



Capital Assets / Construction in Progress

Internal Audit

March 2014

Bernalillo County Internal Audit Capital Assets / Construction in Progress

Executive Summary

SUMMARY OF PROCEDURES

REDW performed an internal audit over capital assets and construction in progress (CIP) at Bernalillo County. Our internal audit focused on testing internal controls for various processes, including whether assets ready for use were capitalized in a timely manner as required by policies and procedures or other requirements. We also tested tracking of fixed assets and processes for additions, updates and deletions. Additionally, we determined whether retirement of assets was conducted in accordance with County policies and New Mexico State Statutes.

The procedures performed included:

- Obtained an understanding of operational procedures through reading relevant County Administrative Instructions, requirements from New Mexico State Statutes and Administrative Codes, and by interviewing various accounting personnel;
- Tested a sample of projects identified as Assets Under Construction (AUC) from the Work Breakdown Structure (WBS) element project listing to determine if the project was still in progress;
- Tested asset purchases exceeding \$5,000 to determine if assets were capitalized and added to the capital asset listing timely;
- Tested assets that were ready for use in 1991 or earlier to determine if the asset was still in use by examination of the most recent annual inventory count; and,
- Tested retired assets to ensure they were retired in accordance with County policies and State Statutes.

SUMMARY OF OBSERVATIONS AND RECOMMENDATIONS

We found areas during the course of the audit where controls were functioning properly and established procedures were followed. Asset retirements were conducted in accordance with policies and State Statutes and older assets included on the listing appeared to be still in use.

Significant high and moderate risk observations are presented below:

- **Construction in Progress was not Capitalized Timely**—Assets should be capitalized and depreciated when the asset is ready for use. We tested a total of 188 assets (Work Breakdown Structure elements) and identified 24 of 46 projects, with a total value of \$11,945,698, had associated WBS elements where the related phase of the project was ready for use, but had not been capitalized.

The lower risk observations are included in the attached detailed report.

* * * * *

Further detail of our purpose, objectives, scope, procedures, observations, and recommendations are included in the internal audit report. In that report, management describes the corrective action taken for each observation.

We received excellent cooperation and assistance from the various departments during the course of our interviews and testing. We sincerely appreciate the courtesy extended to our personnel.

REDW LLC

Albuquerque, New Mexico
June 25, 2014

Bernalillo County Internal Audit Capital Assets/Construction in Progress

Table of Contents

| | <u>Page</u> |
|--|-------------|
| INTRODUCTION | 1 |
| PURPOSE AND OBJECTIVES | 1 |
| SCOPE AND PROCEDURES PERFORMED | 2 |
| OBSERVATIONS, RECOMMENDATIONS AND MANAGEMENT RESPONSES | 4 |

Bernalillo County Internal Audit Capital Assets / Construction in Progress Report

INTRODUCTION

We performed the internal audit services described below solely to assist Bernalillo County in evaluating the internal controls over selected processes relating to capital assets and CIP. Our services were conducted in accordance with the Consulting Standards issued by the American Institute of Certified Public Accountants, Generally Accepted Government Auditing Standards, and the terms of our contract agreement for internal audit services. Since our procedures were applied to samples of transactions and processes, it is possible that significant issues related to the areas tested may not have been identified.

An entrance conference was held on March 25, 2014, at which time most items needed for the audit were requested and had been received. Fieldwork began the week of March 24, 2014. An exit conference was held on April 25, 2014, and final management responses were received on June 25, 2014.

Although we have included management's responses in our report, we do not take responsibility for the sufficiency of these responses or the effective implementation of any corrective action.

PURPOSE AND OBJECTIVES

Our internal audit focused on evaluating selected processes over Capital Assets/Construction in Progress to determine if those processes were in compliance with policies and procedures (P/Ps), applicable regulations, and reflected best practices and sound internal controls. We evaluated the adequacy and reasonableness of the internal controls surrounding processes including: the capitalization of assets, the tracking of fixed assets and processes for additions, updates and deletions, and asset retirements.

As stated in the Bernalillo County’s Comprehensive Annual Financial Report for fiscal year ended June 30, 2013, the County’s investment in capital assets for its governmental and business type activities as of June 30, 2013, was \$588,029,178 (net of accumulated depreciation).

County of Bernalillo’s Capital Assets
(net of accumulated depreciation)

| | Total | |
|--|-----------------------|-----------------------|
| | 2013 | 2012 |
| Land | \$ 136,591,937 | \$ 136,461,953 |
| Buildings | 195,534,615 | 183,031,712 |
| Machinery and equipment | 21,899,986 | 19,884,515 |
| Land improvements | 14,578,482 | 8,014,911 |
| Infrastructure (e.g., roads, bridges, and similar items) | 169,540,945 | 162,945,084 |
| Leasehold improvements | 1,758,510 | 1,887,046 |
| Construction in progress | 45,572,298 | 61,424,198 |
| Art | 2,552,405 | 2,534,675 |
| Total | <u>\$ 588,029,178</u> | <u>\$ 576,184,094</u> |

The County defines capital assets as assets with an initial, individual cost of more than \$1,000 and estimated useful life in excess of one year, and after July 1, 2005, an individual cost of more than \$5,000. Purchased or constructed assets are recorded at historical cost or estimated cost. The cost of normal maintenance and repairs that do not add to the value of the asset or materially extend assets lives are not capitalized. Major outlays for capital assets and improvements are capitalized as projects are ready for use.

SCOPE AND PROCEDURES PERFORMED

In order to gain an understanding of the processes and operations surrounding CIP and capital assets, we interviewed the following Accounting personnel:

- Bonnie Ulibarri-Romero, Financial Projects Coordinator
- Anthony Infantino, Financial Projects Coordinator
- Ryan Travelstead, Financial Administrator – General Ledger

In order to understand policies and procedures over CIP and capital assets we read relevant portions of:

- New Mexico Statute 13-6-1 NMAC – Disposition of Obsolete, Worn-out, or Unusable Tangible Personal Property;
- New Mexico Statute 13-6-2 NMAC – Sale of Property by State Agencies or Local Public Bodies; Authority to Sell or Dispose of Property; Approval of Appropriate Approval Authority;

- New Mexico Statute 13-6-2.1 NMAC – Sales, Trades or Leases; Board of Finance Approval;
- New Mexico Administrative Code 2.20.1 – Accounting and Control of Fixed assets of State Government, Accounting for Acquisitions and Establishing Controls;
- Bernalillo County Administrative Instruction No. AD 04 – Fixed Assets;
- Bernalillo County Administrative Instruction No. IP 01 – Real Property Acquisition and Disposition; and
- Bernalillo County Administrative Instruction No. RM 02 – Loss of County-Owned Equipment.

We performed the following testwork:

Construction in Progress (CIP): Bernalillo County uses SAP Project System software to track projects by using the WBS elements of a Work Breakdown Structure. A work breakdown structure consists of WBS elements that are located at different levels in order to map the hierarchical structure of a project. The County uses projects to purchase cars, purchase art work, purchase of right away, build roads, build fuel stations, build community centers, construct fiber optic installations, make open space improvements, implement software, and for design for proposed projects.

A project may have multiple WBS elements representing capital, non-capital expenditures and could be a combination of capital and noncapital. Departments are required to communicate to the Accounting Department, the status of projects, any change in scope that would affect the type of asset to capitalize, the percent of capitalization resulting from non-capital expenditures, and final completion of the project. Accounting also reviews the project listing at fiscal year-end. We obtained the listing of WBS elements related to CIP as of March 24, 2014, and selected a judgmental sample of 46 projects (based on 95% confidence level (CL) and 5% tolerable deviation (TD)) and determined if the project was still in progress by obtaining a Certificate of Occupancy for buildings, viewing invoices for final payments to determine project completion date, and contracting the responsible department to determine the status of the project. Projects selected ranged in size from approximately \$9,000 to \$5,000,000, with total projects tested of approximately \$25,000,000.

Asset Additions: We obtained a list of purchases made from July 1, 2013 through May 24, 2014, that exceeded \$5,000 and selected a judgmental sample of 20 (based on 90% CL and 10% TD) and determined if the asset was properly capitalized and added to the Capital Asset listing timely.

Old Assets: We obtained the Capital Asset listing from July 1, 2012 through February 28, 2014, and selected a judgmental sample of 30 assets (based on 90% CL and 8% TD) that were ready for use in 1991 or earlier, and determined if the asset was counted during the most recent annual inventory and appeared to still be in use.

Asset Retirements: We obtained the retirements listing from July 1, 2012 through February 28, 2014, and selected a judgmental sample of 10 retired assets to ensure the assets were retired in accordance with County policies and State Statutes.

OBSERVATIONS, RECOMMENDATIONS AND MANAGEMENT RESPONSES

We identified the following weaknesses relating to the Bernalillo County's processes:

1) *Construction in Progress (CIP) was not Capitalized Timely*

Assets that will provide future economic benefit should be capitalized and depreciated as the economic benefit of that asset is used up. Assets are capitalized when they are ready for their intended use and the economic benefit of that asset is being received. We tested a total of 188 assets (WBS elements), which were related to 46 projects and identified the following:

- 24 of 46 projects had associated WBS elements where the related phase of the project was ready for use, but had not been capitalized.

| <u>Department</u> | <u>Number of Projects</u> | <u>Current Book Value</u> |
|---------------------------|---------------------------|---------------------------|
| Capital Improvement | 1 | \$ 4,794,369 |
| Parks & Recreation | 8 | 2,130,860 |
| Infrastructure & Planning | 2 | 2,754,020 |
| Operations & Maintenance | 11 | 1,667,485 |
| Technical Services | 1 | 482,429 |
| Information Technology | 1 | 116,535 |
| Total | 24 | \$ 11,945,698 |

- Two of 46 projects included non-capital expenditures which had carried over from previous fiscal years and had not been closed to fund balance at the end of the applicable fiscal year.

| <u>Department</u> | <u>Number of Projects</u> | <u>Current Book Value</u> |
|--------------------|---------------------------|---------------------------|
| Fleet & Facilities | 1 | \$ 259,379 |
| Technical Services | 1 | 117,293 |
| Total | 2 | \$ 376,672 |

Potential Risk: Moderate – Failure to properly closeout projects and capitalize assets under construction in a timely manner will result in higher total assets reported on the balance sheet. Assets will not be tracked and depreciated as required and related non-capital expenditures will not be closed to fund balance at the end of each fiscal year. Additionally, if expenditures related to assets under construction are not properly tracked, classified and capitalized, Bernalillo County will not be in compliance with NMAC Section 2.20.1.

Recommendation: Project expenditures should be properly tracked and classified as capital and non-capital expenditures. The project should be capitalized and depreciation should begin when the project is ready for use. A project may be ready for use and in operation, but miscellaneous expenditures continue to occur for several years until all invoices are finally paid and the funds are closed. In the meantime, the project has not been capitalized as a completed asset, and is not

being depreciated. Capital expenditures that have been identified as ready for use should be capitalized in the month they have been identified as ready for use and no later than the end of the applicable fiscal year. Non-capital expenditures should be closed to fund balance at year-end.

A formal policy documenting the process for tracking and capitalization of assets under construction projects should be adopted by the Accounting Department and distributed to all departments to ensure that County personnel have a clear understanding of the requirements. Further clarification should be included to address the treatment of additional expenditures that are incurred after the project is ready for use. These expenditures should be assigned a new WBS element for proper tracking and will allow for all WBS elements for phases that are ready for use to be properly capitalized. Training should be conducted to communicate the requirements of the policy with specific attention to educating personnel on classifying a project as ready for use.

Management's Response

Management wants to first respond that additional staff was assigned and \$10,900,960 of the \$11,945,698 expenditures (91%) reported were capitalized by the end of May 2014. The Accounting department was successful with help from the departments.

Procedures that have been implemented or in the process of being implemented follow. Accounting will:

- Tailor its annual training to specific department training needs to include director and representatives from Budget and Purchasing.
- Meet quarterly/semi-annually with departments and their directors on the status of their projects depending on the size or need.
- Require more information from departments before WBS's are created to determine if projects can be set up differently. We would like to capitalize assets more in phases, to simplify the accounting and the capitalization process.
- Produce reports that will aid in the review process; such as last activity and percentage of completion to allocated budget.
- Reconsider naming convention of WBS's so that projects that are 100% non-capital can be easily identified.

The Accounting Department will work on documenting procedures. Projects are maintained by one project accountant; additional resources will assist us based on the scope, size, quantity and total value of projects currently at \$49 million.

2) *Purchased Assets were not Capitalized Timely*

The New Mexico Administrative Code (NMAC) Section 2.20.1 requires Bernalillo County to capitalize fixed assets with a cost of \$5,000 or more. Three of 20 purchases tested exceeded the \$5,000 capitalization threshold but were not added to the capital assets listing and tagged as required. For all three asset purchases (totaling \$35,860), the Department did not complete the shopping cart correctly with an asset master number which is obtained by using an Asset Master form and submitting to the Fixed Asset Section. When the process is used correctly the asset is automatically capitalized when receipted in the system. The three departments identified above were Clerk's Office, MDC, Fire and Rescue.

Potential Risk: Low – Failure to properly capitalize assets will result in lower total assets reported on the balance sheet, and assets will not be tracked and depreciated as required. If assets with a cost of \$5,000 or more are not capitalized, Bernalillo County will not be in compliance with NMAC Section 2.20.1.

Recommendation: The Accounting Department should consider performing regular monitoring of asset purchases to ensure capital assets have been identified and capitalized when required. Additionally, purchasing requirements should be updated to ensure that purchases meeting the criteria for capitalization cannot be purchased under a blanket purchase order (PO) or charged to a cost center due to the difficulty of monitoring these types of purchases. Additional and reoccurring training for departments should be performed to ensure that all County personnel that purchase items for the County understand the process and know that asset purchases should always request an Asset Master number in the shopping cart and an Asset Master form must be completed whenever an asset meeting the capitalization criteria.

Management’s Response

The Accounting department starting in the month of May 2014, has been reviewing monthly expenditures that are \$5,000 or greater for assets that may have been purchased incorrectly as part of month end close procedures. The Accounting department will work with the Purchasing department to determine how to avoid assets being purchased with blanket purchase orders. Additionally, in 2015, the Purchasing Department will be implementing Procurement for Public Sector, SRM 7.0 purchasing module. Included in the implementation process is the development of a “Business Blueprint Document” which will encompass the “To Be” business processes. For assets, the Purchasing Department will work with the consultants to determine if there is a way to differentiate asset payments over \$5,000 at the Shopping Cart Level, PO Issuance Level, and Invoice Payment Level, as well as determine options for flagging items that should be classified fixed assets.

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This report is intended for the information and use of Bernalillo County management, the audit committee, members of the Board of Commissioners of Bernalillo County and others within the organization. However, this report is a matter of public record, and once accepted its distribution is not limited.

We discussed and resolved other minor observations with management and received excellent cooperation and assistance from the various departments during the course of our interviews and testing. We sincerely appreciate the courtesy extended to our personnel.

REDW LLC

Albuquerque, New Mexico
June 25, 2014