



Jerry E. Abramson
Mayor

26 Member
Metro Council

The Office of Internal Audit provides independent, objective assurance and consulting services that adds value to and improves Louisville Metro Government.

Office of Internal Audit

Air Pollution Control
District

Penalty Fees and Permit
Revenue



Audit Report

Office of Internal Audit

Air Pollution Control District

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July 2005



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Transmittal Letter

July 25, 2005

The Honorable Jerry E. Abramson
Mayor of Louisville Metro
Louisville Metro Hall
Louisville, KY 40202

Re: Review of Air Pollution Control District Revenue

Introduction

We have examined the operating records and procedures of operating permit and penalty fee revenue administered by the Metro Air Pollution Control District (APCD). The primary focus of the audit was the operational and fiscal administration of the activity. This included how the Air Pollution Control District processes, records, and monitors the activity.

Our examination was conducted in accordance with Government Auditing Standards issued by the Comptroller General of the United States and with the Standards for the Professional Practice of Internal Auditing issued by the Institute of Internal Auditors.

As a part of the review, the internal control structure was evaluated. The objective of internal control is to provide reasonable, but not absolute, assurance regarding the achievement of objectives in the following categories:

- Achievement of business objectives and goals
- 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.

Scope

The Louisville Metro Air Pollution Control District's revenue policies and procedures were reviewed. Interviews of key personnel were conducted. The focus of the review was the revenue management for various permits and penalty fees. The following types of fee activities were reviewed.

- Penalty fees assessed due to violations of the air quality standards.
- Operations receipts received for permits issued to industries and businesses operating within Louisville Metro. These include asbestos permits, construction/modification, minor source, federally enforceable district origin operating permits, stage I and stage II fuel permits.

A sample of transactions was reviewed. The sample was chosen from the period July 1, 2004 through December 31, 2004. The sample included penalties assessed, permits issued and the fee payments received for the period.

The review included assessing whether transactions were processed in compliance with requirements. This included both Metro policies as well as APCD departmental policies, allowable per State and Federal guidelines. The procedures for monitoring the payments were also reviewed. The details of the scope and methodology of the review will be addressed in the Observations and Recommendations section of this report. Our examination would not reveal all non-compliance issues because it was based on selective review of data.

Opinion

It is our opinion that APCD revenue management could be improved. The internal control rating is on page 5 of this report. This rating quantifies our opinion regarding the internal controls, and identifies areas requiring corrective action.

Opportunities to strengthen APCD fee management were noted in several areas. Examples of these include the following.

Computer Systems. The APCD uses several computer systems to administer permitting and penalty activity. These systems vary in age, functionality and available technical support. Some activity requires additional resources/supplementary reporting to administer the entire life cycle of transactions (e.g., fee assessment, accounts receivable and revenue receipt).

Policies and Procedures. Functional operating policies and procedures are not provided for staff. This may lead to inconsistencies in processing of activities. Additionally, monitoring responsibilities are not documented. This could weaken accountability, along with the completeness and integrity of the information processed.

Penalty Fees. Some problems were noted assessing the accuracy of penalty fees and the related revenue receipts. These weaknesses appear to be related to discretion being used and the lack of documented procedures. Inconsistent treatment of penalty cases increases the risk of the perception of favoritism that may lead to negative publicity and legal liabilities.

Revenue Deposits. Deposits were not made timely for some revenue receipts. These untimely deposits may have been related to routine processing delays (e.g., staff constraints, leave time) and changes in banking procedures.

The implementation of the recommendations in this report will help improve the internal control structure and effectiveness of the APCD revenue activity.

Corrective Action Plan

Representatives from the Air Pollution Control District have reviewed the results and are committed to addressing the issues noted. The Air Pollution Control District staff's corrective action plan is included in this report as responses in the Observations and Recommendations section. We will continue to work with APCD to ensure the actions taken are effective to address the issues noted.

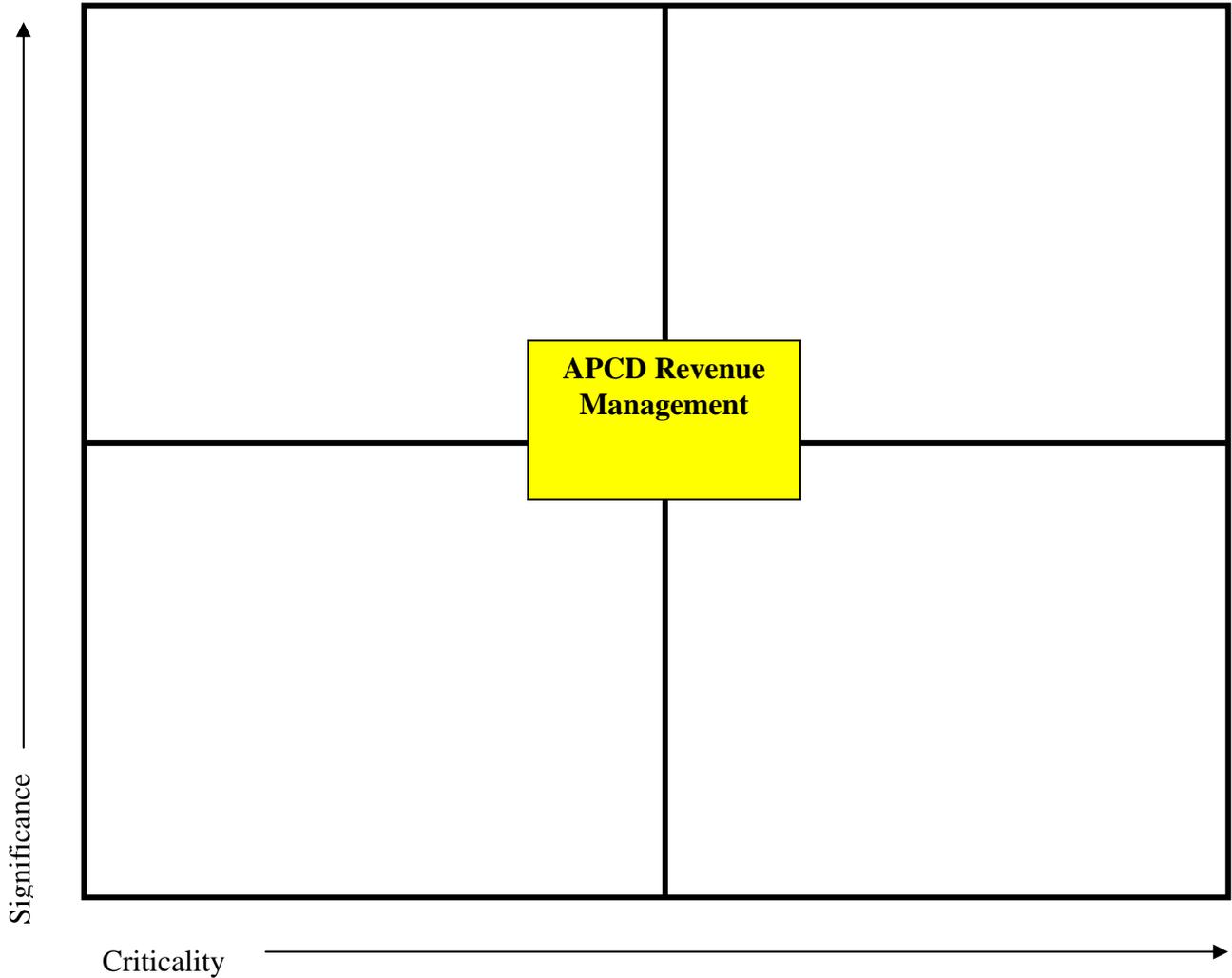
Sincerely,



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
Director of Air Pollution Control District

Internal Control Rating



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

Background

The Louisville Metro Air Pollution Control District (APCD) is the air pollution control agency of Louisville/Jefferson County, Kentucky. It is the only local air pollution control agency in Kentucky. It is part of the Louisville Metro Government Community Development Cabinet. The Louisville Metro APCD was established for the purpose of monitoring the air quality in Jefferson County. The goals of the agency are twofold: ensuring healthy air for breathing while helping local industries and businesses meet local, state and federal air emission standards.

A board of citizens, the Air Pollution Control Board, oversees the APCD. The Air Pollution Control Board is the regulatory authority for air pollution control in Louisville Metro. Air Pollution Control Board members are private citizens appointed by the Louisville Metro Mayor. The board adopts regulations, orders and resolutions as needed to control air pollution. The board also conducts public hearings regarding proposed regulations, board orders or other air pollution issues.

The fiscal year 2005 operating budget for the Air Pollution Control District is approximately \$6 million. This is comprised of Metro Government general funds, Federal and State funds, as well as agency receipts. The areas included in this audit included approximately \$1.8 million of the budgeted funds.

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 performed any previous reviews of the Air Pollution Control District.

III. Statement of Auditing Standards

Our audit was performed in accordance with Government Auditing Standards issued by the Comptroller General of the United States and with the Standards for the Professional Practice of Internal Auditing 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 / Action Plan

An exit conference was held on June 23, 2005. Attending were Art Williams and Mitzi Powell representing the Metro Air Pollution Control District; Mark Doran representing the Office of Internal Audit. The views of Metro Air Pollution Control District officials are included as responses in the Observations and Recommendations section of the report.

Air Pollution Control District officials are committed to addressing the issues noted.

Observations and Recommendations

Scope

The Air Pollution Control District (APCD) permitting and penalty fee revenue procedures were reviewed through interviews with key personnel. The focus of the review was the revenue management for various permits and penalty fees allowable per local, state and federal guidelines. This included the processing, recording, and monitoring of revenues associated with APCD fees.

A sample of APCD permit and penalty fee cases was judgmentally selected for the audit period of July 1, 2004 through December 30, 2004. The sample was selected from the population of activity recorded in the following three data sets.

Permit Fees

Nine permitting transactions were examined. These are considered operations receipts APCD collects for the issuance of permits to companies doing business within the Louisville Metro area that have the potential for emitting pollutants into the air. This review considered the several types of permits including Construction/Modification, Minor Source, Federally Enforceable District Origin Operating Permits (FEDOOP), Stage I & Stage II fuel permits. This activity is processed using the APCD Fortran computer system. The fiscal year 2005 budget for APCD operating receipts, which includes permit fees, is approximately \$1 million.

Asbestos Permit Fees

Three asbestos permit transactions were examined. Companies wishing to remove asbestos materials are required to obtain a permit. This activity is processed using the APCD Asbestos Control Tracking System (ACTS) computer system. The fiscal year 2005 budget for APCD operating receipts, which includes asbestos fees, is approximately \$1 million.

Penalty Fee Assessments

Eleven penalty fee transactions were examined. These cases were associated with penalties assessed against businesses and individuals who were in violation of the APCD regulations. This activity is processed using the APCD Information Management System (IMS) computer system. The fiscal year 2005 budget for penalty fees revenue is approximately \$838,000.

The review consisted of examining the sample of permit and penalty case files and the supporting documentation including 1) permit applications or incident reports, 2) permits or notice of violations, 3) statement of fees or administrative agreements (if applicable), 4) mail log records, 5) revenue receipts, 6) bank deposits, 7) Metro financial system postings, 8) information recorded on the APCD computer systems.

This information was reviewed to ensure that activity was processed accurately and appropriately. Our examination would not reveal all non-compliance issues because it was based on selective review of data.

The following concerns were noted.

Observations

There were several opportunities noted for improving the administration of Air Pollution Control District's permit and penalty fee revenue activity. As a result, the internal control structure is weakened and its effectiveness impaired. The observations are as follows:

- #1 Computer Systems
- #2 Policies and Procedures
- #3 Penalty Fees
- #4 Revenue Deposits

Details of these begin on the following page.

#1 - Computer Systems

The Air Pollution Control District (APCD) uses several computer systems to administer permitting and penalty activity. These systems vary in age, functionality and available technical support. Each of the systems has specific issues associated with it.

Asbestos Control Tracking System (ACTS)

- APCD is currently using the Asbestos Control Tracking System (ACTS) for asbestos permits. Several weaknesses were noted regarding the system.
 - The ACTS system is not a complete permitting, accounts receivable and revenue receipt system. Asbestos revenue due and payments received are not administered using the ACTS system. The system is used for issuing permits only, any revenue monitoring must be performed outside of the ACTS system.
 - According to APCD staff, the ACTS system was provided by the Environmental Protection Agency (EPA) for asbestos permitting activity and the EPA provided technical support through a contract vendor. The contract was not renewed as of March 2005 and there is currently no technical support provided for ACTS.
 - In the past, ACTS may have been mandated, but APCD staff is not certain whether its use is still required. Based on discontinued technical support, it may be a terminal system. While not certain, APCD staff believes other entities may administer asbestos permits using other software systems.
 - Historically, APCD staff provided an ACTS National Asbestos Registry System (NARS) Report for the EPA in electronic form quarterly. This report was not referenced/used by APCD staff and it's not clear whether it is still required by the EPA.
 - The ACTS system does not provide complete user reports. APCD staff must administer supplementary reports to monitor revenue due and received. APCD staff provided a custom report in order to list the asbestos permit activity for the audit period. In addition, APCD permitting and business office staff coordinate monitoring efforts to compile fees collected and monitor delinquent fees due.
 - ACTS is not an efficient permit processing software for users. APCD staff explained that information is not accessible to all users and permitting requires physically delivering information to various APCD staff. APCD staff involved in the process are not physically located in the same office, so the delivery process may result in delayed processing for permits.

Fortran

- APCD is currently using the Fortran system for processing the issuance of operating permits and the collection of fees. This is an antiquated system with limited capabilities and technical support.
 - While the Fortran system does produce various activity reports, APCD staff must administer supplementary reports to monitor revenue due and received.
 - There is limited technical support available for the system. Fortran was historically supported internally, but the staff member who developed and managed the system has since retired.

Information Management System (IMS)

- The APCD Information Management System (IMS) is used for penalty fee management. IMS appears to be a more complete system in that it provides user reports to help monitor penalty fees assessed, collected and still due. APCD staff are currently developing an updated version of the IMS that may be used to service activity currently administered through other APCD software systems.

While APCD staff appear to manage activity adequately considering the weaknesses associated with the above computer systems, it is likely that there are increased risks of efficiency and effectiveness impairment.

Recommendations

Appropriate personnel should take corrective action to address the concerns noted. Specific recommendations include the following.

- ✓ The APCD should develop an action plan to address the computer systems. Ideally, a single computer system would be used to process all permitting and penalty activity. This would include fee assessments, amounts due and payments received. The goal is having a system that can provide accountability and reporting for all APCD activity. Consideration should also include ensuring that the reporting system complies with applicable local, state and federal requirements.
 - An assessment of the APCD needs should be performed to determine the type of system that would be most beneficial. This should include access to computer system information to help promote the efficiency and effectiveness of processing and monitoring activities.
 - The permitting and collection processes may need to be reengineered to conform to the system(s) used.
 - Other entities that process similar activity with comparable reporting requirements could be consulted to determine if existing computer systems would meet APCD's needs (e.g., Louisville Metro Inspections Permits and Licenses).
 - The action plan must consider available resources (e.g., funding, staff).
 - The Metro Department of Technology should be contacted as a resource for consultation and system assessment.
- ✓ In the interim, APCD should continue monitoring accounts receivable and revenue receipts. The reporting methods used should involve a complete reconciliation process to ensure the life cycle of all individual transactions are considered, from fee assessment through collection of the amount due.

Air Pollution Control District's Response

APCD acknowledges having outdated multiple custom applications and continues to work towards upgrading them both internally and with Metro Technology Services. IMS2 (Information Management Systems - 2nd Phase) will upgrade the current system and take over the functionality of the FORTRAN system. This new system will allow for

efficient processing of enforcement actions and a timelier permit issuance could increase revenue flow and monitoring.

#2 - Policies and Procedures

While there are documented guidelines for compliance with air pollution control requirements and fee schedules, there are no documented policies and procedures for the detailed processing of permitting or penalty fee activity. There is not a comprehensive manual that presents the entire processing life cycle of activity (e.g., fee assessment, billing and collection, deposits, write-off procedures).

- There are no documented policies and procedures detailing the permitting/enforcement divisions' administration of activity resulting in fee assessment (permit issuance and penalty processing). There is not sufficient backup for staff performing certain permitting duties. A single individual is mainly responsible for printing permits from the Fortran and Asbestos Control Tracking (ACTS) systems. These transactions may not be completed during times in which this individual is absent.
- There are no documented policies and procedures detailing the business office's administration of fee deposit activity. A backup staff member from the APCD business office deposits receipts in the absence of the primary staff member assigned these duties, but the revenue information is not immediately entered into the APCD computer system. The primary processor is the only staff member who has been trained and is familiar with data entry.

Recommendations

Appropriate personnel should take corrective action to address the concerns noted. Specific recommendations include the following.

- ✓ A written internal policies and procedures manual should be developed. This manual should include sufficient detail for each job duty performed, copies of forms used and the policies followed in the processing of revenue activity. This manual should address all fee activity functions that are performed. This internal policy and procedures manual should be distributed to all applicable personnel. In addition, training of key personnel will help ensure consistent adherence to the requirements.
- ✓ The internal policies and procedures should reflect the most current information and be updated periodically. This will help ensure adherence to applicable guidelines, along with promoting efficiency and effectiveness of permit/penalty fee administration.
- ✓ The formal APCD policies and procedures manual should be disseminated to all applicable staff. The policies and procedures manual should be used as a training manual for new staff and individuals serving in backup roles.
- ✓ The necessary access (e.g., computer access rights, access to files) should be provided to backup staff so that transactions can be completely processed and recorded.
- ✓ A formal reconciliation process should be documented in the departmental policies and procedures. The detailed activity reports should be compared to some type of source documentation (e.g., bank statements, internal computer system, and Metro financial system). This helps ensure the transactions were processed as intended and posted to the proper financial coding in a timely manner. This also helps strengthen the reliability of the financial statements.

- ✓ Routine supervisory review should be required in the documented policies and procedures. These reviews should be performed to assess the completeness of files and the accuracy of the activity, including adherence to applicable guidelines. These reviews should be documented and signed by the reviewer.

Air Pollution Control District's Response

APCD will begin development of a detailed policies and procedures manual that will be revised as needed, updated annually, distributed to applicable staff and annual supervisory review will be conducted. Back-up staffing will be identified and cross training will be conducted to provide seamless continuation of activity. Assistance from Metro Finance will be requested to assist in a more formal reconciliation process for financial statements.

#3 - Penalty Fees

Penalty fees are normally assessed based on a documented fee schedule. If the violator responds within a defined time period, an opportunity to pay a settlement amount (75% of the penalty) is documented in an administrative agreement between APCD and the violator. Some problems were noted regarding the accuracy of penalty fees and the related revenue receipts.

- Air Pollution Control District staff sometimes use discretion when assessing penalty fees. Engineering and Enforcement division staff may meet to discuss the seriousness of a violation and the actions taken to address problems. Based on this, penalty fee assessments may be set within a documented range on the fee schedule, or may vary from the fee schedule.

The authority of APCD staff to vary from the established fee schedule is not documented. Therefore, guidelines and acceptable fees are not clear, along with required documentation to support the actual penalty fee assessment. The use of discretion in this manner increases the risk of the perception of favoritism.

In one of the cases examined, APCD's use of discretion resulted in the settlement amount being \$175 less than anticipated.

- While the policy is not documented, APCD staff round penalty fees to the nearest \$25.00.
- The case file documentation may not support, or additional file documentation may be necessary to verify the penalty fees for some incidents.
 - For example, the payment received might not agree with the settlement amount in cases that include undocumented late fees. Without complete documentation of the amounts charged, including the determination of late fees, it is impossible to monitor the accuracy of the amounts received.
 - In some cases, the penalty recorded on the Notice of Violation (NOV) letter may not agree with the corresponding incident report. This may occur when two or more incidents are combined on one NOV. Individual incident reports reference the applicable NOV, but the NOV does not reference the incident reports. While APCD records/files can be referenced to verify information, the lack of a cross-reference on the NOV makes it more difficult to monitor the information for accuracy.

Recommendations

Appropriate personnel should take corrective action to address the concerns noted. Specific recommendations include the following.

- ✓ Air Pollution Control District policies and procedures should include documentation of all policies, including any allowable exceptions. The documented guidelines should be disseminated to all users and relied upon as comprehensive instructions for related transactions.
- ✓ Documented guidelines should be adhered to. Sufficient documentation should be retained in the case of an exception to policy. Adherence to policy helps to prevent revenue loss, inaccurate records and processing delays. In addition, consistent

compliance with documented guidelines helps avoid the perception of favoritism that may lead to negative publicity and legal liabilities.

- ✓ Air Pollution Control District case documentation should be maintained in a manner so as to be useful for monitoring of transactions to ensure accuracy, completeness and appropriateness.
- ✓ Routine supervisory review should be performed to assess the completeness of files and the accuracy of the activity, including the adherence to guidelines. These reviews should be documented and signed by the reviewer.

Air Pollution Control District's Response

As previously noted, APCD will begin to develop a detailed manual to define authority of APCD staff, the use of discretion when assessing penalty fees and documentation needed to support the assessment. Included will be comprehensive instructions for related allowable exceptions and the basis for the assessment. Routine supervisory review will be conducted.

#4 - Revenue Deposits

Seven of the seventeen transactions (42%) reviewed for which payments were actually received were not deposited timely. The bank deposits were not made within five business days of revenue receipts (deposits made from six to thirty-two working days after receipt). APCD personnel explained that some of the untimely deposits might be related to routine processing delays (e.g., staff constraints, leave time). Also, some deposits were held pending the implementation of new banking procedures established by the Metro Finance Department.

In one case, the check received was short of the amount due. The initial payment was held until a second check was received to cover the full amount due. This resulted in the initial check being held at APCD for twenty-eight business days.

While most payments to APCD are made by check, there are still weaknesses associated with untimely deposits. These include increased risk of loss, untimely financial reports, along with the inability of Metro Government to promote effective cash management practices.

Recommendations

Appropriate personnel should take corrective action to address the concerns noted. Specific recommendations include the following.

- ✓ Deposits should be made as soon as possible to ensure assets are safeguarded and to take advantage of accrued interest. Deposit requirements should be documented in the departmental manual. These policies and procedures should consider the specific business practices and risks associated with various types of payment methods (e.g., cash vs. checks).
- ✓ Prior to deposit, payments received should be retained in a secured environment with access limited to authorized individuals (e.g., locked safe).
- ✓ A formal, documented reconciliation process should be practiced. The detailed activity reports should be compared to some type of source documentation (e.g., bank deposit slip, internal APCD computer system, Metro financial system). This helps ensure the transactions were processed as intended and posted to the proper financial coding in a timely manner. This also helps strengthen the reliability of the financial statements.

Air Pollution Control District's Response

As previously noted, policies and procedures will be developed to identify deposit requirements. The use of the LEAP financial statements will be used as guidance in the agency's reconciliation process with assistance from Metro Finance. Deposits and payments will be limited to authorized staff in a secure location.