

DOUGLAS COUNTY INTERNAL AUDIT DIVISION

**DOUGLAS COUNTY CIP- FIXED ASSETS TESTING
FISCAL YEAR 2008/2009 SPECIAL REPORT - #05**



Douglas County Internal Audit Division

DOUGLAS COUNTY CONSTRUCTION IN PROGRESS FY 2007/2008 ANNUAL TESTING

PURPOSE: To determine construction projects - fixed assets for Douglas County are properly reported, recorded, and processed.

SCOPE: A random selection of 2% (for FY 2007/2008 the sample size is three) of the infrastructure construction projects listed on the Douglas County Construction in Progress (CIP) schedule. (One in progress, one new addition, and one finalized)

SOURCE: FY 2007-2008 worksheets from infrastructure FY 2007/08 bridges and roads (Engineer), and various Douglas County construction projects documents (Finance). Six Year Highway Improvement Plan on the Engineers website.

Note: *Sample selection: **Final project**-check the CIP spreadsheet from Clerk's office Finance (Lee B.). **Addition project**- compare prior year and current six year road plans to determine the projects that are new for the fiscal year. **In progress**- check the Finance spreadsheet and compare with the six year road plan. This will allow you to use the documents compiled by finance w/o going to the engineer. (Unless there is a discrepancy)*

AUDIT STEPS:

STEP (1)

Judgmentally select 2% of the construction projects from the 2007-2008 infrastructures listing in the current year Six year Plan or the Clerk's office Finance CIP worksheet. This selection will include new projects in the fiscal year, continuing CIP projects, and completed and finalized projects in the current fiscal year. (Only finalized projects are assigned asset numbers when they are entered into the Oracle Fixed Asset module and into service)

STEP (2)

Record the total accumulative costs and current fiscal year capitalized¹ cost for each construction project in the fiscal year on the worksheet. Identify the asset number (if spreadsheet does not have this information go to Oracle), project number, transaction number, and reference number, if applicable.

¹ An asset's capitalized cost is the original cost of the asset, plus the present value of replacement, plus the cost of maintenance.

STEP (3)

Prepare a project file for each selection. This file should include, but not limited to, project sub-ledger detail (from Oracle grant module), payment sheets, Oracle project sheets, and spreadsheets used by Engineer's office. Include all information from the Finance file and all information from Oracle.

STEP (4)

If project is over \$20,000, make a copy of the county board resolution authorizing the construction projects or contracts authorizing the purchase of the fixed asset. Copy this document for the file.

STEP (5)

Trace the completed construction project to Oracle fixed assets and determine if it was recorded properly. Verify all adjustments for appropriateness and validity of documentation. Identify the invoice number(s) from the original purchase order. Copy this information to the project spreadsheet.

STEP (6)

For completed/finalized projects only, calculate the monthly depreciation to date of audit. Verify this data with the Journal Entry Reserve Ledger Report for each month (Oracle Fixed Asset module, run report).

Exception # 1 – Period to Date costs of Construction in Progress projects are not recorded in the Douglas County Oracle accounting system.

Criteria: Capital costs incurred during the construction phase are considered to be '*construction in progress*' (CIP) costs that are creating an asset. Costs appropriate to temporarily capitalize (record) as Construction in Progress are all direct costs included in the total cost of the asset.² During this phase, costs are *accumulated and capitalized*; however costs are not *depreciated* during the CIP phase.

Condition: Period to Date (PTD) costs are not recorded in the Oracle Enterprise Resource Planning (ERP) system. The Douglas County Engineer is responsible for the planning, construction management, and maintenance of County roads and bridges. At this time, there are no policies in place to require the Engineers Department to maintain PTD construction costs for Construction in Progress (CIP) projects.

Risk: The accuracy of the data reported in the Douglas County Comprehensive Annual Report (CAFR) cannot be independently verified if PTD costs are not recorded in the county Oracle accounting system. Currently costs reported in the CAFR are maintained on a DC Engineers office internal office spreadsheet (EXCEL) and aggregately reported to the DC Clerk/Comptrollers office annually.

Recommendation: The DC Engineers office should maintain detailed costs for CIP projects in the Oracle accounting system so Period to Date (PTD) costs can be extracted at anytime; independently verified at the end of each fiscal year; and accurately reported on annual financial statements in the Douglas County CAFR.

Exception # 2 - No policies or procedures are in place to require Inception to Date (ITD) costs be recorded in the Oracle accounting system by the end of each fiscal year; or reported on any regular schedule.

Criteria: Inception to Date (ITD) cost data represents an accurate accounting of all accumulated CIP costs to date. Maintaining ITD data permits management to monitor ongoing project costs and better manage limited resources.

Condition: Inception to Date (ITD) cost data is not entered in the Oracle accounting system at the end of the fiscal year or on any regularly scheduled date.

Risk: Not maintaining Inception to Date (ITD) costs increases the possibility that accurate data will not be available in a timely manner for financial statement preparation. Additionally, if ITD data is not maintained, management may not be aware of ongoing project costs and may not be responsive to needed adjustments.

² labor, material, and overhead costs of a construction project

Recommendation: To ensure accurate reporting of financial information for the Comprehensive Annual Financial Report (CAFR), and County records, Inception to Date (ITD) project data should be recorded in the Oracle accounting system on a regular date before the end of every fiscal year.

Note: The Douglas County Engineers office did not integrate information for Construction in Progress prior to July 2002 into the Oracle system; consequently, adding ITD data for construction started before July 2002 is unachievable.

Exception # 3 – Accounting guidance generally directs that upon practical completion, typically defined as the time when the asset is *available for use*, CIP project capitalized costs should be transferred to an appropriate fixed-asset type account (building, road, etc.), deleted from the CIP subsystem account, and depreciated according to the determined useful life schedule. Current practice in Douglas County does not follow accounting standards guidance. This is a recurring finding.

Criteria: Accounting guidance directs that upon practical completion, typically defined as when an asset is *available for use*, construction capitalized costs should be transferred to an appropriate fixed-asset type account (building, road, etc.), deleted from the CIP subsystem account, and depreciated according to the determined useful life schedule.

Condition: The DC Engineers office does not enter an actual completion date or identify a date when projects become "available for use." This makes it difficult to identify the date when a CIP project is "final." Currently, when all monies for a construction project are collected and/or paid, the project is listed on a spreadsheet prepared by the Douglas County Engineers office and reported to the Douglas County Clerk's Finance Division. There are no formal written policies or procedures in place guiding this process.

Risk: Without a formal process in place to identify completion dates for Douglas County construction projects it is possible to misstate fiscal year reported depreciated asset values. Accumulated depreciation is reported in government-wide financial statements.

Recommendation: Douglas County Internal Audit Division recommends that the Douglas County Engineer's office, with assistance from the Douglas County Clerk's office Finance Division, adopt formal written policies and procedures for these processes and identify an agreed upon definition of '*practical completion*' that permits timely reporting of construction information.

Exception # 4 - Any capital costs incurred subsequent to practical completion, which result in an improvement in the value of the capital item, should be recorded and identified as an *asset cost adjustment*.

Criteria: Accounting guidance for asset cost adjustment directs; if capitalized repair or maintenance replaces a part of original construction, the cost of the original item replaced or repaired may not be known because it was included in the total

purchase price. If the cost of the item (roof, AC unit, windows, etc.) is not easily identifiable, no adjustment is required to the fixed asset record. If the cost of the item is easily identifiable (construction addition, etc.) the cost of the subsequent adjustment should be recorded and depreciated over the shorter of the remaining useful life of the original structure or the useful life of the repair.

Condition: A subsequent addition, to a fixed asset that was depreciated, was assigned a new asset number and depreciated on a schedule one year later than the original asset.

Risk: Identifying subsequent additions as separate assets, and depreciating the asset on a different schedule than the original asset may cause depreciation to be overstated at the end of an asset depreciation term.

Recommendation: Any capital costs incurred subsequent to practical completion, which result in an improvement in the value of the capital item, should be recorded and identified as an *asset cost adjustment*. If the asset addition is assigned a new asset number, the asset should be depreciated using the same convention and schedule as the original asset. If the asset addition is not assigned a separate number, the cost of the addition should be added to the original asset, depreciated on the same schedule as the original asset and identified as a subsequent adjustment.

Resolution of prior report exception: For depreciation purposes, all projects finalized in FY 2008 have an in service date of FY 2008, and a prorate date of January 1, 2008. While the practice of not entering completed CIP projects into the Oracle system in a timely manner was identified as a finding in the FY 2007 Douglas County Internal Audit Division (DCIAD) Construction in Progress Annual Testing report, this finding is not substantiated by GASB 34 requirements.

To avoid the complication of depreciating an asset from the specific date on which it was placed in service, Generally Accepted Accounting Principles (GAAP) support guidelines that assume various assets are placed in service on designated dates throughout the year. These guidelines are called averaging conventions. There are five averaging conventions: (1) Full-Month, (2) Half-Year, (3) Modified Half-Year, (4) Mid-Month, and (5) Mid-Quarter. It is recommended that government entities use the full-month convention; however, Douglas County has chosen to use the Half-Year Convention. Under the Half-Year Convention, an asset is treated as though it were placed in service on the first day of the seventh month of the fiscal year, in this case January 1. One-half of a full year's depreciation is allowed for the asset in its first year placed in service, regardless of when it was actually placed in service during that year.

DCIAD Staff participants in Special Report FY 2008/2009 - #05

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