INTERNAL AUDIT REPORT

IMPROVEMENTS NEEDED IN PROPERTY MANAGEMENT

CALIFORNIA EMERGENCY MANAGEMENT AGENCY

OFFICE OF AUDIT AND EVALUATION

Job Number: P07-002

Date: September 2009

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Office of Audit and Evaluation

IMPROVEMENTS NEEDED IN PROPERTY MANAGEMENT

EXECUTIVE SUMMARY

The Office of Audit and Evaluation (OAE) reviewed the Office of Emergency Services' (OES) property management practices during the period of July 1, 2007 through December 31, 2008. This review was conducted to determine a baseline assessment of the related internal controls in place at the time that the OAE was established, and to comply with the Financial Integrity and State Manager's Accountability Act (FISMA). The FISMA requires each agency to periodically report to the Department of Finance on the adequacy of the agency's systems of internal accounting and administrative controls. This report has been prepared to address the risks and controls the OAE identified in the OES' property management practices.

The California State Administrative Manual (SAM) contains procedures designed to maintain uniform accountability for state property. A combination of strong internal controls and accurate accounting records must be in place to detect and protect against the unauthorized use of state property.

The term "property" refers to all assets that are used in governmental operations. Property includes land, buildings, improvements, computers, machinery, equipment, furniture or furnishings, tools and intangibles. Property is capitalized in the accounting records when the following criteria are met:

- The property has a normal useful life of at least one year;
- The property has a unit acquisition cost of at least $5,000; and
- The property is used to conduct state business.

While capitalized property is treated differently in accounting records, the SAM specifies requirements for tracking and managing both capitalized and non-capitalized property. Our review included both capitalized and non-capitalized fixed assets. (Fixed assets include property as defined above, as opposed to liquid assets such as cash or bank accounts.) We assessed the OES' compliance with state standards for property management, as it relates to the internal control framework in place at the OES, to reduce risk of property mismanagement. Our review focused primarily on determining whether the following conditions existed:

- Written procedures existed, and were followed, for acquiring, recording and disposing of property;
- Property was properly tagged when acquired, and readily identifiable;
- There was adequate separation of duties related to property management functions;
- Excessive shrinkage occurred for any class of property;
- A physical inventory was conducted every three years in accord with state policy;
- Assignment, transfer, and disposition of property was properly recorded;

- The OES was compliant with reporting requirements, including a determination of negligence, when appropriate, for disposed, lost, stolen, or destroyed property; and
- Transactions were properly approved and classified and were posted accurately and timely to accounting records.

Results in Brief

Our review concluded that, at the time of the review, the OES internal control framework in place did not ensure effective property management. We identified issues related to inadequate policy, procedures, and practices for receiving, recording, tracking, and disposing of property; separation of duties; reconciliation of accounting records; and incomplete property databases.

Recommendations:

To address the deficiencies identified, the OAE recommends:

The agency should design and implement policy and procedures:

- ✓ To ensure that all property is promptly inspected, tagged and recorded when delivered, and prior to distribution;
- ✓ To eliminate cross-functional operations for purchasing and receiving property, and ensure proper segregation of duties, including limiting the receiving/inspection function to stockroom staff;
- ✓ To comply with the SAM requirements for reporting of disposed, lost, or stolen property;
- ✓ To govern the ongoing monitoring, transfer and disposal of property, consistent with the requirements specified in the SAM, including, but not limited to, periodic physical inventory verification and documentation; and
- ✓ To comply with SAM requirements for the periodic reconciliation of fixed asset entries from source documents with accounting control records.

Management Response and Corrective Action

In responding to our audit, agency management reported corrective actions were underway and being planned. These corrective actions included updating policies and procedures, training staff, conducting a physical inventory, and development of a new inventory tracking database scheduled to be operational by December 30, 2009.

IMPROVEMENTS NEEDED IN PROPERTY MANAGEMENT

BACKGROUND

Internal control review and reporting requirements are detailed in the Financial Integrity and State Manager's Accountability Act of 1983 (FISMA). Chapters 69, Statutes 2006 (effective July 12, 2006) amended the FISMA to require that organization management conduct an internal review and prepare a report on the adequacy of their organization's system of internal control on a biennial basis. Anytime within a biennial period, ending on December 31 of each odd-numbered year, the head of each state agency must assure that an internal review is conducted in accordance with the guidance provided by the California Department of Finance. The review will evaluate compliance with the requirements of the system of internal accounting and administrative control in place at the time of the review.

The Office of Audit and Evaluation (OAE) is conducting a series of reviews in order to establish a baseline measurement of internal control within the agency, since the agency has not had an internal audit department previously. This review of property management was conducted as a part of that series.

SCOPE

The scope of the audit was limited to review of the adequacy and efficiency of the Office of Emergency Services' (OES) property management policies, procedures, and internal controls, as they relate to acquisitions, disposals, transfers, recording, and monitoring of state property. We evaluated compliance with the regulations and requirements of the California State Administrative Manual (SAM) and sound business practices. We reviewed the OES' mitigation of the risks associated with property management policies. The scope of our review was the examination of records from July 1, 2007 through December 31, 2008. We conducted our review in accordance with the International Standards for the Professional Practice of Internal Auditing promulgated by the Institute of Internal Auditors.

To accomplish our primary objective, we performed the following:

- Interviewed OES staff;
- Reviewed the audits by any outside agencies to identify any prior issues and note any corrective actions taken by management in response to these audit reports;

- Reviewed applicable criteria, rules and regulations identified in governing statutes, administrative codes, California Code of Regulations, the SAM, and existing OES policies and procedures; and

- Performed audit steps listed in the Audit Guide for the Evaluation of Internal Control, published by the Department of Finance, with modifications as appropriate for OES operations.

As a part of our activities, we reviewed various types of transactions, as the transactions flowed from inception to final reporting; including receivables, accounting entries, the Property Records Database, and the OES' physical inventory and identity tagging processes.

In developing our opinions, we considered inherent risks and management's efforts toward mitigating those risks. We have also included our observations and value-added recommendations for mitigating risks. Management's response to each recommendation is included in a separately attached matrix.

METHODOLOGY

The SAM establishes property accounting procedures that are designed to maintain uniform accountability for state property. A combination of accurate accounting records and strong internal controls must be in place, in order to protect against and detect the unauthorized use of property. The term "property" refers to all assets that are used in governmental operations. Property includes land, buildings, improvements, computers, machinery, equipment, furniture or furnishings, tools and intangibles. Property is capitalized in the accounting records when the following criteria are met:

- The property has a normal useful life of at least one year;
- The property has a unit acquisition cost of at least $5,000.00; and
- The property is used to conduct state business.

Our review included both capitalized and non-capitalized property. We used the standards established by the SAM to evaluate the degree that the OES systems of internal control and accounting satisfied state requirements. In order for an internal control and accounting system to be considered effective, it must encompass certain elements:

- A plan of organization that provides segregation of duties appropriate to proper safeguarding of assets;
- A plan that limits access to state assets to authorized personnel who require use of these assets in the performance of their assigned duties;
- A system of authorization and record-keeping procedures adequate to provide effective accounting control over assets, liabilities, revenues, and expenditures;

- An established system of practices to be followed in performance of duties and functions; and
- An effective system of internal review.

In assessing the degree to which the OES met the specific standards established by the SAM, our review focused primarily on a determination whether the following conditions existed:

- Written procedures existed, and were followed, for acquiring, recording, and disposing of property;
- Property was properly tagged when acquired, and readily identifiable;
- There was adequate separation of duties related to property management functions;
- Excessive shrinkage occurred for any class of property;
- A physical inventory was conducted every three years in accord with state policy;
- Assignment, transfer, and disposition of property was properly recorded;
- The OES was compliant with reporting requirements, including a determination of negligence, when appropriate, for disposed, lost, stolen, or destroyed property; and
- Transactions were properly approved and classified and were posted accurately and promptly to accounting records.

AUDIT ISSUES

Our review concluded that, at the time of the audit, the OES did not have an appropriate internal control framework in place. We observed internal control issues and weaknesses that could affect the agency's ability to effectively manage state property. We noted deficiencies in the following areas: receiving inventory; assignment, transfer, and disposal of equipment; physical inventory practices; and certain accounting activities. We also noted the property records and databases were not maintained and duplicate incomplete databases existed.

In our opinion, the accounting and administrative controls over property management, in effect at the OES at the time of our audit, taken as a whole, did not sufficiently meet the standards necessary to be considered satisfactory and, as a result, we have concluded that a control deficiency exists.

For purposes of this review, the OES' activities were grouped and analyzed using the following general categories:

- Overall internal controls;
- Purchasing and receiving of inventory;
- Disposals, transfers and assignments of property;
- Accounting;
- Physical inventory; and
- Previous audit findings.

The attached matrix details our objectives, observations, and recommendations for the scope of the review.

REVIEW OBJECTIVES OBSERVATIONS AND RECOMMENDATIONS

OBJECTIVES	OBSERVATIONS	RECOMMENDATIONS
1. *Internal Controls* **OBJECTIVES:** To determine if internal controls are adequately maintained over state property by ensuring that: ▪ Written policies and procedures exist for acquiring, disposing, and recording property. ▪ Recorded property is in existence, is properly tagged upon acquisition, and can be readily identified. ▪ Property records are posted accurately and timely and are periodically reconciled to the control accounts. ▪ There is adequate separation of duties over property management functions.	▪ OES' policies and procedures, at the time of our review, were outdated, incomplete, and had not been periodically maintained. Our interviews with staff indicated a lack of familiarity with current policies and procedures. Additionally staff were not notified of updates or changes made to prior protocols. ▪ The Property Records Database had not been maintained and not all OES property could be easily identified. ▪ Lack of a current property inventory and inaccurate property records prevented the OES from producing accurate and timely reconciliations of General Ledger property accounts. ▪ Insufficient separation of duties was noted in recording receipt of and tracking inventory.	▪ Design and implement policies and procedures to ensure appropriate ordering, receiving, and management of property. Ensure that staff are familiar with policies and procedures. ▪ Ensure that property is properly recorded and tagged, that a complete property inventory is conducted and maintained, and that records are regularly reconciled and updated. ▪ The agency should comply with SAM requirements by ensuring periodic reconciliation of fixed asset entries from source documents with accounting control records. ▪ The agency should eliminate cross-functional operations for purchasing and receiving property and reporting disposed, lost or stolen property.

OBJECTIVES	OBSERVATIONS	RECOMMENDATIONS
2. *Purchasing and Receiving Inventory* To determine if internal controls are adequately maintained over the purchasing functions by ensuring that: • Purchasing policies and procedures are established; • State property is promptly inspected upon receipt to ensure equipment is damage free and affixed with an identification number decal immediately upon receipt. ▪ Adequate separation of duties exists over the purchasing and receiving function; ▪ Determine whether property acquisitions are properly classified in the property records.	▪ Outdated policies and procedures do not specify processes to be followed and are unclear in assigning responsibility for the purchasing and receiving functions. ▪ Identity tagging and inspection of purchased equipment is not always documented or carried out in a timely manner. We observed items in unopened original boxes which had not received property identity tags. Consequently, equipment had not been inspected for damage or shortages, and could have been out of warranty. ▪ We observed instances of cross-functional authorizations for purchasing and inventory receiving functions, indicating improper segregation of duties. ▪ We observed multiple instances of non-capitalized property not recorded in property records because the items were misclassified in the purchase orders and were accounted for as expenditures.	▪ Design and implement policies and procedures to ensure appropriate purchasing, receiving, and management of property. Ensure that staff are familiar with policies and procedures. ▪ The agency should design and implement processes consistent with SAM requirements to assure that all property is timely inspected, tagged, and recorded in property records at the time of delivery, and prior to any distribution. ▪ Ensure proper segregation of duties including limiting the receiving/inspection function to stock room staff. ▪ Design procedures to ensure that property is properly classified in purchasing and property records.

OBJECTIVES	OBSERVATIONS	RECOMMENDATIONS
3. *Disposals, Transfers & Equipment Assignments* To determine if internal controls are adequately maintained over the property disposal and transfer functions by ensuring that: • Policies and procedures are in place to ensure that disposals and transfers of property are properly authorized and recorded in the property and accounting records. • The agency complies with SAM §3520 and §8643 regarding lost, stolen, or destroyed property reporting requirements. • Assigned equipment is returned when employees leave the agency and /or at conclusion of emergency activation.	▪ We identified deficiencies in database records related to disposals, transfers and the assignment of property and equipment. ▪ The OES generally does not utilize the Std. 158 for transfers of location of equipment per SAM §3520.3. ▪ The OES does not always ensure that a determination was made regarding possible negligence in cases of lost, stolen or missing equipment. ▪ We identified numerous instances of employees leaving the agency with equipment signed out to them per the OES databases.	▪ Design and implement processes to govern the ongoing monitoring, transfer and disposal of property consistent with the requirements of SAM, including, but not limited to, periodic physical inventory verification and documentation. ▪ Design and implement processes to comply with SAM requirements regarding lost, stolen, or destroyed property. (NEW) ▪ Develop and implement policies and procedures consistent with SAM requirements that ensure that state property and equipment is returned from employees who leave and/or employees deployed for emergency operations.

OBJECTIVES	OBSERVATIONS	RECOMMENDATIONS
4. *Accounting* To determine if internal controls are adequately maintained over accounting functions by ensuring that: • SAM § 8600 Property Accounting processes and procedures are maintained. • Property and equipment acquisitions and disposals are reconciled with the change in the total of the general ledger accounts (SAM § 8631-§ 8634, § 8641 and § 8642, § 7924) • Acquisitions and disposals of state property are properly authorized and recorded in the accounting records. • Timely financial reporting and reconciliation requirements are in compliance with SAM §7924 and § 8660. ▪ Annual Financial Reporting Statement of Changes in General Fixed Assets requirements are in compliance with SAM §8660.	▪ Lack of a current property inventory and inaccurate property records prevented the OES from accurately reconciling acquisitions and dispositions of capitalized property (equipment with a value of $5000 or more and a useful life of at least one year) with the amounts recorded in the of General Ledger property accounts in accordance with SAM § 7924. • Our review identified late payment penalties of $38,749 related to delayed invoice processing that were incurred for fiscal year 2007-2008. The main reason cited for the late fees was delays in the receiving of inventory in the system. We noted fines, as required per SAM §8474 and detailed in the Prompt Payment Act. • We also noted that appropriate documentation of property receipt was insufficient, in some instances, to assure the delivery of goods prior to payment of vendors' invoices. • The OES accounting staff rely on information provided by the property controller, in order to post CalSTARS fixed asset entries. The submission of the Quarterly Equipment Reconciliation Report is not always timely.	▪ The agency should design and implement policy and procedures, consistent with SAM requirements for the periodic reconciliation of fixed asset entries from source documents with control accounts. ▪ The agency should devise a process to assure that no invoices are paid without appropriate documentation that purchased property has been received.

OBJECTIVES	OBSERVATIONS	RECOMMENDATIONS
5. *Physical Inventory of Property* To determine if internal controls are adequately maintained over the physical inventory function by assuring that: • Policies and procedures are established for the planning and conducting a physical inventory and that a physical inventory count is completed every three years. • Adequate safeguards exist over inventory activities; • A determination is made regarding the type of control improvement needed whenever any class of assets has excessive shrinkage.	• The OES has not completed a full inventory count since year 2000. Inventory databases have not been maintained or actively updated. • The review identified a weakness in internal controls for the proper safeguarding of property. We noted evidence of a significant amount of electronic items that are missing, lost, or unaccounted for. Staff interviews indicated that this is an ongoing problem and that little or no accountability has been exercised. • Proper documentation of lost and stolen property has not been prepared and the agency lacks evidence of a preventive measures statement identifying procedures to be implemented to prevent future losses.	▪ The agency should develop an adequate and accurate central record keeping system to track and ensure return of all assigned equipment during normal and emergency operations.

CONCLUSION

We limited the scope of this review to the areas specified in the *Background, Scope, and Methodology* sections of this report. Our review concluded that, at the time of the review, the OES did not have an appropriate internal control framework in place to ensure effective property management. In our opinion, the accounting and administrative controls over property management, taken as a whole, did not sufficiently meet the standards necessary to be considered satisfactory.

Since our fieldwork for this audit was concluded, agency staff have taken steps to improve property controls. Agency management's response to this audit is included as an appendix to this report.

Respectfully submitted,

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Date: June 2009

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APPENDIX A
MANAGEMENT RESPONSES

PROCUREMENT AND LOGISTICS BRANCH RESPONSE
FISCAL SERVICES RESPONSE

MANAGEMENT'S RESPONSE

OBSERVATIONS	RECOMMENDATIONS	RESPONSE
1. Internal Controls ▪ OES' policy and procedures, at the time of our review, were outdated, incomplete, and had not been periodically maintained. Our interviews with staff indicated a lack of familiarity with current policies and procedures. Additionally staff were not notified of updates or changes made to prior protocols. ▪ Not all OES property can be easily identified in the property records database.	▪ Design and implement policies and procedures to assure appropriate ordering and receiving of property. ▪ Ensure that a complete inventory of property is conducted, maintained and regularly reconciled.	September 9, 2008, during the time period this audit was being compiled, the Procurement Officer and Property Controller completed training with purchasing liaison and inventory receiving staff to address this issue of appropriately ordering and receiving assets. In addition, procedures were added to the Purchasing Manual and are currently being updated in the OES Administrative Manual. Currently staff is working to complete the agency's 3-year inventory. Expected completion date is June 30, 2009. Because an inventory has not been completed on a regular basis, it has taken a considerably longer than expected time to do a thorough inventory. Effective October 1, 2009, "rotating" inventories will begin according to an established calendar to ensure a full inventory has taken place over the consecutive 3 year time frame and ensure compliance with SAM requirements to complete an agency-wide inventory once every 3 years. (Per SAM §8652)

MANAGEMENT'S RESPONSE

OBSERVATIONS	RECOMMENDATIONS	RESPONSE
2. Purchasing and Receiving Inventory • Policies and procedures do not specify processes to be followed and are unclear in assigning responsibility for the purchasing and receiving functions. • Identity tagging and inspection of purchased equipment is not always documented or carried out in a timely manner. We observed items in unopened original boxes which had not received property identity tags. Consequently, equipment had not been inspected for damage or shortages and could have been out of warranty. • We found instances of non-capitalized property not recorded in property records because the items were misclassified in the purchase orders and were accounted for as expenditures.	▪ The agency should design and implement processes consistent with SAM requirements to assure that all property is timely inspected, tagged, and recorded in property records at the time of delivery, and prior to any distribution. ▪ Ensure proper segregation of duties including, but not specifically limiting the receiving/inspection function to stock room staff. ▪ Develop and implement policy regarding purchasing of electronic and technological items that are subject to frequent changes or upgrades in technology. Purchases for unconfirmed future use should be prohibited unless adequately justified. ▪ The agency should assure that A process is in place to check the classifications used for specific items in purchase orders in order to assure that the items are correctly reflected in accounting records.	**Procurement and Logistics Branch:** As noted above, training and updating of policy and procedures are being done. PALS management will meet by February 28, 2009, to discuss the realignment of staff to provide better oversight and ensure fixed assets are inspected, tagged and recorded at the time of delivery and prior to distribution. Site visits to other agencies will be conducted by March 31, 2009, in order to research effective shipping/receiving/property control functions. In accordance with the recently awarded IT contract which will web enable the administrative applications, a new inventory tracking database will be effective December 30, 2009. By January 29, 2009, purchasing and property policies will be provided to Executive Operations updated to include statements that address prohibiting purchases that are to be used for "unconfirmed future use". By December 30, 2009 (estimated) – IT implementation of Inventory Tracking Database. By March 2010 – Update Purchasing Manual and train purchasers on proper "object code" usage.

MANAGEMENT'S RESPONSE

OBSERVATIONS	RECOMMENDATIONS	RESPONSE
3. Disposals, Transfers & Equipment Assignments ▪ We identified deficiencies in the database records related to disposals, transfers and the assignment of property and equipment. ▪ The OES generally does not utilize the Std. 158 for transfers of location of equipment per SAM §3520.3. ▪ The OES does not always ensure that a determination was made regarding possible negligence in cases of lost, stolen or missing equipment. ▪ We identified instances of separated employees with equipment signed out to them.	▪ Design and implement processes to govern the ongoing monitoring, transfer and disposal of property consistent with the requirements of SAM, including, but not limited to, periodic physical inventory verification and documentation. ▪ Develop and implement policies and procedures consistent with SAM requirements that ensure that state property and equipment is returned from separating employees and/or employees deployed for emergency operations.	**Procurement and Logistics Branch:** During the month of December 2008, policy is being updated to address the ongoing monitoring, transfer and disposal of fixed assets consistent with the requirements of SAM. In addition, training is and will continue to be provided. As noted above and beginning January 2, 2010, "Rotating" inventories will be completed according to an established calendar to ensure a full inventory has taken place over the consecutive 3 year time frame and ensure compliance with SAM requirements to complete an agency-wide inventory once every 3 years. (Per SAM §8652) Request closer management/supervisor oversight in cases of lost, stolen, or missing equipment. By December 30, 2009 – Establish possibleconsequences for known staff negligence. The separating of employees and the current processes involved are a function of the Personnel Office. By May 15, 2009, the Property Controller will schedule a meeting with Personnel in order to discuss establishment of a more timely notification of employee separation. In addition, by December 30, 2009, the PALS Branch will have established procedures that address emergency operations and property/equipment deployment. By December 30, 2009 – Establish procedures for emergency operations and property/equipment deployment.