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Audit Report

**Performance Audit of
CONSTRUCTION CONTRACTS
MONITORING**

July 26, 2011

Office of the City Auditor
Austin, Texas

Audit Team

Gus Rodriguez, Auditor-In-Charge, CIA, CISA, CGAP
Joan Ewell, CISA, CCSA, CICA
Kathie Harrison, CFE, CGAP, CICA
Henry Katumwa, CGAP, CICA
Olga Ovcharenko, CGAP, CICA

Assistant City Auditor

Rachel Snell, CIA, CFE, CICA

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City of Austin



Office of the City Auditor

301 W. 2nd Street, Suite 2130

Austin, Texas 78767-8808

(512) 974-2805, Fax: (512) 974-2078

email: oca_auditor@ci.austin.tx.us

website: <http://www.ci.austin.tx.us/auditor>

Date: July 26, 2011

To: Mayor and Council

From: Kenneth J. Mory, City Auditor

Subject: Performance Audit of Construction Contracts Monitoring

I am pleased to present this audit report on the City of Austin Construction Contracts Monitoring. Project Managers within the Public Works Department and Austin Energy manage and monitor construction contracts associated with the City's Capital Improvement Program.

We found that generally, Public Works and Austin Energy have processes in place to perform contract monitoring, but inconsistencies exist related to documenting the review of support documents and invoices prior to approving payments. Based on our work, we recommend that management revise existing policies and procedures to provide for effective monitoring of different types of contracts and to provide for compliance with applicable laws and regulations. Also, we recommend training be provided to appropriate staff on the new policies and procedures to ensure they are effectively and efficiently implemented.

We appreciate the cooperation and assistance we received from staff in the Public Works Department, Austin Energy, Contract and Land Management Department, and Law Department during this audit.

cc: City Manager
Assistant City Managers
Public Works Department Director
Austin Energy General Manager
Contract and Land Management Department
Public Information Officer

COUNCIL SUMMARY

This report presents the results of the City of Austin (COA) Performance Audit of Construction Contracts Monitoring. This audit was conducted as part of the Office of the City Auditor's FY 11 Strategic Audit Plan. Our audit objective was to determine the extent to which contract monitoring is performed in order to ensure vendors comply with agreed upon contract terms and conditions. The audit scope includes the Public Works Department and Austin Energy. We reviewed four major construction contracts managed by these City departments between FY2009 and FY 2011.

Generally, Public Works and Austin Energy have processes in place to perform contract monitoring, but inconsistencies exist related to documenting the review of support documents and invoices prior to approving payments.

- For 2 of the 4 contracts reviewed, there was not a consistent process for documenting the review of support documentation and invoices prior to approving payments.
- Departments did not formally assign state-registered inspectors to conduct independent inspections, reducing assurance that projects were completed in accordance with contract terms and conditions, as well as applicable laws and regulations.
- The contract monitoring process does not always include assessment of liquidated damages, resulting in the City's potential inability to recoup administrative costs caused by project delays.

Based on our work, we recommend that management revise existing policies and procedures to provide for effective monitoring of different types of contracts and to provide for compliance with applicable laws and regulations. Also, we recommend training be provided to appropriate staff on the new policies and procedures to ensure they are effectively and efficiently implemented.



ACTION SUMMARY PERFORMANCE AUDIT OF CONSTRUCTION CONTRACTS



Recommendation Text	Management Concurrence	Proposed Implementation Date
01. To address the first finding, the Public Works Director should ensure that policies and procedures are reviewed and revised to assure sufficient and appropriate documentation is collected, reviewed, and maintained by staff in order to provide reasonable assurance that goods and services were delivered in accordance with contract terms and paid at the correct amount.	Concur	December 2011
02. To address the second finding, the Public Works Department Director should ensure that an effective process is created and implemented to assure that an independent inspector is assigned to perform inspections for design-build contracts in accordance with state law.	Concur	December 2011
03. To address the first finding, the Austin Energy General Manager should either require staff to comply with PW contract monitoring policies and procedures or develop adequate policies and procedures for AE, and ensure that staff is trained in and following contract monitoring procedures.	Concur	July 2011
04. To address our second finding, the Austin Energy General Manager should ensure that an independent engineer or architect is formally assigned to conduct inspections, in accordance with state law.	Concur	July 2011
05. To address the third finding, the Austin Energy General Manager should ensure amounts owed for liquidated damages are collected by staff and any exceptions are appropriately documented.	Concur	July 2011

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BACKGROUND

Project Managers within the Public Works Department (PWD) manage and monitor construction contracts associated with City Capital Improvement Program (CIP). Austin Energy uses its own project managers for contract monitoring services in an effort to ensure compliance with contract terms and conditions.

The Contract and Land Management Department (CLMD) and the Law Department provide support services, including review and approval of construction contracts.

During the audit we selected the following four construction contracts for review (see Exhibit 1). The contract amounts noted below include both design and construction phases, except Water Treatment Plan No. 4 since construction has yet to begin.

EXHIBIT 1
List of Contracts Reviewed by OCA

Contract	Monitored by	Contract Amount (000)
Austin Police Department Training Facility	Public Works	\$ 15,185
Avery Ranch Fire/EMS Station	Public Works	\$ 2,793
Austin Energy Sand Hill Energy Center Project	Austin Energy	\$ 32,246
Austin Water Treatment Plant No. 4	Public Works	\$ 37,553

SOURCE: City of Austin Financial System (AIMS) and Project Reporting System (eCAPRIS)

OBJECTIVES, SCOPE, AND METHODOLOGY

The Performance Audit of Construction Contracts was conducted as part of the Office of City Auditor's FY 2011 Service Plan, as presented to the City Council Audit and Finance Committee.

Objectives

Our audit objective was to determine the extent to which contract monitoring is performed in order to ensure vendors comply with agreed upon contract terms and conditions.

Scope

The audit focused on four major construction contracts managed by the Public Works Department and Austin Energy between FY2009 and FY 2011.

Methodology

To accomplish our audit objectives, we performed the following steps:

- Conducted interviews of City staff as appropriate.
- Conducted site visits for selected contracts.
- Reviewed and analyzed contract and correspondence files.
- Analyzed contract terms, including payments, invoices, and other related support documentation.
- Reviewed monitoring processes and procedures.

We conducted this performance audit in accordance with Generally Accepted Government Auditing Standards (GAGAS). Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

AUDIT RESULTS

Generally, Public Works and Austin Energy have processes in place to perform contract monitoring, but inconsistencies exist related to documenting the review of support documents and invoices prior to approving payments.

In our review of monitoring of construction contracts, we found that documentation in support of reported costs on vendor invoices was not always obtained or reviewed by City staff prior to approving invoices for payment. In addition, an independent architect/engineer was not always formally assigned to review work during the project or provide inspection services. Lastly, contractors were not always assessed liquidated damages when applicable.

FINDING 1: For 2 of the 4 contracts reviewed, there was not a consistent process for documenting the review of support documentation and invoices prior to approving payments.

Without sufficient and appropriate support documentation, the City cannot properly monitor compliance with contract terms and conditions. According to the PWD Project Manager's (PM) Procedures Manual, lump sum contracts require the collection of "minimal documentation" in support of vendor invoices, which are reviewed and approved to verify the appropriateness of reported costs and compliance with contract terms and conditions. The PM Procedures Manual also calls for monthly reconciliation and submission of support documentation.

We selected 10 invoices for each contract and determined whether supporting documentation was maintained and whether review occurred prior to payment. The results of our testing are summarized in Exhibit 2 below.

EXHIBIT 2
Summary of Invoices Reviewed by Contract

Contract	Responsible Department	Percent of Invoices Approved by Project Manager
APD	PWD	100%
AFD/EMS	PWD	100%
WTP 4 (design)	PWD	60%
Sand Hill	AE	60%

SOURCE: OCA Audit Fieldwork Results

For the APD Training Facility and Fire/EMS Station contracts, project managers collected and reviewed appropriate and sufficient supporting documentation prior to approving payment.

For the WTP4 (design) contract, we found that 4 of 10 (40%) invoices were not approved by the project manager. Three of the invoices were missing and one invoice was not signed by the project manager, although there was supporting documentation present in

the file. Of the six invoices that were approved by the project manager, one invoice used design plans as support for the amount shown on the invoice, as opposed to financial related documentation.

For the Sand Hill contract, PWD maintains the official invoice records for contract payments. PWD was unable to provide 4 of the 10 invoices requested; however, the Sand Hill project manager maintained copies and provided the missing documentation. In review of that documentation we found that 4 of 10 (40%) invoices were not approved by the project manager. The documentation was limited to self reported numbers by contractors and did not include support for claimed expenses. At the end of the project, supporting documentation was provided and is currently under staff review for final payment.

Unclear policies and procedures and the broadly defined requirement for the collection of “minimal documentation” may result in inconsistencies in how individual project managers interpret and apply these requirements. Additionally, for the contract managed by AE, project managers are encouraged to follow PM Procedures Manual, but not required, thus allowing for variance of interpretation of requirements by individual project managers.

FINDING 2: Departments did not formally assign state-registered inspectors to conduct independent inspections, reducing assurance that projects were completed in accordance with contract terms and conditions, as well as applicable laws and regulations.

Project managers for the APD Training Facility and the Sand Hill contract did not formally assign state-registered inspectors to conduct independent inspections, as required for design-build contracts by Texas Local Government Code.

For the APD Training facility contract, staff did not ensure the firm hired to perform inspection services was independent from the design-build firm. Instead inspection services were performed by a subcontractor of the design-build firm.

For the Sand Hill contract, the project manager was a licensed engineer independent of the vendor; however, he was not formally assigned an inspection role on the project and other independent inspections of the project were not documented.

Failure to ensure resources are assigned to perform independent inspection services potentially reduces the quality and objectivity of inspection results. According to Public Works and Austin Energy, internal resources are available to perform independent inspections.

FINDING 3: The contract monitoring process does not always include assessment of liquidated damages, resulting in the City's potential inability to recoup administrative costs caused by project delays.

According to contract terms and conditions and the PM Procedures Manual, liquidated damages (LDs) are assessed whenever a contractor does not complete work within the agreed upon milestone project completion dates. PM Procedures Manual further states that project managers must issue a warning letter to the contractor when there is evidence that the project schedule is in jeopardy.

For the Sand Hill contract, final completion was behind schedule 16 days and liquidated damages were not assessed. According to AE and the Law Department, there was \$32,000 in liquidated damages that were not assessed. After further review, AE stated that a decision was made not to assess liquidated damages because the substantial completion was early, and allowed them to start the operation one month ahead of schedule. This decision was not formally documented.

Recommendations:

The recommendations listed below are a result of our audit effort and subject to the limitation of our scope of work. We believe that these recommendations provide reasonable approaches to help resolve the issues identified. We also believe that operational management is in a unique position to best understand their operations and may be able to identify more efficient and effective approaches and we encourage them to do so when providing their response to our recommendations. As such, we strongly recommend the following:

1. To address the first finding, the Public Works Director should ensure that policies and procedures are reviewed and revised to assure sufficient and appropriate documentation is collected, reviewed, and maintained by staff in order to provide reasonable assurance that goods and services were delivered in accordance with contract terms and paid at the correct amount.

MANAGEMENT RESPONSE: Concur

Management concurs, noting that the audited contract for WTP4 was actually a professional services contract, not a construction contract. PW maintains two separate procedures and training modules, one for monitoring professional services contracts and one for monitoring construction contracts.

Proposed Strategies for Implementation:

Management has reviewed the procedure for monitoring construction contracts (<http://cityspace.ci.austin.tx.us/departments/pwd/project-management-division/procedures-manual-for-project-managers/construction-chapter/contractor-payments>) and determined that no revisions are necessary at this time. The procedure was last updated on May 27, 2009 and is consistent with City policies and best practices. Management will ensure that all staff is trained on the procedure.

Management has also reviewed the procedure for monitoring professional services contracts (<http://cityspace.ci.austin.tx.us/departments/pwd/project-management-division/procedures-manual-for-project-managers/preliminary-chapter/professional-service-agreements-psas>). Management will review this procedure to ensure it is consistent with City policies and best practices. Management will also ensure that staff is trained on the procedure, including any possible updates.

2. To address the second finding, the Public Works Department Director should ensure that an effective process is created and implemented to assure that an independent inspector is assigned to perform inspections for design-build contracts in accordance with state law.

MANAGEMENT RESPONSE: Concur

Management concurs.

Proposed Strategies for Implementation:

1. Independent of this audit and prior to receiving the audit recommendations, PW management recently changed our approach to inspecting City building projects. Structural components of all City building projects will now be inspected by a qualified, professional City structural engineer.
 2. Management will also ensure that staff is trained on the TLGC requirements for independent inspections on Design-Build contracts.
-

3. To address our first finding, the Austin Energy General Manager should either require staff to comply with PW contract monitoring policies and procedures or develop adequate policies and procedures for AE, and ensure that staff is trained in and following contract monitoring procedures.

MANAGEMENT RESPONSE: Concur

Proposed Strategies for Implementation:

Austin Energy supports the use of a formal project management process and has a methodology in place which is documented in the Austin Energy Project Management Guidebook. The Austin Energy Project Management Guidebook documents a standard methodology for how projects at Austin Energy (AE) will be requested, approved, and managed. Section 3.2.8 of the guidebook outlines development of a procurement management plan and states: "The procurement management plan identifies and documents the process for acquiring external human resources, equipment, and materials for the project. The plan is required for complex and standard projects. The project manager should contact AE's Legal, Purchasing and Contract Management support groups for assistance regarding procurement and contract policies, guidelines, and procedures to be included in the plan".

To assure consistency across AE Power Supply and Market Operations (PSMO) management team has been notified that all projects must be managed using the AE project management methodology unless a specific exemption is granted and the exemption documented. The AE Project Management Guidebook has been sent to the PSMO management team along with the requirement that they are to review and discuss with their staff. If after this review additional training is deemed necessary we will coordinate with the AE Corporate Project Management Office.

4. To address our second finding, the Austin Energy General Manager should ensure that an independent engineer or architect is formally assigned to conduct inspections, in accordance with state law.

MANAGEMENT RESPONSE: Concur

Proposed Strategies for Implementation:

Austin Energy agrees that oversight by qualified subject matter experts is prudent utility practice. The requirement for independence however should not mean an outside third party, but rather qualified experts who do not report to the project manager or project lead.

Austin Energy did establish an acceptance and inspection team for the Sand Hill project using qualified in house staff. A comprehensive project team was assembled that included various subject matter experts who were assigned to the project but who reported to someone other than the project manager - ensuring independence. This structure was documented in an organizational chart specifically for the Sand Hill project.

Unfortunately there is not a document trail indicating what inspections the independent subject matter experts provided. Additionally only the project manager signed off on all of the construction turnover

packages rather than the subject matter experts and no independent inspection reports were included in the turnover packages.

To correct this documentation deficiency going forward, AE - PSMO managers have been notified that documentation demonstrating appropriate oversight is required and must be included in project files or turnover packages.

5. To address the third finding, the Austin Energy General Manager should ensure amounts owed for liquidated damages are collected by staff and any exceptions are appropriately documented.
with state law.
-

MANAGEMENT RESPONSE: Concur

Proposed Strategies for Implementation:

The Austin Energy Project Management Guidebook states: “The project manager is responsible for reading and fully understanding the terms of the contract to ensure that the vendors meet all contractual agreements”. Liquidated damages are a common contract term and condition and decisions regarding non-enforcement should have been properly documented.

The Sand Hill project was completed one month ahead of the Substantial Completion Date. Project management agreed to delay the Final Completion Date to allow for continued support to ensure that the temporary watering system for the new vegetation would remain in place to help ensure that the vegetation would take hold. Although a reasonable decision this decision was not properly documented.

PSMO management staff has been reminded that project managers are responsible for enforcement of all contract terms and requirements. In the event that a condition is altered or waived it must be appropriately documented and approved.

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APPENDIX A

MANAGEMENT RESPONSE



MEMORANDUM

TO: KEN MORY, CITY AUDITOR

FROM: HOWARD S. LAZARUS, PE, DIRECTOR, PUBLIC WORKS DEPARTMENT

SUBJECT: CONSTRUCTION CONTRACT AUDIT – ACTION PLAN

DATE: JUNE 30, 2011

CC: ROBERT GOODE, ASSISTANT CITY MANAGER
KERI JUAREZ, PE, ASSISTANT DIRECTOR, PUBLIC WORKS DEPARTMENT
LOUIS LINDSEY, PE, PROJECT MANAGEMENT DIVISION MANAGER
JEFFREY TRAVILLION, SYSTEM ENGINEERING DIVISION MANAGER

Once again, I want to convey the appreciation from the Public Works Department (PWD) for the professionalism and courtesies extended to our staff during the recent audit of our construction contract management processes. Your observations and recommendations will be most useful as we continuously review and revise our internal procedures and train our staff to ensure the City receives the services and products specified in our contracts.

Our responses to the two recommendations pertaining to PWD projects are provided in the attached tables. As always, please do not hesitate to contact me if you have any questions or if you need additional information.

1 Attachment
as


ACTION PLAN
Construction Contract Audit

Rec #	Recommendation Text	Concurrence	Proposed Strategies for Implementation	Status of Strategies	Responsible Person/ Phone Number	Proposed Implementation Date
01	To address the first finding, the Public Works Director should ensure that policies and procedures are reviewed and revised to assure sufficient and appropriate documentation is collected, reviewed, and maintained by staff in order to provide reasonable assurance that goods and services were delivered in accordance with contract terms and paid at the correct amount.	Management concurs, noting that the audited contract for WTP4 was actually a professional services contract, not a construction contract. PW maintains two separate procedures and training modules, one for monitoring professional services contracts and one for monitoring construction contracts.	<p>1. Management has reviewed the procedure for monitoring construction contracts (http://cityspace.ci.austin.tx.us/departments/pwd/project-management-division/procedures-manual-for-project-managers/construction-chapter/contractor-payments) and determined that no revisions are necessary at this time. The procedure was last updated on May 27, 2009 and is consistent with City policies and best practices. Management will ensure that all staff is trained on the procedure.</p> <p>2. Management has also reviewed the procedure for monitoring professional services contracts (http://cityspace.ci.austin.tx.us/departments/pwd/project-management-division/procedures-manual-for-project-managers/preliminary-chapter/professional-service-agreements-psas). Management will review this procedure to ensure it is consistent with City policies and best practices. Management will also ensure that staff is trained on the procedure, including any possible updates.</p>	<p>1. Underway</p> <p>2. Underway</p>	Keri Burchard-Juarez, Assistant Director of Public Works 512-974-7298	<p>1. September 30, 2011</p> <p>2. December 31, 2011</p>
02	To address the second finding, the Public Works Department Director should ensure that an effective process is created and implemented to assure that an independent inspector is assigned to perform inspections for design-build contracts in accordance with state law.	Management concurs.	<p>1. Independent of this audit and prior to receiving the audit recommendations, PW management recently changed our approach to inspecting City building projects. Structural components of all City building projects will now be inspected by a qualified, professional City structural engineer.</p> <p>2. Management will also ensure that staff is trained on the TLGC requirements for independent inspections on Design-Build contracts.</p>	<p>1. Implemented</p> <p>2. Planned</p>	Keri Burchard-Juarez, Assistant Director of Public Works 512-974-7298	<p>1. NA</p> <p>2. December 31, 2011</p>



MEMORANDUM

TO: Kenneth J. Mory, City Auditor

FROM: Cheryl Mele, Deputy General Manager 

DATE: July 20, 2011

SUBJECT: Response to construction contract audit

Attached please find Austin Energy's response to the construction contract audit. We concur with your recommendations and have taken appropriate actions that we believe will address them. Your observations and recommendations support our efforts to maintain compliance with our policies and procedures and our commitment to continuously improve our performance or procedures when opportunities are identified.

Please do not hesitate to contact me if you have any questions or if you need additional information.

Cc: Marc Ott, City Manager
Larry Weis, General Manager
Elaine Hart, Sr. VP of AE Finance and Corporate Services
Jackie Sargent, Sr. VP Power Supply and Market Operations

ACTION PLAN

Performance Audit of Construction Contracts

Rec #	Recommendation Text	Concurrence	Proposed Strategies for Implementation	Status of Strategies	Responsible Person/ Phone Number	Proposed Implementation Date
03	To address the first finding, the Austin Energy General Manager should either require staff to comply with PW contract monitoring policies and procedures or develop adequate policies and procedures for AE, and ensure that staff is trained in and following contract monitoring procedures.	Concur	<p>Austin Energy supports the use of a formal project management process and has a methodology in place which is documented in the Austin Energy Project Management Guidebook. The Austin Energy Project Management Guidebook documents a standard methodology for how projects at Austin Energy (AE) will be requested, approved, and managed. Section 3.2.8 of the guidebook outlines development of a procurement management plan and states: "The procurement management plan identifies and documents the process for acquiring external human resources, equipment, and materials for the project. <i>The plan is required for complex and standard projects.</i> The project manager should contact AE's Legal, Purchasing and Contract Management support groups for assistance regarding procurement and contract policies, guidelines, and procedures to be included in the plan".</p> <p>To assure consistency across AE Power Supply and Market Operations (PSMO) management team has been notified that all projects must be managed using the AE project management methodology unless a specific exemption is granted and the exemption documented. The AE Project Management Guidebook has been sent to the PSMO management team along with the requirement that they are to review and discuss with their staff. If after this review additional training is deemed necessary we will coordinate with the AE Corporate Project Management Office.</p>	Complete	Jackie Sargent – AE Senior VP Power Supply and Market Operations – 322-6491	July 14, 2011

Rec #	Recommendation Text	Concurrence	Proposed Strategies for Implementation	Status of Strategies	Responsible Person/ Phone Number	Proposed Implementation Date
04	To address our second finding, the Austin Energy General Manager should ensure that an independent engineer or architect is formally assigned to conduct inspections, in accordance with state law.	Concur	<p>Austin Energy agrees that oversight by qualified subject matter experts is prudent utility practice. The requirement for independence however should not mean an outside third party, but rather qualified experts who do not report to the project manager or project lead.</p> <p>Austin Energy did establish an acceptance and inspection team for the Sand Hill project using qualified in house staff. A comprehensive project team was assembled that included various subject matter experts who were assigned to the project but who reported to someone other than the project manager - ensuring independence. This structure was documented in an organizational chart specifically for the Sand Hill project.</p> <p>Unfortunately there is not a document trail indicating what inspections the independent subject matter experts provided. Additionally only the project manager signed off on all of the construction turnover packages rather than the subject matter experts and no independent inspection reports were included in the turnover packages.</p> <p>To correct this documentation deficiency going forward, AE - PS MO managers have been notified that documentation demonstrating appropriate oversight is required and must be included in project files or turnover packages.</p>	Complete	Jackie Sargent – AE Senior VP Power Supply and Market Operations – 322-6491	July 14, 2011

Rec #	Recommendation Text	Concurrence	Proposed Strategies for Implementation	Status of Strategies	Responsible Person/ Phone Number	Proposed Implementation Date
05	To address the third finding, the Austin Energy General Manager should ensure amounts owed for liquidated damages are collected by staff and any exceptions are appropriately documented.	Concur	<p>The Austin Energy Project Management Guidebook states: "The project manager is responsible for reading and fully understanding the terms of the contract to ensure that the vendors meet all contractual agreements". Liquidated damages are a common contract term and condition and decisions regarding non-enforcement should have been properly documented.</p> <p>The Sand Hill project was completed one month ahead of the Substantial Completion Date. Project management agreed to delay the Final Completion Date to allow for continued support to ensure that the temporary watering system for the new vegetation would remain in place to help ensure that the vegetation would take hold. Although a reasonable decision this decision was not properly documented.</p> <p>PSMO management staff has been reminded that project managers are responsible for enforcement of all contract terms and requirements. In the event that a condition is altered or waived it must be appropriately documented and approved.</p>	Complete	Jackie Sargent – AE Senior VP Power Supply and Market Operations – 322-6491	July 14, 2011