



MEMORANDUM

Date: June 23, 2014

File No. 2169

To: Rhonda Basarich, Chief
Office of Fiscal Services
707 3rd Street, 9th Floor
West Sacramento, CA 95605

From: Department of General Services
Office of Audit Services

Subject: REVIEW OF THE SYSTEMS OF INTERNAL CONTROL FOR FIXED ASSETS

This report presents the results of our review of the systems of internal control of the Department of General Services (DGS) for fixed assets. These systems are primarily administered by the Office of Fiscal Services (OFS). This review was conducted as part of the Office of Audit Services' biennial review of DGS' systems of internal control. Our review was conducted in accordance with the International Standards for the Professional Practice of Internal Auditing.

The objective of our review was to determine the adequacy and effectiveness of the systems of internal control for the fixed assets transaction cycle. A transaction cycle is defined as the route by which a type of transaction flows from inception to final reporting. As of June 30, 2013, DGS had the following categories and amounts of fixed assets recorded on its official accounting records: Equipment \$133,952,178; Intangible Property \$7,552,142; Land \$256,158,477; Buildings \$2,375,621,370; and, Improvements Other Than Buildings \$57,355,993.

Our review of fixed assets primarily involved determining whether sufficient policies and procedures have been implemented to provide reasonable assurance that: (1) assets are safeguarded against loss from unauthorized use or disposition; (2) transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of reliable financial statements; and, (3) financial operations are conducted in accordance with policies and procedures established in the State Administrative Manual (SAM). Reasonable assurance is provided when cost-effective actions are taken to restrict deviations to a tolerable level. These actions should result in material errors and improper or illegal acts being prevented or detected and corrected within a timely period by employees in the normal course of performing assigned duties.

Based on the results of our primary fieldwork that was completed in August 2013 and limited follow-up work performed in May 2014, we concluded that OFS has established adequate and effective systems of internal control over fixed assets. OFS' systems of internal control provide reasonable assurance that assets are safeguarded, transactions are properly executed and recorded, and financial operations are conducted in compliance with SAM requirements.

It should be noted that during our review the Office of Fleet and Asset Management's (OFAM) policies and procedures were not ensuring the periodic reconciliation of its equipment assets, which represent approximately 63% (\$84.4 million) of the department's total equipment assets, to the official property records maintained by OFS. Specifically, OFAM was not periodically reconciling the total number of equipment items, primarily motor vehicles, recorded in its fixed

asset records to the total number of OFAM asset items recorded in DGS' official property ledger maintained by OFS. At the time of our original review of this issue in February 2013, there was a 196 item difference between OFS' records which showed 5,407 vehicles and OFAM's records (Fleet Focus) which showed 5,211 vehicles.

Upon being informed of this issue in February 2013, in consultation with OFS, OFAM immediately assigned staff to perform the reconciliation of its fixed assets records to those maintained by OFS. Due to other operating priorities, the reconciliation process was not completed at that time. However, recently, OFAM reassigned staff to the reconciliation process and has made significant progress in completing that activity. We will follow-up to ensure that the reconciliation process is completed, including the prompt research and resolution of any differences between OFAM's and OFS' fixed asset records.

In addition, we noted that one DGS owned building with a value \$64 million had not been recorded in DGS' official accounting records. Specifically, we determined that the Department of Transportation's (Caltrans) District 3 office building, which was built in 2008, had not been recorded in the Buildings fixed assets account. The Caltrans' building was recorded in the Statewide Property Inventory (SPI)¹, which is maintained by the Real Estate Services Division (RESO), as a DGS owned structure. However, RESO had not included it on a monthly listing of DGS owned buildings it provides to OFS for use in reconciling the department's real property accounts. Consequently, the building valued at \$64 million had not been recorded in the Buildings fixed asset account.

In researching this issue, we determined that Caltrans owned the land for the District 3 building, however, the building was bond funded and owned by DGS. The District 3 building was one of two Caltrans' buildings that were built in this manner. The other building, Caltrans' District 11 office building, was included on the monthly listing of DGS owned buildings provided by RESO to OFS. Therefore, its \$69.9 million cost was accurately posted to the DGS' official accounting records. As previously noted, although completed in 2008, the District 3 building was not included on the monthly listing. Upon being advised of this discrepancy, in April 2013, OFS took immediate action and recorded the District 3 building with a value of \$64 million in the department's fixed assets accounts.

Since prior to the completion of our audit we verified that appropriate actions had been or were being taken to address the above issues, they are not further discussed in this report.

To determine the adequacy and effectiveness of the systems of internal control for fixed assets, we reviewed policies and procedures, interviewed parties involved, observed operations, tested records and transactions and performed other tests as deemed necessary. Our testing included the verification that the amounts shown on the DGS' official accounting records for Land, Buildings, and Improvements Other Than Buildings reconciled to the department's data shown in SPI.

An audit guide issued by the Department of Finance was used to assist us in our evaluation of the systems of internal control. The audit guide identified the following five control objectives that were evaluated during our review of fixed assets: (1) written procedures exist for acquiring, disposing and recording fixed assets; (2) there is adequate separation of duties over fixed assets; (3) acquisitions and disposals of fixed assets are properly authorized and recorded in the accounting records; (4) recorded fixed assets are in existence and can readily be identified; and, (5) subsidiary records are posted accurately and timely and periodically reconciled to the control accounts.

¹ SPI contains a detailed inventory of state properties including land and buildings.

Management should be aware that controls cannot prevent all problems because they would not be cost-effective. Moreover, the effectiveness of controls changes over time. Limitations which may hinder the effectiveness of an otherwise adequate system of controls include resource constraints, faulty judgments, unintentional errors, circumvention by collusion, and management overrides. The presence of these limitations may not always be detected by an audit.

We greatly appreciated the cooperation and assistance provided by OFS' personnel.

If you need further information or assistance on this report, please contact me at (916) 376-5058, or Andy Won, Audit Supervisor, at (916) 376-5052.



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