Executive Summary

Purpose of the Audit

Baker Tilly, in its capacity serving as the Office of the City Auditor, performed a review of asset capitalization focusing on construction in progress (CIP) in accordance with the FY2021 Audit Plan approved by City Council. The objectives of this review were to:

1) Identify the cause of the $12.6M capital asset adjustment made during FY2020 by evaluating the process to record and report the costs associated with CIP

2) Determine whether adequate controls are in place to ensure that costs associated with CIP are properly categorized and recorded in accordance with the accounting policy and relevant accounting standards

Report Highlights

Finding:  
(Page 9)

Description of Finding

The cause of the $12.6M adjustment, initiated by City staff, made to the CIP account in FY2020, which was to remove improperly capitalized costs, was due to staff’s incomplete execution of a periodic review and correction of the costs in the CIP account, a key internal control, in previous years.

The following current CPI processing practices cause difficulties in executing a periodic review of the costs effectively:

- Capital projects are set up using work breakdown structure (WBS) elements to track Design and Construction tasks, not to track capitalizable and non-capitalizable costs separately.
- All costs are settled to the CIP account on a monthly basis whether or not costs are capitalizable. Some projects are described as recurring maintenance and repair projects for which all costs are expenses and should be settled to cost centers (expense), not to the CIP account (capitalizable costs).
- The Fixed Asset Policy is outdated and does not provide a robust CIP policies and procedures including the criteria for categorizing project costs and the required actions by various responsible parties for initiating and tracking the project costs for proper capitalization in the SAP system.

Key Recommendations

- Create capital projects in the SAP system in a manner that WBS elements are set up to keep track of capitalizable and non-capitalizable costs separately. Non-capitalizable costs should be settled to cost centers.
- Formalize a periodic review of the CIP account by establishing and following a review schedule, documenting a review, and requiring a supervisory review and approval.
- Implement a mechanism to receive the status of the project completion and assets placed in service from the responsible departments in a timely manner.
- Periodically review the fixed asset policies and enhance the CIP section in the policies to provide guidance regarding the CIP process to the accounting team and the responsible parties such as the Office of Management and Budget, Business Analysts, and project managers.
# Table of Contents

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Introduction

Objective

The purpose of this review was to:
1) Identify the cause of the $12.6M capital asset adjustment made during FY2020 by evaluating the process to record and report the costs associated with construction in progress (CIP)
2) Determine whether adequate controls are in place to ensure that costs associated with CIP are properly categorized and recorded in accordance with the accounting policy and relevant accounting standards

Background

Approximately 110 projects had activities during FY2020 and/or had balances as of the end of FY2020 in the CIP account for governmental activities. These projects are included in the current or prior years’ Adopted Capital Budget that provides the details such as project descriptions and completion schedules.

In FY2020, City of Palo Alto (the City) recorded a $12.6M adjustment to the $142.1M CIP balance (out of $596.3M capital assets as of 6/30/2020) (Appendix A) for governmental activities to correct the improperly capitalized expenses in the CIP account. The adjustment was made to write off the expenses that should have been reported as part of Public Works functional expenses in the year the costs were incurred but instead reported as capital assets in prior years. This adjustment was discussed during the Finance Committee meeting on December 1, 2020.

The CIP account consists of the costs of construction projects undertaken but not yet completed. It is reported as nondepreciable capital assets and includes costs such as direct labor costs, overhead allocations, materials, and other costs incurred in placing an asset in service. Once an asset is in service, the associated CIP costs are reclassified to the appropriate assets such as buildings, and then the costs of an asset are expensed over the life of an asset through depreciation. On the other hand, the costs for maintenance and repair projects to retain the current condition and value rather than adding value or extending the useful life of assets are expensed as incurred.

Excerpts from City of Palo Alto Fixed Asset Policy

Construction-in-Progress
Construction-in-Progress (CIP) consists of construction projects subject to capitalization.

Maintenance
Maintenance expenses keep assets in normal operating condition and do not extend the life of the asset beyond the expected useful life determined at acquisition. Therefore, maintenance costs are expensed and not capitalized.

As shown in the Table 1, the CIP account balances have been increasing over the years, especially from 2018 to 2019.
Table 1: CIP Balances – Governmental Fund / Internal Service Fund

|-------------|-----------|-----------|-----------|-----------|-----------|-----------|

Source: City of Palo Alto Comprehensive Annual Financial Report

Process Overview

The accounting team is responsible for processing capital asset transactions in the SAP system while Office of Management Budget is responsible for initially setting up a project in the SAP system based on the annual adopted budget.

In the SAP system, the City tracks projects costs using work breakdown structure (WBS) elements. Each project can have multiple WBS elements to allow project tasks to be organized into a hierarchy to track capitalizable and non-capitalizable costs separately (Figure 1). The costs on a WBS element can be allocated (or “settled”) periodically to either cost centers (for non-capitalizable costs) or the CIP account (for capitalizable costs) using a Settlement Rule.

The flowchart in Appendix B shows the current CIP process for Governmental Fund and Internal Service Fund. The City currently uses WBS elements to track the costs for Design and Construction tasks separately. Costs (timecards and invoices) are entered in the SAP Financial Accounting module with a WBS number and then posted in the SAP Project System module. On a monthly basis, a Sr. accountant runs a settlement rule to settle costs to the CIP account in the SAP Asset Accounting module.

The key controls in tracking and recording the project costs in the CIP account are:

- Periodically reviewing the costs recorded in the CIP cost centers (SAP Financial module) to ensure that a project identifier (i.e. WBS) is recorded for each cost
- Periodically reviewing the costs recorded for the CIP projects (SAP Project module) to ensure that (1) non-capitalizable costs are removed from the CIP account and settled to appropriate cost centers no later than the end of the fiscal year and (2) capitalizable costs are reclassified to fixed assets as soon as assets are placed in service
- A mechanism to identify the completed projects and assets placed in service
The Baker Tilly team focused on the processes and controls encompassing costs recorded in the CIP account for governmental activities. We reviewed the details of the CIP costs and projects adjusted in FY2020. We also interviewed the accountants, Office of Management and Budget personnel, and Departmental and Software Business Analysts.

**Methodology**

The Baker Tilly team performed the following procedures to understand the nature of the adjusted costs and projects and the circumstance of the adjustment:

- Reviewed the FY2020 $12.6M CIP adjustment worksheet listing project names, cost details, and adjustments
- Reviewed the project information in FY2016 – FY2021 Adopted Capital Budget documents
- Interviewed the accountants who identified and processed the adjustments

We also performed the following procedures to assess the process and internal controls in place to track and record the cost associated with CIP:

- Reviewed the fixed asset policies
- Interviewed the accountants to discuss the process and internal controls in place
- Reviewed the documents evidencing the key controls in place
- Interviewed an SAP Function Business Analyst to learn the basic SAP system configuration
- Interviewed the Office of Management Budget personnel to understand the project setup in the SAP system
- Reviewed the best practices by discussing with the subject matter expert at Baker Tilly and by researching various fixed asset policies

**Compliance Statement**

This audit activity was conducted from March 2021 to May 2021 in accordance with generally accepted government auditing standards, except for the requirement of an external peer review. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

The Office of the City Auditor greatly appreciates the support of the Administrative Services Department in conducting this audit activity.

**Thank you!**

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1 Government auditing standards require an external peer review at least once every three (3) years. The last peer review of the Palo Alto Office of the City Auditor was conducted in 2017. The Palo Alto City Council approved a contract from October 2020 through June 2022 with Baker Tilly US, LLP (Baker Tilly) and appointed Kyle O’Rourke, Senior Consulting Manager in Baker Tilly’s Public Sector practice, as City Auditor. Given the transition in the City Audit office, a peer review was not conducted in 2020 and will be conducted in the second year of Baker Tilly’s contract.
Detailed Analysis

FY2020 $12.6M Adjustment

The Baker Tilly team reviewed the costs and projects adjusted in the CIP account in FY2020 and interviewed the accountants who identified and processed the adjustments to understand the nature and circumstances of the adjustments.

The FY2020 CIP adjustment was part of the concentrated effort of CIP account review that started in FY2019. The accountants made some adjustments in FY2019 ($2.5M) and continued their efforts in FY2020, which resulted in the $12.6M adjustment. They expect their CIP account review to be up to date in FY2021.

Summarized in the table on the next page is the information obtained from the FY2020 CIP worksheet and schedule, Adopted Capital Budget documents, and the fixed asset accountants. We learned that:

- The adjustments were made for 21 projects.
- All costs remaining in the CIP account were written off by the FY2020 adjustment for 17 projects, as those costs were non-capitalizable (Column F). It was noted that many project names indicate repair and maintenance for which costs are to be expensed (i.e. non-capitalizable costs).
- Out of 21 projects, 13 projects were recurring projects (Column D) for which the types of costs (capitalizable and non-capitalizable) can be predictable to determine how the costs should be settled.
- The older expenses included in the FY2020 CIP balances were incurred in FY2010 through FY2018 (Column E) and totaled approximately $8.3M.
- The capitalizable costs totaling $473K for four (4) projects were reclassified to fixed assets in FY2020 (Column F), but some of them were completed or purchased in FY2012, FY2013, or FY2014.
  - The identified fixed assets included:
    - Public Art
    - Software, machine, and installation service that improved parking
    - Newly installed streetlights
    - Building automation
  - The costs that were written off included:
    - Temporary public art
    - Consultant
    - Study/Survey
    - Design
    - Payroll
    - Miscellaneous costs
    - Supplies and materials related to repairs and maintenance
### Table 2: Summary of $12.6M Adjustment by Project

<table>
<thead>
<tr>
<th>A Project Number</th>
<th>B Description</th>
<th>C Prior year expenses written off in FY2020</th>
<th>D Scheduled Project End Date</th>
<th>E Costs recorded in CIP in:</th>
<th>F Nature of Adjustments</th>
</tr>
</thead>
<tbody>
<tr>
<td>AC-14001</td>
<td>Baylands Facility &amp; Exhibit Improvements</td>
<td>(53,738)</td>
<td>FY2019</td>
<td>FY2017 - FY2019</td>
<td>Removed all costs recorded in CIP</td>
</tr>
<tr>
<td>AC-86017</td>
<td>Art In Public Places</td>
<td>(82,589)</td>
<td>Recurring</td>
<td>FY2019</td>
<td>In addition to the written-off costs, there were FY2019 costs moved to fixed assets</td>
</tr>
<tr>
<td>OS-00001</td>
<td>Open Space Trails &amp; Amenities</td>
<td>(286,674)</td>
<td>Recurring</td>
<td>FY2019 &amp; FY2020</td>
<td>Removed all costs recorded in CIP</td>
</tr>
<tr>
<td>OS-09001</td>
<td>Off-Road Pathway Resurfacing and Repair</td>
<td>(493,062)</td>
<td>Recurring</td>
<td>FY2010 - FY2020</td>
<td>Removed all costs recorded in CIP</td>
</tr>
<tr>
<td>PE-09003</td>
<td>City Facility Parking Lot Maintenance</td>
<td>(1,066,648)</td>
<td>Recurring</td>
<td>FY2014 - FY2019</td>
<td>Removed all costs recorded in CIP</td>
</tr>
<tr>
<td>PE-15020</td>
<td>Civic Center Waterproofing Study</td>
<td>(54,493)</td>
<td>Spring 2021</td>
<td>FY2016 - FY2019</td>
<td>Removed all costs recorded in CIP</td>
</tr>
<tr>
<td>PE-15028</td>
<td>Baylands Levee Improvements</td>
<td>(503,097)</td>
<td>Fall 2017</td>
<td>FY2015, 2016, 2019</td>
<td>Removed all costs recorded in CIP</td>
</tr>
<tr>
<td>PE-17002</td>
<td>CIP City Hall Floor 3 Remodel</td>
<td>(22,355)</td>
<td>Fall 2018</td>
<td>FY2019</td>
<td>Removed all costs recorded in CIP</td>
</tr>
<tr>
<td>PE-17006</td>
<td>Baylands Flood Protection Levee Improvement</td>
<td>(266,666)</td>
<td>Fall 2021</td>
<td>FY2018 &amp; FY2019</td>
<td>Removed all costs recorded in CIP</td>
</tr>
<tr>
<td>PE-17008</td>
<td>CIP City Hall Floor 4 Remodel</td>
<td>(533,727)</td>
<td>Winter 2018</td>
<td>FY2017 - FY2020</td>
<td>Removed all costs recorded in CIP</td>
</tr>
<tr>
<td>PE-17009</td>
<td>CIP City Hall Floor 5 Remodel</td>
<td>(562,410)</td>
<td>Fall 2017</td>
<td>FY2017 - FY2020</td>
<td>Removed all costs recorded in CIP</td>
</tr>
<tr>
<td>PE-18002</td>
<td>High St Parking Garage Waterproofing &amp; Repairs</td>
<td>(31,728)</td>
<td>Spring 2021</td>
<td>FY2018 - FY2020</td>
<td>Removed all costs recorded in CIP</td>
</tr>
<tr>
<td>PF-00006</td>
<td>Roofing Replacement</td>
<td>(996,598)</td>
<td>Recurring</td>
<td>FY2018 - FY2020</td>
<td>Removed all costs recorded in CIP</td>
</tr>
<tr>
<td>PF-02022</td>
<td>Interior Finishes Construction</td>
<td>(75,238)</td>
<td>Recurring</td>
<td>FY2019 &amp; FY2020</td>
<td>Removed all costs recorded in CIP</td>
</tr>
<tr>
<td>PF-15005</td>
<td>Emergency Facility Improvements</td>
<td>(146,408)</td>
<td>Recurring</td>
<td>FY2015 - FY2017</td>
<td>Removed all costs recorded in CIP</td>
</tr>
<tr>
<td>PG-09002</td>
<td>Parks &amp; Open Space Emergency Repairs</td>
<td>(812,793)</td>
<td>Recurring</td>
<td>FY2012 - FY2020</td>
<td>Removed all costs recorded in CIP</td>
</tr>
<tr>
<td>PL-12000</td>
<td>Transportation and Parking Improvements</td>
<td>(2,405,358)</td>
<td>Recurring</td>
<td>FY2012 - FY2020</td>
<td>In addition to the written-off costs, there were FY2012-18 costs moved to fixed assets</td>
</tr>
<tr>
<td>PO-05054</td>
<td>Street Lights Improvements</td>
<td>(534,469)</td>
<td>Recurring</td>
<td>FY2012 - FY2020</td>
<td>In addition to the written-off costs, there were FY2017 costs moved to fixed assets</td>
</tr>
<tr>
<td>PO-12001</td>
<td>Curb &amp; Gutter Repairs</td>
<td>(1,561,525)</td>
<td>Recurring</td>
<td>FY2012 - FY2020</td>
<td>Removed all costs recorded in CIP</td>
</tr>
<tr>
<td>CB-16002</td>
<td>Cubberley Roof Replacements</td>
<td>(1,794,232)</td>
<td>Recurring</td>
<td>FY2017 - FY2020</td>
<td>Removed all costs recorded in CIP</td>
</tr>
<tr>
<td>CB-17001</td>
<td>Cubberley Repairs</td>
<td>(327,830)</td>
<td>Recurring</td>
<td>FY2018 - FY2020</td>
<td>In addition to the written-off costs, there were FY2018 costs moved to fixed assets</td>
</tr>
<tr>
<td><strong>TOTAL ADJUSTMENTS</strong></td>
<td></td>
<td><strong>(12,611,640)</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Audit Results

Finding

The cause of the $12.6M adjustment made to the CIP account in FY2020 to remove improperly capitalized costs was incomplete execution of a key internal control, a periodic review and correction of the costs in the CIP account, in previous years.

The accountants initiated a detailed review of the costs in the CIP account in FY2019 when they noticed the increase in the CIP account balance and continued their concentrated efforts in FY2020. Their review identified that the costs recorded in previous years (FY2010 through FY2019) had to be written off ($12.6M) or were supposed to be reclassified to the appropriate assets in previous years ($473K). This demonstrates that a periodic review of costs for CIP projects (a key internal control) to mitigate a risk of improperly reporting capital assets in the City’s government-wide financial statements was not performed. Otherwise, these costs would have been properly reported as expenses in the year the costs were incurred or as other capital asset items when an asset was placed in service. Additionally, the assets could not be depreciated until they were reclassified from the CIP account.

According to the City’s Fixed Asset Policy, the costs in the CIP account should be reclassified to the appropriate assets upon the earlier occurrence of substantial completion, occupancy, or when the asset is placed into service, and maintenance costs are expensed and not capitalized. The Governmental Accounting Standards Board (GASB) Statement 34 requires that capital assets be depreciated over their estimated useful lives.

The following current practices appear to cause difficulties in executing a periodic review of the costs in the CIP account effectively:

- The Office of Management Budget sets up Capital projects using WBS elements to track Design and Construction tasks for a budgeting and departmental planning purposes, not to track capitalizable and non-capitalizable costs separately for an accounting purposes. As a result, both types of costs are included in one WBS element. This process requires more efforts to review costs to ensure proper classification. It was noted that Enterprise Fund uses a work order system in which operation work orders are settled to cost centers and expensed and capital service orders are used for capitalizable costs and settled to the CIP account.

- All costs are settled to the CIP account on a monthly basis whether or not costs are capitalizable. Some projects are described as recurring maintenance and repair projects for which all costs are expenses (unless a repair project evolves into a project requiring capitalization), and therefore, they should be settled to cost centers, not to the CIP account. As a result, there are more costs to be reviewed and removed in the CIP account than necessary.

- Fixed Asset Policies have not been reviewed and updated since 2012. There are two Fixed Asset Policies: Fixed Asset Policy for General Fund and Internal Service Fund is dated March 2012; Enterprise Fixed Asset Policy is dated March 2014. The Fixed Asset Policy for General Fund and Internal Service Fund
includes only a paragraph for CIP regarding the requirements for a periodic review and timely recording of fixed assets. It does not provide a robust CIP policies and procedures including the criteria for categorizing project costs and the required actions by various responsible parties for initiating and tracking the project costs for proper capitalization in the SAP system. It was noted that only the Enterprise Fixed Asset Policy requires periodic submission of a capitalization and retirement form from the departments.

**Recommendation**

The City should strengthen the internal controls over CIP to ensure that capital project costs are properly recorded and reported by implementing the following:

1. Capital projects should be created in the SAP system in a manner that WBS elements are set up to keep track of capitalizable and non-capitalizable costs separately. Non-capitalizable costs should be settled to cost centers. The accounting team should work with the Office of Management and Budget personnel and Business Analysts to define the criteria and procedures and to maximize the use of the SAP functionality to improve the efficiency and effectiveness of the process. As the City is planning to improve the SAP functionality in FY2022, the accounting team should take this opportunity to ensure the SAP system will be configured to meet their needs.

2. The costs recorded in the CIP account should be reviewed periodically to ensure expenses are removed and costs for the completed assets are reclassified in a timely manner. To ensure that this key control works effectively after the concentrated efforts end in FY2021, the accounting team should formalize the process by establishing and following a review schedule, documenting a review, and requiring a supervisory review and approval.

3. The accounting team should implement a mechanism to receive the status of the project completion and assets placed in service from the responsible departments in a timely manner. Although a fixed asset accountant reviews the annual and mid-year budget documents and occasionally reach out to the departments, this internal control should be formalized and performed more effectively to ensure that the costs are reclassified to assets and start depreciation (if applicable) in a timely manner.

4. The accounting management should enhance the CIP section in the policies to provide guidance regarding the CIP process to the accounting team and the responsible parties such as the Office of Management and Budget, Business Analysts, and project managers. The CIP policies and procedures should include the requirement for project setup, a periodic review of project costs, monitoring and reporting the project completion status, and so on. Additionally, the accounting management should evaluate and update the fixed asset policies periodically to ensure that requirements are appropriate for the current process, system used, and accounting standards. According to Government Finance Officers Association, this should be done no less than once every three years based on a predetermined schedule.
## Appendix

### Appendix A: Page 72 of FY2020 Comprehensive Annual Financial Report

CITY OF PALO ALTO  
Notes to the Basic Financial Statements  
For the Year Ended June 30, 2020

### NOTE 6 – CAPITAL ASSETS (Continued)

#### Governmental Activities

Changes in the capital assets for governmental activities during the year ended June 30, 2020 were (in thousands):

<table>
<thead>
<tr>
<th></th>
<th>Balance July 1, 2019</th>
<th>Additions</th>
<th>Retirements</th>
<th>Transfers</th>
<th>Balance June 30, 2020</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Governmental activities</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Nondepreciable capital assets:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Land and improvements</td>
<td>$ 77,575</td>
<td>$ 1,930</td>
<td>$ -</td>
<td>$ 2,701</td>
<td>$ 82,206</td>
</tr>
<tr>
<td>Street trees</td>
<td>14,720</td>
<td>143</td>
<td>(75)</td>
<td>-</td>
<td>14,787</td>
</tr>
<tr>
<td>Intangible assets - Easement</td>
<td>3,567</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>3,567</td>
</tr>
<tr>
<td>Construction in progress</td>
<td>104,465</td>
<td>57,457</td>
<td>(12,612)</td>
<td>(9,945)</td>
<td>139,365</td>
</tr>
<tr>
<td><strong>Total nondepreciable capital assets</strong></td>
<td>200,327</td>
<td>59,530</td>
<td>(12,688)</td>
<td>(7,244)</td>
<td>239,925</td>
</tr>
<tr>
<td><strong>Depreciable capital assets:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Buildings and structures</td>
<td>247,274</td>
<td>607</td>
<td>-</td>
<td>3,238</td>
<td>251,119</td>
</tr>
<tr>
<td>Intangible assets - Software</td>
<td>279</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>279</td>
</tr>
<tr>
<td>Equipment</td>
<td>12,600</td>
<td>17</td>
<td>(14)</td>
<td>3,134</td>
<td>15,737</td>
</tr>
<tr>
<td>Roadway network</td>
<td>334,330</td>
<td>-</td>
<td>-</td>
<td>872</td>
<td>335,202</td>
</tr>
<tr>
<td>Recreation and open space network</td>
<td>35,186</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>35,186</td>
</tr>
<tr>
<td><strong>Total depreciable capital assets</strong></td>
<td>619,669</td>
<td>624</td>
<td>(14)</td>
<td>7,244</td>
<td>637,523</td>
</tr>
<tr>
<td><strong>Less accumulated depreciation:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Buildings and structures</td>
<td>(98,657)</td>
<td>(7,327)</td>
<td>-</td>
<td>-</td>
<td>(105,984)</td>
</tr>
<tr>
<td>Intangible assets - Software</td>
<td>(279)</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>(279)</td>
</tr>
<tr>
<td>Equipment</td>
<td>(8,376)</td>
<td>(494)</td>
<td>14</td>
<td>-</td>
<td>(8,856)</td>
</tr>
<tr>
<td>Roadway network</td>
<td>(163,779)</td>
<td>(7,743)</td>
<td>-</td>
<td>-</td>
<td>(171,522)</td>
</tr>
<tr>
<td>Recreation and open space network</td>
<td>(14,613)</td>
<td>(1,254)</td>
<td>-</td>
<td>-</td>
<td>(15,867)</td>
</tr>
<tr>
<td><strong>Total accumulated depreciation</strong></td>
<td>(285,704)</td>
<td>(16,818)</td>
<td>14</td>
<td>-</td>
<td>(302,508)</td>
</tr>
<tr>
<td><strong>Depreciable capital assets, net</strong></td>
<td>343,965</td>
<td>(16,194)</td>
<td>-</td>
<td>7,244</td>
<td>335,015</td>
</tr>
<tr>
<td><strong>Internal service fund capital assets</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Construction in progress</td>
<td>2,530</td>
<td>3,176</td>
<td>-</td>
<td>(2,983)</td>
<td>2,723</td>
</tr>
<tr>
<td>Equipment</td>
<td>62,307</td>
<td>18</td>
<td>(1,832)</td>
<td>2,983</td>
<td>63,476</td>
</tr>
<tr>
<td><strong>Less accumulated depreciation:</strong></td>
<td>(43,026)</td>
<td>(3,366)</td>
<td>1,558</td>
<td>-</td>
<td>(44,834)</td>
</tr>
<tr>
<td><strong>Net internal service fund capital assets</strong></td>
<td>21,811</td>
<td>(172)</td>
<td>(274)</td>
<td>-</td>
<td>21,365</td>
</tr>
</tbody>
</table>

**Governmental activities capital assets, net**  
$ 566,103  $ 43,164  $(12,962)  $ -  $ 596,305
Appendix B: CIP processes for Governmental Fund/Internal Service Fund and Enterprise Fund

Construction in Progress - Governmental Fund/Internal Service Funds

**Office of Management and Budget**

- **Budgeting process**
  - Budget is adopted
  - New project with dummy project code

- **SAP PS**
  - Create new project
  - System-generated/project code
  - WBS #
  - Cost Center

**Fixed Asset Accountant (Governmental & Internal Service Funds)**

- **SAP FI**
  - Capital Project Fund 471/472
  - Capital outlay - CIP CC #
  - WBS #
  - Exp AC #

**SAP PS**

- Data with WBS # in SAP FI gets posted

**Payroll & AP**

- Run ZPSR 01 Detail report
- Populates spreadsheet CIP 471 N
- Roll Forward
- Quarterly Review all costs posted in each CIP #

- Program: G13 (CIP Cost Center)
  - Report:
    - Run Settlement Rules
    - Review CIP projects with CIP cost centers for missing WBS

**Fixed Asset Accounting Supervisor**

- **SAP FI**
  - Capital Project Fund 471/472
  - Construction in Progress

- **End of posting process**

- **SAP FI AA**
  - Create new Fixed Asset #
  - Move CIP to Fixed Assets

- **End of posting process**

**External Auditor**

- Review the spreadsheet
  - Manual approval – signature on hard copy, e-mail, comments in spreadsheet, meetings

- **March/April**
  - Mid-year Budget Review Report

- **SAP FI AA**
  - Create new Fixed Asset #
  - Move CIP to Fixed Assets

- **Run ZFIR 43**
  - Profit & Loss Report

- **Year-end reconciliation of Fixed Assets and Capital Outlay**

- **Schedule N-10**

- **End of posting process**

**Note:**

- WBS elements are not set up to separate capitalizable costs and non-capitalizable costs.
- Capitalizable costs and non-capitalizable costs are mixed in a WBS element. Therefore, all costs are settled to CIP.
- Costs to be reviewed by one accountant.
- Review the spreadsheet.
- Approve the corrective actions.
- Manual approval – signature on hard copy, e-mail, comments in spreadsheet, meetings.

**Occasionally**

- Check with departments for completed projects.
- Adjustments needed?

**Mid-year**

- Run G13 (CIP Cost Center) Report

**Monthly**

- Run Settlement Rules
- Review CIP projects with CIP cost centers for missing WBS

**Quarterly**

- Review all costs posted in each CIP #
- Note corrective actions, if any, in the spreadsheet
- Process transactions for correction

**Month-end**

- Review CIP projects with CIP cost centers for missing WBS
- Define Settlement Rules
- Review CIP projects with CIP cost centers for missing WBS

**Year-end**

- Run Program: G13 (CIP Cost Center)
- Report
  - Run Settlement Rules
  - Review CIP projects with CIP cost centers for missing WBS

**Adjustment needed?**

- Yes
  - Program: G13 (CIP Cost Center)
  - Report
    - Run Settlement Rules
    - Review CIP projects with CIP cost centers for missing WBS

**No Action Necessary**

- No
  - Program: G13 (CIP Cost Center)
  - Report
    - Run Settlement Rules
    - Review CIP projects with CIP cost centers for missing WBS

**WBS elements are not set up to separate capitalizable costs and non-capitalizable costs.**

**Current year’s non-capitalizable costs are not settled to Cost Center.**

- [But, this is the way to correct prior year costs]

**Fixed Asset Policy**

- Dated March 2012
- Has not been reviewed/updated

**Fixed Asset Accounting Supervisor**

- Review the spreadsheet
- Approve the corrective actions
- Manual approval – signature on hard copy, e-mail, comments in spreadsheet, meetings

**Need improvement**

- Manual approval – signature on hard copy, e-mail, comments in spreadsheet, meetings

- WBS elements are not set up to separate capitalizable costs and non-capitalizable costs.
- Capitalizable costs and non-capitalizable costs are mixed in a WBS element.
- Therefore, all costs are settled to CIP.
- Costs are settled to CIP. So many to be reviewed by one accountant.
- Current year’s non-capitalizable costs are not settled to Cost Center. [But, this is the way to correct prior year costs]
- Dated March 2012
- Has not been reviewed/updated

**Construction in Progress - Governmental Fund/Internal Service Funds**

Office of Management and Budget

Fixed Asset Accountant

Payroll & AP

Fixed Asset Accounting Supervisor
## Appendix C: Management Response

<table>
<thead>
<tr>
<th>Recommendation</th>
<th>Responsible Department(s)</th>
<th>Agree, Partially Agree, or Do Not Agree and Target Date and Corrective Action Plan</th>
<th>To be completed 6 months after Council acceptance and every 6 months thereafter until all recommendations are implemented</th>
</tr>
</thead>
<tbody>
<tr>
<td>Finding: The costs in the CIP account were not reviewed and corrected in a timely manner in previous years</td>
<td>Administrative Services</td>
<td>Concurrence: The administration concurs with this recommendation. Target Date: FY 2023 Action Plan: With the Administrative Services Department as the lead, staff will work across the stakeholders including accounting, budget, engineering, and departmental teams on the recommended changes to clearly identify capitalizable and noncapitalizable costs. Staff implemented a new structure for WBS codes within the past five years to apply additional clarity in use, which has taught the organization that changes such as these are both multi-system changes and business practice changes. Therefore, the core stakeholder group will evaluate what is feasible to streamline the process and to fully maximize functionality. Accounting guidelines will serve as the authoritative source for when a project is capitalizable or non-capitalizable which will be included in the fixed policies and procedures.</td>
<td>Current Status</td>
</tr>
</tbody>
</table>

1. Capital projects should be created in the SAP system in a manner that WBS elements are set up to keep track of capitalizable and non-capitalizable costs separately. Non-capitalizable costs should be settled to cost centers. The Accounting team should work with the Office of Management and Budget personnel and Department and System Analysts to define the criteria and procedures and to maximize the use of the SAP functionality to improve the efficiency and effectiveness of the process. As the City is planning to improve the SAP functionality in FY2022, the accounting team should take this opportunity to ensure the SAP system will be configured to meet their needs.
<table>
<thead>
<tr>
<th>Recommendation</th>
<th>Responsible Department(s)</th>
<th>Agree, Partially Agree, or Do Not Agree and Target Date and Corrective Action Plan</th>
<th>To be completed 6 months after Council acceptance and every 6 months thereafter until all recommendations are implemented</th>
</tr>
</thead>
</table>
| **2.** The costs recorded in the CIP account should be reviewed periodically to ensure expenses are removed and costs for the completed assets are reclassified in a timely manner. To ensure that this key control works effectively after the concentrated efforts end in FY2021, the accounting team should formalize the process by establishing and following a review schedule, documenting a review, and requiring a supervisory review and approval. | Administrative Services | Concurrence: The administration concurs with this recommendation.  
Target Date: FY 2022 Q2  
Action Plan:  
As noted in the audit, staff completed a concentrated effort of cleanups and reviews in FY 2019 and FY 2020 and has identified projects of which the nature of expenses are recurring maintenance and repair projects. In FY 2021, staff has already implemented a second and final historical review and clean-up effort with a process moving forward of review quarterly at minimum. In FY 2022, these projects will be directly settled into cost centers.  
In the absence of a software system change as discussed in recommendation 1, the at minimum quarterly manual review by the accounting team will review the CIP projects including a supervisory approval. | In Progress | Staff has already implemented a monthly manual review process in FY 2022, and will ensure full supervisory review as part of the first Q1 financial close scheduled to end September 30, 2021, and completion by December 31, 2021. |
| **3.** The fixed asset accounting team should implement a mechanism to receive the status of the project completion and assets placed in service from the responsible departments in a timely manner. Although a fixed asset accountant reviews the annual and mid-year budget documents and | Administrative Services | Concurrence: The administration concurs with this recommendation.  
Target Date: FY 2022 Q3  
Action Plan:  
The Accounting Team will establish a business process for departments to follow including a standardized form, instructions, | |
Occasionally reach out to the departments, this internal control should be formalized and performed more effectively to ensure that the costs are reclassified to assets and start depreciation (if applicable) in a timely manner.

4. The accounting management should enhance the CIP section in the policies to provide guidance regarding the CIP process to the accounting team and the responsible parties such as the Office of Management and Budget, Business Analysts, and project managers. The CIP policies and procedures should include the requirement for project setup, a periodic review of project costs, monitoring and reporting the project completion status, and so on. Additionally, the accounting management should evaluate and update the fixed asset policies periodically to ensure that requirements are appropriate for the current process, system used, and accounting standards. According to Government Finance Officers Association, this should be done no less than once every three years based on a predetermined schedule.

<table>
<thead>
<tr>
<th>Administrative Services</th>
<th>Concurrence: The administration concurs with this recommendation.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Target Date: FY 2022 Q3/Q4</td>
</tr>
<tr>
<td></td>
<td>Action Plan: The Accounting team will review and update the CIP policies and procedures to the extent necessary and practical to clarify and implement these standards. It is expected that this update will include documentation of several the other action plans outlined in this audit as well. The City attempts to routinely update internal policies and procedures, though due to limited resources and competing priorities this is not always completely in a timely manner. As part of annual operating procedures, staff will work to complete this review more routinely as resources allow.</td>
</tr>
</tbody>
</table>