Executive Summary:
Internal Audit Report # 09-06
Capital Planning & Management Performance Audit
March 22, 2010

Organization Impact:

General Audit Conclusions:

Current capital planning and budgeting practices need revision and improvement to ensure consistently sound economic decisions regarding proposed capital investments. When evaluating proposed capital projects, sufficient, relevant data is not always provided to decision makers. For example, half of the capital project justifications (known as “Cost Benefit Analyses” or CBAs) sampled from the FY2007-FY2009 period had insufficient information on how the project aligns with or supports Capital Metro’s strategic objectives. Furthermore, CBAs submitted for six of seven sample projects reflected a negative net present value (NPV) and a negative return-on-investment (ROI). However, because public transit is not a “for profit” entity, decisions need to consider more than just the bottom line. The process to evaluate competing projects also should identify and define the expected non-tangible, qualitative benefits. The lack of sufficient, substantive information increases the risk of misguided investment decisions.

Capital Metro should align its capital planning and budgeting practices with industry best practices. A Capital Improvement Plan (CIP), an essential element of capital planning, has not been prepared for the Authority. A CIP is a multi-year plan which identifies planned capital improvements for the period, how the projects supports strategic goal(s), project funding sources, and anticipated spending requirements (e.g., operating and maintenance costs). Public entities generally use a CIP to detail critical information which is necessary for decision makers and stakeholders, as well as to increase transparency. Without a CIP, the data disclosed to the Board of Directors regarding proposed capital projects has been insufficient and, at times, inaccurate. In addition, there has been an associated lack of transparency and opportunities for meaningful public input on the capital program.

Controls are not in place to ensure that inter-related strategic and capital plans build upon and support each other. (e.g., All Systems Go! Service Plan, Long-Range Financial Plan, asset management plans such as for vehicles and facilities, the “5-Year” capital plan, and the annual capital budget.) As a result, Internal Audit was unable reconcile sample capital project costs between these various planning elements.
Formal, adopted capital planning policy and procedures do not currently exist and capital planning has been handled differently across the past four years. Without standardized processes, the risk of errors or omissions is increased. For example, several instances were noted during the audit in which the supporting spending detail did not agree with summarized capital project information included in the proposed annual budget. In another example, a revised process for screening FY2010 strategic initiatives (including capital projects) was started but never completed. Conversely, when financial planning is institutionalized in the governance of the organization (e.g., written policies and procedures) it leads to consistent decisions and helps preserve continued good practices even through changes in staff and management.

**Agency-wide standards for ongoing project monitoring and reporting are needed.** Outside of the Project Management Office, capital project monitoring and reporting has not been consistently performed. For eight of the eleven sample capital projects, documentation does not exist to support ongoing monitoring of the project’s financial and schedule status. For one project, expenditures were coded incorrectly and should have been charged to at least three other projects—two of which were over budget by 188% and 164% and one which was significantly under budget. In other words, ineffective oversight in one project can impact the quality of monitoring data for other projects.

**Key performance measures for capital projects should be consistently established, monitored, and reported.** A template for reporting project status was developed, but never implemented due to a lack of consensus. As a result, regular reporting to the Capital Metro Board and management on capital project status and performance has not yet started.

The combined impact of these conditions adds up to an inability to consistently answer key questions about a project’s status throughout its lifetime. Before a project is approved, the questions that Board and external stakeholders most want answered are “How much will it cost?” and “How long will it take?” Once the project is approved, the question becomes “Is it on-time and on-budget?” When the project is through, the questions are “Did we get what we want?” and “How can we improve the process?” Answers to these questions are not consistently available given the current state of planning, organization, and monitoring for the Authority’s capital program.

---

1 Other risk factors discussed in the report include a compressed timeline with simultaneous capital and operating budget planning and a lack of a centralized focus within the Finance Department for the capital program.

2 The Project Management Office is located in the Information Technology Department and oversees technology-related implementation projects. Beginning in November 2009, information on technology projects is reported monthly to Capital Metro management.

3 As a start, the Finance Department began in August 2009 to summarize capital spending in the monthly “CEO Report.” However, this spending information is not included in the Board’s regular information packet.
Audit Highlights / Planned Corrective Actions:

This section focuses on proposed corrective actions to improve capital planning and management processes and controls. In order to implement these improvements, the Finance Department will lead a cross-functional team including departmental staff from the Office of Strategic Management, Operations, Property Management, Vehicle Maintenance, and Procurement departments. The Planning Department and the Engineering and Construction Department will also be asked to provide input when establishing the framework for planning, budgeting, and managing capital projects.

Because the FY2011 budgeting cycle is imminent, the corrective action plans (CAPs) will be phased in over a two-year period. The primary goals for the FY2011 capital budgeting cycle are to (1) enhance (but not finalize) existing procedures and controls for selecting and prioritizing capital projects, (2) develop a provisional CIP, and (3) begin quarterly capital project status reporting to the Board of Directors and senior management.

These capital processes will then be further refined for FY 2012 and beyond. Adopting a two-phase approach will allow agency staff to begin making improvements now, but allow sufficient time to refine capital procedures and to incorporate any related recommendations from the Sunset Commission on how the Authority can implement a more reliable, accountable, and transparent capital project process.

Highlighted below are the most significant issues and planned CAPs. For additional information, please refer to the relevant section within the detailed audit report.

1. Establish, document and adhere to standards for selecting and evaluating capital projects.

Current capital planning and budgeting practices will be strengthened to ensure consistently sound economic decisions regarding proposed capital investments. For the FY2011 budgeting cycle, the Finance Department will re-validate by June 2010, all existing capital projects using an interim capital project analysis tool and prioritization criteria. This process will include examining, for each project, the amount spent, completion status, the outstanding balance of (any) remaining financial commitment(s), and an analysis of the available resources needed to successfully complete the project.

This analysis will evaluate and rank both the current (on-going) projects as well as any new capital projects that may be presented for approval and funding in FY2011. Information gathered during this process will form the foundation for an initial CIP that will be presented for the Board’s approval in August 2010.

In FY2012 and beyond, Department will develop and finalize an economic analysis/business case methodology and will also refine the process for prioritizing capital investments. The revised tools are intended to provide sufficient information to key decision makers and help ensure that proposed investments are aligned with the Route 2025 Strategic Plan, and both the Long Range Service and Financial Plans.
2. **Develop a formal Capital Improvement Plan (CIP) and supporting procedures.**

A formal capital planning policy and related procedures will be developed and documented as part of the Authority’s governance structure. The Finance Department is currently developing a project plan to outline and schedule all the required deliverables and steps of a capital budgeting cycle, including providing opportunities for stakeholder and public input. The project plan is expected to be finished by the end of **April 2010**. The goal is to complete all capital related planning and analysis prior to the starting development of the annual operating budget. As mentioned above, one of the products will be a provisional CIP for the FY2011 capital budgeting cycle.

An overall Financial Planning Policy which outlines the primary financial planning elements including the Strategic Plan, Long Range Financial Plan (LRFP), and CIP will be presented to the Board in **May 2010**. A related policy on capital planning and budgeting, jointly developed by the Finance Department and the Office of Strategic Management, will also presented for Board approval in **October 2010**.

To assist with the re-engineering of the capital planning and management cycle, a new position will be created within the Finance Department by **June 2010** which will have as its primary focus capital planning and management. For example, a CIP manager or coordinator would provide needed oversight on capital project selection, CIP development and monitoring of capital budgets, costs and project status.

3. **Strengthen oversight and accountability for capital projects.**

Regular, periodic reporting of capital spending and project status is needed to increase transparency and to provide timely, actionable information on capital projects. Beginning in **June 2010**, quarterly reports on capital project spending and status will be provided to the Board of Directors. For ongoing projects, the variances from initial project scope and budget, along with total current costs, percentage of completion status, and schedule adherence will be disclosed. Baseline metrics for all completed projects will include both (1) Percentage of CIP projects within original budget, and (2) Percentage of CIP projects completed on original schedule.

In **FY2012**, a new process will be implemented for de-authorizing projects which have been on the books for an extended period but have not had substantive progress and/or which no longer support strategic objectives. The Finance Department will also work with the Office of Strategic Management to develop a more robust economic analysis tool which would require defined key project metrics which will be used to (1) evaluate the project results and (2) to emphasis accountability for results to project managers and Project Sponsors. The revised tool will be implemented for use during the **FY2012** capital budgeting cycle.
ACCEPTED:

Signature on File          Signature on File
Frank Fernandez           Doug Allen
Chair, Finance & Audit Committee Interim President/CEO

cc: Capital Metro Board of Directors
    Randy Hume, EVP Finance & Administration
    Elaine Timbes, EVP Performance & Quality and Interim Chief Operating Officer