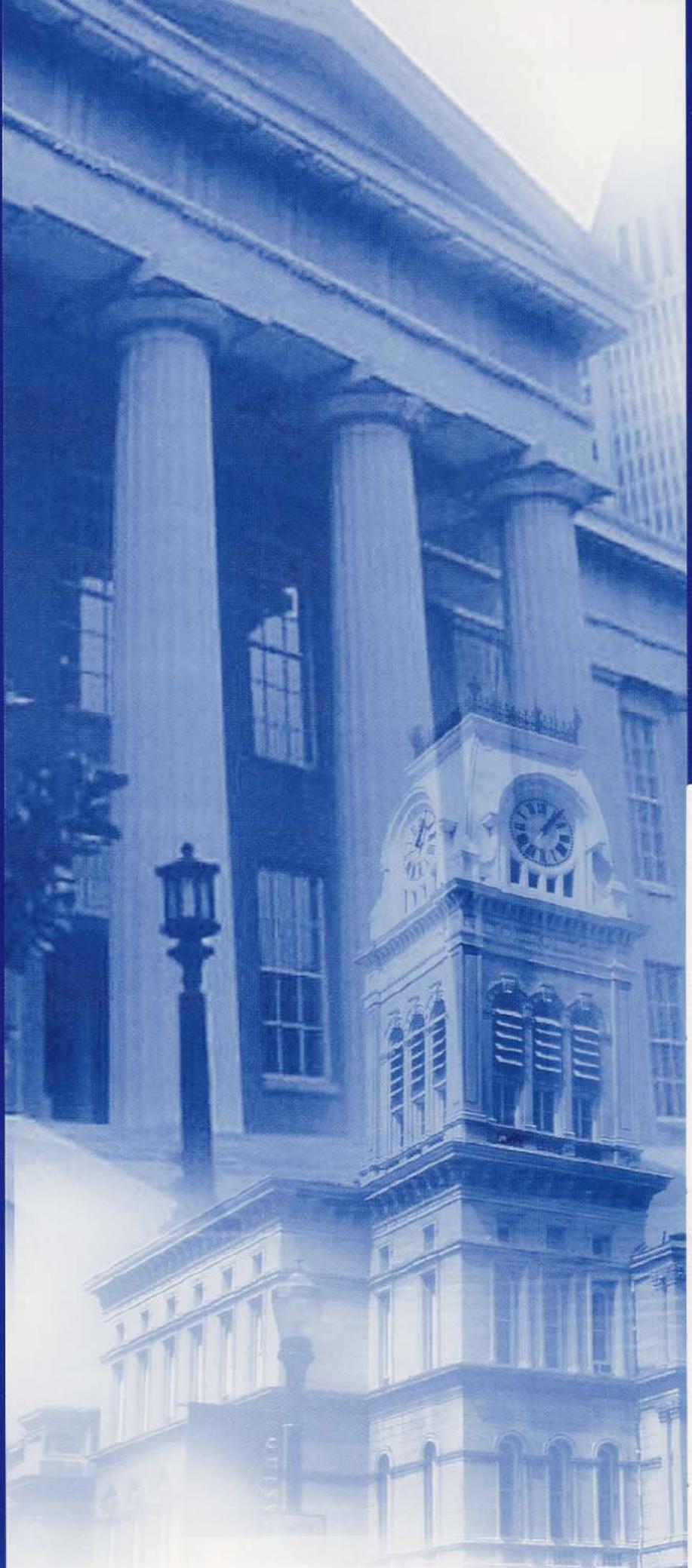




Jerry E. Abramson
Mayor

26 Member
Metro Council

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Office of Internal Audit

Report

Office of Internal Audit

Office for Business Services

Industrial Revenue Bonds

April 2003



Office for Business
Services

Industrial Revenue
Bonds

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LOUISVILLE, KENTUCKY
OFFICE OF INTERNAL AUDIT

JERRY E. ABRAMSON
MAYOR

RON WESTON
PRESIDENT, METRO COUNCIL

Transmittal Letter

April 28, 2003

The Honorable Jerry E. Abramson
Mayor of Louisville Metro
Louisville Metro Hall

Re: Attached Audit of the Office for Business Services Industrial Revenue Bonds

Scope and Opinion

We have examined the operating records and procedures of the Industrial Revenue Bond (IRB) activity administered by the Louisville-Jefferson County Office for Business Services (OBS). The primary focus of the audit was to review the operational and fiscal administration of the revenues and how OBS processes, records, and monitors the activity.

As a part of our examination, we performed an evaluation of the internal control structure. Our examination was conducted in accordance with Generally Accepted Government Auditing Standards (1994 Revision), issued by the Comptroller General of the United States; with the Standards for the Professional Practice of Internal Auditing issued by the Institute of Internal Auditors; and Generally Accepted Auditing Standards to the extent we considered necessary to evaluate the system.

The objective of internal control is to provide reasonable, but not absolute, assurance regarding the achievement of objectives in the following categories:

- Effectiveness and efficiency of operations
- Reliability of financial reporting
- Compliance with applicable laws and regulations
- Safeguarding of assets

There are inherent limitations in any system of internal control. Errors may result from misunderstanding of instructions, mistakes of judgment, carelessness, or other personnel factors. Some controls may be circumvented by collusion. Similarly, management may circumvent control procedures by administrative oversight.

The operating procedures of the Louisville-Jefferson County Office for Business Services Industrial Revenue Bonds were reviewed through interviews with key personnel. The operational and fiscal administration of activity was reviewed. The following specific topic was included:

- Bond Processing

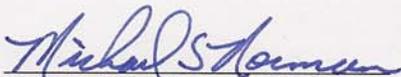
The scope and methodology of the areas reviewed will be addressed in the Observations and Recommendations section of this report. Our examination would not reveal all weaknesses because it was based on selective review of data.

The internal control rating for each area reviewed is on page 4. These ratings quantify our opinion regarding the internal controls used in managing the activity and identify areas requiring corrective action.

It is our opinion that the overall internal control structure for Industrial Revenue Bonds is inadequate. There were some major problems noted that indicate the internal control structure is not effective. Examples of these include the following.

- Deposits are not made in accordance with established policies and procedures. This hinders the safeguarding of the funds and weakens the usefulness of the financial statements.
- There is not adequate segregation of duties. This places too much reliance upon a single individual and weakens the oversight necessary to ensure assets are protected and activity reports are reliable.
- Monitoring and reconciliation of the bond information and associated revenue is inadequate. This lack of oversight does not adequately protect the revenue and weakens the reliability of the financial statements.
- The bond files are manually prepared and information is often incomplete or missing. This hampers the efficiency and effectiveness of information management, as well as, weakens the reliability of records.
- Documented functional operating policies and procedures are not provided for staff. This may lead to inconsistencies in administration and management of activities.

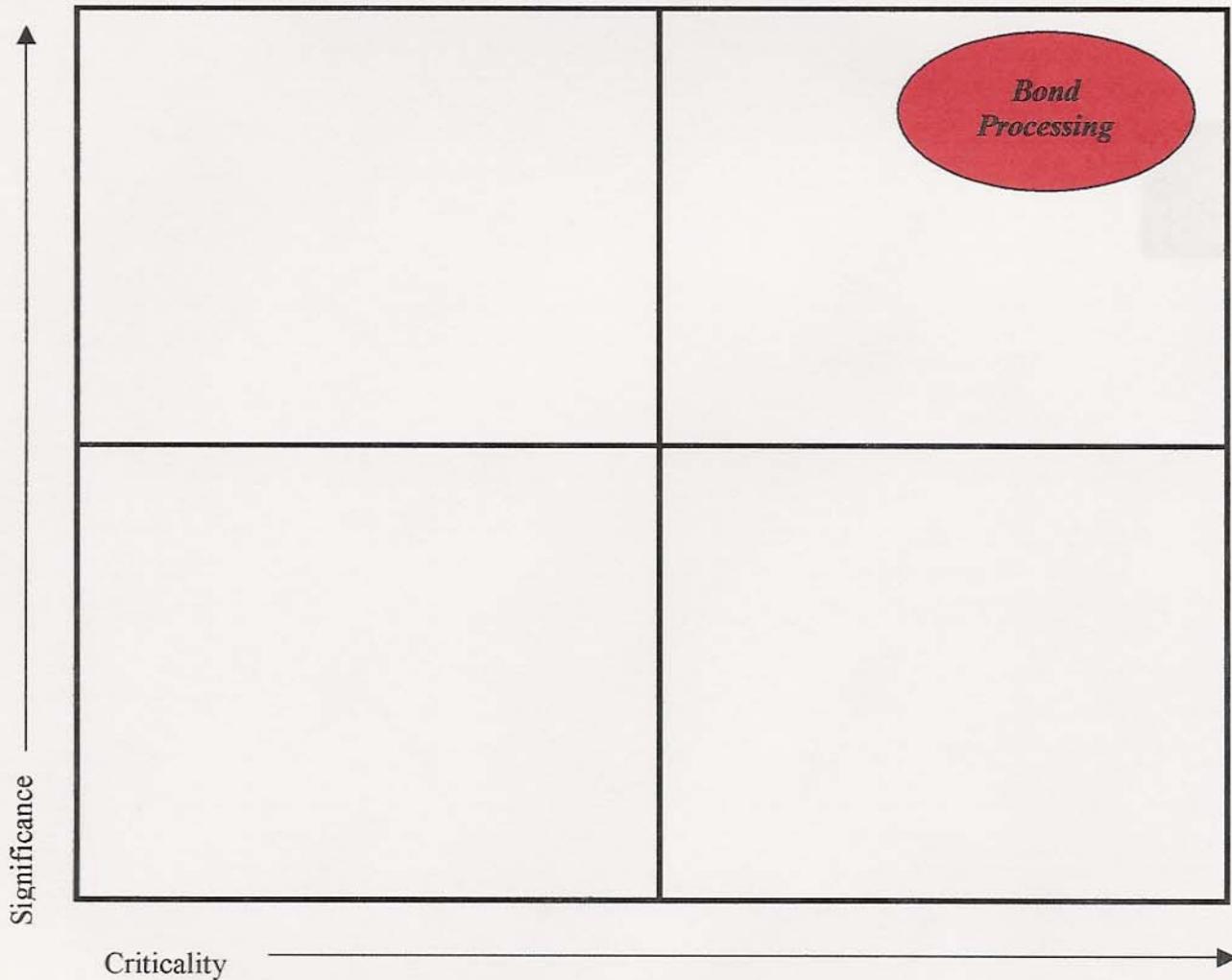
The implementation of the recommendations in this report will help improve the internal control structure and effectiveness of Industrial Revenue Bond activity administered by the Office for Business Services.



Michael S. Norman, CIA
Chief Audit Executive

cc: Louisville Metro Council Audit Committee
Louisville Metro Council Members
Deputy Mayors
Secretary of the Cabinet for Community Development

Internal Control Rating



<u>Legend</u>			
<u>Criteria</u>	<u>Satisfactory</u>	<u>Weak</u>	<u>Inadequate</u>
<u>Issues</u>	Not likely to impact operations.	Impact on operations likely contained.	Impact on operations likely widespread or compounding.
<u>Controls</u>	Effective.	Opportunity exists to improve effectiveness.	Do not exist or are not reliable.
<u>Policy Compliance</u>	Non-compliance issues are minor.	Non-compliance issues may be systemic.	Non-compliance issues are pervasive, significant, or have severe consequences.
<u>Image</u>	No, or low, level of risk.	Potential for damage.	Severe risk of damage.
<u>Corrective Action</u>	May be necessary.	Prompt.	Immediate.

Introduction

The Office for Business Services (OBS) was established in 1998 as a jointly funded City/County agency with the City serving as its fiscal agent. The Office of Economic Development was the predecessor to OBS. OBS is a cooperative government effort in support of Greater Louisville's economic development. OBS promotes a positive business climate and assists local businesses by providing a comprehensive approach to the development and revitalization of retail/commercial areas.

Local government is authorized by Sections 103.200 to 103.285 of the Kentucky Revised Statutes to issue Industrial Revenue Bonds (IRB) and apply the proceeds to finance the costs of the acquisition, rehabilitation, and equipping of industrial facilities. This is intended to serve a public purpose promoting economic development, relieving and preventing conditions of unemployment, and encouraging the increase of industry.

OBS receives fee payments for Industrial Revenue Bonds and administers the associated files. The Jefferson County Attorney's Office processes the actual bonds, which are approved by the local government legislative branch. OBS records IRB application and bond ordinance fees as part of operations receipts.

The fiscal year 2003 operating budget amount for IRB operations receipts is \$8,300.

This was a scheduled audit.

Summary of Audit Results

I. Current Audit Results

See Observations and Recommendations section of this report.

II. Prior Audit Issues

The Office of Internal Audit has not conducted any reviews of the Louisville-Jefferson County Office for Business Services Industrial Revenue Bonds.

III. Statement of Auditing Standards

Our audit was performed in accordance with Generally Accepted Government Auditing Standards (1994 edition) issued by the Comptroller General of the United States and with the Standards for the Professional Practice of Internal Auditing (2001 edition) issued by the Institute of Internal Auditors.

IV. Statement of Internal Control

We conducted a formal study of the internal control structure in order to obtain a sufficient understanding to support our final opinion.

V. Statement of Irregularities, Illegal Acts, and Other Noncompliance

Our examination did not disclose any instances of irregularities, any indications of illegal acts, and nothing came to our attention during the examination that would indicate evidence of such. Any significant instances of noncompliance with laws and regulations are reported in the Observations and Recommendations section of this report.

VI. Views of Responsible Officials

An exit conference was held at the Metro Development Authority Administrative Offices on April 10, 2003. Attending were Bruce Traugher and Drew Shryock representing the Metro Development Authority; Mike Norman representing Internal Audit. Final audit results were discussed.

The views of the Metro Development Authority officials are included as responses in the Observations and Recommendations section of the report.

Observations and Recommendations

Bond Processing

Scope

Key Office for Business Services (OBS) personnel were interviewed in order to review the operational and fiscal administration of the Industrial Revenue Bonds (IRB) and associated activity. This included processing, records management, and monitoring activities.

The population of sixteen bond files for the period July 1, 2001 through December 16, 2002 was examined. The review consisted of examining the applicant files and required processing forms, fees due, treasury receipts and financial system statements to determine the completeness, accuracy, timeliness and appropriateness of amounts processed. The following concerns were noted.

Observations

There were some major problems noted with the processing of Industrial Revenue Bond activity. As a result, the internal control structure is inadequate. Examples of the weaknesses include the following.

- Deposits are not made in accordance with established policies and procedures. This increases the likelihood that payments could be lost or misplaced and does not promote timely recording of activity on the financial statements.
 - Deposits are held until several checks have been received. Therefore, payments could be held for several weeks until they are presented to Treasury. Louisville Finance and Budget policies and procedures require that receipts be deposited when they total \$1,000 or more, or weekly, whichever occurs first.
 - Two checks, totaling \$3,500, were in the bond files and had been withheld from deposit. One check, in the amount of \$500, was still in the file fourteen months after its issue date. A second check for \$3,000 was deposited after being held for approximately two months.
- There is not adequate separation of duties for bond revenue processing. A single individual receives payments and is responsible for monitoring the records.
- OBS staff were not able to account for all activity or to ensure that several cases were processed appropriately.
 - In one case, it appears that the application fee payment was inaccurate. The application fee charge effective during the period was \$500, but the actual payment made was \$750. There was no record of the overpayment being refunded to the applicant.
 - There were several cases in which payments for fees could not be verified during the initial inquiry. Problems were noted in the following four cases.

- ❖ Two instances were noted in which it could not be verified as to whether the company paid the bond ordinance fee. OBS could not locate check copies or treasury receipts.
- ❖ In a third case, OBS staff located the check making payment for the fees after a few weeks. However, the treasury receipt associated with the payment could not be found.
- ❖ In the fourth case, a copy of the check and the treasury receipt was located several weeks later.
- The role of OBS is not defined. It's not clear as to whether they serve as a file depository, should recruit and attract potential IRB applicants, or have any decision-making authority for IRB cases. One area that exhibits this problem is the maintenance of files. Manual files exist for each application, but are not adequately maintained and organized so as to serve as an efficient source of data. Also, they do not contain complete and accurate information. Several instances were noted in which the following information was not contained in the files, or the file copies were not signed.
 - Memorandum of Agreement
 - Inducement Resolution
 - Public Hearing Notice
 - Notice of Intended Passage and Summary of Bond Ordinance
 - Notice of Passage and Summary of Bond Ordinance
 - Opinion of County Attorney
 - Arbitrage Certificate
 - Proposed Bond Ordinance
- OBS does not time/date stamp documents when received. Therefore, monitoring of document submission and processing requirements, along with deposit timeliness, is impaired.
- There is not sufficient monitoring of the revenue activity. The deposits are not reconciled to the financial statements. A cursory review of the receipts retained in the manual files did not agree with the activity posted to the City's financial system. Monitoring is an integral part of a sound control structure.
- There is no electronic tracking or monitoring system in place to record IRB information. All IRB case information must be referenced using the manual files. This is not an efficient manner to retain and manage information.
- There are documented procedures and guidelines for IRB's, but these address the requirements and process for applicants requesting bonds. There is not any type of documented policies manual or detailed desk procedures for staff performing assigned tasks. This may lead to inconsistencies in administration and management of activities.
 - OBS staff do not strictly adhere to the documented procedures and guidelines. According to the OBS policies, the Development Officer is responsible for compiling comments from the review agencies, comprised of interested parties (e.g., Air Pollution Control, Landmarks and Preservation, Planning and Zoning,

Human Rights Commission, local government representative for the area). These comments afford the opportunity to express concerns related to the proposed bond purpose, but do not have direct authority regarding its approval. However, the actual procedure in place is for the agencies to contact the Development Officer only if there is a problem with the application. This negative confirmation does not ensure that all parties have received and reviewed the information.

- The bond fees have changed several times over the years. However, the effective date of the fees is not documented. Though the IRB procedures and guidelines document amounts for bond fees, they have not been updated to reflect the current amounts charged.
- Office of Business Services staff receive the application and fee, but are not always aware of the status of IRB processing. The information is processed through the County Attorney and the legislative body, so OBS does not have any direct involvement.
 - There are not any procedures in place to identify and follow-up on inactive IRB cases. The OBS Development Officer is not notified when there may be a delay processing an IRB.
 - The OBS Development Officer was not always made aware of when the former City of Louisville Board of Aldermen would meet to consider IRB's.

Recommendations

Appropriate Office for Business Services personnel should take action to address the concerns noted. Specific recommendations include the following.

- Deposits should be made in accordance with Finance and Budget policies and procedures (e.g., when they total \$1,000 or more, or weekly, whichever occurs first).
- Controls should be implemented to ensure adequate segregation of duties. This would ensure that activities such as record keeping, custodial responsibility of funds, and reconciliations are performed by separate individuals. Implementation of these types of controls will allow for a better security and safeguarding of assets.
- Revenue receipts should be logged by an individual independent of IRB processing and monitoring responsibilities. This will promote proper segregation of duties. In addition, the log should be reconciled with IRB case and financial records to ensure that all receipts are properly deposited.
- OBS staff should be cross-trained for IRB administration. The processes should be thoroughly documented and accessible for reference as needed.
- Payments should adhere to established fees. OBS staff should review payments upon receipt to ensure accuracy.
- OBS's level of monitoring and participation for IRB activity should be determined. This would help define the types and extent of documentation that should be retained in case files. If OBS is intended to serve as more than an initial contact and application receiver, the following should be considered.
 - ✓ A notification process should be established to ensure appropriate OBS personnel are aware of key processing steps (e.g., council meeting). This will ensure that

staff is current on the proceedings of the IRB and that the file is updated with pertinent information.

- ✓ A process to monitor the status of bond processing should be implemented. This will require establishing routine communication with the County Attorney to provide updates as the requests are processed.
- Files and records should be maintained in a complete and accurate manner. Periodic monitoring and supervisory review should be conducted.
- OBS should maintain copies of the required documentation in the case file. These copies should include signatures, if applicable. This will ensure that the appropriate authorities reviewed and approved the documentation.
- OBS staff should consider developing a checklist of all relevant information required to be retained in the case file. As steps are completed and information is obtained, the individual managing the file should sign and date to document that the information has been included.
- A formal reconciliation process should be implemented. It is strongly recommended that the detailed monthly financial reports be compared to the applicable internal records. Source documents should be referenced when necessary to rectify any reconciling items. This helps ensure the transactions were processed as intended and posted to the proper financial centers. This also helps strengthen the reliability of the financial statements.
- All documents and payments should be time/date stamped as received. This will allow for monitoring of processing timeliness and adherence to document submission time requirements.
- A major component of a sound control structure is proper reconciliation and monitoring. It is imperative that administrative staff review the information on a regular basis. This includes verification of receipts to the revenue records and, ultimately, to the financial statements. In order to promote proper segregation of duties, an administrator independent of the actual processing of activity should perform this function.
- It would be beneficial to maintain a computer file containing the significant information (e.g., applicant names, processing dates, payments received, deposit information, etc.) for IRB activity. A database or spreadsheet software could be used to record this data so that information could be compiled and referenced more efficiently. This information could also be used to monitor the progress of individual cases and serve as a reconciliation tool for the financial reports.
- Written policies and procedures for the IRB should be developed and updated periodically. These should correspond with the policies and guidelines for IRB applicants. This documentation should be distributed to all applicable personnel. This manual should include sufficient detail for each job duty performed, copies of forms used and policies followed in the process. In addition, training of key personnel will help ensure consistent adherence to the requirements.
- The IRB policies and guidelines should be updated to reflect any changes and be distributed to all applicable personnel. This will ensure that everyone is receiving the most up to date information.

- All IRB fees should be documented. This would help ensure that OBS is charging consistent and correct amounts.
- Written policies and procedures associated with the administration of the Industrial Revenue Bonds should be strictly adhered to. The procedures should be updated to reflect any changes and distributed to all applicable personnel.

Metro Development Authority Response

The Louisville/Jefferson County Office for Business Services (OBS) and its predecessors coordinated local government's IRB process from the mid-1970s until the merger of local government in January 2003. The duties performed by OBS and its predecessors had remained essentially the same over the last twenty-five (25) years. Whatever inadequacies may have existed as of the date of this audit were not a result of a deterioration of processes or procedures over the past several years. OBS had been merely continuing the operation of the program as it had been operated in the past. The current audit is the first program audit ever performed on the IRB process. There were no prior audits offering guidance or suggestions as to the acceptability of the existing process.

OBS' function was to coordinate between the County Attorney's Office and Jefferson County Fiscal Court. (From the mid-1980s on virtually all of the IRB applications were made to Jefferson County Government.) That coordination consisted of insuring that IRB applications that were reviewed by the County Attorney's Office were promptly placed before Fiscal Court for consideration. As a part of this process OBS collected a fee on behalf of Jefferson County Government. OBS' duties were entirely clerical in nature.

The files maintained by OBS were for its own benefit. The official files including all of the legal documentation became a part of the "Transcript of Proceedings" and were maintained by the Clerk of Jefferson County Fiscal Court.

When OBS was created in 1998 there was no job slot for a business manager-type person. That function was performed by a number of program people from July 1998 to January 2003. None of these people had any training for the position and certainly no one had any real understanding of Finance's "established policies and procedures". As a consequence not all items were dealt with as promptly as they should have been.

The Metro Development Authority (MDA), OBS' successor for IRB processing, is working with the County Attorney's Office to develop more specific procedures relating to the processing of IRBs for the Metro Council. We anticipate these procedures will be finalized over the next couple of months. We are in the process of cross-training personnel to insure that more than one person is familiar with the IRB process.

In the future we anticipate the MDA files dealing with IRBs will include a copy of the application, a copy of the Memorandum of Agreement, a copy of the Inducement Resolution, a copy of the proposed Bond Ordinance, and a copy of the Treasury Receipt evidencing collection of the applicable fees. MDA, however, will not be responsible for the maintenance of the official records of the transaction. (At this time we are presuming the "Transcript of Proceedings" will be maintained by the Clerk of the Metro Council as they were previously maintained by the Clerk of the Fiscal Court.)

MDA, unlike OBS, has a business office and a business manager who will be responsible for processing IRB fee income in the future. This should insure that financial "good practices" are followed and that all deposits are made promptly.

Many of the shortfalls specified in the audit should be corrected by virtue of the inclusion of the IRB function within the Metro Development Authority, an entity with more resources and more specialized personnel.



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