

**Performance Audit 20-03:  
Capital Assets Management**

**December 2020**

**City Auditor**

Stan Sewell, CPA, CGFM, CFE

**Senior Auditor**

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# OFFICE OF INTERNAL AUDIT

Stan Sewell, City Auditor

December 15, 2020

To: Mayor Andy Berke  
City Council Members

Subject: Capital Assets Management (Report #20-03)

Dear Mayor Berke and City Council Members:

The attached report contains the results of our audit of capital assets management. Our audit found the Finance Department has controls, including policy and procedures for capital assets, and conducts physical inventories of capital assets. However, we also found there is value in exploring opportunities for improvement.

In order to address the noted areas for improvement, we recommended actions to update policies and procedures, as well as comply with guidance and practice reoccurring training for department liaisons.

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

Sincerely,

Stan Sewell, CPA, CGFM, CFE  
City Auditor

Attachment

cc: Audit Committee Members  
Jim Arnette, Tennessee Local Government Audit  
Kerry Hayes, Chief of Staff  
Maura Sullivan, Chief Operating Officer  
Daisy Madison, Chief Financial Officer  
Tanikia Jackson, Deputy Chief Financial Officer

## TABLE OF CONTENTS

AUDIT PURPOSE.....	2
BACKGROUND .....	2
FINANCIAL INFORMATION .....	3
FINDINGS AND RECOMMENDATIONS.....	3
Review and update policies & procedures guide for capital assets....	3
The capital asset process did not comply with written guidelines ..	4
Quarterly physical inventory is required.....	4
Purchased assets were not capitalized. ....	5
Inaccurate reporting of capital assets. ....	5
APPENDIX A: SCOPE, METHODOLOGY AND STANDARDS	7

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## AUDIT PURPOSE

This audit was conducted in accordance with the Office of Internal Audit's 2020 Audit Agenda. The objectives of this audit were to determine if the policy and procedures guide is adequate and being adhered to.

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## BACKGROUND

Generally, capital assets are the largest asset of a local government. The term capital assets, also known as fixed assets, describes assets that are used in operations and have useful lives extending beyond a single reporting period. These assets include major government facilities, infrastructure (such as roads, bridges, sidewalks, sewers, lights drainage, etc.), equipment and networks that enable the delivery of public sector services. The performance and continued use of these assets is essential to the health, safety, economic development and quality of life of those receiving services.<sup>1</sup>

The City defines capital assets as assets with an initial, individual cost of more than \$5,000 (\$15,000 for software and \$25,000 for infrastructure) and an estimated useful life of three years or greater. Donated capital assets, donated works of art and similar items are reported at their estimated fair market value at the date of the contribution.

The initial capitalization of infrastructure assets reported by governmental activities was based on replacement cost deflated to the acquisition year. As the City constructs or acquires additional assets each year, including infrastructure, they are capitalized and reported at historical cost.

Land and construction in progress are not depreciated. Other property, plant and equipment, and infrastructure of the primary government are depreciated using the straight-line method over their estimated useful lives.<sup>2</sup>

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<sup>1</sup> Government Finance Officers Association, Best Practice, Capital Asset Management, [www.gfoa.org/capital-asset-management](http://www.gfoa.org/capital-asset-management) .

<sup>2</sup> City of Chattanooga FY2019 Comprehensive Annual Financial Report (CAFR), Page A-23, Note 1. Summary of Significant Accounting Policies, Capital Assets.

## Financial Information

In fiscal years ending 2018, 2019 and 2020, the total capital assets (net of depreciation) for the primary government were \$1,474,616,841, \$1,490,673,886 and \$1,494,459,266.

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## FINDINGS AND RECOMMENDATIONS

### Review and update policies & procedures guide for capital assets.

Policy and procedures are living documents that should be updated periodically as needed. The core elements will remain the same, but the details will change as required based on evolving best practices and the organization. Policy and procedures review and revision are an important part of effective management.

The *Policies & Procedures Guide for Capital Assets* was last updated June 2013. Section 2 of the policy states, “Finance will review and update policy and procedures as necessary”. Regularly reviewing policies and procedures keeps the City up to date with regulations, technology, and best practices. Additionally, periodic reviews ensure that policies and procedures remain consistent and effective.

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

- The policy refers to SME (Sensitive Minor Equipment), which has a separate policies and procedures guide. However, the capital assets policy does not define or explain SME.
- Computer software is included under equipment in the policy without further explanation. It appears the intent is to separately account for software that is commercial off the shelf (COTS) versus internally developed software.
- The policy does not address assets purchased with grant funds, which could have differing capitalization thresholds or special disposal restrictions. In addition, donated assets may also have disposal restrictions.
- There are outdated references to the City’s Purchasing Manual.
- The policy does not sufficiently cover assets that have been cannibalized, lost, stolen or destroyed, which can be handled on a disposal form.
- The policies and procedures related to physical inventories are minimal. Expectations should be enumerated.
- The policies and procedures do not include any requirements for the assessment of condition of the assets.

A similar finding was reported in a previous audit (Capital Assets Policy Audit 09-02 dated April 3, 2009). The policy and procedures guide was updated in 2013, subsequent to the 2009 audit.

**Recommendation 1:**

We recommend the Finance Department update their *Policies & Procedures Guide for Capital Assets* after reviewing their process for fixed assets management. Training should be provided after the guide is updated.

**Auditee Response:** *We concur with the audit finding and recommendation.*

**Recommendation 2:**

We recommend the *Policies & Procedures Guide for Capital Assets* be reviewed and updated at least annually.

**Auditee Response:** *We concur with the audit finding and recommendation.*

**The capital asset process did not comply with written guidelines.**

**Quarterly physical inventory is required.**

Generally, capital assets are the largest asset category on the statement of net position of a local government. They are used in the operations of the local government and have an initial useful life beyond one reporting period. It is important to maintain an effective inventory system to mitigate the loss or misuse of capital assets.

Section 6 (Physical Inventory) of the *Policy and Procedures Guide for Capital Assets* states, “Quarterly, a physical inventory of capital assets will be conducted under the direction of the Finance Division and the department capital asset liaisons.” It further states, accounted for assets should be checked off the report, assets found but not on the report should be noted, assets that no longer exist should be noted, and untagged assets that are found should be noted.

We made inquiries of the capital asset liaisons and determined quarterly physical inventories are not consistently performed. Additionally, we found capital asset liaisons are not regularly provided a listing of capital assets for which they are responsible.

Non-compliance with written guidance increases the risk of errors and ultimately the risk that capital asset information in the City’s accounting system is not accurate or complete.

A similar finding was reported in a previous audit (Capital Assets Policy Audit 09-02 dated April 3, 2009).

**Recommendation 3:**

We recommend the Finance Department comply with their *Policies & Procedures Guide for Capital Assets* in regard to the frequency and completeness of physical inventories.

*Auditee Response: We concur with the audit finding and recommendation.*

**Purchased assets were not capitalized.**

Section 3 (Capitalization Procedures) of the *Policy and Procedures Guide for Capital Assets* states, “It is the responsibility of the Finance Division to prepare capital asset records based on accounts payable documentation and information received from the departments. Immediately upon acquisition of a new capital asset, the Department liaison should complete the *City of Chattanooga Fixed Asset Information Sheet for New Fixed Assets* and send electronically to Finance and via interoffice mail.”

We found purchases that exceeded the capitalization threshold but were not added to the capital assets inventory and tagged as required, due to incorrect coding in the accounting system. Failure to properly capitalize assets will result in lower total assets reported on the statement of net position, and assets will not be tracked and depreciated as required.

A similar finding was reported in a previous audit (Bike Chattanooga Contract Audit 19-04 dated December 18, 2019).

**Recommendation 4:**

We recommend reoccurring training for department liaisons and staff involved in the approval process to ensure they understand the capital asset purchase process, including proper account coding.

*Auditee Response: We concur with the audit finding and recommendation.*

**Inaccurate reporting of capital assets**

Section 2 (Property Control Responsibilities) of the *Policy and Procedures Guide for Capital Assets* states, “Each Department is responsible for properly safeguarding and accounting for fixed assets for which they are assigned.” It further states, “The Finance Division is responsible for maintaining a centralized accounting for all of the capital assets information.”

We found the City's capital asset list had inaccuracies and issues such as:

- Insufficient detail,
- Poor asset descriptions,
- Asset impairment, and
- Assets not being found.

Inaccurate reporting of capital assets may lead to over or understatement of cost, improper safeguarding which may result in theft, misappropriation or unauthorized use, and improper confirmation that the asset actually exists.

**Recommendation 5:**

We recommend the Finance Department develop a plan of action for a detailed inventory count that will instruct personnel to detect and correct errors.<sup>3</sup> The Finance Department should ensure physical counts are executed in accordance with the Policy & Procedures Guide for Capital Assets. (See Recommendation Number 3)

***Auditee Response:** We concur with the audit finding and recommendation. The Policies and Procedures will be updated to include instructions such as how to verify the locations as well as the descriptive information of the assets found within the inventory list are correct.*

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<sup>3</sup> During November 2020, the Finance Department commenced a detailed inventory count of capital assets.



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## **APPENDIX A: SCOPE, METHODOLOGY AND STANDARDS**

Based on the work performed during the preliminary survey and the assessment of risk, the audit covers capital asset management from July 1, 2019 to June 30, 2020. When appropriate, the scope was expanded to meet the audit objectives. Source documentation was obtained from the Finance Department. Original records, as well as copies, were used as evidence and verified through physical examination.

To evaluate the efficiency of capital asset management, we reviewed and assessed the adequacy of the policies and procedures. We also contacted accounting staff and department liaisons to determine compliance with policies and procedures. In addition, we physically verified a sample of capital assets. Additionally, we reviewed capital asset records to identify purchases that should have been capitalized.

To develop our recommendations, we reviewed industry best practice documents. We also reviewed similar capital asset audit reports from comparable municipalities.

The sample size and selection were statistically generated using a desired confidence level of 90 percent, expected error rate of 5 percent, and a desired precision of 5 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. When appropriate, judgmental sampling was used to improve the overall efficiency of the audit.

To achieve the audit's objectives, reliance was placed on data contained in the Oracle E-Business Suite. The reliability of the data contained in the system had been previously assessed and tested for other performance audits. Based on these assessments and tests, we concluded the data was sufficiently reliable to be used in meeting the audit's objectives.

We conducted this performance audit from April 2020 to November 30, 2020 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.

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