OFFICE OF THE CITY AUDITOR

AUDIT OF PERSONAL PROPERTY

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CITY OF DALLAS

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Honorable Mayor and Members of the City Council
City of Dallas

We have performed an audit of City owned personal property (equipment, furniture, and vehicles). Our audit objective was to determine whether the City Controller's Office (CCO) has effective procedures to properly account for and safeguard City property.

We determined that the CCO needs to develop and enforce policies and procedures to ensure that fixed assets are properly accounted for and safeguarded. In addition, the CCO needs to enhance inventory records management. These issues are addressed in the Opportunities for Improvement section of this report.

We appreciate the cooperation shown by staff during our audit.

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AUDIT OF PERSONAL PROPERTY

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EXECUTIVE SUMMARY

We performed an audit of City owned personal property. Our audit period was from October 1, 2002, to March 31, 2004.

Our Opportunities for Improvement are summarized below:

- The CCO has not developed policies and procedures to prevent the theft of expendable property (e.g. laptop computers, audio-visual equipment, and recreational equipment). These types of property are at an increased risk of theft since they are portable and are generally easy to sell or pawn.

- Expenditures for supplies and/or repairs were misclassified as capital outlays.

- Physical inventory verification could not be performed using the fixed asset inventory records because they were incomplete or inaccurate. Confirming the existence of City-owned property would have been very difficult without the personal knowledge of the buyer or user at the department owning the property.

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Authorization

We performed an audit of City owned personal property (equipment, furniture, and vehicles). This audit was performed under the authority of Chapter IX, Section 2 of the Dallas City Charter and in accordance with the annual audit plan approved by the City Council.

Scope and Methodology

Our audit was performed in accordance with generally accepted government auditing standards and, accordingly, included tests of the accounting records and other audit procedures that we considered necessary in the circumstances. Our audit focused on personal property purchased during the period from October 1, 2002, to March 31, 2004.

The audit objective was to determine whether the City Controller's Office (CCO) has effective procedures to properly account for and safeguard City property.

To achieve our objectives, we:

- Reviewed City policy and procedures for property management and asset accounting.
- Reviewed prior audit reports prepared by the City's external auditor.
- Interviewed City employees.
- Selected test samples and performed a physical inventory of fixed assets[1] and expendable property[2].

Accounts payable vouchers, classified as capital outlays, were used to identify all personal property items purchased during the audit period. Two separate populations were identified. One population consisted of purchases equal to or greater than $5,000 since this amount is the threshold for classifying personal property as fixed assets. The second population consisted of purchases less than $5,000. These items are considered expendable property. Statistical sampling techniques were used to identify a sample from each of the populations.

[1] Personal property with a unit cost of at least $5,000 and a life span of greater than one year. These purchases are capitalized and recorded as fixed assets (i.e., a balance sheet asset and subject to depreciation).

[2] Personal property with a unit cost of less than $5,000. This property is considered expendable because it is not recorded as an asset and thus is recognized as an expense.

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Overall Conclusion

The CCO does not enforce its policies and procedures to ensure that fixed assets are properly accounted for and safeguarded, and the CCO has not provided guidance and procedures for safeguarding expendable property. Inventory records for fixed assets were inaccurate and confirming the existence of City-owned property would have been difficult without the personal knowledge of the buyer or user at the department owning the property. These issues are addressed in the Opportunities for Improvement section of this report.

Background

The CCO is a division of the Office of Financial Services. Among its responsibilities, the CCO develops citywide administrative and accounting policies and procedures, and maintains the City's fixed asset records.

The Cost Accounting section of the CCO administers, reviews, and authorizes all entries into the Fixed Asset Subsystem (FAS) of the RESOURCE accounting system. This section coordinates with the Accounts Payable section of the CCO to review City purchases for classification as capitalized assets. Additionally, it coordinates with fixed asset coordinators (FAC) in each City department to reconcile entries into FAS with department purchasing and inventory records. The FAC are the main administrators of department efforts to provide inventory safeguards over assets assigned to their departments. FAC duties are outlined in Administrative Directive (AD) 6-1, *Control of City Property*. FAC are the chief points of contact with the CCO to reconcile department records to FAS and correct any errors identified in the reconciliations.

The City's policy for capitalizing and safeguarding real and personal property[3] is addressed in A.D. 6-1. This AD assigns to department directors the primary responsibility for safeguarding all real and personal property assigned to their departments. Prior to the implementation of GASB 34[4], the City used a threshold of $1,000 to classify personal property as a fixed asset, and thus account for the property through the FAS. GASB 34 allowed capitalization thresholds for fixed assets to be increased.

To implement GASB 34 in June 2002, the CCO submitted a revised draft of A.D. 6-1, which included the increased capitalization thresholds listed below:

- Land, machinery, and equipment - $ 5,000
- Buildings - $25,000
- Infrastructure - $50,000

[3] AD 6-1 defines personal property as specific items of property (except land and buildings) that are tangible in nature, which the City owns.

[4] Governmental Accounting Standards Board (GASB) prescribes the accounting rules for state and local governments. Statement No. 34: *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments,* requires the recognition of depreciation expense.

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Therefore, only personal property equal to or greater than $5,000 is now capitalized and recorded as a fixed asset. All property less than $5,000 is considered expendable and is no longer accounted for in the City's FAS.

On or about May 2003, the Cost Accounting section removed assets valued at less than the new capitalization levels from the FAS, to reduce the number of assets to be tracked and depreciated. Consequently, about 95,000 assets were deleted.

The CCO also affected a number of software changes in the City's accounting system to implement the new rules outlined in GASB 34. The revised A.D. 6-1 did not include any policies and procedures for safeguarding or accounting for assets below the new capitalization thresholds.

The City's external auditors identified issues related to fixed asset management in their last three audits. Subsequently, accounting adjustments were necessary each year to correct either the general ledger's (GL) fixed asset balance or accumulated depreciation balance.

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We identified certain policies, practices, and procedures that could be improved. Our audit was not designed or intended to be a detailed study of every relevant system, procedure, or transaction. Accordingly, the opportunities for improvement presented in this report may not be inclusive of where improvement may be needed.

1. There are no standardized controls to properly safeguard expendable property.

The CCO has not developed citywide administrative and accounting policies and procedures to prevent the theft of expendable property owned by the City. Examples of vulnerable property are laptop computers, audio-visual equipment, various electronic devices and recreational equipment. These types of property are at an increased risk of theft, since they are generally easier to sell.

The CCO increased the capitalization threshold (for equipment, furniture, software, and vehicles) from $1,000 to $5,000. Upon increasing the threshold, CCO purged its fixed assets system (i.e., property inventory) of all property items with a unit cost of less than $5,000.

We discussed the changes and impacts brought about by the increased capitalization thresholds with the Chief Financial Officer (CFO) and the CCO. Their position was:

- Property less than $5,000 is expendable and did not require accountability and safeguarding.
- Use of "City Property Tags" to identify expendable property as City property is not required.
- Inventory and related controls are at the sole discretion of Department Directors.

Our sample of expendable property (valued at $55,884) consisted of 23 items from 19 City Departments. Our inventory of the 23 items confirmed their existence but revealed that:

- 12 of 23 were not tagged as City property.
- 20 of 23 were not included in an annual inventory.
- 22 of 23 were not recorded in departmental inventory records.

Safeguarding of assets is an integral part of internal control objectives. Therefore, internal controls should be designed to provide reasonable assurance for the prevention of or the prompt detection of unauthorized acquisition, use, or disposition of assets.

Wiley's GAAP[5] for Governments 2004, Chapter 12 – Capital Assets, states in part:

> Governments should periodically review their capitalization thresholds to make sure that they make sense, given their significance to the government's financial statements. To address the accountability issue that is likely to arise in raising these thresholds, keep in mind that **assets do not have to be recorded in the fixed asset account group or in a proprietary fund to be safeguarded** (emphasis added). … the government must also consider that accountability standards may be imposed on the government by outside sources e.g. federal/state contracts or grants may specify a capitalization level for tracking fixed assets that are acquired with federal/state funds…although this level must be adhered to for contract/grant management purposes, the level should not determine the capitalization threshold for financial reporting purposes.

We recommend that the CCO:

- Develop and issue a policy and implement procedures to ensure that expendable property is adequately accounted for and safeguarded.
- Require that expendable property be tagged to clearly show that it is City owned property.
- Require that expendable property be inventoried at least annually.

Management's Response:

Management does not concur. As stated in the City Auditor's Audit Report, all 23 sample items (fixed assets) were located by the City Auditor's staff. **No assets were missing.**

The Auditors imply that expendable assets should be inventoried and controlled to the same degree as assets with values above $5,000.00. In discussions, the Auditors have been asked what threshold value would be appropriate. The Auditors have offered no suggestion. Management can only conclude that the Auditors would expect an annual inventory of staples, pens, and paper clips. In addition, they seem to encourage a separate inventory system (aside from the City's Financial System). Management does not concur with a recommendation

[5] GAAP – generally accepted accounting principles

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that results in a separate, off-line, additional inventory system. Previously, City Controller's office charged Department Directors with the responsibility to safeguard expendable property via section 4.2.1 and 4.2.6 in A.D. 6-1.

Each Department Director is responsible for:

> 4.2.1 establishing and maintaining adequate internal controls and security for all real and personal property charged to that department (listed on UX01 under their agency/fund structure)
>
> 4.2.6 ensuring/testing the internal controls/procedures for safeguarding all real and personal property assigned to that department are functioning as intended. An annual inventory of fixed assets (those recorded in RESOURCE via UX01 and those not recorded) is encouraged. All recorded assets should be marked with a City of Dallas property tag if feasible.

Safeguarding assets primarily resides under the umbrella of any department's system of internal control. These controls include procedures and observations that adequately protect the City from loss.

Additionally, the Controller's Office, with concurrence of the City Auditor's Office, raised the fixed asset threshold based in part on recommendations from the Government Accounting Standards Board in conjunction with implementation of GASB-34. All assets under the increased thresholds were removed from the fixed asset subsystem with no objections from the Internal Audit Department.

Auditor's Comments:

Although there were no assets missing at this time, the lack of a standardized policy and procedures increases the risk of misappropriation of expandable property. We identified for the CFO assets that should be protected; any property that is at an increased risk of theft.

The decision to increase the capitalization threshold is at management's discretion. This is a decision regarding financial reporting; it does not exempt nor avoid the requirement for internal controls for non-capitalized property (i.e. expandable property).

2. Expenditures for supplies and/or repairs were misclassified as capital outlays.

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We used statistical sampling techniques to draw a test sample of 55 payment vouchers, valued at approximately $2.9 million. Our review of vendor invoices revealed that 21 of 55 payments ($612,125 or approximately 20% of the sample's dollar value) were for expenditures that did not meet the City's policy for classification as capital outlays for fixed assets. The remaining 34 payment vouchers had multiple purchases of fixed assets, 50 of which we used for testing.

Our inventory confirmed the existence of the 50 fixed assets. However, our inventory and interviews with 19 department FACs owning the fixed assets revealed the following:

- Five of the 19 departments have a written policy addressing fixed assets.
- Nine of the 19 departments performed an annual documented inventory.
- Six of the 50 fixed assets were not tagged as City property.
- Twelve of the 50 fixed assets were not reported (by the owning department) as a fixed asset.

We asked department managers why expenditures for supplies or repairs were classified as purchases of capital equipment. The department managers responded that:

- The purchase was urgent and that the only available funds were in the capital equipment account.
- The past practice has been to budget and pay for these expenditures from the capital equipment accounts.

The Government Finance Officers Association, in their book *Governmental Accounting, Auditing and Financial Reporting Using the GASB 34 Model*, describe this requirement for governmental fund financial statements.

> The governmental fund statement of activities reports expenditures rather than expenses. Expenditures should be presented by function and character. The character of an expenditure is based on the periods it is presumed to benefit. Expenditures that primarily benefit the present period (current expenditures) are distinguished from those presumed to benefit both the present and future periods (capital outlays).

Misclassification of expenditures was identified by the City's external auditor in its audit of the fiscal year ending 9/30/03. The external auditor identified differences between the GL and the FAS. There was a $63.4 million difference between the GL and FAS in the fixed asset balance amount and a $27.1 million difference between the GL and FAS in the accumulated depreciation balance. As a result, the City adjusted the GL to agree with the amounts reported in the FAS.

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We recommend that the CCO:

- Provide citywide, mandatory, and recurring training on property management and asset accounting. This training should also address the importance of using the correct object codes for developing the annual budget and classifying expenditures.
- Ensure its staff (Accounts Payable and Cost Accounting) monitors expenditure classifications throughout the fiscal year.

Management Response:

Management agrees. However, the period covered by this internal audit was October 1, 2002 through March 31, 2004. Procedures have been in place since April 2004 that ensure all capital outlay classifications are monitored by Accounts Payable and Cost Accounting staff to prevent further misclassification.

3. Fixed asset inventory records are incomplete or inaccurate.

Our physical inventory verification could not be performed using the current inventory records because they were incomplete or inaccurate. Additionally, some FACs did not know the location of their department-owned property. Location of assets had to be accomplished through the individuals who initiated the payment vouchers or by the equipment users. Confirmation of fixed assets would have been very difficult if these individuals were not currently employed at the department owning the property.

The incompleteness and inaccuracy of inventory records can be attributed to the following:

A. Most departments do not conduct periodic inventories of assets.

According to Administrative Directive 6-1, *Control of City Property*, department directors are responsible for conducting an annual inventory of all real and personal property assigned to that department. We surveyed 19 department FACs and noted that:

Yes	6	(32%)	Performed an inventory of department's assets
Partially	3	(16%)	Partially performed an inventory
No	10	(52%)	Did not perform an inventory
Totals	19	(100%)	

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Most FACs reported that they did not have adequate staff to perform periodic inventories. Some reported that they were not sure how to perform inventories of assets. Many were inexperienced in taking inventories and had no prior formal training before assuming their responsibilities as FAC.

One of the greatest deterrents to theft of organizational assets is taking regular periodic inventories of those assets. When such inventories are not performed, any thefts of assets will not be immediately missed, and it becomes difficult or impossible to identify the persons responsible for the loss. If this practice becomes widely known among those with access to the assets, then the deterrent value of inventories is lost. In addition, fixed asset records are less accurate.

B. Most departments do not reconcile department asset records to the CCO Fixed Asset System records.

Administrative Directive 4-9, *Internal Control*, requires department directors to submit to the CCO a signed attestation that the department has:

- Reconciled monthly, the departmental property records to the CCO fixed asset listing.
- Recorded any needed corrections to departmental records.
- Identified each departmental property with the CCO assigned fixed asset number as part of the property's description.
- Notified the CCO of all changes required to be made by the CCO.

None of the department directors submitted the signed attestations and our survey of FACs noted that:

Yes	6	(32%)	Performed monthly reconciliation of fixed asset records
Partially	2	(10%)	Partially performed monthly reconciliations
No	11	(58%)	Did not perform monthly reconciliations
Totals	19	(100%)	

The Government Finance Officer's Association, in *Governmental Accounting, Auditing and Financial Reporting Using the GASB 34 Model*, states that effective control-related policies and procedures include periodic verification of accounting records to ensure their accuracy. "Management should periodically undertake a physical inventory of its

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fixed assets, compare the results of that inventory to the accounting records, and make appropriate adjustments to those records."

Failure to perform reconciliations precludes assurances that errors will be resolved promptly and that financial data is accurate.

C. The CCO did not maintain a current listing of department FACs.

At the beginning of our field work, we requested a copy of the most current FAC list from the CCO. The CCO provided a list dated 3/24/2004. However, when we contacted the departments to coordinate our field work, we learned that only ten of the 19 people currently assigned as coordinators were shown on the list. We noted that the Department of Development Services, created in October 2002, was not included on the CCO's list of department FACs. Thus the CCO's list of department FACs was outdated.

D. Unique location codes were not used to track fixed assets.

We performed an inventory using our fixed asset statistical sample of 50 property items to confirm that the property existed and could be located as reported in the FAS. Our inventory revealed the following:

Assets were located but not yet entered into the FAS	4	(8%)
Assets that could be located from FAS location codes	11	(22%)
Assets that could not be located from FAS location codes, but were subsequently located	<u>35</u>	<u>(70%)</u>
	50	(100%)

Of the 35 sample assets that could not be located from their FAS location codes, only two resulted from the asset being moved to a different location from the one shown in the FAS. The remaining 33 exceptions occurred because the FAS location identified the department that owned the asset rather than specifying a location. For example, assets that were purchased by DWU included LDWU as the location code in the FAS, and all sample assets for PKR had a location code of LPKR. Both departments had multiple locations throughout the City, but the FAS codes indicated only the department.

We reviewed the location code table (FLOC) in the FAS and noted that several departments had codes that corresponded with specific locations. Most notably, Dallas Fire Department (DFD) and the Dallas Police Department (DPD) had numerous location codes for their specific sites

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and used those codes in their entries in the FAS. Other departments seemed to have an adequate range of location codes in the system, but only used their generic department codes.

It is significant to note that the FAS location code accepts both alphabetic and numeric codes, thus each of the four digits could accept 26 plus 10 characters. Even if you exclude similar characters like the numbers 0 and 1 with upper case O and lower case L, that leaves 32 characters for each of the four digits, yielding a possibility of 1,048,576 unique codes. This demonstrates that FAS can accommodate a unique location code.

Administrative Directive 6-1, *Control of City Property*, does not assign specific responsibility for updating the location code table in the FAS. CCO's Cost Accounting manager told auditors that this is a responsibility of the department FACs. We discussed this with several FACs. Only those who had held that responsibility for several years were aware of that requirement. We noted that the most accurate records occurred in those departments with experienced personnel who were assigned fixed asset duties as their primary responsibility. The least accurate records occurred in those departments with personnel who were recently assigned those responsibilities, usually as a collateral responsibility.

Since the CCO has the overall responsibility for financial reporting, it must take the lead in ensuring that the fixed asset records are complete and accurate.

We recommend that the CCO:

A. Ensure that periodic inventories are performed.
B. Ensure that department property records are periodically reconciled to CCO accounting records.
C. Maintain a current listing of fixed asset coordinators.
D. Ensure that FAS inventory records correctly reflect the location of fixed assets.

Management Response:

Management does not agree. The auditors randomly selected 50 asset records for review. **<u>All 50 samples assets were located and accounted for</u>**. Annual updates of departmental fixed asset coordinators will be performed in January each year through revision of Administrative Directive 6-1 in an effort to maintain departmental contacts familiar with the department's assets listed on the UX01. Location codes will be updated annually in January in an effort to provide more accurate date regarding location of assets.

Auditor's Comments:

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Sampled assets were located and accounted for, with considerable effort, but not based on inventory records. Personnel turnover (terminations, retirements, transfers) could easily preclude a subsequent confirmation of City assets due to inaccurate records and insufficient data identifying the location of assets.