



City of Chattanooga

Stan Sewell
Director

INTERNAL AUDIT
City Hall
Chattanooga, Tennessee 37402

Ron Littlefield
Mayor

April 3, 2009

Mayor and City Council
City of Chattanooga
City Hall
Chattanooga, TN 37402

RE: Capital Assets Policy Audit, 09-02

Dear Mayor Littlefield and City Council Members:

Attached is the Internal Audit Division's report on Capital Assets Policy.

We thank the management and staff of the Accounting department for their cooperation and assistance during this audit.

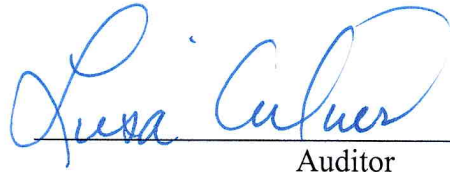
Sincerely,

Stan Sewell, CPA, CGFM
Director of Internal Audit

cc: ___ Dan Johnson, Chief of Staff
Daisy Madison, Finance Administrator

**FINANCE
CAPTIAL ASSETS POLICY
AUDIT 09-02
MARCH 3, 2009**

**FINANCE
CAPITAL ASSETS POLICY
AUDIT 09-02
MARCH 3, 2009**

A handwritten signature in blue ink, appearing to read "Lisa Culver", written over a horizontal line.

Auditor

A stylized handwritten signature in blue ink, written over a horizontal line.

Audit Director

**FINANCE
CAPITAL ASSETS POLICY
AUDIT 09-02
MARCH 3, 2009**

INTRODUCTION

At the end of fiscal year 2007, the City had \$2.2 billion (net of accumulated depreciation) invested in capital assets. This investment includes land, buildings, utility system improvements, machinery and equipment, park facilities and infrastructure. The City records capital assets at historical cost and donated capital assets are recorded at their estimated fair market value on the date acquired. The City defines capital assets with an initial, individual cost of \$5000 or more (\$25,000 for infrastructure) and an estimated useful life of three years or more. Additions, improvements and other capital outlays that would significantly extend the useful life of an asset are capitalized.

City Code Section 2-5 assigns the supervisory responsibility of inventory management to the City Finance Officer. City Code Section 2-505 states the method of installing and keeping all financial records of the City shall be prescribed by the City Finance Officer who shall establish the City accounting procedures in such a way that accounts will show all transactions affecting the acquisition, custody, and disposition of assets. Title 1, Chapter 4, Section 2 of the Internal Control and Compliance Manual for Tennessee Municipalities requires all fixed assets be tagged and that an annual inventory be performed.

STATISTICS

The following figures are from the City's Comprehensive Annual Financial Report for Year Ended June 30, 2007. The totals represent the City's capital assets from both the governmental activities and business-type activities.

	2007	2006
Non-Depreciable:		
Land & Easements	\$1,014,095	\$1,003,072
Work in Progress	\$ 42,886	\$ 70,364
Depreciable:		
Buildings	\$ 211,446	\$ 173,882
Equipment	\$ 273,517	\$ 257,644
Improvements	\$ 8,754	\$ 7,987
Infrastructure	\$ 663,716	\$ 679,651
Total	\$2,214,414	\$2,192,600

(Net of depreciation, in thousands of dollars)

STATEMENT OF OBJECTIVES

This audit was conducted in accordance with the Internal Audit Division's 2009 Audit Agenda. The objectives of this audit were to determine if:

1. The Capital Asset Policy and Procedures Manual is adequate.
2. The Capital Asset Policy and Procedures Manual is being adhered to.

STATEMENT OF SCOPE

Based on the work performed during the preliminary survey and the assessment of risk, the audit period will cover the operations and procedures related to the Finance department's capital assets policy from June 30, 2008 to current. The scope was expanded when necessary to meet the objectives of the audit.

STATEMENT OF METHODOLOGY

During the audit, Accounting staff were interviewed about the capital assets policy and process. We reviewed applicable State and City regulations concerning capital assets as well as the City's Capital Asset Policy and other related policies and documents. A judgmental sample of fixed assets was pulled from original documentation, as well as from the fixed assets register and verified in the field. Some departmental employees were interviewed about their responsibilities concerning the capital assets policy and procedures. Source documentation was obtained from the Accounting department. Original records as well as copies were used as evidence and verified through physical examination.

STATEMENT OF AUDITING STANDARDS

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

1. The Capital Asset Policy and Procedures Manual could be strengthened.
2. The Capital Asset Policy and Procedures Manual is not being fully adhered to.

While the findings discussed below may not, individually or in the aggregate, significantly impair the operation of the Accounting department, they do present risks that can be more effectively controlled.

AN ANNUAL INVENTORY IS NOT CONDUCTED FOR CAPITAL ASSETS

The City's capital assets total approximately \$2.2 billion dollars (net of accumulated depreciation). Since capital assets are a large investment there are specific requirements for the safeguarding of these assets. The Internal Control and Compliance Manual for TN Municipalities and the Capital Asset Policy both require an annual inventory be conducted. Specifically, the City's Policy and Procedures Guide for Capital Assets assigns responsibility of an annual inventory to the Accounting Division. Conducting an annual inventory provides an accurate accounting of current assets and requires the owners to safeguard and monitor their assets in hopes of deterring theft, waste, and abuse of the fixed assets. Based upon discussions with accounting staff, an inventory of capital assets has not been conducted in several years.

RECOMMENDATION 1

We recommend that the Finance Department perform and/or oversee a physical inventory annually, make corrections to the fixed asset listing and accounting records based on the inventory results, and investigate any missing assets.

AUDITEE RESPONSE

The City's current Capital Asset Policy and Procedures addresses the procedures to be followed with respect to the annual physical inventory. We will make sure these procedures are adhered to in the future to ensure the city's capital assets are properly accounted for.

LACK OF DETAIL IN FIXED ASSET INFORMATION

The Policy and Procedures Guide for Capital Assets requires the capital asset record to contain the description, manufacturer, model number, serial number, etc. During the review of selected assets, some invoices and/or purchase orders/requisitions did not always contain all the required asset information. The general review of the fixed asset listing indicates an inconsistent use of the record fields and a lack of information keyed into the required record fields. Therefore, assets can't be identified, tracked or monitored due to the lack of information entered into the fixed asset listing.

RECOMMENDATION 2

We recommend that the Finance Department include in the written policies and procedures a requirement that when pay documents are submitted for payment of fixed assets they must contain the required descriptive information before they will be processed. Also, a periodic review of the data entered into the fixed asset listing should be done at the supervisory level by the Accounting Division.

AUDITEE RESPONSE

Payment documents generally do contain all the required descriptive information. However, we will expand our asset policy to provide that all required information be submitted to ensure the asset is properly identified.

Fixed asset records will be reviewed by senior staff on a routine basis. Training will be provided to make sure the information is properly and consistently entered into the data fields.

ASSETS NOT BEING TAGGED

Both the Internal Control and Compliance Manual for Tennessee Municipalities and the City's Policy and Procedures Guide for Capital Assets require each Department to apply capital asset identification tags to the appropriate assets. During the audit, we observed that assets were not always being tagged with a fixed asset sticker. The Finance Department issues the asset tags to the various Departments. However, the information sheet attached to the asset tag sometimes lacks enough information for the Department to determine the corresponding asset. In some cases, the department staff indicated they do not attach the tags because they are not durable enough to withstand long-term exposure to weather conditions. Further, the Finance department has not conducted annual physical inventories and has therefore failed to identify a systemic problem exists with regards to this issue.

RECOMMENDATION 3

We recommend that all the required information be entered into the fixed asset list and the detail information be distributed along with the corresponding asset tag. In addition, we recommend the Finance Department determine if the fixed asset sticker currently being used should be replaced with a more durable, tamperproof and weather resistant sticker. Also, we recommend that the Finance Department do random periodic checks on the assets to verify that asset tags are being applied by the Departments.

AUDITEE RESPONSE

All required information as outlined in the policy will be entered into the fixed asset system. Information distributed along with the asset tag will be more descriptive in order to adequately identify the related asset.

We will examine the tags currently in use for possible alternatives. Random periodic checks to verify tag placement will be conducted as staffing permits.

RECEIPT/POSSESSION NOT DOCUMENTED

The Internal Control and Compliance Manual for Tennessee Municipalities, as well as general accounting principles require a receiving report be matched to other supporting documentation (purchase order and invoice) prior to payment. This is typically referred to as a “three way match.”

During the review of selected fixed assets, we noted a signed and dated receiving report was not always included in the payment documentation. Without proper internal controls, the City may pay for assets that were never received or lack the necessary audit trail to determine the responsible custodian for missing assets.

RECOMMENDATION 4

We recommend that the Finance Department include in the written policies and procedures a requirement that the Departments submit a signed and dated receiving report along with all other documents. This may be accomplished by the employee receiving the item signing the packing slip, bill of lading, invoice or any other identifying document with the indication “received by.”

AUDITEE RESPONSE

We will continue to review possible ways to strengthen the 3-way match process.

COMPREHENSIVE POLICY REVIEW NEEDED

The Policy and Procedures Guide for Capital Assets was developed in September 2002. Per Section 1 of the policy, the Accounting Division is required to annually evaluate and modify the procedures in the manual. Based upon our discussions with personnel, we learned the Policy has not been reviewed or updated since inception. Further, staff stated the Capital Asset Policy manual is not used as a governing guide in their job duties associated with the capital asset process. It was developed to comply with new fixed asset requirements in GASB but never actually implemented.

After reviewing the current policy, we noted the following issues that should be addressed or need more clarification or detail in the policy manual:

- Departmental requirement to include a signed receiving report (signed by the employee that took possession of the asset) with the payment documentation.
- An Accounting Department requirement for a random physical periodic check to verify asset tags have been affixed to the assets.
- A set of detailed instructions on reporting lost, stolen, damaged assets and the removal process for these items.
- Clarification on the instructions for non-tagable assets.
- Redefine acquisition date to match current practice (assuming there is no material impact on financial reporting) or change the current practice to match the policy.

In addition, the Accounting Division's current practices are not always consistent with the written Policy and Procedure Guide for Capital Assets. For example, the policy requires an email notification for disposals but the City's intranet has a disposal form that is not mentioned in the written policy. Also, the written policy states the City does not capitalize telecommunication systems but the 2008 CAFR indicates telecommunications are to be capitalized and depreciated over 5 to 40 years. Further, we noted several separate policies and/or procedures related to the capital asset management process that are not incorporated in the current policy guide.

RECOMMENDATION 5

We recommend the Finance Department update their Capital Asset Policy based upon a comprehensive review of their entire process for capital asset management. We further recommend including the issues addressed above in the updated policy manual. Once the manual is updated, we recommend that training be provided to all Department employees who may use this information in their daily job. We further recommend the Accounting Division perform an annual review of the Capital Asset Policy Manual and update as necessary in the future.

AUDITEE RESPONSE

A comprehensive review of the Capital Asset Policy will be performed to ensure the City's capital assets are properly safeguarded and accounted for. We will make sure staff is properly trained to facilitate compliance with policy. This policy will be reviewed on an annual basis.