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October 20, 2009

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## **SUBJECT: AUDIT OF ARCHITECTURE AND ENGINEERING CAPITAL IMPROVEMENT PROGRAM'S ADMINISTRATION**

### **Introductory Remarks**

In compliance with Article V, Section 6, of the San Bernardino County Charter, the Board of Supervisor's Policy Statement on Internal Operational Auditing, we have completed an internal audit of the Architecture and Engineering department (A&E). The internal audit was conducted in accordance with the *International Standards for the Professional Practice of Internal Auditing*.

### **Background**

The County's Capital Improvement Program (CIP) provides for the construction, reconstruction, renovation, rehabilitation or replacement of facilities with life expectancy of at least five years and capital costs in excess of \$5,000. The department collaborates with other county agencies, the County Administrative Office, and the Board of Supervisors to determine the scope, schedule, and budget of projects. A&E is responsible for planning and implementing the quality design and construction of projects included in the CIP. The department manages CIP projects by facilitating the selection of vendors, processing the payment of vendor invoices, and performing accounting functions for projects.

### **Objectives, Scope and Methodology**

The audit objectives were to evaluate the department's existing procedures to determine whether A&E followed contractual terms within the payment process, met its budgetary goals and reported its percentages of completion figures properly.

The Internal Audits Section examined management's control framework, source documentation, policies and practices. In addition, we performed tests of accrual amounts. The examination covered activities that have occurred in the period July 1, 2007 through June 30, 2008. The criteria used to assess the department were the contractual agreements with vendors, California government codes, and Governmental Accounting and Financial Reporting Standards.

## **Conclusion**

Based on the procedures evaluated, we have concluded that A&E appeared to follow contractual terms in regards to the payment process. A&E also appeared to have met its budgetary goals, although we did note a control weakness in its budget stewardship process. In addition, A&E did not properly report some of its capital expenditure accruals and did not report any of its retention payable.

We identified a few procedures and practices that A&E could improve. We have listed these areas and our recommendations for improvement in the Findings and Recommendations section of this report.

We sent a draft report to the department on June 22, 2009 and discussed our observations with management on July 1, 2009. As of October 13, 2009, the department had not responded to the recommendations included in this report.

## **Findings and Recommendations**

### **Finding #1: Inaccurate Accruals**

Expenses should be recognized according to the period to which they relate, and not when they are paid as required by Generally Accepted Accounting Principles. Per the Year-End Closing Manual issued by General Accounting (GA), departments that receive services and/or supplies from outside vendors for which payments have not been made as of June 30 must submit accrual documents to General Accounting to properly record these amounts in the Comprehensive Annual Financial Report (CAFR). In addition, departments are required to submit estimates of accruals when actual amounts are not yet known or available. Departments must also include their assumptions made in arriving at these estimates and all other supporting documentation.

Our audit disclosed that the accrual amounts submitted by A&E were inaccurate, because A&E did not include construction services provided to the County from all outside vendors through June 30, 2008. We tested 70% of all accrual amounts submitted to GA for fiscal year 2007-2008, and approximately 55% of the accrual amounts tested did not include all vendor services provided through June 30, 2008.

A&E did not have a formal policy or process to ensure the accuracy of accrual estimates submitted to GA. Therefore, vendors were either not informed of the need to provide estimates or vendors simply did not invoice services they provided through June 30 until after GA's accruals deadline. As a result, the department understated both its current liabilities and assets. In our sample of twenty-two CIP projects, A&E excluded approximately \$266,000 or 49% of capital expenditure accruals for fiscal year 2007-2008.

### **Recommendation:**

We recommend that management include a clause in all future vendor contracts that expressly states the vendor must submit by July 1 a written estimate for services provided (but not billed) through June 30 of each year.

We also recommend that management create and implement a formal policy to develop its own estimate for services provided from vendors in the event that the department cannot obtain vendor-provided estimated amounts. Management should communicate this policy to all applicable staff. Source documents and assumptions made in determining estimates must be submitted with the accrual package as support.

**Finding #2: Not Reporting Retention Payable**

The A&E department should report any unpaid retention on CIP projects to GA at year-end. This will enable GA to accrue unpaid retention, so the County correctly reports its liabilities on the CAFR. We reviewed 13 of 117 completed CIP projects to track the accuracy of the department's retention payable system. Although GA sends a Year-end Closing Manual to the department with reporting instructions, A&E staff was unaware that the department was supposed to report retention payable at year-end. Consequently, the A&E department did not report any unpaid retention.

Because the department did not properly report unpaid retention, current liabilities and assets were understated. However, we were unable to calculate the total amount of the understatement, because the department tracked each project manually.

**Recommendation:**

We recommend that management utilize the automated system that it recently implemented to calculate retention payable at year-end.

Management should create a formal policy on retention reporting, which ensures that the department submits the necessary information to GA at year-end.

Thank you very much for the cooperation extended by your staff during the course of this audit.

Respectfully submitted,

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Auditor/Controller-Recorder

By: \_\_\_\_\_  
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