Performance Audit:
Asset Management

October 2013

City Internal Auditor's Office

City of College Station

File#: 13.02

Asset Management Audit

Table of Contents

Introduction

The City Internal Auditor's Office conducted this performance audit of asset management pursuant to Article III Section 30 of the College Station City Charter, which outlines the City Internal Auditor's primary duties.

A performance audit is an objective, systematic examination of evidence to assess independently the performance of an organization, program, activity, or function. The purpose of a performance audit is to provide information to improve public accountability and facilitate decision-making. Performance audits encompass a wide variety of objectives, including those related to assessing program effectiveness and results; economy and efficiency; internal control; compliance with legal or other requirements; and objectives related to providing prospective analyses, guidance, or summary information.

A performance audit of city assets was included in the fiscal year 2013 audit plan based on direction given by the City's Audit Committee.

Asset management, in its most basic form, is the proper safeguarding and recording of assets. In the City of College Station, asset management is mostly decentralized, with each department given primary responsibility for tracking and safekeeping their own assets. According to city policy, Fiscal Services is responsible for keeping a city-wide record of all capitalized assets, which is defined as an asset with "an original cost or value of at least $5,000 and a useful life of more than three years."

Audit Objective and Scope

This audit evaluated the City's asset management policies and practices, to determine if the City's capital assets are being adequately recorded and safeguarded.

In July 2013, an asset management audit of the Fire Department was completed. Based on the findings of that audit, it was decided to expand the scope of our review of the City's asset management practices to include all city departments. As of September 30, 2013, there were over 6,000 assets in the City's asset management system recorded as being still in use. However, for most audit tests performed, we excluded assets that make up land, infrastructure, buildings, or have an acquisition value of less than $5,000. This left about 1,300 assets that were included in the scope of at least one of the audit tests performed. These assets were mostly vehicles or equipment.

Audit Methodology

This audit was conducted in accordance with government auditing standards (except for the completion of an external peer review),[1] which are promulgated by the Comptroller General of the United States. Audit fieldwork was conducted from July 2013 through September 2013. The audit methods included:

- Reviewing the work of auditors in other jurisdictions and researching professional literature to identify best practices regarding asset management.
- Interviewing city staff responsible for performing various related duties and/or oversight functions.
- Reviewing applicable city policies and procedures, relevant state and federal laws and regulations, and GASB and GFOA standards and best practices.
- Examining the City's asset records to identify any inaccurate records or inconsistencies in data recording.
- Evaluating the purchasing through asset disposal process to identify potential process or procedural breakdowns.
- Performing on-site inspections of city departments' assets to determine if the asset observed in the field corresponds to the asset information recorded in the City's financial records.

[1] Government auditing standards require audit organizations to undergo an external peer review every 3 years.

Findings and Recommendations

This audit of asset management focused on the following areas of review: recording capital assets timely and accurately, performing periodic capital asset inventories, estimating useful lives of capital assets consistently, recording multi-part assets consistently, and disposing of assets properly.

Significant analysis and research support each audit finding. Although this report does not provide these details, documentation supporting the audit findings may be provided to city officials upon request.

Overall Recommendation: Well-written policies and procedures encourage compliance, consistency, sound decision-making, and productivity. Therefore, Fiscal Services should develop an accounting policy and procedures manual that is sufficiently detailed to help ensure that capital asset records are complete, accurate, consistent, understandable, reliable, relevant, timely, and comparable.

Capital Assets should be Recorded Timely into the City Record

Criteria: Timeliness is one of the primary principals of financial reporting. According to the Government Accounting Standards Board (GASB), financial reporting is the means of communicating financial information to users. For this communication to be effective, information in financial reports must have these basic characteristics: understandability, reliability, relevance, **timeliness**, consistency, and comparability (GASB 1.62).

Accounting professionals at 16 Texas cities[2] were interviewed to determine when they record capital assets into their accounting system. Of these 16 Texas cities, 11 record capital assets into their financial system soon after they are acquired and put into service (monthly or sooner). Two cities record capital assets quarterly and three record capital assets at least by the end of the fiscal year.

We also interviewed several certified public accountants (CPA)—including the City's external auditors at Ingram & Wallace. According to the CPAs we interviewed, capital assets should ideally be entered into an accounting system soon after they are placed into service.

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[2] Cities contacted were as follows: Beaumont, Denton, Grand Prairie, Laredo, McKinney, Mesquite, Plano, San Antonio, Carrollton, Frisco, Killeen, Lubbock, Midland, Odessa, Round Rock, and San Marcos.

Potential Risk: Not recording a capital asset in the fiscal year it is put into service may impact the accuracy of financial statements. There is also a higher risk of asset misappropriation if assets are not timely entered into the City's record.

Scope: Capital assets currently in use (as of June 2013) that were put into service between September 2009 and June 2013. Not including land, buildings, or infrastructure.

Observations:

1. We were unable to identify documented policies and procedures that provided sufficient direction regarding how and when capital assets are to be entered into the asset management system.

2. Between September 2009 and June 2013 it took, on average, three months after a capital asset had been received and put into service to be recorded in the City's asset management system. In fiscal year 2012, it took an average of five months for capital assets to be entered into the system.

3. There are at least 17 (6%) capital assets that were not recorded in the fiscal year they were put into service. This finding is based on the difference between the asset's install date and the date the asset record is created. To ensure that these dates were accurate for our analysis, we examined other records such as invoices, checks, and purchasing documents. For example, we found a forklift that was recorded in the asset management system 616 days after the install date.

Recommendation:

Documented policies and procedures regarding the timing of when assets must be entered into the asset management system should be developed. Separate procedures for capital asset true additions (e.g. vehicles and equipment) and capital projects may be reasonable. For example, waiting until the end of the fiscal year to ensure that all capital projects are entered into the accounting system could be justified under some circumstances. However, capital asset true additions should be entered into the system soon after the City takes ownership of the asset.

Periodic Capital Asset Inventories should be Conducted

Criteria: The Government Finance Officers Association (GFOA) recommends that every state and local government periodically inventory its tangible capital assets so that all such assets are accounted for, at least on a test basis, **no less often than once every five years.** While well-designed and properly maintained perpetual inventory systems can eliminate the need for an annual inventory of a government's tangible capital assets, **no inventory system is so reliable as to eliminate completely the need for a periodic physical inventory.**

Potential Risk: According to the GFOA, it is essential that governments establish and maintain appropriate inventory systems for their tangible capital assets. Such systems are needed to protect tangible capital assets from the danger of loss or misuse.

Scope: Capital assets currently in use (as of June 2013). Not including land, buildings, or infrastructure. *Excluding non-fleet Department of Information Technology (DIT) capital assets.*[3]

Observations:

1. External Audit: The external auditors perform an annual financial audit. This audit does not involve a physical inspection of assets, except for some limited testing in the College Station Utilities warehouse inventory.

2. Asset Inventory: It has been more than ten years since the last physical inventory of capital assets has been conducted.

3. Assets not in the Records: We were unable to find asset management records for 32 (5%) capital assets within our scope. We discovered these assets by reconciling fleet management's records with the asset management records, interviewing knowledgeable employees, and via physical inspection. Most of these assets would have been fully depreciated several years ago. Therefore, regardless of whether the assets are missing from the asset management record or not, there is likely no material impact on recent financial statements.

4. Unverified Assets: There were 643 assets in the City's record within our scope that needed to be verified. We verified through physical inspection 634 (99%) of these

[3] There were 328 DIT capital assets recorded as being still in use as of June 2013 (not including land, buildings, infrastructure, or fleet vehicles or equipment). Identifying and verifying these assets, however, proved especially difficult given the state of the records in the asset management system. To provide for a more timely audit report, these assets were excluded from our scope.

capital assets. Therefore, asset records lacked sufficient information for us to identify and verify the remaining 9 assets (1%).

Recommendation:

A policy and procedure should be developed requiring an inventory of capital assets to be conducted at least once every five years. Several options utilized by other government agencies for performing periodic capital asset inventories exist. For example, requiring departments to perform physical inventories and submit a report centrally to Fiscal Services or the Internal Auditor's Office. Alternatively, the physical inventory could be conducted by Fiscal Services or the Auditor's Office. In addition, consideration should be given to implementing a bar code system (or some other type of inventory tracking system) to more efficiently identify and track tangible capital assets such as vehicles and equipment.

Capital Assets Records should Be Reliable

Criteria: According to GASB 1.62, **reliability** is one of the basic characteristics of effectively communicating financial information to users.

According to city policy, Fiscal Services is responsible for maintaining the permanent records of the City's capital assets. The policy dictates that Fiscal Services should ensure that the following information is recorded for each asset record: description, cost, department of responsibility, date of acquisition, depreciation, and expected useful life. In addition, we found that recording serial or vehicle identification numbers are helpful in managing and locating assets.

Potential Risk: When the City's asset records are inaccurate, inconsistent, or missing data, it makes asset management less effective, it makes asset inventory excessively difficult, and increases the risk of misappropriation. In addition, when recorded install dates do not accurately reflect the asset's actual installation, calculations for depreciation could be incorrect.

Scope: Capital assets currently in use (as of June 2013). Not including land, buildings, or infrastructure.

Observations:

1. Install Dates: We found at least 12 instances (4%) where it appears that incorrect install dates were entered into the system. For example, a Polaris ATV was entered into the asset record in September 2013 and received and paid for in January 2013. However, the install date entered for this asset is January 2012. Because depreciation is tied to the install date, the life-to-date depreciation (as of October 2013) is more than double what it would appear it should be.

2. Serial Numbers: We found 32 instances (8%) where an asset's serial number was not entered into the records even though a serial number was available. We also identified 96 instances (15%) where vehicle identification or serial numbers were entered incorrectly into the asset management system.

Recommendation:

Before periodic inventories of capital assets can be efficiently and effectively performed, asset management records need to be better maintained so that assets can be more easily identified and found using these records. Therefore, specific policies and procedures should be considered with this aim in mind.

Capital Asset Useful Life should be Estimated Consistently

Criteria: According to GASB, capital assets should be depreciated over their estimated useful lives unless they are either inexhaustible or capital infrastructure. For estimated useful lives, governments can use (a) general guidelines obtained from professional or industry organizations, (b) information for comparable assets of other governments, or (c) internal information. In determining estimated useful life, a government also should consider an asset's present condition and how long it is expected to meet service demands.

According to the GFOA, the best source of relevant information on the estimated useful lives of a government's capital assets normally is its own past experience with similar assets. At the same time, a government should make whatever adjustments are needed to estimated useful lives that were obtained from others to ensure that such estimates are appropriate to its own particular circumstances. Once established, estimated useful lives for major categories of capital assets should be periodically compared with a government's actual experience and appropriate adjustments should be made to reflect this experience.

The State of Texas also publishes recommended useful lives for varying types of assets called State Property Accounting Class Codes (SPA). The SPA can be found on the Financial Management Extranet (FMX) and is specifically designed to give guidance to state agencies and institutions of higher education. Therefore, it is not actually binding on cities, but can still act as useful guidelines for assessing the reasonableness of capital asset useful lives. We also found that some municipalities use the Modified Accelerated Cost Recovery System (MACRS) tables described in IRS publication 946 when determining their useful life estimates.

Potential Risks: GFOA states that the estimated useful life assigned to a capital asset will directly affect the amount of depreciation expense reported each period in an accrual-based operating statement. Therefore, it is important to the quality of financial reporting that governments establish reasonable estimates of the useful lives of all of their depreciable capital assets.

Scope: Capital assets currently in use (as of June 2013). Not including land, buildings, or infrastructure.

Observations:

1. The City is not consistent in assigning estimated useful lives to assets. We found multiple occurrences of identical assets with identical uses being assigned different useful lives. We also tested to see if the actual useful lives of city capital assets corresponded with the criteria set out by the SPA or MACRS—and did not find a consistent relationship.

2. Typically, the City's useful life estimates are much shorter than the actual useful life of the assets. Of retired assets, the average actual useful lives of these assets are 21 months greater than their estimated useful lives. Of assets recorded as still in use (as of June 2013), the average actual useful lives of these assets are at least 52 months greater than their estimated useful lives.

Recommendation:

A policy and procedure should be developed to ensure that capital asset useful lives are consistently applied to asset groups. In addition, the GASB standards and the GFOA best practices described in this report should be considered when developing this policy and procedure.

Multi-part Assets should be Capitalized Consistently

Criteria: According to GASB 1.62, **consistency** and **comparability** are two of the basic characteristics of effectively communicating financial information to users.

It is the auditor's opinion that the following policies found in the Texas A&M University Accounting Manual are good practices that should be emulated: (1) component assets should be able to function independently or "stand alone" before it is capitalized by itself and (2) when an asset is incorporated into another asset (component asset), the asset's value should be increased accordingly. These policies are not unique to Texas A&M. For example, we found that the accounting manuals of the City of Houston and University of Texas San Antonio have similar policies.

Potential Risk: When assets are inconsistently capitalized, the records become more difficult to understand, less reliable, and less comparable. When a component asset is capitalized with another asset without increasing the other asset's value accordingly, the action is essentially the same as not capitalizing the component asset.

Scope: Capital assets currently in use (as of June 2013). Not including land, buildings, or infrastructure.

Observations:

1. Component Assets (not capitalized): There are instances in the records where component assets have not been capitalized as their own asset (but probably should be). For example, ambulance stretchers have not been capitalized as their own assets, even though they meet capitalization thresholds. We were informed that the stretchers have not been capitalized because they are component assets of ambulances. However, we found instances where the value of an ambulance was not updated to reflect the addition of these stretchers. Furthermore, the stretchers can operate independently of the ambulances, have different useful lives, and are purchased and sold separately from the ambulances.

2. Component Assets (capitalized): There are instances in the records where an asset has a component asset that has been capitalized as its own asset (but probably should not be). For example, the City owns two street sweeper vehicles. For both sweepers, the front portion is a separate asset from the back portion. The sweepers cannot work independently without the truck, and the truck cannot function without the sweeper.

Therefore, these two assets work together as a single asset and cannot function independently.

3. Inconsistent Capitalization: There are instances where the same types of assets and their components are capitalized inconsistently. The following examples were found in the course of the audit:

   a. The City owns six hydraulic rescue tools. Five of these component assets were capitalized with fire trucks; whereas, one was capitalized as a separate asset. It is the auditor's opinion that these assets can function independently of fire trucks; therefore, they could be capitalized separately.

   b. The City owns three dual loader boom trucks for refuse collection. The loader arm and the vehicle are capitalized separately once; whereas, the other two vehicles' loader arms are capitalized with their vehicles. The loader arm is manufactured with the vehicle; therefore, it does not function independently of the vehicle. Consequently, it is our opinion that the loader arm and the vehicle should be capitalized together.

   c. The City owns three large rear-load refuse collection vehicles. The rear-load compaction unit and the vehicle are capitalized separately once; whereas, the other two vehicles' compaction units are capitalized with their vehicles. The compaction unit is manufactured with the vehicle; therefore, it does not function independently of the vehicle. Consequently, it is our opinion that the compaction unit and the vehicle should be capitalized together.

   d. College Station Utilities owns two sewer line pressure cleaning vehicles. The pressure cleaning unit is manufactured with the vehicle; therefore, it does not function independently of the vehicle. Consequently, it is our opinion this unit and the vehicle should be capitalized together. However, one of the vehicles and its corresponding compression unit were capitalized separately.

Recommendation:

Cities have a fair amount of flexibility in determining how component assets are to be capitalized; however, no matter what policy the City chooses, it should ensure consistent multi-part asset capitalization. Additionally, a policy and procedure should be developed that ensures when an asset is incorporated into another asset (component asset); the asset's value is increased accordingly. Finally, a policy specifying that component assets should be able to function independently or "stand alone" before it is capitalized by itself should be considered. For example, it would be more reasonable to capitalize street sweepers with their trucks than stretchers with their ambulances.

Capital Assets Records Should Show Proper Disposal

Criteria: Reliability is one of the basic characteristics of effectively communicating financial information to users (GASB 1.62).

According to city policy, Fiscal Services is required to keep a record of each item of surplus or salvage property sold and the sale price of each item. In addition, the policy dictates that the record of each item disposed of must be kept for a period of one year.

Potential Risk: Asset records that inaccurately indicate whether an asset is retired or still in use increases the risk of misappropriation. In addition, if the asset is sold prior to the end of its useful life, the depreciated value of the asset is inaccurately reflected in the City's financial statements until the asset is finally recorded as retired or fully depreciated.

Scope: Capital assets recorded as retired in asset management records in 2012 or 2013. Not including land, building, infrastructure, or non-fleet DIT capital assets.

Observations:

1. We found two assets (0.3%) that were recorded as retired even though they are still in use in the City.

2. Many disposed assets are not being timely recorded as retired in asset management records. We found six assets (7%) that were sold more than 10 years ago that only recently, in 2013, had their status changed to indicate they had been retired. There were an additional 21 assets (23%) recorded as retired between July and September 2013 that were sold or otherwise disposed of more than a year ago.

3. More than half of the assets in our scope had incorrect retirement dates recorded in the asset management system. For many of these assets, the incorrect retirement dates appear to be the result of entering the date the retirement was recorded as the retirement date—rather than the date payment for the sale of the asset was received or ownership ended. In addition, we found a few assets that were retired prior to the end of their useful lives. Therefore, these assets erroneously appeared to still be active in the asset management system and accumulate depreciation expense despite already being sold.

4. Of the assets included in our scope, we were unable to verify the retirement of only three (3%) assets. These three assets may have been component parts attached to trucks, and therefore may have been sold along with the trucks. However, due to lack of sufficient documentation this could not be confirmed.

Recommendation:

Policies and procedures regarding the timely entry of asset disposal into the asset management system should be developed. In addition, an asset's recorded retirement date should reflect the date the City receives payment for the disposed assets or when the City's ownership of the asset ends. Finally, if the City chooses to implement the GFOA best practice of conducting physical inventories of capital assets at least every five years, consideration should be given to changing its document retention policy to require asset sale and disposal documentation be held by the City for at least five years.

Management's Response to the Audit Recommendations

To: Ty Elliott, Internal Auditor

From: Jeff Kersten, Executive Director of Business Services

Date: November 26, 2013

Subject: Management Responses to Recommendations to the Audit

The recommendations included in this audit report are in synch with the process changes the finance department has been discussing over the last couple of years. However, the current Enterprise Resource Planning (ERP) system has not allowed many of these changes without costly implications.

The City is currently evaluating ERP software vendors that provide integrated solutions and functionality the current software does not offer including notifications, alerts, and approval capabilities to automate and streamline the process for recording the proper data elements, capitalization, depreciation, and disposal of capital assets. Revised business processes, policies and procedures will be created as part of the implementation of the new ERP system.

The City hires an independent audit firm every year to audit the City's financial records. During the audit, they check transactions related to the recording of new assets, and the disposal of retired assets. The City has received an unqualified opinion every year – which means that the assets are recorded materially correct. This has allowed the City to delay the costly implementation of these improvements until an updated ERP solution is found.

As we develop our new policies and procedures, we will review the audit recommendations, the capabilities of a new ERP system, and weigh the costs and benefits of this implementation including whether or not additional staffing resources should be considered. This statement applies to all of the recommendations in the report.

Below are the audit report recommendations and management responses:

Capital Assets should be Recorded Timely into the City Record

Recommendation: Documented policies and procedures regarding the timing of when assets must be entered into the asset management system should be developed. Separate procedures for capital assets true additions (e.g. vehicles and equipment) and capital projects may be reasonable. For example, waiting until the end of the fiscal year to ensure that all capital projects are entered into the accounting system could be justified under some circumstances. However, capital assets true additions should be entered into the system soon after the City takes ownership of the asset.

Management Response: Management concurs that assets should be recorded in a timely manner. Updated policies and procedures will be developed to address the recording and tracking of capital assets. As we develop our new policies and procedures, we will review the audit recommendations, the capabilities of a new ERP system, and weigh the costs and benefits of this implementation including whether or not additional staffing resources should be considered.

Periodic Capital Asset Inventories Should be Conducted

Recommendation: A policy and procedure should be developed requiring an inventory of capital assets to be conducted at least once every five years. Several options utilized by other government agencies performing periodic capital asset inventories exist. For example, requiring departments to perform physical inventories and submit a report centrally to Fiscal Services or the Internal Auditor's Office. In addition, consideration should be given to implementing a bar code system (or some other type of inventory tracking system) to more efficiently identify and track tangible assets such as vehicles and equipment.

Management Response: Management concurs that a physical inventory should be done on a periodic basis. Updated policies and procedures will be developed to address the recording and tracking of capital assets. As we develop our new policies and procedures, we will review the audit recommendations, the capabilities of a new ERP system, and weigh the costs and benefits of this implementation including whether or not additional staffing resources should be considered.

Capital Asset Records Should be Reliable

Recommendation: Before periodic inventories of capital assets can be efficiently performed, asset management records need to be better maintained so that assets can be more easily identified and found using these records. Therefore, specific policies and procedures should be considered with this aim in mind.

Management Response: Updated policies and procedures will be developed to address the recording of capital assets. As we develop our new policies and procedures, we will review the audit recommendations, the capabilities of a new ERP system, and weigh the costs and benefits of this implementation including whether or not additional staffing resources should be considered.

Capital Asset Useful Life should be Estimated Consistently

Recommendation: A policy and procedure should be developed to ensure that capital asset useful lives are consistently applied to asset groups. In addition, the GASB standards and the GFOA best practices described in this report should be considered when developing these policies and procedures.

Management Response: Staff will develop a policy and procedure addressing the consistent recording of capital assets. As we develop our new policies and procedures, we will review the audit recommendations, the capabilities of a new ERP system, and weigh the costs and benefits of this implementation including whether or not additional staffing resources should be considered.

Multi-part Assets Should be Capitalized Consistently

Recommendation: Cities have a fair amount of leeway in determining how component assets are to be capitalized; however, no matter what policy the City chooses, it should ensure consistent multi-part asset capitalization. Additionally, a policy and procedure should be developed that ensures when an asset is incorporated into another asset (component asset); the asset's value is increased accordingly. Finally, a policy specifying that component assets should be able to function independently or ―stand alone‖ before it is capitalized by itself should be considered. For example, it would be more reasonable to capitalize street sweepers with their trucks than stretchers with their ambulances.

Management Response: Staff will develop a policy and procedure addressing how component assets are capitalized. As we develop our new policies and procedures, we will review the audit recommendations, the capabilities of a new ERP system, and weigh the costs and benefits of this implementation including whether or not additional staffing resources should be considered.

Capital Asset Records should Show Proper Disposal

Recommendation: Policies and procedures regarding the timely entry of asset disposal into the asset management system should be developed. Finally, if the City chooses to implement the GFOA best practice of conducting physical inventories of capital assets at least every five years, consideration should be given to changing its document retention policy to require asset sale and disposal documentation be held by the City for at least five years.

Management Response: Staff will review the process and procedure for entering records, and the document retention policy regarding asset sale and disposal documentation. As we develop our new policies and procedures, we will review the audit recommendations, the capabilities of a new ERP system, and weigh the costs and benefits of this implementation including whether or not additional staffing resources should be considered.