AUDITOR'S REPORT

PURCHASING DEPARTMENT
UNRECORDED CAPITAL ASSETS

August 15, 2014

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HARRIS COUNTY AUDITOR

August 15, 2014

DeWight Dopslauf, C.P.M, CPPO
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Houston, Texas 77002

RE: Purchasing Department (Purchasing) Unrecorded Capital Assets for the 12 months ended June 30, 2013

The Audit Services (Audit Services) Department performed procedures relative to the Purchasing Department Unrecorded Capital Assets. The objective of the engagement was to comply with Local Government Code (LGC) §262.011 (i) which requires an examination of the inventory and an accounting for all property purchased or previously inventoried and not appearing in the inventory. Our procedures included the following:

- Determining whether the Purchasing Agent submitted an inventory of all the property on hand with the County Auditor by July 1, 2013.

- Selectively examining purchases made during the period July 1, 2012 to May 31, 2013 to determine if capital purchases were appropriately accounted for.

- Examining the inventory submitted by the Purchasing Agent to determine whether items previously listed and no longer appearing on the inventory were appropriately removed.

The engagement process included providing you with engagement and scope letters and conducting an entrance and exit conference with your personnel. The purpose of the letters and conferences were to explain the process, identify areas of concern, describe the procedures to be performed, discuss issues identified during the engagement, and solicit suggestions for resolving the issues. A draft report was provided to you and your personnel for review.

The enclosed Auditor's Report presents the significant issues identified during our procedures, recommendations developed in conjunction with your staff, and any actions you have taken to implement the recommendations.

DeWight Dopslauf, C.P.M, CPPO
Purchasing Agent

We appreciate the time and attention provided by you and your staff during this engagement.

Sincerely,

Barbara J. Schott
County Auditor

cc: District Judges
County Judge Ed Emmett
Commissioners:
R. Jack Cagle
El Franco Lee
Jack Morman
Steve Radack
Devon Anderson
Vince Ryan
William J. Jackson

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OVERVIEW

The Harris County Purchasing Agent (Purchasing Agent) is an independent officer of the County and is appointed by a Board comprised of three State District Judges and two members of Commissioners Court in accordance with Texas Local Government Code §262.011(a). The Office of the Purchasing Agent (Purchasing Office) is responsible for the procurement of goods and services that are essential to the operations of Harris County, Harris County Flood Control District, Harris Health System, Community Health Choice, Inc., Harris County Toll Road Authority, Community Supervision & Corrections, and Harris County Juvenile Probation. Additionally, the Purchasing Office is responsible for establishing policies and procedures that ensure the procurement methods used are transparent, fair, and instill integrity. These procedures are approved by the County's Commissioner's Court.

The duties of the Purchasing Office include, but are not limited to, the following broad categories:

- **Advertised Bids and Request for Proposals:** Purchases of goods and services above $50,000. The County Purchasing Act (Texas Local Government Code §262.021 requires that a proposed purchase exceeding $50,000 be published at least once a week in a newspaper of general circulation with the first day of publication being at least 14 days before the date of bid opening.

- **Informal Quotations:** Purchases of goods and services for $50,000 or less that do not require publication in a newspaper, and purchases made through a federal or state agency. For these purchases, the end user department is responsible for obtaining adequate information and price quotes to evaluate the required products or services.

- **Contract Administration:** Oversight/management of term contracts (purchase commitments), which includes the initial procurement, renewal, termination of an existing contract, change in contract or amendments to existing contracts.

- **County Inventory Management:** Storage, transfer, and/or disposal of county property, including recycling.

Accordingly, it is the duty of the Purchasing Agent to purchase all supplies, materials, and equipment, and to contract for all repairs to property used by the County (or a subdivision, officer, or employee of the County), except purchases or contracts required by law to be made by competitive bid. Only the Purchasing Agent may make the purchase of supplies, materials, or equipment or make a contract for repairs [LGC §262.0ll (d)]. Further, the Purchasing Agent shall supervise all purchases made by the competitive bid or proposal processes, and shall see that all purchased supplies, materials, and equipment are delivered to the proper County officer or department in accordance with the purchase contract [LGC §262.011(e)]. The Purchasing Agent shall also maintain an inventory of County property and transfer surplus County property between County departments as required by [LGC § 262.0ll (i) (G) J]. Violation of these laws by any County official or employee carries criminal penalties [LGC 262.0ll (m)].

The Purchasing Office includes the Purchasing Services Division (Purchasing Services), which is responsible for County inventory records, transfers, sales, and disposition of County surplus, salvage, and/or abandoned or unclaimed property [LGC §267.011(j); §263,151 et seq., as amended; and Texas Code of Criminal Procedure §18.17, as amended].

Purchasing Services records changes for all items on the County Inventory Listing. Changes to records must be requested by user departments with the appropriate County form. Each individual user department is responsible for all items assigned to its department, regardless of value. When requested, Purchasing Services will assist any user department in conducting its inventory. Pursuant to the Purchasing and Procedures manual approved by Commissioners Court, Purchasing Services must "randomly schedule periodic inventories and spot checks of user departments in order to verify the accuracy of the inventory records."

The following is a list of inventory responsibilities by department:

- **Purchasing Agent:** LGC §262.011(1) requires that each year: "the County Purchasing Agent shall file with the County Auditor and each of the members of the board that appoints the County Purchasing Agent an inventory of all property on hand and belonging to the County and each subdivision, officer, and employee of the County." Further, LGC §262.011(j) states: "the County Purchasing Agent shall transfer County supplies, materials and equipment from a subdivision, department, officer, or employee of the County that are not needed or used to another subdivision, department, officer, or employee requiring the supplies, materials and equipment."

- **Auditor's Office:** LGC § 262.011(i) requires that "the County Auditor shall carefully examine the inventory and make an accounting for all property purchased or previously inventoried and not appearing in the inventory." Further, the Harris County Road Law, Section 10, requires the County Auditor to take inventory of property assigned to any County official whose employment is terminated due to death, resignation, or retirement.

- **All Departments:** Each department manager or elected official has the primary responsibility for safeguarding and accounting for assets which have been assigned to their department. This responsibility includes conducting an annual departmental inventory and comparing the results to the County inventory listing. Any appropriate reconciling documentation should be submitted to Purchasing Services.

An inventory detail listing indicating the current departmental inventory of record is available in the County financial system to each department manager and elected official for the applicable department. No later than May 1 of each year, every department and elected office is required to submit to Purchasing Services a completed Inventory Completion Statement (County Auditor's Form 3368). Thereafter, that department or office inventory is considered current and acceptable for filing with the County Auditor and each of the members of the board that appoints the County Purchasing Agent, as required by LGC §262.011(i). Any department or office submitting Inventory Completion Statement (County Auditor's Form 3368) later than May 1 will be considered delinquent, and included on a quarterly report submitted by Purchasing Services to

the Purchasing Office and the County Auditor for communication to Commissioners Court, as necessary.

On July 1st of each year, the Purchasing Office files with the County Auditor, and each of the members of the Board, an inventory of all the property on hand and belonging to the county and each subdivision, officer, and employee of the county pursuant to LGC §262.011(i). For purposes of the annual inventory and fulfilling statutory requirements, Harris County defines "property on hand" as personal property and further classifies reportable property according to the following guidelines:

Category I Capital County Assets	• County Personal Property with a unit value of $5,000 or more • Capitalized on the County's General Ledger. Examples: rolling equipment, some generators, pumps, and mainframe computer equipment.
Category II Controlled County Assets	• County Personal Property with a unit value of or between $500-$4,999.99 <u>WITH</u> unique identifying number such as a serial number applied by the manufacturer (and not part of larger item) • Not capitalized on the County's General Ledger. Examples: CPUs, computer peripherals such as scanners, printers, monitors, projectors, some radios, some small rolling equipment, and some power tools.
Category III Discretionary County Assets	• County Personal Property with a unit value of less than $5,000 <u>WITHOUT</u> unique identifying number such as a serial number applied by the manufacturer • Not capitalized on the County's General Ledger. Examples: chairs, desks, file cabinets, book cabinets, hand tools, inexpensive small equipment, as well as items not included in Category I and II but coded to an asset code.

RESULTS

Based on the procedures performed for compliance with Local Government Code (LGC) §262.011 (i), items previously listed on the 2012 Fixed Asset Identification CD that no longer appear on the 2013 Fixed Asset Identification CD were appropriately removed. However, it appears controls surrounding the creation of the Fixed Asset Identification CD (FAID CD) and relative transmittal letter need improvement. The following items were noted during testing:

- The Purchasing Agent submitted an inventory of all the property on hand with the County Auditor by the July 1, 2013 deadline. However, the FAID CD and related transmittal letter were not accurate.

- Based on testing of purchases made during the period July 1, 2012 to May 31, 2013, Capital purchases were not always appropriately accounted for and purchase orders did not consistently contain enough detail to determine the product or service purchased.

- Purchasing Services does not have formal written policies and procedures to govern the performance of inventories they perform at County departments.

These and other matters are discussed in more detail within the attached Issues and Recommendations matrix.

ISSUES AND RECOMMENDATIONS				
Subject	**Background**	**Issue**	**Recommendation**	**Management Response**
Purchasing Services Inventories	Pursuant to the Purchasing and Procedures Manual approved by Commissioners Court on May 21, 2013, "Purchasing Services will randomly schedule periodic inventories and spot checks of user departments in order to verify the accuracy of the inventory records". Best practice when performing an inventory includes selecting a sample of inventory items both from the general ledger to be traced to the inventory location and from the inventory location to be traced to the general ledger.	Although Purchasing Services personnel perform processes they have established over time, there are no formal written policies and procedures governing the performance of inventories they perform at County departments. In addition, the current processes being performed are not adequate as Purchasing Services does not utilize or document a sampling methodology to support how many items/departments they select for testing and how they are selected for testing. Furthermore, Purchasing Services does not consistently select a sample of inventory items from the County's Financial System (IFAS) to be traced to the items' locations. As such, errors associated with inventory items that are recorded in IFAS but are	Purchasing Services should create and implement formalized policies and procedures that detail the process they use to perform inventories at County departments. The procedures should include documenting the methodology used to determine the number of departments to test and how to select the departments to test. Additionally, the procedures should document the methodology used to determine the number of inventory items to test, and how to select the sample of inventory items to test. Finally, the procedures should require that samples be selected from both the IFAS inventory listing to be traced to the inventory location and from the inventory location to be	Management is implementing new procedures and policies to detail the process used to perform test sampling of department inventories.

ISSUES AND RECOMMENDATIONS				
Subject	**Background**	**Issue**	**Recommendation**	**Management Response**
(Continued) Purchasing Services Inventories		missing or do not exist will go undetected and could lead to an overstatement of the County's inventory balance on the financial statements.	traced back to IFAS.	
Annual Inventory Listing	On July 1 of each year, the County Purchasing Agent files with the County Auditor, and each of the members of Commissioners Court, an inventory of all the property on hand and belonging to the County and each subdivision, officer, and employee of the County pursuant to LGC § 262.011(i). The inventory comes in the form of an excel spreadsheet exported to a CD. Accompanying the CD is a transmittal letter which presents the number of items and amount spent for each category of assets (Category 1, 2 or 3). Categories are assigned by Purchasing Services based	Controls surrounding the entry and accuracy verification of assets and inventory items entered into the IFAS Fixed Assets Module (Module) need improvement. As a result the 2013 FAID CD prepared by Purchasing Services and the related transmittal letter to the County Auditor prepared by the Purchasing Agent are not accurate. During testing, the following was noted: - The numbers of items in each category is misstated due to an improper application of threshold values and/or characteristics for each	Purchasing Services, in conjunction with Financial Accounting and County Departments, should reevaluate entries in the Module to determine if there are any entries which may contain components which were not unitized that should be inventoried, entries which should be capitalized and depreciated or unrecorded costs that should be accounted for. In addition, monitoring controls should be implemented to detect entries made into the Module that did not go through candidate processing but should be reviewed for capitalization.	**Financial Accounting Response:** Financial Accounting will work with Purchasing, the departments, and others as appropriate to assist in ensuring proper capitalization of items in accordance with GAAP and County policy. Financial Accounting will provide any requested assistance to the departments regarding Procedure A.7, Accounting for Gifts, and the associated Form 770, Proposed Gift to Harris County. **Purchasing Agent Response:** The duplicated items have

ISSUES AND RECOMMENDATIONS				
Subject	**Background**	**Issue**	**Recommendation**	**Management Response**
(Continued) Annual Inventory Listing	on the unit dollar value associated with the entry. In the past the category has been assigned manually each year subsequent to exporting the inventory listing to an excel spreadsheet. Going forward an existing field in the Module will be utilized for the entry of the category.	category (See Reference 1 in Appendix A) - The number of inventory items in each category cannot be determined as documentation supporting entry into the Module does not consistently provide enough detail to determine whether there are component parts that should have been entered into the Module and annually inventoried (See Reference 2 in Appendix A) - The numbers of items in each category is misstated due to a duplication of unique identifying serial numbers associated with multiple items. (See Reference 3 in Appendix A) - Items entered into the Module were not appropriately capitalized and depreciated (See Reference 4 in Appendix		been corrected and the transmittal letter was revised to incorporate the changes recommended.

ISSUES AND RECOMMENDATIONS				
Subject	**Background**	**Issue**	**Recommendation**	**Management Response**
(Continued) Annual Inventory Listing		A) - The number of items for each category listed on the transmittal letter is misstated as Purchasing counted the number of line items in the Module rather than summing the value from the "Quantity" field. Inaccurate entries into the Module could lead to a misclassification of capital assets and result in an over or understatement of capital assets and associated depreciation expense along with noncompliance with LGC § 262.011(i).		
Purchase Order Detail	Pursuant to the memorandum titled "Line Item Review" issued by the Purchasing Agent on July 15, 2005, purchases in which an item is made up of components should be entered on the PO by using the first line of the requisition/purchase order	The Office is not consistently including enough detail in the purchase order (PO) description field to determine what service or product is being purchased. During testing, it was noted that 12 of the 60 (20%) POs examined contained line	Purchasing Management should ensure that enough detail is included in the PO description field to determine what product or service is being purchased. This might include retraining staff on how to fill out the PO description field pursuant to the "Line	Additional training will be provided to buyers as well as performing quality assurance reviews to ensure PO descriptions are accurate.

ISSUES AND RECOMMENDATIONS				
Subject	**Background**	**Issue**	**Recommendation**	**Management Response**
(Continued) Purchase Order Detail	screen to include the total of the principal item as well as all associated items. All associated item descriptions and costs should be included in the text under the description in item one. In addition, attached to the memorandum was a document titled "Capital Assets" issued by the County Auditor on September 14, 2005, which details a complete list of additional costs, with explanation, to be considered in the total acquisition cost of an asset.	items, totaling approximately $5,000,000, which did not contain enough detail in the PO description field to determine what product or service was purchased. Not including enough detail in the PO description field could result in unauthorized and/or inappropriate disbursements. In addition, not including enough detail in the PO description field could lead to a misclassification of capital assets and result in an over or understatement of capital assets and associated depreciation expense.	Item Review" memorandum issued by the Purchasing Agent on July 15, 2005 and the "Capital Assets" memorandum issued by the County Auditor on September 14, 2005. Purchasing Management may also want to consider performing a quality assurance review over a sample of PO's on a monthly basis. In addition, Management should consider incorporating above memorandums into the Purchasing Manual and policies and procedures.	

PURCHASING DEPARTMENT UNRECORDED CAPITAL ASSETS
APPENDIX A
ANNUAL INVENTORY LISTING EXCEPTIONS

Reference	Issue Symptom	Exception Noted
1	The numbers of items in each category are misstated due to an improper application of threshold values and/or characteristics for each category. (Purchasing)	8 of 15 (53%) items tested were incorrectly categorized according to Accounting Procedure A.1-1, Attachment A.
		1 of 5 (20%) items tested were incorrectly categorized in IFAS.
		Computer Assisted Audit Techniques (CAATS) identified 7,540 of 67,267 Category 2 Assets line items on the 2013 FAID CD where the category assigned was Category 2 Assets but the unit value was less than $500. These items were either input into the Module incorrectly or should be Category 3 Assets items.
		CAATS identified 10,904 of 67,267 Category 2 Assets line items on the 2013 FAID CD where the category assigned was Category 2 Assets but did not have a serial number or identifying number. These were either input without the required identifying information or were incorrectly categorized and should be Category 3 Assets.
		CAATS identified 279 of 29,009 line items on the 2013 FAID CD where the unit value input was greater than $500 and less than $5,000 AND also had a serial number populated in the system. By procedure definition, these items should be Category 2 Assets items.
2	The number of inventory items in each category cannot be determined as documentation supporting entry into the module does not consistently provide enough detail to determine whether there were component parts that should have been entered into the Module and annually inventoried.	12 of 60 (20%) POs examined contained line items for approximately $5 million which did not contain enough detail in the description to determine what product or service was being purchased.
		8 of 10 (80%) items for approximately $8 million appeared to have inventoriable items associated with a parent entry which were not properly entered as a component to the parent asset. However, due to the County's document retention standards, documentation is not available for review.
3	The numbers of items in each category are misstated due to a duplication of unique identifying serial numbers associated with multiple items or not entered. (Purchasing)	30 serial numbers were used 3 or more times. The 3 serial numbers appearing the most were examined and all 3 were true duplicates.
4	Items entered into the Module were not appropriately capitalized and depreciated (Financial Accounting)	4 of 60 (6.67%) POs examined contained approximately $1 million worth of Category 1 Assets which were not added to the Module and thus were not capitalized and/or depreciated appropriately.
		1 of 5 (20%) did not have the appropriate paperwork (County Auditor's Form 770) submitted to Accounting in order to be capitalized and added to the GL and accounting records.
		4 of 10 (40%) items tested may not have been appropriately capitalized and depreciated. Due to the County's document retention standards, all documentation needed to review these transactions may not be available for review. However, all 4 items would now be fully depreciated if capitalization was appropriate.