



Office of the City Auditor

*Committed to increasing government efficiency, effectiveness,
accountability and transparency*

CITYWIDE **Construction Work in Progress Audit** Report#: 2017-05



Issue Date: January 10, 2017

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Umesh Dalal, CFA, CIA, CIG
Richmond City Auditor

Richmond City Council

The Voice of the People

Richmond, Virginia

Office of the City Auditor

Executive Summary

January 10, 2017

Ms. Selena Cuffee-Glenn, CAO

Subject: Construction Work in Progress Audit

Construction costs incurred prior to substantial completion are known as construction work in progress (CWIP). The CWIP balance at the end of FY2015 was \$219.5 million and represented 10% of the City's total capital assets. The City's external auditors issued a qualified opinion on the governmental activities for FY2014 due to City management's inability to accurately determine the total amount of the capital assets. Specifically, management was unable to accurately determine the construction in progress balance and the related in-service dates for any capital projects that had been completed and should have been reclassified as depreciable assets.

Based on the audit observations, inquiries and available evidence, the auditors found that the internal controls over CWIP need the following improvements:

- The Finance Department does not have control over how capital project costs are tracked and accounted for due to the City's decentralized process.
- The City departments are using inconsistent accounting procedures for CWIP. The Finance Department provides minimal guidance regarding the CWIP process to these departments. The City does not have standardized CWIP policies and procedures in place. Further, the Finance Department has not updated its Fixed Assets Policies & Procedures since March 2012. These outdated policies and procedures do not specifically address CWIP.
- In the City's financial system (RAPIDS) Projects and Grants module, project costs are recorded into a default account instead of to the specific project if the project and/or award numbers are entered incorrectly or omitted. The project's costs are understated in the general ledger until corresponding adjustments are made. It is not clear if this issue has been corrected.
- The FY2015 CWIP schedule was inaccurate. Ownership of the Landmark Theater (now known as Altria Theater) was transferred to the Economic Development Authority in FY2013. However, a balance of approximately \$14 million in construction in progress was erroneously carried on the City's books. An adjustment has been made to remove the

amount from the City's CIP balance. In addition, differences totaling approximately \$1.46 million were noted between the general ledger and CWIP schedule balances.

- The in-service date indicates when the capital project is substantially completed. The auditors found that the in-service date documentation did not adequately support the date reported on the CWIP schedule for seven of the 42 projects tested. In addition, it was noted that of the 517 projects on the governmental activities CWIP schedule, there were 100 projects (nearly 20%) with both in-service dates and ending balances. If assets remain in construction work in progress after the projects have been substantially completed, the net capital asset balance is overstated.
- For business-type activities, hundreds of Department of Public Utilities' projects were completed or substantially completed but had not been transferred to the fixed asset in RAPIDS. These projects totaled approximately \$386.7 million. They remain on the active project listing because DPU has not received the inspector's in-service report with the official in-service date. The depreciation for the completed projects without in-service reports is tracked outside of RAPIDS and the net amount (cost less accumulated depreciation) is reported in the City's CAFR.

The City Auditor's Office made four recommendations in this report. The City Administration has concurred with all four recommendations. Their responses are included in Appendix B. Please contact the City Auditor's Office for additional information or responses to any questions.

Sincerely,

Umesh Dalal

Umesh Dalal, CPA, CIA, CIG
City Auditor

cc: The Richmond City Audit Committee
Lenora Reid, DCAO
John Buturla, DCAO
John Wack, Director of Finance

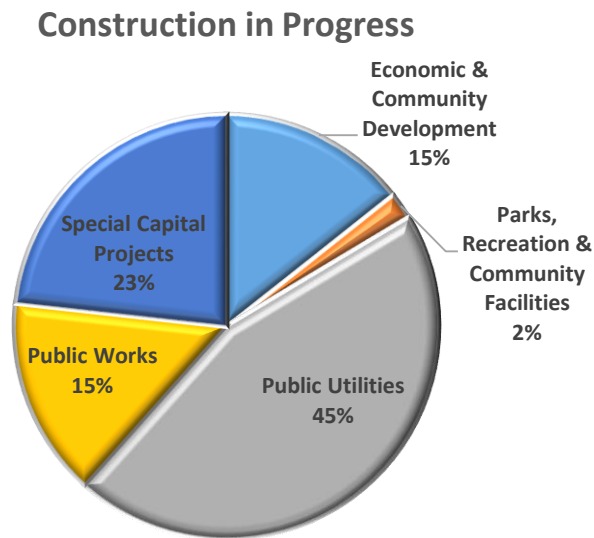
Comprehensive List of Recommendations

#		PAGE
1	The DCAO over Finance and Administration needs to mandate that the Department of Finance create and implement a citywide policy for construction work in progress to ensure uniform accounting practices and consistent recordkeeping.	10
2	The CAO needs to ensure that departments with capital projects comply with the citywide CWIP policy issued by the Department of Finance.	10
3	The DCAO over Finance and Administration needs to require the RAPIDS administrator to add a control that prevents project costs from going to a default account.	10
4	The Finance Director needs to work with the applicable departments to transfer capital projects upon substantial completion to the appropriate major asset classes in a timely manner.	10

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What is Construction Work In Progress (CWIP)?

According to Stephen Gauthier's (Director of the Technical Services Center of the Government Finance Officers Association) *Accounting for Capital Assets*, construction in progress¹ is a major class of capital assets used for costs incurred to construct or develop a tangible or intangible asset before it is substantially ready to be placed in service. Once put into service, the asset is reclassified into the appropriate major class and depreciation is initiated. Below is a breakdown of the City's FY2015 construction in progress by department/division.



Source: Finance's CWIP Schedule and DPU's Active Project Listing

¹ Throughout the audit report, construction work in progress (CWIP) and construction in progress (CIP) are used interchangeably.

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FY2015 CIP Balances:

In FY2015, the City of Richmond (COR) reported construction in progress of \$219.5 million. This balance consisted of \$111.4 million for governmental activities and \$108.1 million for business-type activities. As shown below, construction in progress represents 10 % of the City's total capital assets.

Capital Assets	Governmental Activities	Business-type Activities	Total
Land and Works of Art/Historical Treasures	\$103,247,526	\$30,924,415	\$134,171,941
Infrastructure, Net	\$301,215,671	\$0	\$301,215,671
Buildings, Structures, Improvements, and Equipment, Net	\$480,081,081	\$1,125,354,770	\$1,605,435,851
Construction in Progress	\$111,372,705	\$108,112,709	\$219,485,414
Total Capital Assets, Net	\$995,916,983	\$1,264,391,894	\$2,260,308,877

Source: City of Richmond FY2015 CAFR

Financial Restatements

The FY2014 beginning CIP balances for both governmental and business-type activities were restated. The City identified capital assets recorded in prior years as CIP, which were already placed in service in previous years. Specifically, the CIP balances were reduced by approximately \$67 million for governmental activities and \$176 million for business-type activities.

FY2014 Beginning Balance Restatement		
Capital Assets Changes	Governmental Activities	Business Type Activities
Capital Assets not Depreciated	\$(66,646,111)	\$(176,252,731)
Capital Assets Depreciated	\$67,309,321	\$176,252,731
Accumulated Depreciation	\$11,358,165	\$13,453,377
Total Capital Assets Being Depreciated (Net)	\$55,951,156	\$162,799,354

Source: City of Richmond FY2014 CAFR, Note 17

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In FY2015, the beginning CIP balance for governmental activities was again restated as shown in the table below. The restatement for business-type activities was for the addition of land associated with the Parking Enterprise Fund and not CIP related.

FY2015 Beginning Balance Restatement		
Capital Assets Changes	Governmental Activities	Business Type Activities
Capital Assets not Depreciated	\$(26,601,531)	\$14,268,255
Capital Assets Depreciated	\$(43,303,583)	\$36,732,887
Accumulated Depreciation	\$(4,284,391)	\$3,095,280
Total Capital Assets Being Depreciated (Net)	\$(39,019,192)	\$33,637,607

Source: City of Richmond FY2015 CAFR, Note 17

OBSERVATIONS AND RECOMMENDATIONS

Internal controls need improvement

According to the Government Auditing Standards, internal control, in the broadest sense, encompasses the plan, policies, procedures, methods, and processes adopted by management to meet its mission, goals, and objectives. Internal control includes the processes for planning, organizing, directing, and controlling program operations. It also includes systems for measuring, reporting, and monitoring program performance. An effective control structure is one that provides reasonable assurance regarding:

- Efficiency and effectiveness of operations
- Accurate financial reporting
- Compliance with laws and regulations

Adequate internal controls are critical to ensure the accuracy of the City's CIP balance and proper presentation in the City's financial statements. If the City's CIP information is materially inaccurate, it may result in a material misstatement of financial statements. This can also negatively impact the report of the independent auditors as evident by the issuance of a qualified opinion for the FY14 financial statements². Based on the audit observations, inquiries and available evidence, the internal controls over CWIP need improvement.

² The City's external auditors issued a qualified opinion on the governmental activities for FY2014 due to City management's inability to accurately determine the total amount of the capital assets. Specifically, management was unable to accurately determine the construction in progress balance and the related in-service dates for any capital projects that had been completed and should have been reclassified as depreciable assets.

The following issues are root causes of the weak internal controls over the CWIP process:

1. City's Decentralized Process

The City has a decentralized process for CWIP. This means the Finance Department does not have control over how capital project costs are tracked and accounted.

- The Department of Public Utilities (DPU) performs its own capital asset accounting for the business-type activities and prepares information for the City's Comprehensive Annual Financial Report (CAFR).
- The other departments record expenses via procure to pay, which is used to create the CWIP schedule for governmental activities. For each project, the departments provide Finance with a physical file folder with all related invoices and a summary sheet specifying which costs to capitalize and expense. Finance works with the departments to reconcile projects to the general ledger and record adjusting journal entries as needed.

2. Lack of Guidance and Staff

According to the City staff interviewed, the Finance Department provides minimal guidance regarding the CWIP process. The City does not have standardized CWIP policies and procedures in place. Further, the Finance Department has not updated its Fixed Assets Policies & Procedures since March 2012. These outdated policies and procedures do not specifically address CWIP. Since the implementation of RAPIDS, the individual departments have created their own accounting procedures for CWIP. These procedures are inconsistent and do not always follow generally accepted accounting principles (GAAP). The inconsistencies have resulted in improper reporting in the City's Comprehensive Annual Financial Report (CAFR).

In addition, the Finance Department had a significant number of vacancies including the Fixed Assets Manager position. This position is expected to create and monitor policies and procedures for all fixed assets, including construction in progress. In addition, the Fixed Assets

Manager is responsible for reviewing and updating the CWIP schedule on a regular basis. This situation may have led to inconsistent accounting of certain project costs described as follows:

Capitalized vs Expensed Costs

Based upon audit testing, it was generally noted that project costs were properly capitalized and expensed with minor exceptions described below:

- One of the selected projects consisted of costs totaling approximately \$93,000 for adding bike lane markings to existing roads. The project manager indicated all costs were to be expensed due to the nature of the project. However, the auditors found that during FY14 and FY15 costs of approximately \$7,000 for design and construction were capitalized. An explanation for the different treatment of project costs was not provided to the auditors. The auditors contacted the Virginia Department of Transportation for guidance regarding how to account for pavement markings. According to a VDOT accounting representative, the costs of adding markings are only capitalized if part of a large restorative program. Otherwise, the markings are considered maintenance and the related costs are expensed. Based on this guidance, all of the costs for the bike lane markings should have been expensed.
- New lighting for City ball fields was installed at a cost of \$7,000 by Parks, Recreation and Community Facilities (PRCF). However, these costs were expensed and not capitalized to an asset as they should have been. The project manager did not capitalize these costs due to a lack of guidance on how to record them at the time of expenditure.
- The auditors found landscaping costs totaling approximately \$13,000, which were needed to replace the grass disturbed by installing new sidewalks, were improperly expensed. Unlike DPU's practice of capitalizing landscaping costs incurred in relationship with a capital project, the Department of Public Works (DPW) expensed all of the landscaping costs reviewed by the auditors regardless of the circumstances. In addition, the Department of Parks, Recreation and Community Facilities (DPRCF) expensed the labor

cost of its project managers while DPW capitalized this cost. This represents inconsistent accounting treatment by the City departments.

- The auditors tested project costs totaling approximately \$13.08 million. Sufficient documentation was provided to support costs totaling approximately \$13.04 million. For the remaining costs, either insufficient documentation or no documentation was provided to support them. Also, it was noted that supporting documentation was not readily available. Based upon discussion with the Finance Department staff, it was noted that costs were expensed if invoices/supporting documentation could not be located.

3. System Limitations

In the RAPIDS Projects and Grants module, project costs are recorded into a default account instead of to the specific project if the project and/or award numbers are entered incorrectly or omitted. For example, DPW project costs totaling approximately \$40,000 were excluded from the FY2015 CWIP additions. The project manager on this project indicated some of these costs were captured in a default account. As a result, the project's costs are understated in the general ledger until corresponding adjustments are made. It is not clear if this issue has been corrected. If a control is implemented to prevent project costs from going to a default account, these projects and subsequent depreciable assets would be accurately tracked in the financial system.

In addition to the above, the auditors found the following issues could have been prevented with better monitoring controls:

CWIP schedule was misstated

Based upon testing, it was noted that the FY2015 CWIP schedule was inaccurate as noted below. During this audit, the following specific discrepancies were noted:

- Ownership of the Landmark Theater (now known as Altria Theater) was transferred to the Economic Development Authority (EDA) in FY2013. However, a balance of approximately \$14

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million in construction in progress was erroneously carried on the City's books³. An adjustment has been made to remove the amount from the City's CIP balance.

- Differences⁴ totaling approximately \$1.46 million were noted between the general ledger and CWIP schedule balances as follows for projects with FY15 additions greater than \$500,000:

Project #	Project Name	CWIP Schedule	General Ledger	Difference
100237	Huguenot HS	\$20,100,011	\$21,423,066	(\$1,323,055)
100546	CFP Trans Proj. City	\$9,756,002	\$9,905,431	(\$149,429)
101699	Parker Field Rem	\$2,579,781	\$2,584,617	(\$4,836)
101931	Major Parks	\$515,206	\$544,431	(\$29,225)
101971	Fire Station 10	\$1,407,412	\$1,410,347	(\$2,935)
102954	Main Library – 2 nd Floor	\$902,727	\$849,670	\$53,057

- End of the year FY15 costs totaling approximately \$30,000 were excluded from project balances for five DPW projects.
- FY14 costs totaling approximately \$130,000 were improperly recorded as FY15 additions. The related invoices were paid after the end of the fiscal year.

Assets were not booked in a timely manner

The in-service date indicates when the capital project is substantially completed. The documentation (e.g. AIA's Certificate of Substantial Completion, final invoice, or project closeout form) used to determine the in-service date depends on the nature of the project. The auditors found the in-service date documentation adequately supported the date captured on the CWIP schedule for 35 out of 42 projects tested. Discrepancies between the CWIP schedule and supporting documentation were noted for the seven remaining DPW projects.

³ The City issued general obligation bonds and transferred \$14 million of the proceeds to the EDA for restoration of the Landmark Theater. The bond proceeds were included as revenue in EDA's FY2014 financial statements.

⁴ These differences were not explained and it is not known if they were included with the adjustments made by the external auditors.

In addition, it was noted that of the 517 projects on the governmental activities CWIP schedule, there were 100 projects (nearly 20%) with both in-service dates and ending balances. If assets remain in construction work in progress after the projects have been substantially completed, the net capital asset balance is overstated. Finance should consult with the departments to determine whether these projects are substantially completed and if so, transfer them to the appropriate major asset classes to begin depreciating these assets.

For business-type activities, it was noted that hundreds of DPU projects that were completed or substantially completed had not been transferred to the fixed asset system in RAPIDS. These projects totaled approximately \$386.7 million. They remain on the active project listing because DPU has not received the inspector's in-service report with the official in-service date. According to DPU staff, the policy to submit an in-service report has not been strictly enforced. The depreciation for the completed projects without in-service reports is tracked outside of RAPIDS and the net amount (cost less accumulated depreciation) is reported in the City's CAFR. The auditors confirmed these projects are included in the depreciable capital asset balance. However, the risk of misstating capital assets is greater when depreciation is tracked manually. Further, many of the assets not depreciated in RAPIDS have very old in-service date estimates and an in-service report is unlikely to be obtained. Specifically, there are 621 DPU assets with start dates in FY10 or earlier, including four in 1997. DPU needs to take steps to transfer these assets to the fixed asset system. As for the remaining projects with in-service dates, DPU should obtain the in-service reports as soon as possible. Finally, DPU should enforce the policy of submitting an in-service report upon the completion of all future projects.

Recommendations:

The Auditor's Office offers the following recommendations to assist the Finance Department and departments managing capital projects in strengthening their internal controls over the CWIP function.

- 1. The DCAO over Finance and Administration needs to mandate that the Department of Finance create and implement a citywide policy for construction work in progress to ensure uniform accounting practices and consistent recordkeeping.*
- 2. The CAO needs to ensure that departments with capital projects comply with the citywide CWIP policy issued by the Department of Finance.*
- 3. The DCAO over Finance and Administration needs to require the RAPIDS administrator to add a control that prevents project costs from going to a default account.*
- 4. The Finance Director needs to work with the applicable departments to transfer capital projects upon substantial completion to the appropriate major asset classes in a timely manner.*

Appendix A – Objective, Scope, & Methodology

The City Auditor's Office has completed an audit of the City's construction work in progress (CWIP) function for the 12 month period ended June 30, 2015. The overall objectives of this audit were to:

- Determine if adequate internal controls existed over the construction and accounting processes
- Verify compliance with laws and regulations
- Review the efficiency and effectiveness of construction and financial reporting processes

The auditors conducted this performance audit in accordance with Generally Accepted Government Auditing Standards. Those Standards require the auditors plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for their findings and conclusions based on the audit objectives. The auditors believe the evidence obtained provides a reasonable basis for their findings and conclusions based on the audit objectives.

Scope

The audit scope included the construction work in progress process for the 12 months ended June 30, 2015. The project cost review focused on 43 capital projects. The auditors excluded projects that were tested by the City's FY15 external auditors.

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The audit pertained to the following Departments:

Department	Number of Projects
Department of Public Works	22
Special Capital Projects Group	1
Department of Parks, Recreation and Community Facilities	2
Department of Economic & Community Development	3
Department of Public Utilities (Stormwater and Wastewater funds)	15

Methodology

Below is a detailed list of the objectives of the audit:

1. Determine if adequate internal controls existed over the construction and accounting processes, including the verification of:
 - o Finance's capital assets policy
 - o In-service date documentation
 - o Employee time records
2. Verify compliance with laws and regulations; specifically, the following requirements:
 - o U.S. GAAP
 - o GASB Statement No. 34
3. Review the efficiency and effectiveness of construction and financial reporting processes, which consisted of evaluating the:
 - o Communication between Finance and departments with capital projects
 - o Accuracy of Finance's CWIP schedule

The auditors performed the following procedures to address the above objectives and support the findings and conclusions:

- Reviewed and evaluated relevant policies and procedures;

- Conducted interviews with departmental representatives;
- Vouched FY15 additions to supporting documentation such as vendor invoices and employee timesheets;
- Compared the in-service date in RAPIDS to the date on the appropriate backup document;
- Evaluated a sample of larger payments from the Repairs & Maintenance accounts to ensure that cost for capital assets were not charged to expense;
- Traced completed or substantially completed projects on DPU's Active Project Listing to the depreciable capital asset balance on the Statement of Net Position; and
- Performed other tests, as deemed necessary.

Management Responsibility

City management is responsible for ensuring resources are managed properly and used in compliance with laws and regulations; programs are achieving their objectives; and services are being provided efficiently, effectively, and economically.

MANAGEMENT RESPONSE FORM
2017-05 Construction Work In Progress (CWIP)

APPENDIX B

#	RECOMMENDATION	CONCUR Y/N	ACTION STEPS
1	The DCAO over Finance and Administration needs to mandate that the Department of Finance create and implement a citywide policy for construction work in progress to ensure uniform accounting practices and consistent recordkeeping.	Y	The Director of Finance will work with the Controller to develop a more comprehensive citywide policy for construction work in progress, which will be implemented prior to the commencement of the City's FY2017 audit. The DCAO will ensure this occurs.
	TITLE OF RESPONSIBLE PERSON		TARGET DATE
	City Controller		March 31, 2017
	IF IN PROGRESS, EXPLAIN ANY DELAYS		IF IMPLEMENTED, DETAILS OF IMPLEMENTATION
#	RECOMMENDATION	CONCUR Y/N	ACTION STEPS
2	The CAO needs to ensure that departments with capital projects comply with the citywide CWIP policy issued by the Department of Finance.	Y	The Director of Finance will work with the Controller to develop a more comprehensive citywide policy for construction work in progress, which will be implemented prior to the commencement of the City's FY2017 audit. The CAO will ensure that all departments comply.
	TITLE OF RESPONSIBLE PERSON		TARGET DATE
	City Controller		March 31, 2017
	IF IN PROGRESS, EXPLAIN ANY DELAYS		IF IMPLEMENTED, DETAILS OF IMPLEMENTATION
#	RECOMMENDATION	CONCUR Y/N	ACTION STEPS
3	The DCAO over Finance and Administration needs to require the RAPIDS administrator to add a control that prevents project costs from going to a default account.	Y	The projects and grants module is in need of reconfiguration. The Finance and Administration portfolio is in the process of engaging an outside firm to address the FY2014 audit finding regarding the projects and grants module in RAPIDS. At the conclusion of that engagement, staff will work to establish systematic controls and provide training to the respective departments using that module.
	TITLE OF RESPONSIBLE PERSON		TARGET DATE
	Deputy Director I for Finance & Admin		August 31, 2017
	IF IN PROGRESS, EXPLAIN ANY DELAYS		IF IMPLEMENTED, DETAILS OF IMPLEMENTATION
#	RECOMMENDATION	CONCUR Y/N	ACTION STEPS
4	The Finance Director needs to work with the applicable departments to transfer capital projects upon substantial completion to the appropriate major asset classes in a timely manner.	Y	The Director of Finance will work with the Controller to develop a more comprehensive citywide policy for construction work in progress (to include the transfer upon substantial completion), which will be implemented prior to the commencement of the City's FY2017 audit.
	TITLE OF RESPONSIBLE PERSON		TARGET DATE
	City Controller		March 31, 2017
	IF IN PROGRESS, EXPLAIN ANY DELAYS		IF IMPLEMENTED, DETAILS OF IMPLEMENTATION