 2013 the Information Services Department, in partnership with Human Resources, placed the position in an appropriate pay range during a class and compensation study.

In 2013 Information Services also re-wrote the position description and re-classified the position from a Linux & Network Administrator I to a more senior Linux & Network Administrator II position. Comparing the position to market as well as re-classifying the position from a I to a II increased the compensation to an appropriate level.

The position was filled in early 2014 and the incumbent has been assigned an individual goal to complete Linux server build documentation, application installation documentation, and storage configuration documentation associated in calendar year 2014.

**2014 Update – Matt Sayre, Information Technology Manager:** Technical descriptions of the build process is complete. Application installation documentation and storage configuration documentation are in progress.

### ***IT opportunities for business process improvements – part 2***

An issue from the project to replace the hardware underlying the Oracle systems related to Service Level Agreements with third-party vendors. The project team had made some assumptions regarding the level of support they should expect from their vendors, particularly with respect to when that support is available. EWEB should be sure to document an understanding of SLAs and should consider enhancing vendor management practices to review SLAs on a regular basis, assessing vendor performance against them to ensure that the vendors remain acceptable business partners.

**Management Response – Matt Sayre, Information Technology Manager:** EWEB recognizes that comprehensive SLAs for both external and internal hosted systems are crucial in achieving our Information Services transformation goals from a legacy system structure to a services delivery structure. The Information Services department has embraced the best practices framework, Information Technology Infrastructure Library (ITIL), for all new and upgraded hardware and software services. Information Services has trained and certified over 60% of I.S. employees in the ITIL model. Prior to promoting new systems, replacements or upgrades to operations, the Information Services Department now follows the ITIL Services Transition process which requires a review and validation of SLAs. The SLA will

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clarify support performance levels as well as contract enforcement. This information will be stored in a SharePoint location and reviewed upon each contract renewal.

**2014 Update** – *Matt Sayre, Information Technology Manager:* Automated monthly reports are now run that list all temporary and inactive (30 days not logged-in) accounts. Those accounts are then manually verified and ultimately deleted if the corresponding supervisor confirms they are no longer needed.

### Prior Year Matters

#### Internal Control Structure

##### *Review of meter setup*

During our discussions with management, we noted that upwards of \$300,000 in new loans had been issued to commercial customers as a result of under-billings to 10-15 commercial accounts.

The under-billings were caused by improper meter setup that resulted in a multiplier being used that was much lower than what was required for the type of account being serviced. The setup of these meters was not reviewed for accuracy in a timely manner and months passed without management detecting the underlying issue. The lack of a timely review of the installation and proper setup of these meters resulted in additional loans that the customers have agreed to pay back in the future.

We recommend that a policy be established and implemented to require someone other than the person installing the meter, to review the work performed and the attributes setup in the billing system to ensure the appropriate usage is being calculated.

**2013 Update** – We interviewed personnel in the meter shop in the current year and noted that procedures have been established to ensure that new meter setup is reviewed by an employee other than the person installing the meter. We believe this issue has been appropriately resolved in the current year.

**2014 Update** – None required.

##### *Anonymous whistleblower hotline*

During several of our discussions with personnel at varying levels throughout the organization, we noted a perceived apprehension regarding the willingness to communicate internal control and ethics concerns for fear of having personal repercussions if the information is leaked to the wrong person. We also noted that the organization does not have a method in place for employees to safely, and anonymously report suspicious activity occurring inside the organization. We recommend that a whistleblower hotline service be utilized so that employees feel comfortable reporting

issues in a safe and anonymous manner. Using a third party vendor for this service will help improve the likelihood of anonymity and employee's perceived safety.

**2013 Update** – Management has taken steps to address this issue in the current year through two actions. First, management updated the internal dispute resolution and whistleblowing policy to help employees determine the appropriate course of action when they have a concern. Second, EWEB held training for its managers and supervisors to educate them on EWEB's policies and procedures as well as ethical business practices. However, through our current year conversations with several of the employees throughout the organization, we have noted a continued trend of employees concerned about the lack of anonymous outlets for reporting internal control or ethics concerns. We have included in a recommendation for an Internal Audit Manager within our material weakness comment above, which we feel would fully address this comment as well. See our recommendation above.

**2014 Update** – See "Internal Audit Manager" comment.

#### ***EWEB Credit Cards***

During our discussions with EWEB personnel and through review of credit card statements, we noted one case in which a supervisor was using an employee's credit card to make purchases, and then approving that employee's credit card statement. We recommend that each employee's credit card be used only for purchases made by that specific employee, as required by current policy, and that a supervisor or manager review and approve the charges before being submitted for payment. Any purchases should also be made by the appropriate personnel and go through the normal process to ensure compliance with EWEB policy.

**2013 Update** – We have discussed this issue with the employee and noted that the issue has been resolved in the current year. However, we still believe that the risk for additional issues like this is present given the number of employees with EWEB credit cards coupled with the current credit card policy. We recommend decreasing the number of employee's with access to EWEB credit cards and revisiting the credit card policy to ensure that the credit card limits assigned, and the types of items allowed to be purchased are appropriate to achieve a stronger level of internal controls.

**Management Response – Gail Murray, Purchasing and Risk Manager:** The credit card policy is in the process of being updated to mirror policies of other local government agencies and findings as the result of this audit. Training will occur on the new policy and the use of credit cards. We are in agreement that too many employees have credit cards that are not necessarily needed for their day to day work. We will work with departments on reducing the number of credit cards as well as the dollar limits associated with the cards to lessen our risk exposure.

**2014 Update** – Gail Murray, Purchasing and Risk Manager:

The Purchasing Card Policy and Procedure Manual has been revised and updated. The new policy sets the maximum monthly and single transaction limit at \$2500 (with possible exceptions for approved business purposes). The Purchasing and Risk Manager has conducted training sessions with each Leadership Team Manager and their supervisors on the new Purchasing Card Policy and Procedure Manual. The supervisors have been provided with cardholder, current credit limit and usage reports to assist them with determining appropriate card limits and/or card availability for their staff. Each cardholder and approver is required to sign a new Cardholder/Approver agreement to document knowledge and agreement with the new policy and requirements.

**Customer Service Billing System*****Customer Adjustments Report***

During our review of the controls surrounding customer adjustments and review of those adjustments, we noted that a listing of customer adjustments is run on a monthly basis and reviewed by someone other than the person making the adjustments. However, we noted that the listing was large and contained much more information than is needed to verify adjustments. The person reviewing the listing stated that she is not able to thoroughly review all the adjustments to determine that they were appropriate and booked by authorized personnel. In addition, we noted that any adjustments recorded by the City of Eugene are not reviewed during this process. We recommend that the format and parameters used to run the adjustments report be revisited to ensure that a more streamlined user-friendly report is produced that can be reviewed in a more efficient and effective manner. We also recommend that the review of the adjustments report include the City of Eugene adjustments to ensure that they are appropriate and restricted to the sewer portion only.

**2013 Update** – Through our current year procedures, we noted an updated report format that is run electronically to assist the billing department in more efficiently reviewing billing adjustments. EWEB policy states that all adjustments over \$300 should be reviewed on a monthly basis to ensure that they are appropriate and have supporting notes in the customer information system. However, although this issue has been partially resolved, we noted a few remaining issues.

First, we noted a segregation of duties issue since the person responsible for reviewing the monthly adjustments report also has access to record adjustments. Second, no adjustments under \$300 are reviewed, which may leave a significant fraud risk to the organization since most residential customer bills would be below this amount.

***Management Response – Mark Freeman, Customer Service and Energy Management Services Manager:***

- Requests for adjustments received in Billing Control are initially reviewed and approved from an internal control perspective, before processing. Questionable adjustments are brought to management for separate review/inquiry/approval.
- EWEB does not have a “Customer Adjustments Policy”. Customer Service departments developed and now use a “Conflict of Interest Statement” which is annually covered and documented with all CS staff.
- Going forward, EWEB will implement a mitigated control, to provide a segregated review of the initial reviewer’s work.
- Going forward, EWEB has removed the \$300 threshold and will randomly select 25-30 adjustments monthly to audit.

***2014 Update – Mark Freeman, Customer Service and Energy Management Services Manager:***

- Implementation of above is complete.

***Customer Adjustment Access Controls***

During our review of the controls surrounding customer adjustments and through our IT testing procedures, we noted that anyone with read-write access to the CIS system could record adjustments. We also noted that a listing of personnel who has access to the CIS system is not routinely reviewed and therefore personnel that moved from the customer service department to another department still may have access to post adjustments to customer accounts. Our IT procedures revealed that over 200 users have access to the billing system and most have the ability to record adjustments. We recommend that management implement controls to review current access to the billing system and restrict read-write access to only the individuals authorized to record adjustments in the billing / customer service department or other authorized departments. Access to the system should be reviewed on a periodic basis to ensure that access to the system is appropriate.

***2013 Update*** – During our current procedures, we noted that a new class called “adjustments” was established and EWEB allowed employees access to this group only if they required the ability to make adjustments. These employees consisted primarily of customer service representatives. EWEB has also developed a new report to identify the amount of adjustments made by each individual. We believe this issue has been appropriately resolved in the current year.

***2014 Update*** – None required.

***Customer Adjustments Policy***

During our review of the process used to record adjustments, we noted that although a policy for recording adjustments is present, it is not followed on a consistent basis and therefore adjustments are not reviewed and approved prior to being recorded. We also noted that the policy does not include provisions for the dollar thresholds that each employee is allowed to record. We recommend that management update the policy to incorporate provisions for which employee positions are allowed to record adjustments. The policy should also establish thresholds for the amounts that each position can record and should also specify who is authorized to review and approve those adjustments prior to being recorded.

These provisions should be implemented such that adjustments, over a specified dollar threshold, are prepared and approved by separate individuals to ensure the appropriate segregation of duties.

**2013 Update** – See 2013 update to “Customer Adjustments Report” comment above, which addresses both comments.

**2014 Update** – See “Customer Adjustments Report” update.

**Work Order and Asset Management*****Work Order Documentation Consistency***

During our review of work orders, we noted that the documentation maintained to explain and support the reason for significant variances from budget / estimate differs significantly from job coordinator to job coordinator. Often, no documentation exists in the job packets to explain the reason for significant variances from budget / estimate, and only limited comments in the Work Tracking system are maintained to explain variances at the project level. As a best practice, we recommend working with the job coordinators to develop a close out sheet to document when the work was completed and why the job was over / under budget (if applicable). It may be helpful to set a threshold for when these controls need to be applied as not all jobs require this detailed level of monitoring.

**2013 Update** – Through our discussions with engineering and operations personnel, we noted that the organization has established a threshold of \$50,000 for requiring a uniform close-out document. However, this policy was in the process of being implemented during our audit and our work order sample selections did not include any work orders that were subjected to the new uniform closeout form. We recommend that management continue to work on implementing the uniform closeout form to ensure that a consistent set of analyses and closeout procedures be followed.

**Management Response – Mel Damewood, Engineering Manager:** Engineering has established uniform close-out documents for all Capital driven projects over

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\$50,000 in 2013. The initial phase of this work was focused solely on projects generated and managed out of the Engineering Dept. The work orders found lacking the documentation were projects generated from other departments, which were not included in the initial scope of the close-out standardization. The remainder of the coordination will occur in 2014, and include all Departments of EWEB that generate capital driven work. Implementation will be completed by the end of the year.

**2014 Update – Mel Damewood, Engineering Manager:** Engineering has met with respective Operations and Support Departments (e.g. Water Engineering with Water Operations, Engineering Management with IT Management) and have outlined the documentation needed in order to ensure that capital projects over \$50,000 are properly accounted for. Engineering will conduct a review/audit of projects over \$50k in Q4 of 2014 to ensure that the proper documentation is being adhered to.

### ***Water Department Exception Reporting***

During our walkthrough of exception/validity reports, we determined that the water department does not review the listing of zero-read meters. We did note that the billing department runs a zero-read report for the water department (approximately monthly). However, we believe the best practice recommendation below would improve the controls in this area and make them consistent with the practices of the electric department. As a best practice, the zero-read exception report should be run by the water department on at least a weekly basis similar to the treatment of zero reads for the electric department.

**2013 Update** – We noted that no consumption report is now being utilized as one of the water system exception reports and therefore, this issue has been resolved.

**2014 Updated** – None required.

## **Prior Year IT Matters**

### **Information Technology Matters**

#### ***IT Financial Statement Active Directory***

During the IT examination, a user extract of the Active Directory (AD) was compared against a listing of current employees. This comparison identified numerous AD accounts for persons not included on the current employee list. It was also noted that EWEB does not conduct formal access reviews on a regular basis. The goal of these reviews would be twofold: 1- to ensure that accounts for terminated employees have been disabled, and 2- to ensure that permissions and access rights are appropriate for each user's job responsibilities, and that the systems are configured to help ensure proper segregation of duties. It is recommended that EWEB distribute user listings to

managers to verify the access rights of direct reports. This should happen at least annually, and it is recommended this be conducted semi-annually.

**2013 Update** – During the current year IT examination, we performed similar procedures and identified 11 AD accounts and 4 CIS accounts for persons on the inactive employee list. We do not believe this issue has been resolved and recommend that EWEB distribute user listing to managers to verify access rights to direct reports on at least an annual basis.

**2014 Update** – **Matt Sayre, Information Technology Manager:** Automated monthly reports are now run that list all temporary and inactive (30 days not logged-in) accounts. Those accounts are then manually verified and ultimately deleted if the corresponding supervisor confirms they are no longer needed.

#### **IT Other Matters**

Access Management around Re-org/Reduction in Force: There was some concern over the re-organization activities that occurred during July 2012. Through inquiry and observation of tracking spreadsheets the following was noted:

- i. During the re-org, service desk tickets were created for all changed roles
- ii. In addition, a spreadsheet was prepared that listed all changes including lay-offs to ensure that access was managed appropriately

Potential Issues: Given the active accounts noted for users not on the current employee list and the lack of formal reviews, it is possible that there may be some access rights that have not been managed appropriately. This risk is low given the effort put into planning the re-organization.

**2013 Update** – See 2013 update to IT active directory comment above

**2014 Update** – See “IT Active Directory” comment above.

#### **IT Opportunities for Potential Business Process Improvement - Network**

It was reported that EWEB still maintains two distinct core network operating systems- Novell and Windows AD network operating systems. The organization has not completely migrated off of the Novell system and sets up user accounts in both domain controllers. Users login utilizing Novell which passes the credentials on to AD, where Outlook has replaced GroupWise as the email system. This situation requires the maintenance of multiple systems that do the same thing, but also poses risks when it comes to terminating users. Also, it was reported that password settings for the Novell operating system are somewhat weak, requiring only six characters minimum, no strength characteristics, and change every six months. It is recommended that the organization phase Novell out completely if there is not a strong argument to keep it, and that Active Directory group policy be used to enforce stronger password

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requirements. Best practices typically include 8-character minimums, strength characteristics pertaining to case or special characters, the forced change of passwords at initial login and every 90 days, and the maintenance of password history so that users cannot re-use prior passwords. In addition, access review processes should be examined to ensure that all systems where active user accounts had been created are addressed.

A project listed on the current project listing for IT has been defined to retire Novell, but the project has not yet been completed. In addition, it was also noted that the current Active Directory group policy related to password configurations does not require a minimum age for passwords. It is recommended that EWEB modify this setting to require passwords to be used for a minimum period of time once the Novel retirement project has been completed. Otherwise, when prompted to change their passwords every 110 days, users could simply change their password repeatedly until they are able to use the same password again. While this scenario is not likely, the possibility that users can circumvent the forced password change still exists.

**2013 Update** – Management was able to discontinue use of Novell during the last audit period. We believe this issue has therefore been resolved.

**2014 Update** – None required.

***IT Opportunities for Potential Business Process Improvement – Electronic Commerce Transactions***

EWEB processes electronic commerce transactions over the Internet. However, a recent project was completed to outsource the Electronic Bill Payments to a third-party. This will allow EWEB to offload significant risk associated with a bulk of the card transactions. However, there are still credit card transactions that EWEB manages directly themselves, particularly at the customer service center.

Processing even a few credit card transactions exposes EWEB to the compliance requirements from the Payment Card Industry (PCI) Data Security Standards (DSS). Per inquiry with the IT Manager and review of the current project listing, PCI compliance has been defined as a project goal and is underway. It is recommended that EWEB continue with this process to identify all processes and functions wherein EWEB handles credit/debit card data of customers.

**2013 Update** – Management was able to provide multiple reports around PCI compliance. The reports address EWEB's compliance and non-compliance to PCI standards, as well as address structured goals to work towards over the next fiscal year. We believe this issue has been appropriately resolved in the current year.

**2014 Update** – None required.

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The Board's written responses to the material weakness and other recommendations identified in our audit were not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

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This communication is intended solely for the use of the Board and members of management and is not intended to be and should not be used by anyone other than these specified parties.

Sincerely,

Portland, Oregon  
March 7, 2014