Metropolitan Council

Program Evaluation and Audit

Central Corridor Light Rail Transit Inventory

February 18, 2010

INTRODUCTION

Background

The Federal Transit Administration (FTA) requires its grant recipients to maintain control over real property, facilities, and equipment that have been acquired with federal funds (FTA Circular 5010.1D; FTA Master Agreement). FTA Circular 5010.1D defines "equipment" as "nonexpendable, tangible personal property having a useful life of more than one year and an acquisition cost which equals or exceeds the lesser of the capitalization level established by the government for financial statement purposes, or $5,000" (Ch. I, Section 5.s). For grantees to demonstrate that they are maintaining control over equipment or fixed assets, the FTA requires that they maintain records that provide the following information: Description, I.D. Number, Acquisition Date, Cost, Federal Percentage, Grant Number, Location, Use and Condition, Disposition Action, Vested Title, and Useful Life (Ch. IV, Section 3.k). It also requires that grantees conduct a physical inventory of equipment and reconcile the results with their equipment records once every two years (Ch. IV, Section 3.k).

The Metropolitan Council also has a policy on Fixed Asset Management, 3-4-2. It states that "Fixed assets will be managed in accordance with appropriate federal requirements." Central Corridor Light Rail Transit (CCLRT) Procedure 215-03, Capital Equipment Inventory, reproduces this policy and assents to it. It states that fixed assets will be "tagged" by the Central Corridor Project Office (CCPO) Task Manager as they are received and "cataloged appropriately." Together, they commit CCLRT to equipment records for fixed assets and a biennial physical inventory of the same.

CCLRT does not yet have many fixed assets. As it enters construction, however, it will acquire more. In addition, CCPO has other inventory that should be accounted for, including computer hardware and software and office supplies. All this makes an audit of CCLRT inventory timely.

Scope

The scope of the audit was from the start of preliminary engineering on CCLRT--December 13, 2006--to July 2009.

Purpose

The main purpose of the audit was to evaluate CCLRT's process of accounting for equipment or fixed assets. In the course of evaluating the process, it was also determined if CCLRT had purchased any equipment that meets the FTA definition of a fixed asset.

Although most information technology (IT) equipment does not cost more than $5000, a second purpose of the audit was to evaluate the Council's process of accounting for it at CCLRT. The Council's Information Services department (IS) tags all of the Council's IT

hardware, and maintains files matching those tags with the equipment's serial number. Software too is tracked, so that IS can show that users are properly licensed to use it. The audit reviewed if software records were accurate at CCLRT, and if CCLRT was in compliance with the terms of software licenses.

Finally, although minor office supplies do not rise to the level of fixed assets, they are inventory, and a lack of control over them can negatively affect project management and increase direct costs. A third purpose of the audit was to evaluate the effectiveness of CCLRT's process for ordering, tracking, and accounting for supplies, and, for a sample of CCLRT's more expensive or unusual supplies, to evaluate the business case made by either Council or consultant employees for buying them.

Methodology

Accounting for Equipment

To identify and evaluate the accounting of CCLRT equipment or fixed assets, Audit:

- examined the records of spending on the project maintained by Metro Transit's Asset Management (AM) Clerk, and determined if CCLRT had purchased any equipment that meets the FTA definition of a fixed asset.
- checked if AM is maintaining equipment records of those assets.
- checked if a physical inventory of CCLRT equipment has been done in the past two years, and if the results of that inventory have been reconciled with equipment records.
- evaluated whether AM's records of spending were accurate and complete by comparing them to the descriptions and amounts of spending contained in the Council's Accounts Payable (AP) system.

Verifying IT Inventory and Software Licensure

To evaluate the Council's process of accounting for information technology (IT) equipment at CCLRT, Audit:

- obtained, from IS personnel, the Council's records of software purchases made by the Council for CCLRT and the licenses in effect at CCLRT.
- obtained, from IS personnel, the Council's automated record of software installed on CCLRT computers, and compared the licenses in effect at CCLRT to the number of actual users of the software.
- drew a judgmental sample of computer hardware at CCLRT from IS's inventory of IT equipment, and, by physically examining the computers in that sample, checked that the information about them was accurate and complete.
- inventoried the programs installed on the computers sampled, and checked that the programs were licensed for those computers.

Evaluating CCLRT Controls Over Supplies

To evaluate the effectiveness of CCLRT's process for ordering, tracking, and accounting for supplies, Audit:

- examined CCLRT's spending on office supplies, as recorded in AP, from the start of the project to July 2009, and analyzed the data for any unusual or excessive orders of supplies.
- interviewed CCLRT administrators, both Council and consultant, about when and how they order minor office supplies, and obtained their suggestions for improving the system.
- identified the more expensive or unusual supplies in use in the project office (the smart board and other projection equipment; plan room equipment like specialized copiers, plotter printers, and finishing supplies; large pieces of furniture; kitchen appliances), and evaluated the business case made for buying them.

Assurances

This audit was conducted in accordance with the Institute of Internal Auditors' *Standards for the Professional Practice of Internal Auditing* and the US Government Accountability Office's *Governmental Audit Standards*.

OBSERVATIONS

Accounting for Equipment

This audit began with the question of whether CCLRT had purchased any equipment that meets the FTA definition of a fixed asset. To answer that question, Metro Transit's Asset Management (AM) department's records of spending on the project were sorted and stratified for charges over $5000, and those charges were compared to the actual invoices contained in the Council's Accounts Payable (AP) system. The analysis showed that housed in the Central Corridor Project Office (CCPO) are four pieces of equipment that meet the FTA definition:

Table 1: CCLRT Fixed Assets as of July 2009

Asset Description	Date Purchased	Price Per Unit on Invoice	Number of Units
Cisco/Catalyst 4500 Supervisor V (Computer Server)	9/19/2007	$9,402.15	1
Net App/FTA XDrive3-R5-C FAS2XX Channel Bundle Drives	12/5/2007	$11,613.00	1
HP DesignJet 42" Printer	7/30/2007	$7,869.00	2
NetApp/X74015B-ESH4-Q5-R5 (Computer Server)	2/20/2009	$19,124.00	1

Source: Asset Management records, Accounts Payable records

AM does not have a record of these assets, at least at that level of detail. For inventory purposes, AM classifies CCLRT (like the Hiawatha Light Rail project before it) as a "work in progress," or WIP. When the Council buys an asset for a project that is finished, like a bus to serve a route, it is given a separate "tag" number in the asset management system and *capitalized*. That is, its useful life is estimated and the asset is depreciated over the course of that useful life. When the Council buys an asset for a WIP, however, that asset is assigned the same generic tag as all the other spending on the project and held in progress. The assets accumulated on the project will only be taken out of the WIP account and capitalized when the project becomes operational. At that time, they are assigned a specific tag and tracked as inventory. On the Hiawatha project, the Council hired an outside consultant to sort through the WIP account and inventory the fixed assets when the rail line became operational.

WIP accounts are a recognized way of accounting for spending on large-scale capital projects, especially when the spending is directed to building an asset that will become operational only at the end of the work. Standard accounting principles, however, do not address the issue that arises on public works projects when fixed assets or equipment are acquired and put into service to build the capital asset. Similarly, to maintain control over fixed assets, the FTA requires detailed equipment records and regular physical inventories, but FTA regulations do not explicitly state when equipment must be accounted for: when it is acquired and put into service, or at the end of a project. In fact,

Regional Administration capitalizes fixed assets when they are put into service, so the accounting practice across the Council is not consistent.

On a rotating basis, AM conducts a physical inventory of every Council location every two years, but no inventory has yet been done at CCPO. The project office has been open since August 2007, and has been housed in the Griggs-Midway Building in St. Paul since that September.

In the course of identifying fixed assets, Audit found several differences between the descriptions and amounts in AM's records of spending on the project and the descriptions and amounts contained in AP. Some Asset Management (AM) entries in the worksheets that were provided did not match the totals of separate Accounts Payable (AP) entries that they seemed to point to; and some AP entries could not be located in the AM worksheets. Finance personnel stated that the differences would be reconciled in the course of the accounting process.

Verifying Information Technology (IT) Inventory and Software Licensure

The four pieces of equipment that Audit identified were all IT equipment: computer servers and large plotter printers. In general, however, IT equipment—the computers, displays, and software that runs on them—is not expensive enough to be separately tagged and capitalized. It represents a significant investment of project funds, however, and it is at risk. Hardware is portable and software is corruptible. Software can also be out of license, and thus subject the Council to fines.

These three dimensions of IT assets—hardware, software, and software licenses—must all be tracked. IS keeps track of hardware by physically tagging it. Every piece of hardware—laptop and desktop computers or towers, displays, printers, copiers, and combination copiers/fax machines—is assigned a tag number and has a "Property of the Metropolitan Council" sticker with that tag number affixed to it. Computers and computer monitors are tagged separately. The model of the equipment is described and that description entered in the record of that asset, together with the tag number, the serial number, and the "jack" number—the internet connection into which the computer is plugged. This record of IT assets is updated periodically, and IS can generate a report from it at any time, customized to the physical location being queried.

A previous Program Evaluation and Audit report, *Information Services Software Licensure* (December 2005), recommended that the Council acquire a network discovery tool that could "determine what hardware is connected to its network and what software resides on the hardware." Since then, the Council has acquired such a tool, Landesk, which manages all the computers on its network. Landesk did not generate the hardware report that was used for this audit, but it has the capacity to do so, and will be used to track and maintain hardware information in the future. Landesk is already used to scan and remotely index the software running on all the computers in a given physical location.

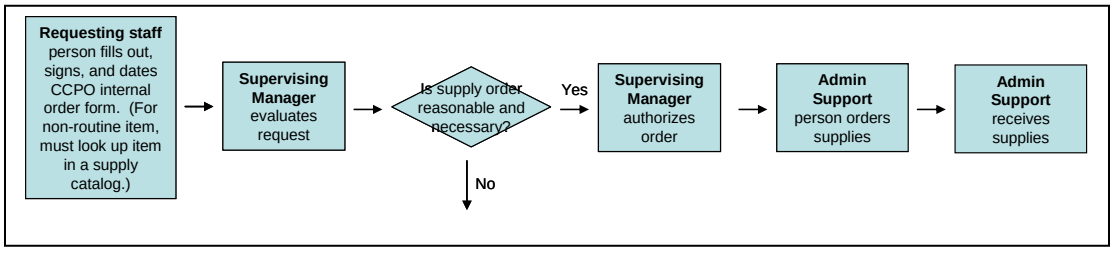
LANDesk reveals what software programs are installed on Council computers—the hardware. To determine what programs are *licensed* to be installed, it was necessary to compare the Landesk data to IS's records of software purchases made by the Council for CCLRT and the licenses in effect at CCLRT. (The software records were corroborated by the direct inspection of invoices from Accounts Payable records.) That is, the number of computers actually containing or carrying the software was compared to the number of users licensed to use the software. There were two computers that were using a program without a license. IS took steps to purchase the two licenses. Also, IS records contained one program—a photograph management program called ACDSee Pro 2.0—that had been paid for but was not being used.

All software records were reviewed. To evaluate the accuracy of IS's hardware records, Audit inspected a judgmental sample of 12 CCLRT computers from IS's inventory of IT equipment. There were five instances where the tag numbers of the computers plugged into the hardware jack did not match the records, and two displays that did not yet have IS tags on them. There were no computers in IS's inventory that were missing from this sample. IS stated that they would update their records.

Evaluating CCLRT Controls Over Supplies

The CCLRT Procedure (215-02) for purchasing routine office supplies draws on Council Procedure 3.4.3a, Procurement, especially—given the relatively small dollar value of most supply purchases—Section 4.0 of that Procedure, "Micro Purchases." ("Micro Purchases are defined as the purchase of any goods or services with a total value of less than $2,500.") The segregation of duties between the person requesting the supplies and the person approving the purchase is especially important here, because micropurchases are not subject to additional review. The requestor makes the request of the CCLRT Manager of Transitways Administration, who reviews it for reasonableness and necessity. If he approves the request, he sends it to an Office Administrator, who enters it into TXbase, the Council's automated purchasing system. TXbase generates the purchase order and sends it to the approved vendor, who fills the order and sends it back to CCLRT. The Office Administrator takes delivery, checks the goods against the purchase order and the invoice, and distributes them. The process is flowcharted in Figure 1.

Figure 1. CCLRT Office Supply Ordering Process



Source: CCLRT Procedure 215-02

In addition to examining the process, purchasing data from more than two years of CCLRT operations were analyzed for any unusual or excessive orders of supplies.

Dividing the spending amounts by vendor established the *average* amount of an order per vendor, and individual orders that departed from that average by more than one standard deviation were identified. When this deviation was significant—outside our control limit of $100 or more— the invoice was inspected for unusual or excessive supplies, and the order was evaluated for its reasonableness and necessity. Thirty-six (36) invoices were inspected.

On inspection, the need for the supplies ordered was apparent. In most cases, the unusually high orders of supplies were explained by heightened office activity: a large number of track plans had to be printed for project partners during the month of a major submittal, for example. In one case, the deviation from the norm was explained by the misclassification of a purchase of office furniture as office supplies. Similarly, among the more expensive or unusual supplies in use in the project office—most of which were previously identified as fixed assets—none were found that seemed unnecessary. The "smart board," an expensive piece of high-tech equipment used to write on during meetings and then generate printed and electronic files, was arguably underused for the first year of the project, but a recent upgrade and additional training has made it more accessible and increased its use.

The main thing that complicates the ordering of CCLRT office supplies is the relationship between the Council, in charge of administering the project, and the engineering consultants who are designing it. The chain of authority in that relationship is sometimes unclear. The contract for AECOM, the prime engineering consultant, says only that requests for "Reimbursable Expenses" should be itemized and submitted with supporting documentation. According to interviews with both sides, however, the consultant is supposed to make such requests directly to the Council's Manager of Transitways Administration, who channels the order through the Office Administrator. What sometimes happens is that the consultant orders a supply item directly and charges it to the project as a direct cost. Consultant employees told us that they charge supplies as a direct cost when they need them immediately, or when they have a preferred vendor (UPS rather than the Council's FedEx for deliveries). Council employees, however, worry that this deviation from the de facto procedure may result in unnecessary supplies being ordered and paid for.

Audit examined consultant direct costs through October 2008 for a previous audit, and AECOM's office supply charges from November 2008 through May 2009 for this one. There were no supply orders that appeared to be unreasonable or unnecessary. Nonetheless, the lack of clarity in the process is a concern. Suggestions will be made later in this report for clarifying roles and responsibilities between consultants and the project office, and for improving accountability, mainly related to better recordkeeping and improved data gathering.

CONCLUSIONS

Metro Transit and Regional Administration account for fixed assets differently.

Metro Transit Asset Management defines CCLRT as a "work in progress" (WIP). All spending on the project is tracked in the asset management system and assigned temporary tags that identify it as CCLRT spending. AM did not tag fixed assets until the end of the Hiawatha Light Rail project, and it is not presently tracking equipment that meets the FTA definition of a fixed asset as that equipment is put into use on the CCLRT project. Its practice has been to account for project spending in the WIP file, and, when the project becomes operational, to allocate that spending--whether it was for actual physical equipment or labor--to the portion of the project that it was used to build. At that time, when the project is finished, individual pieces of equipment that meet the FTA definition of a fixed asset will be taken out of the WIP account and tagged. Their useful life will be estimated, and they will be capitalized. They will also be tracked with the information the FTA requires, including useful life.

Regional Administration, however, accounts for fixed assets differently. If an asset is acquired in the course of a capital project and put into service to build it, it is tagged and capitalized *as* it is put into use. In other words, equipment is depreciated throughout the construction, or work in progress, phase, if it is being used before the project is operational.

Accounting principles are unclear as to what practice is proper or recommended, and either practice may be acceptable in an organization, so long as the accounting practice is consistent. However, the results of this audit demonstrate that the practice across the Council currently is not consistent.

Landesk allows for better tracking of Council IT assets, but—until greater functionality is used or obtained—it must be supplemented by a manual count of licenses.

The Landesk network discovery tool, which is already used to scan and remotely index the software running on Council computers and can be used to track individual pieces of computer hardware, will eventually allow IS to track licenses automatically and prevent unlicensed computers from using software programs, but that functionality has not been built in yet. Until then, the number of valid licenses must be manually compiled from IS's record of Information Technology Request forms (ITRs) and the purchase orders of the software itself. Because it took some time to produce an accurate count of licenses in effect at CCLRT, that added functionality will be welcome.

Transitways Administration's system of accounting for office equipment trades some control over inventory for more responsiveness to project needs.

Transitways Administration makes the effort to track individual pieces of equipment (not including minor supplies like pens and paper) that are needed for daily project office business. Overhead projectors or flash drives, for example, must be checked out, so that responsibility can be assigned if they are lost. Administration also discourages the use of PCards, both because the cards do not save time (as designed) and because ordering supplies through the Council's traditional TXbase system provides an audit trail for later reference. At the same time, the supply room is left unlocked to give employees open access to it, even during evenings and weekends, and equipment is at risk for being lost or stolen by being out "in the field." For example: two flash drives have been lost, and some computer cases unaccountably disappeared from the unlocked supply room.

Transitways Administration knows in general terms when supply orders are unusually high. It does not track office supply spending in detail.

Although CCLRT has a budget for office supplies, that budget is not informed by data on actual supply purchases. A 2009 *Procurement Trends* report from Office Max, CCLRT's vendor for office supplies, states that an important "best practice" for saving money on office supplies (cited by 63 percent of "top-level performers") is "getting more detailed views" of supply spending. The Council's PeopleSoft system for Accounts Payable can produce reports that analyze spending on office supplies by individual vendors. Vendors like Office Max can provide data to their customers that break this spending down in even more detail, to individual items like pens and Post-It notes. CCLRT Transitways Administration may not need that level of detail, but without some analysis of what it has spent on office supplies, it is difficult to formulate a budget for what it should.

RECOMMENDATIONS

Program Evaluation and Audit recommendations are categorized according to the level of risk they pose for the Council. The categories are:

- **Essential** – Steps must be taken to avoid the emergence of critical risks to the Council or to add great value to the Council and its programs. Essential recommendations are tracked through the Audit Database and status is reported twice annually to the Council's Audit Committee.
- **Significant** – Adds value to programs or initiatives of the Council, but is not necessary to avoid major control risks or other critical risk exposures. Significant recommendations are also tracked with status reports to the Council's Audit Committee.
- **Considerations** – Recommendation would be beneficial, but may be subject to being set aside in favor of higher priority activities for the Council, or may require collaboration with another program area or division. Considerations are not tracked or reported. Their implementation is solely at the hands of management.
- **Verbal Recommendation** – An issue was found that bears mentioning, but is not sufficient to constitute a control risk or other repercussions to warrant inclusion in the written report. Verbal recommendations are documented in the file, but are not tracked or reported regularly.

1. Metro Transit and Regional Administration should determine a consistent method of accounting for fixed assets acquired in the course of capital projects. (Significant.)

Metro Transit does not tag or capitalize fixed assets until the end of a work in progress like CCLRT, when the project becomes operational. Regional Administration tags and capitalizes fixed assets as they are put into use on capital projects, and starts depreciating them when that occurs, even if it is before the project is operational. Neither approach is explicitly recommended by accounting principles, but it is important--for external auditors and other means of oversight--that the Council approach the accounting of fixed assets consistently.

It is recommended that the Finance functions of the Council determine a consistent method of accounting for fixed assets acquired in the course of large-scale capital projects like CCLRT. This method needs to encompass both how the spending on those assets is accounted for and how the physical assets themselves are tracked, in order to satisfy FTA requirements about detailed equipment records and regular physical inventories.

It should be noted that although this instance of asset reporting is immaterial, CCLRT is still in its early stages of development. The same methodological problems later in this project or in other large transit projects very likely could be material.

Management Response: *Regional Administration Finance staff will meet with Metro Transit and Environmental Services to consider pros and cons of accounting methods and determine council-wide approach. As noted, Generally Accepted Accounting Principles (GAAP) do not favor one approach over another, and results are immaterial to the Council's financial reporting in conformance with GAAP.*

Responsible: Mary Bogie, Deputy Chief Financial Officer.
Estimated Completion: December 2010

2. The record that IS maintains of software licenses in effect at the Council should be kept accurate and current. CCLRT administrative personnel should periodically verify their purchases against that IS record, and should inform IS of any extraordinary purchases. (Significant.)

Management Response*: The CCPO has achieved extraordinary success in complying with software licensing requirements. The Project Office has purchased several hundred software licenses in the past three years and has worked consistently with Information Services on software procurement. In only two instances was the CCPO found to be out of compliance (failing to purchase a license while using the software). This occurred when two consultant employees began working at the CCPO without advanced notice being provided to Transitways Administration. Adobe software was installed on the consultant computers with the intention to purchase two licenses. However, procurement documents were initiated but not completed for the purchase. This has been corrected.*

Gary Berger, Manager of Transitways Administration, CCPO.

Management Response*: Information Services activated a software license project that involves a historical investigation of Council procured software licenses and the establishing of best practices for software license management using Landesk Management Suite (LDMS). The LDMS will identify software licenses installed on networked computers and servers, monitor software license usage, and provide the tools needed to manage license compliance and provide useful reports. This project will provide IS with the baseline information that is needed to establish and sustain accurate software inventory records for the Metropolitan Council. Once the first phase of the inventory project is complete (end of May 2010), Information Services will design inventory identification and control processes in Landesk to monitor and manage software licenses for accuracy, usage, and compliance.*

Pancho Henderson, Manager of Enterprise Technical Services, Information Services.

3. **Transitways Administration should regularly clarify with project consultants and partners sharing office space their procedures for ordering and tracking supplies. (Significant.)**

CCPO is in a steady state of transition, but, especially as of this writing, with the transition from preliminary to final design and the influx of additional employees from the Northstar Project Office, some clarification is in order. In particular, consultants can be reminded of CCLRT Procedure 215-02, which channels routine purchases of office supplies through the Manager of Transitways Administration, who determines reasonableness and necessity.

***Management Response**: Since the opening of CCPO on October 1, 2007, the Project consultants and partners must coordinate ordering of supplies through Transitways Administration. Transitways Administration maintains centralized control over all ordering and tracking of supplies. The Manager of Transitways Administration directly supervises this function under the review and final authority of the CCLRT Project Director. All procurements of supplies for consultants and partners must have a "business purpose" directly related to the Project. Supplies are ordered through the Metro Transit TX Base procurement system software.*

Gary Berger, Manager of Transitways Administration, CCPO.

4. **Transitways Administration should use more detailed data on office supply spending to produce a flexible budget for office supplies, and should periodically review that budget for possible savings or categorical adjustments. (Consideration.)**

***Management Response**: All CCPO supplies are procured through competitive processes that are administered by Metro Transit Purchasing and Council Purchasing Unit (IT equipment/software only). These competitive processes ensure that the CCPO achieves the highest cost savings possible. CCPO capital budget, unlike an operating budget, has wide variation in spending patterns due to Project phases, activities and scope. As the CCPO expects to transition to a new Project phase it looks forward to assessing required changes, up or down, in the future need for office supplies.*

Gary Berger, Manager of Transitways Administration, CCPO.