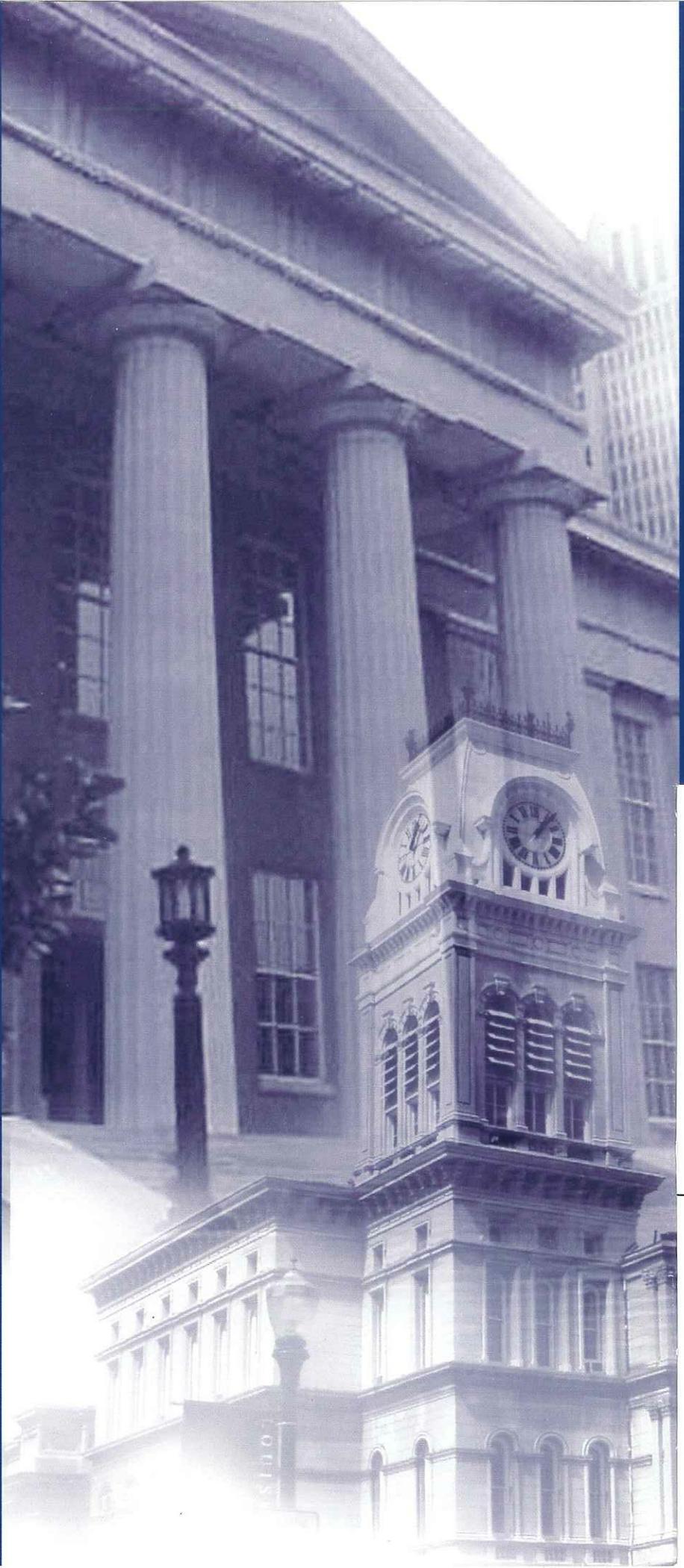




Jerry E. Abramson
Mayor
Louisville Metro Council

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

Department of Neighborhoods

Supplier Invoices

Report

Department of Neighborhoods

Supplier Invoices

December 2010



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Transmittal Letter

December 6, 2010

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

SUBJ: Review of Department of Neighborhoods Supplier Invoices

Introduction

In July 2009, the Office of Internal Audit received information regarding supplier invoices processed by the Department of Neighborhoods. The information alleged that invoices for certain suppliers were being fabricated by Neighborhoods personnel. This was supposedly done to pre-pay for goods and services. The Office of Internal Audit performed a review in order to determine if the allegation could be substantiated.

Scope

The Office of Internal Audit was provided a list of nineteen suppliers that were allegedly paid through fabricated invoices during fiscal years 2008 and 2009. A review of all transactions between the Department of Neighborhoods and the nineteen suppliers was performed. This involved 407 invoices. The purpose was to determine if the allegation of fabricated invoices could be substantiated. The details of the scope and methodology of the review are addressed in the Observations and Recommendations section of this report.

The review 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.

Criminal Investigation

Due to issues identified in the review, the assistance of the Louisville Metro Police Department's Public Integrity Unit was requested. This occurred in November 2009. The purpose was to determine if criminal activity had occurred, and if so, who was

responsible. In accordance with professional internal auditing standards and internal protocol, further action by the Office of Internal Audit was delayed until completion of the criminal investigation. This included reporting the results of the review. This was done in order to protect the integrity of the criminal investigation.

The results of the criminal investigation were reviewed by the Commonwealth Attorney in order to determine if criminal prosecution would occur. In July 2010, the Commonwealth Attorney informed the Public Integrity Unit that no criminal prosecution would take place. The documentation used in the investigation was returned to the Office of Internal Audit in September 2010. The Office of Internal Audit was then authorized to complete its review, including reporting the results to appropriate Metro officials in order to ensure corrective actions plans were developed.

Results

The results are as follows.

- **Fabricated Invoices.** There were a total of 37 invoices, associated with 15 suppliers, which appeared to be fabricated. The total of these invoices was \$368,660. These invoices are summarized in the following table.

Fabricated Invoices		
Supplier Number	Number of Invoices	Total Amount
565	1	\$900
763	1	\$2,500
1537	4	\$6,085
2523	1	\$2,500
2718	1	\$500
5288	11 ⁽¹⁾	\$196,194.50
13516	1	\$2,000
13944	1	\$2,500
82104	1	\$2,500
88684	6	\$138,398
92381	1	\$980
94932	1	\$910
103006	5	\$9,930
200258	1	\$1,662.50
200576	1	\$1,100
Total	37	\$368,660

⁽¹⁾ Includes one fabricated invoice that was processed twice via two different payment documents. There was a minor modification to the invoice number for one invoice so Louisville Metro’s financial system did not identify it as a duplicate.

- **Internal Controls.** It is important to note the processing of these invoices occurred without detection because of the involvement of several key parties. This included key departmental personnel who prepared and processed the invoices. Internal controls cannot detect or prevent the processing of fabricated invoices when collusion occurs.
 - During the criminal investigation, the former Director of Neighborhoods confirmed the fabrication of supplier invoices. Invoices were completed for the suppliers for operational and budgetary issues, such as pre-paying for services and to avoid lapsing of funds at year-end.

Corrective Actions

Several corrective actions have already been implemented. This includes the resignation of the Department of Neighborhoods Director and Special Assistant; the Special Assistant reimbursing Louisville Metro Government \$14,900; the dissolution of the Department of Neighborhoods (this was not related to the supplier invoice review, but is an action that helps ensure it doesn't recur); and revisions to Louisville Metro's procurement policy.

The Office of Management and Budget (OMB) was requested to provide a corrective action plan since invoice documentation issues could impact the entire enterprise. OMB's corrective action plan is included in the Observations and Recommendations section of this report. Upon receipt of OMB's corrective action plan, it was determined that additional information was needed in regards to reconciliation of the supplier pre-payments. Many of the supplier pre-payments were associated with the special events function of the Department of Neighborhoods. This function had been transferred to Metro Parks after the dissolution of the Department of Neighborhoods. Therefore, Metro Parks was asked to provide an update on the corrective actions involving the reconciliation of supplier pre-payments. A summary of Park's corrective actions is included in the Observations and Recommendations section of this report. It is important to note that while OMB and Metro Parks are committed to addressing the issues noted, the reconciliation of supplier pre-payments is dependent on the availability and integrity of documentation from the former Department of Neighborhoods.

If you would like to discuss this further, or need additional information, please contact me.

Sincerely,



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

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

Observations and Recommendations

Scope

The Office of Internal Audit was provided a list of nineteen suppliers that were allegedly paid through fabricated invoices during fiscal years 2008 and 2009. A review of all transactions between the Department of Neighborhoods and the nineteen suppliers was performed. The purpose was to determine if the allegation of fabricated invoices could be substantiated.

All supporting payment documentation, including the Payment Document, the Internal Purchase Request, the Invoice, and Contractual agreements (when applicable) for each of the nineteen suppliers was examined. These transactions were from fiscal years 2008 and 2009 (July 1, 2007 through June 30, 2009). In addition, invoices from the nineteen suppliers for other Louisville Metro departments were obtained. This was done in order to have a “standard” invoice from the suppliers to use in comparison with the Neighborhoods invoices.

The payment documentation was reviewed and compared to invoices issued to other Louisville Metro departments for the nineteen suppliers. This was done in order to identify fabricated invoices. A total of 407 invoices and corresponding supporting documents were reviewed.

Observations

Fabricated Invoices

There were a total of 37 invoices that appeared to be fabricated. These 37 invoices were associated with 15 different suppliers and totaled \$368,660. Details are in the following table.

Fabricated Invoices				
Supplier Number	Invoices Examined		Fabricated Invoices	
	Number	Amount	Number	Amount
565	28	\$5,892.50	1	\$900
763	10	\$6,561.24	1	\$2,500
1537	17	\$15,086.50	4	\$6,085
2523	27	\$8,732.50	1	\$2,500
2718	71	\$77,298.66	1	\$500
5288	39	\$460,803.66	11 ⁽¹⁾	\$196,194.50
13516	7	\$4,725	1	\$2,000
13944	1	\$2,500	1	\$2,500
82104	2	\$5,000	1	\$2,500
88684	14	\$198,254.68	6	\$138,398
92381	11	\$19,997	1	\$980
94932	52	\$34,769	1	\$910
103006	33	\$48,640.39	5	\$9,930
200258	26	\$20,838.40	1	\$1,662.50
200576	2	\$2,200	1	\$1,100
Total			37	\$368,660

⁽¹⁾ Includes one fabricated invoice that was processed twice via two different payment documents. There was a minor modification to the invoice number for one invoice so Louisville Metro's financial system did not identify it as a duplicate.

- **Internal Controls.** It is important to note the processing of these invoices occurred without detection because of the involvement of several key parties. This included key departmental personnel who prepared and processed the invoices. Internal controls cannot detect or prevent the processing of fabricated invoices when collusion occurs.
 - During the criminal investigation, the former Director of Neighborhoods confirmed the fabrication of supplier invoices. Invoices were completed for the suppliers for operational and budgetary issues, such as pre-paying for services and to avoid lapsing of funds at year-end.

Other Issues

Other issues were noted with some of the supplier invoices examined.

- **Invoice paid twice.** One of the invoices identified as fabricated for supplier 5288 was paid twice using two different payment documents (the invoice number for one was slightly modified so the controls within Louisville Metro's financial system did not detect it as duplicate). The invoice was for \$30,000.

- **Invoices for one supplier paid through another supplier.** There were four invoices for supplier 5288 that were actually for the contract services of supplier 103006. Supplier 103006 had a professional services contract with the Department of Neighborhoods. It appears these invoices were processed through supplier 5288 instead of amending the contract's "not to exceed" amount and effective dates. The total of the invoices processed for supplier 103006 through supplier 5288 was \$9,450.
 - During the criminal investigation, supplier 5288 indicated that this practice occurred at the direction of the former Department of Neighborhoods Director.

- **Supplier paid twice for same time period.** Supplier 94932 was paid twice for the same time period, June 2009. The total overpaid was \$910. This involved three difference invoices.

Recommendations

Appropriate personnel should review the results and implement corrective action. Specific recommendations include the following.

- ✓ The programs and functions associated with the supplier pre-payments should be identified. The Louisville Metro Department that now has the responsibility for the programs and functions should ensure the activity has been reconciled so that the pre-payments were appropriately credited to goods and services delivered to Louisville Metro Government. If any pre-payment balances exist with suppliers, the Louisville Metro Department should determine the necessity of requesting the supplier to return the balance.
- ✓ Louisville Metro Policy should specifically address invoice documentation issues, such as what is acceptable as an invoice, use of original invoices only, and not paying from statements. The policy should also address pre-payment of activities, supplier deposits, and “do not mail” check processing.
- ✓ Additional training of key personnel throughout Louisville Metro Government should be provided. This will help ensure consistency in the processing of activity.

Corrective Action Plan

Several corrective actions have already been implemented. These include the following.

- In March 2010, the Director of Neighborhoods and the Special Assistant resigned from Louisville Metro Government.
 - The Special Assistant reimbursed Louisville Metro \$14,900. This amount was identified in the State Auditor of Public Accounts Fiscal Year 2009 Annual Single Audit Report for Louisville Metro Government. The report indicated this amount was for activity from three fiscal years.
- In July 2010, the Department of Neighborhoods was dissolved. Its functions and programs were transferred to other Louisville Metro Departments.
 - The dissolution of the department was not related to the supplier invoice issues.
- In July 2010, the Office of Management and Budget issued a revised procurement policy. The policy addresses the requirements for invoice documentation, and the requirements for allowing pre-payment for goods and services.

Office of Management and Budget's Corrective Action Plan

In order to ensure appropriate corrective action was implemented for all of Louisville Metro Government, a draft report was issued to the Office of Management and Budget (OMB) on September 22, 2010. A meeting was held with OMB on October 4, 2010 in order to review the issues and examine the fabricated documents. OMB was requested to provide a response in the format of a corrective action plan. The response was received on October 22, 2010.

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. The response is as follows.

The Office of Management and Budget (OMB) places great importance on proper invoice processing and Accounts Payable internal controls.

Upon review of the fabricated invoices, it was determined that it would be very difficult, if not impossible for Accounts Payable staff to detect these fabrications. This is because the invoices were fabricated to look like actual vendor invoices, including the use of the vendor's logo(s), slogan(s), etc., which gave the appearance that the fabricated invoice had been issued directly from the vendor. Moreover, many of the invoices were reviewed by and signed as “ok to pay” by the Director of Neighborhoods. As the report notes, internal control cannot prevent this type of activity when collusion occurs.

After learning of this business practice in the Department of Neighborhoods, OMB immediately notified department directors, business managers and staff that this practice was unacceptable.

OMB agrees with the recommendations. As the report states, many of the recommendations proposed were implemented prior to the issuance of the report. Specific information for the recommendations follows.

1. Programs and functions associated with supplier pre-payments should be identified.
 - OMB will ensure that that the department now responsible for these programs and functions has reconciled the prepayments to ensure they are appropriately credited to the goods and services delivered to Louisville Metro Government. If any pre-payment balances exist with suppliers, the responsible department will request repayment of the remaining credit balance.
2. Louisville Metro Policy should specifically address invoice documentation issues.
 - OMB published revised procurement policies that provide more extensive detail and explanation regarding the basis of procuring goods and services for Metro government. The policy now specifically addresses vendor pre payments, vendor payment discounts and proper invoice processing procedures. This policy was originally announced to Departments at the May 2010 Business Manager meeting and formally adopted and reviewed at the June 2010 Business Manager meeting with a policy effective date of July 1, 2010. The only area the revised policy does not address is “do not mail” processing; however, changes are currently under review and it is anticipated that a new “do not mail” check policy will be issued by close of calendar year 2010.
3. Additional Training of key personnel should be provided
 - After releasing the policy, OMB staff provided in depth training to departmental staff involved in the procurement of goods and services for Louisville Metro Government, as well as, proper invoice processing requirements, vendor pre payments, and other topics that are directly related to financial management within department business offices. This training was conducted by six key OMB staff and directed to all personnel responsible for the procurement of goods/services for Metro Government. The training provided the opportunity for individual departmental staff to ask questions directly to OMB regarding the policy. OMB received an overwhelming positive response to this training approach. Many of the attendees stated that the training was the best they have been provided while working for Metro Government. OMB will continue offering and providing this training on both a large scale and individual basis, depending on the individual needs of each department.

Metro Park’s Corrective Action Plan

Upon receipt of OMB’s corrective action plan, it was determined that additional information was needed in regards to reconciliation of the supplier pre-payments and delivery of goods / services. Many of the supplier pre-payments were associated with the special events function of the Department of Neighborhoods. This function had been transferred to Metro Parks after the dissolution of the Department of Neighborhoods. Therefore, Metro Parks was asked to provide an update on the corrective actions involving the reconciliation of supplier pre-payments. It should be noted that the reconciliation is dependent on the availability and integrity of documentation at the former Department of Neighborhoods. Since Metro Parks was not aware of the details of the supplier pre-payments prior to October 2010, additional time was provided so a

feasible action plan could be formulated. A summary of Metro Park's corrective actions as of the end of November 2010 follows.

- The Metro Parks Business Office has been assigned the responsibility for reconciling the supplier pre-payments identified in the review.
- The fabricated invoices and related documentation were obtained.
- Financial paperwork from the former Department of Neighborhoods location was obtained. It needs to be determined if there is any other financial documentation still at the location.
- Former Department of Neighborhoods personnel associated with the special events function have been interviewed and have supplied their records related to the supplier pre-payments.
- Once all available documentation is reviewed, a report of the supplier's pre-payments and billings will be prepared. The intent of this report is to document that the supplier provided goods / services for the pre-payments or that a credit balance exists. Upon completion of the report, it will be determined if additional actions are needed.
- It is anticipated that the report will be completed by the end of the 3rd quarter of fiscal year 2011.
- New procedures have been implemented for suppliers that require pre-payments for services associated with special events. Controls have been implemented requiring supplier documentation for the use of pre-payments, and pre-payments have been limited to two suppliers. Pre-payment provisions will be included in contractual agreements with these suppliers. Documentation required includes cancelled checks and reconciliations of revenues and expenditures.

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