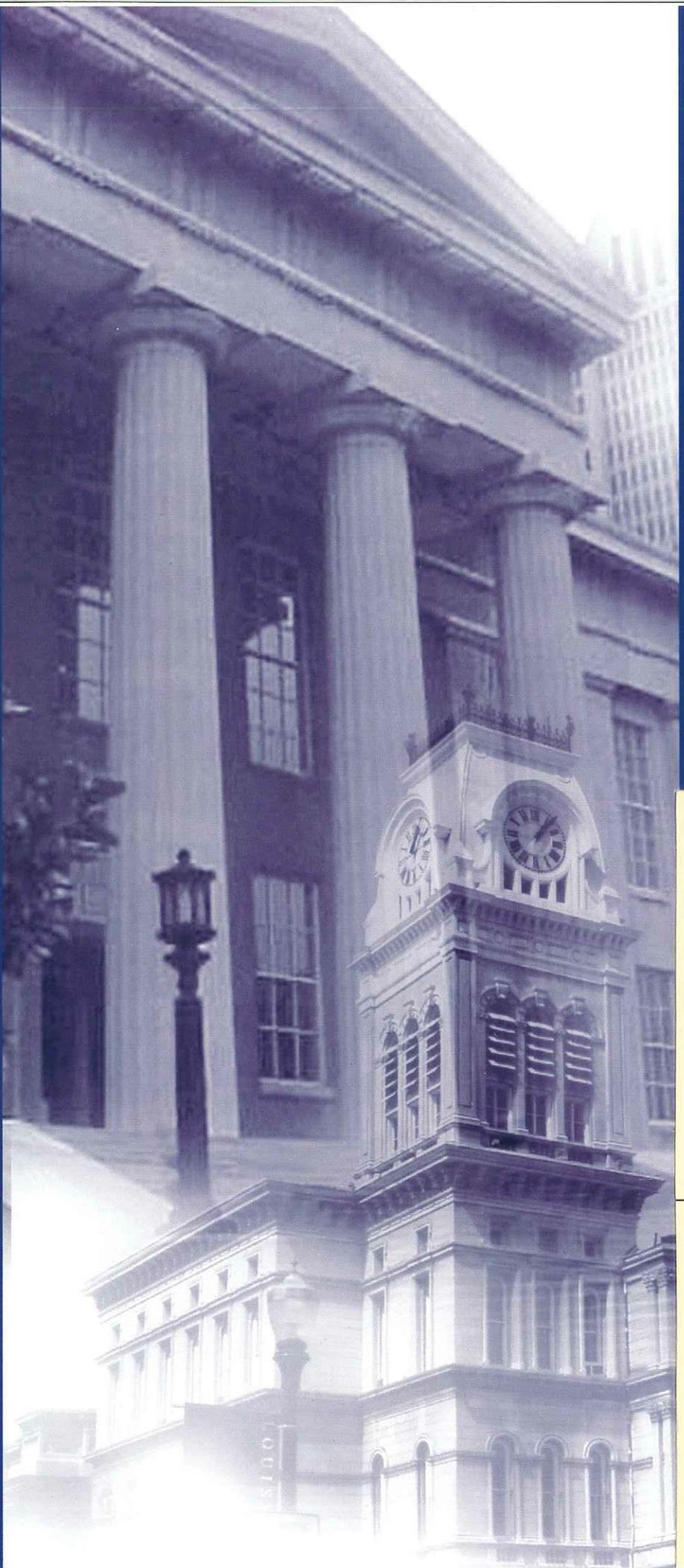




Jerry E. Abramson
Mayor
Louisville Metro Council

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

Louisville Metro Government

Privileges Receipts

Audit Report

Office of Internal Audit

Louisville Metro Government

Privileges Receipts

December 2009



Louisville Metro Government

Privileges Receipts

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

 Office of Management and Budget’s Corrective Action Plan 11



OFFICE OF INTERNAL AUDIT
LOUISVILLE, KENTUCKY

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Transmittal Letter

December 28, 2009

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

Subject: Audit of Louisville Metro Government's Privileges Receipts

Introduction

An audit of Louisville Metro Government's privileges receipts was conducted. This included a review of all receipt activity posting to the financial revenue account #431136, called "license fees" This account encompasses an annual Louisville Gas and Electric franchise fee and monthly Transit Authority of River City shelter fees. 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

The procedures for the administration of Louisville Metro Government's privileges receipts were reviewed through interviews with key personnel and an examination of applicable support documents. This included all revenue activity posting to the "license fees" financial account #431136. The primary focus was the operational and fiscal administration of the activity. Sample data pertaining to the Louisville Gas & Electric (LG&E) annual franchise fee paid in February 2009 was reviewed. In addition, monthly Transit Authority of River City (TARC) shelter fee receipts were reviewed from the period July 2008 through September 2009.

The review included assessing whether activity was processed, recorded, and monitored accurately and appropriately. This included ensuring that receipts were complete and accurate in accordance with agreement terms. 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 the administration of Louisville Metro's privileges receipt activity needs improvement. The internal control rating is on page 5 of this report. The rating quantifies our opinion regarding the internal controls, and identifies areas requiring corrective action. Opportunities to strengthen the internal control structure were noted. Examples include the following.

• Louisville Gas and Electric Franchise Fee.

- The franchise agreement between Louisville Metro and LG&E ended October 15, 2003. Office of Management and Budget (OMB) personnel were aware the agreement had ended and stated it had not been renewed due to considerations of other options. LG&E is still making payments to Louisville Metro even though the agreement has expired.
- Though OMB performs a cursory review of the annual franchise fee, the review is not documented to support that the amount is appropriate based on agreement terms.

• TARC Shelter Fees.

- Louisville Metro receives monthly payments from TARC for advertising revenue TARC receives from a contracted vendor. The basis for TARC providing the fees could not be determined. It could not be determined whether TARC has an obligation or is required to pay the advertising revenues to Louisville Metro. It does not appear that a documented contract or agreement exists between Louisville Metro and TARC for the revenue payments.

- OMB does not perform a reconciliation of TARC shelter fees to ensure amounts are appropriate.

The implementation of the recommendations in this report will help improve the internal control structure and effectiveness of the administration of Louisville Metro's privileges receipt activity.

Corrective Action Plan

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

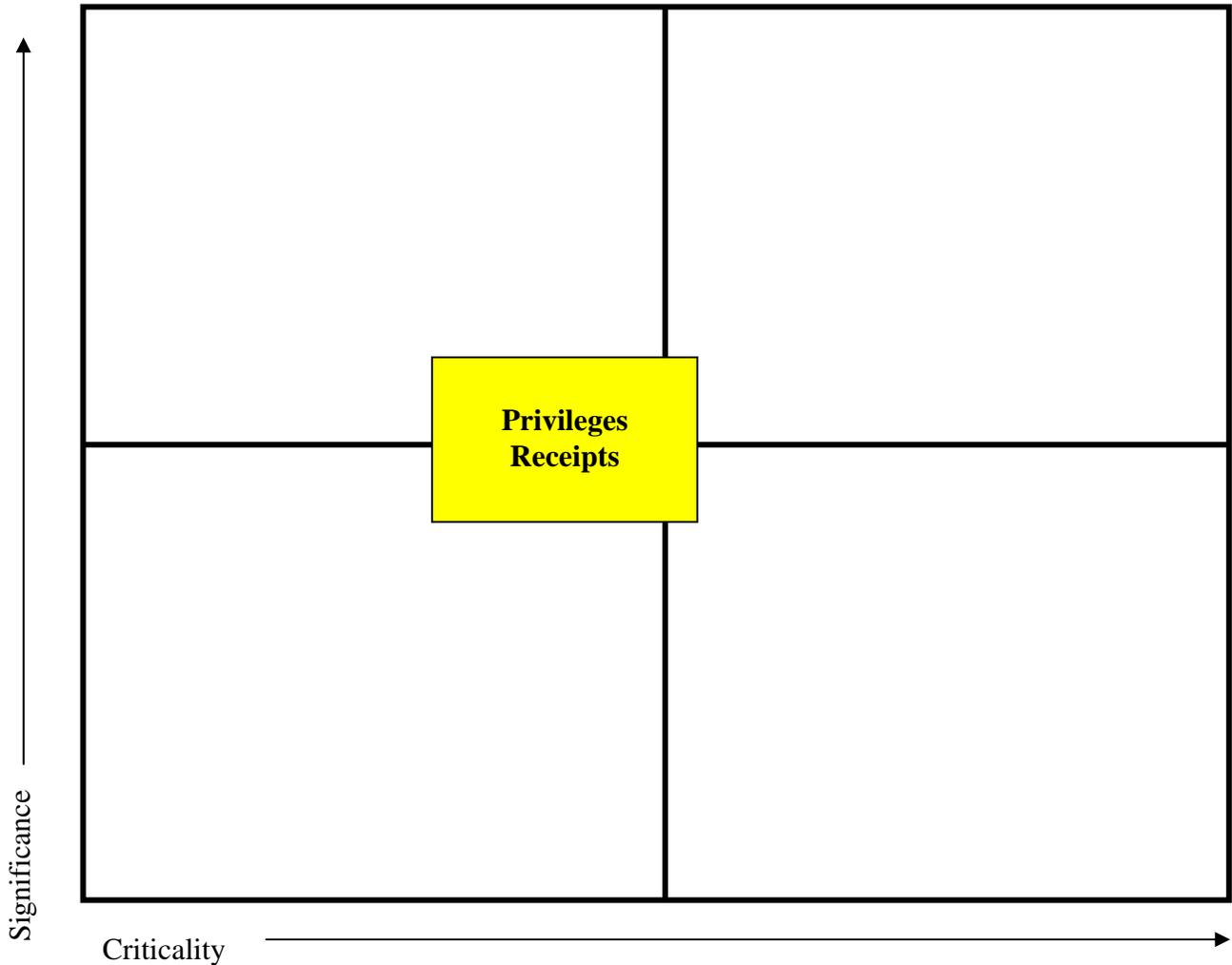
Sincerely,



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 privileges receipts represent payments for encroachment along right-of-ways. Funds received during fiscal year 2009 included the following.

Louisville Gas and Electric (LG&E) Franchise Fee. Louisville Metro Government entered into a franchise agreement with LG&E beginning October 1996. The franchise was created to ensure that a system was in place for the transmission, distribution, and sale of gas for heating and other purposes along the City of Louisville's public streets, avenues and other public ways. The franchise requires that a fee be paid to Louisville Metro annually based on specific terms noted within the agreement. Louisville Metro received approximately \$549,000 for the annual LG&E franchise fee payment made in February 2009.

Transit Authority of River City (TARC) Shelter Fees. Louisville Metro receives monthly payments from TARC pertaining to advertising revenues it receives from a contract vendor. According to the contract between TARC and the vendor, the vendor provides transit shelter services, such as the construction and maintenance of shelters, and compensates TARC for the right to display advertising on the shelters. TARC then passes the advertising revenues on to Louisville Metro Government. Louisville Metro received approximately \$90,000 for the monthly TARC shelter fee payments in fiscal year 2009.

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 a review of Louisville Metro Government's privileges receipt 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

A draft report was issued to the Office of Management and Budget on November 23, 2009. It was determined that a formal exit conference was not necessary.

The views of OMB officials were received on December 18, 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.”*

OMB’s response was provided within this required timeframe.

Observations and Recommendations

Scope

The administration of Louisville Metro Government's privileges receipts was reviewed. This included all revenue activity posting to the "license fees" financial account #431136. The primary focus was the operational and fiscal administration of the activity, including how it is processed, recorded, and monitored. The objective was to obtain assurance that the risks are adequately mitigated through the internal control structure.

Key personnel were interviewed and applicable support documents were examined in order to gain a thorough understanding of the administration of the privileges receipts. Testing of activity, such as the completeness and accuracy of revenue receipts, was also performed to determine the effectiveness of the controls. Sample data pertaining to the Louisville Gas and Electric (LG&E) annual franchise fee paid in February 2009 was reviewed. In addition, monthly Transit Authority of River City (TARC) shelter fee receipts were reviewed from the period July 2008 through September 2009. The review would not reveal all weaknesses because it was based on selective review of data.

Observations

Some issues were noted with the administration of Louisville Metro Government's privileges revenue receipts. As a result, the effectiveness of the internal control structure is impaired and needs improvement. Examples include the following.

LG&E Franchise Fee

- **Expired Agreement.** The franchise agreement between Louisville Metro and LG&E was created with a term of seven years, ending October 15, 2003. The ordinance creating the franchise also noted a term no greater than seven years. Office of Management and Budget (OMB) personnel were aware the franchise agreement had ended and stated it had not been renewed due to considerations of other options. LG&E is still making franchise fee payments to Louisville Metro. The lack of a documented renewal agreement could lead to a loss of revenue for Louisville Metro since LG&E does not appear obligated to make payments based on the agreement expiration date.
- **Reconciliation.** Though OMB performs a cursory review of account activity to ensure the franchise fee payment is received and is appropriate, the review is not documented. There is no support documentation to indicate the review was performed and nothing to support whether the payment amount was appropriate based on agreement terms (e.g., recalculation of payment amount based on prior year's fee payment and applicable Consumer Price Index; payment timeliness).
 - The Office of Internal Audit did not recalculate the fee due to the complexity of the agreement formula and lack of support documentation.

TARC Shelter Fees

- **Lack of contract / agreement.** Louisville Metro receives monthly payments from TARC for advertising revenue TARC receives from a contracted vendor. The basis for TARC providing the fees to Louisville Metro could not be determined. Inquiries were made of OMB and Louisville Metro Public Works and Assets personnel. It could not be determined whether TARC has an obligation or is required to pay the advertising revenues to Louisville Metro. It does not appear that a documented contract or agreement exists between Louisville Metro and TARC regarding the revenue payments. The lack of documentation regarding the activity could lead to a loss of revenue for Louisville Metro since an obligation to pay is not documented.
- **Reconciliation.** The Cash Management division of OMB receives the monthly TARC shelter fee payments and deposits them accordingly. They maintain and store documentation of the shelter fee payments with their daily cash deposit activity. However, a reconciliation is not performed to ensure the shelter fee payment amounts are appropriate (i.e., payments are not verified for agreement to the contract terms between TARC and the vendor).
 - All of the TARC shelter fee payments received by Louisville Metro during the review period appear to agree with the contract terms noted between TARC and the vendor. However, the verification is qualified in that the review did not include verifying the accuracy of net billing amounts reported by the vendor.

Recommendations

Appropriate Office of Management and Budget personnel should take corrective action to address the issues noted. Specific recommendations include the following.

- ✓ Louisville Metro Government should have a legally executed agreement with LG&E for the annual payment it receives. This will help ensure that LG&E is held accountable for the payment and will provide support documentation regarding payment terms (e.g., payment amount and due date). OMB personnel should obtain legal guidance in determining the best way to address this issue. It is important to note that this should not be perceived as a recommendation to renew the franchise agreement. The Office of Internal Audit is not making a recommendation related to the franchise agreement. The focus of this recommendation is an agreement only for the annual payment.
- ✓ OMB personnel should document the reconciliation of the annual franchise fee payment. Documentation should note who performed the reconciliation, when it was performed, and details regarding the appropriateness of the payment (e.g., prior year payment, applicable Consumer Price Index, recalculation of amount due). Documenting reconciliations provides for accountability of monitoring efforts and in turn helps ensure that Louisville Metro is receiving the proper funds due.
- ✓ OMB personnel should determine the basis (e.g., statutory, contractual) for TARC's monthly shelter fee payments. Once the basis is determined, the necessity of a formal agreement between Louisville Metro Government and TARC can be determined. A formal agreement helps ensure the payments continue to be made as anticipated and provides support documentation regarding payment terms (e.g., payment amounts and due dates).

- ✓ OMB should assign the responsibility of reconciling the monthly TARC shelter fee payments to appropriate personnel. Monitoring of the activity will help ensure that payments are being made and for the appropriate amounts. Reconciliations should be documented to support that they were performed. This could be in the form of initialing payment support documentation to indicate the amount paid is appropriate. If feasible, it may also be beneficial to obtain some type of assurance of net billings.

Office of Management and Budget's Corrective Action Plan

LG&E Franchise Fee

- OMB will seek appropriate advice from the County Attorney as it relates to this annual payment.
- The annual franchise fee payment was monitored relative to the budgeted expectation of associated revenue based on the CPI increases to the agreement through routine monthly review of General Fund revenue receipts as well as forecasting; however, the specific reconciliation was not documented. To address the need for documentation, OMB will put into practice, a review of the payment from LG&E signed (or initialed) by a member of the Budget Division, with a review date, and the appropriate calculation, as supporting documentation to the fee collected.

TARC Shelter Fees

- OMB agrees with the recommendation and has subsequently worked with the County Attorney's Office to draft a Memorandum of Understanding regarding TARC's monthly shelter fee payments to Louisville Metro. The draft agreement has been forwarded to TARC for review.
- OMB currently has a Cash Management Coordinator reconciling the associated deposit to the back-up material provided by TARC. To implement the recommendation, the Cash Management Coordinator will now initial the deposit activity to indicate that the back-up material was reviewed. OMB will seek the assistance of Internal Audit to provide assurance of net billings for this revenue activity.

Office of Internal Audit
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