



Jerry E. Abramson
Mayor

Louisville Metro Council

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Office of Internal Audit

Louisville Metro Government

Capital Projects Reporting

Audit Report

Office of Internal Audit

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October 2010



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Transmittal Letter

October 13, 2010

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

Subject: Audit of Louisville Metro Government's Capital Projects Reporting Process

Introduction

An audit of Louisville Metro Government's capital projects reporting process was performed. The primary focus of the review was the operational and fiscal administration of the activity, which included how the activity is processed, recorded, monitored and reported. This included verifying the accuracy of activity reported to the Louisville Metro Council, and compliance with requirements. The objective of the review was to obtain assurance that risks are adequately mitigated through the internal controls in the process.

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 operating procedures for Louisville Metro Government's capital projects reporting process were reviewed through interviews with key personnel. This primarily consisted of Office of Management and Budget personnel due to their responsibility in reporting capital project activity to the Metro Council. The focus of the review was the operational and fiscal administration of the activity, which included how activity is processed, recorded, monitored and reported. The objective was to obtain assurance that risks are adequately mitigated through the internal control structure.

The fiscal year 2010 first quarter Capital Projects Status Report was reviewed. The review focused on the accuracy of the amounts shown in the Budget, Encumbrance, Actual and Remaining Budget columns for each capital project listed. Supporting financial system records were reviewed for a sample of projects listed on the report.

The review included assessing whether the Capital Projects Status Report was processed accurately and in compliance with requirements. 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 Louisville Metro Government's capital projects reporting process 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.

- **Reporting Consistency.** The fiscal year 2010 capital budget ordinance requires written quarterly reports of the status of all capital projects to be submitted no later than six weeks after each quarter end. There were two compliance issues noted in regards to the capital budget ordinance.
 - The fiscal year 2010 first quarter Capital Projects Status Report was dated November 30, 2009, which is eight weeks after the quarter ending September 30, 2009. This report was due to the Metro Council's Budget Committee no later than six weeks after the quarter end.
 - The capital projects activity was not reported on a quarterly basis. The fiscal year 2010 first quarter Capital Projects Status Report included expenses through December 3, 2009. The first quarter report should have only included transactions through September 30, 2009.
- **Policies and Procedures.** The Office of Management and Budget has standard operating procedures for end of quarter capital projects reporting. However, there is not a documented, comprehensive procedure to guide personnel in creating and reconciling the Capital Project Status Report. This increases the risk of non-

compliance with ordinance requirements and can lead to inconsistencies and inefficiencies with activity processing.

The implementation of the recommendations in this report will help improve the internal control structure and effectiveness of the administration of the capital projects reporting process.

Corrective Action Plan

The focus of this review was Louisville Metro Government's capital projects reporting process. The Office of Management and Budget (OMB) is responsible for submitting written quarterly reports to the Louisville Metro Council Budget Committee. OMB was asked to provide a corrective action plan for the recommendations in this report. The corrective action plans are included in this report in the Observations and Recommendations section. We will continue to work with OMB to ensure the actions taken are effective to address the issues noted.

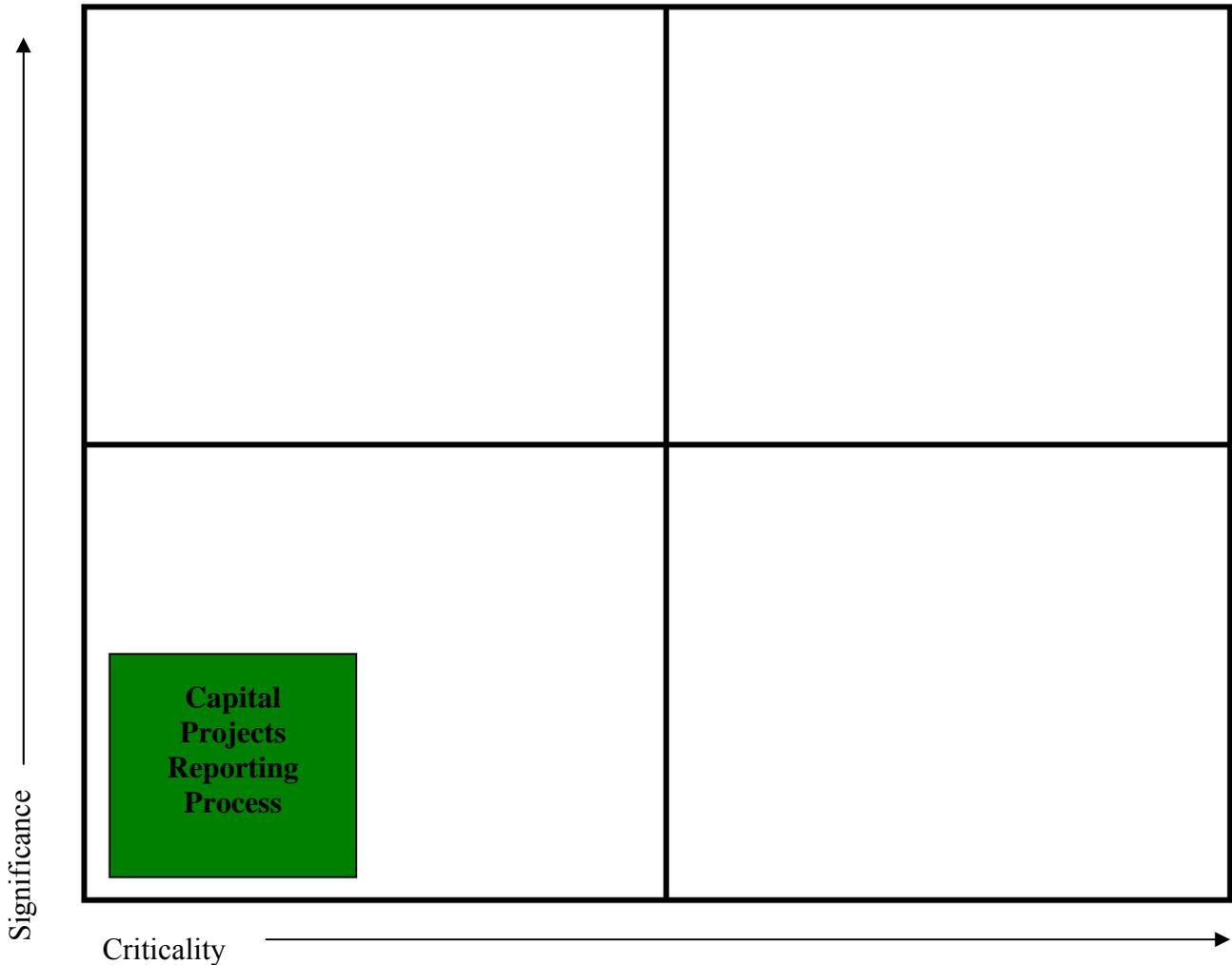
Sincerely,



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

Capital projects are authorized by ordinances approved by the Louisville Metro Council, and may be authorized as part of the annual budget process or appropriated at any time during the fiscal year. The fiscal year 2010 capital budget ordinance requires written quarterly reports of the status of all capital projects. These quarterly reports are to be submitted to the Metro Council Budget Committee no later than six weeks after each quarter ending September 30, December 31, March 31, and June 30.

Expenses and encumbrances to a capital project are initiated and processed by the department for which the project was approved or by the Office of Management and Budget's (OMB) Budget Division. A master list of all capital projects is updated by OMB's Budget Division the second Thursday of each month after the close of the quarter. Departments file quarterly reports with the Budget Division that includes the status of capital projects. Budget Division personnel review the status of capital projects and update the master list.

The fiscal year 2010 first quarter Capital Projects Status Report listed approximately 1,150 capital projects, with a total budget of \$588.6 million and expenditures of \$308.4 million.

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 performed a review of Louisville Metro Government's capital projects reporting process.

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 (OMB) on September 7, 2010. It was determined that a formal exit conference was not necessary.

The views of OMB officials were received on October 4, 2010 and are included as corrective action plans in the Observation 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’s response was provided within this required timeframe.

Observations and Recommendations

Scope

The operating procedures for Louisville Metro Government's capital projects reporting process were reviewed through interviews with key personnel. This primarily consisted of Office of Management and Budget personnel due to their responsibility in reporting capital project activity to the Metro Council. The focus of the review was the operational and fiscal administration of the activity, which included how activity is processed, recorded, monitored and reported. The objective was to obtain assurance that risks are adequately mitigated through the internal control structure.

The fiscal year 2010 first quarter Capital Projects Status Report was reviewed. The review focused on the accuracy of the amounts shown in the Budget, Encumbrance, Actual and Remaining Budget columns for each capital project listed. Supporting financial system records, such as Leap capital budget reports, were reviewed for a sample of projects listed on the report. The review included assessing whether the Capital Projects Status Report was processed accurately and in compliance with requirements. The audit would not identify all issues because it was based on a selective review of data.

Observations

The internal control structure for the Louisville Metro capital projects reporting process is satisfactory. While the overall rating is satisfactory, some opportunities to strengthen the internal control structure were noted. Specifics include the following.

- **Reporting Consistency.** The fiscal year 2010 capital budget ordinance requires written quarterly reports of the status of all capital projects to be submitted to the Metro Council Budget Committee no later than six weeks after each quarter ending September 30, December 31, March 31, and June 30. There were two issues noted in regards to compliance with the ordinance.
 - The fiscal year 2010 first quarter Capital Projects Status Report was dated November 30, 2009, eight weeks after the quarter ending September 30, 2009. The report was due to Metro Council's Budget Committee no later than six weeks after the quarter end.
 - The capital projects activity was not reported on a quarterly basis. The fiscal year 2010 first quarter Capital Projects Status Report, dated November 30, 2009, included activity that was entered into Louisville Metro's financial system through December 3, 2009. The first quarter report should only include transactions through September 30, 2009. This weakens the reliability of the report and limits its usefulness for oversight purposes.
- **Policies and Procedures.** The Office of Management and Budget has standard operating procedures for end of quarter capital projects reporting. However, there is not a documented, comprehensive procedure to guide Budget Division personnel in creating and reconciling the Capital Project Status Report. This increases the risk of

non-compliance with requirements and can lead to inconsistencies and inefficiencies with activity processing.

- **Inaccurate Reporting.** The fiscal year 2010 first quarter Capital Projects Status Report contains subtotals for each funding source and department within the funding source. There were two incorrect subtotals noted.
 - The subtotals were created through manually entered formulas that omitted two department totals in the calculation. It is important to note that the projects for the two departments were listed, so the information was recorded on the report.
 - The two subtotals were underreported by \$1,492,000.

Recommendations

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

- ✓ The Office of Management and Budget should submit written quarterly Capital Project Status Reports to the Louisville Metro Council Budget Committee in compliance with ordinance requirements.
- ✓ The Capital Project Status Reports should be prepared on a quarterly basis. This will allow for consistency for use in oversight and monitoring activities.
- ✓ The Office of Management and Budget should develop policies and procedures to guide personnel in the quarterly reporting of capital projects to the Louisville Metro Council Budget Committee. The policies should include sufficient detail for each duty performed so that someone unfamiliar with the process could complete the activity.
- ✓ Policies and procedures should include a verification process for all manually entered formulas in the Capital Project Status Report.

Office of Management and Budget's Corrective Action Plan

The Office of Management and Budget (OMB) provided the Metro Council Budget Committee a Capital Project Status Report that was run as of December 3, 2009. This means that the financial information provided to the Budget Committee at its December 8, 2009 meeting was less than one week old. Had OMB provided a report as of September 30, 2009, the financial information would have been more than nine weeks out-of-date. The December 8th Budget Committee meeting was the first opportunity for OMB to provide an update on the FY10 capital report due to Committee agendas that were comprised of legislation related to the multi-decade firefighter settlement, a bond refunding, and a new bond issue related to the American Reinvestment and Recovery Act. In short, OMB attempted to provide the most recent financial information to the Metro Council relative to its opportunity to address the Budget Committee. OMB will work with the Budget Committee chair to provide the most beneficial capital project status information to the committee.

As indicated in this report OMB, “has standard operating procedures for end of quarter capital projects reporting.” Logically, the policies inherently include sufficient detail for each duty performed—the procedures clearly give direction so that a new budget analyst would be able to produce a Capital Project Status Report. As indicated in the interview process, the budget analyst interviewed was not the first analyst to produce the report, nor was he the only analyst in OMB capable of producing the report.

As noted in this report, all projects “were listed” on the Capital Project Status Report. The issue of subtotals arose because there is no pre-existing report in the financial system against which to confirm the subtotals. The financial system does contain an overall total of projects (not delineated by subtotals) and the totals are simply used as the verification check for data provided to the Metro Council. Subtotal references will be eliminated from future Capital Project Status Reports.

Office of Internal Audit
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