



Douglas County Internal Audit

October 16, 2012

Douglas County Board of Commissioners
1819 Farnam Street, Suite LC2
Omaha, NE 68183

Attention: Marc Kraft, Mary Ann Borgeson, Clare Duda, Mike Boyle, PJ Morgan,
Chris Rodgers and Pam Tusa

Thomas Cavanaugh, Douglas County Clerk/Comptroller
Eric Carlson, Purchasing Agent
1819 Harney St.
Omaha, NE 68183

Dear Commissioners, Mr. Cavanaugh, and Mr. Carlson:

I have completed an audit of Douglas County fixed assets and construction-in-process. The purpose of the audit was to assess the adequacy and effectiveness of the control processes used to ensure that capital assets are properly authorized and recorded. The audit revealed that, overall, controls were adequately designed and worked effectively. However, there were exceptions related to recording assets in the correct period and maintaining informal bid documentation. Details appear in the Findings section below.

Background

As part of the fiscal year audit plan, Douglas County Internal Audit performs internal control testing for the Douglas County external audit firm, Hayes and Associates, LLC. The external auditor uses the test data provided by Internal Audit to formulate a professional opinion about the County's year-end financial statements. Below are the details related to tests of the controls over fixed assets and construction-in-process.

Objectives

The objectives of the audit were to determine that:

- Capital asset additions were properly authorized.
- Capital asset additions represented real assets owned by the County.
- All additions were recorded completely and accurately.
- Depreciation was recorded completely and accurately.
- Disposals were properly authorized.

- Disposals were recorded completely and accurately.

Scope and Methodology

The audit included a test of forty additions capitalized on the Oracle Fixed Assets system. The items were chosen using a judgmental sampling methodology. The sample included tests of items added to the fixed asset system in the 2012 fiscal year. The assets included in the sample were tested to verify that:

- Purchase orders and requisitions were approved by the appropriate persons.
- Board approval, bidding, and quotes were obtained according to policy.
- The additions were added to the system in the correct period, account, and amount.
- The purchase orders and invoices for the additions matched each other and agreed with the information recorded in the fixed asset system.

Twenty asset retirements were chosen for testing. Ten items were chosen randomly from a list of fixed assets that were retired during the 2012 fiscal year. Ten other items were chosen judgmentally from a file containing Fixed Asset Status Reports and a listing of items included in the yearly auction. The items were tested to verify that:

- The retirements were properly recorded in the system including all related transactions.
- The retirement was properly authorized.

Forty transactions from the 2012 fiscal year were randomly chosen from various Oracle expense accounts that included both asset purchases and repairs and maintenance. The items were reviewed to determine if the transactions were expensed or capitalized appropriately.

Ten pre-existing assets were reviewed to determine that both the current depreciation expense and the accumulated depreciation were properly calculated.

Four of sixteen 201 fiscal year Engineering Department construction projects tracked in Oracle were judgmentally selected for testing. One additional construction project not tracked in Oracle was also tested. The tests included:

- Verification of Board approval of the project.
- Review of 80% of the 2012 fiscal year expenditures related to the five projects to ensure that the amounts were valid capital costs.
- Examination of evidence showing that the projects were related to valid County assets. Evidence included review of plan approvals, purchase agreements, and GIS mapping that showed the assets were within County jurisdiction.

Two of six construction projects completed during the 2012 fiscal year were judgmentally selected for testing. The tests included:

- Verification that the assets were transferred to fixed assets in the correct account, period and amount.

- Recalculation of depreciation expense for accuracy.

Findings

Recording Fixed Asset Transactions

Criteria: Fixed asset transactions, including related depreciation, should be properly reflected in the County's financial statements.

Condition: Testing for proper capitalization revealed a number of errors as shown below:

- There were three exceptions related to the testing of forty expense and asset expenditures.
 - A \$255,000 striper truck was placed in service in the 4th quarter of 2012, but was not paid for until July 2012. It was classified as an expense at year-end.
 - Rulings from the Douglas County Attorney's office regarding the interlocal agreements with DOT.Comm indicate that IT assets are the property of DOT.Comm. The assets, however, were never transferred to DOT.Comm through financial transactions. The estimated value of these purchases for FY 2012 was \$276,000.
- One of the two completed construction projects tested was substantially completed in fiscal year 2011 but was not recorded as a fixed asset until 2012. The value of the project was \$10,654,000.

Effect: The items noted above resulted in net assets being overstated \$231,000 due to transactions that understated and overstated net assets. Net assets were understated \$237,000 due to the accounting treatment of the striper. (The difference between the cost in the Condition section and the amount noted in this section is due to the half-year of depreciation that was not recorded for 2012.) Net assets were overstated \$468,000 - \$255,000 due to IT purchases not transferred to DOT.Comm and \$213,000 for the construction project that was recorded as an asset in FY 2012 rather 2011. (The difference between the costs in the Condition section and the amount listed here is due to recording half a year's depreciation in 2012 rather than a full-year which would have occurred if the construction project had been placed in service in 2011. The \$21,000 difference between the \$276,000 of IT purchases noted in the Condition section and the \$255,000 in this section is due to an IT purchase that was classified as maintenance and repair rather than an IT purchase.)

Cause: There were a number of reasons for the errors noted above:

- The policy followed by Douglas County to capitalize and depreciate fixed assets based upon the payment date rather than the in-service date does not follow Generally Accepted Accounting Principles. This policy was used to simplify the process of classifying fixed asset purchases.
- The accounting treatment of IT asset purchases was not consistent with the intent of the interlocal agreement to transfer legal title.
- The cut-off procedures used in the prior year for properly recording transactions in the correct fiscal year did not identify the items noted above for inclusion in the appropriate fiscal year.

Recommendation: Consider the following recommendations:

- Change the current policy of using in-service dates rather payment dates to add and begin depreciation of fixed assets.

Management Response: The long standing policy of the County has been to determine the in-service date as the month that the invoice is validated by the Finance Division Accounts Payable auditors. The payment will then be on the next Board agenda for the Board to approve payment. The County does not own the asset until we pay for it. There is very little GAAP advice available for determining in-service dates, beyond “. . . The asset is considered to be placed in service when it is first put into a condition or state of and availability for a specific assigned function.” It would be our continued opinion that it is not in this state until we have paid for it. We will continue to encourage departments to submit claims for payment in a timely manner.

- Verify the amount of IT purchases attributed to DOT.Comm for 2012 and prior years and transfer the amounts as a non-cash contribution to DOT.Comm.

Management Response: Management concurs and will discuss with external auditors how to present in the 2012 BFY financial statements for the 2012 fiscal year.

- Current procedures identify invoices to review for proper recording in the correct time period. Enhance the review by gaining clear information on the nature of the purchase and confirming in-service dates with the appropriate personnel.

Management Response: See response above regarding in-service dates. Clerk/Comptroller staff will work to enhance the current review procedures.

Purchasing Documentation

Criteria: State statute requires the Purchasing Department to obtain at least three informal bids for purchases under \$20,000.

Condition: Twenty of the forty asset additions tested were less than \$20,000 and required informal bids. Three of the twenty bids less than \$20,000 lacked documentation showing that informal bids were obtained.

Effect: Without appropriate documentation, it cannot be assured that the County had the information it needed to make an appropriate purchase decision per state statute.

Cause: The highest level of effort was not put forth to appropriately document and safeguard the informal bid information.

Recommendation: Ensure that purchase documentation always includes the appropriate bids and quotes required and a review to ensure that the information is included. Consider using a checklist that references the documentation that includes explanations that fully present the rational for each purchase decision.

Management Response: Purchasing staff has reviewed the findings and is already addressing the recommendations. Purchasing staff will continue to reference the appropriate bid or quote documents to demonstrate the basis for all purchasing activities involving the Purchasing Department. These documents will be kept on file for future reference. Additionally Purchasing staff will continue to document any allowable exceptions to the bid process for a particular purchase (GSA, Sole source, State contract, or other Cooperative purchase agreement). These documents will be kept in our contract database for future reference. Purchasing will continue to communicate to all County departments the need to adhere to all purchase policies and procedures as they relate to the purchase of fixed assets.

Audit Standards

Internal Audit conducted this audit in accordance with generally accepted government auditing standards. Those standards require that the audit is planned and performed to obtain sufficient, appropriate evidence to provide a reasonable basis for the findings and conclusions based on the audit objectives. Internal Audit believes that the evidence obtained provides a reasonable basis for its findings and conclusions based on the audit objectives.

Internal Audit has reviewed this information with the Chief Deputy Douglas County Clerk and the Purchasing Agent. Internal Audit appreciates the excellent cooperation provided by management and staff. If you have any questions or wish to discuss the information presented in this report, please contact Mike Dwornicki at (402) 444-4327.

Sincerely,

Mike Dwornicki
Internal Audit Director

- cc: Paul Tomoser
Joni Davis
Trent Demulling
Donald Stephens
Kathleen Kelley
Joe Lorenz
Patrick Bloomingdale
Kathleen Hall
Jerry Prazan
Mark Rhine