



**MEMORANDUM**

**DATE:** April 30, 2019

**TO:** Audit Committee of the School Board of the City of Virginia Beach

**FROM:** Terrie L. Pyeatt, CPA  
Director, Office of Internal Audit

**SUBJECT:** **Construction in Progress Expenditures Audit**

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**BACKGROUND**

As part of the 2019 Audit Work Plan, the Office of Internal Audit (IA) has performed a Construction in Progress Expenditures Audit.

The Office of Facilities Services (Facilities), within the Department of School Division Services, is responsible for managing the construction of new schools, additions, major renovations, and ongoing maintenance projects in accordance with Virginia Beach City Public School's (VBCPS) six-year Capital Improvement Program (CIP) Budget. All but two capital projects in the CIP are managed by Facilities. The Chief Information Officer manages the Student Data Management System project and the Chief Financial Officer (CFO) and Chief Human Resources Officer jointly manage the School Human Resource/Payroll project.

The Facilities staff is responsible for preparing the CIP budget annually, which is then presented by the superintendent to the School Board of the City of Virginia Beach (School Board) for approval and then ultimately presented to the City of Virginia Beach City Council (Council) for final approval. In FY19, \$47,461,000 was appropriated for the CIP budget. Projects are reflected in the CIP annually until they do not require additional funding. A Long Range Facilities Master Plan is used to determine the priorities for modernizing or replacing aging buildings when developing the CIP budget. Recurring maintenance and renovation projects are budgeted in phases and are developed from data gathered from the Office of Maintenance Services and Facilities staff.

The VBCPS Purchasing Policy and Procedures Manual delegates procurement responsibility to Facilities for all capital construction and all related architectural and engineering (A/E) services. The Executive Director of Facilities Services (Executive Director) and the Chief Operating Officer (COO) must approve requisitions and payments for all Facilities-managed projects. VBCPS typically processes payments by entering a requisition or request for payment into BuySpeed. Once electronically approved, payments are uploaded from BuySpeed into InSite for processing a payment by the City. However, payments for A/E services and construction contracts are not processed this way as these invoices for construction contracts require a portion of the contract to be retained until all work is completed. Because BuySpeed has historically not been able to accommodate retainage, the BuySpeed/InSite interface has not been used. As a result, an alternative method was developed by the Office of Business Services (OBS) which uses the approval path in BuySpeed for routing purposes, but Accounts Payable, a division within OBS, directly keys the payment into InSite and then cancels the BuySpeed transaction. OBS and Purchasing are currently testing a newer version of BuySpeed to determine if the software can now process retainage.

OBS capitalizes expenditures for school replacements and modernizations once a building is occupied then partially capitalizes all expenditures periodically thereafter. Facilities informs OBS annually of any completed projects. For accounting purposes, a project is not closed until any surplus budgetary appropriation is moved out of the completed project. VBCPS does not have a requirement on how long projects are allowed to remain open. According to Facilities, it is typical for school replacement and modernization projects to remain open for two to three years following occupancy to finalize pending construction issues, and longer if there is ongoing litigation. Recurring maintenance projects remain open until the funds are fully expended.

## **AUDIT OBJECTIVES**

This audit was performed to determine if:

- Funds spent in the later stage of a project were within the scope of the project as it was appropriated; and
- Project expenditures were properly procured.

## **AUDIT SCOPE AND METHODOLOGY**

Inquiry and examination of documents and data, as well as interviews, were the methods of reviewing internal controls. The audit period was from July 1, 2016 – October 31, 2018.

IA obtained InSite reports of all capital projects with new expenditures, budgetary activity, or remaining balances during the audit period. IA considered a project to be late in its life if it had spent more than 95% of its estimated total project cost. To calculate this percentage, IA divided project expenditures recorded in InSite through 10/31/2018 by the total expected project cost (the total appropriations figure taken from the City of Virginia Beach's (the City) CIP budget book).

The following capital projects had been 95% expended during the audit period:

**Building Replacement and Modernization Projects:**

- #1005 Green Run High School Collegiate Renovations
- #1019 Great Neck Middle School Replacement
- #1078 Pupil Transportation Services Maintenance Facility
- #1233 Old Donation School

**Phased/Recurring Maintenance Projects:**

- #1001 Renovation Replacement and Energy Management
- #1006 Various School Site Acquisitions Phase I
- #1062 ADA School Modifications
- #1095 Comprehensive Long Range Facilities Planning Update
- #1099 Renovations Replacements Grounds Phase II
- #1103 Renovations Replacements HVAC Systems Phase II
- #1105 Renovations Replacements Various Phase II
- #1109 Energy Performance Contracts
- #1195 Student Data Management System
- #1232 Tennis Court Renovations
- #1237 School Human Resources/Payroll System

IA reviewed 100% of the post-occupancy building replacement and modernization project expenditures and a sample of expenditures for the phased/recurring maintenance projects during the audit period. IA reviewed supporting documentation for these expenditures to:

- Determine if the expenditure appeared reasonable based on the project scope, taking into consideration the project timeline;
- Ensure payments were made in a timely manner, the vendor listed on the invoice matched the payee, the amount paid agreed to the invoice amount, and the expenditure was recorded in the proper account code in the general ledger;
- Determine if proper approval was obtained, as applicable, as follows:
  - Appropriate signature authorities approved the expenditure;
  - Legal review and Superintendent's approval on A/E contracts exceeding \$30,000, construction contracts exceeding \$50,000, and all other contracts exceeding \$100,000; and
  - School Board approval of A/E contracts exceeding \$50,000 and construction contracts exceeding \$100,000.
- Determine if procurement for the selected expenditures was performed as required by School Board Policy as follows:
  - At least three firms were interviewed during the selection process for A/E services exceeding \$30,000;
  - At least three quotes were obtained during the selection process for all non-A/E purchases between \$30,000 – \$100,000 made after 2/13/18;

- At least four quotes were obtained during the selection process for all non-A/E purchases between \$30,000 – \$100,000 made before 2/13/18; and
- Competitive negotiation process was publicly advertised for non-A/E purchases exceeding \$100,000.

Two projects did not have any expenditures during the audit period; therefore, no expenditure testwork was conducted on these projects. These projects are:

- #1006 Various School Site Acquisition Phase I; and
- #1237 School Human Resource/Payroll System.

Finally, IA reviewed Facilities' processes as it relates to CIP expenditures to identify potential efficiencies.

We conducted this performance audit in accordance with generally accepted government auditing standards. 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.

## **CONCLUSION**

The results of the audit were discussed with management. We thank management and staff of the Office of Facilities Services for their cooperation throughout the audit. A summary of the audit results, audit recommendations, as well as responses from management, are included in this report. These recommendations are intended to further strengthen compliance with policies, procedures, as well as to strengthen internal controls and offer process improvements.

In our opinion, the results of the audit indicate from the sample tested that:

- Funds spent in the later stage of a project were substantially within the scope of the project as it was appropriated; and
- The selected project expenditures were properly procured.

cc: Anthony L. Arnold, Executive Director, Office of Facilities Services  
Jack Freeman, Chief Operating Officer

## AUDIT RESULTS AND MANAGEMENT'S RESPONSES

### **Finding No. 1: Timing of Capital Project Expenditures**

VBCPS has not established requirements to govern the timeline that spending should occur once a project is substantially completed and/or a building is occupied. The Government Finance Officers Association recommends that entities establish policies and procedures for capital project monitoring and reporting, including project close-out procedures. IA recognizes that there are several costs that may not be paid on construction projects until after occupancy, such as legal fees and punch list items.

IA found that seven of the eighty-two payments tested occurred more than one year after occupancy, but the supporting documentation did not indicate these items were on the punch list or related to legal matters. These payments represented 8.5% of the number of transactions tested and less than 1.5% of the dollar amount of the transactions tested. The Executive Director stated that if a stakeholder, such as a principal, requests an item and the construction project has funds available, the Executive Director will consider approving the item to be purchased if it can be linked to the project, regardless of the timing of the purchase. See details below on the seven payments:

- A. Pupil Transportation Services Maintenance Facility – occupied March 2011
  - a. \$6,390.00 invoice dated September 2016
    - i. Automatic pump at dock well sump
    - ii. An earlier partial payment of \$6,390 was made for this service, but it was dated outside of the audit period
  - b. \$9,786.00 invoice dated November 2016
    - i. Concrete walkway and handicap ramp
  - c. \$17,818.85 invoice dated November 2017
    - i. Front sidewalk repairs
- B. Great Neck Middle School Replacement – occupied January 2012
  - a. \$2,209.72 invoice dated September 2016
    - i. Guidance reception furniture reconfiguration
- C. Green Run Collegiate Renovations for School Year 2015-2016
  - a. \$5,026.05 invoice dated March 2017
    - i. Student collaboration furniture
    - ii. This expenditure also did not have proper approval – see Finding #3 below
- D. Old Donation School – occupied April 2017
  - a. \$882.72 invoice dated September 2018
    - i. Outdoor art easels
    - ii. This expenditure also did not have proper approval – see Finding #3 below
  - b. \$299.99 invoice dated October 2018
    - i. Battery operated speaker
    - ii. This expenditure also did not have proper approval – see Finding #3 below

**AUDIT RESULTS AND MANAGEMENT’S RESPONSES, CONTINUED**

Note that IA only examined the expenditures made from 7/1/16 – 10/31/18 for these projects. The following chart quantifies the amount of money being spent post-occupancy for recently completed construction projects which will put this issue into perspective:

Project	Occupancy Date	All Expenditures	One Year Post-Occupancy Expenditures	
			Paid one year AFTER occupancy through 7/1/16	Paid during audit period (7/1/16 - 10/31/18)
Pupil Transportation Services Maintenance Facility	Mar 2011	\$ 458,911	38,507	33,995
Great Neck Middle School Replacement	Jan 2012	458,653	2,210	2,210
Green Run Collegiate Renovations for SY15-16	Sept 2015	n/a	20,075	5,026
Old Donation School	Apr 2017	n/a	280,850	1,183
<b>Total</b>		<b>\$ 917,564</b>	<b>341,642</b>	<b>42,414</b>

In addition, VBCPS has two non-Facilities managed projects, the Student Data Management System and the School Human Resources/Payroll System projects that have both been open for more than fifteen years. Spending on these projects include updates, software replacements, and other related items on an ongoing basis. The Student Data Management System had unspent funds of approximately \$471,000 at the end of our audit period and incurred approximately \$731,000 in expenditures during the audit period. The School Human Resources/Payroll System had unspent funds of approximately \$328,000 at the end of our audit period and incurred no expenditures during the audit period.

Guidance on spending post-occupancy or after significant project completion will give management the opportunity to redirect funds to higher priority projects.

***Recommendations:***

We recommend that management establish and follow written guidelines to govern the timeline of spending funds on CIP projects after occupancy has occurred and/or after significant project completion.

***Management’s Response:***

COO concurs. The Department of School Division Services, Department of Budget and Finance, and Facilities will develop guidelines for project spending timelines and project closure procedures. Anticipate completing the guidelines during the fall of 2019.

## AUDIT RESULTS AND MANAGEMENT'S RESPONSES, CONTINUED

### **Finding No. 2: Expenditures Outside of Project Scope – Nature of Expenditures**

Three of the eighty-two payments tested occurred outside of the scope of the CIP projects. These payments represent 3.7% of the number of transactions tested and less than 0.4% of the dollar amount of the transactions tested. IA considered a payment to be within the project scope if it was consistent with the project description in the CIP book. See details below:

- Renovations and Replacements HVAC Systems Phase II
  - \$4,663.86 purchase of chairs and tables for an elementary school
  - \$5,738.26 purchase of custom counter for an elementary school office
  - \$1,486.47 purchase of storage cabinets for an elementary school
    - This expenditure also did not have proper approval – see Finding #3 below

According to Facilities, built-in bookshelves were damaged while replacing the HVAC system at a school. The HVAC CIP project properly funded the damaged bookshelves. During the same time frame, the principal also wanted to purchase other furniture not related to the damaged bookshelves nor the HVAC work. Facilities approved the purchase of these additional items noted above because there were funds remaining in the HVAC project. These instances indicate errors in judgment during the approval process. Proper review and approval of expenditures allows management the opportunity to redirect funds to higher priority projects.

#### **Recommendations:**

We recommend that management more closely scrutinize purchases on CIP projects to ensure the expenditures relate to the projects' scopes.

#### **Management's Response:**

COO concurs. Facilities project staff has been reminded that CIP expenditures must be directly related to the project.

## AUDIT RESULTS AND MANAGEMENT'S RESPONSES, CONTINUED

### **Finding No. 3: Proper Approval**

Nine of eighty-two payments did not have proper approval. All of these payments were Facilities-managed projects but not approved by the COO. One payment was not approved by the COO nor by the Executive Director. See the table below for details:

<b>Project #</b>	<b>Vendor Name</b>	<b>Invoice Date</b>	<b>Amount</b>
1005	FSI Office	March 2017	\$ 5,026.05
1233	AED Authority	May 2017	4,755.96
1233	Folding Chairs and Table.com	April 2017	1,527.35
1233	FSI Office	May 2017	1,500.00
1103	School Specialty Inc.	September 2017	1,486.47 *
1233	Cuda Zoo LLC	April 2017	1,237.72
1233	Blick Art Materials	September 2018	882.72
1233	Home Depot Credit Services	August 2017	537.95
1233	Alpha Music	October 2018	299.99

\* This expenditure was also not approved by the Executive Director

According to the VBCPS's Signature Authority List, purchases made for all Facilities-managed CIP projects require the approval of the Executive Director and the COO. IA noted in these instances that the building principal approved the purchase; however, the required signature authorities were not included in the electronic approval path in BuySpeed. It appears that neither the school nor the Executive Director added the appropriate signatories in the BuySpeed approval path. Appropriate authorization by the signature authorities ensures that expenditures are necessary and appropriate and allows management the opportunity to redirect funds to higher priority projects if needed.

#### ***Recommendations:***

We recommend that Facilities remind the schools that they must add the appropriate signatories to the BuySpeed approval path if CIP funds are being spent at the school level. In addition, we recommend that the Executive Director ensure that the Facilities staff includes the COO on the approval path if he has been omitted.

#### ***Management's Response:***

COO concurs. Facilities will instruct the school to include the appropriate signature authorities on the BuySpeed approval paths for all CIP school level purchases. In addition, the Executive Director has already met with the Facilities staff to remind them to ensure that all CIP approval paths include both the Executive Director and the COO.



## AUDIT RESULTS AND MANAGEMENT'S RESPONSES, CONTINUED

### **Finding No. 4: Timely Payments**

Seven of eighty-two payments tested were not made timely. See the table below for details:

<b>Project #</b>	<b>Vendor Name</b>	<b>Invoice Date</b>	<b>Payment Date</b>	<b>Amount</b>	<b>Project Manager</b>
1195	Edupoint Educational Systems LLC	7/24/17	9/13/17	\$21,617.00	DOT
1105	Integrated Security Technologies Inc.	8/28/17	10/30/17	18,912.05	Facilities
1195	Schoology Inc	8/29/17, 9/29/17	2/20/18	9,000.00	DOT
1233	AED Authority	4/26/17	6/22/17	4,755.96	Facilities
1233	Folding Chairs and Tables.com	4/5/17	6/7/17	1,527.35	Facilities
1233	FSI Office	5/4/17	7/25/18	1,500.00	Facilities
1233	Home Depot Credit Services	8/21/17	10/9/17	735.20	Facilities

According to the *Business Manual for Central Offices*, Section 9.1, Prompt Payment Requirements, payments should be made in accordance with the terms of the contract. In the absence of a contract, payment should be made not more than forty-five days after the receipt of goods or services or the date of the invoice, whichever is later. All of the Facilities-managed late payments were related to orders placed by other departments/schools. It appears that there was a lack of coordination to ensure that invoices were either received and or processed timely. Payments made after the due date can damage the division's reputation.

#### ***Recommendations:***

We recommend that the appropriate project manager ensure that CIP purchases are monitored on a frequent, routine basis to ensure timely payment.

#### ***Management's Response:***

COO concurs. The Executive Director has already met with the Facilities staff to remind them of the importance of monitoring the payment of purchases, specifically on projects that are winding down. The CIO followed up with staff members on these two payments to ensure that future project payments are made timely.

## OTHER ITEMS NOTED

### **Item Noted No. 1: Process Efficiencies/ Improvements**

During the course of testwork, IA noted several examples where process efficiencies/improvements can be made as follows:

#### **A. Policies and Procedures**

- Facilities does not have a written policies and procedures manual to document internal procedures related to CIP procurement and spending; and
- There are no VBCPS departmental written procedures or School Board policies or regulations related to CIP Fund transfers as it relates to approval or disclosure to the School Board (this was previously addressed in the June 2018 Budget Transfers Audit).

VBCPS departments and schools use the Purchasing Manual for detailed guidance of procuring and expending funds. However, the Purchasing Manual excludes construction expenditures and certain other expenditures related to architectural and engineering services. The Facilities staff has been relying on School Board Policies for guidance as it relates to procuring and expending CIP funds. A written procedures manual is a common best practice to document controls and uniform methods to complete tasks. Without written processes, it is difficult to provide consistent direction and guidance for personnel. Documenting policies and regulations promotes accountability and provides a framework to ensure that controls are in place. We recommend that Facilities document their internal policies and procedures as it relates to procuring and expending CIP Funds.

There has not been any formal clarification of the required level of approval or School Board disclosure for CIP fund budget transfers. IA noted one CIP budget transfer of \$23,272, which was requested by the Executive Director and approved by the City budget office. The entry was not approved by the COO or CFO. Currently, there are School Board policies relating to the applicable approval level and disclosure to the School Board for non-CIP budget transfers but none for the CIP budget transfers. Transparency in the approval and reporting process will allow those charged with oversight the ability to monitor and redirect funds as necessary. We recommend that management propose School Board policies or create School Board regulations related to CIP Fund transfers as it relates to approvals and disclosures.

#### ***Management's Response:***

COO concurs. Facilities staff has a draft Procedures Manual for project management that is actively being developed with the anticipated completion date being during FY20. Regarding CIP budget transfers, the COO and CFO will work together to develop the appropriate regulations/guidelines. Anticipate completing the regulations/guidelines during FY20.

## OTHER ITEMS NOTED, CONTINUED

### B. Retention of Records

VBCPS does not maintain copies of approved CIP budget journals. The approved budget journals are maintained by the City budget office, but not all were available for review during the audit. We recommend that management identify responsibility for retaining copies of the approved CIP budget transfer records to increase transparency and accountability.

#### *Management's Response:*

COO concurs. The Department of School Division Services, Department of Budget and Finance, and Facilities will meet in June 2019 to assign responsibility for retaining budget journals as well as document the appropriate process.

### C. Payment Processing

IA noted that payments made on A/E and general construction contracts are not made through BuySpeed like the rest of VBCPS's payments due to retainage being held on the certifications for payments. A/E and general construction payments were initially set up differently than all other VBCPS payments because BuySpeed could not process payments with retainage. The alternative process developed by OBS uses BuySpeed for routing purposes only with the actual payment being directly keyed into InSite. There are several problems with this approach, including the following:

- The alternative process relies on manual intervention to directly key payments into InSite which increases the possibility of errors;
- The approval for payments is attached to the original requisition which is subsequently canceled;
- The dollar amount in BuySpeed is zeroed out when the original requisition is canceled making it difficult to find previous payments;
- The payments are not numerically connected with the original requisition except through a reference number which OBS assigns to the contract; and
- All payments related to a particular contract are not stored together against one purchase order that Facilities can view.

OBS and Purchasing are currently testing a newer version of BuySpeed to determine if retainage can be processed using the normal flow of payments. We recommend that they continue to refine this process.

#### *Management's Response:*

CFO concurs. OBS will continue working with Purchasing to test the new BuySpeed functions as it relates to retainage.

### D. Capital Project Reports

During the course of fieldwork, IA identified improvements that could be made to several InSite reports utilized by OBS. OBS immediately incorporated our suggestions and modified the reports. In addition, IA recommended that Facilities have access to an OBS report that will assist Facilities staff with their payment monitoring process. The two offices are currently coordinating Facilities' access to the report.