



City of Chattanooga

INTERNAL AUDIT

City Hall

Chattanooga, Tennessee 37402

Stan Sewell
Director

Ron Littlefield
Mayor

August 9, 2007

Honorable Ron Littlefield
Mayor, City of Chattanooga
City Hall
Chattanooga, TN 37402

RE: Audit Clause, Audit 07-06

Dear Mayor Littlefield:

Attached is the Internal Audit Division's report on Audit Clauses.

We thank the management and staff of the Purchasing and Finance Department for their cooperation and assistance during this audit.

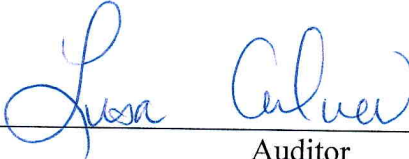
Sincerely,

Stan Sewell, CPA, CGFM
Director of Internal Audit

cc: Dan Johnson, Chief of Staff
Paul Page, General Services Administrator
Daisy Madison, Finance Administrator

**PURCHASING DEPARTMENT
AUDIT CLAUSE
AUDIT 07-06
August 3, 2007**

**PURCHASING DEPARTMENT
AUDIT CLAUSE
AUDIT 07-06
August 3, 2007**



Auditor



Audit Director

**PURCHASING DEPARTMENT
AUDIT CLAUSE
AUDIT 07-06**

INTRODUCTION

The City of Chattanooga routinely enters into agreements and contracts with individuals, not-for-profits, companies, and governmental entities. One function of these agreements and contracts is to protect the City of Chattanooga from loss or other economic harm.

STATEMENT OF OBJECTIVES

This audit was conducted in accordance with the Internal Audit Division's 2007 Audit Agenda. The objectives of this audit were to ensure that:

1. Determine if an audit clause is routinely present in City agreements, and
2. Determine if audit clauses included in City agreements are sufficient.

STATEMENT OF SCOPE

Based on the work performed during the preliminary survey and the assessment of risk, the audit will cover all contracts and grant files located in the Finance Department's centralized contract file.

STATEMENT OF METHODOLOGY

Interviews were made with the Purchasing staff to gain an understanding if and when audit clauses are used in City contracts. A review of Finance's centralized contract file was reviewed to set the sample for review. The sample size and selection were statistically generated using a desired confidence level of 90 percent and expected error rate of 10 percent. Statistical sampling was used in order to infer the conclusions of test work performed on a sample to the population from which it was drawn and to obtain estimates of sampling error involved.

STATEMENT OF AUDITING STANDARDS

We conducted our audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to afford a reasonable basis for our judgments and conclusions regarding the organization, program, activity, or function under audit. An audit also includes assessments of applicable internal controls and compliance with requirements of laws and regulations when necessary to satisfy the audit objectives. We believe that our audit provides a reasonable basis for our conclusions. In addition, we abide by the standards of professional practice established by the Institute of Internal Auditors.

AUDIT CONCLUSIONS

Based upon the test work performed and audit findings noted below, we conclude that:

1. Audit clauses are not routinely present in City agreements.
2. When present, the audit clauses were not standardized and were often insufficient.

AUDIT CLAUSES NOT REQUIRED

During the audit, various documents were reviewed and interviews were made with the Purchasing Department staff and the Director of General services to gain knowledge of the use of audit clauses in the City's contracts. It was determined that audit clauses are not required by City Code or any other city-wide policy. Further, the Purchasing Department does not have a requirement for them in their Terms and Conditions statements that are given to vendors.

RECOMMENDATION 1

As a matter of good business practice the City should be protected by requiring a comprehensive audit clause in all contracts and agreements (including grant agreements). The Purchasing Agent should establish a city-wide policy that requires audit clauses in all contracts and agreements. We would further recommend (as we have in the past) that this policy be included in a complete purchasing manual that is available to all city employees.

AUDITEE RESPONSE

We concur. The Purchasing Department is currently developing a city-wide purchasing policy manual. We will ensure that the policies require an audit clause in all formal, written contracts and agreements. We will immediately begin including an audit clause in all contracts processed by the Purchasing Department. We also support your recommendation that the City have a right to audit any organization receiving a grant or donation. Because the Purchasing Department does not administer the grant process, we would recommend the Finance Department implement policies to ensure written agreements with audit clauses are present for all not-for-profit entities receiving city funds.

AUDIT CLAUSES NOT SUFFICIENT

During the review of the City's contracts it was found that only 22% (twenty-two percent) contained audit clauses. Furthermore, one half of the contracts containing an audit clause were deficient in one or more of the following areas:

- A requirement that records be maintained in accordance with appropriate accounting principles and procedures;
- A requirement that records be retained for a minimum and sufficient time period;
- A requirement that the City have access to all records that may be needed.

RECOMMENDATION 2

The policy established by the Purchasing Agent should require a standardized audit clause that is comprehensive to allow oversight of contracted activities. The audit clause should include the elements noted in the attached "Audit Provisions."

AUDITEE RESPONSE

We concur. The Purchasing Department will make available to all departments, a standardized audit clause, similar to the attached example.

AUDIT CLAUSE (example)

The term “<Contractor>” is used in the sample section below to describe signatories to contracts, grants, and agreements with the City and must be changed to accurately reflect the relationship with the City (Contractor, Licensee, Supplier, Vendor, Consultant, Grant Recipient, etc.).

Audit Provisions

1. The City or its assign may audit all financial and related records (including digital) associated with the terms of the contract or agreement including timesheets, reimbursable out of pocket expenses, materials, goods, and equipment claimed by the <Contractor>. The City may further audit any <contractor> records to conduct performance audits (to identify waste and abuse or to determine efficiency and effectiveness of the contract or agreement) or to identify conflicts of interest.
2. The <Contractor> shall at all times during the term of the contract or agreement and for a period of five years after the end of the contract, keep and maintain records of the work performed pursuant to this Contract or Agreement. This shall include proper records of quotations, contracts, correspondence, invoices, vouchers, timesheets, and other documents that support actions taken by the <Contractor>. Documents shall be maintained by the <Contractor> necessary to clearly reflect all work and actions taken. All such records shall be maintained in accordance with generally accepted accounting principles. The <Contractor> shall at its own expense make such records available for inspection and audit (including copies and extracts of records as required) by the City at all reasonable times and without prior notice.
3. The obligations of this Section shall be explicitly included in any subcontracts or agreements formed between the <Contractor> and any subcontractors or suppliers of goods or services to the extent that those subcontracts or agreements relate to fulfilment of the <Contractor>'s obligations to the City.
4. Costs of any audits conducted under the authority of this section and not addressed elsewhere will be borne by the City unless the audit identifies significant findings that would benefit the City. The <Contractor> shall reimburse the City for the total costs of an audit that identifies significant findings that would benefit the City.
5. This Section shall not be construed to limit, revoke, or abridge any other rights, powers, or obligations relating to audit which the City may have by Federal, State, or Municipal law, whether those rights, powers, or obligations are express or implied.