



Jerry E. Abramson
Mayor
Louisville Metro Council

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Office of Internal Audit

Louisville Fire Department

Incentive Pay

Audit Report

Office of Internal Audit

Louisville Fire Department

Incentive Pay

February 2009



Louisville Fire Department

Incentive Pay

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OFFICE OF INTERNAL AUDIT
LOUISVILLE, KENTUCKY

JERRY E. ABRAMSON
MAYOR

MICHAEL S. NORMAN, CIA, CFE, CGAP
CHIEF AUDIT EXECUTIVE

DAVID W. TANDY
PRESIDENT METRO COUNCIL

Transmittal Letter

February 11, 2009

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

Subject: Audit of Louisville Fire Department's Incentive Pay

Introduction

An audit of the Louisville Fire Department's incentive pay activity was performed. Fire is a division of Louisville Metro's Public Protection department. The primary focus of the review was the operational and fiscal administration of incentive pay activity. This included how activity is processed, recorded, and monitored. The objective was to obtain assurance that risks are adequately mitigated through the internal control structure.

The audit was conducted in accordance with Government Auditing Standards issued by the Comptroller General of the United States and with the International 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 procedures for administering Fire incentive pay activity were reviewed through interviews with key personnel. The focus of the review was the operational and fiscal administration of the activity, to include ensuring that eligible Fire employees were appropriately paid and that Louisville Metro was properly reimbursed from the State. Tests of sample data were performed on activity from July 1, 2007 through August 31, 2008. Activity reviewed included payroll system reports (employee earnings reports, benefit plan summary reports), monthly reimbursement requests, and Metro financial system postings. A review of employee training records was not performed since the State Fire Commission reviewed this activity in April 2008 and no significant issues were noted.

The review included assessing whether activity was processed, recorded, and monitored accurately and appropriately. The details of the scope and methodology of the review will be addressed in the Observations and Recommendations section of this report. The audit would not identify all issues because it was based on selective review of procedures and data.

Opinion

It is our opinion that the administration of Fire's incentive pay activity needs improvement. The internal control rating is on page 5 of this report. This rating quantifies the opinion regarding the internal controls, and identifies areas requiring corrective action. Opportunities to strengthen the internal control structure were noted. Examples include the following.

- **Incentive and Pension Reimbursement Requests.** The Metro Finance Payroll division completes and submits a Fire incentive pay request form monthly to the State Fire Commission for reimbursement of expenses paid. However, Payroll does not have documented policies or procedures to guide personnel in the completion of the form. The paperwork is completed based on past practices, of which the usefulness is not readily apparent and can not be verified as accurate.
 - There were some months where the amounts requested differed from the payments received. The net result was Metro was overpaid approximately \$5,800.
 - There was one month where the incentive request was miscalculated by Finance, resulting in Metro being owed approximately \$60,690. An amended request has been submitted to the State.

- **General Administration.** There were some issues noted with the general administration of Fire's incentive pay activity.

- The monthly review of incentive pay financial accounts is cursory in nature and not a formal documented reconciliation of activity. This increases the risk that improper or inaccurate postings could go undetected.
- Fire's standard operating procedures for the training records area are outdated and do not address the current processes for employee training and record keeping.
- Some incentive pay related forms are not being completed as required by State regulations.

The implementation of the recommendations in this report will help improve the internal control structure and effectiveness of the administration of Fire's incentive pay activity.

Corrective Action Plan

Representatives from the Louisville Fire Department have reviewed the results and are committed to addressing the issues noted. Fire's corrective action plans are included in this report. We will continue to work with Fire to ensure the actions taken are effective to address the issues noted.

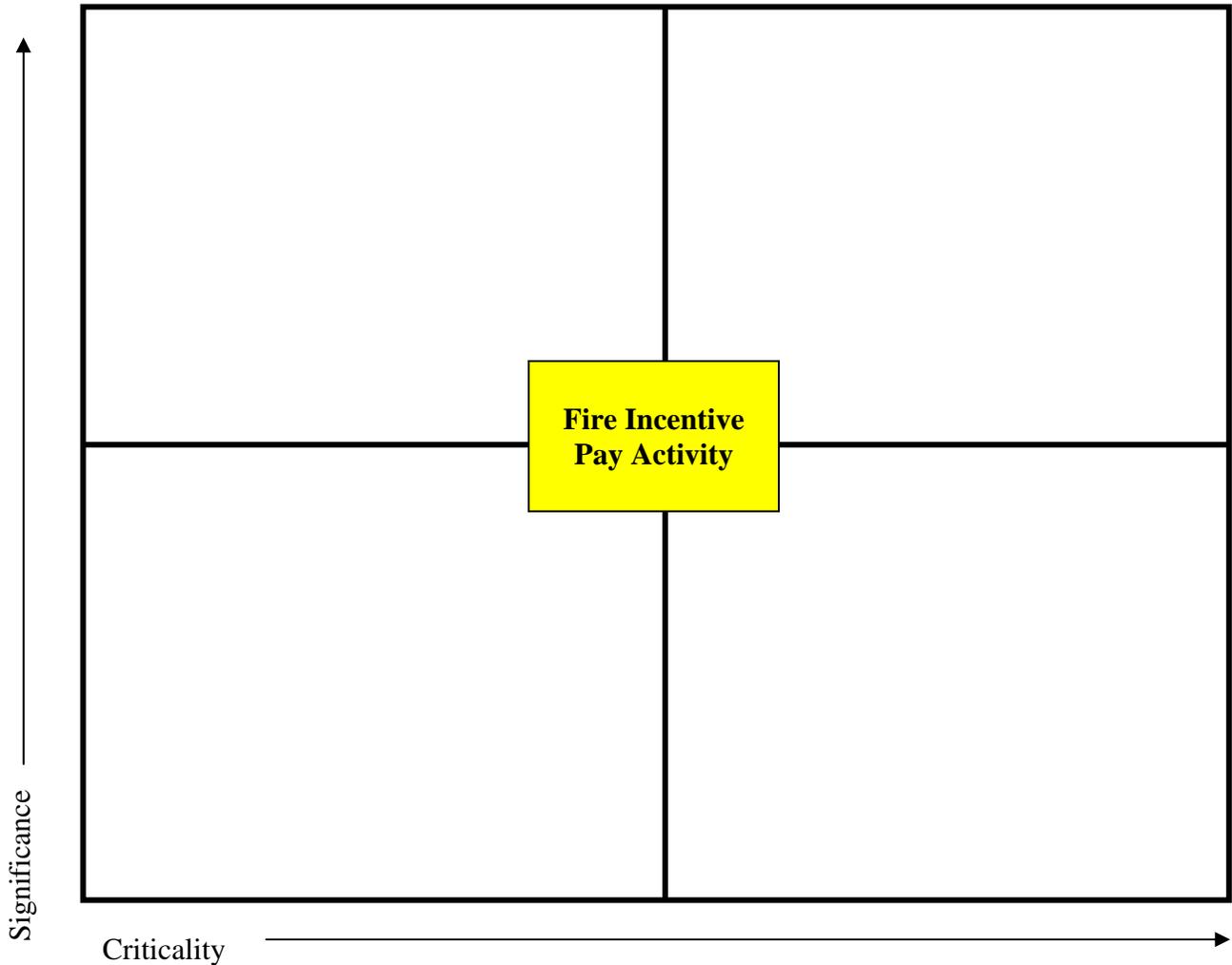
Sincerely,



Michael S. Norman, CIA, CFE, CGAP
Chief Audit Executive

cc: Louisville Metro Council Government Accountability and Audit Committee
Director of Public Protection
Louisville Metro Fire Chief
Director of Finance and Administration
Louisville Metro External Auditors

Internal Control Rating



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

Background

Louisville Fire is a division of Metro Government's Public Protection department. Through a variety of programs, Fire provides services that include the prevention of fires and injuries, emergency response, and environmental protection. The division helps create a safer environment through public education, building inspection and fire cause determination. Louisville Fire has also expanded its role in regional response teams to provide hazardous materials and specialized rescue response to disasters and terrorist events. Fire responds to thousands of incidents a year and relies on highly trained men and women to accomplish its mission.

In order to assist with maintaining highly trained firefighters, Fire participates in the Commonwealth of Kentucky's Professional Firefighters Foundation Program Fund. The program offers a monetary supplement for local firefighters while upgrading the educational and training standards of such firefighters. The program allows for local governments to receive reimbursements based on eligible employees receiving Fire incentive pay, up to \$3,100 per employee per year. Incentive pay expenditures above this amount are incurred by Louisville Metro but are not reimbursed by the State. During fiscal year 2008, Louisville Fire incurred approximately \$1,583,000 in reimbursable incentive pay expenditures and \$520,000 in reimbursable pension costs associated with the incentive pay.

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 Louisville Fire's incentive pay activity.

III. Statement of Auditing Standards

The audit was performed in accordance with Government Auditing Standards issued by the Comptroller General of the United States and with the International Standards for the Professional Practice of Internal Auditing issued by the Institute of Internal Auditors.

IV. Statement of Internal Control

An understanding of the internal control structure was obtained in order to support the final opinion.

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

The audit did not disclose any instances of irregularities, any indications of illegal acts, and nothing was detected 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

A draft report was issued to the Louisville Fire Department on January 20, 2009. An exit conference was held at Fire's administrative office on February 6, 2009. Attending were Chief Gregory Frederick, Colonel Thomas Carroll, and Lieutenant Colonel Albert Tronzo representing Fire; and Michael Norman and Mary Ann Wheatley representing Internal Audit. Final audit results were discussed.

The views of Louisville Fire Department officials were received on February 11, 2009 and are included as corrective action plans in the Observations and Recommendations section of the report. The plans indicate a commitment to addressing the issues noted.

LMCO §30.36(B) requires Louisville Metro Agencies to respond to draft audit reports in a timely manner. It specifically states that

“The response must be forwarded to the Office of Internal Audit within 15 days of the exit conference, or no longer than 30 days of receipt of the draft report.”

The Louisville Fire Department's response was provided within this required timeframe.

Observations and Recommendations

Scope

Louisville Fire's procedures for administering incentive pay activity were reviewed through interviews with key personnel. The primary focus of the review was the operational and fiscal administration of the activity. This included assessing whether activity was processed, recorded, and monitored accurately and appropriately. The objective was to ensure that eligible Fire employees were paid appropriately and that Louisville Metro was reimbursed for appropriate expenses from the State.

Tests of sample data were performed on transactions from the period July 1, 2007 through August 31, 2008. Activity reviewed included payroll system reports (employee earnings reports, benefit plan summary reports), monthly reimbursement requests, and Metro financial system postings. A review of employee training records was not performed since the State Fire Commission reviewed this activity in April 2008 and no significant issues were noted. The review would not reveal all issues because it was based on selective review of data.

Observations

Some issues were noted with the administration of Fire incentive pay activity. As a result, the internal control structure is impaired and needs improvement. Opportunities noted to strengthen the controls are as follows.

#1 – Incentive and Pension Reimbursement Requests

#2 – General Administration

Details of these begin on the following page.

#1 – Incentive and Pension Reimbursement Requests

Issues were noted with the processing of the monthly Fire incentive and pension reimbursement requests. Specifics include the following.

- **Incentive Pay Request Form.** Monthly, Metro Finance personnel complete and submit a Fire incentive pay request form to the State Fire Commission for reimbursement of expenses paid. However, Finance does not have documented policies or procedures to guide personnel in the completion of the form. The paperwork is completed based on past practices, of which the usefulness is not readily apparent and can not be verified as accurate. For example, the amounts noted in the fields requesting “previous month received” and “previous month paid out” are noting totals for two different months. A calculation to note the difference between the two totals is noted on the form; however, the result of the calculation does not appear meaningful as the totals are not comparable. An explanation is noted on the form to explain the difference, but it does not accurately describe a valid reason.
 - For three of fourteen monthly incentive requests reviewed, the amounts requested differed from the payments received. Payroll was not aware of the differences since the actual checks were received and deposited by Finance’s General Accounting division. Payroll contacted the State Fire Commission for explanations of differences.
 - For each of the three cases, it appears an incorrect pension rate was used to calculate the reimbursement. The State reimbursed based on appropriate rates, resulting in one payment exceeding Metro’s request (July 2007), and two payments that were lower than the requested amounts (July and August 2008). However, in the two cases where the payment was lower, the State made an error in their calculations and overpaid Metro approximately \$5,800.
 - For one month (July 2008), it appears Payroll requested incentive and pension reimbursement based on three pay periods instead of two. The State appropriately paid less than what Metro requested, based on two pay periods.
 - For one month, the State reimbursed the requested amount. However, it was discovered during the review the request (October 2007) was miscalculated in that Payroll used two pay periods instead of three. This resulted in a shortage of approximately \$60,690 due Metro. Payroll has submitted an amendment to request the funds due.

Payroll is working with the State Fire Commission to resolve the issues noted with requested funds.

Recommendations

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

- ✓ Effective December 1, 2008, Louisville Metro Government ceased paying employees Fire incentive pay on Metro pay checks. Therefore, reimbursement requests are no longer completed and submitted to the State Fire Commission. As a result, all of the issues noted related to the processing of reimbursement requests would no longer be applicable. However, it is essential that appropriate Payroll personnel continue to work with the State on rectifying any past requests / payments that were submitted in error.

Note: If in the future a decision is made for Metro to reinstate and process Fire incentive pay, corrective actions should be taken to address the processing issues noted. Specific recommendations include the following.

- ✓ The State Fire Commission should be contacted for guidance on completing the monthly Fire incentive request form to ensure that appropriate data is being reflected. Past practices for completing the form may no longer be the most effective means by which to communicate data to the State. The use of more sophisticated payroll systems and technologies allows for improved retrieval of real-time data which in turn allows for more accurate reporting (i.e., real-time data could be reported as opposed to figures based on activity from two months prior).
- ✓ Desktop policies and procedures should be documented to help guide Metro personnel in the accurate completion and submission of Fire incentive request forms. The procedures should be detailed enough that others can follow the instructions in the absence of key personnel.
- ✓ Fire should consider taking over the responsibility for completing and submitting monthly Fire incentive requests. This would remove Payroll from the process and would allow Fire to have direct access to the information they need to properly monitor and reconcile incentive activity (i.e., incentive pay revenue). Fire should consult with the Payroll division to ensure they have the necessary system capabilities to obtain the incentive pay information needed to complete the requests.

#2 – General Administration

Issues were noted with the general administration of Fire incentive pay activity. Specifics include the following.

- **Monitoring and Reconciliation.** Though Fire personnel perform a monthly review of incentive pay financial accounts, the review is cursory in nature and not a formal documented reconciliation of the activity. This increases the risk that improper or inaccurate postings could go undetected, thus weakening the reliability of the financial statements.

Fire relies on Metro Finance personnel to submit monthly fire incentive pay requests to the State Fire Commission and to post the revenue when it is received. Fire does not receive copies of the requests submitted and does not reconcile the revenue activity to ensure it is appropriate.

- **Policies and Procedures.** Though Fire has a standard operating procedure (SOP) to address training records, it does not reflect the most current processes for employee training and record keeping. The SOP was last revised on 12/11/92 and does not address the computerized records management system that Fire currently uses to record and maintain training data.
- **Required Forms.** Kentucky Administrative Regulations (KAR) require that certain forms be completed with regards to Fire incentive pay activity. However, Metro is not completing and submitting some forms as required.
 - KAR title 739 chapter 2:020 requires a KPF-2A form be completed and submitted by the local unit monthly acknowledging the receipt of the incentive check. Metro Finance's General Accounting division receives incentive checks and was unaware of the KAR requirement.
 - KAR title 739 chapter 2:020 also requires a KPF-3A form be completed and submitted by the local unit quarterly listing eligible incentive pay personnel and employment data, and signed by the Mayor or County Judge. Although it appears the appropriate information is being submitted to the State Fire Commission via monthly payroll reports and quarterly training records reports, Fire and Finance personnel were unaware of the KAR requirement and have not been completing the form.
- **Financial Posting Error.** There was one case in which a Firefighter's incentive pay expense did not post to the correct financial account (unit activity, division) in Metro's financial system. This appeared to be due to a keying error made by Metro Finance personnel while manually entering incentive pay for an employee on military leave. Though the error was for an immaterial amount (\$258.33) and had no impact on the incentive request submitted to the State Fire Commission, it weakens the reliability and usefulness of the financial statements for reporting purposes.

Recommendations

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

- ✓ A major component of any reporting system is proper monitoring and reconciliation. It is imperative that Fire reviews incentive pay expenditure and revenue activity on a regular basis. This includes reviewing individual transactions for appropriateness, completeness and adherence to requirements. Ultimately, transactions should be reconciled to the Metro financial statements to ensure the accurate and timely reflection of activity. This helps ensure the transactions were processed as intended and properly recorded. This also helps ensure the accuracy of, and strengthen the reliability of, the financial statements. Reconciliations should be documented to indicate that activity has been reviewed and appears appropriate.
- ✓ Fire should ensure their standard operating procedures regarding training records include all pertinent information related to the processing, recording, and monitoring of activity. The procedures should include sufficient details regarding the use of a computerized records management system, job duties to be performed, and copies of forms used. It should be distributed to all applicable personnel and may be used as a training manual for new staff. In addition, key personnel should be trained to help ensure consistent adherence to the requirements. The procedures should reflect the most current information and be updated periodically.
- ✓ Appropriate Fire personnel should contact the State Fire Commission regarding the requirement to submit the KPF-2A and KPF-3A forms. If it is determined that Metro is submitting sufficient documentation to the Commission and is exempt from completing the required forms, then documentation should be obtained to indicate the exemption. This will help provide support that Metro is in compliance with State regulations and requirements. If an exemption is not granted, the forms should be completed as required.

Fire's Corrective Action Plan

The Louisville Division of Fire will take the following corrective actions to address those areas identified for improvement listed in the "Incentive Pay Activity Audit Report" conducted by the Office of Internal Audit that was completed in January 2009:

1. The Louisville Division of Fire will update Standard Operating Procedure (SOP) 122.1 "Training Records." The current version of this SOP is outdated and does not accurately reflect the practice used by the Division for recording training hours by Division personnel. The updated SOP will detail the current procedures that are in place related to the processing, recording, and monitoring of training activity by the Division's personnel. The Fire Assistant Chief has been tasked with the responsibility of updating this Standard Operating Procedure.
2. The Louisville Division of Fire will work with the State Fire Commission and the Metro Finance Department on rectifying any past requests and payments that were submitted in error to assure proper reimbursement from the State to Metro Government. Fire's Business Manager II will monitor this activity for the Division.
3. Effective December 1, 2008, Louisville Metro Government ceased participation in the incentive pay program. Legislation is pending which may result in changes to this program. If in the future Metro government decides to reinstitute this program for Louisville Division of Fire employees, the Division will:
 - Consider taking over the responsibility for completing and submitting the monthly fire incentive reimbursement pay requests,
 - Contact the State Fire Commission for guidance on completing the monthly incentive pay request and assure that all required documentation and required forms are submitted, and
 - Institute written procedures to guide Division of Fire payroll personnel in the accurate completion and submission of incentive pay requests as well as establishing a procedure to review, reconcile, and document incentive pay expenditure and revenue activity on a regular basis.



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609 West Jefferson Street
Louisville, Kentucky 40202
Fax: (502) 574-3599
Email: internalaudit@louisvilleky.gov
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Name of Report Louisville Fire Department – Incentive Pay

| How do you rate this report? | | | |
|-------------------------------------|--------------------------|--------------------------|--------------------------|
| | Beneficial | Somewhat Helpful | Needs Improvement |
| Background Information | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| Details | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| Length of Report | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| Clarity of Writing | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| Potential Impact | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |

Suggestions, comments, ideas, thoughts: _____

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