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Office of the City Auditor

Audit Report

**AUDIT OF CAPITAL IMPROVEMENT PROGRAM
FUNDS MONITORING**
(Report No. A08-015)

June 20, 2008

City Auditor

Craig D. Kinton

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Executive Summary

The Department of Public Works and Transportation (PWT) monitors Capital Improvement Program (CIP) funds availability by a labor-intensive process that is not documented in any written procedures. As a result, the City Auditor's Office estimated that approximately \$6.7 million was still allocated to finalized construction projects as of June 30, 2007. Some projects had been finalized for two to six years. These available funds could have been more timely reallocated to other projects or used to pay debt service.

Background Summary

Capital Improvement Program (CIP) project funding involves multiple processes, such as: project identification, budget appropriation, payments, project close-out, and monitoring of funds.

The CIP budget is \$729.5 million or 28 percent of the City's Fiscal Year (FY) 2007-2008 adopted budget of \$2.6 billion. The CIP budget consists of \$392 million for General Purpose Capital Improvements, such as the City's street system, with the primary financing mechanism being general obligation bonds, and, \$337.5 million for Enterprise Fund Capital Improvements, such as water and wastewater systems, with the primary financing mechanisms being Enterprise Fund revenue and issuance of commercial debt or revenue bonds.

The City's Comprehensive Annual Financial Report for fiscal year ended September 30, 2006 shows a construction-in-progress balance of \$396,036,000. This amount represents 18.4 percent of the \$2.2 billion total for capital assets.

The Bond Program Fund / Unit Summary Report, the key document the Office of Financial Services (OFS) uses to monitor CIP budgets and expenditures, includes a "miscellaneous" category to temporarily account for available funds. The purpose of this "miscellaneous" category was not clearly defined and was seldom used by PWT. During the audit, the City Auditor's Office discussed with department management the need for CIP funds transactions to be appropriately classified and promptly recorded. PWT conducted additional monitoring and review, and the CIP funds identified were released from not only finalized projects, but also from completed projects and projects with an undetermined use of the funds. As a result, the identified funds transferred to the "miscellaneous" category and made available for reallocation increased from approximately \$7 thousand to \$13 million.

Furthermore, the City has had problems with construction-in-progress accounting controls because OFS throughout the year does not have timely, accurate, and reliable information on construction project activities. The City Auditor's Office identified 38 projects, as of FY 2006, with construction-in-progress balances totaling \$17,866,902, which had not been properly transferred to capital assets. As a result, the construction-in-progress account is overstated, the capital assets subject to depreciation are understated, and depreciation expense is not timely recognized.

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An additional 380 projects with construction-in-progress balances totaling \$158,252,680, as of FY 2006, were not further tested because the City Controller wanted to work with the departments to determine whether these projects should also be transferred to capital assets.

Summary of Recommendations

We recommend the Director of PWT:

- Establish written policies and procedures for CIP funds monitoring and determine if an automated process can be developed to more efficiently and effectively monitor and report CIP fund activities.
- Establish written policies and procedures for a “contingency” fund category for each bond program proposition, ensure all CIP projects are reviewed for funds that could be reallocated, and identify in the Capital Budget any transfer of funds to the “contingency” category.

We also recommend the Interim Director of Financial Services / City Controller establish written policies and procedures on the construction-in-progress account and reconcile construction-in-progress general ledger accounts to the department records more frequently than the current annual reconciliation.

Summary of Management’s Response

The Director of PWT, the City Controller, and the Interim Budget Director of Financial Services agreed or partially agreed with the six recommendations in this report and provided comments with corrective action plans, as well as implementation dates. The complete response is included as Appendix III to this report.

Summary of Objectives, Scope and Methodology

Our audit objectives were to evaluate the process used to ensure CIP funds are timely and properly allocated between projects and to evaluate the financial reporting controls over construction-in-progress. The audit focused on the General Purpose Capital Improvement funds managed by PWT. The audit covered the period October 1, 2006 through June 30, 2007.

To achieve the audit objectives, we interviewed City staff and managers, reviewed City ordinances and policies, researched industry best practices, analyzed relevant financial records, randomly sampled construction projects to

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identify unexpended funds remaining on completed projects, used sampling methodologies to estimate the total unexpended funds, and issued a memorandum of preliminary audit results to City Council and City management.

Audit Results

Overall Conclusion

The City of Dallas (City) needs to establish internal controls to ensure Capital Improvement Program (CIP) funds are timely reallocated after projects are finalized and funds available for reallocation are properly classified as “contingency” funds. Further, financial transactions for construction projects need to be accurately reported. A primary obstacle, however, is the manual, labor-intensive process required to support capital project management. Processes to document and monitor CIP activities are inefficient or non-existent and present increased potential for error and ineffective management reporting. Further, managers do not have access to information that could be useful in controlling operations and making decisions.

CIP planning, funding, and implementation is complex. The following table shows the status of the budget appropriation and the unexpended funds remaining on existing CIP projects as shown in the Fiscal Year (FY) 2007-2008 Capital Budget.

Table 1 – Status of CIP Funds Budget Appropriation ¹

General Obligation Bond Program	Total Budget Appropriation	Unexpended ² Budget Appropriation	Percent of Unexpended to the Total Budget Appropriation
1995	\$ 180.6 million	\$ 12.7 million	7%
1998	534.0 million	172.2 million	32%
2003	602.0 million	356.5 million	59%
2006 ³	135.7 million	135.7 million	100%
Total	\$ 1.45 Billion	\$ 677.1 million	47%

¹ Source: June 30, 2007 Bond Program Fund / Unit Summary Report provided by the Office of Financial Services Capital Budget staff.

² “Unexpended” Budget Appropriation includes both “unencumbered” and “encumbered”, but not expended. Encumbrances represent City’s commitments to expend resources.

³ 2006 General Bond Program sales did not occur until June 2007; therefore budget appropriation remained “unexpended” as of June 30, 2007.

Capital Improvement Program funds are not always timely reallocated after construction projects are finalized

The Department of Public Works and Transportation (PWT) did not timely close 39 of 184 sampled construction projects (21 percent) and reallocate the remaining \$2.6 million when the projects were completed and finalized. These projects had been completed and finalized from May 16, 2001 through June 11, 2007. On September 11, 2007, the City Auditor issued a memorandum to the City Council regarding the preliminary audit results that funds were available that had not been previously identified and could be re-allocated to other projects, used for new projects, or used to pay debt service. Subsequent testing identified additional funds.

The following table shows the time period CIP projects were actually finalized, number of projects, and amount of CIP funds available for reallocation as a result of the audit tests.

Table 2 – CIP Funds Allocated to Finalized CIP Projects ⁴

Time Period CIP Projects Actually Finalized	Number of Projects	CIP Funds Available for Reallocation
May 2001 – June 2002	1	\$ 10,001
July 2002 – June 2003	1	168,551
July 2003 – June 2004	2	243,697
July 2004 – June 2005	28	405,575
July 2005 – June 2006	3	1,658,661
July 2006 – June 2007	4	177,370
TOTAL	39	\$ 2,663,855

PWT monitors CIP funds availability and project status by a manual, labor-intensive process that is inefficient and that is not documented in any written procedures. Current procedures require:

- The financial manager to contact each project manager individually to obtain the project status, such as the percentage of completion

⁴ Source: June 30, 2007 Bond Program Fund / Unit Summary Report provided by the Office of Financial Services Capital Budget staff.

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- Project managers to manually maintain financial information and project status in project folders which can only be reviewed manually to retrieve information

The City began implementation of a citywide centralized capital project management system (CapPro) several years ago; however, CapPro is only updated by project managers to show the actual or estimated project completion dates. Currently, PWT staff cannot fully use the system's functionality because it is not fully funded for implementation and maintenance, and quarterly reports do not show the status of funds remaining on project or the percentage of project completed. Further, CapPro does not interface with the City's financial accounting system.

The City Auditor's Office estimates that, as of June 30, 2007, approximately \$6.7 million was still allocated to PWT construction projects that actually had been finalized. If PWT department management had conducted more timely and effective monitoring, these excess funds could have been reallocated to other projects or used to pay debt service.

Further, as a result of the CIP funds monitoring internal control weaknesses, the Office of Financial Services (OFS) has been provided inaccurate financial information. OFS does not have direct access to construction project information maintained by the other departments and OFS has not established mechanisms or procedures to verify the reasonableness or accuracy of the information provided by other departments. For example, the:

- FY 2007-2008 Capital Budget information states projects funded in prior years, but finalized as of June 30, 2007, are excluded from the budget. Projects, however, that had been finalized for two to six years were still identified as projects needing funding in the FY2007-2008 budget.
- Bond Program Fund / Unit Summary Report is the key document that OFS uses to monitor CIP budgets and expenditures; however, the report incorrectly showed the finalized projects as active with unexpended funds awaiting further expenditure.

Recommendation I:

We recommend the Director of PWT establish written policies and procedures for CIP funds monitoring to address how fund monitoring is conducted, frequency of monitoring, management responsibilities and approval, and a reporting mechanism that documents the monitoring results and actions taken.

Management's Response

Agree. Attached is a binder containing all written policies and procedures related to capital projects contract management, and management of funding sources and approvals. Public Works will work the Office of Financial Services (OFS) to begin updating the information contained in the binder and to specifically address monitoring of CIP funds and the reporting mechanisms to document the results and actions taken in compliance with established guidelines and directives.

City Auditor's Follow-Up Comments

The written policies and procedures attached to the June 18, 2008 management response pertain to bond program development, funding sources, and general project management, but do not address monitoring CIP funds. Further, some of the information has not been updated for over a decade. Management acknowledges the information needs to be updated and needs to specifically address the issues in this report. Although the current management response does not provide an implementation date to correct the issues, a previous response indicated the corrective actions will be implemented in December 2008.

Recommendation II:

We recommend the Director of PWT work with OFS and the Department of Communication and Information Services (CIS) to determine if an automated process can be developed to more efficiently and effectively monitor and report CIP fund activities or coordinate with OFS to develop other mechanisms to verify the accuracy and reliability of CIP information provided by PWT and other departments.

Management's Response

Agree. Public Works and OFS will work to establish the criteria by which to evaluate the options related to automating the CIP funds monitoring process. This will include reviewing and assessing the current Prolog software system to

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determine if it is suitable for this purpose. We intend to have a plan by December of 2008. Public Works and OFS will work with CIS early in 2009 to determine what options are available to automate the CIP funds monitoring process based on the criteria established between Public Works and OFS.

For your information, including the information binder, is the Financial Fundamentals manual for the Prolog Software that Public Works currently uses to manage capital projects. The financial capability of Prolog has not been implemented due to its apparent inability to interface with the City's AMS financial software after the upgrade to Advantage 3.

Capital Improvement Program funds available for reallocation are not always properly classified and recorded for financial transparency

The FY 2007-2008 Capital Budget Appropriation Ordinance authorizes funds, with remaining unexpended balances, to be reallocated from projects that have been completed under budget to other projects within the same fund that need more budget appropriation. Some cities, however, revert the excess funds to a contingency fund for future appropriation rather than to individual projects. Although the Bond Program Fund / Unit Summary Report includes a “miscellaneous” category to temporarily account for excess funds, this category is not clearly defined. Further, PWT department management seldom transferred the available funds using this “miscellaneous” category.

During the audit, the City Auditor’s Office discussed with PWT management the need for transactions to be appropriately classified and promptly recorded to maintain relevance, value and usefulness in controlling operations, and making decisions. PWT conducted additional monitoring and the available funds were released from not only finalized projects, but also completed projects, and projects with an undetermined use of the funds. As a result, PWT management:

- Increased the available CIP funds balance in the “miscellaneous” category (contingency funds) from \$6,717 to \$1.5 million as of January 22, 2008 for the 1995 and 1998 bond propositions
- Established a “miscellaneous” category for the 2003 bond propositions showing available funds of \$11.5 million as of January 22, 2008

The table on the next page shows the comparison of the “miscellaneous” CIP funds balance before and after the audit started.

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Table 3 – Changes in Contingency CIP Funds Balance

Bond Program Proposition	“Miscellaneous” (Contingency) Funds Balance as of June 30, 2007⁵ (Before Audit)	“Miscellaneous” (Contingency) Funds Balance as of January 22, 2008⁶ (After Audit)
1995 Street	\$ 1,427	\$ 550,991
1995 Flood Protection	1,647	2,175
1998 Street	3,643	958,043
Sub Total	6,717	1,511,209
2003 Street		11,304,986
2003 Specified Street	("Miscellaneous" category had not been established for 2003 Bond Program propositions)	174,295
2003 Flood Protection		37,965
Sub Total	0	11,517,246
Total	\$ 6,717	\$ 13,028,455

Recommendation III:

We recommend the Director of PWT in cooperation with OFS establish written policies and procedures for a “contingency” fund category for each bond program proposition. These procedures should include: the purpose of the fund; describe how the funds are transferred to “contingency” category; management responsibilities and approval of transfers; and, a reporting mechanism that documents the monitoring results and actions taken.

Management’s Response

1. Partially agree. The Director of PWT responded that a process and policy already exist and all funds are fully accounted for by PWT and OFS. PWT concurs that updated guidelines need to be documented in written policies and procedures by December 2008.
2. Agree. The Interim Budget Director responded that transfer of appropriations from one project to another within a given fund is authorized by the annual capital budget ordinance. OFS will formalize in writing by October 2008 the procedures which are already in place to transfer appropriations including transfers to the contingency.

⁵ Source: June 30, 2007 Bond Program Fund / Unit Summary Report provided by the Office of Financial Services Capital Budget staff.

⁶ Source: Information provided by PWT staff.

Recommendation IV:

We recommend the Director of PWT in cooperation with OFS ensure all CIP projects are reviewed and any transfer of available funds to the “contingency” category is completed and identified in the Capital Budget.

Management’s Response

1. Agree. The Director of PWT responded that, as previously mentioned, all projects are reviewed and continued to be reviewed. PWT will request that OFS develop a “contingency” identifier by December 2008.
2. Agree. The Interim Budget Director responded that, as part of the preparation of the capital budget, the Capital Budget Division of OFS annually provides instructions to departments regarding the transfer of appropriations for completed projects. The Capital Budget staff ensures that the projects noted as “completed” by the departments do not have any remaining encumbered balances and that the appropriations are equal to the expended amount. Any appropriation variances are corrected. OFS will ensure that all amounts identified as “contingency” are included in the Capital Budget.

Capital Improvement Program funds monitoring problems contribute to internal control weaknesses over financial reporting

The OFS does not have written policies and procedures for construction-in-progress account reconciliation to PWT project records. Reconciliation is only performed once a year. Further, OFS does not have routine management reports to use in analyzing and monitoring construction-in-progress project activities and to verify the accuracy and reasonableness of the information provided by other departments.

The City Auditors' Office requested OFS and the Controller's Office to provide information on the construction-in-progress account to identify projects that could be transferred to capital assets. We compared a list of 418 construction-in-progress projects with no activity provided by the OFS / Controller's Office to the list of current Capital Improvement Program projects with capital bond funds appropriated, but not expended, that was provided by the OFS Budget Office. Further analysis and audit tests showed:

- 38 projects (34 in PWT and four in the Park and Recreation Department) with construction-in-progress balances totaling \$17,866,902, as of FY 2006, which had not been properly transferred to capital assets. As a result, the construction-in-progress account is overstated, the capital assets subject to depreciation are understated, depreciation expense is not timely recognized
- 380 projects with construction-in-progress balances totaling \$158,252,680, as of FY 2006, were not further tested because the City Controller wanted to work with the departments to determine whether these projects should also be transferred to capital assets

The proper classification and recording of construction transactions should occur during authorization, processing, and final close-out of the project. Management should have throughout the year timely, accurate, and reliable information on construction project activities.

The Single Audits for FY 2005 and FY 2006 identified construction-in-progress accounting controls as a material control weakness. Specifically, the Independent Auditor's Report on Internal Control over Financial Reporting for FY 2005 identified errors and / or control weaknesses relating to the transfer of construction-in-progress to capital assets for completed projects, and the FY 2006 report identified problems with the transfer of construction-in-progress to capital assets for completed projects that were not completed.

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The City's Comprehensive Annual Financial Report for Fiscal Year ended September 30, 2006 shows a construction-in-progress balance of \$396,036,000. This amount represents 18.4 percent of the \$2.2 billion net total for capital assets.

Recommendation V:

We recommend the Interim Director of Financial Services / City Controller establish written policies and procedures on the construction-in-progress account to address: how the reconciliation process is conducted; develop computerized routine management analysis and reports to assist in the reconciliation; define the criteria for the project status that should be transferred from construction-in-progress to capital assets; the frequency of reconciliations; management responsibilities and approval; and, a reporting mechanism that documents the reconciliation results.

Management's Response

Agree. The City Controller's Office has put in place an accounting internal control system designed to increase reliability and provide protection against potential errors or fraud. To ensure reliability of transactions, all capital improvement transactions are verified for accuracy and are required to have proper documentation attached before they can be approved in the fixed asset system. At present, the City Controller's Office (CCO) is building an accounting database system within Microsoft Access for summarizing, organizing, and retrieving information. This database system was recently used by CCO as a mechanism for providing the City Auditor and department managers with a report about inactive projects in construction-in-progress. With this report, over \$170 million in construction-in-progress was identified as completed and/or finalized and transferred to capital assets.

In order to ensure construction in progress projects are timely transferred to capital assets, analysis of the Retainage Payable account is an additional mechanism used. In FY 2007, CCO timely transferred \$30 million from construction-in-progress to capital assets using the analysis of retainage payable mechanism. Although this control mechanism has limitations as not all capital improvement projects require retainage payments, it serves as a basis for ensuring completeness of transfers from construction-in-progress to capital assets.

In addition to the retainage payable analysis, the Bond Program Fund / Unit Summary report is being used as a mechanism to ensure completeness and timely transfers from construction-in-progress to capital assets. The Fund / Unit Summary report is a key indicator about the project status. A project must be at least 95 percent complete in order to be transferred to capital assets. In other

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words, a program which has five percent or less unexpended funds would be considered substantially complete and transferred to capital assets. However, the Fund / Unit Summary Report alone is not sufficient proof about whether a project is complete or finalized if the unexpended funds exceed five percent. That said, if unexpended funds exceed five percent, further evaluation is required in order to establish proof about whether the project is in fact completed / finalized.

The construction-in-progress subsidiary records listing is reconciled with the general ledger account annually at fiscal year end. Afterwards, the listing is to be provided to the departments. This listing indicates the accumulated expenditures for each program in construction-in-progress and the amounts transferred to capital assets. Departments will be asked to confirm whether the projects are completed / finalized. Unless a completion memo or other official documentation has already been provided by the department, proper backup support will also be requested.

Written policies and procedures about the above internal accounting control mechanisms are being established to ensure complete, accurate records and timely transfer of construction-in-progress to capital assets. As of FY 2007, over \$200 million in construction-in-progress has been properly identified and transferred to capital assets using the above control mechanisms that have been put in place.

Recommendation VI:

We recommend the Interim Director of Financial Services / City Controller reconcile construction-in-progress general ledger accounts to the other departments' subsidiary records more frequently than the current annual reconciliation. At a minimum, we recommend quarterly reconciliations.

Management's Response

Partially agree. The City Controller responded that, at present, internal accounting controls have been designed to detect and prevent misstatements from occurring in the construction-in-progress general ledger account and ensure timely reporting of transfers to capital assets. The following controls have been established and enforced:

- Object code approval process – ensure accuracy and existence
- Capital outlay analysis – ensures completeness of expenditure transactions

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- Retainage payable analysis – ensure timely transfer of CIP to capital assets
- Unit Summary Report Analysis – ensure timely transfer of CIP to capital assets
- Communication with departments – provides proper evaluation and verification

Because expenditures are ongoing throughout the fiscal year, the construction-in-progress general ledger is updated annually at fiscal year end. Capital improvement expenditures are extracted from the financial system into a Microsoft Access database to be summarized and organized. The results are then exported into Excel for further analysis. More frequent updated subsidiary records would be less cost effective and reduce overall efficiency considering the time resource and complexity of data extracts and analysis.

The construction-in-progress subledger records are reconciled to the audited general ledger account annually. With the subledger records being provided to department managers, the basic intent is for departmental verification and analysis. Departments will be asked to identify any variances between their reports and the CCO subsidiary records. If unusual or significant variances exist further evaluation will follow in order to identify possible system breaks or opportunities for improvement to the accounting internal controls.

Background, Objectives, Scope and Methodology

Background

Capital Improvement Program project funding involves multiple processes, such as: project identification, budget appropriation, payments, project close-out, and monitoring of funds.

The Office of Financial Services (OFS) provides financial, management, and accounting services support to the City Manager's Office. The OFS is responsible for preparing and monitoring the citywide budgets and producing the City of Dallas financial statements.

The Capital Improvement Program (CIP) budget is \$729.5 million, or 28 percent, of the City's Fiscal Year (FY) 2007-2008 adopted budget of \$2.6 billion. The CIP budget consists of \$392 million for General Purpose Capital Improvements, such as the City's street system, with the primary financing mechanism being general obligation bonds; and, \$337.5 million for Enterprise Fund Capital Improvements, such as water and wastewater systems, with the primary financing mechanisms being Enterprise Fund revenue and issuance of commercial debt or revenue bonds.

The Department of Public Works and Transportation (PWT) manages approximately \$70 million worth of CIP projects on an annual basis. With the approval of the 2006 Bond Program, the total dollars of capital projects increased to \$200 million for FY 2007-08. PWT staff manually manages and monitors CIP funds, expenditures, and construction project status.

Objectives, Scope and Methodology

This audit was conducted under the authority of the City Charter, Chapter IX, Section 3.

Our audit objectives were to evaluate the process used to ensure CIP funds are timely and properly allocated and to evaluate the financial reporting controls over construction-in-progress accounts.

The audit was conducted in accordance with generally accepted government auditing standards. The audit period covered October 1, 2006 through June 30,

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2007. We also examined certain events, records, and transactions occurring before and after this period. We limited our review primarily to the 1995, 1998, and 2003 General Obligation Bond Funds in PWT; however, during our preliminary audit tests, we also reviewed certain projects in the Park and Recreation Department (PKR).

To achieve these objectives, we:

- Interviewed City department managers and staff to develop an understanding of relevant internal controls and evaluated relevant policies and procedures
- Reviewed various City ordinances, the City's FY 2007-2008 Adopted Budget, Single Audit reports, City Council briefings, and other relevant documents and information; researched industry best practices on CIP process and management
- Used computer-assisted audit techniques to compare and analyze the 418 projects in the Construction-in-Progress No Activity Report provided by the Controller's Office and the Capital Program Bond Fund / Unit Summary Report provided by the OFS Capital Budget staff
- Based upon the data analysis, identified data anomalies which included 319 construction projects that had no construction-in-progress account activities in FY 2007, but had unexpended funds remaining in the accounts
- Conducted preliminary audit tests on 108 of the 319 projects that were identified as data anomalies in PWT and PKR
- Randomly selected a statistical sample of an additional 76 projects from the remaining 1995, 1998, and 2003 Bond Program projects managed by PWT and conducted tests to identify unexpended funds remaining on the projects that have been completed and finalized
- Projected the sample error rate to the population and estimated the total unexpended funds remaining on the projects that have been completed and finalized in PWT

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- Reviewed the CIP contingency funds activities and discussed with PWT management the need for transactions to be appropriately classified and recorded for financial transparency
- Assessed OFS policies and procedures on construction-in-progress financial reporting and the annual reconciliation process; requested and analyzed the construction-in-progress account management report to identify the projects that should be transferred to capital assets
- Issued a memorandum to City Council and City management informing them of the preliminary audit results

Major Contributors to This Report

Gary Lewis, CPA, CIA, CFE, Audit Manager

Rowena Zhang, CPA, CITP, CIA, CISA, CFE, Project Manager

Theresa Hampden, CPA, Quality Control Manager

Management's Response

Memorandum

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JUN 05 2008

CITY AUDITOR'S OFFICE



CITY OF DALLAS

DATE: 6/5/08

TO: Craig D. Kinton, City Auditor

SUBJECT: Response to Audit Report: Audit of Capital Improvement Program Funds

Our responses to the audit report recommendations are as follows:

Recommendation I:

We recommend the Director of PWT establish written policies and procedures for CIP fund monitoring to address how fund monitoring is conducted, frequency of monitoring, management responsibilities and approval, and a reporting mechanism that documents the monitoring results and actions taken.

Management Response / Corrective Action Plan

Agree Disagree Partially Agree

A process and policy already exist that is handled and maintained electronically and in a hard copy. This information is stored and monitored at PWT and at the Office of Financial Services (OFS).

PWT concurs that guidelines need to be updated to document procedures for monitoring the CIP fund. PWT is working with CCO and OFS to establish them.

Implementation Date

December 2008

Responsible Manager

Zaida Basora

Recommendation II:

We recommend the Director of PWT work with OFS and the Department of Communication and Information Services (CIS) to determine if an automated process can be developed to more efficiently and effectively monitor and report CIP fund activities or coordinate with OFS to develop other mechanisms to verify the accuracy and reliability of CIP information provided by PWT and other departments.

Management Response / Corrective Action Plan

Agree Disagree Partially Agree

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A meeting will be set up with CIS to task them on searching how to better automate the CIP monitoring process.

Implementation Date

A meeting will be set up by July 2008

Cannot account when CIS will be able to help make a determination

Responsible Manager

Zaida Basora

Recommendation III:

We recommend the Director of PWT in cooperation with OFS establish written policies and procedures for a "contingency" fund category for each bond program proposition. These procedures should include: the purpose of the fund; describe how the funds are transferred to "contingency" category; management responsibilities and approval of transfers; and, a reporting mechanism that documents the monitoring results and actions taken.

Management Response / Corrective Action Plan

Agree Disagree Partially Agree

A process and policy already exist and all funds are fully accounted for by PWT and OFS.

PWT concurs that updated guidelines need to be documented in written policies and procedures.

Implementation Date

December 2008

Responsible Manager

Zaida Basora &

Recommendation IV:

We recommend the Director of PWT in cooperation with OFS ensure all CIP projects are reviewed and any transfer of available funds to the "contingency" category is completed and identified in the Capital Budget.

Management Response / Corrective Action Plan

Agree Disagree Partially Agree

As previously mentioned, all projects are reviewed and continue to be reviewed. PWT will request that OFS develop a "contingency" identifier.

Implementation Date

December 2008

Responsible Manager

Zaida Basora

Recommendation V:

"Dallas: The City That Works: Diverse, Vibrant, and Progressive."

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We recommend the Interim Director of Financial Services / City Controller establish written policies and procedures on the construction-in-progress account to address: how the reconciliation process is conducted; develop computerized routine management analysis and reports to assist in the reconciliation; define the criteria for the project status that should be transferred from construction-in-progress to capital assets; the frequency of reconciliations; management responsibilities and approval; and, a reporting mechanism that documents the reconciliation results.

Management Response / Corrective Action Plan

Agree Disagree Partially Agree

<Insert your response / corrective action plan here.>

Implementation Date

<Insert your implementation date here.>

Responsible Manager

<Insert responsible manager here.>

Recommendation VI:

We recommend the Interim Director of Financial Services / City Controller reconcile construction-in-progress general ledger accounts to the other departments' subsidiary records more frequently than the current annual reconciliation. At a minimum, we recommend quarterly reconciliations.

Management Response / Corrective Action Plan

Agree Disagree Partially Agree

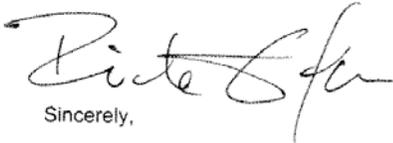
<Insert your response / corrective action plan here.>

Implementation Date

<Insert your implementation date here.>

Responsible Manager

<Insert responsible manager here.>


Sincerely,

"Dallas: The City That Works: Diverse, Vibrant, and Progressive."

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Memorandum

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JUN 05 2008
CITY AUDITOR'S OFFICE



DATE: June 4, 2008

TO: Craig D. Kinton, City Auditor

SUBJECT: Response to Audit Report: Audit of Capital Improvement Program Funds

Office of Financial Services responses to the audit report recommendations III, IV, V and VI are as follows:

Recommendation III:

We recommend the Director of PWT in cooperation with OFS establish written policies and procedures for a "contingency" fund category for each bond program proposition. These procedures should include: the purpose of the fund; describe how the funds are transferred to "contingency" category; management responsibilities and approval of transfers; and, a reporting mechanism that documents the monitoring results and actions taken.

Management Response / Corrective Action Plan

Agree Disagree Partially Agree

Transfer of appropriations from one project to another within a given fund is authorized by the annual capital budget ordinance. OFS will formalize in writing the procedures which are already in place to transfer appropriations including transfers to the contingency.

Implementation Date

October 2008

Responsible Manager

OFS Assistant Director for the Capital Budget

Recommendation IV:

We recommend the Director of PWT in cooperation with OFS ensure all CIP projects are reviewed and any transfer of available funds to the "contingency" category is completed and identified in the Capital Budget.

Management Response / Corrective Action Plan

Agree Disagree Partially Agree

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As part of the preparation of the capital budget, the Capital Budget Division of the Office of Financial Services annually provides instructions to departments regarding the transfer of appropriations for completed projects. The Capital Budget staff ensures that the projects noted as “completed” by the departments do not have any remaining encumbered balances and that the appropriations are equal to the expended amount. Any appropriation variances are corrected. OFS will ensure that all amounts identified as “contingency” are included in the Capital Budget.

Implementation Date

The recommended procedures have been in place and the FY08-09 Capital Budget will identify contingency funds.

Responsible Manager

OFS Assistant Director for the Capital Budget

Recommendation V:

We recommend the Interim Director of Financial Services / City Controller establish written policies and procedures on the construction-in-progress account to address: how the reconciliation process is conducted; develop computerized routine management analysis and reports to assist in the reconciliation; define the criteria for the project status that should be transferred from construction-in-progress to capital assets; the frequency of reconciliations; management responsibilities and approval; and, a reporting mechanism that documents the reconciliation results.

Management Response / Corrective Action Plan

Agree Disagree Partially Agree

The City Controller’s Office has put in place an accounting internal control system designed to increase reliability and provide protection against potential errors or fraud. To ensure reliability of transactions, all capital improvement transactions are verified for accuracy and are required to have proper documentation attached before they can be approved in the fixed asset system. At present, the City Controllers Office (CCO) is building an accounting database system within Microsoft Access for summarizing, organizing and retrieving information. This database system was recently used by CCO as a mechanism for providing the City Auditor and department managers with a report about inactive projects in construction-in-progress. With this report, over \$170 million in construction-in-progress was identified as completed and/or finalized and transferred to capital assets.

In order to ensure construction in progress projects are timely transferred to capital assets, analysis of the Retainage Payable account is an additional mechanism used. In FY 2007, CCO timely transferred \$30 million from construction-in-progress to capital assets using the analysis of retainage payable mechanism. Although this control mechanism has limitations as not all capital improvement projects require retainage payments, it serves as a basis for ensuring completeness of transfers from construction-in-progress to capital assets.

In addition to the retainage payable analysis, the Bond Program Fund/ Unit Summary Report is being used as a mechanism to ensure completeness and timely transfers from construction-in-progress to capital assets. The Fund/ Unit Summary Report is a key indicator about the project status. A project must be at least 95 percent complete in

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order to be transferred to capital assets. In other words, a program which has 5% or less unexpended funds would be considered substantially complete and transferred to capital assets. However, the Fund/ Unit Summary Report alone is not sufficient proof about whether a project is complete or finalized if the unexpended funds exceed 5%. That said, if unexpended funds exceed 5%, further evaluation is required in order to establish proof about whether the project is in fact complete/ finalized.

The construction-in-progress subsidiary records listing is reconciled with the general ledger account annually at fiscal year end. Afterwards, the listing is to be provided to the departments. This listing indicates the accumulated expenditures for each program in construction-in-progress and the amounts transferred to capital assets. Departments will be asked to confirm whether the projects are completed/finalized. Unless a completion memo or other official documentation has already been provided by the department, proper backup support will also be requested.

Written policies and procedures about the above internal accounting control mechanisms are being established to ensure complete, accurate, records and timely transfer of construction-in-progress to capital assets. As of FY 2007, over \$200 million in construction-in-progress has been properly identified and transferred to capital assets using the above control mechanisms that have been put in place.

Implementation Date

Procedures have been revised; written policies will be completed December 2008

Responsible Manager

Fixed Asset Manager

Recommendation VI:

We recommend the Interim Director of Financial Services / City Controller reconcile construction-in-progress general ledger accounts to the other departments' subsidiary records more frequently than the current annual reconciliation. At a minimum, we recommend quarterly reconciliations.

Management Response / Corrective Action Plan

Agree Disagree Partially Agree

At present, internal accounting controls have been designed to detect and prevent misstatements from occurring in the construction-in-progress general ledger account and ensure timely reporting of transfers to capital assets. The following controls have been established and enforced:

- Object code approval process - ensures accuracy and existence
- Capital outlay analysis - ensures completeness of expenditure transactions
- Retainage payable analysis - ensures timely transfer of CIP to capital assets
- Unit Summary Report Analysis - ensures timely transfer of CIP to capital assets
- Communication with departments - provides proper evaluation and verification

Because expenditures are ongoing throughout the fiscal year, the construction-in-progress general ledger is updated annually at fiscal year end. Capital improvement expenditures are extracted from the financial system into a Microsoft Access database to be summarized and organized. The results are then exported into Excel for further analysis. More frequent updated subsidiary records would be less cost effective and

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reduce overall efficiency considering the time resource and complexity of data extracts and analysis.

The construction-in-progress subledger records are reconciled to the audited general ledger account annually. With the subledger records being provided to department managers, the basic intent is for departmental verification and analysis. Departments will be asked to identify any variances between their reports and the CCO subsidiary records. If unusual or significant variances exist, further evaluation will follow in order to identify possible system breaks or opportunities for improvement to the accounting internal controls.

Implementation Date

Procedures have been revised

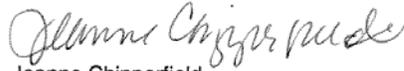
Responsible Manager

Fixed Asset Manager

Sincerely,



Edward R. Scott
City Controller



Jeanne Chipperfield
Interim Budget Director

C: Mary Suhm, City Manager
David Cook, Chief Financial Officer

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Capital Improvement Program Funds Monitoring**

Memorandum

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JUN 18 2008



CITY OF DALLAS

DATE June 18, 2008

TO Craig D. Kinton, City Auditor

CITY AUDITOR'S OFFICE

SUBJECT Response to Audit Report: Audit of Capital Improvement Program Funds

This is to follow up on the referenced audit report, dated April 25, 2008.

Recommendation I:

We recommend the Director of PWT establish written policies and procedures for CIP fund monitoring to address how fund monitoring is conducted, frequency of monitoring, management responsibilities and approval, and a reporting mechanism that documents the monitoring results and actions taken.

Management Response:

Attached is a binder containing all written policies and procedures related to capital projects contract management, and management of funding sources and approvals. Public Works will work with the Office of Financial Services (OFS) to begin updating the information contained in the binder and to specifically address monitoring of CIP funds and the reporting mechanisms to document the results and actions taken in compliance with established guidelines and directives.

Recommendation II:

We recommend the Director of PWT work with OFS and the Department of Communication and Information Services (CIS) to determine if an automated process can be developed to more efficiently and effectively monitor and report CIP fund activities or coordinate with OFS to develop other mechanisms to verify the accuracy and reliability of CIP information provided by PWT and other departments.

Management Response:

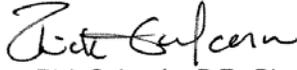
Public Works and OFS will work to establish the criteria by which to evaluate the options related to automating the CIP fund monitoring process. This will include reviewing and assessing the current Prolog software system to determine if it is suitable for this purpose. We intend to have a plan by December of 2008. Public Works and OFS will work with CIS early in 2009 to determine what options are available to automate the CIP fund monitoring process based on the criteria established between Public Works and OFS.

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For your information, included in the information binder, is the Financial Fundamentals manual for the Prolog Software that Public Works currently uses to manage capital projects. The financial capability of Prolog has not been implemented due to its apparent inability to interface with the city's AMS financial software after the upgrade to Advantage 3.

Please contact me if you should have additional questions.



Rick Galcerán, P.E., Director
Public Works and Transportation

Attachments

c: Mary K. Suhm, City Manager
Ramón F. Míguez, P.E., Assistant City Manager
Jeanne Chipperfield, Interim Director, Office of Financial Services
Edward Scott, Interim Director, Office of Financial Services