COMMONWEALTH of VIRGINIA

Auditor of Public Accounts

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May 17, 2012

The Honorable Dwight C. Jones
Mayor of the City of Richmond Virginia

The Honorable Kathy C. Graziano
President of Richmond City Council

The City of Richmond requested the Auditor of Public Accounts to review the City's methodology to implement Governmental Accounting Standards Board Statement No. 34 – Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments specifically regarding capital assets, and to determine if that methodology was appropriate. This request came as a result of the City's internal and external auditors citing issues with the City's capital asset reporting and attached is our report.

Based on the data available, the City did not properly implement GASB 34 with respect to land and buildings. Specifically, the City's methodology did not take into consideration improvements occurring subsequent to the acquisition or construction of the property.

Before taking any further actions, the Department of Finance, Richmond City Auditor, and the external auditors need to meet and agree on a plan of action to move forward to prevent duplication of efforts or wasted efforts. Starting with the methodology applied and opined upon as of June 30, 2011, by the external auditor, the parties should agree upon a work plan approach. Otherwise, this matter will continue to remain unresolved.

Should you have any questions, please contact me.

AUDITOR OF PUBLIC ACCOUNTS

cc: Byron C. Marshall
Chief Administrative Officer

Sharon Judkins
Deputy Chief Administrative Officer (DCAO)
of Finance and Administration

William D. Wheeler
Interim City Controller

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City Auditor

Review Results

Request for Assistance

The City of Richmond requested the Auditor of Public Accounts to review the City's methodology to implement Governmental Accounting Standards Board (GASB) Statement No. 34 – *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments* specifically regarding capital assets and determine if that methodology was appropriate. This request came as a result of the City's internal and external auditors citing issues with the City's capital asset reporting.

Further, this Office provided guidance to localities for developing methodologies for implementing GASB 34 requirements for reporting of capital assets and infrastructure. These methodologies combined the efforts of localities, state agencies, public accounting firms, and others to assist in the implementation of the new accounting standard in 2002.

Objective and Scope of Work

The purpose of our review is to determine whether the City implemented GASB 34 and reports capital assets in accordance with the accounting standards. We reviewed documentation related to the City's capital assets and made inquiries of the City's management, internal auditor, and external auditors.

Background

Prior to GASB 34, accounting principles required governments to maintain a General Fixed Assets Account Group (GFAAG), which included only land, buildings, and equipment at a summary level with no depreciation. The supporting records for the GFAAG varied by government from a complete detailed listing of all land, buildings, and equipment with records supporting reasonable historical cost for older structures to detailed cost records for most structures, including renovations. Alternatively, some governments maintained no records and had an appropriate opinion qualification by their external auditors.

It is our understanding that the City reported a GFAAG and had listings of certain capital assets. The City had inventory listings for equipment. Various departments throughout the City had inventory listings for buildings; however, there is no indication of their completeness.

Further, while the GFAAG included buildings and Finance updated the balance each year to include additions and deletions at cost over time, this balance did not have detailed information to show whether the various building listings supported this balance. Additionally, the City did not have records available to support the original historical cost and costs for improvements that occurred over the decades for many of the City owned buildings.

Implementing GASB 34

The City of Richmond implemented GASB 34 for their fiscal year ended June 30, 2002 Comprehensive Annual Financial Report (CAFR). Prior to fiscal year 2002, the City developed an inventory and estimated historical cost for their infrastructure. Using the available information for equipment, the City recorded the existing equipment and calculated and recorded the appropriate accumulated depreciation and annual depreciation expense.

It is our understanding, that for land and buildings, the City started with the GFAAG balance as reported in fiscal year 2001 financial statements, adjusted for known additions and deletions, based on actual purchases, construction in progress expenses, and the capitalization of construction in progress. Finance also determined that there was a need for a central listing of land and buildings, which did not exist at the time the City implemented GASB 34.

Post GASB 34 Implementation Efforts

During the period of 2002 to 2005, the City developed a complete inventory of City owned buildings using the City Assessor's records. During this period, the City also recorded new construction and renovations by individual asset at cost. In fiscal year 2006, the City obtained the assessed values for the buildings from the City Assessor's office.

Using the Assessor's listing, the City discounted the assessed value of the buildings based on the acquisition date to assign an estimated historical cost for the individual buildings in the fixed asset subsidiary ledger system. For buildings where the acquisition date was unknown, the City defaulted to an acquisition year of 1980. The City used the same process to develop an inventory and estimated historical cost for land. This methodology did not take into consideration improvements occurring subsequent to acquisition or construction of the property during the period 1980 to 2006.

From 2002 to 2006, while the City was working to arrive at detailed records for its land and buildings, the City continued to report additions and deletions to the land and building balances in their CAFR based on actual purchases, construction in progress expenses, and the capitalization of construction in progress. When analyzed, the total value for the buildings after the discount adjustment was less than the amount recorded in the fiscal year 2006 CAFR.

Because the land and building balances in the CAFR had undergone audit each year prior to implementation of GASB 34 and since its implementation, the City decided the 2006 CAFR balance was reasonable and therefore there was the need for an adjustment to reflect the difference between the calculated land and building values and CAFR value. To adjust the individual building values in the fixed asset subsidiary ledger to agree with the CAFR, the City applied a formula to allocate the overall difference to the value of each individual building on a weighted average basis.

Unfortunately, the City did not exclude land and buildings acquired and constructed during the period 2002 to 2006, which the City was properly recording. The City applied the weighted average adjustment to all individual land and building values, which resulted in an overall increase in building values and a decrease in land values.

Current Observations

The City did not have records to support the land and building balances recorded in the fiscal year 2002 CAFR, when they initially implemented GASB 34. They also do not have complete records documenting the implementation and valuation process. We understand the lack of records is due in part to the City's adherence to their record retention policy and turnover of Finance Department personnel since the implementation. We believe the differences between the amount the City calculated by discounting the assessed value of land and buildings to arrive at historical cost and the amount recorded in the CAFR were most likely the result of not having records to support improvements that occurred subsequent to acquisition of the property.

Additionally, the City has a decentralized procurement process, allowing individual departments to procure and manage their own capital assets, at least below a set threshold. This decentralization without strong Finance Department oversight increases the risk of errors in the capital asset inventory and the resulting balance recorded for capital assets.

A capital asset system should provide a detailed inventory of individual capital asset items. Capital asset values should generally reflect cost, including improvements, and include the asset's remaining useful life. When historical cost records are not available, entities should determine an alternate means to record capital asset balances that reasonably reflects their current value using a reasonable estimate of their remaining useful life.

For fiscal year 2011, after proposing a $21 million adjustment, the external auditor opined on the fairness of the capital asset balance. However, the auditor did report material weaknesses in the *Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards,* indicating the City's internal control processes were not in place to support the value of buildings and improvements reported on the Statement of Net Assets for governmental activities. The auditor cited the following conditions.

- Significant amounts representing improvements and betterments could not be associated with individual properties.
- No support for the historical cost, or the estimated historical cost of individual buildings.
- No process to identify building impairments that could affect the value of buildings.
- Several existing buildings were not on the list.

We agree with the external auditor's recommendations for the City to strengthen their process for managing the subsidiary ledger detail listing of buildings to ensure the subsidiary ledger properly supports capital asset balances in the financial statements. The internal control process should ensure the subsidiary ledger properly includes all buildings and related improvements, associates improvements with specific buildings, and considers any possible impairments resulting from a significant change in either the use or condition of a building.

Conclusion and Recommendations

Based on the data available, the City did not properly implement GASB 34 with respect to land and buildings. Specifically, the City's methodology did not take into consideration improvements occurring subsequent to the acquisition or construction of the property. In addition, the City's weighted average adjustment to bring the subsidiary ledger balances in agreement with the CAFR appears arbitrary and compromised the value of some assets where the City had actual cost amounts.

Before taking any further actions, the Department of Finance, Richmond City Auditor, and the external auditors need to meet and agree on a plan of action to move forward to prevent duplication of efforts or wasted efforts. Starting with the methodology applied and opined upon as of June 30, 2011, by the external auditor, the parties should agree upon a work plan approach. Otherwise, this matter will continue to remain unresolved.

This agreement should be in writing. When developing a plan of action, we recommend the above parties consider the following recommendations.

1. As part of the plan of action, the City should compile and validate a complete inventory of City owned land and buildings.

2. The parties should review the work of the external auditor to arrive at their adjustment to the City reported amount as buildings in the CAFR. Based on the review of the external auditors support for their adjustment and the results of the inventory noted above, the parties should determine what additional work is necessary to adjust the value of land and buildings taking into consideration coverage over significant properties and properties that the City has recently acquired, constructed, or renovated.

3. If the parties agree, the City should perform additional analysis over remaining land and building balances; the City should determine the assessed value of the properties and adjust the current reported value of each property to this assessed value. We do not believe it is appropriate for the City to discount the assessed value back to original cost as of the acquisition date. This approach ignores any major repairs or renovations since the City does not have records supporting improvements that occurred subsequent to the acquisition or construction of the property. The current assessed value takes into account all renovations bringing the property value to its current book value.

4. The parties involved should also agree on the controls and processes for Finance to implement to properly report and manage capital assets, specifically buildings, in the future.