

AUDIT REPORT



CITY OF NEW YORK
OFFICE OF THE COMPTROLLER
BUREAU OF MANAGEMENT AUDIT
WILLIAM C. THOMPSON, JR., COMPTROLLER

Audit Report on the Compliance of the Department of Correction with Comptroller's Directive 10, *Charges to the Capital Projects Fund,* For the Purchase of Capital Equipment

MH04-104A

JUNE 18, 2004



THE CITY OF NEW YORK
OFFICE OF THE COMPTROLLER
1 CENTRE STREET
NEW YORK, N.Y. 10007-2341

WILLIAM C. THOMPSON, JR.
COMPTROLLER

To the Citizens of the City of New York

Ladies and Gentlemen:

In accordance with the Comptroller's responsibilities contained in Chapter 5, §93, of the New York City Charter, my office has examined the Department of Correction purchases of capital equipment to ensure that they were made in compliance with Comptroller's Directive 10, Charges to the Capital Projects Fund.

The results of our audit, which are presented in this report, have been discussed with DOC officials, and their comments have been considered in the preparation of this report.

Audits such as this provide a means of ensuring that the Department of Correction capital purchases of equipment are capital eligible.

I trust that this report contains information that is of interest to you. If you have any questions concerning this report, please e-mail my audit bureau at audit@comptroller.nyc.gov or telephone my office at 212-669-3747.

Very truly yours,

A handwritten signature in cursive script that reads "William C. Thompson, Jr.".

William C. Thompson, Jr.
WCT/fh

Report: MH04-104A
Filed: June 18, 2004

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*The City of New York
Office of the Comptroller
Bureau of Management Audit*

**Audit Report on the Compliance of the
Department of Correction with Comptroller's Directive 10,
Charges to the Capital Projects Fund,
For the Purchase of Capital Equipment**

MH04-104A

AUDIT REPORT IN BRIEF

To manage its penitentiary facilities, the New York City Department of Correction (DOC) expends millions of dollars on capital projects and procurements. DOC spent a total of \$11.1 million on capital equipment purchases in Fiscal Years 2002 and 2003. This audit determined whether DOC's capital equipment purchases were made in compliance with City Comptroller's Directive 10, *Charges to the Capital Projects Fund*.

Audit Findings and Conclusion

In general, DOC's purchases of capital equipment were in compliance with Directive 10. During Fiscal Years 2002 and 2003, DOC issued 319 capital purchase orders for a total of \$11.1 million. The 20 projects associated with these purchases all met the requirements of Directive 10. Based on our review, we determined that items purchased with 304 (95%) of the 319 capital purchase orders met the eligibility criteria described in Directive 10.

However, during our audit, we found other matters of concern that were not related to Directive 10, namely, that DOC incorrectly coded as "equipment" on its purchase orders materials and supplies used for capital construction projects. Based on our review of the purchase orders, we determined that 95 (30%) of the 319 purchases, totaling \$1.4 million, were incorrectly coded as equipment. The items purchased were for materials or supplies, such as plumbing supplies, electrical supplies, tiles, lumber, drywall, compound, and paint brushes, and were incorrectly coded with the object code 2200, which is the object code for capital equipment. These purchases should have been coded with the object code 2110, which is for construction.

Furthermore, DOC does not maintain an inventory listing of capital assets as recommended by Comptroller's Directive #1. According to this directive, agencies should ensure that accurate and complete inventory records are maintained for all assets. The only listing of capital equipment available from DOC was generated by the City Financial Management System. However, this list is incomplete and is not updated to reflect all purchases or the location of the items.

Audit Recommendations

To address these issues, we make three recommendations, namely, that DOC should:

- Continue to ensure that all equipment purchased with capital funds meets the eligibility requirements of Directive 10. Questionable purchases should be referred to the Office of Management and Budget or to the Capital Unit of the Bureau of Accountancy at the Comptroller's Office for a determination of capital-eligibility.
- Code all purchases of construction materials and supplies with the construction object code and not the equipment object code.
- Maintain a complete inventory listing of all capital assets. A physical inventory should be conducted yearly to ensure that the inventory records are accurate.

INTRODUCTION

Background

DOC provides custody of males and females, 16 and older, who, after arraignment on criminal charges, have been unable to post bail or were remanded without bail, pending adjudication of their criminal charges. DOC also incarcerates persons sentenced in the City to terms of up to one year, parole violators awaiting parole revocation hearings, and persons charged with civil crimes. DOC averages a daily inmate population of between 14,000 to 19,000. The majority of inmates are housed in one of the 10 facilities on Rikers Island in the East River, adjacent to LaGuardia Airport. To manage its penitentiary facilities, DOC expends millions of dollars on capital projects and procurements. DOC spent a total of \$11.1 million on capital equipment purchases in Fiscal Years 2002 and 2003.

To be considered eligible for capital financing and inclusion in the City's Capital Budget, an agency must meet City standards of purpose, cost, useful life, and replacement. In general the capital project's expected useful life must be at least five years, the total cost must be \$35,000 or more, and it must be tangible property that provides for the "construction, reconstruction, acquisition or installation of a physical public betterment or improvement."¹

Capital projects vary widely and include, but are not limited to, construction or rehabilitation projects such as new buildings and additions, kitchens, or stand-alone purchases of major equipment such as trucks or forklifts and mainframe computers. Once a project is established as a capital project, the agency must make sure that only capital-eligible expenditures are charged to the project.

New York City Comptroller's Directive 10, *Charges to the Capital Projects Fund* (Directive 10), describes the accounting policies for determining when an agency can use capital funds for City projects. Among other things, it identifies the general categories, types of projects, and the appropriate purposes for the use of capital funds.

Objective

The objective of this audit is to determine whether DOC's purchases of capital equipment are made in compliance with City Comptroller's Directive 10, *Charges to the Capital Projects Fund*.

Scope and Methodology

The scope of the audit is a review of the \$11.1 million of capital equipment purchased by DOC in Fiscal Years 2002 and 2003.

¹ The New York City Charter, §210.

To gain an overall understanding of capital projects and capital equipment (asset) purchases we reviewed Comptroller's Directive 10, *Charges to the Capital Projects Fund*, Chapter 9 of the New York City Charter, *Capital Projects and Budget*, and the City Financial Management System's (FMS) *Policies and Procedures*. We also met with the DOC Assistant Commissioner of Capital Policy and Development, the Chief Contracting Officer, and the Director of Capital Budgets to obtain an understanding of DOC policies and procedures for purchasing equipment with capital funds. In addition, we met with personnel from the Capital Accounting Unit of the Comptroller's Bureau of Accountancy to gain a better understanding of the eligibility requirements of Directive 10 and to obtain their assessment on specific purchases.

To ensure that we received all purchase orders of equipment made by DOC in our scope period, we compared the purchase orders listed on the FMS *Capital Contract—New Registration Reports* for Fiscal Years 2002 and 2003 to copies of the purchase orders obtained from DOC.

To determine whether DOC capital equipment purchases were capital-eligible, as set forth in Directive 10, we identified the capital equipment in the 319 capital purchase orders issued by DOC in Fiscal Years 2002 and 2003. We analyzed the purchase orders and identified 20 capital projects with which they were associated. We then determined whether these 20 projects met the cost-eligibility requirement of at least \$35,000, the purpose-eligibility requirement, and the criterion of a minimum useful life of at least five years established in Directive 10. We reviewed all 20 contract scopes of work and the approvals received from the Office of Management and Budget. We determined whether the purchased capital asset is tangible property, met the minimum-cost and minimum useful-life criteria, and other relevant criteria described in Directive 10.

To determine whether capital equipment purchases were being used for the intended project, we requested an inventory listing of all Capital Assets. DOC does not maintain its own inventory list and instead provided us with the FMS Fixed Asset Inventory by Location Report as of August 31, 2003. From this list, we judgmentally selected 63 items of equipment, and from our purchase orders we judgmentally selected 25 items of equipment. We selected the additional sample from our purchase orders because of our concerns about the completeness of the FMS report. The items chosen were large items that could easily be found and identified. Accompanied by DOC personnel, we visited eight different areas on Rikers Island to view these items. The results of this test, while not projectable to all items purchased, provided us a reasonable basis to assess whether the capital equipment purchases were used for the intended project.

This audit was conducted in accordance with generally accepted government auditing standards (GAGAS) and included tests of records and other auditing procedures considered necessary. The audit was performed in accordance with the audit responsibilities of the City Comptroller as set forth in Chapter 5, §93, of the New York City Charter.

Discussion of Audit Results

The matters covered in this report were discussed with DOC officials during and at the conclusion of this audit. A preliminary draft report was sent to DOC officials on May 4, 2004, and was discussed at an exit conference held on May 19, 2004. On May 21, 2004, we submitted a draft report to DOC officials with a request for comments. We received a written response from DOC officials on June 9, 2004. In their response, DOC officials generally agreed with the three recommendations made in the audit report.

The full text of the DOC response is included as an addendum to this report.

FINDINGS AND RECOMMENDATIONS

Capital Equipment Purchases Made In Compliance with Directive 10

In general, DOC's purchases of capital equipment were in compliance with Directive 10. During Fiscal Years 2002 and 2003, DOC issued 319 capital purchase orders for a total of \$11.1 million. The 20 projects associated with these purchases all met the requirements of Directive 10. The purchases included vans, buses, large kitchen equipment, computers, forklifts, and communication systems. Based on our review, we determined that items purchased with 304 (95%) of the 319 capital purchase orders met the eligibility criteria described in Directive 10.

Directive 10 states, "Once an agency project is established as a Capital Project in accordance with the requirements of this Directive, agencies must insure that only capital eligible expenditures are charged to the project." It also states, "Funds obtained through long-term borrowing must be used for long-lived assets rather than for current expenses or minor purchases." The above-mentioned purchases were made with capital-eligible funds and were charged to capital projects that had a useful life of more than five years.

The remaining 15 (5%) purchase orders totaling \$267,756 did not meet the eligibility criteria set forth in Directive 10 and were incorrectly purchased with capital funds. (See Appendix for a brief description of the 15 purchase orders and reasons for ineligibility.) We brought these items to the attention of DOC officials, who disagreed with our conclusions on 14 of the 15 purchase orders. They stated, "We have determined that all but one of the items in question were justified capital procurements as they were components of a larger OMB approved capital project. While each individual item may not appear to satisfy Directive 10, when viewed within the scope or intent of the larger capital project with which it is associated, the individual purchases comply with Comptroller's Directive 10."

We requested a second opinion from staff at the Capital Unit of the Bureau of Accountancy at the Comptroller's Office who are experienced with these matters. They independently reviewed these purchases and agreed with our assessment that these 15 purchase orders did not meet the eligibility criteria set forth in Directive 10. They also concluded that these items of equipment were incorrectly purchased using capital funds and should have been purchased with funds from DOC's expense budget.

Overall, DOC complied with Directive 10 for purchases of capital equipment during Fiscal Years 2002 and 2003.

Recommendation

1. DOC should continue to ensure that all equipment purchased with capital funds meets the eligibility requirements of Directive 10. Questionable purchases should be referred to the Office of Management and Budget or to the Capital Unit of the Bureau of Accountancy at the Comptroller's Office for a determination of capital-eligibility.

DOC Response: DOC agreed, stating: “As recommended, the Department will continue to ensure that all equipment purchased with capital funds meets the eligibility requirements of Directive 10. In the future, we will better document the rationale for the use of capital funds when capital eligibility cannot be determined *prima facie*. Also, as recommended, questionable purchases will be referred to the Office of Management and to the Capital Unit of the Bureau of Accountancy at the Comptroller’s Office for a determination of capital-eligibility.”

Other Matters

Capital Purchases Incorrectly Coded as Equipment

DOC capital purchases are authorized and issued on Capital Purchase Orders, which are prepared by the Agency Chief Contracting Officer’s (ACCO) unit. The DOC Capital Projects Unit identifies and assigns the unit of appropriation, the object codes, the budget codes, and capital project identification codes. The use of the correct object code allows the agency to track expenses by category within a fiscal year and to generate year-end reports that identify expenditure patterns.

We found that DOC incorrectly coded on their purchase orders as “equipment” materials and supplies used for capital construction projects. Based on our review of the purchase orders, we determined that 95 (30%) of the 319 purchases, totaling \$1.4 million, were incorrectly coded as equipment. The items purchased were for materials or supplies, such as plumbing supplies, electrical supplies, tiles, lumber, drywall, compound, and paint brushes, and were incorrectly coded with the object code 2200, which is the object code for capital equipment. These purchases should have been coded with the object code 2110, which is for construction.

According to Comptroller’s Directive #24, §8.4 (b) (9), a reviewer should, “examine the accounting and budget codes used and determine that they are correct.” The use of incorrect object codes compromises management’s ability to plan future budgets. In addition, the improper coding affects the accuracy of the City’s Financial Statements. By incorrectly coding the purchases, the amount of capital funds spent on equipment is overstated and the amount spent on construction is understated in the City’s Financial Statements.

In addition, according to the Bureau of Accountancy, construction materials and supplies should be included in the cost of the construction of the building or structure. Buildings are depreciated over a longer period of time than equipment. As a result of incorrectly coding construction materials and supplies as equipment, DOC overstates depreciation expense for the short term and understates depreciation expense for the long term.

DOC officials stated that these items were purchased to complete a capital project using in-house support services and maintenance staff for labor. They stated, “while most of the materials are construction-related, only code 220 for the purchase of equipment matches the required budget structure.” However, the items purchased with the above-mentioned 95 purchase orders are clearly not equipment and should have been coded with the construction object code.

Recommendation

2. DOC should code all purchases of construction materials and supplies with the construction object code and not the equipment object code.

DOC Response: DOC agreed, stating: “Using existing budget guidelines, the Department exercised its best judgment when coding the purchases questioned by the auditors. The Department will begin to code all construction-related materials and supplies purchases, with or without a labor component, to the construction object code and not the equipment object code.”

Inadequate Inventory Controls over Capital Assets

DOC does not maintain an inventory listing of capital assets, as recommended by Comptroller’s Directive # 1.² According to this directive, agencies should ensure that accurate and complete inventory records are maintained for all assets. The only listing of capital equipment available from DOC was generated by FMS. However, this list was incomplete and not updated to reflect all purchases. Without an accurate, up-to-date inventory list, DOC increases the risk that equipment purchased for capital projects may be lost or stolen.

We attempted to find 88 major equipment items from our sampled purchase orders and the FMS list. These items of equipment included computers, a forklift, a pan greaser, can openers, and machines that crush and wash cans. The FMS listing was not adequate and often did not include the location of the items. We found 45 items at the time of our visit to Rikers Island. DOC was unable to provide us the exact locations for the remaining 43 items at the time of our visit. Subsequently, DOC researched and found these items and provided additional documentation that stated the reasons for the omission of some of the items on the FMS list or for the differing locations of the items (we did not visit the new locations). DOC should maintain an inventory list of assets and should perform an annual physical inventory of purchased items to ensure that all are included on the list, tagged and that the location is known to ensure that purchased equipment is not misplaced, lost, or stolen.

Recommendation

3. DOC should maintain a complete inventory listing of all capital assets. A physical inventory should be conducted yearly to ensure that the inventory records are accurate.

² The Comptroller’s Directive #1, *Financial Integrity Statement*, is an annual internal control self-assessment that City agencies are required to conduct. Agencies are required to send the completed assessment (which includes an extensive internal control checklist reporting on the state of their internal controls) to the Comptroller and Mayor’s Office of Operations. The head of the agency is required to sign this assessment and provide an opinion regarding the adequacy of agency internal controls.

DOC Response: DOC agreed, stating; “As recommended, the Department will maintain a complete inventory listing of all capital assets on the City’s Financial Management System. . . . The Department will, as has been recommended, conduct a physical inventory once a year to ensure accuracy.

“As to maintaining a listing of the physical location of capital assets, we feel the continued use of the FMS ‘Responsibility Center’ field is most practical for the capital asset listing. Many of our assets are items subject to relocation on a daily basis (e.g. vehicles, computer equipment). However, the Department does recognize the need to improve its inventory systems in general and its inventory of computers in particular.”

Auditor Comment: We are pleased that DOC agreed to improve its inventory system and to conduct a yearly physical inventory. However, DOC first must review the current FMS listing to ensure that all items previously purchased by DOC and DCAS are added to this list. Second, since DOC claims that many items are “relocated” daily, it is important that DOC have a procedure in place to ensure that the inventory list reflects the current locations of the items so the item can be accounted for immediately.

Fifteen Purchase Orders Incorrectly Charged to the Capital Budget

ITEM DESCRIPTION	PURCHASE ORDER #	DOLLAR AMOUNT	REASON FOR INELIGIBILITY
Pan greaser	CT 072 20020002275	\$ 22,000.00	Replacement equipment
Electrical tools and hardware	PO 072 00000027399	\$ 8,893.95	Supplies
Fluorescent and halogen bulbs	PO 072 00000027401	\$ 7,489.50	Consumable supplies.
Smoke detectors	CT 072 20020015848	\$ 16,418.75	Replacement equipment
1,200 Smoke detectors	CT 857 20020014921	\$ 40,800.00	Each individual unit costs less than \$110 and therefore, does not meet the initial outfitting criteria as coded on the purchase order.
Labor & materials to remove & install new power soak machine	CT 072 20030017778	\$ 30,300.00	Replacement equipment therefore did not meet the initial outfitting criteria.
Labor & materials Pallet rack removed, stored, & reinstalled	CT 072 20030019008	\$ 13,800.00	Replacement equipment therefore did not meet the initial outfitting criteria.
Labor, material, and construction for removal & replacement of electric & 3 combi ovens	CT 072 20030019104	\$ 12,567.26	Replacement equipment therefore did not meet the initial outfitting criteria.
Maintenance contract	CT 072 20030008687	\$ 25,000.00	Maintenance contract
Paint brushes, roller handles, paint trays,	PO 072 00000031771	\$ 5,365.58	Consumable supplies.
Fork lift	CT 072 20030003988	\$ 18,955.00	Stand -alone equipment less than \$35,000
Electric cold storage pallet jack	CT 072 20030007517	\$ 22,584.00	Stand -alone equipment less than \$35,000
5 computers	CT 072 2003001095	\$ 14,140.00	Less than \$35,000. No indication that computers were additions to an existing system.
Electric fork lift	CT 072 20030014834	\$ 19,350.00	Stand -alone equipment less than \$35,000
6 computers	PO 072 00000027422	\$ 10,092.00	Less than \$35,000. No indication that computers were additions to an existing system.
TOTAL		\$ 267,756.04	



NEW YORK CITY DEPARTMENT OF CORRECTION
Martin F. Horn, Commissioner

Leroy Grant, Bureau Chief
Inspectional Services and Compliance Division
320 - Mandanici Road
East Elmhurst, NY 11370

718 • 546 • 8155
Fax 718 • 546 • 8162

June 4, 2004

Glen Brooks
Deputy Comptroller, Policy, Audits,
Accountancy and Contracts
Office of the City Comptroller
1 Centre Street
New York, N.Y. 10007-2341

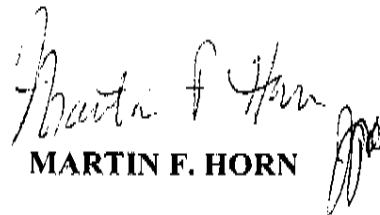
Mr. Brooks:

Attached is this agency's response to your Draft Audit Report on the Compliance of the Department of Correction with Comptroller's Directive 10, *Charges to the Capital Projects Fund*, For the Purchase of Capital Equipment (MH04-104A).

In this response, we have addressed each of your recommendations. Please include our response as an appendix to your final report.

If you have any questions regarding this response, please contact Leroy Grant, Bureau Chief, Inspectional Services and Compliance Division at (718) 546-8155.

Sincerely,


MARTIN F. HORN

NEW YORK CITY DEPARTMENT OF CORRECTION RESPONSE

THE DEPARTMENT OF CORRECTION'S COMPLIANCE WITH COMPTROLLER'S DIRECTIVE 10, CHARGES TO THE CAPITAL PROJECTS FUND, FOR THE PURCHASE OF CAPITAL EQUIPMENT (MH04-104A)

Recommendation # 1:

DOC should continue to ensure that all equipment purchased with capital funds meets the eligibility requirements of Directive 10. Questionable purchases should be referred to the Office of Management and Budget or to the Capital Unit of the Bureau of Accountancy at the Comptroller's Office for a determination of capital-eligibility.

Agency Response:

In regard to the 5% of the purchases questioned in your report, we carefully reviewed the auditors' findings on its compliance with Directive 10, which establishes the criteria that agencies must follow when using capital funds. The Department disagrees with this finding. Most of the items in question appear to have been examined as stand alone purchases and not in the context of the larger project scopes that they were a part of (each scope totaled over \$35,000). Directive 10 clearly allows items under \$35,000 to be purchased with capital funds when the items are components of a capital-eligible equipment system that is being simultaneously acquired or upgraded or when the items are furniture or equipment that are necessary to outfit a capital-eligible facility. The items listed as ineligible in the audit essentially consisted of kitchen equipment to outfit newly constructed/upgraded kitchens, smoke detectors that were components of larger fire safety systems, computers that were a part of a larger network upgrade, or construction materials that were purchased for the construction of capital assets. The cited maintenance contract was necessary as part of the phasing of the Department's Cook-Serve Project (i.e. it was necessary for the continuation of food service operations while the kitchens were in construction). The Department consulted with OMB's bond counsel about these issues on several occasions. We agree that capital eligibility determinations can be difficult and may depend on the totality of the circumstances. The Department tries to be conservative in our use of capital funds. In these cases, we made good-faith judgments based on expert advice.

As recommended, the Department will continue to ensure that all equipment purchased with capital funds meets the eligibility requirements of Directive 10. In the future, we will better document the rationale for the use of capital funds when capital eligibility cannot be determined *prima facie*. Also, as recommended, questionable purchases will be referred to the Office of Management and Budget and to the Capital Unit of the Bureau of Accountancy at the Comptroller's Office for a determination of capital-eligibility.

Recommendation # 2:

DOC should code all purchases of construction, materials, and supplies with the construction object code and not the equipment object code.

Agency Response:

Using existing budget guidelines, the Department exercised its best judgment when coding the purchases questioned by the auditors. The Department will begin to code all construction-related materials and supplies purchases, with or without a labor component, to the construction object code and not the equipment object code.

Recommendation # 3:

DOC should maintain a complete inventory listing of all capital assets. A physical inventory should be conducted yearly to ensure that the inventory records are accurate.

Response:

The Department maintains an inventory listing of capital assets. This listing resides on FMS, the City's automated financial management system. Due to safeguards coded into FMS, this system is updated whenever the Department purchases a new Capital Asset. When we attempt to register a capital procurement, FMS automatically prompts the data entry person to enter a fixed asset document before Comptroller approval can be obtained. However, for capital procurements processed by DCAS/DMSS on behalf of DOC, the process is not the same. We have learned that DCAS/DMSS can enter a procurement on behalf of DOC into FMS and register the contract without the fixed asset document. As a result, some items are missing from the fixed asset inventory listing, as there is no fixed asset prompt for DCAS/DMSS procurements.

As recommended, the Department will maintain a complete inventory listing of all capital assets on the City's Financial Management System. Rather than create a duplicative capital asset system, we will work with DCAS to find a solution to the problem described above. The Department will, as has been recommended, conduct a physical inventory once a year to ensure accuracy.

As to maintaining a listing of the physical location of capital assets, we feel that the continued use of the FMS "Responsibility Center" field is most practical for the capital asset listing. Many of our assets are items subject to relocation on a daily basis (e.g., vehicles, computer equipment). However, the Department does recognize the need to improve its inventory systems in general and its inventory of computers in particular.

Lastly, in regard to the statement in the audit report that "We found 45 items at the time of our visit to Rikers. DOC was unable to provide us the exact locations for the remaining 43 items (all PC's) at the time of our visit." While we were not able to advise the auditors of the location of every computer on the spot, within two days of the auditors' field visit, the Department located 41 of the 43 PC's.