



A Tradition of Stewardship
A Commitment to Service

Attachment A

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COUNTY-WIDE AUDIT OF CAPITALIZED ASSETS

Napa County Board of Supervisors
Minh Tran, County Executive Officer
Karen Dotson, Internal Audits Manager

Scope and Objective

Our engagement was conducted in conformance with *the International Standards for the Professional Practice of Internal Auditing*. We performed a County-wide audit on capitalized assets recorded as of June 30, 2016. The scope of the engagement was restricted to equipment listed in the records of the County. This is a summary of the audit results. The audit work papers and discovery materials will be made available upon request. The objective of our engagement was to:

- Evaluate the effectiveness of internal controls;
- Determine whether capital assets are adequately accounted for, identified and safeguarded against loss from unauthorized use, theft, or disposal; and
- Determine if the capital asset policies and procedures are adequate and provide the departments with clear guidance.

Background/Authority

On June 30, 1964, the Napa County Board of Supervisors authorized the Auditor-Controller to establish procedures to conform with to the uniform accounting manual of the State Controller's Office. On March 28, 1978 and June 27, 1978, the Board of Supervisors appointed the Auditor-Controller as the County Property Officer with authority to exercise control over the County's property. Effective July 1, 2001 the capital asset threshold was set at \$5,000. In accordance with Board authority, the Auditor-Controller's Office has developed a Capital Asset Policies and Procedures manual [issued July 2016] and an Internal Control Policy [adopted by the Board of Supervisors on October 18, 2016].

After the completion of the Capital Asset Policies and Procedures, the Auditor-Controller's Office conducted training sessions and provides annual trainings as part of the year end close process.

The Internal Audit staff utilized a list of capital assets maintained by the financial reporting section of the Auditor-Controller's Office to perform observations and examinations of the controls. The list is updated, distributed and then certified by each department annually (by September 1) as part of the year end close process. For the fiscal year ended June 30, 2016, the County had over 1,000 vehicles and equipment listed for a total value of \$39 million. The majority of the assets reside with Public Works, Fire Protection and Information Technology Services.

Procedures

In achieving the engagement objectives, the following procedures were performed, including but not limited to:

1. **Asset Existence** – We verified the existence of capital assets by physical observation, date stamped photos from the departments for assets in rural areas such as roads and fire stations, or by verifying the functionality of the assets such as the cell towers.
2. **Authorized Disposals** – We compared the assets that were noted as being sent to surplus for auction or disposal to the records maintained by Purchasing and the Board of Supervisors minutes authorizing disposal.
3. **Safeguarding of Assets** – We examined assets to verify they were identified by County issued inventory tags or County seals affixed to the asset. In addition, we examined the departmental practices to ensure assets are protected against unauthorized use or theft.

Summary of Results and Recommendations

Asset Existence

Result: The verification of assets was dependent in many cases on the clarity of the description within the County's financial system. In addition, deposits on equipment could not always be linked to an asset, especially when the deposit was paid in one fiscal year and the balance owed on the equipment was paid in the subsequent year. There are many limitations to our current system as most of the process is manual. The number of characters permitted for the description field is limited and does not allow for much detail; asset numbers are not assigned until after the procurement process is complete; and, if there are multiple payments for one asset, there is no linkage between the multiple payments and the complete asset within the system.

Recommendation: The asset should be identified through the requisition process prior to when procurement takes place. Until the County implements a new financial system integrated with an automated requisition process, departments should use the most meaningful descriptions as possible and maintain complete asset records. Departments should also complete physical observation inventories prior to certifying the annual asset list. If there are discrepancies or areas for improvement on the description, the department should request the changes to be made to allow for the asset lists to be more accurate and meaningful.

Authorized Disposals

Result:

- 72% (valued at \$29.0 million) of the County's assets were verified at the time of the audit.
- 17% (valued at \$3.15 million) were deemed obsolete or disposed of utilizing the procedures established by the Auditor-Controller's Office "Capital Asset Policies and Procedures" and County Executive Offices' Surplus Property requirements contained in Section 12 of the Napa County Purchasing Policy.
- 10% (valued at \$6.45 million) were not physically observed mainly because they were components utilized on fire engines. The components are interchangeable and there is no tracking system in place to determine which engine has which components.
- 1% (valued at \$325,760) could not be located and there was no supporting disposal paperwork on file within the Department or with the Auditor-Controller's Office.

Recommendation: With 1% of overall assets no able to be located, equating to less than 1% of the total value, the County departments generally follow the policies and procedures of tracking and managing capital assets. However, ideally no assets should go missing. Therefore, we recommend when departments are disposing of assets, they should contact Purchasing for proper disposal. If the asset is sent to surplus or transferred, there are specific procedures to follow. If the asset is funded by State or Federal funding, there may be additional procedures to follow. In all cases, department heads are responsible for maintaining the assets held under their control. We also recommend the annual certification should be signed only after a physical observation is conducted and include an explanation and resolution if any listed asset cannot be found.

Regarding the fire engines, this is a result of not having an automated inventory system that links the various components of each asset. It is also a result of each individual component being recognized as separate assets. Following current accounting standards, all components should be listed as "children" to the "parent" asset. If the children can be interchangeable, the parent asset values do not necessarily increase or decrease as one component simply replaces another. At this time, short of implementing a manual and time consuming process, our recommendation is for the Auditor-Controller to work with Fire to design a solution that could be implemented with a new financial system.

Safeguarding of Assets

Result: As stated above, approximately 11% of the County's assets were either not observed because the asset was a component of a larger asset, or could not be verified due to the Department not knowing the physical location of the asset. In accordance with the County's Internal Control Policy, the County's Purchasing Policy, and California Government Code, the County is responsible for the prudent stewardship of all items acquired with taxpayer funds.

Recommendation: Components make up a complete asset. Therefore, generally the risk in this area is low because the asset would not be able to function properly without the components (i.e.: a fire engine without a hose). For those assets not found, this can open a high risk of theft, fraud or misuse. Departments must follow the procedures for proper disposal of assets and should complete, at a minimum, an annual observation of their assets prior to certifying the inventory listing to the Auditor-Controller. Identifying assets each year provides awareness, better controls and accountability. If assets cannot be identified, we recommend the Auditor-Controller compile and present a listing from the annual certifications to the Board of Supervisors. This shall include an explanation by each department and subsequent authorization to have them removed from the County's records.

Conclusion

The County has policies and procedures in place to comply with Generally Accepted Accounting Principles (GAAP) and the Governmental Accounts Standards Board (GASB) for the recording and tracking of capital assets. The policies enforce the internal controls and safeguarding of assets, and provide departments with clear guidance.

Having a manual system puts the County at high risk for errors and omissions, and even theft and fraud. Annual certifications require a physical observation of assets each year by the departments. However, our audit results indicate assets that are no longer in the County's possession are still on the asset listing and financial records. In addition, because of the manual tracking, we may not have the sufficient controls to ensure all assets were recorded at the time of purchase, and in the case of multiple payments, if the values recorded were accurate. The financial reporting division of the Auditor's Office reviews for this each year, but it is a manual process and many assumptions have to be made.

With the technological advances in financial software today, an integrated system would have the ability to identify and track an asset from the initial requisition stage through to final payment to place the asset into production, allowing the parent/child relationships to be tracked. Departments would have access to their listing at all times and would have the ability to update it throughout the year as events occur, such as disposals or retirements.

Best practices that should be implemented immediately include the following:

Review the Policies and Procedures – Departments should review the policies and procedures provided by the Purchasing Policy and the Capital Asset Policies and Procedures on an annual basis. The Auditor-Controller staff and Purchasing Manager are available for departmental trainings upon request.

Monitoring – Departments should ensure that the information recorded in the financial system, through the claim reviewing process, is accurate and reflects the true asset description for easy identification.

Annual Observation and Certification – Departments should complete a physical annual observation as of June 30 each year to determine if the assets on the prior year's list still exist or have been properly disposed of. If an asset cannot be identified, the department should work with the Purchasing Manager to follow the proper procedures. In addition, all disposals and additions should be noted with proper documentation (Board minutes and/or invoices). This will greatly improve the accuracy and timeliness of the year end closing process.

I want to thank the Internal Audit staff and management for their expertise and professionalism in conducting this engagement. I also want to express my sincere gratitude to the Department Heads and staff who spent many hours assisting with the physical observation reaching every corner of the County.

Sincerely,

Tracy A. Schulze

Tracy A. Schulze
Auditor-Controller