

Full Performance Evaluation

Purchasing Division

**The Fixed Asset Inventory List Maintained
by the Division of Purchasing is not Current
or Accurate**

**Cannibalization of Fixed Assets Should Be
Allowed by State Agencies Under Appropriate
Circumstances**

**West Virginia Code Should Be Amended to
Allow State Agencies to Send “Junk” or
“Trash” Assets to the Landfill**



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John Sylvia
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December 7, 2003

The Honorable Edwin J. Bowman
State Senate
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Weirton, West Virginia 26062

The Honorable J.D. Beane
House of Delegates
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1900 Kanawha Boulevard, East
Charleston, West Virginia 25305-0470

Dear Chairs:

Pursuant to the West Virginia Sunset Law, we are transmitting a Full Performance Evaluation of the Purchasing Division, which will be presented to the Joint Committee on Government Operations on Sunday, December 7, 2003. The issues covered herein are "The Fixed Asset Inventory List Maintained by the Division of Purchasing is not Current or Accurate;" "Cannibalization of Fixed Assets Should Be Allowed by State Agencies Under Appropriate Circumstances;" and "West Virginia Code Should Be Amended to Allow State Agencies to Send "Junk" or "Trash" Assets to the Landfill."

We transmitted a draft copy of the report to the Purchasing Division on November 25, 2003. We held an exit conference with the Division on December 1, 2003. We received the agency response on December 4, 2003.

Let me know if you have any questions.

Sincerely,

Handwritten signature of John Sylvia in cursive script.
John Sylvia

JS/wsc

Joint Committee on Government and Finance

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Executive Summary

Issue 1: The Fixed Asset Inventory List Maintained by the Division of Purchasing is not Current or Accurate.

West Virginia *Code §5A-3-36* mandates that the Director of the Purchasing Division maintain a current list of the State's fixed assets and that this inventory list be a public record. Each year during the process of certifying fixed assets, some agencies indicate that they cannot certify their fixed assets because items on the list are no longer in their possession.

The Purchasing Division has a procedure in place to remove missing items from the fixed asset inventory. Purchasing has approved the removal of missing assets from an agency's fixed asset list. However, there are assets that the Purchasing Division has not removed.

In order to ensure a fixed asset inventory that is current and accurate, improvements need to be made to the method of removing missing assets from the inventory list. **Maintaining missing assets on the list presents public information that is not current or correct.**

Issue 2: Cannibalization of Fixed Assets Should Be Allowed by State Agencies Under Appropriate Circumstances.

A recent survey conducted by the Legislative Auditor's Office of surplus property managers in 20 other states indicates that the majority believe that cannibalization of fixed assets can result in cost savings to the state. Cannibalization of fixed assets is the removal of parts from one fixed asset to use in the creation or repair of another fixed asset. Nothing in statute allows for cannibalization of fixed assets. **Despite this fact, cannibalization is taking place in state agencies.**

Under certain circumstances, cannibalization of fixed assets can save the State money. Given that cannibalization is occurring and it can be a benefit to the State as well as a detriment under certain circumstances, the Legislative Auditor recommends that West Virginia code 5A-3-45 be amended to make cannibalization of fixed assets an allowable form of asset disposal. State agencies should be required to obtain approval from the Purchasing Division prior to cannibalization. Furthermore, the Legislative Auditor recommends policy

that should be implemented in determining the appropriate circumstances in which cannibalization should be allowed or disapproved.

Issue 3: West Virginia Code Should be Amended to Allow State Agencies to Send “Junk” or “Trash” Assets to the Landfill.

According to the Manager of the Surplus Property Agency, state agencies are permitted by policy to send items to the landfill for disposal, although this practice is not permitted by law. It is the opinion of the Legislative Auditor’s Office that this practice has the potential to save the State of West Virginia money. Since allowing state agencies to send “junk” or “trash” assets to the landfill has the ability to save the State of West Virginia money, then the Legislature should consider amending West Virginia *Code* to allow for the disposal of assets in this manner. Furthermore, it is the opinion of the Legislative Auditor’s Office that the policy currently in practice by the Surplus Property Agency should be detailed in the Purchasing guidelines relating to the disposal of fixed assets.

Recommendations

1. *The Purchasing Division should provide annual training for all inventory control officers and include proper asset disposal procedures.*
2. *The Surplus Property Agency should ensure that proper paperwork accompanies all items submitted for asset disposal. Furthermore, Surplus Property should retain all documentation of items submitted for disposal.*
3. *The Legislature should consider amending West Virginia code §5A-3-36 to incorporate the following procedure to remove items from an agency’s fixed asset list that are not in the agency’s possession.*
 - A. *Agencies should continue to submit requests to the Purchasing Division to remove missing assets from the fixed asset inventory as is the current procedure.*
 - B. *If the Purchasing Division rejects an asset removal request for reasons that do not involve the suspicion of*

misappropriation, the Purchasing Division should place such assets on a depreciation schedule and remove such items from the fixed asset inventory when the value falls below the established \$1,000 for reportable property.

- C. *When the Purchasing Division rejects a request for removal of an asset because it suspects misappropriation of the asset, it should request an investigation by an appropriate police agency or the Legislature's Commission on Special Investigations (CSI). If, upon the completion of an investigation, no misappropriation of the assets is determined, then the Purchasing Division should place such assets on a depreciation schedule and remove such items from the fixed asset inventory as in step B.*
4. *The Legislature should consider amending the West Virginia code §5A-3-45 to authorize cannibalization as an allowable method of surplus property disposal. If the Legislature chooses to amend §5A-3-45 to allow the cannibalization of fixed assets, it should consider requiring surplus property to approve or disapprove any cannibalization of items with an initial value of over \$5,000.*
 5. *The Purchasing Division should implement policy that allows for the cannibalization of fixed assets when appropriate by collecting information described in this report if it is allowed by code.*
 6. *The Legislature should consider amending West Virginia Code §5A-3-45 to allow state agencies to send "junk" or "trash" assets to the landfill if the destruction of the assets is approved by the Surplus Property Agency.*
 7. *If the Legislature amends West Virginia Code 5A-3-45 to allow the sending of "junk" or "trash" assets to landfills, in those instances where an agency would request to send multiple items to the landfill or instances where the Surplus Property Agency was unsure if the items have salvage value remaining, the Surplus Property Agency should send a representative to inspect the condition of the assets.*
 8. *The Purchasing Division should amend the current fixed asset guidelines to reflect the current policy in practice if it is allowed by Code.*

Review Objective, Scope and Methodology

This Full Performance Review of the Division of Purchasing is required and authorized by the West Virginia Sunset Law, Chapter 4, Article 10, Section 5 of the West Virginia *Code* as amended. The Division is the designated agency for this Full Performance Review.

Objective

The objective of this review is to determine whether or not the Purchasing Division is maintaining a current list of fixed assets, to establish a policy for the removal of missing items, to establish a policy on cannibalization, and to recommend amendments to the West Virginia *Code*.

Scope

The scope of this review covers the period from May 2003 to present.

Methodology

The methodology of this review includes interviews and correspondence with Purchasing, Surplus Property Agency, and other state agency staff, review of Purchasing Fixed Asset Certification files, as well as observation at the Surplus Property Agency October auction.

Issue 1

The Fixed Asset Inventory List Maintained by the Division of Purchasing is not Current or Accurate.

Issue Summary

Some agencies indicate that they cannot certify their fixed assets because items on the list are no longer in their possession.

West Virginia Code §5A-3-36 mandates that the Director of the Purchasing Division maintain a current list of the State's fixed assets and that this inventory list be a public record. Each year during the process of certifying fixed assets, some agencies indicate that they cannot certify their fixed assets because items on the list are no longer in their possession. These items were either lost, stolen, destroyed, sold, disposed of through the Surplus Property Agency, or disposed of improperly or without documentation to support the disposal.

The Purchasing Division has a procedure in place to remove missing items from the fixed asset inventory. Essentially, the agency head must submit to the Department of Administration an explanation of the disposition of the assets along with any available documentation. If the explanation is approved by the Purchasing Division, the items are removed. Purchasing has approved the removal of missing assets from an agency's fixed asset list. However, there are assets that the Purchasing Division has not removed. For example, the Purchasing Division has issued rejection notices in response to some of the Legislative Auditor's requests to have certain property removed from its fixed assets inventory. The rejection notices in some cases appear to be based on technicalities, and other rejection notices indicate that the Surplus Property Agency has no documentation that it received the property from the Legislative Auditor, even though the Legislative Auditor insists the items were picked up by the Surplus Property Agency.

Improvements need to be made to the method of removing missing assets from the inventory list.

In order to ensure a fixed asset inventory that is current and accurate, improvements need to be made to the method of removing missing assets from the inventory list. **Maintaining missing assets on the list presents public information that is not current or correct.** The Legislative Auditor recommends that West Virginia code 5A-3-36 be amended to include the following requirements for removing missing assets from the fixed assets inventory:

1. Agencies should continue to submit requests to the Purchasing Division to remove missing assets from the fixed asset inventory as is the current procedure.
2. If the Purchasing Division rejects an asset removal request for

reasons that do not involve the suspicion of misappropriation, the Purchasing Division should place such assets on a depreciation schedule and remove such items from the fixed asset inventory when the value falls below the established \$1,000 for reportable property.

3. When the Purchasing Division rejects a request for removal of an asset because it suspects misappropriation of the asset, it should request an investigation by an appropriate police agency or the Legislature's Commission on Special Investigations (CSI). If, upon the completion of an investigation, no misappropriation of the assets is determined, then the Purchasing Division should place such assets on a depreciation schedule and remove such items from the fixed asset inventory as in step 2.

Inventory List Is not Current Or Accurate

West Virginia *Code* §5A-3-36, requires the director of the Purchasing Division to

Make and keep current an inventory of all removable property belonging to the state.

“Make and keep current an inventory of all removable property belonging to the state. Such inventory shall be kept on file in the office of the director as a public record.”

The Purchasing manual provided to state agencies details the following:

Agencies are required to complete an annual Inventory Certification Cover Sheet and submit to the Purchasing Division by July 15th of every year. A certifiable inventory is identified as a true and accurate statement from the department head or designee verifying:

- *the date the last physical inventory was last taken of all equipment under the department head's jurisdiction, and*
- *all assets under the department head's jurisdiction as of June 30th with an acquisition cost of \$1,000 or more with a useful life of one year or more were entered in the WVFIMS Fixed Asset System for the current fiscal year, and*
- *all obsolete assets under the department head's jurisdiction were retired in accordance with policy, procedures and guidelines.*

Often, these items were disposed of without documentation to support the disposal.

Each year during the certification process, some agencies will indicate that they cannot certify their fixed assets because items on the fixed asset list are no longer in their possession. Often, these items were disposed of without documentation to support the disposal. These items may have been disposed of in a variety of manners, such as:

- thrown away;
- transferred or sold to another office;
- donated;
- cannibalized (parts removed from one fixed asset and used on another); or,
- traded in.

In certain instances, fixed assets may have been sent to the Surplus Property Agency but appropriate paperwork was not submitted. In these instances, it may be impossible to determine what items have been sent to Surplus Property for disposal.

Reasons for Improper Disposal of Property

1. Lack of Training for Inventory Managers

One factor which contributes to improper disposal of fixed assets is the lack of training for inventory managers.

One factor which contributes to improper disposal of fixed assets is the lack of training for inventory managers. Each year, the Purchasing Division provides an optional training conference. **However, when the Legislative Auditor's Office matched the most recent list of inventory coordinators provided by the Purchasing Division with the attendance form from the last purchasing conference, it indicates that only 22 of 118 inventory coordinators were in attendance at the conference.** Furthermore, the classes on inventory control were offered at the same time as other classes. Since the Purchasing Division only tracks conference attendance and not class attendance, it is unsure whether these 22 individuals attended the class on inventory control. The following is a response from the Purchasing Division on training:

The Purchasing Division believes training is important... We did not match the class attendance against the list of inventory coordinators and were surprised at your results. We had not considered a class for inventory coordinators, but would be pleased to arrange this.

The Purchasing Division should conduct training for all inventory control managers. This training should include methods of inventory control,

proper asset disposal, as well as inventory audit methods. As noted above, the Purchasing Division indicated that it is in favor of inventory training.

2. Inadequate Record Keeping At Surplus Property Agency

Another factor which has complicated asset disposal is a lack of proper record keeping at the Surplus Property Agency. Some agencies have indicated that items were sent to Surplus Property but proper records were either lost, misplaced or never submitted. According to the Director of Purchasing, “[The] Surplus Property Manager noticed through routine supervision that staff on occasion had become lax with regard to paperwork.”

Had the Surplus Property Agency kept better records, some missing assets that are unaccounted for would not be on the fixed asset list.

Had the Surplus Property Agency kept better records, some missing assets that are unaccounted for would not be on the fixed asset list. This same concept was elaborated upon by a surplus property agent in the State of Arkansas. A survey conducted by the Legislative Auditor’s Office was sent to surplus property agents in other states and one question contained on the survey dealt with agencies who have “missing” fixed assets. According to the Arkansas agent, “Yes, this happens each year during the agency’s audit. They come crying to us for the back-up documentation, which we maintain meticulous records.”

The Surplus Property Agency must ensure that proper paperwork is submitted by state agencies to dispose of fixed assets. According to the Purchasing Division, “Occasionally, Surplus Property receives items without proper documentation. As this occurs, items are being rejected [sent back to the agency] and the agency advised.” Additionally, the necessary paperwork submitted by agencies should be retained by Surplus Property to ensure documentation at the agency and Purchasing Division.

Procedure to Remove Missing Assets Needs to be Improved

The Purchasing Division has a procedure in place to remove items that are no longer in the possession of state agencies. This procedure is described in the Purchasing Division’s “Policies and Procedures Handbook.” Essentially, the agency head must submit to the Department of Administration an explanation of the disposition of the assets along with any available documentation. If the explanation is approved by the Purchasing Division, the items will be removed. Purchasing has approved the removal of missing assets through this process.

Purchasing has approved the removal of missing assets through this process. However, there are assets that the Purchasing Division has not removed.

However, there are assets that the Purchasing Division has not removed. For example, the Legislative Auditor has 48 items that total an original value of

\$495,586 on its fixed asset list that are not in his possession (see Table 1). Some of these items were improperly thrown away, some were sold to West Virginia Network (WVNET), and others were sent to the Surplus Property Agency.

Table 1 Assets on the Legislative Auditor's Fixed Asset Inventory That Are Not In His Possession		
Disposition of Assets:	Original Value	Rejection Notice From Purchasing Division
1. Improperly Thrown Away (17 items)	\$25,426	"PROPERTY WAS DISPOSED OF PRIOR TO RETIREMENT"
2. Sold to WVNET (12 items)	\$444,991	"PROPERTY WAS DISPOSED OF PRIOR TO RETIREMENT"
3. Sent to Surplus (19 items)	\$25,169	"ITEMS NOT RECEIVED"
Total	\$495,586	

Although the items were improperly disposed of, rejecting the removal of these items from the fixed asset list appears to be a technicality.

The Legislative Auditor has had some property removed from his inventory list; however, the items described in Table 1 were rejected by Purchasing for removal. The rejection notices are recorded in the West Virginia Financial Information Management System (FIMS). For the items that were improperly thrown away, the rejection notices indicate that the Legislative Auditor should have first received approval from the Surplus Property Agency to dispose of the property by submitting an appropriate retirement form requesting approval to throw the items away. Although the items were improperly disposed of, rejecting the removal of these items from the fixed asset list appears to be a technicality.

The rejection notice: "ITEMS NOT RECEIVED," indicates that the Surplus Property Agency has no documentation that it received certain items from the Legislative Auditor, even though the Legislative Auditor insists the items were picked up by the Surplus Property Agency. It is less clear why the rejection notices were reported for assets that were sold to WVNET, since other assets that were sold in the same transaction were earlier approved for removal from the fixed asset list. The items of this sale that were rejected for removal were submitted in a second request for removal form. This occurred because there were so many items in the sale that some items were overlooked when the first request for removal was submitted. A second request for removal was submitted to Purchasing when it was discovered that other items of the transaction were not included in the first request. Purchasing rejected the second request for removal of these assets. According to the Purchasing

Division, WVNET never responded to the Purchasing Division to verify that the additional items were sent to WVNET. Therefore, the Purchasing Division has no verification that these additional items were indeed sent to WVNET.

The Legislative Auditor's Office does not consider it in the best interest of the State to leave items on the fixed asset inventory that are not in an agency's possession.

As can be seen, some of the fixed assets on the Legislative Auditor's inventory are not in his possession, yet they remain on his inventory list because of disposal technicalities, lack of documentation that Surplus Property received property from the Legislative Auditor, and undisclosed reasons. **The Legislative Auditor's Office does not consider it in the best interest of the State to leave items on the fixed asset inventory that are not in an agency's possession. Continuing to list these items misrepresents the State's fixed asset inventory to the public.**

According to the Director of the Purchasing Division:

We believe that some agencies have items on their fixed asset inventories that may no longer be in their possession. There are many possible options for addressing this issue including, but not limited to: (1) one time removal and write off after a complete physical inventory; (2) a change in code, legislative rule or guideline; (3) investigation and documentation by appropriate authorities; (4) continued refusal to allow removal of fixed asset items.

It is the opinion of the Legislative Auditor, that a *carte blanche* approach of removing fixed assets is not in the best interest of the State. This opinion is shared by the Purchasing Division. According to the Director of Purchasing,

The West Virginia Code does not clearly address removing items from fixed asset inventory. To allow state agencies to remove items from fixed asset inventory without some documented evidence of specific disposition, places the Purchasing Division in an awkward position in future performance and post audits. Additionally, this action could set a precedent that may damage the integrity of the fixed asset system.

In order to ensure a fixed asset inventory that is current and accurate, improvements need to be made to the method of removing missing assets from the inventory list.

In order to ensure a fixed asset inventory that is current and accurate, improvements need to be made to the method of removing missing assets from the inventory list. The Legislative Auditor recommends the following procedure be implemented for removing missing assets from the fixed assets inventory:

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1. Agencies should continue to submit requests to the Purchasing Division to remove missing assets from the fixed asset inventory as is the current procedure.
 2. If the Purchasing Division rejects an asset removal request because of a lack of documentation of its disposition, or documentation exists but the property was disposed of improperly, or for other reasons that do not involve the suspicion of misappropriation, the Purchasing Division should place such assets on a depreciation schedule and remove such items from the fixed asset inventory when the value falls below the established \$1,000 for reportable property.
 3. When the Purchasing Division rejects a request for removal of an asset because it suspects misappropriation of the asset, it should request an investigation by the Commission on Special Investigations (CSI). If, upon the completion of CSI's investigation, no misappropriation of the assets is determined, then the Purchasing Division should place such assets on a depreciation schedule and remove such items from the fixed asset inventory as in step 2.

The depreciation schedule could follow along the method described below using the Legislative Auditor's Office as an example. The Legislative Auditor's Office has \$1,460,092.23 listed on the fixed asset system. It should be noted that the Legislative Auditor's Office is not required by West Virginia code to comply with Purchasing's fixed asset guidelines; however he chooses to do so. According to a fixed asset inventory taken last year, there are 48 items that have a total original value of \$495,586 on the Legislative Auditor's fixed asset list which are no longer in his possession. Nearly \$450,000 of that amount is computer equipment which was sold to WVNET. According to the American Appraisal Associates,

The paragraphs that follow will offer information on the average estimated useful lives of various types of capital assets. This information is based upon our experience performing studies designed to assist clients as they implement GASB Statement No. 34....The following is a list of average estimated useful lives for some of the most commonly encountered categories of moveable equipment:

Table 2					
Estimated Useful Lives of Common Moveable Equipment					
Asset	Useful Life	Asset	Useful Life	Asset	Useful Life
Athletic Equipment	10 Years	Contractors/ construction Equipment	12 Years	Licensed Vehicles	6 Years
Appliances/ Food Service Equipment	10 Years	Computer Equipment	5 Years	Machinery and Tools	15 Years
Audio Visual Equipment	7 Years	Fire Department Equipment	12 Years	Musical Instruments	10 Years
Books/ Multi Media Equipment	5 Years	Furniture	20 Years	Outdoors Recreational Equipment	15 Years
Business Machines	7 Years	Grounds/ Agricultural Equipment	15 Years	Stage and Auditorium Equipment	20 Years
Communications Equipment	10 Years	Lab, Science Equipment	10 Years	Custodial Equipment	15 Years
Computer Software	5 Years	Law Enforcement Equipment	10 Years	Photocopiers	5 Years

Based on Table 2, many of the missing items on the Legislative Auditor's inventory list have exceeded their useful life span and have no real value. All of the missing items listed on the Legislative Auditor's Fixed Asset list are computer equipment or computer software, both of which have a useful life of 5 years. Only 5 of the 48 missing items are less than 5 years old. Therefore, only 5 items have any real value remaining. However, of the 5 items, 3 are actually duplicate entries and the asset never existed. Of the remaining 2 items, one is a software program, which according to Division of Purchasing guidelines, should have never been placed on the fixed asset list. Since the other 43 items have no real value remaining, they could be removed from the fixed asset list and still maintain the integrity of the fixed asset system.

Conclusion

The Purchasing Division is the state agency charged with the administration of the State's fixed assets. However, many agencies report having fixed assets on their inventories which are no longer in their possession. In some cases, these items were improperly disposed of or there is no documentation to support the disposition of these items. On some occasions, there is only internal documentation which is unacceptable to the Purchasing

Maintaining a list of assets that includes items that are not in the possession of an agency does not fulfill the intended purpose of the Legislature.

Division. The Purchasing Division must restore accountability to this system through improved training and documentation by the Surplus Property Agency. In addition, the process of removing missing items from the State's fixed asset system needs to be improved. The Purchasing Division has appropriately removed some missing items from the fixed asset list; however, some missing items remain on the list because of apparent technicalities, disputes over whether property was received by the Surplus Property Agency or legitimate documentation concerns. The Legislative Auditor recommends that the procedure described in this report, which would improve the asset removal process, should be amended into West Virginia code. Maintaining a list of assets that includes items that are not in the possession of an agency does not fulfill the intended purpose of the Legislature.

Recommendations

1. *The Purchasing Division should provide annual training for all inventory control officers and include proper asset disposal procedures.*
2. *The Surplus Property Agency should ensure that proper paperwork accompanies all items submitted for asset disposal. Furthermore, Surplus Property should retain all documentation of items submitted for disposal.*
3. *The Legislature should consider amending West Virginia code §5A-3-36 to incorporate the following procedure to remove items from an agency's fixed asset list that are not in the agency's possession.*
 - A. *Agencies should continue to submit requests to the Purchasing Division to remove missing assets from the fixed asset inventory as is the current procedure.*
 - B. *If the Purchasing Division rejects an asset removal request for reasons that do not involve the suspicion of misappropriation, the Purchasing Division should place such assets on a depreciation schedule and remove such items from the fixed asset inventory when the value falls below the established \$1,000 for reportable property.*
 - C. *When the Purchasing Division rejects a request for removal of an asset because it suspects misappropriation of the asset, it should request an investigation by an appropriate*

police agency or the Legislature's Commission on Special Investigations (CSI). If, upon the completion of an investigation, no misappropriation of the assets is determined, then the Purchasing Division should place such assets on a depreciation schedule and remove such items from the fixed asset inventory as in step B.

Issue 2

Cannibalization of Fixed Assets Should Be Allowed by State Agencies Under Appropriate Circumstances.

Issue Summary

Cannibalization is taking place in state agencies.

A recent survey conducted by the Legislative Auditor's Office of surplus property managers in 20 other states indicates that the majority believe that cannibalization of fixed assets can result in cost savings to the state. Cannibalization of fixed assets is the removal of parts from one fixed asset to use in the creation or repair of another fixed asset. Nothing in statute allows for cannibalization of fixed assets. The Purchasing Division has full authority over inventories and property of the State, and its current practice is to discourage cannibalization. Despite this fact, cannibalization is taking place in state agencies.

Under certain circumstances, cannibalization of fixed assets can save the State money. Using a cannibalized part in another asset would preclude the need to purchase a new or used part for that asset. However, the current practice of unregulated cannibalization can reduce revenue to the State by preventing an asset from being sold by the Surplus Property Agency. Given that cannibalization is occurring and it can be a benefit to the State as well as a detriment under certain circumstances, the Legislative Auditor recommends that West Virginia code 5A-3-45 be amended to make cannibalization of fixed assets an allowable form of asset disposal. State agencies should be required to obtain approval from the Purchasing Division prior to cannibalization. Furthermore, the Legislative Auditor recommends policy that should be implemented in determining the appropriate circumstances in which cannibalization should be allowed or disapproved.

Cannibalization Has the Potential To Save Money

The majority believed cannibalization of fixed assets could result in cost savings to the state.

A recent survey of surplus property managers in 20 other states indicates that the majority believed cannibalization of fixed assets could result in cost savings to the state. This idea was clearly expressed in several responses from other state surplus property agents. Following are a few remarks from surplus agents in other states.

- *“By cannibalizing parts, a new part does not have to be purchased. Of course it probably doesn't bring as much for resale, but it doesn't seem to matter that much.”* Missouri

-
- *“If you can take, as an example, two State vehicles that are inoperable, but between the two make one operable unit, then you basically save the State from buying one vehicle.”* New Jersey
 - *“Personally, I believe cannibalization can be a cost-effective process in certain situations. Those situations include available and competent resources to perform the process, ease of process and cost compared to buying used, new or going without, etc. It is often better left to the business managers of each agency.”* Minnesota
 - *“I believe in many cases the state has saved several dollars by cannibalization of items.”* Arkansas
 - *“If you can maintain a piece of equipment without having to purchase new parts you save money, as long as the parts come from an un-serviceable piece of equipment.”* Kentucky

Cannibalization is Taking Place in State Agencies

Despite the fact that nothing in code or purchasing policies allows state agencies to cannibalize fixed assets, cannibalization is taking place. Pictured below are a John Deere Lawn Tractor and a stack of computers recently sold at the Surplus Property Auction which have clearly been cannibalized.



Figure 1 shows a cannibalized tractor.



Figure 2 shows cannibalized computers.

The current practice of unregulated cannibalization has several problems.

The current practice of unregulated cannibalization has several problems. First, the Purchasing Division is responsible for removing the asset from the fixed asset inventory and it must be accountable for those items. There is no assurance that the parts were not stolen, lost or were indeed actually used. Second, if the item was in working condition and not obsolete, then there is a potential cost to other agencies or approved entities who could have purchased the item from Surplus Property. Consider the following statement from the State of New Mexico relating to cannibalization:

It deprives other public agencies and qualified non-profit organizations from acquiring computers or other assets. The less these entities spend on capital items, the more dollars go into service delivery.

This is the unseen cost that many individuals in state agencies are unaware of. It is clear that cannibalization is not always in the best interest of the State. However, there are times when it may make sense to cannibalize an asset. For example, according to the Director of the Surplus Property Agency, “The State Police sometimes cannibalize vehicles, although these are usually wrecked (they are self-insured).” In these instances, cannibalization may be in the best interest of the State.

The Purchasing Division Generally Opposes Cannibalization

The current practice of the Purchasing Division is to discourage cannibalization.

The current practice of the Purchasing Division is to discourage cannibalization. According to the Director of the Purchasing Division, “*The Purchasing Division generally opposes cannibalization.*” One reason the Purchasing Division opposes cannibalization is the reduced revenue received by the Surplus Property Division if assets are cannibalized. According to the Director of the Purchasing Division, “*We believe that cannibalization of fixed assets has the potential of significantly reducing revenues received by Surplus Property.*” This same fear and concern is offered from several states who responded to the Legislative Auditor’s Office survey. Following are a few statements from respondents.

The items cannibalized do not usually match the new computers and is or will shortly be outdated. The remaining parts sent to surplus are then junk and thrown away at a cost to the state. North Dakota

Cannibalization drastically reduces any re-utilization or sale value that an item may have and reduces items to salvage value only. Tennessee

For the most part we feel that cannibalization of fixed assets is not beneficial to the State because it significantly reduces the value of the surplus equipment for resale. We feel that the loss in revenue to the surplus program far outweighs the cost benefit to individual agencies that attempt to cannibalize the fixed assets. New Hampshire

Although lost revenue is a valid concern, there is no data to determine the extent of cannibalization on surplus revenues.

Although lost revenue is a valid concern, there is no data to determine the extent of cannibalization on surplus revenues. In the illustration of cannibalized items listed above, the stack of cannibalized computers sold for \$10. Pictured below is a stack of computers that were not cannibalized and sold for \$150 at auction, a difference of approximately \$25 per computer.



Figure 3 shows complete computers.

Cannibalization Policy Recommended by the Legislative Auditor

There are clearly instances where cannibalization can result in cost savings.

There are clearly instances where cannibalization can result in cost savings. There are also instances where cannibalization can result in lost revenue or lost use to other agencies. Given that many State agencies are concerned with only their own budget and not the budget of the State as a whole, a determination needs to be made on whether the savings to the State through cannibalization exceeds the revenue received by the sale of the uncannibalized asset. This determination should be made by the Purchasing Division.

Regardless of the asset to be cannibalized, the asset has value to one of three parties:

1. The state agency already in possession of the asset;
2. The Surplus Property Agency that could benefit from the sale of the asset; and,
3. The state agency which might obtain the asset thus recycling the asset in public use.

In determining whether or not to allow an agency to cannibalize an asset, the Purchasing Division must gather sufficient information to determine where the asset has its greatest value among the three interests above.

Table 3 shows the information that should be submitted to the Purchasing Division in order for it to determine if cannibalization of an asset should be approved or disapproved. This information could be condensed into a form such as illustrated in Appendix B. Since the Surplus Property Agency is part of the Purchasing Division, the Purchasing Division should be able to determine from the above information whether or not the asset to be cannibalized is more valuable to the agency already in possession of the asset or whether or not it has a greater value being sold through the Surplus Property Agency. Furthermore, since other state agencies acquire assets internally through the Surplus Property Agency, the Purchasing Division should be able to determine from the above information whether or not the asset has a greater value to the agency already in possession of the asset or whether it has a greater value to another state agency.

In addition to the above information, agencies need to submit information to the Purchasing Division regarding who will be cannibalizing the fixed asset and how that individual is qualified to remove and reinstall the parts. Also, the agency should indicate what method of disposal will be used for the remaining parts of the fixed asset. **When the information is submitted, Purchasing should provide to the agency approval of cannibalization or disapproval and the reasons for not approving the cannibalization.**

Table 3	
Information Needed to Determine if Cannibalization should be Approved	
Donor Asset (Asset to be Cannibalized)	Receiving Asset (Asset to Receive Cannibalized Part)
Asset ID	Asset ID
Acquisition date	Acquisition date
Acquisition cost	Acquisition cost
Asset description	Asset description
Is the asset operable?	Is the asset operable?
How well does the asset operate?	Are the parts to restore the asset to an operable condition available?
	What is the cost of the parts and/or labor to restore the asset to an operable condition without cannibalization?

Right of First Refusal

This would allow the Surplus Property Agency to claim the remaining parts from any cannibalized fixed asset since some items maintain a residual value even after cannibalization.

One additional section which the Legislature should consider adding to the West Virginia code, is a section which would allow the Surplus Property Agency the right of first refusal. This would allow the Surplus Property Agency to claim the remaining parts from any cannibalized fixed asset since some items maintain a residual value even after cannibalization. This concept is easily observed in lawn mowers (as cited previously in the report) as well as in automobiles or other heavy equipment. Additionally, expecting the Surplus Property Agency to bear the cost of disposing of the remains of a cannibalized fixed asset which it cannot sell, could be considered an unfunded mandate. Therefore, state agencies should make arrangements to dispose of the remains of a cannibalized fixed asset unless the Surplus Property Agency exercises its right of first refusal.

Conclusion

It is also the opinion of the Legislative Auditor that individuals in state agencies are not necessarily in the best position to determine whether or not an asset should be cannibalized.

Currently, neither statute nor Surplus Property Rules allow for the cannibalization of assets. It is clear that in certain cases cannibalization can result in cost savings to the State. It is also the opinion of the Legislative Auditor that individuals in state agencies are not necessarily in the best position to determine whether or not an asset should be cannibalized since their primary focus is on their own budgets and not the interest of the State as a whole. Ultimately, any policy on cannibalization must take all costs and benefits into consideration. The Purchasing Division must collect sufficient information to make an informed decision. Where does the asset have its highest value? Consider finally this statement made by the Idaho Board of Examiners (the agency charged with fixed asset management),

The Board of Examiners encourages the most efficient disposal that enables conveyance of surplus personal property to other state and local agencies or sale to the public at large, while providing maximum value received to the State. This philosophy therefore encourages recycling, whether it be performed by the agency in possession of the property, or a vendor. This policy is stated in the Surplus Personal Property Policy. "Cannibalizing" computers may be practiced by agencies who have capable technicians to utilize/ recycle the components when that is the best value for the State of Idaho.

Recommendations

4. *The Legislature should consider amending the West Virginia code §5A-3-45 to authorize cannibalization as an allowable method of surplus property disposal. If the Legislature chooses to amend §5A-3-45 to allow the cannibalization of fixed assets, it should consider requiring surplus property to approve or disapprove any cannibalization of items with an initial value of over \$5,000.*
5. *The Purchasing Division should implement policy that allows for the cannibalization of fixed assets when appropriate by collecting information described in this report if it is allowed by code.*

Issue 3

West Virginia Code Should be Amended to Allow State Agencies to Send “Junk” or “Trash” Assets to the Landfill.

State agencies are permitted by policy to send items to the landfill for disposal, although this practice is not permitted by law.

According to the Manager of the Surplus Property Agency, state agencies are permitted by policy to send items to the landfill for disposal, although this practice is not permitted by law. The current policy requires agencies to submit to the manager of the Surplus Property Agency a list of items to be sent to the landfill. If the agency is only requesting to send a small number of items to the landfill, and if the manager of the Surplus Property Agency is reasonably sure that the items have no salvage value, he will approve sending the items to the landfill. However, if the agency is requesting to send multiple items to the landfill, or if the manager of the Surplus Property Agency is unsure that the items have a salvage value, he will send a representative of Surplus Property to examine the items.

It is the opinion of the Legislative Auditor’s Office that this practice has the potential to save the State of West Virginia money.

It is the opinion of the Legislative Auditor’s Office that this practice has the potential to save the State of West Virginia money. First, unless the manager of the Surplus Property Agency is unsure whether or not the items have a salvage value, there is no cost associated with transporting the items from the state agency to the Surplus Property Agency. In instances where the state agency is not in Kanawha County (for example the Ohio County Correctional Facility located in Wheeling), this savings can be significant. Second, the Surplus Property Agency does not bear the cost of storing and marketing the items. Finally, in many instances these items may be sold in a large lot at auction and left unclaimed, in which case the Surplus Property Agency must pay to dispose of the items. Although state agencies will still spend money to dispose of the items, the two additional costs of transportation and storage will be saved.

As was previously mentioned, West Virginia *Code* §5A-3-45 is very specific in the manner in which state owned fixed assets may be disposed of:

- transfer of assets between agencies;
- selling assets to duly authorized entities such as county boards of education or county commissions;
- trading in assets; and,
- selling assets to the highest bidder.

As can be seen, disposing of assets through landfills is not allowed by law. Since allowing state agencies to send “junk” or “trash” assets to the landfill has the ability to save the State of West Virginia money, then the Legislature should consider amending West Virginia *Code* to allow for the disposal of assets in this manner. Furthermore, it is the opinion of the Legislative Auditor’s Office that the policy currently in practice by the Surplus Property Agency should be detailed in the Purchasing guidelines relating to the disposal of fixed assets.

Recommendations

6. *The Legislature should consider amending West Virginia Code §5A-3-45 to allow state agencies to send “junk” or “trash” assets to the landfill if the destruction of the assets is approved by the Surplus Property Agency.*
7. *If the Legislature amends West Virginia Code 5A-3-45 to allow the sending of “junk” or “trash” assets to landfills, in those instances where an agency would request to send multiple items to the landfill or instances where the Surplus Property Agency was unsure if the items have salvage value remaining, the Surplus Property Agency should send a representative to inspect the condition of the assets.*
8. *The Purchasing Division should amend the current fixed asset guidelines to reflect the current policy in practice if it is allowed by Code.*

Appendix A: Transmittal Letter

WEST VIRGINIA LEGISLATURE *Performance Evaluation and Research Division*

Building 1, Room W-314
1900 Kanawha Boulevard, East
Charleston, West Virginia 25305-0610
(304) 347-4890
(304) 347-4939 FAX



John Sylvia
Director

November 25, 2003

Mr. David R. Tincher, Director
Purchasing Division
2019 Washington St. East
PO Box 50130
Charleston, WV 25305-0130

Dear Mr. Tincher:

This is to transmit a draft copy of the Full Performance Review of the Purchasing Division. This report is scheduled to be presented during the December 7-9, 2003 interim meeting of the Joint Committee on Government Operations. We will inform you of the exact time and location once the information becomes available. It is expected that a representative from your agency be present at the meeting to orally respond to the report and answer any questions the committee may have.

We need to schedule an exit conference to discuss any concerns you may have with the report. We would like to have the meeting on Monday, December 1, 2003. Please notify us to schedule an exact time. In addition, we need your written response by noon on Friday, December 5, 2003 in order for it to be included in the final report. If your agency intends to distribute additional material to committee members at the meeting, please contact the House Government Organization staff at 340-3192 by Thursday December 4, 2003 to make arrangements.

We request that your personnel treat the draft report as confidential and that it not be disclosed to anyone not affiliated with your agency. Thank you for your cooperation.

Sincerely,

Handwritten signature of John Sylvia in cursive script.
John Sylvia

Enclosure

Joint Committee on Government and Finance

Appendix B: Agency Response



BOB WISE
GOVERNOR

STATE OF WEST VIRGINIA
DEPARTMENT OF ADMINISTRATION
PURCHASING DIVISION
2019 WASHINGTON STREET, EAST
P.O. BOX 60130
CHARLESTON, WEST VIRGINIA 25305-0130

TOM SUSMAN
ACTING CABINET SECRETARY
DAVID TINCHER
DIRECTOR

December 3, 2003

Mr. John Sylvia, Director
West Virginia Legislature
Performance and Evaluation and Research Division
Building 1, Room W-314
1900 Kanawha Boulevard, East
Charleston, WV 25305-0610

RECEIVED
DEC 04 2003
PERFORMANCE EVALUATION AND
RESEARCH DIVISION

Dear Mr. Sylvia:

This letter is in response to your letter dated November 25, 2003 regarding the Full Performance Review of the Purchasing Division. Please see our responses to your recommendations listed below:

1. The Purchasing Division should provide annual training for all inventory control officers and include proper asset disposal procedures.

Response: We agree and will schedule training as recommended.

2. The Surplus Property Agency should ensure that proper paperwork accompanies all items submitted for asset disposal. Furthermore, Surplus Property should retain all documentation of items submitted for disposal.

Response: We agree and currently comply.

3. The Legislature should consider amending West Virginia Code §5A-3-36 to incorporate the following procedure to remove items from an agency's fixed asset list that are not in the agency's possession.

- A. Agencies should continue to submit requests to the Purchasing Division to remove missing assets from the fixed asset inventory as is the current procedure.

- B. If the Purchasing Division rejects an asset removal request for reasons that do not involve the suspicion of misappropriation, the Purchasing Division should place such assets on a depreciation schedule and remove such items from the fixed asset inventory when the value falls below the established \$1,000 for reportable property.
- C. When the Purchasing Division rejects a request for removal of an asset because it suspects misappropriation of the asset, it should request an investigation by an appropriate police agency or the Legislature's Commission on Special Investigations (CSI). If, upon the completion of an investigation, no misappropriation of the assets is determined, then the Purchasing Division should place such assets on a depreciation schedule and remove such items from the fixed asset inventory as in step B.

Response: The Purchasing Division has no objections to the suggested changes to the Code and will support these changes.

- 4. The Legislature should consider amending the West Virginia code §5A-3-45 to authorize cannibalization as an allowable method of surplus property disposal. If the Legislature chooses to amend §5A-3-45 to allow the cannibalization of fixed assets, it should consider requiring surplus property to approve or disapprove any cannibalization of items with an initial value of over \$5,000.

Response: The Purchasing Division has no objections to the suggested changes to Code and will support these changes.

- 5. The Purchasing Division should implement policy that allows for the cannibalization of fixed assets when appropriate by collecting information described in this report. If it is allowed by Code.

Response: We agree.

- 6. The Legislature should consider amending West Virginia Code §5A-3-45 to allow state agencies to send "junk" or "trash" assets to the landfill if the destruction of the assets is approved by the Surplus Property Agency.

Response: We agree.

Mr. John Sylvia
December 3, 2003
Page 3

7. If the Legislature amends West Virginia Code §5A-3-45 to allow the sending of "junk" or "trash" assets to landfills, in those instances where an agency would request to send multiple items to the landfill or instances where the Surplus Property Agency was unsure if the items have salvage value remaining, the Surplus Property Agency should send a representative to inspect the condition of the assets.

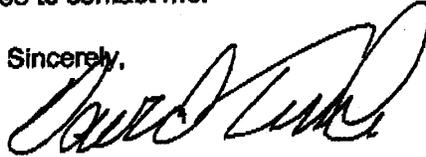
Response: We agree.

8. The Purchasing Division should amend the current fixed asset guidelines to reflect the current policy in practice if it is allowed by Code.

Response: We agree.

If you have any questions, please feel free to contact me.

Sincerely,



David Tincher, CPPO, Director
Purchasing Division

DT/dw

