



Jerry E. Abramson
Mayor
Louisville Metro Council

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Office of Internal Audit

Louisville Metro Government

Professional Services
Expenditures

Audit Report

Office of Internal Audit

Louisville Metro Government

Professional Services Expenditures

November 2009



Louisville Metro Government

Professional Services
Expenditures

Table of Contents

Transmittal Letter 2

 Introduction..... 2

 Scope..... 3

 Opinion 3

 Corrective Action Plan..... 4

 Internal Control Rating 5

 Background..... 6

 Summary of Audit Results..... 6

Observations and Recommendations 8

 #1 – Departmental Procurement 9

 #2 – Policies and Procedures 10

 #3 – Contract Compliance 13



OFFICE OF INTERNAL AUDIT
LOUISVILLE, KENTUCKY

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Transmittal Letter

November 2, 2009

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

Subject: Audit of Louisville Metro Professional Services Expenditures

Introduction

An audit of Louisville Metro Government's professional services expenditures was conducted. This included activity posted to the Metro financial system account for professional service expenditures. The primary focus of the review was determining if the activity was in compliance with Metro purchasing policies and procedures. The objective was to obtain assurance that the 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

Louisville Metro Government's professional services expenditures were reviewed. The objective was assessing compliance with the use of Professional Service Contracts in accordance with policy, including appropriate approvals, receipt of contract deliverables prior to payment processing, and service provider registration with the Metro Revenue Commission.

The audit period covered expenditures from July 1, 2008 through June 30, 2009. The population of professional service expenditures was identified by the Metro financial account (#521301) designated for this activity. Analytical reviews were performed in order to determine the number of suppliers paid, amounts paid, and the number of transactions. Samples of supporting documentation were examined to determine compliance with Metro purchasing policies and procedures. Activity reviewed included supplier payment documents, along with supporting documentation, Metro contracts and Metro financial system postings.

The review assessed whether expenditure activity was in compliance with various requirements in Louisville Metro's policies, procedures, and ordinances. The details of the scope and methodology of the review are addressed in the Observations and Recommendations section of this report. The audit would not identify all issues because it was based on a selective review of data.

Opinion

It is our opinion that the internal control structure for professional services expenditures is satisfactory. The internal control rating is on page 5 of this report. This rating quantifies the opinion regarding the internal controls. While the overall rating is satisfactory, some opportunities to strengthen the internal control structure were noted. Examples include the following.

- **Departmental Procurement.** A Louisville Metro department competitively bid and awarded a contract that exceeded \$100,000 without the involvement of Metro's Office of Management and Budget Purchasing division. It could not be independently determined if the contract was awarded to the lowest bidder or if a resolution approved by Metro Council should have been sought. Contracts awarded without the oversight of Metro Purchasing increase the risk of non-compliance with Kentucky statutes and Metro purchasing policies and procedures.
- **Policies and Procedures.** There were several transactions reviewed which did not appear to comply with procurement policy due to the absence of documentation or payment processing errors. Also, Louisville Metro's purchasing policies and procedures require updates to ensure purchases are handled appropriately and reflect the most current practices. The lack of updated policies and procedures increases the risk of non-compliance and can create inconsistencies and inefficiencies with activity processing.

- **Contract Compliance.** For two professional service contracts, work began prior to the execution of the agreements. Metro Council had not approved the appropriation to fund the renewal contracts. In addition, while activity appeared reasonable, a lack of adequate support documentation for expenditures totaling approximately \$26,700 impaired the ability to verify compliance with contractual terms.

The implementation of the recommendations in this report will help improve the internal control structure and effectiveness of the administration of professional services expenditure activity.

Corrective Action Plan

The focus of this review was the Louisville Metro enterprise, not an individual department. Each Louisville Metro department is responsible for ensuring its professional services expenditure activity is appropriate. Formal responses from the departments were not requested for inclusion in this report.

Representatives from the Office of Management and Budget were asked to provide a corrective action plan. The Office of Management and Budget's corrective action plans are included in this report. We will continue to work with the Office of Management and Budget to ensure the actions taken are effective to address the issues noted.

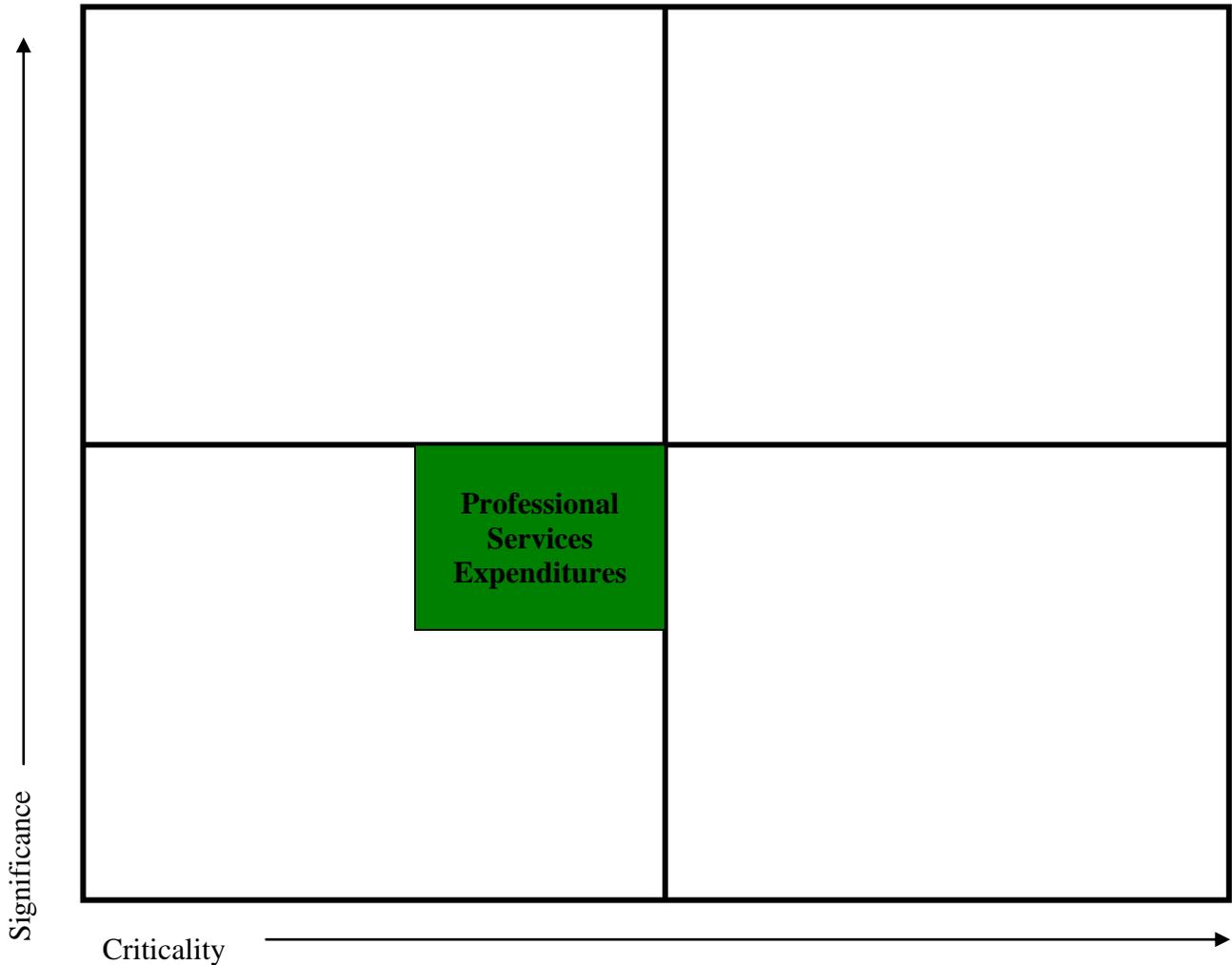
Sincerely,



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

cc: Louisville Metro Council Government Accountability and Oversight Committee
Director of Office of Management and Budget
Louisville Metro External Auditors

Internal Control Rating



<u>Legend</u>			
<u>Criteria Issues</u>	<u>Satisfactory</u> Not likely to impact operations.	<u>Needs Improvement</u> Impact on operations likely contained.	<u>Inadequate</u> 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

Louisville Metro Government's purchasing policies are based on the provisions of Kentucky Revised Statutes (KRS) 45A.343 through 460, and KRS 67C.119 (6). The policies are designed to promote sound business practices. Metro department personnel with specific purchasing authority are responsible for ensuring that Metro policies are followed. The Metro purchasing policies and procedures are specific to several types of expenditures for goods, services, and real estate.

There are four primary methods of purchasing services.

1. Purchases of licensed and non-licensed (e.g., artist) professional services \$10,000 or less use the Intent to Purchase Services procedure.
2. Purchases of licensed and non-licensed professional services of \$10,000 or more use the Professional Services Contract procedure.
3. Purchases of skilled trade services (e.g., plumber, electrician):
 - Between \$2,500 and \$10,000, Metro's Office of Management and Budget Purchasing division facilitates the transaction using the price quote procedures.
 - Purchases above \$10,000 are made using Competitive Sealed Bidding or Competitive Negotiation.
4. Purchases using State price contracts.

For fiscal year 2009, there were 3,994 payable transactions totaling approximately \$12.3 million charged to the professional services account.

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 previously conducted reviews focused solely on Louisville Metro's professional services expenditures 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 review did not disclose any instances of irregularities, any indications of illegal acts, and nothing was detected during the review 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

The focus of this review was the Louisville Metro enterprise, not an individual department. Each Louisville Metro department is responsible for ensuring its professional services expenditure activity is appropriate. Formal responses from the departments were not requested for inclusion in this report.

The Office of Management and Budget was asked to provide a corrective action plan. A draft report was issued to the Office of Management and Budget on September 30, 2009. An exit conference was held at the Office of Management and Budget on October 21, 2009. Attending were Jane Driskell, Kevin Moore and Daniel Frockt representing the Office of Management and Budget; and Michael Norman, Mary Ann Wheatley and Scott Shelton representing Internal Audit. Final audit results were discussed.

The views of the Office of Management and Budget were received on October 30, 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 Office of Management and Budget response was provided within this required timeframe.

Observations and Recommendations

Scope

Louisville Metro Government's professional services expenditures were reviewed. The objective was assessing compliance with the use of Professional Service Contracts in accordance with policy, including appropriate approvals, receipt of contract deliverables prior to payment processing, and service provider registration with the Metro Revenue Commission.

The audit period covered expenditures from July 1, 2008 through June 30, 2009. The population of professional services activity was identified by reviewing the activity recorded in the Metro financial account for professional services (#521301). An analytical review of fiscal year 2009 activity was performed to quantify the number of transactions and dollar amount by Metro department.

A sample of 20 professional services expenditures was selected for review from the period July 1, 2008 through December 31, 2008. Judgmental sampling techniques were used to select the sample. Departments and suppliers with greater than 5% of the total population represented 65% of the sample selected. This included the number of transactions and total dollar amounts expended. The other 35% of the sample was intentionally selected to represent a broad coverage of Metro departments. Care was used so that the sample did not include only activity with a higher probability of compliance issues.

The review assessed whether expenditure activity was in compliance with Metro purchasing policies and procedures. This included examination of supplier payment documents, along with supporting documentation, professional services contracts, price contracts, intent to purchase services contracts and Metro financial system postings. The audit would not identify all issues because it was based on a selective review of data.

Observations

The overall internal control structure is satisfactory. However, there were some opportunities noted for improving the Louisville Metro professional services expenditure activity. Examples include the following.

- #1 Departmental Procurement
- #2 Policies and Procedures
- #3 Contract Compliance

Details of these begin on the following page.

#1 – Departmental Procurement

A Louisville Metro department competitively bid and awarded a contract that exceeded \$100,000 without the involvement of Metro's Office of Management and Budget Purchasing division. In the absence of a fiscal agent agreement specifying purchasing authority, contracts awarded without the oversight of Metro Purchasing increase the risk of non-compliance with Kentucky statutes and Metro purchasing policies and procedures.

- Compliance with intended policies and procedures could not be determined. As department personnel competitively bid the awarded contract, it could not be independently substantiated that the contract was awarded to the lowest evaluated bidder, and subsequently whether a resolution approved by Metro Council should have been obtained.
- Custodial responsibility for the required insurance certificate could not be substantiated. The Metro department awarding the contract forwarded the contract to the Office of Management and Budget Risk Management division without a copy of the insurance certificate. While a copy of the insurance certificate was obtained from the Metro department, in the absence of a fiscal agent agreement, the appropriate custodian of record could not be determined.

Recommendations

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

- ✓ It is the responsibility of each department to administer its fiscal activity in compliance with applicable guidelines. However, when guidelines do not exist for certain purchasing activities, it becomes the responsibility of the Office of Management and Budget and the department to define fiscal agent responsibility. Documented procedures and agreements should ensure risks are properly mitigated.

Office of Management and Budget's Corrective Action Plan

The Office of Management & Budget is in the process of re-evaluating the services Metro Government provides to agencies as fiscal agent. During FY2010/2011, OMB will be working to implement formal fiscal agent agreements that specifically define the roles of both Metro Government and the agency.

#2 – Policies and Procedures

Issues were noted regarding the processing of professional services expenditures activity and compliance with Louisville Metro's purchasing policies and procedures. Specifics include the following.

- **Activity Processing.** There were several transactions reviewed which did not comply with procurement policy or payment procedures. When policies and procedures are not followed, the effectiveness of the internal control structure is impaired.
 - For one transaction, it appeared the service provider billed for two separately contracted services on one invoice. However, the entire invoice amount of \$8,435 was incorrectly charged to one purchase order.
 - For one transaction, professional services were purchased directly from the supplier, without the required Intent to Purchase Services (ITPS) form. According to the Office of Management and Budget small purchase policy, if the service is under \$10,000 and not a skilled trade, it should be purchased using an ITPS form.
 - For one transaction, a Contract Data Sheet (CDS) could not be provided for an addendum to amend a Professional Services Contract (PSC). Completion of the form includes the identification of the PSC as either new, renewal or addendum. A completed CDS is part of satisfying the written determination that competition is not feasible and that 1 of 12 conditions has been met.
 - For one transaction, the invoice number was altered to process a separate payment for mileage expense through an account other than professional services. Although the expense was allowable under the terms of the contract, the invoice number should not have been altered.
- **Documented Procedures.** Louisville Metro's purchasing policies and procedures are not up to date to reflect the most current practices. The lack of updated policies and procedures increases the risk of non-compliance, and can create inconsistencies and inefficiencies with activity processing.
 - There were eight competitively bid service contracts (price, management agreements, and special projects) reviewed where the expenditures were expected to be greater than \$100,000. Metro purchasing policies and procedures require these types of contracts to have a resolution approved by Metro Council. However, none of these contracts received Metro Council approval. Metro Purchasing personnel indicated that all competitively bid contracts are awarded to the lowest evaluated bid, and therefore do not require Metro Council approval, as cited in the FY09 Operating Budget Ordinance #112.
 - A review of Metro purchasing policies and procedures for non-competitive negotiation procedures indicated the routing instructions for Professional Services Contracts require updates. There were references made to forward the original contract to the Cabinet Secretary. Metro no longer has Cabinet Secretaries.

- **Account Usage.** There appeared to be a number of transactions that did not belong in the professional services expenditures account. In these instances, an account was available that was more descriptive of the services purchased. Using financial accounts that are not as descriptive of the activity limits the usefulness of financial reports as oversight and management tools.
 - For two Metro departments, the professional services account was used to classify rentals and food. One of the two departments used the account for membership dues, gift cards and DVD players, while the other department used the account for supplies.

Recommendations

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

- ✓ Exceptions to established policies and procedures should be thoroughly documented. This includes approval for the exception. This documentation should be retained with the other contractual documentation in the Office of Management and Budget. This will assist in the ability to monitor contractual activity for appropriateness.
- ✓ The Office of Management and Budget should be the official custodian of all records pertaining to Metro procurement activity. Original documentation (invoices, contracts, bid quotes) should be maintained by the official custodian (either the Accounts Payable division or Purchasing division) in a centralized file. This is necessary to ensure that various requirements (e.g., KRS) are satisfied.
- ✓ Department personnel should not alter an invoice. This includes changing an invoice number to create a different invoice. Required changes should only be made by the supplier submitting a corrected invoice. Training of key personnel may be beneficial to ensure compliance with Metro policies and procedures.
- ✓ The Office of Management and Budget personnel should review the Metro purchasing policy and procedures to ensure they are up to date in addressing all aspects related to purchasing. The procedures should address all purchasing practices with regard to who is responsible for processing and monitoring the activity. The updated procedures should be distributed to all applicable personnel. This will assist in the adherence to applicable guidelines, and promote consistency in the processing and monitoring of contractual activity.
- ✓ Departmental personnel should ensure expenditure activity is coded to the financial accounts most descriptive of the goods / services received. The financial system chart of accounts should be referenced to identify the most appropriate account to use.
- ✓ Departmental personnel should be aware that while specific accounts may not have a budget allocation, they can still be used in many cases to best describe financial activity.
- ✓ Ultimately, each department is responsible for administering its fiscal activity in compliance with applicable guidelines. Each Louisville Metro department should review its policies and procedures related to the administration of expenditures. The

goal should be ensuring the risks are properly mitigated through the use of internal controls.

Office of Management and Budget's Corrective Action Plan

It is important to note that the findings in the audit were not related to contracts initiated by the Office of Management & Budget. However, because OMB controls the policies and procedures governing professional service contract, the internal auditor requested OMB to respond to the audit recommendations.

Exceptions to established policies and procedures are documented and retained with contractual or payment documentation in the Office of Management and Budget. As stated in the auditor's recommendations, "Ultimately, each department is responsible for administering its fiscal activity in compliance with applicable guidelines." Many of the recommendations made by the auditor are currently documented in existing policies (i.e. invoice splitting, procurement methods, contract documentation). OMB is currently in the process of thoroughly reviewing existing policies and procedures and will be issuing revisions to most policies during FY 2010 and FY 2011. Going forward, policies will be reviewed on an annual or bi-annual basis, depending on the policy, to ensure the policies remain up to date. As the policies are revised, departments will be notified of the changes prior to their effective date.

In the case where the Contract Data Sheet was missing, it cannot be determined if the form was originally submitted to Accounts Payable and misfiled once the contract was set up in the financial system, or not completed and submitted by the requesting department at all. OMB is in the process of implementing an imaging system that will retain scanned images of all contractual documentation. OMB believes this new technology will greatly reduce the misfiling of documentation and increase the efficiency of the overall process.

Departments do have access to the full listing of natural accounts available for use in the financial system. Departments are solely responsible for ensuring expenditures are charged to the appropriate account code.

To ensure corrective actions were taken as a result of this audit, OMB staff met with the auditor that conducted the review and obtained documentation related to contract compliance examples. These findings, as well as appropriate corrective actions were reviewed, or are being reviewed, with each department during their monthly budget review with OMB. Several of those departments have already conducted a follow up review to the finding and are implementing corrective actions within their department.

#3 – Contract Compliance

Issues were noted regarding compliance with contractual terms for professional services expenditures. Examples include the following.

- **Authorization.** There were two transactions reviewed where contractor services were provided prior to their respective noncompetitively negotiated Professional Service Contracts (PSC) receiving approval from the Metro Council.
 - According to one invoice, activity began October 2008. The pay document also included a second invoice for activity that began in July 2008. Metro Council approved the contract renewal on November 20, 2008. The total payment amount for the two invoices was \$650,000.
 - According to another invoice, services were rendered for the month of June 2008. Metro Council approved the contract on July 10, 2008. In this instance the invoice for prior period services was paid under a new, renewal PSC rather than the PSC in effect when services were performed. The payment amount for this invoice totaled approximately \$4,465.
- **Support Documentation.** There were several payment transactions in which compliance with contractual terms for price or services rendered could not be verified. The total amount of expenditures associated with these issues was approximately \$26,700. While the activity appeared to be reasonable, a lack of adequate support documentation impaired the ability to verify compliance with contractual terms. Issues include the following.
 - For one invoice, the billing rate of \$130 per hour was significantly more than any hourly rate listed in the contract. Although the contract was renewed, no documentation was available to support rate adjustments or approval through Metro Purchasing. Also, a description of the services performed was not provided. As the contract listed varying hourly rates based on specific services provided, there was insufficient detail to verify the invoice amount of \$9,750 to contractual terms.
 - For a second invoice, the billing contained an amount due for the period and number of service contacts made, but not the services provided. As the contract listed varying fees based on specific services provided, there was insufficient detail to verify the invoice amount of \$9,990 to contractual price terms.
 - For a third invoice, a third party reimbursable charge was paid without adequate support documents (invoice / receipt) as specified in the contract. In addition, a charge for an administrative fee was paid that was not included in the contract's payment terms. The amount totaled approximately \$520.
 - For another invoice, a daily account of activity performed and hours expended was not provided as specified in the professional services contract. In the absence of a descriptive daily accounting of hours and services performed, compliance with contractual service terms could not be verified. This payment was approximately \$6,440.

Recommendations

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

- ✓ Departmental personnel should verify applicable contract terms are followed before a request for payment is made. Support documentation should be reviewed for accuracy, to ensure payment terms and contract deliverables are met. Ultimately, it is the responsibility of the department to ensure the accuracy of contract payments.
- ✓ Departmental managers responsible for approving payments should ensure applicable requirements / terms have been followed. This may require reviewing supporting documentation to include the actual contract. This will help ensure contract compliance and the accuracy of the payment.
- ✓ Additional training of key personnel may be beneficial to ensure support documentation is forwarded to the Office of Management and Budget, the official custodian of all payment records. This includes payment documents, invoices, and any support detail. This will improve consistency with required documentation for payment.
- ✓ The Office of Management and Budget should monitor payment transactions to help ensure invoice detail is complete. Departments should be held accountable for ensuring sufficient detail is provided on the invoice or included as supporting documentation when submitting a request for payment. This will support the appropriateness of the payment requested.
- ✓ Care should be taken by department personnel to ensure additions / deletions to contract terms and conditions are handled through Metro Purchasing. This includes contract addendums, renewals, contract deliverables and any rate changes. Training of key personnel should be required to ensure contract related information is properly forwarded for review. This will also help ensure contractual requirements are met and consistent with Metro policies and procedures.

Office of Management and Budget's Corrective Action Plan

Departments that allow a contractor to begin work prior to the full execution of the professional service contract are in violation of the procurement policy. Without a fully executed contract, departments do not have the authority to allow the work to commence. Further, departments cannot make payment to contractors without an executed contract and approved Council resolution approving the appropriation to fund a contract where the annual amount spent with the contractor is greater than \$10,000. Accounts Payable standard operating procedures only allow a contract to be established on Metro's financial system once the contract is fully executed by all parties and is accompanied by an approved resolution from Council approving the appropriation to fund the contract.

Accounts Payable staff is responsible for reviewing payment transactions to ensure invoice documentation is complete. Overall, the division is staffed with one Supervisor and three Finance Specialists. In addition, a Finance Technician was reassigned to the Accounts Payable division within the last several months. The division processes on average 135,000 invoices per year, not including employee travel

documents, Professional Service Contracts and Intent to Purchase Service agreements. Of the 135,000 invoices processed manually, many are returned to the originating department for additional support. As previously stated, OMB is in the process of implementing an imaging and process management system. This system will increase visibility into invoice processing and the dialog between AP and department business offices. All approvals and supporting documentation will be maintained in an electronic format within the financial system. OMB feels this project will substantially reduce, if not eliminate documentation issues on the large volume of invoice processed annually.

To ensure corrective actions were taken as a result of this audit, OMB staff met with the auditor that conducted the review and obtained documentation related to contract compliance examples. These findings, as well as appropriate corrective actions were reviewed, or are being reviewed, with each department during their monthly budget review with OMB.

With regards to training, OMB has provided and continues to provide training opportunities to appropriate departmental staff. This training ranges from individual one on one training to classroom style training sessions for larger groups of employees.

On August 17, 2009, OMB held a meeting with department representatives and invited the Attorney General's office to attend in order to specifically address records management and the responsibilities of all Metro Government employees. Additionally, Metro Government's Open Records policy clearly defines the director of Office of Management and Budget as the official custodian of Louisville Metro's public records with exception to official records of the Louisville Metro Council and 911 dispatch tapes held by MetroSafe.

OMB agrees with the auditor's recommendation to ensure contract changes are handled through the Purchasing division of OMB. Additional training and clarification of the process will be disseminated to key personnel to ensure contractual requirements are met and consistent with Metro policies and procedures.

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