



Audit Report Number 2005-11  
**City of Richmond**  
**Department of Public Utilities**  
**Capitalization Policy Audit**  
Eighteen Months Ended December 31, 2003

**Prepared by**  
CITY AUDITOR  
Richmond, Virginia

Submitted to  
The Honorable Members of City Council  
May 23, 2005

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The Honorable Members of City Council  
Richmond City Audit Committee  
City of Richmond, Virginia 23219

## **City Auditor's Report**

### **SCOPE**

We conducted an audit of the process for asset capitalization of the Department of Public Utilities, covering the eighteen months ended December 31, 2003. We reviewed and evaluated the internal controls in place during the same period to the extent considered necessary.

### **OBJECTIVES**

Our audit objectives were to:

- Determine whether adequate internal controls over the asset capitalization process existed.
- Ascertain whether the Department properly recorded and reported assets and their related depreciation in accordance with Finance's policies and procedures.
- Ascertain if the Department performed capital asset reconciliations between property records and accounting records.
- Determine if items recorded as capital expenditures were indeed capital items.
- Determine whether the Department properly used the Fixed Asset System to account for capital assets and depreciation in accordance with the City Finance Department's policies and procedures.

We also identified opportunities for improvement in the internal control structure. Our testing did not indicate any internal control weaknesses that would allow material misstatement in the records processed and maintained by the City to go undetected.

## **METHODOLOGY**

We conducted our audit in accordance with Government Auditing Standards for Performance Audits issued by the Comptroller General of the United States. During the course of our work, we reviewed supporting documents, evaluated the internal control structure, and conducted other appropriate tests. We believe that our audit provides a reasonable basis for our conclusions regarding the internal control structure and our recommendations.

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

## **CONCLUSIONS**

Based on the results of our audit, we concluded that:

- Internal controls appeared adequate. However, the Department does not have a written supplemental internal policies and procedures manual to reflect their current practices.
- The Department did not always properly record and report assets in accordance with Finance's policies and procedures.
- The Department did perform capital asset reconciliations.
- The Department did not always properly record and approve items as capital expenditures.
- The Department did properly use the Fixed Asset System to account for capital asset and depreciation. However, the majority of their capital assets are accounted for manually.

We discussed the attached comments and recommendations with management throughout the audit and formally on May 2, 2005. We have included management responses from the responsible officials.

We would like to thank the departmental management and staff for their cooperation and assistance during this audit.

This report is intended for the members of the Richmond City Council, the City Audit Committee and City and departmental management; it is a matter of public record.

Respectfully submitted,

Lance Kronzer, CPA  
City Auditor

Michele Sykes, CGAP  
Auditor II

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Auditor II

April 8, 2005

## Executive Summary

### BACKGROUND

A fixed asset is defined as a unit of tangible property with a useful life of two years or more and a value of \$5,000 or more. An item is considered to be a fixed asset if it falls into the following category:

- building and building improvements
- equipment
- land
- infrastructure
- improvements other than buildings
- vehicles

The capital asset account for the Department of Public Utilities (DPU) is mainly comprised of infrastructure items. Total capital assets at the end of fiscal year 2004 were approximately \$788.5 million.

### RECOMMENDATIONS TO IMPROVE OPERATION OR EFFICIENCY

There were several weaknesses in the DPU process for recording capital assets. In order to improve the capitalization policy function, we have made the following recommendations for management's consideration:

1. **Develop supplemental policies and procedures manual.**
2. **Perform a physical inventory annually.**
3. **Properly record the acquisition date for fixed assets.**
4. **Ensure capital expenditures are properly recorded and approved.**
5. **Improve the authorized signature process for disposals.**



## **FINDINGS AND RECOMMENDATIONS**

### **1. Develop Supplemental Policies and Procedures Manual**

We observed that the City Finance Department's (Finance) policies and procedures dated March 15, 2002, are still in draft form. However, the Department of Public Utilities (DPU) uses Finance's draft policies and procedures in their day-to-day operations. DPU does not have written internal policies and procedures that supplement Finance's existing manual regarding fixed assets.

DPU should develop written supplemental internal policies and procedures that will adequately address the following:

- Assigning salvage value to an asset
- Qualifications an asset must meet in order to be surplus and disposed
- Procedures to record capital expenditures
- Fully depreciated asset procedures
- Notification procedures for suspected loss of assets
- Reconciliation procedures

Written procedures should be available to enhance the effective operation of the department. Written procedures:

- Help ensure management that procedures are being carried out according to its intention;
- Provide guidance whenever a question arises concerning the appropriate way to resolve a problem; and
- Facilitate training of new employees.

### **RECOMMENDATION:**

We recommend that the Department develop written supplemental policies and procedures for fixed assets that reflect current practices as noted above. It should be specific to the Department's operations.

## **MANAGEMENT RESPONSE**

Management agrees that supplemental department policies and procedures are needed. Since the Department of Finance's Capitalization Policy is in draft form at this time, DPU will create departmental policies and procedures to supplement the draft policy. The departmental draft will be completed by August 31, 2005 and finalized within 60 days of receiving the adopted policy from Finance. The Financial Reporting Manager is responsible for creation of this manual.

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### **2. Perform a Physical Inventory Annually**

The Department could not provide evidence that a physical inventory was performed for major movable items. Additionally, the policies and procedures manual does not address physical inventory counts.

As a best business practice, the Department should conduct a physical inventory each year.

If a physical inventory is not performed, the Department cannot ensure that assets are properly accounted for and classified in accounting records. Additionally, physical inventory counts can help prevent theft and misuse of assets.

## **RECOMMENDATION**

We recommend that the Department perform a physical inventory annually for major movable items and make corrections to the asset listing and accounting records based on the inventory results. Additionally, the Department should develop written policies and procedures to address physical inventory for major movable items and include in the supplemental manual.

## **MANAGEMENT RESPONSE**

Management agrees that an annual inventory of major movable items should be taken. Currently DPU inventories vehicles, meters and information technology equipment. We will continue these inventories and include all other major movable equipment effective with the fiscal year ending 6/30/06. Annual inventory reporting will be coordinated through the Financial Operations Division

of DPU and monitored by the Utility Financial Analyst for Property Records. The department supplemental policies and procedures will incorporate these inventories.

\* \* \* \*

### **3. Properly Record Acquisition Dates**

The Department did not always follow policy to properly record the acquisition date of fixed assets. We tested 26 fixed assets and noted the following deficiency:

- 19 of 26 fixed assets' acquisition date in the fixed asset system did not match the received date or completion/in-service date of the work order for the asset.

Rather, DPU used the payment voucher date. The City Finance Department's policy states "The acquisition date is the date the City received the asset not the date of the payment voucher." The risk of not following the Finance policy is that an incorrect acquisition date will overstate or understate the depreciation expense and cause the accounting records to be inaccurate.

### **RECOMMENDATION**

We recommend that (1) the Department remind staff of the City's policy to ensure that the acquisition date is used to properly record fixed assets, and (2) the Fixed Asset Coordinator should review the acquisition date to ensure that the date is correct.

### **MANAGEMENT RESPONSE**

Management agrees with the recommendation. Historically, DPU used the Purchase Voucher (PV) date for acquisition date of assets and the completion report date for Projects. We will continue to use the completion report date for Projects (because the substantial completion report documents the date assets are placed in-service). Effectively immediately we will adopt the Receipt Confirmation (RC) date for other assets (individual item purchases). The Utility Financial Analyst for Fixed Assets will continue to review the dates for accuracy.

\* \* \* \*

#### **4. Ensure Capital Expenditures are Properly Recorded and Approved**

The Department of Public Utilities (DPU) did not always properly record and approve capital expenditures. We tested 61 capital expenditures and noted the following deficiencies:

- 2 expenditures were recorded as capital assets, but were not capital items
- 1 capital expenditure could not be verified due to the lack of supporting documentation
- contrary to City's policy, 2 expenditures for over \$10,000 each were not properly approved

As noted in Recommendation #1, the Department did not have a specific policy to identify the difference between capital expenditures and other expenditures.

#### **RECOMMENDATION**

We recommend that management (1) establish written procedures with guidelines that are specific to DPU to record capital expenditures. It may help to make the policies as specific as possible and provide examples of items that do not qualify as capital assets, and (2) the Department should adhere to the City's policy of a second signature to approve invoices greater than \$10,000 and maintain adequate supporting documentation.

#### **MANAGEMENT RESPONSE**

Management agrees with the recommendation. The DPU will include the auditor's recommendation in its supplemental Capitalization Policy which will be issued by August 31, 2005. The Utility Financial Analyst for Property Records is responsible for creation of the capitalization procedures.

\* \* \* \*

## **5. Improve the Authorized Signature Process for Disposals**

The Department told us it uses an internal form called the Retirement Work Order. The form requires signatures from various levels of management to authorize the disposal of vehicles. The Retirement Work Order form is routed through email to obtain typed signatures from authorized individuals for approval. They have no capability to sign the forms with electronic signatures, which would be password-protected and thus serve as a much better proof of actual authorization.

The form that DPU uses is certainly a better approval mechanism than the Procurement Department's form. However, we believe this method of approval process is inadequate because there is the potential for anyone to type in the approver's name. Additionally, the forms we reviewed did not consistently include all the typed authorized signatures called for.

The risk of not insisting upon authorized signatures is that the asset cannot be protected from misappropriation. The purpose of the signatures, therefore, is to reduce theft or misuse of the DPU's assets.

### **RECOMMENDATION**

We recommend that the Department modify their internal fleet management policy and procedure to improve the authorized signature process by (1) developing an electronic signature process through email that is protected by password or requiring actual signatures/initials (DPU may want to revisit the number of signatures presently required for retiring assets), and (2) incorporating the Retirement Work Order form and the electronic signature process in their internal policies and procedures manual.

### **MANAGEMENT RESPONSE**

Management agrees that authorized signatures are essential for fleet asset retirements. DPU will modify the "project routing form" to include the "Disposition of Notification Form" by August 31, 2005. A second password (in addition to the network logon password) will be added to the retirement work order as additional protection for routing electronic approvals of retirements by May 31, 2005. Changes to the routing and signature process will be included in the DPU supplemental policies and procedures manual by August 31, 2005. The Utility Financial Reporting Manager is responsible for these changes.

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