

City of



Budget and Management Studies – Internal Audit

DATE: July 18, 2011

TO: JOE GRAY, Finance Director/City Controller, Finance
KAREN BRADLEY, Assistant Controller, Finance

THROUGH: RENENA SMITH, Budget Director *Renena Smith*
Budget and Management Studies

FROM: BOB KOURY, Principal Internal Auditor *Bob Koury*
Budget and Management Studies - Internal Audit

SUBJECT: FINAL AUDIT REPORT - PHYSICAL INVENTORY OF CITY-OWNED
BUILDINGS, LAND AND PLEDGED ASSETS AUDIT

Attached is the Final Audit Report of the Physical Inventory of City-Owned Buildings, Land and Pledged Assets Audit. An Audit Exit Meeting was held with appropriate Department personnel on March 14, 2011, to discuss the audit findings and proposed recommendations. The Finance Department had no changes or revisions to the Revised Preliminary Audit Report issued on March 4, 2011.

The Finance Department's "Management Responses and Comments" to the Final Draft Audit Report issued on March 16, 2011, were not received by Internal Audit until July 13, 2011. Those responses and comments have been included in this audit report exactly as submitted by the Finance Department.

Internal Audit will perform a follow-up audit six to twelve months after this report is issued to verify that the recommendations have been implemented or that the issues documented in the findings have been resolved in a manner that addresses the risk identified. The follow-up review is performed in accordance with AO 1-12 and Government Auditing Standards.

Internal Audit sincerely thanks the Finance Department for your assistance during this audit. If you have any questions regarding this matter, please do not hesitate to contact Bob Koury, Principal Internal Auditor, at 621-7072.

Attachments

cc: Ashley Swearengin, Mayor
Council Members
Mark Scott, City Manager
Bruce Rudd, Assistant City Manager
Nicole Zieba, Deputy City Manager
James Sanchez, City Attorney
All Department Directors
Dan Turner, Risk Manager, Risk Management Division
Henry Fierro, Principal Budget Analyst, BMSD



Budget and Management Studies – Internal Audit

FINAL AUDIT REPORT

**Physical Inventory of City-Owned Buildings, Land
And Pledged Assets Audit**

Audit Number 11-0003

**Performed by:
Bob Koury, Principal Internal Auditor
Mary Viancourt and Bill Richards, Internal Auditors
Budget and Management Studies – Internal Audit**

Issued on July 18, 2011

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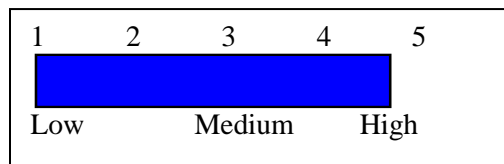
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EXECUTIVE SUMMARY

This audit report is intended to assist the Finance Department and all other City Departments in the performance of their responsibilities in the administration, recording, monitoring and tracking of Buildings and Land Assets. While performing the audit, Internal Audit considered whether improvements could be made to strengthen the existing reporting and tracking of Buildings and Land Assets.

Risk is the degree of or the lack of internal controls, management oversight and fiscal responsibility. Based upon Internal Audit's findings, the Finance Department's Citywide Fixed Asset Control File for the recording, monitoring, tracking and the verification of Buildings and Land risk factor is high.

Audit Risk



Key Issues Identified:

- The Finance Director should continue to work with the City Manager's Office to finalize and implement the revised AO 1-3 Financial Fixed Assets Inventory for improved internal controls, fixed asset accountability, and streamlining of the current Fixed Asset Control File.
- Of the total 293 Main Buildings sampled:
Internal Audit physically verified 92 with an approximate historical cost of \$215,923,407 (77%). Internal Audit did not attempt to verify 95 Main Buildings with an approximate historical cost of \$54,090,474 (19%) due to the lack of an address in the Fixed Asset Control File. Internal Audit also did not attempt to verify 106 Main Buildings with an approximate historical cost of \$10,623,836 (4%) because these were a repair or addition and not an actual Building.
- Internal Audit verified City ownership of 23 of 187 Main Buildings. Internal Audit was unable to verify City ownership of 164 of the 187 Main Buildings due to the lack of address in the Fixed Asset Control File or the address was not found in the City's "FrontCounter" system. Department Property Monitors are not annually ensuring the accuracy of the Building asset information in the Fixed Asset Control File.
- Internal Audit was unable to reconcile with certainty the Fixed Asset Control File and Insured Property Schedule for the sampled Department's Buildings and Land. Department Property Monitors are not annually ensuring the accuracy of the information in both the Fixed Asset Control File and the Risk Management Insured Property Schedule.
- Of the total 451 Land line items sampled:
Internal Audit physically verified 114 Land line items totaling approximately \$8,176,468 (19.7%). Internal Audit attempted but could not verify with certainty 295 Land line items totaling approximately \$33,198,797 (80.1%). Internal Audit did not attempt to physically verify 42 Land line items (mostly Easements) totaling approximately \$6,334 due to the length of time and driving distance and the immaterial dollar values for these assets. Department Property

Monitors are not annually ensuring the accuracy of the Land assets information in the Fixed Asset Control File.

- Internal Audit could only verify City of Fresno Ownership for 201 out of the 451 Land line items sampled with “Front Counter”. Other Agencies or Private Parties were listed as the Owner of Record for the remaining 250 out of 451 Land line items sampled.

INTRODUCTION

Background

As a Best Practice, Internal Audit periodically conducts a Citywide Risk Assessment to identify areas of potential risk to the City. Internal Audit recently conducted a Citywide Risk Assessment which was used to develop our FY-10 and FY-11 Audit Plan. In accordance with that annual audit plan, Internal Audit conducted a Physical Inventory of City-Owned Buildings, Land and Pledged Assets.

The Finance Department is responsible for the control and record keeping of the City's Fixed Assets per Administrative Order (AO) 1-3 dated October 10, 2003. The Finance Department's Accounting/Fixed Asset Management Section is responsible for establishing and maintaining a Citywide Fixed Asset Control File.

Capital or fixed assets are real or personal property that have a value equal to or greater than the capitalization threshold for the particular classification of the asset and have an estimated useful life of greater than two years. The Capitalization Threshold for fixed assets is a useful life of two or more years and a cost of \$5,000 for Buildings, Land, Improvements and Infrastructure. The Finance Department has drafted a revised AO 1-3 that changes the Capitalization and Depreciation Thresholds, among other revisions. The revised AO is still pending approval as of the audit date.

Audit Objectives

The primary audit objectives were to: (1) perform a physical inventory of a sample of City-Owned Buildings and Land to verify their actual existence, and to compare the physical inventory of such City assets/real property to the related reports and records maintained by the Finance Department, Risk Management Division and other responsible City Departments, as applicable; (2) evaluate the effectiveness and efficiency of the City's fixed asset policies and procedures specifically related to City-Owned Buildings and Land, and verify the adequacy of the internal controls and accountability of such City assets; (3) review and verify the current title/ownership of City-Owned Buildings and Land with the County Assessor's Office and related property records; and (4) determine and verify any and all City-Owned Buildings and Land that have been pledged as collateral for current City loans/financings, and that these pledged City assets are adequately documented for accountability and reporting purposes.

Audit Scope and Methodology

Internal Audit performed the audit during the period September 2010 through January 2011, in accordance with AO 1-12 and Government Auditing Standards. In order to accomplish our objectives, our audit procedures included, but were not limited to, interviews of appropriate personnel, reviews of pertinent records, reports and documentation, the physical verification of a sample of City-Owned Buildings and Land, and procedures related to pledged assets.

Audit Conclusion

The Finance Department and Personnel-Risk Management Division and their staffs are a professional group of individuals and are commended for their efforts in the oversight of the Fixed Asset Control File and Insured Property Schedule. Internal Audit did note, however, several areas during the course of the audit that need improvement to strengthen internal controls, and accountability and reporting of City-Owned Buildings and Land Assets. These areas are addressed throughout this Audit Report.

REPORT SECTIONS - RESULTS AND RECOMMENDATIONS

I. Finance Department's Fixed Asset Control File

Internal Audit obtained the Finance Department's Fixed Asset Control File as of September 22, 2010 for Buildings, Land and Improvements. Internal Audit decided not to include the Improvements in this audit. From the following table developed from the Fixed Asset Control File, Internal Audit selected seven (7) Departments as our initial sample (*) for testing purposes.

Dept	Buildings		Land		Total	
	Count	Asset Cost	Count	Asset Cost	Count	Asset Cost
PW *	60	64,508,733	483	189,714,815	543	254,223,548
DPU *	175	212,148,558	263	27,814,856	438	239,963,414
Airports *	84	73,453,645	280	10,816,649	364	84,270,294
GSD *	36	42,592,733	3	56,688	39	42,649,421
CMO *	3	39,228,633	2	847,000	5	40,075,633
ConvCntr *	42	21,759,351	1	2,215,259	43	23,974,610
PARCS	143	11,742,926	67	11,246,510	210	22,989,436
FAX *	26	14,843,690	0	-	26	14,843,690
Fire	40	10,364,593	17	686,975	57	11,051,568
Police	8	4,612,080	5	1,801,422	13	6,413,502
DARM	1	13,750	9	3,745,747	10	3,759,497
RDA	0	-	2	352,388	2	352,388
DCR	0	-	1	275,547	1	275,547
ISD	5	50,180	0	-	5	50,180
Finance	0	-	0	-	0	-
Personnel	0	-	0	-	0	-
Total	623	\$495,318,872	1,133	\$249,573,856	1,756	\$744,892,728

Finance Department's General Comments

Before responding to each of the audit recommendations that follow, Finance would like to put into perspective the magnitude of the fixed asset population that one individual in Finance is working to oversee, coordinate, manage and enhance with more detail. The overall citywide fixed asset count consists of 29,835 asset lines. Keep in mind that each of these listed asset lines may consist of more than one physical item; for example, one line in the PeopleSoft Fixed Asset Module may represent 10 garbage trucks or 14 police cars. When purchased in mass, the acquired assets are listed as a group for fixed asset reporting purposes, they are not listed individually. The City has purchased assets, transferred assets, sold assets, had assets donated to it, and "acquired" assets as a result of private/public partnerships gone badly. All of these events may or may not have had the involvement of the Finance Department.

The financial fixed asset reports should not be confused with fixed asset "inventory" control. The PeopleSoft Fixed Assets Module is not an inventory control system. The actual accountability for fixed assets falls to numerous different departments throughout the City. Police cars are overseen by fleet as are garbage trucks. However it is also prudent that the Police Department know how many cars they have in service, out for repairs, damaged, etc. The same goes for Solid Waste and their fleet of garbage trucks.

The hurdle the Finance Department has had to overcome was educating individuals within each department as to what was meant by a capitalized fixed asset; what the distinction is between repairs and maintenance and long-lived assets; particularly in those departments where prior to GASB 34 infrastructure assets such as roads, streetlights, bridges, rights of way, etc., were expensed directly and not capitalized. In addition, particularly in the area of Land and Buildings, there had been no consideration given to tying an asset improvement to the original asset itself. Finance certainly recognizes the inadequacy of much of the data available in the PeopleSoft Fixed Asset Module, but it also is acutely aware of the limited people and time resources available to “clean up” the data, most certainly in the near future. That is not to say that all departments are not working with Finance to continue to chip away at the data base and make it more usable. This is and will continue to be an ongoing process, but is extremely dependent upon available resources which will certainly impact the speed at which this work continues.

In fact, for several years an individual in the finance Department, separate from the Citywide Property Monitor, has been spending several months each year, when not devoted to the CAFR, working on an asset management land project comparing and reconciling information from the Asset Management System, I-view, and the County Assessor’s Office. In the course of the project, numerous errors have been identified and corrected. Due to the magnitude of the project it was estimated that prior to the recent loss of staff in Finance it would take several more years to complete. Unfortunately, the individual who was working on this project has been re-assigned as a result of the recent staffing cuts and the Finance Department no longer has available personnel to work on the project. It is not known as this time when this project will be resumed. The question that must be asked, is the reconciliation of the City’s fixed asset records a critical core public service at this time given the budgetary and personnel limitations? Finance believes that while it is important it is not an essential key core service.

The citywide population of fixed assets has an original cost of \$3,480,001,305 and a net book value of \$2,128,412,555. The earliest acquisition date reflected on the PeopleSoft fixed asset listing is 1909, 102 years ago. Asset tracking has been performed on many different systems over the last 102 years, from manual tracking cards to hard copy accounting paper to excel spread sheets to various electronic data bases. The control over this process has been handed off three times alone in the past 10 years (and now a 4th with the recent layoff of staff) and countless additional times over the 102 years. GASB asset recognition requirements have also changed and expanded repeatedly over the years with the greatest change occurring with GASB 34. Finance has been working with each department over the past several years in an effort to enhance the listing of capitalized fixed assets. This has been an arduous and time consuming processing. As will be noted later in the responses to this report there are numerous assets where more detailed information simply does not exist or will take countless hours to track down. These methods include, searching through boxes of records at offsite storage, digging through years of microfiche, visiting the County Hall of Records and searching through similar archives, and accessing various different financial accounting systems once utilized by the City as well as available electronic tools such as Front Counter, iView and Google Earth. Even after all of these resources are exhausted, it may still be determined that no additional detailed or other information is available.

By no means is Finance nor any other department taking these recommendations lightly. Finance concurs with the issues and the problems found and is not surprised by what was discovered by Internal Audit. What Finance will however challenge is the ease with which or the time frame under which it is presumed that these “fixes or recommendations” can be accomplished.

II. Administrative Order (AO) 1-3 Fixed Assets Inventory

Finance’s AO 1-3 Fixed Asset Inventory (copy attached) Purpose states: “To establish a uniform policy for the recording and tracking of fixed assets.”

- AO 1-3 Policy 1 states: “Fixed Assets must be capitalized if they have a ... cost of ... \$5,000 for land, buildings and infrastructure.”
- AO 1-3 Procedure 1 states: “Each City department and division is responsible for the physical security, the use, maintenance, accounting and disposal of the fixed assets assigned to their units.”
- Procedure 2 states: “The Finance Department Accounting Division is responsible for establishing and maintaining a Citywide Fixed Asset Control File”.

- Procedure 3 states: “The Accounting Division will designate a Citywide Property Monitor who is responsible for maintaining the Citywide Asset Control File, and who is responsible for providing quarterly asset lists to Departmental Property Monitors.”
- Procedure 4 states: “Each department will designate its own Department Property Monitor...He/she is also responsible for coordinating department physical inventories at least every four years, and for notifying the Citywide Property Monitor of any changes to the Fixed Asset Control Files.”

Internal Audit was informed by the Citywide Property Monitor in Finance that annually a sample of recorded assets is selected to be reviewed and verified by each Departmental Property Monitor. Land along with Buildings was selected for verification approximately five years ago and has not been selected since.

Internal Audit was informed by the Citywide and Department Property Monitors that a full physical inventory by each Department of their Fixed Assets is impossible due to the length of time to perform the full inventory and current staffing levels. Therefore, the annual inventory of a sample of Fixed Assets was instituted. Further, for some Departments, a photo (e.g. digital photo) is not required. Internal Audit was informed some Departments have been granted permission by the Citywide Property Monitor to provide an Aerial View of the asset instead of a photo. Aerial photos do not capture the same quality and type of information as an actual onsite photo.

Internal Audit obtained the Finance Department’s Fixed Asset Control File as of September 22, 2010 for Buildings, Land and Improvements. Internal Audit noted the following assets meet the current AO 1-3 Capitalization Threshold of \$5,000 or more:

- Approximately 404 of 623 Buildings, and
- Approximately 650 out of the 1,133 Land line item entries (each line item does not represent a single parcel or sub-parcel of Land.)

Audit Recommendation:

1. The Finance Director should instruct the Citywide Property Monitor to review and remove any current Building, Land and Easement entries under the \$5,000 limit unless the City Manager’s Office approves the revised AO 1-3. At a minimum, an Asset Retirement File should be created for Buildings, Land and Easements that do not comply with the current \$5,000 reporting and recording requirement for future reference or audit purposes. Further, the Finance Director should instruct the Citywide Property Monitor to only record newly acquired Buildings, Land and Easements in the Fixed Asset Control File that comply with the \$5,000 dollar value as stipulated in AO 1-3.

Finance Department Management Response to Recommendation 1

After reviewing the audit findings and revisiting the draft of AO 1-3, it has been determined that the capitalization of land needs to be further broken down in the new AO. Land is really made up of three distinct groups; 1) Land acquisitions, 2) Rights of Way and Easements and 3) Intangibles. The City virtually acquires little “Land” with a value of less than \$5,000; however it frequently acquires “Rights of Way, Easements and Intangibles” with significantly lesser values. For CAFR capitalization purposes, Land will be further differentiated between “Land”, “Rights of Way and Easements and finally, Intangibles”. Land acquisitions will be capitalized when the value is \$1 and greater; and Rights of Way, Easements and Intangibles will be capitalized at \$5,000 or more. This distinction is critical as it relates to how the City utilizes Land and Buildings for General Fund bonding purposes. When JPFA/General Fund

bonds are issued, they must be secured by assets. Land and Buildings are used as collateral. Rights of Way, Easements and Intangibles are not used for this purpose nor are they eligible. Therefore in order to make the accounting for these items more meaningful, it would be more appropriate to segregate these items from one another in the AO.

The new Citywide Property Monitor will undertake the process of reviewing Land, Rights of Way, Easements and Intangibles and categorize these in such a manner that they can be better identified. (This process has been put on hold as the new Citywide Property Monitor must become familiar with the system before making any deletions or attempting any segregation. Due to budget cuts, Finance lost its seasoned property monitor and a new monitor is being trained. While the individual had overseen fixed assets before, they were related to one department only and not the entire City. Once the new Property Monitor is fully trained, the “clean-up work will begin again.) Any items identified as Rights of Way or Easements with a value of less than \$5,000 that cannot be connected with a greater valued parcel of land will be removed. Items that can be identified as Land and Intangibles will remain on the fixed asset schedules. A record of those items removed will be clearly identified and a control document retained for later reference if necessary.

During our audit, the Finance Department made Internal Audit aware of a revised draft of AO 1-3 titled Financial Fixed Assets Inventory. The revised draft AO contains significant changes, including changes of the Capitalization and Depreciation Thresholds, and the addition of a detailed four page section addressing the Recording of Land, Rights of Way, Easements and Intangibles. This revised draft AO, when approved by the City Manager’s Office and implemented, will address many of the conditions noted by Internal Audit during this audit. Since the Revised AO 1-3 is still pending approval at the time of this audit, Internal Audit felt a complete review of the revised AO was not appropriate at this time.

If the revised draft AO 1-3 is approved and implemented, then only 338 of the 623 Buildings in the current Fixed Asset Control File would meet the new Capitalization Threshold of \$10,000 or more. Also, if the revised AO 1-3 is approved and implemented, then of the remaining 483 Land line items that did not meet the current AO criteria, Internal Audit noted the following:

- 402 Land line items entries ranged from \$1 to \$4,999, and
- 81 Land line item entries had a zero dollar value listed.

Therefore, 402 of the above Land line items would meet the new Capitalization Threshold of \$1 or more. Internal Audit is not able to conclude whether the remaining 81 Land line items with a zero dollar value would meet the revised criteria due to the lack of accurate information in the Fixed Asset Control File.

Audit Recommendation:

2. The Finance Director should continue to work with the City Manager’s Office to finalize and implement the revised AO 1-3 Financial Fixed Assets Inventory for improved internal controls, fixed asset accountability, efficiencies, and streamlining of the current Fixed Asset Control File for reporting purposes.

Finance Department Management Response to Recommendation 2

The initial revised AO 1-3 was submitted to the City Manager’s Office prior to the on boarding of the new City Manager. While the Assistant City Manager was involved with the AO, it will be resubmitted for consideration for renewed consideration. The new AO 1-3 takes into consideration GFOA (Government Finance Officers Association) best practices recommendations with respect to accounting for Fixed Assets as they relate to CAFR (Comprehensive Annual Financial Report) reporting purposes. (Copy of revised draft AO 1-3 attached for reference purposes).

Regarding land line items with zero dollar values, it should be noted that the Asset Management System uses parent and child asset designations. Certain land line items with zero values have APN numbers and acreage and are child assets assigned to a parent asset that contains the dollar value for the entire section. It would not be appropriate to remove those zero lines as they are vital parts of the whole asset. Certain other land items with low dollar amounts

are child assets of other larger parent assets, and the combined amounts are above the threshold. Line items with amounts below the threshold which are not related to parent assets and/or with inadequate descriptions that can't be tied to I-view or the documents at the County Assessor's Office should be removed by the Citywide Property Monitor when time permits.

III. Fixed Asset Form (F/A 91)

Finance's current and revised draft AO 1-3 do not have formalized procedures for the addition of new fixed assets. Currently, Finance receives new fixed asset information from Department Property Monitors via e-mail, Excel Spreadsheets or Word Documents. The lack of formalized procedures for new additions can cause the reporting of inaccurate or incomplete information that would be imperative for the recording and tracking of these assets. Currently, Departments are to submit an F/A 91 Form (included with attached AO 1-3) for the transfer, sale, or disposal of a fixed asset as required by AO 1-3.

AO 1-3 Procedure 6 (Transfers) states: "A form F/A 91 must be completed and signed by the department director relinquishing the asset for transfers. If the asset being transferred has a historical cost of \$5,000 or more, the F/A 91 form must be signed by the City Manager. Asset transfers that cross funds or orgs must be communicated to the Citywide Property Monitor through submission of the form F/A 91."

AO 1-3 Procedure 7 (Disposal) states: "For all fixed asset disposals, a form F/A 91 must be completed..."

Internal Audit did not audit F/A 91 Forms, E-mails, Excel Spreadsheets or Word documents submitted by Departments for the addition of Buildings or a parcel or sub-parcel of Land and/or Easements in Finance's Fixed Asset File. Internal Audit did review the current F/A 91 Form attached to AO 1-3 for the type and format of information Departments should submit for the recording of Buildings, Land and Easements in Finance's Fixed Asset Control File.

The current F/A 91 Form appears to only address the transfer, sale or disposal of equipment, furnishings or vehicles rather than Buildings and Land. The current F/A 91 Form does not instruct Departmental Property Monitors to provide the following types of information for Buildings, Land and Easements purchased which is necessary for reporting, recording, tracking and verifying these assets in Finance's Fixed Asset Control File.

1. Classification – Main Building, Land, Easement, Right-of-Way, Improvement, Etc.
2. Owner of Record - Legal Title to the Buildings & Land, or Fee Title to the Land if different
3. Parent/Child asset ID relationship
4. APN and Sub-Parcel number(s) as appropriate
5. Physical Address - unless deemed a City health and safety issue) which can be verified with another source(s).
6. Accurate, Concise Description - Description should match the recorded address (e.g. the description is for West Shaw but the address is for East Shaw) and/or the asset name at a given address (e.g. the System description states Land-Forkner School – Park Vale when the actual site states Orchid Park).
7. Acreage – (e.g. Farm Land or Land purchased for future use)
8. Physical Verification by photo - not an aerial printout from some type of a system (e.g. "Front Counter" "I-View")

Audit Recommendation:

3. The Finance Director should instruct the Citywide Property Monitor to develop a detailed Fixed Asset Form for Buildings and Land reporting and tracking in the Fixed Asset Control File. This Building and Land Form should specifically state the required data and data format for Buildings, Land, Easements and Right-A-Way entries like those cited above as well as other pertinent fields deemed necessary by the Finance Director and/or Citywide Property Monitor.

Finance Department Management Response to Recommendation 3

The Form F/A 91 was being redesigned to include much of the suggested information above and was to be added to the resubmitted AO. However the person redesigning the form was laid off and the work has not yet been resumed. Given that the PeopleSoft Fixed Asset Module is rather restrictive with respect to the data fields available and the length of characters available in each field, Finance, as an alternative, is looking into maintaining an "Active" Binder of F/A 91 forms for asset additions that are still held by the City or even more promising, would be the ability to scan and attach the F/A 91 form to the fixed asset file in PeopleSoft. This would allow for more detailed information to be maintained for each asset beyond what the asset listing provides. This functionality, for now however, has been put on hold as a result of limited staffing and a new property monitor.

As for requiring that a photograph be taken of the asset, a photograph with respect to Land and Buildings is only good so long as the asset does not change or is not altered in anyway. As long as physical addresses are/can be obtain and/or APN numbers, I-View, Front Counter and Google Earth will be able to provide more current and up to date pictures of the items acquired and can be easily obtained by the Property Monitors in each Department. In addition, each time the asset is selected for verification, the picture on Front Counter and Google Earth can be updated for a more current view.

Once completed and approved, the new F/A 91 forms will be used on a go forward basis. Given limited resources, it is not possible at this time to go back in time and accumulate this information for assets previously acquired. It is hoped that when the economy improves, funding and personnel may become available to gather this historical data for assets long held.

IV. City-Owned Buildings

Internal Audit discussed the existence of a listing of all City-Owned Buildings with the Public Works Real Estate Section, the ISD/GIS staff, and the County Assessor's Office. We were unable to obtain a complete and current listing of all City-Owned Buildings from any additional source in order to verify that the Citywide Fixed Asset Control File contains all City-Owned Buildings.

A. Physical Verification of Buildings

Internal Audit's objective was to physically verify the Main Buildings in the Finance Fixed Asset Control File for a sample of City Departments. We selected Airports, CMO, Convention Center, GSD, FAX, DPW and DPU as the sample Departments. We obtained the Finance Fixed Asset Control File as of September 22, 2010 for Buildings, Land and Improvements.

Internal Audit sorted the Fixed Asset Control File by the DEPT column code and then added a column and entered the name of the Departments to facilitate sorting. We created a sheet for Buildings as identified by BLDG in the CAT (category) column and removed the Improvements identified by IMPR in the CAT column as these items were not considered a Building. The Building sheet lists 623 Buildings with a historical cost of \$495,318,872.

Internal Audit then sorted the Building sheet by the Class Description column and noted that this column contained numerous classes – Main Buildings, Bldg Additions, Improvements, Animals, Bldg Heating and Cooling, Miscellaneous, Cabins/Club House/Residence, Equipment Sheds/Parking Booths/Storage, Motor Vehicle Miscellaneous, Restrooms, Runways and Shop. We created a sheet for the assets with a Class Description of Main Building. The Main Building sheet lists 400 Main Buildings with a historical cost of \$303,576,250.

Internal Audit sorted the Main Building sheet by Department and created a final sheet of the selected departments' Main Buildings. We used this list to attempt to physically verify the existence of the Main Buildings for the sampled Departments during the period November and December 2010. This final sheet for the sampled departments lists 293 Main Buildings with a historical cost of \$280,637,717.

For the 293 Main Buildings of the seven departments sampled, we noted the following:

- Physically Verified - 92 of 293 Main Buildings with an approximate historical cost of \$215,923,407 (77%).
- Verification not attempted - 95 of 293 Main Buildings with an approximate historical cost of \$54,090,474 (19%) due to the lack of an address or a sufficient address in the Location Description column to attempt to locate the Buildings. (Note: 3 of the 95 Buildings accounted for an approximate historical cost of \$50,000,000 with only the description “WWTF” and no address on the Fixed Asset Listing.)
- Verification not attempted - 106 of 293 assets that we determined were not a Main Building with an approximate historical cost of \$10,623,836 (4%). These assets were recorded as a Main Building in the Class Description column but the Description column has Addition, Remodel, Rehab, Repair, Lighting, Cooling, Electrical, Heating, etc.
- Lack of an entry in the Parent ID column which should be entered to link Additions, Remodel, Rehab, etc. to a specific Main Building.

Internal Audit did not consult with Departments' staff regarding the location of a Building as we believe an independent third party, e.g. External and Internal Auditors, should be able to locate/verify Buildings using only the information contained in the Finance Department's Fixed Asset Control File.

Audit Recommendation:

4. The Finance Director should formally (via memo) direct all Department Directors and their Property Monitors to perform a complete physical inventory of all Buildings for the next scheduled annual verification. In addition,
 - a. The Department Property Monitors should review and add, or correct as appropriate, the Location Description address to ensure the address is complete and accurate to facilitate physically locating the assets by an independent party without assistance from the department.

- b. The Department Property Monitors should review and correct, as appropriate, the Class Description to ensure Additions, Repairs, etc. are classified as an Improvement and are not classified as a Main Building for accountability and audit purposes.
- c. The Department Property Monitors should review and provide the appropriate Parent ID asset number to link an Addition, Repair, etc. to the appropriate Main Building for accountability and audit purposes.
- d. The Department Property Monitors should review and correct, as appropriate, the Main Buildings assigned to their Department due to the recent City Department reorganizations for accountability and audit purposes.

Finance Department Management Response to Recommendation 4

While all of the above are excellent recommendations, current economic conditions and the loss of key personnel make it impossible for departments to perform a detailed and in-depth analysis and reconciliation of City owned buildings at this time. Many of the departmental property monitors are the same staff members, who prepare their department's budget, assist with the preparation of their related CAFR documents, perform special projects for the benefit of the Council and/or City Manager and provide key daily operating data to their respective departments' management.

Each year, the Finance Department makes a random selection of a specified number of assets to be verified by each property monitor. The Monitors are asked to verify information related to the assets and to confirm whether or not the assets are still owned by the City. They are also asked to provide a picture, an overhead view from front counter or any other means of currently identifying the asset as well as documenting the assets current state. With the number of assets owned by the City particularly since the capitalization thresholds have been so low up to this point, and asset descriptions being extremely limited, this has and continues to be an extremely slow process. As a result of the recent staffing cuts, it would not be possible to obtain the detailed inventory of buildings that we would all like to see completed this year. When preparing for the annual inventory of assets, it could be possible for the Finance Department to limit the random selection to land and buildings only rather than to select from the entire population of assets. By concentrating on one general area of Asset Management for a few years, rather than attempting to spread the cleanup over the entire Asset system, it would be possible to see progress on the cleanup on buildings and land much sooner. It is true that the inventory of the rest of the asset system would be temporarily neglected, but that would be balanced by results in the land and building category. While this option is less than ideal, the lack of staff leaves few choices.

Another helpful option would be for Internal Audit to partner with City departments and to assist them in performing the very audit recommendations that they are suggesting. It is not from an unwillingness to gather the suggested information or a disagreement with the fact that this data would be helpful, it is simply due to a lack of staffing and insufficient funds available to be allocate to this task that it is not being done. The Finance Director could formally direct all Department Directors and their Property Monitors to perform a complete physical inventory of all Buildings for the next scheduled annual verification, but the reality is that there is simply insufficient staff to devote to an undertaking of this magnitude without help. In addition, the Finance Department individual previously working on the land and buildings project has been re-assigned in the latest round of cuts. This process simply is not considered to be a key or core function to the City at this time. Since Internal Audit is aware of the issues at hand and possess an in-depth understanding of what needs to be done, their expertise and familiarity with the task at hand would be invaluable. While this solution is also less than ideal, current options are limited.

Internal Audit Comment

As much as Internal Audit would like to assist other City Departments with their fixed asset responsibilities for the physical inventory, accountability and recordkeeping of their Department's assets, the readers of this report need to

know that the Principal Internal Auditor is the only Internal Auditor currently employed and responsible for internal audit services for the entire City of Fresno. This situation was the effect, just like all other City Departments, from the recent staffing reductions. Additionally, Government Auditing Standards require strict objectivity and independence by the Internal Auditor from the entity that was audited, thus maintaining an attitude of impartiality and being free of any conflicts of interest. For internal audit to participate and/or assist City Departments in the implementation of the very audit recommendations proposed by the Internal Auditor would not be in accordance with Government Auditing Standards.

B. Reconciliation of the Fixed Asset Control File and Insured Property Schedule

The Risk Management Division issued a memo in July 2010 to all Department Heads asking them to review and make any additions, deletions or revisions to the Insured Property Schedule, and to provide those changes to Risk Management by August 31, 2010. The Insured Property Schedule contains the City-Owned properties insured by Alliant Insurance Services, Inc. Internal Audit obtained a copy of the Property Schedule as of September 20, 2010 from Risk Management which does not contain any updates submitted by the Departments in response to the July 2010 request by Risk Management. Therefore, some of the conditions noted by Internal Audit may have been addressed by the time this audit report is issued.

Internal Audit used the building sheet created for the physical verification of buildings that lists 623 assets as a BLDG (Building) in the CAT (category) column with a historical cost of \$495,318,872 to create a sheet for each sampled department. Internal Audit printed the appropriate pages of the Insured Property Schedule for the sampled departments.

Internal Audit attempted to identify and reconcile the Buildings in the Finance Fixed Asset Control File and the Risk Management Insured Property Schedule to ensure that all current City-Owned Buildings are insured.

For the departments sampled, we noted the following:

- 21 Buildings with an approximate historical cost of \$90,789,212 in the Finance Fixed Asset List were not identified with certainty in the Property Schedule,
- 19 Buildings with an approximate insured amount of \$54,560,442 in the Risk Management Property Schedule were not identified with certainty in the Finance Fixed Asset List,
- 5 Buildings assigned to departments on one list but assigned to different departments in the other list, and
- Unable to verify the Buildings of DPU due to the large volume and inadequate identifying information.

Internal Audit could not reconcile the Finance Fixed Asset File and Risk Management Property Schedule with certainty due to the following:

1. The lack of an adequate description of the Building in the Fixed Asset File,
2. The lack of a location address or complete address in the Fixed Asset File,
3. The lack of a consistent or matching address and/or description between the lists, and
4. The lack of an Asset ID number or APN in the Property Schedule to match to the Asset ID or APN in the Fixed Asset File.

In addition, we noted nine RDA properties during this audit that had been sold but were still in the Risk Management Insured Property Schedule with a total insured value of \$1,488,915. We informed both the

RDA and Risk Management of this audit finding and were told the properties would be removed from the Insured Property Schedule immediately.

Audit Recommendation:

5. The Finance Director should formally direct (via memo) all Department Directors, in conjunction with Risk Management, to reconcile the Buildings in their Finance Fixed Asset File and the Risk Management Insured Property Schedule as part of the annual fixed asset verification process to ensure all City-Owned Buildings do, in fact, exist and are properly insured.

In addition, the Department Property Monitors should (a) provide the Asset ID number and APN for addition into the Insured Property Schedule to facilitate future reconciliations, and (b) match the address and description on both listings, and provide corrections as appropriate to ensure accuracy and consistency in recording and for audit purposes.

Finance Department Management Response to Recommendation 5

Finance certainly would be more than happy to work with each respective department as well as Risk Management to work toward reconciling and coordinating the recording of Buildings being insured. Several factors must be kept in mind however; the historical cost maintained on the fixed asset listing will not agree with the insurable basis reflected on the files retained by Risk Management. Risk Management is reporting replacement cost and not historical cost. As noted previously, the ability to reconcile these two reports more than likely has been restrained and will continue to be limited by the availability of staff to devote to this project. Issues that will be encountered are that lists are for two different purposes and the PeopleSoft Fixed Assets Module is not intended to be an inventory listing. The Fixed asset report will reflect numerous entries for a building as it will include the initial acquisition or construction and then additional entries over the years for improvements, major repairs, etc. The Risk Management report will reflect one entry for the building. This reconciliation process will take an extended period of time and will once again need to be undertaken as time, staffing and budgetary constraints allow. However, as mentioned above, hands on assistance from Internal Audit would be most helpful and welcomed and would most certainly assist in moving the project forward more expediently.

Internal Audit Comment

As much as Internal Audit would like to assist other City Departments with their fixed asset responsibilities for the physical inventory, accountability and recordkeeping of their Department's assets, the readers of this report need to know that the Principal Internal Auditor is the only Internal Auditor currently employed and responsible for internal audit services for the entire City of Fresno. This situation was the effect, just like all other City Departments, from the recent staffing reductions. Additionally, Government Auditing Standards require strict objectivity and independence by the Internal Auditor from the entity that was audited, thus maintaining an attitude of impartiality and being free of any conflicts of interest. For internal audit to participate and/or assist City Departments in the implementation of the very audit recommendations proposed by the Internal Auditor would not be in accordance with Government Auditing Standards.

C. Verification of Ownership of Buildings

Internal Audit attempted to verify the current ownership of Buildings using the County Assessor's Office List and related property records. We were unable to verify current ownership using the County Assessor's Office List because the list has the asset APN but not the address; therefore, we used the City's "FrontCounter" System to verify title/ownership.

For 187 of the 293 Buildings that we determined were Main Buildings in the Fixed Asset File, we researched the City's "FrontCounter" System for ownership and noted the following;

- 23 - Verified the City of Fresno listed as the owner, and
- 164 - Unable to verify due to no address recorded in the Fixed Asset Control File or the address not found in “FrontCounter”.

In addition, Internal Audit printed appropriate pages from Risk Management’s Insured Property Schedule as of September 20, 2010 for the sampled Departments. We examined the pages and identified approximately 120 assets that appear to be a Main Building. We entered each of the 120 Buildings’ address into “FrontCounter” to verify ownership. For the 120 Buildings in the Insured Property Schedule, we noted the following;

- 93 - Verified the City of Fresno listed as the owner, and
- 27 - Unable to verify ownership due to an incomplete street address or the address was not found in “FrontCounter”.

Audit Recommendation:

6. The Finance Director should formally direct (via memo) all Department Directors to conduct a Property Ownership search and provide documentation to Finance of Legal Title for Buildings. In addition, if the current “Owner of Record” is not the City but should be the City of Fresno, the Department Property Monitor should inform the County Assessor’s Office in writing and include any necessary or required documentation to show proof of City ownership.

Finance Department Management Response to Recommendation 6

Prior to the City selling an asset or using it as collateral for a JPFA General Fund bond issuance, the City has a title search performed by a local Title Company so as to ensure that the City has clear title to an asset. This is the most expedient way of verifying that the City has title to the assets, however these title reports naturally come with a cost and they are only good for the snapshot in time for which they are prepared. A title report run today does not guarantee that a year or so from now, a Department does something with their asset that is not communicated to Finance for updating on the PeopleSoft system. The only accurate way to ensure that the City has current legal title to a building is to have a Title Report prepared. This is simply cost prohibitive and certainly not wise during these difficult economic times. Because the project is too large to tackle in one year, especially in a year when departments are short staffed, the Finance Department can request that all Department Directors begin the process of verifying ownership and legal title for all buildings by working a portion of the project each year with the goal to have completion of the project in a future year. Certain departments might be able to verify and clean up their reporting relatively quickly, but for others such a project would take many years and need additional staff to be devoted to the project, staff that is unavailable at this time.

V. City-Owned Land

A. Land Recorded in the Citywide Fixed Asset Control File

The Finance Department’s Citywide Fixed Asset Control File contains 1,133 Land line items with a total historical cost of \$249,573,856. The acquisition date for these 1,133 Land line items range from December 1924 to April 2010. Not all City Departments have Land or Easements. The top three City Departments with Land/Easements are Public Works, Public Utilities and PARCS.

Each line item entry in the Fixed Asset Control File does not appear to represent the total acquisition cost for a parcel (or sub-parcel) of land owned by the City of Fresno. Other costs possibly related to land acquisition are also recorded individually in the Fixed Asset Control File.

The audit objectives were revised for the Land portion of the audit due to the type and quality of the information recorded or not recorded in the Fixed Asset Control File. The revised audit objectives will be detailed in the appropriate sections below.

B. Classification of Land Assets

Finance currently uses only two categories to classify Land - Land or Easement. Of the 1,133 line entries, 733 were designated as Land and 400 were designated as Easements. Reviewing the Land data fields by Class Description and Asset Description, Internal Audit noted three separate Class Descriptions. Therefore, the revised Class Description should be as follows:

Category	Recorded Number	Revised Number	Total Value
Land	733	707	\$83,170,780
Easements	400	414	166,322,611
Improvements		12	80,465
Total	1,133	1,133	\$249, 573,856

The current two categories of Land and Easements do not accurately capture Cost Reporting of all associated expenses per parcel or sub-parcel of Land/Easement. Internal Audit also noted that Finance and/or Departments do not use a “Parent/Child” relationship to reflect associated costs related to the acquisition costs of one parcel or sub-parcel of Land or an Easement.

Internal Audit noted the following other categories of Land line item descriptions with associated dollar values in the Fixed Asset Control File:

- Documents – Agreements, Appraisal Reports, PIRT Policies, Title Reports, Etc.
- Improvements – Assessment Improvement, Expansion, Removal of Debris, Etc.
- Payments – Closing Costs, Escrow Fees, Payment for Consideration, Petty Cash, Title Insurance, Etc.
- Projects – Jefferson Project, Shaw/Cedar Project, Etc.
- Services – Professional Services, Property Management Services, Study, Vehicle Impact Analysis, Etc.
- Unknown – Dedication, Land Account, Purchase and Sale, Etc.

Audit Recommendation:

7. The Finance Director should determine whether the City’s Fixed Asset Control File is an Asset Reporting and Tracking System or if the Fixed Asset Control File is also a Project Cost Tracking System. Based upon the Finance Director’s decision regarding the purpose of the Asset File, the Finance Director should instruct the Department Property Monitors to (a) Use a “Parent/Child” Relationship for all Land/Easement entries (if applicable); and (b) To properly categorize and classify all Land type assets and/or associated costs for improved asset accountability and reporting.

Finance Department Management Response to Recommendation 7

As acknowledged by Internal Audit and their selection of assets for review, the Fixed Asset Module contains Land line items that go back many years. As noted previously, the earliest recorded asset in the PeopleSoft System dates back to 1909, 102 years ago. As previously noted, over the decades, the City has utilized numerous different methods or systems for recording assets and with each system change, it is unfortunate but true, that detailed data

has been lost or was never initially recorded in such a manner that it could be transferred to a newer system. In addition, asset recording requirements have changed over the years and assets such as infrastructure, easements, rights of way and intangibles that once did not require capitalization now do.

Prior to FY 2002 when GASB 34 became applicable to the City of Fresno, the City engaged the services of a property appraisal specialist to assist with identifying and providing a valuation of these previously expensed infrastructure type assets. Similar to other cities, the information provided was limited and summarized at best. There simply is not sufficient information available to “fill in” some of the missing data. Finance has been and is working on accumulating more accurate and detailed asset information and will continue to strive to make it even better in the future. The Finance Department is committed to Parent/Child asset reporting and wholeheartedly believes improved asset reporting would provide many benefits. It must however be recognized that some of this historical data either cannot be easily reconstructed or is simply too time consuming or cost prohibitive to devote the City’s already stretched to the limit resources to at this time. The PeopleSoft Fixed Asset Module is a tool for gathering sufficient information for financial reporting purposes and nothing more. It is not intended to be a comprehensive detailed, item by item inventory of all City owned assets nor is it intended to be a Project report.

C. Imperative Land Information for Physical and Other Types of Land Verification

Section III of this report details key information that should be included on an F/A 91 Form for the addition of Land. The most critical field for physical verification is an accurate and valid address. The second critical field is an APN for verification of the owner of record with other sources (i.e. County Assessor’s Property List). An address or APN is necessary to ensure Land/Easements are not recorded more than once in the Fixed Asset File. Of the 1,133 Land line entries with a total historical cost of \$249,573,586, Internal Audit noted:

- 688 Land line items had an APN listed with a total asset cost of approximately \$68,078,368. Not all recorded APNs were valid, and
- 53 line items in Finance’s Land Asset File had a physical address listed. Twenty-five (25) out of the 53 Land line items had only a physical address with a total asset cost of approximately \$607,061. The remaining 28 Land line items had both an Address and an APN with a total asset cost of approximately \$5,917,883. Not all Addresses were verifiable with other sources.

Therefore, the initial total sample for verification of ownership and physical verification was 713 Land line items (688 with APNs and 25 with an Address only). Internal Audit used “FrontCounter” and “I-View” to look up and/or verify the addresses and APNs as recorded in the Fixed Asset Control File in order to conduct Ownership Verification, Physical Verification and potential Duplicate Asset Reporting testing.

- Internal Audit was only able to locate or verify a potentially valid address for 451 of the 713 Land line items.

Audit Recommendation:

8. (Same as Recommendation 3 above).

Finance Department Management Response to Recommendation 8

Same response as made to Recommendation 3 above.

D. Potential Duplication of Land Assets:

Duplicate APNs

Internal Audit sorted all Land line items in the Land Asset File and reviewed for duplicate APNs. Internal Audit identified 86 different duplicate APNs for a total of 275 individual Land line item entries. These duplicate APN line entries were classified as Land Only, Easements Only or a combination of Land and Easements. Internal Audit noted that 82 out of 275 individual Land line entries met the \$5,000 criteria per AO 1-3 to be recorded in the Fixed Asset Control File.

The Department of Public Utilities and Department of Public Works had the most duplicate APN entries, 13 and 49, respectively. Other City Departments also had duplicate APN entries. Internal Audit noted most duplicate APN entries were for a different dollar amount and a different acquisition date.

Multiple Departments with Duplicate Land/Easement Assets Recorded by Address or APN

Internal Audit identified five of the 86 APNs with more than one Department (Airport, DPU, DPW, PARCS and Police) reporting the Land or Easement to Finance as their asset in the Fixed Asset Control File. One entry was for an Easement and the remaining entries were for Land.

Internal Audit identified four addresses with more than one City Department (Airport, DPU, DPW, PARCS and Police) reporting Land to Finance for recording in the Fixed Asset Control File. All entries were for Land only.

Internal Audit concluded two Departments reporting the same address might be valid and two Departments reporting the same APN for three different APNs might be valid. For example, DPU's Pump Station located within a City Park or DPU's easement at a Park.

Internal Audit could not validate why both Police and Public Works and both Airport and PARCS would report Land with the same Address or APN as their asset. The only possible explanation for this scenario might be each Department's Land has a different sub-parcel number within a whole APN. Finance doesn't require Departments to provide the Sub-Parcel (LCID in "FrontCounter") number for recording, tracking, and physical verification. Further, the Asset Parcel Description was not concise by all Departments, except PARCS, for Internal Audit to be able to determine why more than one Department is reporting Land with the same Address or APN as their asset.

Audit Recommendations:

9. The Finance Director should formally direct (via memo) the applicable Department Directors to investigate the duplicate reporting of Land type assets by either Address or APN by more than one Department, correct these possible duplications and report the corrections to the Finance Department.
10. The Finance Director should formally direct (via memo) the Department Directors to use "Parent/Child" Relationships for Land type assets to be recorded in the Fixed Asset Control File so that all Land costs can be traced to one Asset ID number, APN, LCID, or Address, and for improved accountability and reporting purposes.

Finance Department Management Response to Recommendations 9 & 10

Given the current budgetary and staffing situation, the Finance Director does not believe that the best and most prudent use of limited resources is to divert their attention to tracking down purported duplicate APN numbers. In most cases that appear to be duplicates, there is most likely a reasonable explanation. Some duplicates may be errors, that Finance hopes to correct in the future, however given the low level of materiality, research into that area will have to take a back seat to more pressing issues. Before Land is pledged or sold, title, ownership and clear and concise identification information is obtain via a title search. Until such time as staffing and budgetary dollars become more available, this work will need to be deferred.

E. Verification of Ownership of Land

AO 1-3 does not address whether Land or Easements entered into the Fixed Asset Control File must be solely owned by the City of Fresno. The current F/A 91 Form does not request information about the “Owner of Record” to ensure proper ownership of Land or Easements before a sale, transfer or disposal.

To determine whether the City is the “Owner of Record” for all the Land/Easements recorded in Finance’s Fixed Asset File, Internal Audit used two sources – the County Assessor’s Property List and the City’s “FrontCounter” System. Internal Audit understands the information in “FrontCounter” is provided by the County Assessor’s Office.

The County Assessor’s Property List contained approximately 1,181 APNs listing Fresno City or Fresno City Housing Authority as the Property Owner. Internal Audit attempted to verify the City of Fresno’s ownership using the APN for the sampled 451 Land line items. Internal Audit was only able to verify with certainty the City of Fresno’s ownership of 245 out of the sample of 451 Land line items on the County Assessor’s Property List.

The County Assessor’s Office informed Internal Audit they do not maintain this list on a current basis due to staffing constraints. Valid Property Title must be verified through the County Recorder’s Office. Internal Audit did not attempt to verify current property ownership with the County Recorder’s Office for Land in the Fixed Asset Control File as this is the Reporting Department’s responsibility.

“FrontCounter” was also used by Internal Audit to look up either the line item APN or Address. Internal Audit found the following Owner of Record results for the 451 Land line items:

Ownership per City’s “FrontCounter” System

Owner of Record	Number of Line items	Total Dollar Value per Owner in “FrontCounter”
City of Fresno	201	\$25,916,698
Redevelopment Agency	5	\$76,500
Fresno County	6	\$449,894
Fresno Unified School District	4	\$1,300,024
Private Citizen	175	\$2,231,773
No Recorded Owner	53	\$11,400,695
Unknown (No information)	7	\$81,564
Total of Non-City Owned	250	\$15,540,450
Total of City and Non-City Owned	451	\$41,457,148

Easement ownership can and often is different from Land ownership. Internal Audit noted 177 out of the 451 line items were classified as an Easement. For line items classified as an Easement, the City of Fresno was listed as the Owner of Record for 9 out of 177 line items in the County Assessor's List.

Internal Audit identified two other Easements per the Asset Description which were classified as Land. For the two line items classified as Land but described as Easement, the City of Fresno was listed as the Owner of Record for one of the two line items. Internal Audit inquired of several Departments of who has legal title to easements and received different answers.

Due to the conflicting information regarding title/ownership of Easements between the County Assessor's Property List and "FrontCounter", Internal Audit was unable to conclude with certainty whether the City of Fresno owns or has legal title to all 451 Land and Easements with an address or APN for Land line item entries in the Fixed Asset Control File.

Audit Recommendation:

11. The Finance Director should formally direct (via memo) all Department Directors to conduct a Property Ownership search and provide documentation to Finance of Legal Title for both City-Owned Land and Easements. Further, the Department should identify whether the Land falls under an Easement, "Fee Simple": through a Grant Deed, or is a Right-of-Way not an Easement.

In addition, if the current Owner of Record is not the City but should be the City of Fresno, the Department Property Monitor should inform the County Assessor's Office in writing and include any necessary or required documentation to show proof of City title/ownership.

Finance Department Management Response to Recommendation 11

Easements and Rights of Way have very little value and technically cannot be sold by the City. They are simply a "right to use" that the City has obtained from the property owner. Many times these rights are utilized by the City for years and when it comes time for the City to abandon these rights, there no longer exists an owner of record and as such the City is unable to return the property to the original owner. At that time the City is able to sell the right. Since the County receives no property taxes on any property owned or used indefinitely by the City, they have little concern or eagerness to worry about who the listed owner is. However as noted in a previous response, when time, money and staffing allow, it is the intent of the Finance Department to have the new Citywide Property Monitor undertake the process of reviewing Land, Rights of Way, Easements and Intangibles and categorize these in such a manner that they can be better identified. Once again however, this is not viewed as being an indispensable core service and must be put on hold for the time being.

F. Physical Verification of Land

Initially, Internal Audit selected Airports, CMO, Convention Center, GSD, FAX, DPW and DPU to verify a sample of their Buildings and Land as recorded in Fixed Asset Control File. GSD and FAX do not have Land type assets recorded in the Fixed Asset Control File. In addition, the following obstacles were considered in our sample selection:

1. Lack of physical address for each Land line entry in the Fixed Asset Control File,
2. Lack of an Assigned Parcel Number (APN) for each Land line entry in the Fixed Asset Control File,
3. Lack of an accurate and concise Land Description in the Fixed Asset Control File,
4. Lack of an individual Dollar Value for each line entry in the Fixed Asset Control File,

5. Inability of an independent third party to utilize currently recorded Land assets for physical verification,

Internal Audit revised the sample selection for Land type assets to include all Land and Easements that either the Fixed Asset Control File had an address listed or Internal Audit was able to obtain a potentially valid address using the recorded APN for the recorded Land/Easement entry.

Therefore, Internal Audit started with a sample of 451 out of 713 Land entries to attempt physical verification from the address either provided by Finance or obtained by Internal Audit. These 451 Land/Easement entries represented \$41,457,148 (16.6%) out of the total 1,133 entries totaling \$249,573,856. Internal Audit used a Fresno map and Yahoo or MapQuest driving directions in an attempt to locate these Land/Easement assets throughout the entire City over the course of a month's time and approximately 600 miles driven. Internal Audit did not consult with departments' staff regarding the location of Land/Easements as we believe an independent third party, e.g. External and Internal Auditors, should be able to locate/verify Land/Easements using only the information contained in the Fixed Asset Control File.

Internal Audit found that streets or street numbers did not exist for each sample entry. For example, the Land is a Vacant Lot, Parking Lot or Farm acreage with no physical address; the address is not visible from the Street (e.g. the Land is a sub-parcel of a larger parcel accessed through an alley or easement), or the address does not physically exist.

Further, most City Parks' signs do not include the address. Also some City-Owned Land may not display a street number for Health and Safety purposes; therefore, making physical verification nearly impossible with only Finance's Fixed Asset Control File information.

For the 451 Land line items sampled with a potentially valid address, Internal Audit noted the following:

- Internal Audit physically verified 114 Land line items totaling approximately \$8,176,468 (19.7%);
- Internal Audit attempted but could not verify with certainty 295 Land line items totaling approximately \$33,198,797 (80.1%);
- Internal Audit did not attempt to physically verify 42 Land line items (mostly Easements) totaling approximately \$6,334 due to the length of time and driving distance and the immaterial dollar values for these assets. Department Property Monitors are not annually ensuring the accuracy of the Land assets information in the Fixed Asset Control File.

G. Potentially Non-Recorded Land

During physical verification of the selected Land/Easement line items recorded in the Fixed Asset Control File, Internal Audit identified Land potentially not currently recorded in the Fixed Asset Control File as of September 22, 2010. Therefore, Internal Audit attempted to use other sources (Department websites, the Risk Management's Insured Property Schedule, and physical knowledge of City Land with a structure) to identify other potential non-recorded Land Assets.

Internal Audit identified some Land Assets with structures potentially not recorded for the following Departments. Internal Audit does not consider this list to be complete for non-recorded Land assets.

- Airports – New Rental Car location

- City Manager – City Hall
- Fire – 23 Fire Stations are listed on the Fresno Fire Department’s (FFD) website. Five of the 23 Fire Stations listed appear to be property of the Fig Garden and North Central Fire Districts or Grantland Avenue LLC. The Fixed Asset Control File currently lists only 14 Fire Stations. Internal Audit physically located three out of four other Fire Stations erected on Land that do not appear in the Fixed Asset Control File. Internal Audit was unable to determine if FFD reported the Building and Land acquisition cost as one under Buildings. Land acquisition costs should never be reported with Building acquisition costs because Land does not depreciate whereas Buildings do depreciate.
- PARCS – approximately 45 City Park locations are listed on the PARCS Department’s website. The Fixed Asset Control File currently lists only 42 City Parks. Internal Audit physically located three parcels of Land with a City Park constructed on the Land. Internal Audit was unable to determine if PARCS reported the Building and Land acquisition costs as one under Buildings. Land acquisition costs should never be reported with Building acquisition costs because Land does not depreciate whereas Buildings do depreciate.

In addition, Internal Audit physically verified the West Fresno Boys and Girls Club that does not appear in the Fixed Asset Control File. Internal Audit was unable to determine if PARCS reported the Building and Land acquisition costs as one under Buildings.

- Public Utilities – Internal Audit noted 278 Wells (Pump Stations) on Risk Management’s Insured Property Schedule as of September 20, 2010. The Fixed Asset Control File lists approximately 118 Pump Stations. Therefore, the Land for approximately 160 Pump Stations appears not to be recorded in the Fixed Asset Control File. Internal Audit physically verified 24 out of the 160 non-recorded Pump Stations.

Internal Audit had great difficulty locating Pump Stations even after obtaining a physical address from “FrontCounter” for a Pump Station. Many Pump Station locations do not have the actual Street Number on the Station or surrounding fences in order to verify their existence.

Audit Recommendation:

12. The Finance Director should direct the Citywide Property Monitor to:
 - a. Develop a Form for the reporting of Land Assets to Finance for entry, monitoring and tracking in the Fixed Asset Control File with information as detailed in Section III of this report and per Recommendation 3.
 - b. Distribute a current Land Assets Report from the Fixed Asset Control File to each Department Director for review, update and documentation of physical verification with a photograph (not a System Aerial View) e.g. “FrontCounter” or “I-View” as proof of existence.
 - c. If the Land acquisition cost was reported as part of the Building acquisition cost, the Department must provide documentation to show separate Building and Land acquisition costs since Land does not depreciate but Buildings do depreciate. If the Department is unable to provide separate acquisition costs for Buildings and Land, a detailed explanation must be submitted to Finance as to why they have reported the Building and Land acquisition cost as one and cannot provide the individual Building and Land cost.

- d. If the Land is sub-parceled and the Land acquisition cost has been reported as one cost for all parcels, the acquisition cost of each sub-parcel should be identified if the whole parcel was not purchased in entirety at one time.

Finance Department Management Response to Recommendation 12

Once again while the Finance Department appreciates the recommendations made by Internal Audit, given current budgetary and staff constrains, it is not realistic for the Finance Director to direct that departments to divert their already stretched resources away from core services toward tracking down assets that more than likely are recorded but not in such a way that they can be easily identified. At most, the Finance Department can draw Department Directors attention to the problem in hopes that they will be willing to devote resources to the project in the future. Finance acknowledges that the data base available leaves much to be desired but it is the result of over 100 years worth of diverse record keeping systems, reporting guidelines; hundreds if not thousands of different staff being involved and even in good times, years worth of management not being willing to devote the resources toward cleaning up the system. Certainly during the current economic environment, the time and money to take on such an effort simply is not feasible. Finance will continue to work with departments to make the slow, steady inroads toward a much cleaner, concise and accurate system, but this will take many more years to achieve. Even the individual working on the project in Finance has been reassigned in the latest round of cuts. In all good conscious, it is not feasible for the City to devote limited staff and dollars toward this massive of an undertaking at this time. The comments of Internal Audit are well thought out and extremely thorough and do indeed address many of the issues at hand, but at this time, the City simply cannot take the course of action recommended without resulting in substantial impacts to the City core services.

VI. City-Owned Buildings and Land Assets Pledged as Collateral for Bonds/Loans

Internal Audit's objective was to verify City-Owned Building and Land Assets that have been pledged as collateral for current City bonds/loans, and that these pledged City assets are adequately documented for accountability and reporting purposes, and are not being pledged more than once.

Internal Audit obtained the list of bonds/loans with assets pledged as collateral from the Finance Department as of January 14, 2011. The list contained the assets pledged as collateral for eight Lease Revenue Bonds, one Lease Refunding Bond and one HUD Section 108 Loan. Finance provided the bond/loan documentation and we reviewed the list for any duplication of assets pledged and reviewed the supporting documentation.

Internal Audit did not identify any assets pledged more than once as collateral for a bond/loan and the documentation received and reviewed was adequate for accountability and reporting purposes.

No audit recommendations are considered necessary at this time.

Subject: Fixed Assets Inventory	Number: 1-3
	Date Issued/Revised: October 10, 2003
Responsible Department: Finance	Approved:

Purpose

To establish a uniform policy for the recording and tracking of fixed assets.

Policy

1. Fixed assets must be capitalized if they have a useful life of two or more years and a cost of \$2,000 or more for equipment, furnishings, vehicles; \$5,000 for land, buildings, improvements, and infrastructure.
2. Capitalization thresholds must be applied to individual assets, not to a group of assets.
3. Tracking and control methods over non-capitalized fixed assets must be maintained:
 - a. Assets that are, by nature, susceptible to theft or personal use (i.e., cameras, telecommunications equipment, etc.), which have a cost of less than \$2,000, but more than \$300, may be tracked, at the discretion of the departments, in the fixed asset system.
 - b. Security of these and all fixed assets is to be maintained at the department level.

Procedures

1. Each City department and division is responsible for the physical security, the use, maintenance, accounting and disposal of the fixed assets assigned to their units.
2. The Finance Department Accounting Division is responsible for establishing and maintaining a Citywide "Fixed Asset Control File."
3. The Accounting Division will designate a Citywide Property Monitor who is responsible for maintaining the Citywide Asset Control File, and who is responsible for providing quarterly asset lists to Departmental Property Monitors.
4. Each department will designate its own Department Property Monitor. This individual must be independent of record keeping and custody of the department's fixed assets. He/she is also responsible for coordinating department physical inventories at least every four years, and for notifying the Citywide Property Monitor of any changes to the Fixed Asset Control Files.
5. All departmental inventory records are subject to audit by the City's internal auditors, external auditors, or at the discretion of the Citywide Property Monitor.

6. **Transfers.** A form F/A 91 must be completed and signed by the department director relinquishing the asset for all asset transfers. If the asset being transferred has a historical cost of \$5,000 or more, the F/A 91 form must be signed by the City Manager. Asset transfers that cross funds or orgs must be communicated to the Citywide Property Monitor through submission of the form F/A 91.

7. **Disposals.** For all fixed asset disposals, a form F/A 91 must be completed. If an asset being disposed of has a historical cost of \$5,000 or more, the form must be signed by the City Manager. All other fixed asset disposals require the signature by the department director. The form F/A 91 can be used for a single asset disposal or a group of assets, provided a list is attached. The Citywide Property Monitor is to be provided a copy of every form F/A 91 completed by the departments. Any proceeds resulting from the disposed asset(s) must also be disclosed (with supporting documents attached).

Subject: Financial Fixed Assets Inventory	Number: 1-3
	Date Issued: July 15, 1999 Date Revised: July 1, 2010
Responsible Department: Finance	Approved:

Purpose

To establish a uniform policy for the accounting control and accountability of the City's financial fixed assets. The Finance Department is the central accounting and reporting locale for all audited fixed assets. Assets under this classification must follow specific accounting rules and are subject to annual audit requirements. The accounting and reporting policies utilized by the City for its fixed assets conform to GAAP, GASB and GASB Statement No. 34.

Capital or fixed assets are real or personal property that have a value equal to or greater than the capitalization threshold for the particular classification of the asset and have an estimated useful life of greater than two years. [Land, land improvements, buildings, building improvements, machinery and equipment, vehicles, infrastructure, leasehold improvements and construction-in-progress (excluding projects donated by outside developers).]

Infrastructure assets are long-lived capital assets that normally can be preserved for a significantly greater number of years than most capital assets and that are normally stationary in nature. [Roads, bridges, tunnels, drainage systems, water systems and dams.] Infrastructure assets do not include buildings, drives, parking lots or any other items incidental to property or access to the property.

Policy

1. Fixed assets must be capitalized if they have a useful life of two or more years. In determining useful life, the City should consider the asset's present condition, use of the asset, construction type, and maintenance policy and adherence to policy as well as how long it is expected to meet service demands.
2. Not every asset with a useful life greater than two years needs to be capitalized. To do so is an unnecessary burden and will not materially affect financial results. The table below lists what will be used in determining the dollar thresholds to use for tracking the City's financial fixed assets.

Capitalization and Depreciation Thresholds	
Land	\$1 or more (capitalized but not depreciated)
Land Improvements	\$10,000 and more
Building	\$10,000 and more
Building Improvements*	\$10,000 and more
Machinery and Equipment	\$10,000 and more
Infrastructure – based on total project cost	\$50,000 and more
Construction in Progress	Costs accumulated and capitalized upon completion
*excludes painting, carpeting, draperies, window shades or blinds	

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3. Capitalization thresholds should be applied to individual assets, not to a group of assets except in specific situations. **(Contact the Finance Department for guidance.)**
4. Tracking and control methods over non-capitalized fixed assets should be maintained:
 - a. Assets that are, by nature, susceptible to theft or personal use (i.e., cameras, telecommunications equipment, such as cell phones and PDA's, laptops, tablet PC's, etc.), which have a cost of less than \$10,000, but more than \$300, should be tracked, and at the discretion of the departments, may be tracked in the PeopleSoft Asset Management system using the classification of "sensitive".
 - b. Security of these and all fixed assets is to be maintained at the department level and is the responsibility of the Department Budget Officer or his/her designee, such as the property management custodian/property monitor.

Procedures

1. Each City department and division is responsible for the physical security, the use, maintenance, accounting and disposal of the fixed assets assigned to their units.
2. The Finance Department Accounting/Fixed Asset Management Division is responsible for establishing and maintaining a City-wide "**Financial** Fixed Asset Control File."
3. The Accounting Division will designate a City-wide Property Monitor who is responsible for maintaining the Citywide Financial Fixed Asset Control File, and who is responsible for providing at a minimum, annual asset lists to Departmental Property Monitors.
4. Each department will designate its own Department Property Monitor. This individual must be independent of record keeping and custody of the department's fixed assets. He/she is also responsible for coordinating department physical inventories, and for notifying the City-wide Property Monitor of any changes to the Fixed Asset Control Files.
5. Financial fixed assets will be physically observed and counted, on an annual rotational basis, such that at end of every fourth year, all assets, City-wide have been accounted for. The Finance Department will assist departments in making random selections of assets to be observed at the end of each fiscal year and will provide instructions and appropriate forms to be completed for assets observed. More frequent audits of non-capitalized "sensitive" assets are left to the discretion of each department.
6. All departmental inventory records are subject to audit by the City's internal auditors, external auditors, or at the discretion of the City-wide Property Monitor.
7. **Transfers.** A form F/A 91 must be completed and signed by the department director relinquishing the asset for all asset transfers. If the asset being transferred has a historical cost of \$50,000 or more, the F/A 91 form must be signed by the City Manager. Asset transfers that cross funds or orgs must be communicated to the City-wide Property Monitor through submission of the form F/A 91.

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8. **Disposals.** For all fixed asset disposals, a form F/A 91 must be completed. If an asset being disposed of has a historical cost of \$50,000 or more, the form must be signed by the City Manager. All other fixed asset disposals require the signature by the department director. The form F/A 91 can be used for a single asset disposal or a group of assets, provided a list is attached. The City-wide Property Monitor is to be provided a copy of every form F/A 91 completed by the departments. Any proceeds resulting from the disposed asset(s) must also be disclosed (with supporting documents attached).

Recording of Land, Rights of Way, Easements and Intangibles:

Land: Land is capitalized but not depreciated. It is recorded at historical cost and remains at that cost until disposed of. If there is a gain or loss on the sale of the land, it must be reported on the form F/A 91. All land will be capitalized unless the City plans to immediately sell it instead of putting it to use.

The following items should be included as part of the cost of the land: purchase price or fair market value at the time of the gift or donation, commissions, professional fees (title searches, legal costs, appraisals, etc.) grading removal, relocation, or reconstruction of properties of others (telephone and power lines); interest, accrued and unpaid taxes at the date of purchase; other costs incurred in acquiring the land.

Rights of Way (ROW) and Easements: ROW cost will be recorded at the time of the project. If the Row costs are known at the time of the project they should be based upon actual costs. If actual cost is not available, a cost per square foot should be determined using an assessor's valuation. An **easement** is the right to use the real property of another without possessing it.

Intangibles: Governments possess many different types of assets that may be considered intangible assets, including ROW, easements, water rights, timber rights, patents, trademarks, and computer software. The useful life of an intangible asset arising from contractual or legal rights should be limited by the contractual or legal provisions. Some intangible assets will have indefinite useful lives as no contractual, legal or other factors limit the useful life of the asset. Intangible assets with indefinite useful lives should not be amortized. (See also Intangibles below.)

Land Improvements: Land improvements consist of betterments, other than buildings, that ready land for its intended use. A few examples are retaining walls, parking lots, sidewalks, outdoor lighting, fencing/gates and landscaping. They can be categorized as non-exhaustible or exhaustible.

Non-exhaustible – expenditures for improvements that do not require maintenance or replacement, expenditures that bring land into condition to commence erection of structures, improvements that do not deteriorate with usage or passage of time.

Exhaustible – other improvements that are part of a site, such as parking lots, landscaping and fencing, gates, outside sprinkler systems, fountains, retaining walls, sidewalks, etc.

Buildings: Buildings should be recorded at either their acquisition cost or construction cost. The various components such as land, land improvements, building construction, furniture,

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fixtures and equipment should be broken out separately. Building components such as design/engineering costs, heating and air conditioning, windows etc., should be included in the initial cost of the building.

Building Improvements: Building Improvements that extend the useful life of the building by more than 25% should be capitalized. Building improvements would include major roofing projects that tear the original roof down to the rafters, major energy conservation projects or remodeling and replacing major building components. Normal maintenance and repair projects like re-shingling or re-tarring a roof would be expensed.

Equipment and Vehicles: Assets such as furniture, shop equipment, lawn equipment, computers, machinery and other equipment that meet the threshold levels should be identified and capitalized. Some assets, individually, may fall below the capitalization threshold but may be purchased in large quantities. When these items have a useful life of more than two years and meet the cost threshold as a group they should be capitalized and depreciated.

Computer equipment – computers will be excluded if they individually cost less than the threshold limit. If the dollar amount exceeds the limit, those assets will be capitalized and depreciated.

Vehicles – vehicles should be identified, capitalized and depreciated if they exceed the threshold limit. When setting up the initial costs of the vehicle, the cost of sirens, light bars, etc. on police cars will be included as part of the cost of getting the car into service. In the case of moving existing sirens, etc. that cost will be included as part of the initial cost associated with the new purchases.

Leased Equipment – equipment should be capitalized if the lease agreement is non-cancelable and meets one of the following criteria:

- The lease transfers ownership of the property to the lessee by the end of the lease term.
- The lease contains a bargain purchase option.
- The lease term is equal to 75% or more of the estimated economic life of the leased property.
- The present value of the minimum lease payments at the inception of the lease, excluding executory costs, equals at least 90% of the fair value of the leased property.

Infrastructure Assets: Most infrastructure construction is associated with a project, with certain funds set aside based on the project. Infrastructure items will be evaluated based on the total cost of the project. Any project with a total cost that meets the threshold should be capitalized. The date of completion and placement into service determines when infrastructure is capitalized. If a project includes various components of infrastructure, each major component should be capitalized separately. In addition to actual construction costs, engineering fees and other incidental expenses should be added to the project cost. If certain shared costs cannot be determined for each segment, then the costs should be prorated to each segment based on the segment's percent of the overall project costs (excluding costs that will be allocated).

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If ownership of the infrastructure associated with land, such as roads, sewers, etc. is unclear; the government with primary responsibility for managing the asset should report the asset.

Streets, roads and other components – The City will capitalize and include frontage roads and alleys as part of the street and road network if they exceed the dollar threshold. This category also includes the associated curbs and gutters. It excludes however, sidewalks constructed on private property.

Bridges – The initial cost of a bridge will include the sidewalks and guardrails associated with the bridges.

Sidewalks – Sidewalks owned and maintained by the City will be classified as a land improvement subject to the category threshold limits of the class.

Street signs – Street signs are installed once a street project is completed. The cost of the sign is not part of the construction cost. Given the nominal amount of the cost of the signs, when compare to project costs and the nominal cost for sign replacement, the City will not capitalize street signs.

Street lighting – Streetlights included in any project that meets the capitalization threshold will be capitalize as a part of that project.

Traffic lights – Traffic lights will be evaluated by intersection and all intersections that meet the infrastructure threshold will be capitalized.

Bike Paths – Assets associated with a bike path project will be capitalized as one project asset. These assets will include benches, receptacles, engineering costs, etc. Costs associated with the replacement of benches, receptacles, etc. will be expensed in the year replaced.

Construction in Progress: Construction in Progress costs are accumulated by the City and not reported as assets or depreciated until such time as the projects are completed and placed in service. These costs relate primarily to long lived assets that are construction over several years.

Capital Asset Donations: Donated capital assets are to be capitalized at fair market or appraised value of the asset at the date that it was donated.

Real Estate – All gifts of real estate much have council approval prior to title transferring. Contributed capital assets are valued at their appraised or estimated fair market value on the date donated.

Developers – Private developers install infrastructure that is then given to the City. The acquisition date will be the date that council accepts the development. The developer is to provide the cost of construction associated with the infrastructure being donated. Each infrastructure component should be capitalized separately. These components include such items as:

- Storm sewer
- Lift stations

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- Sanitary sewer
- Water mains
- Streets, curbs and gutters
- Traffic Signals
- Bike paths
- Street lights
- Land and right of ways

Public Works/Engineering will be responsible for obtaining this information from the developer.

Asset Cost or Acquisition Value: Fixed assets should be reported at historical cost and should include the cost of freight, site preparation, architect and engineering fees, etc. If something other than cash is used to pay for the asset, then the fair-market value of non-cash payment or consideration determines the asset's cost of acquisition value. When the value of the consideration paid cannot be determined, the asset's fair-market value determines the cost.

With few exceptions, an asset's cost should also include necessary costs incurred to place the asset in service. Costs include the invoice price plus incidental costs (insurance during transit, freight, title search, installation costs, etc.).

Repairs and Maintenance: The list below will help to determine if maintenance and repair costs should be capitalized or expensed. With respect to asset improvements, costs over \$5,000 (\$50,000 for infrastructure) should be capitalized if:

1. The estimated life of the asset is extended by more than 25%, or
2. The cost results in an increase in the capacity of the asset, or
3. The efficiency of the asset is increased by more than 10%, or
4. Significantly changes the character of the asset, or
5. In the case of streets and roads – if the work done impacts the "base" structure.

All other costs should be expensed as repairs and maintenance.

Intangibles: An intangible can be recognized as an asset only if it is identifiable, meaning that 1) it can be sold, transferred, licensed, rented, or exchanged, or 2) it arises from contractual or other legal rights.

Internally generated intangible assets include items created or produced by the government itself, or by a contracting party acting on its behalf. The term also encompasses costs associated with assets acquired from a third party that "require more than minimal incremental effort on the part of the government to begin to achieve their expected level of service capacity" (e.g., "off-the-shelf" software).

Capitalization of internally generated intangible assets, such as software, patents, copyrights and trademarks can only occur after all of the following conditions have been met:

- * The specific objective of the project has been determined;
- * The nature of the service capacity to be provided has been determined;
- * The technical or technological feasibility of successfully completing the project has been demonstrated; and

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* The government has demonstrated that it 1) intends, 2) is able, and 3) is making an effort to develop/complete the project.

No outlays incurred prior to meeting all of these criteria may be capitalized.

There are three stages of software development. The preliminary project stage includes conceptual formulation, evaluation of alternatives, determination of existence of needed technology, and final selection of alternatives for development. All outlays incurred during this stage need to be expensed as incurred. This stage must also be completed before outlays of another stage may be capitalized.

The application development stage includes: design of the chosen path (including software configuration and interfaces), coding, installation to hardware, testing (including the parallel processing phase), and data conversion needed to make the software operational (but only to the extent strictly necessary for that purpose). All outlays incurred during this stage should be capitalized, provided that management authorizes and commits to funding (either implicitly or explicitly), at least through the current period.

The post-implementation/operation stage includes: application training, data conversion (beyond what is strictly necessary to make the software operational), and software maintenance. All outlays incurred during this stage should be expensed rather than capitalized.

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