



Seattle Public Schools Office of Internal Audit

Internal Audit Report Accounting and Record Keeping for Fiber Sharing Projects

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Internal Audit Report

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Introduction and Background

In accordance with the fiscal year 2019 capital audit plan, we have completed a review of the district's accounting and record keeping for fiber sharing projects under an intergovernmental agreement with other local, state, and federal agencies.

Washington's Interlocal Cooperation Act authorizes local governments to contract with other public agencies to enable cooperation in carrying out governmental activities and delivering public services. Local governments work with other public entities on a wide range of cooperative efforts. This type of cooperation can present economies of scale and increase the efficiency of government.

Thirteen government entities, including Seattle Public Schools, are currently partners in a consortium created to construct telecommunications systems using fiber optic cable as the transmission medium. The consortium has built a network of more than 700 miles of fiber throughout the Seattle area. This partnership consists of city departments and other agencies that share the resources and costs of the regional fiber optic network.

The effort began with an interagency agreement signed in December 1995. Seattle Public Schools joined in October 1998. A substantial amount of the district's fiber optic cable has been installed and maintained through this partnership. The 20-year agreement signed by the district in 1998 was extended in 2018, for another 10 years.

The interagency agreement is managed by the City of Seattle's Department of Information Technology (DoIT), which serves as the lead agency for installing and upgrading projects. DoIT obtains all relevant permits for fiber installation projects and maintains the fiber infrastructure once it is built. The district's projects are managed by the Department of Technology Services (DoTS).

Each fiber project can have multiple participating agencies that share the cost proportionally based on their ownership of the active fiber strands. It is common for project participants to install more fiber than they need at the time in anticipation of future demand. If, after a fiber installation project is completed, another public entity purchases any of the excess fiber, that entity will reimburse the paying parties for their proportional share of the total project cost. The city processes this transaction by issuing credits to the original paying parties. The district received more than \$200,000 in credits in 2017. This audit focuses on how the district has accounted for and managed credits.

Audit Objectives

The objectives of the audit were to determine whether:

1. The district maintains records that ensure accountability for fiber projects and related resources.
2. The district has adequate controls over its accounting for fiber sharing transactions, particularly credits.
3. There is transparency regarding the existence and management of fiber project credits.



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Audit Approach and Methodology

To accomplish the audit objectives using a risk-based approach, we performed procedures that included, but were not limited to, the following:

- Interviewed district staff and other partners in the consortium.
- Researched standard practices of public fiber consortiums and established expectations for record keeping.
- Identified high-risk elements of fiber project activity, with an emphasis on how the district accounts for credits.
- Evaluated the district's practices for applying credits.
- Examined payment and credit documentation for fiber projects.
- Reviewed the district's purchase order and check request processes as it relates to fiber expenditures.

Roles and Responsibilities

District management is responsible for establishing effective internal controls and complying with laws, contracts, agreements, and district policies. District management is also responsible for creating, obtaining, and maintaining records that pertain to district operations. Internal Audit's responsibility is to test controls, assess the district's current practices, and make recommendations for improvement. We extend our appreciation to the staff in Accounts Payable for the valuable assistance they provided throughout this audit.

Results and Conclusions

The district does not maintain fiber project records. Some fiber expenditures are not authorized through the purchase order process, and the district does not obtain project estimates. The district does not account for credits as they are received, track how credits are used, or maintain awareness of the credit balance. The management of fiber credits does not ensure accountability or transparency.

This report identifies opportunities for the district to enhance internal controls and accountability of public resources, increase transparency as it pertains to fiber credits, and make fiber refunds available for their intended use.

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Findings and Recommendations

1) Overarching Finding - Record keeping for fiber projects

The district does not maintain fiber project records. Our expectation was that the district would have documentation consistent with the terms of the interagency agreement and with the district's history of fiber projects as a partner in the consortium.

The district did not have the intergovernmental agreement, and management was unfamiliar with its terms and conditions. The district does not execute written agreements for any of its fiber projects, retain records of completed projects, or maintain supporting documentation for annual maintenance expenses. The district did not demonstrate that it obtains cost estimates for planned fiber projects, accounts for and tracks the use of credits, or issues purchase orders for fiber expenditures in a consistent manner.

The absence of records limits the ability of the Office of Internal Audit to properly assess risk, identify suitable audit criteria, and determine which procedures are appropriate to address significant risks. This is an overarching finding, and recommendations to address these issues are detailed throughout this report.

Recommendations

While this was not an audit of the district's compliance with the interagency agreement, we recommend the district obtain a copy of the agreement and all of its addendums and ensure that management is familiar with the terms and conditions.

We recommend management determine when it is appropriate to execute formal project agreements. Management should also maintain records for each fiber project, including documentation to verify all relevant transactions or activity under the project.



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2. Purchasing procedures and cost estimates for fiber projects

The district uses the traditional requisition, purchase order, and invoice method to procure goods and services. DoTs follows the purchase order process for some fiber projects, but we found fiber expenditures for capital projects that did not have an approved purchase order authorizing the procurement of services. Instead, the district followed a direct payment (check request) process, a procedure that allows invoices to be paid without an approved purchase order. Authorization for these expenditures is granted once the invoice arrives, after goods have been received or services have been rendered.

The check request procedure is not appropriate for fiber project payments. It is meant for payments such as postage, subscriptions, dues, registrations, permits, certain refunds, and one-time purchases. The check request procedure is also used to pay vendors that do not accept purchase orders. For fiber project expenditures, an approved purchase order is more appropriate. The purchase order should be issued before fiber project services are performed and before the district begins receiving invoices.

In addition to completing the approval process prior to the buy, purchase orders also allow the district to encumber the amount of the purchase against the budget. We found that the district does not obtain cost estimates for fiber projects.

The district's contracting and purchasing approval matrix is not applied to check requests. The current check request procedures require only the approval of the budget authority. There is no limit on the amount of a payment when a check is requested. Therefore, approvals that would be required for a purchase order or contract are not required with a check request.

Recommendations

We recommend DoTS obtain cost estimates and an approved purchase order to authorize all fiber project expenditures. The cost estimate should include any related administrative fees the district will incur to complete the project.

We recommend the district enhance its check request procedure and form to:

- clarify the intended spending thresh holds and required approval levels
- require the initiator to select from the list of allowable payment categories



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3. Accountability for fiber credits

When a public agency purchases excess fiber from a completed project, DoIT issues a credit to the original partners based on their proportional share. There is little transparency within the district regarding the existence and application of fiber credits. The district's practice is to use credits to pay for unfunded general fund fiber projects. However, the district does not account for credits as they are received and does not have internal controls in place to ensure accountability.

The district does not maintain documentation to support each credit and does not track or record the current balance. DoTS does not retain records to show how credits are applied to unfunded projects. In 2018, Accounting attempted to substantiate the credit balance of \$227,000, most of which was carried over from 2017. However, DoTS did not have the records to facilitate that effort. Furthermore, there is no official guidance that informs management as to how the staff should account for or apply fiber credits. This is important because the balance can fluctuate as credits are used or as more credits are received.

Recommendations

1. We recommend the district request a cash refund of \$227,000 from DoIT and apply it to the original expenditure accounts.
2. We recommend management create a formal policy requiring Accounting to request a refund of any fiber credit that exceeds a specified amount, within 30 days of receiving a credit invoice from the city. This is consistent with the amount of time generally required for the district to process standard invoices.
3. For greater transparency, we recommend DoTS work with Capital Finance to determine where fiber program credits should be applied. We recommend refunds of capital project fiber expenditures be applied to a capital account.



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4. Process for managing fiber credits

The process of initiating, approving, and paying for fiber projects can involve DoTS, Purchasing, Capital, and Accounting. When the audit began, however, only DoTS was fully aware that fiber credits existed or understood how they are earned.

The city's practice was to send all invoices for fiber project expenditures directly to DoTS. This included standard invoices for fiber project work, credit invoices, and annual maintenance invoices. This practice allowed DoTS to decide whether to send invoices to Accounts Payable, whether to use credits, and which invoices should have a credit applied. It was customary for DoTS to send invoices for capital fiber projects to Accounts Payable to be paid. The district's policy requires that vendors send invoices to Accounts Payable, not to individual departments.

Recommendations

We recommend the district instruct the city to send all invoices-standard, credit, and maintenance-directly to Accounts Payable and to include the purchase order number on the invoices.

We recommend Accounting process both standard and credit invoices and ensure that refunds are reflected in the accounting system.



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5. Verification of annual maintenance costs

As a partner in the consortium, the district pays approximately \$120,000 annually to the City of Seattle for maintenance on its fiber network. Maintenance expenses, which are shared with existing partners, include facilities leasing costs and lead agency (City of Seattle) management labor. The district does not retain the electronic files that validate the amount billed. DoTS is the process owner and should verify the amount billed for accuracy or reasonableness before approving these invoices for payment.

Recommendations

We recommend DoTS maintain supporting documentation for maintenance invoices and verify the accuracy of the amount charged.



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6. Review and approval of fiber interagency agreement

Although it is not codified in district policies, the district's practice is for the board to authorize the superintendent to execute interlocal agreements. This practice is consistent with other public agencies in Washington State and with the Washington Interlocal Act. DoTS signed a 10-year extension to the fiber interagency agreement in 2018 and returned it to the city without further authorization.

Recommendation

After review by the district's Legal Department, we recommend the school board authorize the execution of the intergovernmental agreement between the City of Seattle, the district, and other local, state, and federal agencies.

In accordance with the Washington Interlocal Act, we recommend the district create a policy that requires all interlocal or interagency agreements be authorized by the governing body.



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Management Response

Technology Services agrees with the auditor's recommendation that the district should request refunds for fiber projects and not let the credits accumulate as a credit on the account with the City. We understand that these credits are from 3rd party purchases of fiber since we entered the fiber agreement with the City. These funds will be placed in the appropriate fund used to support unfunded projects related to the fiber in the city.

John Krull, Chief Information Officer