



State of Nevada
Department of Administration
Division of Internal Audits

Audit Report

Colorado River Commission

Report No. 14-06
June 2014

EXECUTIVE SUMMARY
Colorado River Commission of Nevada

Introduction.....page 1

**Objective 1: Can the CRC Assist SSEA Improve Compliance
With its Risk Management Procedures?**

The Colorado River Commission (CRC) can assist the Silver State Energy Association (SSEA) improve compliance with its risk management procedures by: documenting reviews of all trade transactions; ensuring reviews are performed within the timeframes set forth in the SSEA risk management procedures; and generating confirmation agreements for all physical trade transactions.

Consistent documentation and timely review of trading activities ensure adequate oversight and risks are managed in accordance with risk management procedures. Generating confirmation agreements ensures both parties are aware of contract commitments.

Ensure Reviews are Performed and Documented Timely.....page 9

Risk management procedures require reviews of physical and financial trades to be documented in the trade capture system database within 24 hours of the trade being executed.

We reviewed 159 energy trading transactions of which 124 were financial trades and 35 were physical trades. For the financial trades, we noted there was no documentation evidencing that reviews were performed. For the physical trades, we noted reviews were not consistently documented or performed timely.

Ensure Confirmation Agreements are Generated or Validated.....page 9

Risk management procedures require confirmation agreements to be generated (sell) or validated (buy) and completed in accordance with the Western Systems Power Pool guidelines. We noted confirmation agreements were not generated for physical trade transactions with the Basic Management Industrial Complex.

**Objective 2: Can the CRC Enhance its
Contract Process?**

The CRC can enhance its contract process by strengthening its policies and procedures to extend the solicitation period to the recommended six to eight weeks and maintaining the request for proposal (RFP) selection criteria documentation.

Strengthen Contract Policies and Procedures.....page 11

The CRC should extend the solicitation period to help increase the number of applicants for RFPs.

The State Administrative Manual 0338 recommends the RFP solicitation period be open for six to eight weeks. This allows vendors sufficient time to develop proposals and apply for contracts.

We reviewed all the RFP's issued for the period 2010 through 2013. We noted only three RFPs for the period under review. In each case, only one vendor submitted a bid. Our review of the three RFPs revealed solicitation periods were only open for three to five weeks.

Maintain RFP Selection Criteria Documentation.....page 11

The CRC should maintain documentation to support the selection process.

The State Administrative Manual 0338 states prior to a solicitation being released, the evaluation criteria should be developed and the evaluation committee determined. Since these contracts may involve significant dollars, this allows the selection process to be as transparent as possible and provide accountability for contract decisions.

Our examination of RFPs revealed documentation was not retained by the CRC to provide a record of the evaluation committee's discussions, decisions, and rankings of the applicants.

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Timetable for Implementing Audit Recommendations

INTRODUCTION

At the direction of the Executive Branch Audit Committee, we conducted an audit of the Colorado River Commission of Nevada (CRC). Our audit addressed the following four questions:

- ✓ What is the CRC's role?
- ✓ What services must the CRC provide?
- ✓ Is the state the proper level of government to provide these services?
- ✓ If state government is the appropriate level of government, is the CRC carrying out its duties efficiently and effectively?

Our audit focused on compliance monitoring and contract process.

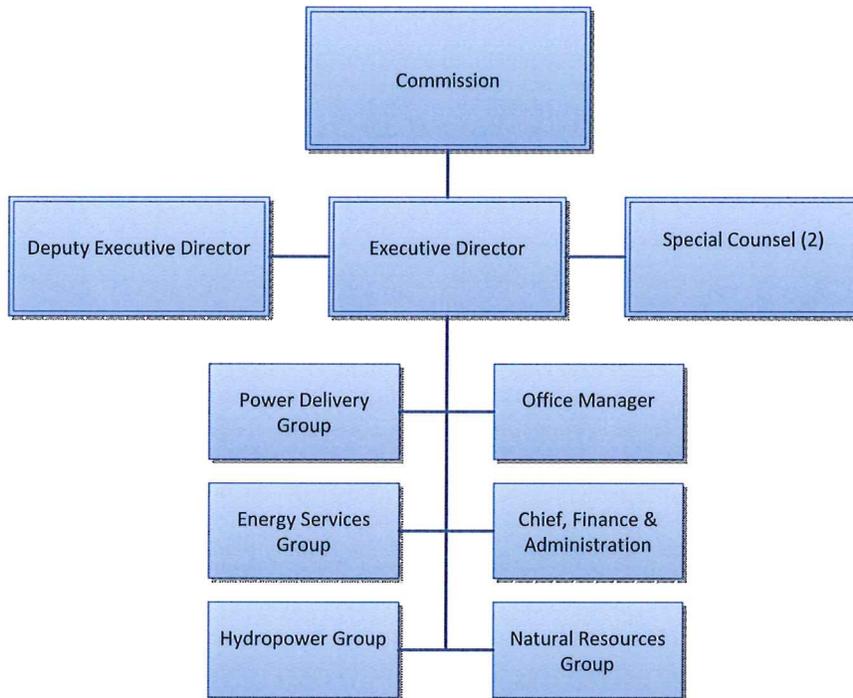
CRC's Role and Public Purpose

The CRC was created by the Nevada Legislature in 1935. The CRC is governed by seven commissioners. The chairman and three commissioners are appointed by the Governor and the remaining three are appointed by the Southern Nevada Water Authority. The CRC is responsible to receive, protect, safeguard, and hold in trust for the state of Nevada both water and power-related resources associated with the Colorado River.

Exhibit I illustrates the organizational structure of the CRC.

Exhibit I

CRC Organizational Structure



The CRC does not receive any state or federal funds to support its administrative and operating functions. All functions are funded from revenues received from electrical power sales and water administrative charges to its customers. The legislatively approved budget for the 2013-2015 biennium is \$307 million of which less than three percent is personnel costs for 40 approved full time equivalent positions.

The CRC administers the following programs:

- **Environmental** – The CRC provides information to address environmental and economic issues related to Nevada’s water and power allocations of the Colorado River.
- **Water** – The CRC holds and protects the state’s rights to its share of the Colorado River water and represents the state on issues affecting the management and operation of the river.
- **Power** – The CRC purchases hydroelectric power generated from the Hoover, Parker, and Davis dams, and the Salt Lake City Area Integrated

Project from the federal government. The CRC distributes the hydroelectric power to its customers¹ in southern Nevada.

Prior to 2013, the CRC purchased energy from the energy market to supplement the hydroelectric power resources that are available to its customers and other customers who do not receive hydroelectric power. In 2013, the responsibility for purchasing supplemental energy from the energy market was assumed by the Silver State Energy Association² (SSEA).

Silver State Energy Association

The SSEA was formed by an interlocal agreement among the following member agencies:

- CRC
- Southern Nevada Water Authority (SNWA)
- City of Boulder City
- Lincoln County Power District No. 1
- Overton Power District No. 5

The collaboration of SSEA members when undertaking specific projects provides economies of scale not available to individual members. SSEA projects include: planning, developing, owning, and operating power resources to meet the needs of its members. In addition, the SSEA reduces energy price fluctuations for its members through its hedging activities.

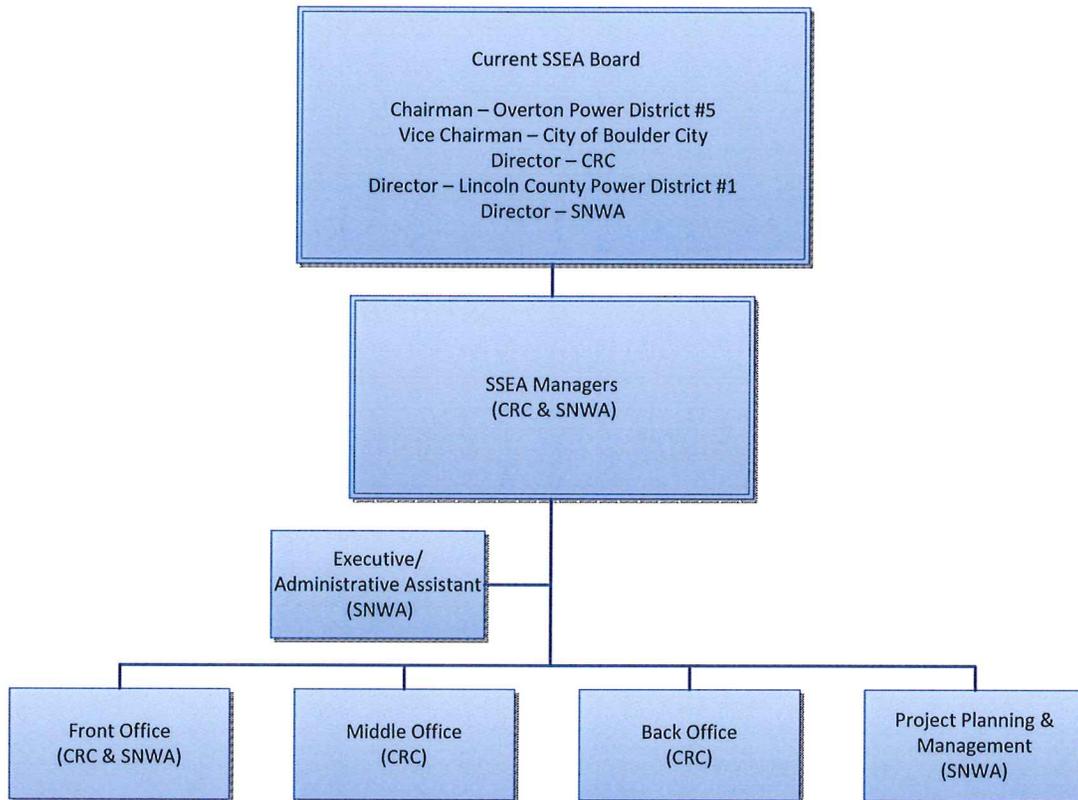
The SSEA's business affairs are conducted by a board of directors which is made up of one director from each of the member agencies. The SSEA contracts with the CRC and the SNWA to use their employees for performing day-to-day operations, which include energy trading. The SSEA divides energy trading functions into front office, middle office and back office activities, similar to investment banks. This allows for segregation of duties for executing, reviewing, and settling energy trades. Exhibit II illustrates the organizational structure of the SSEA.

¹ The CRC's energy customers include: City of Boulder City, Lincoln County Power District No. 1, Nevada Power Company, Overton Power District No. 5, Valley Electric Association, Southern Nevada Water Authority, and the Basic Management Industrial Complex, which consists of a group of industrial businesses located near Henderson, Nevada.

² The Silver State Energy Association (SSEA) is an association of public agencies with the common goal of meeting the energy needs of its customers.

Exhibit II

SSEA Organizational Structure



The formation of SSEA allowed member agencies to provide energy at stable rates to Nevada citizens.

The state is the proper level of government to protect and manage Nevada's share of water and hydroelectric power resources from the Colorado River. The CRC provides the resources, knowledge, and education to ensure proper conservation and management of Nevada's water and hydroelectric power resources.

Scope and Objectives

We began audit work in November 2013. In the course of our audit, we interviewed management and staff of the CRC and the Department of Administration's Purchasing Division. We reviewed the CRC's policies and procedures, Nevada Revised Statutes, Nevada Administrative Codes, and the State Administrative Manual. We concluded field work and testing in April 2014.

Our audit focused on the following objectives:

- ✓ Can the CRC assist SSEA improve compliance with its risk management procedures?
- ✓ Can the CRC enhance its contract process?

We performed our audit in accordance with the *Standards for the Professional Practice of Internal Auditing*.

The Division of Internal Audits expresses appreciation to the management and staff of the CRC and the Purchasing Division for their cooperation and assistance throughout the audit.

Contributors to this report included:

Vita Ozoude, CMA, CGMA, CPA, MBA
Executive Branch Audit Manager

Lynnette Pagaling, CPA, MBA
Executive Branch Auditor III

Colorado River Commission of Nevada Response and Implementation Plan

We provided draft copies of this report to the CRC officials for their review and comments. The CRC's comments have been considered in the preparation of this report and are included in Appendix A. In its response, the CRC accepted our recommendations. Appendix B includes the CRC's timetable to implement our recommendations.

NRS 353A.090 specifies within six months after the final report is issued to the Executive Branch Audit Committee, the Administrator of the Division of Internal Audits shall evaluate the steps the CRC has taken to implement the recommendations and shall determine whether the steps are achieving the desired results. The administrator shall report the six month follow-up results to the committee and the CRC officials.

The following report contains our findings, conclusions, and recommendations.

Can the CRC Assist SSEA Improve Compliance with its Risk Management Procedures?

The CRC can assist the Silver State Energy Association (SSEA) improve compliance with its risk management procedures by: documenting reviews of all trade transactions; ensuring reviews are performed within 24 hours; and generating confirmation agreements for all physical trade transactions. Improved compliance ensures trading activities are performed under adequate oversight and risks are managed in accordance with established risk management procedures.

Risk Management Procedures

In 2011, the SSEA established risk management procedures to minimize the risks associated with energy trading activities. Due to the complex nature of trading in energy markets, financial risks cannot be fully eliminated but can be managed. The following are some of the risks inherent in the energy market and procedures established to mitigate these risks:

- Market price risk – The risk that the price for energy will change.
 - The SSEA mitigates this risk by engaging in hedging activities.
- Credit risk – The risk of financial loss from the failure of a counterparty to perform according to the terms and conditions of a contract.
 - The SSEA mitigates this risk by performing credit reviews of potential counterparties prior to engaging in energy trading activities.
- Operational risk – The risk of failure by people, systems, and processes in achieving organizational objectives.
 - The SSEA mitigates this risk by establishing policies and procedures to provide guidance on conducting energy trading activities.

The risk management procedures segregate energy trading activities into the front, middle, and back offices. These offices provide a series of checks and balances to ensure compliance with established procedures and accurate reporting of trading activities. The procedures for each office are as follows:

Front Office

The front office's employees execute energy trades. These employees complete a deal sheet³ for each trade and enter the deal sheet information into the trade capture system⁴ (TCS) database. SSEA risk management procedures require deal sheets to be entered into the database the same day the transaction is executed.

Middle Office

According to the SSEA risk management procedures, within 24 hours of the trade being executed by the front office, the middle office must review the trade to verify it was appropriate. This ensures mistakes are corrected in a timely manner to avoid unexpected energy price fluctuations. For example, if a trade was intended to be a sell but was executed as a buy, an additional trade must be made promptly to correct the error. When energy markets are volatile, the likelihood of the price changing quickly can be greatly increased.

The middle office must also review each trade for compliance with the risk management procedures, such as trade limits on megawatt hours bought or sold and contract terms. The middle office staff is required to document their review in the TCS database. Any noted discrepancies are reported to the SSEA manager.

Back Office

According to the SSEA risk management procedures, within 24 hours of the trade being executed, the back office must review information entered into the settlement system⁵ for accuracy. Information in the TCS database is populated into the settlement system. The back office staff is required to document their review in the TCS database. Once the trade has been reviewed, the back office invoices and settles all trade transactions.

Additionally, the back office must generate (sell) or validate (buy) a counterparty confirmation agreement using the deal sheets for physical energy trades⁶. Confirmation agreements are not required for financial energy trades⁷. A confirmation agreement provides written documentation of a verbal or electronic commitment between SSEA and its counterparty. Confirmation agreements

³ A deal sheet contains: trader name, date/time, type of trade, client, volume, fixed price, terms, delivery point, delivery schedule, counterparty and trader name, and transaction ID.

⁴ The TCS maintains all the information related to each energy trade transaction.

⁵ The settlement system is used to invoice and settle all energy trade transactions.

⁶ Physical energy trades involve the actual exchange of energy between contracting parties.

⁷ Financial energy trades are used to hedge against price fluctuations. No actual energy is exchanged.

must be completed according to guidelines of the WSPP⁸ (formerly Western Systems Power Pool).

Compliance with Procedures for Energy Trading Activities Needs Improvement

We reviewed 159 energy trading transactions of which 124 were financial trades and 35 were physical trades. For the financial trades, we noted there was no documentation evidencing that reviews were performed. For the physical trades, we noted reviews were not consistently documented or performed timely. See Exhibit III. Additionally, we noted confirmation agreements were not generated for physical trade transactions with the Basic Management Industrial Complex.

Exhibit III

Physical Trade Exceptions

Type of Exceptions	Middle Office		Back Office	
	Number of Exceptions	Percent	Number of Exceptions	Percent
Review not documented	25	71%	17	49%
Not reviewed within 24 hours	9	26%	3	9%

Consistent documentation and timely review of trading activities ensure adequate oversight and risks are managed in accordance with risk management procedures. Generating confirmation agreements ensures both parties are aware of contract commitments.

⁸ WSPP is an agreement and an organization that creates power trading opportunities and allows WSPP members to manage power delivery and price risk. The SSEA is a member of the WSPP.

Recommendations

1. Document review of all physical and financial trade transactions in the TCS database.
2. Ensure reviews are performed and documented in the TCS database in accordance with the timeframes set forth in the SSEA risk management procedures.
3. Ensure confirmation agreements are generated or validated for all physical trade transactions.

Can the CRC Enhance Its Contract Process?

The CRC can enhance its contract process by strengthening its policies and procedures to extend the solicitation period to the recommended six to eight weeks and maintaining request for proposal (RFP) selection criteria documentation. Extending the solicitation period may increase the number of applicants. Additionally, maintaining the selection criteria documentation enhances transparency and accountability.

Strengthen Contract Policies and Procedures

We reviewed all the RFP's issued for the period 2010 through 2013. We noted only three RFPs for the period under review. In each case, only one vendor submitted a bid. Our review of the three RFPs revealed solicitation periods were only open for three to five weeks.

The State Administrative Manual 0338 recommends the RFP solicitation period be open for six to eight weeks. This allows vendors sufficient time to develop proposals and apply for contracts.

The CRC should extend the solicitation period to help increase the number of applicants for RFPs.

Maintain RFP Selection Criteria Documentation

Our examination of RFPs revealed documentation was not retained by the CRC to provide a record of the evaluation committee's discussions, decisions, and rankings of the applicants.

The State Administrative Manual 0338 states prior to a solicitation being released, the evaluation criteria should be developed and the evaluation committee determined. Since these contracts may involve significant dollars, this allows the selection process to be as transparent as possible and provide accountability for contract decisions.

The CRC should maintain documentation to support the selection process.

Recommendations

4. Extend the RFP solicitation period to six to eight weeks.
5. Maintain documentation to support the selection process.

Appendix A

Colorado River Commission of Nevada Response and Implementation Plan

STATE OF NEVADA

BRIAN SANDOVAL, *Governor*
GEORGE F. OGLVIE III, *Chairman*
BERLYN D. MILLER, *Vice Chairman*
JAYNE HARKINS, P.E., *Executive Director*



BOB COFFIN, *Commissioner*
J. BRIN GIBSON, *Commissioner*
DUNCAN R. MCCOY, *Commissioner*
PUOY K. PREMSRIRUT, *Commissioner*
STEVE SISOLAK, *Commissioner*

COLORADO RIVER COMMISSION
OF NEVADA

June 3, 2014

RECEIVED

JUN - 4 2014

DIVISION OF INTERNAL AUDITS

State of Nevada Department of Administration
Division of Internal Audits
Steve Weinberger, Administrator
209 East Musser Street, Room 302
Carson City, Nevada 89701

Dear Mr. Weinberger,

The Colorado River Commission has reviewed the draft audit report received May 27, 2014 related to power procurement risk management procedure compliance and Commission contracting processes. The Commission appreciates the review and research performed by the audit staff and the recommendations to improve our compliance and contracting processes. We also appreciate the opportunity to review and provide comment on the draft audit report. Pursuant to NRS 353A, the following contains the Commission's responses to the findings and recommendations included in the report.

Recommendation #1 - Document review of all physical and financial trade transactions in the TCS database.

Recommendation #2 - Ensure reviews are performed and documented in the TCS database in accordance with the timeframes set forth in the SSEA risk management procedures.

Response: The Commission accepts the recommendations provided and will propose several modifications to Section 3.3 of the Silver State Energy Association (SSEA) Risk Procedures. For all physical trades, the modified language will require the Back Office to validate that all Deal Sheets were accurately entered into the Settlement System within 5 business days of trade execution, concurrent with the deadline in the WSPP Agreement for executing confirmation agreements. For financial transactions, the proposed language will require the Back Office to review the broker statements at month end and validate that all trades executed during the month were accurately entered into the Settlement System within 5 business days after the close of each month. The Back Office will be required to document its review of all physical and financial trades in the Trade Capture System (TCS).

Within 3 business days, the Middle Office will be required to validate that all physical and financial trades were accurately entered into the TCS and review the trades for compliance with the SSEA Risk Procedures. The Middle Office will be required to document its review of all physical and financial trades in the TCS.

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Within six months of the final audit report, the CRC will propose these changes to the SSEA Working Group, and request that they be adopted. If adopted, the implementation of the procedures will be immediate.

Recommendation #3 - Ensure confirmation agreements are generated or validated for all physical trade transactions.

Response: The Commission accepts the recommendation provided and has implemented the recommendation to generate confirmation agreements for the identified transactions. The audit identified a subset of physical trades, for WSPP transactions occurring between the SSEA and the CRC, which did not have executed confirmation agreements.

Recommendation #4 - Extend the RFP solicitation period to six to eight weeks.

Recommendation #5 - Maintain documentation to support the selection process.

Response: The Commission accepts the recommendations provided and will develop an agency wide comprehensive contracting policy that will provide guidelines related to extending the solicitation period and require retention of all selection processes including those related to single response solicitation. The policy will also provide guidance on the complete contracting process from procurement to final approval in accordance with state policy.

The Commission will develop the policy within six months of the final audit report with full implementation of the policy, including some completed contracting efforts, within one year of the report.

In addition, the Commission requested and received contract training from the Deputy Administrator of the Purchasing Division and approximately fifty percent of the staff (including a majority of staff responsible for contract preparation and monitoring activities) attended a two and one half day course. The training was completed on May 30, 2014. This training will aid the staff in developing, understanding and adhering to the contracting policy when developed.

The Commission would like to again express our appreciation for the suggestions and comments of the Internal Audit staff and the opportunity to improve agency performance in these two critical areas. If you have any questions please contact me at 702-486-2670 or at jharkins@crc.nv.gov.

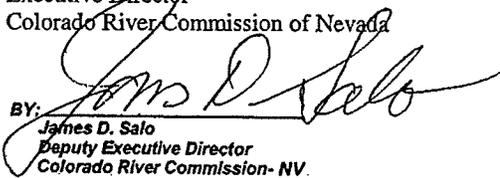
Sincerely,

JAYNE HARKINS

Jayne Harkins, P.E.
Executive Director
Colorado River Commission of Nevada

n1105/tdp

Cc: Vita C. Ozoude
Douglas N. Beatty
Gail A. Bates

BY: 
James D. Salo
Deputy Executive Director
Colorado River Commission- NV
Date: _____

Appendix B

Timetable for Implementing Audit Recommendations

In consultation with the CRC, the Division of Internal Audits categorized the five recommendations contained within this report as having a period of less than six months to implement. The CRC should begin taking steps to implement all recommendations as soon as possible. The CRC's target completion dates are incorporated from Appendix A.

Recommendations with an anticipated implementation period of less than six months.

<u>Recommendations</u>	<u>Time Frame</u>
1. Document review of all physical and financial trade transactions in the TCS database. (page 10)	Dec 2014
2. Ensure reviews are performed and documented in the TCS database in accordance with the timeframes set forth in the SSEA risk management procedures. (page 10)	Dec 2014
3. Ensure confirmation agreements are generated or validated for all physical trade transactions. (page 10)	Jun 2014
4. Extend the RFP solicitation period to six to eight weeks. (page 12)	Dec 2014
5. Maintain documentation to support the selection process. (page 12)	Dec 2014