



Office of the Inspector General

Audit Report

To the Vice President and
Controller

REVIEW OF CONTROLS OVER DEPRECIATION EXPENSE AND ACCUMULATED DEPRECIATION

Senior Auditor
Thomas M. Blair

Audit 2005-023F
June 13, 2005



Memorandum from the Office of the Inspector General

June 13, 2005

Randy P. Trusley, WT 5C-K

**REQUEST FOR MANAGEMENT DECISION – AUDIT 2005-023F – REVIEW OF CONTROLS
OVER DEPRECIATION EXPENSE AND ACCUMULATED DEPRECIATION**

Attached is the subject final report for your review and management decision. You are responsible for determining the necessary actions to take in response to our findings. Please advise us of your management decision within 60 days of the date of this report.

Information contained in this report may be subject to public disclosure. Please advise us of any sensitive information in this report that you recommend be withheld.

If you have any questions, please contact Mike Blair, Senior Auditor, at (865) 632-6056 or Louise B. Beck, Manager, Financial and Operational Audits, at (865) 632-2622. We appreciate the courtesy and cooperation received from your staff during this review.

Ben R. Wagner
Assistant Inspector General
(Audits and Inspections)
ET 3C-K

TMB:JP

Attachment

cc (Attachment):

Tom D. Kilgore, ET 12A-K
Richard W. Moore, ET 4C-K
Ellen Robinson, ET 12A-K
OIG File No. 2005-023F

SYNOPSIS

We conducted an audit to assess Tennessee Valley Authority's (TVA) controls for calculating and recording depreciation expense as documented in the Accounting Policy and Procedures and Risk Control Tracking System (RCTS). Our audit included the controls in place as of February 28, 2005. During the first five months of fiscal year 2005 (October 1, 2004–February 28, 2005), TVA recorded depreciation expense in the amount of \$445.1 million, resulting in a balance in accumulated depreciation to date of \$13.9 billion.

In summary, we determined the depreciation policy and procedures do not accurately reflect (1) the control activities described in RCTS and (2) the current management practice. Specifically, management's review and approval of the following key control activities are not documented:

- Revised utilization rates encoded into the Oracle Asset (Oracle) system.
- Employee review and sample testing of the monthly depreciation expense.
- Reconciliation of the monthly expense to the general ledger.
- Creation and posting of journal vouchers.

BACKGROUND

TVA's Fixed Assets group resides within the Chief Financial Officer's organization and is responsible for the calculation and recording of the depreciation expense. Depreciation is recorded monthly and is calculated using the pooling method where similar types of assets are aggregated and an asset utilization rate is applied to the group. The utilization rate is based upon the estimated useful life of the asset type comprising the group.

Fixed Assets reviews the reasonableness of the utilization rate(s) at least annually. If a rate adjustment is indicated, the proposed adjustment is submitted to the senior manager of Accounting and Performance Reporting for review and approval. The approved rate adjustment is encoded into Oracle by an accountant in the Fixed Assets group. An Asset Category report is generated and reviewed by the accountant and the manager of Fixed Assets.

During the month, completed projects are removed from Construction Work In Progress and added to the appropriate Completed Plant asset classification. In addition, any asset retirements are removed from the Completed Plant asset base. Oracle then generates the monthly depreciation expense amounts based upon the asset base and the rate assigned to the asset classification. Using the amounts generated by Oracle, Fixed Assets generates journal vouchers which are posted into TVA's general ledger system, Integrated Business System (IBS).

An accountant in Fixed Assets verifies the monthly recording of depreciation by manually recalculating depreciation expense on a sample of asset types.

OBJECTIVE, SCOPE, AND METHODOLOGY

The objective of our audit was to assess the controls for calculating and recording depreciation expense as documented in the Accounting Policy and Procedures and RCTS. Our audit addressed the depreciation controls included in the RCTS as of February 28, 2005. To complete our audit, we obtained an understanding of the financial reporting controls and processes relating to depreciation by:

- Accessing RCTS to obtain all the related information/documentation for the depreciation subprocess including the Depreciation Accounting Policy and Procedure.
- Interviewing Fixed Assets personnel and other controller personnel to gain an understanding of the subprocess and obtain additional control documentation.
- Documenting in narrative and flowcharts the subprocess using information obtained.
- Conducting a walkthrough of the subprocess with Fixed Assets to (1) confirm our understanding of the process and key control activities, (2) identify areas where subprocess and/or control documentation needs to be prepared or revised, (3) determine if documentation agrees with actual practices, and (4) identify any additional key control activities necessary to achieve the control objective.
- Assessing the control design and documentation.

This audit was performed in accordance with generally accepted government auditing standards. Although we did not test for compliance with laws and regulations, nothing came to our attention during the audit that indicated noncompliance with laws and regulations.

FINDINGS AND RECOMMENDATIONS

The appendix summarizes the results of our review and related recommendations.

Risk: Unauthorized charges are transacted resulting in incorrect depreciation expense and accumulated depreciation.

Control Objective: All depreciation expenses are accurately calculated and recorded.

No.	Control Activities	Findings	Recommendation
1.	Depreciation rates and methods of calculation are reviewed periodically to ensure that they are reasonable and in accordance with generally accepted accounting principles and/or regulatory requirements.	Rates are reviewed on an annual basis. However, operating organizations can request a rate review at any point during the year. Changes of the rates are approved by the senior manager of Accounting and Performance Reporting. Fixed Assets personnel enter new rates into Oracle Asset (Oracle). An Asset Category report is then generated listing all current rates, and the report is reviewed by Fixed Assets management. No documentation of review approval is noted on the report after input of rates, and the approval process is not addressed in the Depreciation policy.	<p>Manager of Fixed Assets should document indication of the review and approval at the completion of the encoding of the revised rates.</p> <p>Review and approval process should be documented in the Depreciation policy.</p>
2.	Depreciation exception items (in terms of expectations established by management) are consistently identified, monitored, and promptly corrected.	Fixed Assets personnel review the monthly projected work order closings to determine which projects should have been closed by the end of the month and the related asset(s) to be retired. In some cases, communication with the operating organization is required to determine if the work order should (should not) be closed.	None
3.	Depreciation calculations are performed electronically using approved depreciation rates.	Utilization rates are entered into Oracle. The monthly depreciation expense is calculated in Oracle Script based upon information retrieved from Oracle (Asset Base and utilization rate).	None
4.	Depreciation is independently recalculated annually on a sample basis.	<p>On a monthly basis, Fixed Assets personnel review the total depreciation expense calculation and on sample basis recalculate the expenses by utilization rate.</p> <p>No indication of management oversight is noted on the documentation, and the approval process is not addressed in the Depreciation policy.</p>	<p>Manager of Fixed Assets should document indication of the review and approval of the recalculation of the depreciation expense.</p> <p>Review and approval process should be documented in the Depreciation policy.</p>

Risk: Unauthorized charges are transacted resulting in incorrect depreciation expense and accumulated depreciation.

Control Objective: All depreciation expenses are accurately calculated and recorded.

No.	Control Activities	Findings	Recommendation
5.	The balances in fixed asset and accumulated depreciation are rolled forward from one processing cycle to the next and reconciled to the general ledger.	The previous month's accumulated depreciation is rolled forward. Oracle calculates the current monthly depreciation expense which is added to the prior month's accumulated depreciation balance. Monthly, the Fixed Assets personnel reconcile the depreciation expense to the general ledger. No indication of management oversight is noted on the documentation, and the approval process is not addressed in the Depreciation policy.	<p>Manager of Fixed Assets should document indication of the review and approval of the reconciliation.</p> <p>Review and approval process should be documented in the Depreciation policy.</p>
6.	Depreciation charges are reviewed by management including consideration of the recording of such charges in the appropriate accounting period.	On a monthly basis, the manager of Fixed Assets reviews the current month journal vouchers and IBS depreciation expenses. The manager does not indicate any review/approval signature on the documentation, and the approval process is not addressed in the Depreciation policy.	<p>Manager of Fixed Assets should document indication of the review and approval of the current month's journal vouchers and Integrated Business System (IBS) depreciation expenses.</p> <p>Review and approval process should be documented in the Depreciation policy.</p>
7.	Fixed Assets personnel ensure correcting adjustments are made to depreciation expense when the project is actually recorded in the fixed asset database in a different month/fiscal year than the project was placed in-service.	Every asset has a date in service (DIS). The DIS is provided by the operating organization. In some cases, the effective DIS is in a previous period. Fixed Assets personnel enter the DIS into Oracle. Oracle incorporates the asset into the asset category base and calculates an adjusted depreciation expense for the effective DIS.	None