



# Richmond City Council

*The Voice of the People.*

*Richmond, Virginia*

## OFFICE OF THE CITY AUDITOR

REPORT # 2012-07

AUDIT

Of the

### City of Richmond Department of Finance Fixed Assets

January 2012

## OFFICIAL GOVERNMENT REPORT

*Richmond City Council*

### **OFFICE OF THE CITY AUDITOR**

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*Committed to increasing government efficiency, effectiveness,  
and accountability on behalf of the Citizens of Richmond.*

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Umesh Dalal, CPA, CIA, CIG  
Richmond City Auditor

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## Office of the City Auditor

### Executive Summary

The City Auditor's Office has completed an audit of the City's fixed (capital) assets for the 12 months ended May 31, 2009. The City Auditor shared the results of this audit with the Finance Department (Finance) in November 2009 to enable them to address the significant issues included in this audit. Since then, an external law enforcement agency began an investigation to determine if criminal wrongdoing occurred. Recently, the external law enforcement agency closed the investigation and did not report any criminal wrongdoing.

#### *Salient Findings*

- The City's internal controls over procurement and accounting of fixed assets are inadequate. Currently, there is no mechanism to ensure that all of the fixed asset acquisitions are properly accounted for in the City's financial statements (CAFR).
- The auditors found that the CAFR did not match the detailed accounting records in the fixed assets subsidiary ledger prior to FY 2006. **In November 2006, the City made an unjustified adjustment to the subsidiary ledger that increased the asset carrying values for buildings by \$177 million and decreased the asset values for land by approximately \$35 million. The City did not have any rational basis for making these adjustments.** The Finance Department could not explain their actions that were not conforming to Statement No. 34 of the Government Accounting Standards Board (GASB 34) provisions. The increase in net book value after depreciation was about \$57 million.
- Finance did not have any supporting documentation for 760 entries representing 96% of the land assets, and 244 entries representing 84% of the buildings assets recorded in Fixed Assets System (FAS).
- GASB 34 generally requires all governments to report fixed assets at historical costs. Of the 103 items sampled by the auditors, the historical costs did not match the values for land and buildings presented in the CAFR for all of the 103 items sampled. The audit revealed that the City might

not have implemented GASB 34 provisions properly since FY 2002. This discrepancy might have resulted in significant overstatement of fixed assets values in the City's financial statements.

- In addition, auditors found numerous discrepancies in recordkeeping for periods subsequent to FY 2002 (after implementation of GASB 34) that resulted in erroneous fixed assets balances reported in the financial statements (CAFR). These occurrences clearly indicated that the CAFR balance was not being updated appropriately when additions or deletions were necessary.
- The Finance Department could not explain several entries made in the CAFR supporting documentation for several million dollars. The auditors were told that any discrepancy under \$1 million is considered immaterial and therefore is not researched. Materiality is a concept used by the external auditors. The City's accounting staff must be able to explain all the discrepancies unless they are minimal such as a few cents to a few dollars due to rounding the numbers.
- Finance did not provide documentation demonstrating how depreciation on fixed assets was calculated for the periods prior to FY 2006. For subsequent years, the Finance Department used arbitrarily inflated fixed assets figures to compute the depreciation.
- Depreciation on properties worth \$31 million was charged for a period prior to when the assets were acquired.
- The City Auditor and the interim Finance Director worked with the external auditors to agree upon a plan of action to bring the Fixed Asset values in compliance with accounting principles. In addition, the City agreed to adjust the FY2011 financial statements by a net asset value of approximately \$21 million to provide the external auditors reasonable assurance and enable them to issue an unqualified opinion. The Finance Department also agreed to adopt and execute the following plan prior to the issuance of the FY 2012 financial statements:
  - a. The City will determine current replacement costs of the City-owned properties;
  - b. The replacement costs of all the properties for which the original cost is not known will be discounted using acceptable indices, in accordance with GASB 34 provisions, to determine values at July 1, 1980 in accordance with GASB 34 provisions;
  - c. Depreciation for all the properties, including the properties for which original cost is not known, will be recalculated;
  - d. Based upon the above analysis, the capital assets values and depreciation will be adjusted in the FY 2012 financial statements, and appropriate disclosure will be made in the footnotes.

The interim Finance Director and the Chief Administrative Officer have agreed with the above plan and committed their efforts to implement the plan.

The City Auditor's Office appreciates the cooperation of the Chief Administrative Officer and the Interim Finance Director. Please contact me for questions and comments on this report.

Umesh Dalal, CPA, CIA, CIG  
City Auditor

A handwritten signature in black ink, appearing to read "Umesh Dalal", with a long horizontal flourish extending to the right.

Cc: Mr. Byron C. Marshall, CAO

<b>#</b>	<b><i>COMPREHENSIVE LIST OF RECOMMENDATIONS</i></b>	<b><i>PAGE</i></b>
1	Appraise the City’s fixed assets to determine current replacement values for the assets whose original costs and subsequent improvements are not known.	24
2	Make appropriate adjustments in assets values and depreciation for the fixed assets as specified in GASB 34.	24
3	Make appropriate disclosure of the ensuing adjustments in the FY 2012 CAFR.	24
4	Use the capabilities of the incipient ERP system to: <ul style="list-style-type: none"> <li>• “centralize” the record keeping of purchase transactions which qualify as fixed assets;</li> <li>• automatically update the detailed subsidiary ledger and the general ledger;</li> <li>• enforce the City’s fixed asset capitalization policies;</li> <li>• develop queries and an audit trail to detect potential purchase transactions that qualify as fixed assets but were not properly flagged;</li> <li>• develop appropriate controls, comprehensive project files, and transparent audit trails for CWIP activity over the life of all projects to ensure that such activity is accurately recorded and transferred to fixed assets upon completion in a timely manner and properly documented to ensure enforcement of City policy;</li> <li>• build controls over adjustments to fixed asset records to ensure that all such adjustments are approved by authorized personnel;</li> <li>• include standardized street addresses consistent with the Assessor’s records for the City’s land and building assets that enable the ERP to be reconciled with the City Assessor’s ProVal record system.</li> </ul>	24
5	Develop written policies and procedures that: <ul style="list-style-type: none"> <li>• provide sufficient detailed records to demonstrate that CAFR balances are recorded at historical costs;</li> <li>• build controls and audit trails over art/treasures and infrastructure assets to ensure that such assets are accurately recorded in sufficient detail, supported by credible documentation, and subject to periodic physical inventory verification.</li> </ul>	25
6	Ensure that all fixed asset policies are kept current and available electronically to all agency fixed asset coordinators.	25
7	Provide periodic training to all fixed asset coordinators to ensure that all coordinators understand the rules and can apply them to properly account for fixed assets, including CWIP, in the City’s financial system.	26

## **Audit Overview**

### ***Introduction***

The City Auditor's Office has completed an audit of the City's fixed (capital) assets for the 12 months ended May 31, 2009. The City Auditor shared results of this audit with the Finance Department (Finance) in November 2009 to enable them to address the significant issues included in this audit. Since then, an external law enforcement agency began an investigation to determine if criminal wrongdoing occurred. Recently, the external law enforcement agency closed the investigation and did not report any criminal wrongdoing.

Auditors conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that auditors plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for the auditors' findings and conclusions based on their audit objectives. Auditors believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on the audit objectives.

### ***Objectives***

The objectives of the audit were to:

- Evaluate whether internal control procedures in operation are adequate, and
- Determine that fixed assets are properly approved and recorded in accordance with the accepted accounting standards.

### ***Methodology***

To accomplish the objectives, the auditor performed the following procedures:

- Conducted interviews with management and departmental representatives;

- Surveyed agency staff using questionnaires;
- Researched best practices;
- Obtained deeds and assessor records;
- Reviewed and evaluated relevant policies and procedures and system manuals;
- Reviewed financial data and supporting documents; and
- Conducted other audit procedures as deemed necessary.

***Management  
Responsibility***

The management of the City of Richmond is responsible for maintaining the financial records of the City. They are also responsible for establishing and maintaining a system of internal accounting and management controls. In fulfilling this responsibility, management is required to assess the expected benefits and related costs of control procedures.

***Background***

The City of Richmond reported net fixed assets of \$696 million in FY2008 for Government Activities. Major fixed asset categories are defined by policy:

- Land
- Buildings
- Infrastructure (*Infrastructure includes roads, bridges, tunnels, drainage systems, water and sewer systems, dams and street lighting systems*)
- Equipment
- Vehicles
- Art/Treasures
- Improvements other than Buildings (*Includes all improvements not specifically identifiable to an individual building*)

- Construction Work-in-Progress (*Represents expenditures of a project that will provide a long term future economic benefit to the City of Richmond when completed*)

***Accounting  
Requirements***

According to Government Accounting Standards Board (GASB) 34 Basic Financial Statements – and Management’s Discussion and Analysis – for State and Local Governments:

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***Governments are  
required to report  
fixed assets at their  
historical costs***

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*“Capital assets should be reported at historical cost. The cost of the capital asset should include capitalized interest and ancillary charges necessary to place the asset into its intended location and condition for use.”*

*“Donated capital assets should be reported at their estimated fair value at the time of acquisition plus ancillary charges, if any.”*

***According to Wiley GAAP for Governments, an interpretation and application of GAAP for state and local governments:***

*“As a general rule, capital assets should be initially recorded at cost. Cost is defined as the consideration that is given or received, whichever is more objectively determinable. In most instances, cost will be based on the consideration that the government gave for the asset, because that will provide the most objective determination of the cost of the asset....*

*Governments often found it necessary to estimate the original costs of these assets on the basis of documentary evidence as may be available, including price levels at the time of acquisition, and to record these estimated costs in appropriate fixed assets records.”*

## Tests on Adequacy of Internal Controls

### *Internal Controls*

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*The controls  
over the fixed  
assets process  
are inadequate*

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According to Government Auditing Standards, internal control, in the broadest sense, encompasses the plan, policies, procedures, methods, and processes adopted by management to meet its mission, goals, and objectives. Internal control includes the processes for planning, organizing, directing, and controlling program operations. It also includes systems for measuring, reporting, and monitoring program performance.

Based upon staff interviews, departmental surveys and review of records, policies and regulations, the auditors concluded that internal controls in the fixed asset process are inadequate.

### *Recordkeeping*

The City has a decentralized fixed assets management process. Each City agency is responsible for receiving assets in working order, assigning a fixed asset number, and assigning the tag on the asset. Each agency is responsible for recording assets they acquire into the Fixed Asset System (FAS) as well as the custody, proper use, reasonable care and maintenance of the asset.

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*Currently, there is  
no assurance that  
all fixed assets are  
properly identified  
and recorded*

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For each fixed asset purchase, the agencies are expected to complete necessary documentation to assure proper recordkeeping in FAS. Currently, the Finance Department can only review the documentation presented to them. However, there is no mechanism to ensure that the departments are submitting documentation for recording all of the fixed asset acquisitions in FAS.

Periodically, Finance requests a list of assets from all City agencies, but there is no assurance that the lists received are complete because there is no control to detect discrepancies, if they exist, in the agency lists. Appropriately configuring and using the new ERP system in conjunction with a departmental review of transactions would address this issue.

#### *Fixed Assets Policy*

Finance appears to have an adequate policy for capitalization limits, recording newly acquired assets, useful lives, and keeping records of disposals. However, not all the fixed asset policies are available to fixed assets coordinators in various departments. Without knowledge of the policies, the departments' ability to comply with them may be impaired.

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*All the fixed asset policies are not available to fixed assets coordinators, which may lead to noncompliance*

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A survey of departmental fixed assets coordinators resulted in 16 responses. The coordinators were asked various questions related to their knowledge of the fixed asset policies and their responsibilities. The following are salient issues identified by the survey results:

- 31% of the coordinators did not have any knowledge related to FAS.
- Only 50% of the coordinators indicated that they conduct physical inventory verifications routinely and periodically. The remaining coordinators did not know if and when the fixed assets in their departments were physically verified.

#### *Training*

There are specific accounting rules for fixed assets that governments must follow to be in compliance with GASB pronouncements. Finance does not train the departmental fixed assets coordinators extensively in the accounting requirements for fixed assets. The departmental

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*The City must train Fixed Asset Coordinators to follow the accounting rules*

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representatives must understand these rules to properly account for the fixed assets in the City's financial system.

***Issues with  
FAS Data***

***Fixed Assets Accounting in the Department of Public Utilities (DPU)***

The FAS is supposed to be used Citywide for recording and tracking fixed assets. DPU uses FAS for recording and tracking fixed assets and for the calculation of related depreciation. At the time of conversion to the current FAS, DPU did attempt to convert all of its assets to the new system; however, it was quickly realized that doing so would create material discrepancies with depreciation, and the decision was made to continue that depreciation in an Excel spreadsheet for the remainder of the asset lives. All new assets acquired by DPU from the time of conversion forward are being tracked in the FAS system.

DPU has over \$823 million in assets recorded and tracked in the Excel spreadsheet. DPU does not keep a record of the changes made to these records. Lack of controls over alteration of data without an audit trail could compromise accuracy of this recordkeeping.

***Accuracy and Completeness***

The Assessor's Office receives daily updates/changes to property ownership from the Courts that they key into ProVal, their computer system. The Assessor's Office also has electronic access to Court records. Therefore, the Assessor's records are fairly complete and accurate.

The City can verify accuracy of the building and land ownership if the accuracy and completeness of the list can be verified with independent records such as the Assessor records. Currently, Finance records do not

include parcel ID information. In addition, the Finance records do not always include addresses of properties. Therefore, it is not possible to verify accuracy of Finance's records using the Assessor's data.

## Fixed Assets Recordkeeping and Reporting

### *Use of Fixed Assets System*

Auditors found that Finance is using FAS for keeping fixed assets records as:

- The FAS listing of assets and values very closely resembled the schedule of assets found in the City's external auditor's work papers and Finance's documentation supporting the Comprehensive Annual Financial Report (CAFR) for FY 2008.
- Finance claimed that they computed annual depreciation using FAS information.

### *Appropriateness of Capitalization*

The City has a policy to capitalize expenditures resulting in an asset where the cost exceeds \$5,000 and the asset has a useful life of 2 years or more. Periodic monitoring by Finance could improve enforcement of this policy.

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### *There is no assurance that all fixed assets acquired are appropriately capitalized*

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During FY 2009, the City generated almost 4,000 purchase orders having a value per order of \$5,000 or more, totaling over \$425 million. Under the current process, it is not possible to easily differentiate between purchase orders for capital assets, and non-asset purchases for services, supplies, or any other purpose. Without proper monitoring, the fixed asset purchases recorded as operating expenditures may not be recorded in either the CAFR fixed assets balance or in FAS. These purchases, if identified, will have to be accounted for in FAS and the CAFR simultaneously.

### *System Functionalities*

The City's financial system (Advantage) has the functionality to identify a fixed asset purchased in accordance with City policies. This feature is essentially a link (fixed asset shell process) between the Procurement/Accounts Payable process and FAS. Auditors found that

*The City does not utilize already existing functionality of the Advantage system to capture fixed assets information*

City employees are not trained to utilize these capabilities and in the last three years, not a single asset was updated in FAS via this method.

Currently, the City's purchase order information is not linked to the fixed assets data. This prevents verification of proper recordkeeping of fixed asset procurements in FAS. Therefore, it is not possible to determine the completeness of records in FAS. Currently, the risk exists that some assets may never get recorded in FAS, which needs to be mitigated through proper procedures.

***Reporting of Fixed Assets Values***

The following is the summary of fixed assets information presented in the FY 2008 financial statements (*amounts in millions*):

Capital Assets	Government Activities	%	Business Type Activities	Total
Land	\$34.6	2.51%	\$12.8	\$47.4
Capital Work in Progress	\$62.5	4.54%	\$176.6	\$239.1
Art/Treasures	\$ 6.9	0.50%	-	\$6.9
<b>Total Assets Not Depreciated</b>	<b>\$104.0</b>		<b>\$189.4</b>	<b>\$293.4</b>
Infrastructure	\$726.2	52.72%	-	\$726.2
Buildings	\$434.1	31.52%	\$1,156.8	\$1,590.9
Equipment	\$103.9	7.54%	\$6.3	\$110.2
Improvement (Other Building)	\$9.2	0.67%	-	\$9.2
Internal Service Fund (Stores Utility)			\$29.0	\$29.0
<b>Total Assets Depreciated</b>	<b>\$1,273.4</b>		<b>\$1,163.1</b>	<b>\$2,436.5</b>
Less Accumulated Depreciation	\$681.2		\$430.1	\$1,111.3
<b>Net Depreciated Assets</b>	<b>\$592.2</b>		<b>\$733.0</b>	<b>\$1,325.2</b>
<b>Total Assets, Net</b>	<b>\$696.2</b>		<b>\$922.4</b>	<b>\$1,618.6</b>

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***Finance did not have detailed lists for several classes of assets reported in the FY 2008 CAFR and caused concern about the accuracy of the CAFR***

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The City discloses in its financial statements that the assets are either presented at historical costs or computed by using other accepted accounting practices. The auditors requested detailed listings for the above assets from Finance to support the values presented in the City's FY 2008 CAFR. However, Finance did not have a detailed list for all of these assets as of that date. Finance could provide only the following listings:

- Infrastructure and Equipment for the year ending FY 2002
- Art/Treasures and Other Improvements for FY 2003
- Buildings and Land for FY 2008

Not having detailed lists of assets presented in the financial statements raises concerns about the accuracy and completeness of this information. The auditors subsequently requested additional information from Finance and other departments, analyzed data included in the FAS, and interviewed numerous City employees.

***Buildings and Land Included in Government Activities***

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***For FY 2002, Finance adjusted FAS balances to match the CAFR***

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In 2002, the City implemented GASB 34 provisions. The individual who was the Controller at that time informed the auditors that, prior to 2002, the fixed assets were accounted for in the Fixed Assets Group of Accounts. This group had only a lump sum figure, and supporting details were not available. The former Controller and her staff used the best available data from City Assessor's records, which are the most accurate records of all the land and buildings owned by the City. According to the former Controller, Finance staff spent significant efforts to determine historical costs of the assets and researched capital improvements made on the City-owned land and buildings. For some of the properties for which historical costs were not available, the Finance staff discounted 2002 assessed values, in accordance with GASB 34, to arrive at historical

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*In 2002, CAFR fixed assets balance for government type activities differed from detailed records by over \$110 million.*

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costs as of July 1, 1980. After their best efforts, they could only locate assets at their historical cost, along with capital improvements with a total value of \$215,682,413, which was input in FAS as beginning balances. Compared to this balance, the 2002 CAFR balance for land and buildings in government type activities was \$325,775,641, which differed by the FAS balances by over \$110 million.

According to the former Controller, the City's external auditors advised her to keep using the Fixed Assets Group of Accounts balance as the fixed assets balance for the FY 2002 CAFR.

### *Unjustified Adjustments*

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*In 2006, Finance adjusted the FAS to match CAFR information without justification*

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According to the former Controller, in 2006, the external auditors and she participated in adjusting FAS balances to match them with the CAFR balance. They used a weighted average factor to accomplish these adjustments. **This adjustment increased the asset carrying values for buildings by \$177 million and decreased the asset values for land by approximately \$35 million.** This process is not in accordance with the generally accepted accounting principles and resulted in improper adjustments in official government records.

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*Finance does not have documentation supporting 96% of land values and 84% of building values*

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Based on the audit tests, the total of the adjusted balances currently reflected in the FAS matches with the values provided by management to support the CAFR. The increase in net book value after depreciation was about \$57 million. Finance could not explain how their actions were in conformity with GASB 34 provisions. In addition, Finance does not have any supporting documentation that justifies historical values for 760 entries representing 96% of the land assets, and 244 entries representing 84% of the buildings assets recorded in FAS.

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***Auditors performed extensive research to evaluate the fixed assets balance reported in the CAFR***

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Auditors sampled 103 properties consisting of land and buildings at a carrying value of \$177.1 million (38%) of a total population of \$468.7 million in government type activities. Auditors compared the assets' historical cost with the carrying value to determine the appropriateness of the values presented in the CAFR for FY 2008.

In order to find historical values for the properties, the auditors:

- Researched and found original deeds for purchase or other method of acquisition of the properties.
- Used assessed values for the properties at or around the time of the acquisition for properties with deeds that were not available.
- Used market values at or around the time of donations for donated assets. For this method, the auditors used either assessed values or the City's Real Estate Division's estimated market values at the time of donation.

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***Building and Land values are not reported at historical costs as required by the accounting standards***

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Of the 103 items sampled, the historical costs did not match the values for land and buildings presented in the CAFR for all of the 103 items sampled. Finance pointed out that, in the case of Richmond Public School buildings, betterments were not included in the sample of asset values compiled by the auditors. While this is possible, no credible evidence was presented to corroborate this statement. Finance has not been able to demonstrate that CAFR balances are at historical costs.

***Finance Department Actions***

Subsequent to the external law enforcement agency's notice allowing the City Auditor's Office to release this report, the auditors performed one additional test. The purpose of the test was to determine if Finance had taken any action since the original notification of these issues in 2009. The auditors obtained a current assessment from the City Assessor's Office of all City-owned property used in government type activities.

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*Finance has not taken any action to rectify overstatement of fixed assets since they were notified in 2009*

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The auditors discounted the applicable properties in accordance with GASB 34 provisions and found a similar overstatement of assets, as reported earlier, in the FY 2010 financial statements. Based on this analysis, it does not appear that Finance has addressed the discrepancy since they were notified in 2009. This means that the City's 2010 financial statements continue to reflect inflated values. The need for an adjustment of the financial statements to present asset values in accordance with the accepted accounting principles cannot be overemphasized.

***Post 2002 Accounting Discrepancies***

Auditors identified additional accounting discrepancies as follows:

1. Auditors found the controls over the Fixed Asset Accountant's ability to adjust FAS data and the verification of the accuracy of posted adjustments to be inadequate. The Fixed Asset Accountant, without justification, altered the building and land values on about 240 land and building entries in FAS to equal their January 2009 assessed valuation for property tax purposes. These new values significantly exceeded the values at which the assets should have been recorded in accordance with GASB 34. In addition, the auditor found two typographical keying errors (approximately \$8 million) within these mass adjustments, which further overstated the asset values. Finance does not have any process to detect the type of errors which were discovered during the audit. Finance corrected these discrepancies subsequent to the auditors' notification of the occurrence.
2. Auditors obtained a list of City properties sold during FY 2002 through FY 2008 from the Assessor's office. Auditors found that the Assessor's records indicated the sale of 14 properties during the seven-year period, which remained on the City's CAFR for FY2008.

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*Controls over the changes made to FAS data are inadequate*

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*The sale of properties and acquisition of buildings were not properly reflected in the CAFR*

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These properties consisted of ten parcels of land valued at \$137,375 and four buildings which represented a CAFR value of approximately \$1.1 million (with accumulated depreciation of \$674,561).

3. The auditors found two spreadsheets: The first erroneously reported additions of 14 buildings valued at \$5.66 million. The second spreadsheet appropriately listed 18 building additions valued at \$6.61 million in FY 2008. Finance confirmed to the auditor that it had used the wrong spreadsheet and understated the 2008 CAFR balance for buildings and structures by about \$ 950,000.

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***The City's former external auditor did not detect reporting discrepancies***

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These occurrences clearly indicate that the CAFR balance is not being updated appropriately when additions or deletions are necessary. An independent public accounting firm audited the City's financial statements during this period. These audits did not identify the above discrepancies.

In light of the above accounting errors and the lack of a mechanism to detect them, it does not appear to be prudent to assume that the unsupported balance in the fixed assets group of accounts at the time of GASB 34 implementation was accurate. Instances such as the above accounting discrepancies reduce confidence in accuracy of information presented in the financial statements. Therefore, the overstatement in the fixed assets values may have originally occurred in FY 2002.

***Construction Work in Progress***

In the City's five-year Capital Improvement Plan (CIP) there are two types of capital projects:

- Funding for a specific project; and
- Citywide, ongoing projects

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*With exception of  
DPU, the City  
agencies are not  
accounting for  
CWIP costs  
appropriately*

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It is typical for a capital project to extend over a period of time and span over one or more fiscal years. The City's policy requires accounting for all of the costs of a capital project until it is considered to be complete in a Construction Work in Progress (CWIP) account. Upon completion, all of qualifying costs are transferred to the capital asset account where it begins accumulating depreciation.

It is the responsibility of the agencies' Project Managers to manage each project and communicate the status of the project to their respective agency accounting personnel. Until the project is complete, a project is considered CWIP. Auditors found that with the exception of DPU, all departments charge expenses directly to the capital project without the use of a CWIP balance sheet account. The City's financial accounting system is capable of tracking these expenses appropriately to ensure accurate accounting.

The auditors learned through employee interviews that each agency has developed its own processes to track, record and account for capital projects. A citywide standard accounting practice for this important function does not exist. Agencies other than DPU use manual worksheets to track CWIP expenditures until a project is capitalized. Without a standard procedure, Finance cannot be assured that capital assets are properly removed from CWIP and converted into a capital asset in a timely manner. A manual process may introduce the risk for errors. In fact, in the Notes to Financial Statement #17 for the FY 2007 CAFR, significant adjustments were made because capital projects had not been transferred from CWIP to the proper capital asset category to be depreciated.

Most agencies keep the payment backup in files by vendor. Therefore, invoices for various projects are commingled if a common vendor is used for multiple projects. These agencies cannot produce all the documents supporting a given project easily, as a complete "Project File" with every pertinent document does not exist for each project. Only DPU uses a computerized project module (Advantage Extended Projects) to track a project from start to finish. They also maintain complete project files as well. Modeling their processes for citywide use may be beneficial.

The weaknesses to these procedures used by all agencies except DPU are:

- There is no visible transfer from CWIP to the capital accounts via a journal voucher accounting entry. Without this distinction, the timeliness and appropriateness of capitalizing a project is not transparent.
- For non-specific projects (e.g. Library Renovations or Street Signs Program) which involve multiple locations that will need capitalization along the way as they are completed, payments for closed projects remain commingled with payments for incomplete projects.
- The lack of comprehensive project files makes project monitoring and the tracking of its progress more difficult. Other than DPU, the City agencies do not have a structured process and monitoring of the completeness of project files.

During audit testing several additional discrepancies were observed:

- A project for building/remodeling of the Drug Court was included in FY 2008 building additions. The following are pertinent observations:
  - The supporting documentation received from Finance included two fixed asset acquisition forms for \$366,347 and \$117,231 that

total \$483,578. However, the value of the asset booked was only \$472,222, a difference of \$11,356. According to Finance, this amount represents a recording error.

- The expenses included temporary staffing costs of \$18,498. This expense was capitalized as a part of the asset. There was no documentation related to the tasks performed by this labor. Generally accepted accounting principles require capitalizing ancillary costs that are directly attributable to asset acquisition. Without the description of tasks performed by the temporary staff, a proper evaluation of the appropriateness of these capitalized costs is not possible. In addition, the job site listed on the invoice was City Hall rather than the Drug Court. It is not clear if the expense pertained to the project.
- The capitalized costs also included \$636, the cost of meals provided to emergency crew. The rationale for capitalizing these costs is not clear.
- The total project costs included a betterment of \$117,230 incurred in FY 2008 but recorded in FY 2009.
- Supporting documentation was not available for a \$3.4 million Richmond Public School maintenance CWIP entry.
- A review of the Main Street Station building addition project expenses indicated that the expenses capitalized on this project included \$551 spent on food for a Motor Coach breakfast meeting and \$60 spent on a Mayor's sash for the gala opening. The rationale for capitalizing these items is not known.

***Equipment  
and  
Art/Treasures***

***Equipment***

Auditors selected a sample of 15 equipment entries at a carrying value of \$6.3 million from a population of \$103.9 million. Auditors found

adequate support for 10 pieces of equipment. The observations on the remaining five equipment items are discussed as follows:

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*Inaccuracies and missing supporting documentation were identified in record keeping for equipment*

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- The equipment sample included Custom Shelters that were gifted to the City in 1999. The Fixed Assets Accountant in Finance did not have any support for the asset. However, the Department of Public Works provided a copy of a resolution number 99-R223-223 adopted on October 25, 1999. The resolution authorized the City Manager to accept the donation of bus shelters, bus stop benches, and trash cans at an approximate value of \$1.0 million. These assets are recorded in FAS at \$770,000. There was no support available to justify the recording of this value other than that recognized in the City resolution.
- The HVAC system at the Landmark was selected in an audit sample. Auditors were not provided with credible evidence such as vendor invoices supporting this expenditure of \$700,000. Upon further inquiry, a bank note payment schedule was provided that identified the cost of the loan for repayment and the purpose of the loan. This is not credible evidence supporting the expenditure.
- Pistol Records Systems was purchased by the Police Department. The software was booked at the cost of \$942,210, but the documentation supporting the purchase indicated a cost of \$1,900,000. It is not clear why the discrepancy existed.
- Similar to the above observation, MUNIS software purchased by Finance is booked at \$146,310. The actual costs incurred, as identified in the recent audit, were about \$1.45 million as of June 30, 2008. Finance is currently developing procedures for capturing the appropriate capitalized costs.

- There was no supporting documentation available for the purchase of a sign machine costing \$53,000.

Some of the above documentation may have been discarded in compliance with the record retention policy.

#### *Art/Treasures*

According to the FY 2008 CAFR, the City owns works of art valued at \$6.9 million. The auditors selected 10 line items from the list of art work. The list included two line items noted as “Various works of art” for \$215,149 and “unknown assets” for \$2,100. Finance could not provide any details or support for these line items. It is not clear if these assets exist.

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*Finance could not provide evidence if \$217,249 in Art/Treasures exists*

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#### *Infrastructure*

For general government activities, the auditors selected 31 infrastructure items valued at approximately \$33.2 million. Adequate documentation was available for only 13 items and five items belonged to the Community Development Authority. The combined worth of these items was \$9 million. The other 13 items, valued at \$24.2 million, were transferred from the CWIP category. The auditors requested additional details and supporting documentation. However, Finance could only provide a completed fixed asset acquisition form and a composite summary spreadsheet listing the amount capitalized for various projects and the expenditure listing for these projects. Detailed cost information for the 13 projects was not available. Auditors were informed that the City’s external auditors verify the appropriateness of capitalizing these expenditures during the annual audit. However, it was observed that for 11 items, the total of the detailed expenditures did not match with the capitalized value of the assets. No explanation was available for the discrepancies. The external audit did not identify these discrepancies.

Based on the above observations, Finance needs to have procedures verifying the accuracy of the infrastructure assets reported by the departments. In this situation, any errors or omissions would not be detected in a timely manner.

A review of roll-forward balances for capital assets indicated several discrepancies as follows:

***Unexplained  
Discrepancies***

***Insufficient documentation exists to support the CAFR:***

Auditor's inquiries revealed that Finance needs to keep proper documentation to explain discrepancies encountered when preparing the CAFR. The following example illustrates the department's inability to explain observed discrepancies in the FY 2008 CAFR. The following is the reconciliation included in Finance's work papers:

Beginning Bal 2008	\$	37,358,328
Additions from FAS	\$	30,631,127
<i>Expenses reported by agencies not in FAS</i>	\$	5,547,967
<i>Deletions</i>	\$	(5,975,598)
CWIP moved to FAS	\$	<u>(7,753,832)</u>
<b>Total 2008 CWIP</b>	\$	59,807,992
DPU CWIP on CAFR electric utility	\$	<u>2,731,982</u>
Ending 2008 CAFR Balance	\$	<u>62,539,974</u>

Finance could not provide details supporting the expenses reported by the other agencies and deletions in the above calculation. When the

above data is compared to the FY 2008 CAFR, the following discrepancies come to light:

	<i>Finance Work Paper Documentation</i>	<i>CAFR FY 2008</i>	<i>Discrepancies Not Considered Material by Finance</i>
Beginning Bal 2008	\$37,358,328	\$38,194,046	\$(835,718)
FAS - additions	\$30,631,127	\$31,615,889	\$(984,762)
CWIP moved to FAS	<u>\$(7,753,832)</u>	<u>\$(7,269,961)</u>	<u>\$(483,871)</u>
<b>Total 2008 CWIP</b>	\$60,235,623	\$62,539,974	\$(2,304,351)

***Accounting discrepancies totaling \$2.3 million were not resolved prior to publishing the CAFR***

Finance personnel could not explain the discrepancies. The auditors were told that any discrepancy under \$1 million is considered immaterial and therefore is not researched. Materiality is a concept used by the external auditors. Staff must be able to explain all the discrepancies unless they are absolutely minimal such as a few cents to a few dollars due to rounding the numbers.

- **Loss of Data Integrity**

The auditors could not find system reports to verify the validity of the data presented. Finance transfers system information to Excel spreadsheets and makes necessary adjustments to the data. However, this process results in the loss of data integrity, since the files are downloaded in an Excel format and data could be manipulated with or without support. Keeping a “hard copy” system report allows an independent third party to verify the accuracy of information presented in the City’s financial statements. System limitations do not allow verification of year-end financial statement balances.

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*Finance accepts information from other agencies for inclusion in CAFR without verifying its accuracy*

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- **Lack of Verification of Data:**

Finance accepts spreadsheet information from other agencies to compile information for the financial statements. For example, the Business Type Activity CAFR balance of \$922.4 million for FY2008 was based on information reported by DPU. These values reported in the CAFR are not verified by Finance, and they do not maintain any documents supporting those figures. In FY 2007, the Fleet System (MCMS) inventory reconciliation data related to additions and data reported in the Financial Statements as depicted in Finance's work papers had a difference of \$358,739 (5.5%) in total additions to the assets of about \$6.6 million. This difference was not resolved. Finance does not verify other agencies' quality control measures in preparing information for the CAFR. Relying on information received from other agencies without appropriate verification results in a risk of presenting inaccurate information.

- **Depreciation Computation Errors:**

Auditors reviewed depreciation schedules provided by Finance for FY 2008. Tests on a sample of 45 properties revealed that Finance calculates depreciation using 2006 inflated values. The details of how depreciation was calculated prior to 2006 were not available to the auditors.

In addition, as presented in the following table, the values of the following buildings began depreciating before the building was constructed:

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*Depreciation is calculated based on inflated asset values and therefore may be overstated*

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<i>Address</i>	<i>Building Value</i>	<i>Construction Year</i>	<i>Beginning of Depreciation</i>
3400 Hopkins Road	\$8,185,985	1986	1980
6300 Jahnke Road	\$17,205,591	1998	1982
1500 Franklin and 1500 Main Street	\$5,535,763	Reacquired in 2000	1980

***Depreciation on some assets began prior to acquisition of the assets***

Finance personnel indicated that a common acquisition date of July 1, 1980 was used if the date of acquisition of the property was not known. Auditors found that pertinent information was available in relevant documents, which could have been identified if researched.

***Reaction by the City's External Auditor***

The City Auditor and the interim Finance Director worked with the external auditors to agree upon a plan of action to bring the Fixed Asset values in compliance with accounting principles. In addition, the City agreed to adjust the FY2011 financial statements by a net asset value of approximately \$21 million to provide the external auditors reasonable assurance and enable them to issue an unqualified opinion. The Finance Department also agreed to adopt and execute the following plan prior to the issuance of the FY 2012 financial statements:

- a. The City will determine current replacement costs of the City-owned properties;
- b. The replacement costs of all the properties for which the original cost is not known will be discounted using acceptable indices to determine values at July 1, 1980 in accordance with GASB 34 provisions;

- c. Depreciation for all the properties, including the properties for which original cost is not known, will be recalculated;
- d. Based upon the above analysis, the capital assets values and depreciation will be adjusted in the FY 2012 financial statements, and appropriate disclosure will be made in the footnotes.

The interim Finance Director and the Chief Administrative Officer have agreed with the above plan and committed their efforts to implement the plan.

***Recommendations:***

1. *Appraise the City's fixed assets to determine current replacement values for the assets whose original costs and subsequent improvements are not known.*
2. *Make appropriate adjustments in assets values and depreciation for the fixed assets as specified in GASB 34.*
3. *Make appropriate disclosure of the ensuing adjustments in the FY 2012 CAFR.*
4. *Use the capabilities of the incipient ERP system to:*
  - *“centralize” the record keeping of purchase transactions which qualify as fixed assets;*
  - *automatically update the detailed subsidiary ledger and the general ledger;*
  - *enforce the City's fixed asset capitalization policies;*
  - *develop queries and an audit trail to detect potential purchase transactions that qualify as fixed assets but were not properly flagged;*

- *develop appropriate controls, comprehensive project files, and transparent audit trails for CWIP activity over the life of all projects to ensure that such activity is accurately recorded and transferred to fixed assets upon completion in a timely manner and properly documented to ensure enforcement of City policy;*
  - *build controls over adjustments to fixed asset records to ensure that all such adjustments are approved by authorized personnel;*
  - *include standardized street addresses consistent with the Assessor's records for the City's land and building assets that enable the ERP to be reconciled with the City Assessor's ProVal record system.*
5. *Develop written policies and procedures that:*
- *provide sufficient detailed records to demonstrate that CAFR balances are recorded at historical costs;*
  - *build controls and audit trails over art/treasures and infrastructure assets to ensure that such assets are accurately recorded in sufficient detail, supported by credible documentation, and subject to periodic physical inventory verification.*
6. *Ensure that all fixed asset policies are kept current and available electronically to all agency fixed asset coordinators.*
7. *Provide periodic training to all fixed asset coordinators to ensure that all coordinators understand the rules and can apply them to properly account for fixed assets, including CWIP, in the City's financial system.*

**MANAGEMENT RESPONSE FORM  
DEPARTMENT OF FINANCE**

**Fixed Assets Audit Appendix A**

#	RECOMMENDATION	CONCUR Y. N	ACTION STEPS
1	<i>Appraise the City's fixed assets to determine current replacement values for the assets whose original costs and subsequent improvements are not known.</i>	Y	The Assessors Office has committed to thoroughly assessing each City owned building during FY12 and 13 in order to help with the valuation process.
	TITLE OF RESPONSIBLE PERSON		TARGET DATE
	City Assessor		1-Sep-12
	IF IN PROGRESS, EXPLAIN ANY DELAYS		IF IMPLEMENTED, DETAILS OF IMPLEMENTATION
#	RECOMMENDATION	CONCUR Y. N	ACTION STEPS
2	<i>Make appropriate adjustments in assets values and depreciation for the fixed assets as specified in GASB 34.</i>	Y	The assessors office will forward completed assessments to Finance during their process in above. Finance will discount the values back to the earlier of the acquisition date or 7/1/1980 and adjust the buildings in the fixed asset / Advantage system. Betterments and improvements will also be researched and recorded appropriately.
	TITLE OF RESPONSIBLE PERSON		TARGET DATE
	Accountant II		31-Oct-12
	IF IN PROGRESS, EXPLAIN ANY DELAYS		IF IMPLEMENTED, DETAILS OF IMPLEMENTATION
#	RECOMMENDATION	CONCUR Y. N	ACTION STEPS
3	<i>Make appropriate disclosure of the ensuing adjustments in the FY 2012 CAFR.</i>	Y	Any adjustments done to fixed asset balances will be properly footnoted in the appropriate CAFR year of completion.
	TITLE OF RESPONSIBLE PERSON		TARGET DATE
	Accountant II		31-Oct-12
	IF IN PROGRESS, EXPLAIN ANY DELAYS		IF IMPLEMENTED, DETAILS OF IMPLEMENTATION
#	RECOMMENDATION	CONCUR Y. N	ACTION STEPS
4	<i>Use the capabilities of the incipient ERP system to:</i> <ul style="list-style-type: none"> <li>• “centralize” the record keeping of purchase transactions which qualify as fixed assets;</li> <li>• automatically update the detailed subsidiary ledger and the general ledger;</li> <li>• enforce the City’s fixed asset capitalization policies;</li> <li>• develop queries and an audit trail to detect potential purchase transactions that qualify as fixed assets but were not properly flagged;</li> <li>• develop appropriate controls, comprehensive project files, and transparent audit trails for CWIP activity over the life of all projects to ensure that such activity is accurately recorded and transferred to fixed assets upon completion in a timely manner and properly documented to ensure enforcement of City policy;</li> <li>• build controls over adjustments to fixed asset records to ensure that all such adjustments are approved by authorized personnel;</li> <li>• include standardized street addresses consistent with the Assessor’s records for the City’s land and building assets that enable the ERP to be reconciled with the City Assessor’s ProVal record system.</li> </ul>	Y	Finance will work with the ERP implementation team to understand the capabilities of the new system related to fixed asset reporting and recording. As part of the process we will see what rules can be put into the system that mirror the guidelines outlined in the fixed asset policy and procedures guidelines. Because not all CWIP costs are capitalizable costs, there will still need to be a manual review at the project completion date to determine which costs should be recorded in the fixed asset system. We will work on including a CWIP section of the fixed asset training to help those responsible for these projects properly identify the capitalizable costs. Finance will add a section to the fixed asset policy and procedures relating to controls over changes to assets already recorded in the fixed asset system and document the approval requirements to make such a change. Finance will review the ProVal system with the Assessors Office to determine feasibility of including an identifier in ERP’s fixed asset records that relates to the ProVal record ID’s. Additionally, the Finance Department will submit a proposed mandate to both the CAO and Auditor’s Offices outlining new centralized agency processes and reporting structures that would allow for enforcement of fixed asset policies, the development of better controls as well as the facilitation of overall improved efficiency.
	TITLE OF RESPONSIBLE PERSON		TARGET DATE
	General Accounting Manager		30-Jun-13
	IF IN PROGRESS, EXPLAIN ANY DELAYS		IF IMPLEMENTED, DETAILS OF IMPLEMENTATION

#	RECOMMENDATION	CONCUR Y- N	ACTION STEPS
5	<p><i>Develop written policies and procedures that:</i></p> <ul style="list-style-type: none"> <li><i>• provide sufficient detailed records to demonstrate that CAFR balances are recorded at historical costs;</i></li> <li><i>• build controls and audit trails over art/treasures and infrastructure assets to ensure that such assets are accurately recorded in sufficient detail, supported by credible documentation, and subject to periodic physical inventory verification.</i></li> </ul>	Y	<p>The current policies in place already detail the valuation process of the purchased fixed asset according to their acquisition method. These policies also document the required support needed to substantiate the original value. Finance will add a section to the buildings and land valuation piece to include specific GASB language relating to estimated historical value.</p> <p>As part of the inventory audit process beginning in FY13, a requirement will be added to the process to test a minimum percentage of each agency's art and infrastructure inventory.</p>
	TITLE OF RESPONSIBLE PERSON		TARGET DATE
	Accountant II		30-Jun-13
	IF IN PROGRESS, EXPLAIN ANY DELAYS		IF IMPLEMENTED, DETAILS OF IMPLEMENTATION
#	RECOMMENDATION	CONCUR Y- N	ACTION STEPS
6	<p><i>Ensure that all fixed asset policies are kept current and available electronically to all agency fixed asset coordinators.</i></p>	Y	<p>The policies will be posted to the City's Starnet in order to make them available to the coordinator's. Notices will go out to all FA coordinators when any changes are made to the policies.</p>
	TITLE OF RESPONSIBLE PERSON		TARGET DATE
	Revenue Manager/Administration		30-Jun-12
	IF IN PROGRESS, EXPLAIN ANY DELAYS		IF IMPLEMENTED, DETAILS OF IMPLEMENTATION
#	RECOMMENDATION	CONCUR Y- N	ACTION STEPS
7	<p><i>Provide periodic training to all fixed asset coordinators to ensure that all coordinators understand the rule and can apply them to properly account for fixed assets, including CWIP, in the City's financial system.</i></p>	Y	<p>Finance will offer annual training to FA coordinators and any City employee who would like to attend. This training will most likely take place around May of every year. As stated above this training will include a topic covering CWIP projects.</p>
	TITLE OF RESPONSIBLE PERSON		TARGET DATE
	Accountant II		30-May-12
	IF IN PROGRESS, EXPLAIN ANY DELAYS		IF IMPLEMENTED, DETAILS OF IMPLEMENTATION