



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

Tax Increment Financing Process

# Audit Report

Office of Internal Audit

## Louisville Metro Government

### Tax Increment Financing Process

December 2010



Louisville Metro Government

---

Tax Increment Financing Process

**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..... 7

**Observations and Recommendations..... 8**

    Departmental Responses..... 10



OFFICE OF INTERNAL AUDIT  
LOUISVILLE, KENTUCKY

JERRY E. ABRAMSON  
MAYOR

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

THOMAS L. OWEN  
PRESIDENT METRO COUNCIL

**Transmittal Letter**

December 10, 2010

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

**Subject: Audit of Tax Increment Financing Process**

**Introduction**

An audit of Louisville Metro's Tax Increment Financing (TIF) process was performed. The primary focus of the review was Louisville Metro's procedures for administering the TIF projects in compliance with applicable laws, regulations, and policies. 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

A thorough understanding of the Tax Increment Financing process was obtained through interviews of key personnel and reviews of applicable documentation. This included Louisville Metro personnel from the Economic Development Department, the Office of Management and Budget, and the Metro Revenue Commission. Documentation reviewed included applicable Kentucky Revised Statutes, general information from Kentucky's Economic Development Finance Authority, and project files. Since Louisville Metro's responsibilities may differ among the TIF projects, an understanding of each project was obtained through reviews of project specific documents such as Local Participation Agreements and Project Grant Agreements.

The review included the current TIF process and all approved TIF projects. This included the process for review and approval of increment payments for the two TIF projects that are receiving increment payments. The focus was confirming the process for review and approval of the increment payments only, i.e., the calculations were not reviewed for accuracy or completeness. There were mitigating factors that reduced the risks of miscalculations to a minimal level, so detailed testing was not warranted. 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 activity.

### Opinion

It is our opinion that the internal control structure for Louisville Metro's Tax Increment Financing process is satisfactory. The internal controls within the TIF process, along with the nature of the activity, combine to mitigate the operational and compliance risks to a minimal level. The internal control rating is on page 5 of this report. This rating quantifies the opinion regarding the internal controls. Specific results are as follows.

- **Approval of TIF Projects.** No observations were noted, and no recommendations are necessary at this time.
  - Documentation, including legal agreements, was available for all TIF projects in Louisville. The documentation appeared to indicate the projects were properly authorized and approved.
- **Administration of TIF Projects.** No observations were noted, and no recommendations are necessary at this time.
  - Only two TIF projects (Marriott Hotel, Renaissance Zone) are receiving increment payments. The documentation for the increment payments appeared to indicate the activity was appropriately reviewed and authorized.

*Corrective Action Plan*

A corrective action plan was not necessary since there were no recommendations made. However, the Economic Development Department and the Office of Management and Budget were provided an opportunity to respond to the report. The responses are included in the Observations and Recommendations section of the report.

Sincerely,



---

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

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

**Internal Control Rating**



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

According to the Kentucky Economic Development Finance Authority, Tax Increment Financing (TIF) is a tool to use future gains in taxes to finance the current improvements that will create those gains. When a public project is carried out, there is an increase in the value of surrounding real estate, and often new investment (e.g., new or rehabilitated buildings). This increased site value and investment creates increases in values of taxable properties and taxable activities, which increases tax revenues.

The increased tax revenues are the “tax increment.” Tax Increment Financing dedicates the future increased revenue to finance the debt issued to pay for the public infrastructure of the project. TIF is designed to channel funding toward the public improvements in distressed or underdeveloped areas where these public projects may otherwise be unaffordable to localities.

There are several approved TIF projects in Louisville. Some TIF projects involve State and Local government participation, while others may involve only one or the other. The TIF projects for Louisville are in the following table.

| <b>Approved Tax Increment Financing Projects in Louisville <sup>(1)</sup></b>  |   |                      |
|--|---|----------------------|
| <b>I. State and Local Participation</b>  |   |                      |
| Name   | Local Agency                                      | Status               |
| <b>Center City</b>   | Metro Development Authority                       | No increments paid   |
| <b>Churchill Downs</b>   | Louisville Development Authority                  | No increments paid   |
| <b>Marriott Hotel</b>  | Downtown Development Corporation                  | Receiving increments |
| <b>Medical Center</b>  | Louisville Medical Center Development Corporation | No increments paid   |
| <b>Museum Plaza</b>  | Metro Development Authority                       | No increments paid   |
| <b>Renaissance Zone</b>  | Louisville Renaissance Zone Corporation           | Receiving increments |
| <b>II. Local Participation Only</b>  |   |                      |
| Name   | Local Agency                                      | Status               |
| <b>Appliance Park</b>  | Metro Development Authority                       | No increments paid   |
| <b>III. State Participation Only</b>   |   |                      |
| Name   | Agency  | Status               |
| <b>Louisville Arena</b>  | Louisville Arena Authority                        | No increments paid   |
| <b><sup>(1)</sup> Information obtained from Kentucky Economic Development Finance Authority website and Louisville Metro Economic Development Department</b> |   |                      |

The TIF process was originally included in the audit of the Louisville Metro Revenue Commission’s Revenue Collection Process (report issued November 2009). Preliminary research of the TIF process indicated that the Revenue Commission’s role was minimal. Therefore, it was determined that this should be addressed as a separate audit project.

## 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's Tax Increment Financing 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 Economic Development Department and the Office of Management and Budget on November 11, 2010. It was determined that a formal exit conference was not necessary. Since there were no recommendations made, a corrective action plan was not necessary. However, both Economic Development and the Office of Management and Budget provided a response, which is included in the Observations and Recommendations section of the report.

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."*

Economic Development's response was provided on December 6, 2010, which is within this required timeframe.

Office of Management and Budget's response was provided on November 12, 2010, which is within this required timeframe.

## Observations and Recommendations

### Scope

An understanding of the current Tax Increment Financing process was obtained by interviewing key Louisville Metro Government personnel and reviews of applicable documentation. This included personnel from the Economic Development Department, the Office of Management and Budget, and the Metro Revenue Commission. Documentation reviewed included applicable Kentucky Revised Statutes, general information from Kentucky's Economic Development Finance Authority, and project files. Since Louisville Metro's responsibilities may differ among the TIF projects, an understanding of each project was obtained. The objective was to obtain assurance that risks are adequately mitigated through the internal control structure so that the TIF projects are administered in compliance with laws and regulations.

The population of approved TIF projects in Louisville was obtained from the Kentucky Economic Development Finance Authority, and from interviews with Louisville Metro personnel. Project files for each TIF project were reviewed. This included reviewing applicable Grant Contracts, Project Grant Agreements, Local Participation Agreements, and Release Contracts. The files were reviewed to determine Louisville Metro's responsibilities in the administration of the TIF projects, and to verify compliance with applicable laws, policies and other requirements.

The audit included the process for review and approval of increment payments for the two TIF projects that are receiving increment payments. The focus was confirming the process for review and approval of the increment payments only. The increment payment calculations were not reviewed for accuracy or completeness. The review would not reveal all issues because it was based on a selective review of activity.

### Observations

The internal control structure is satisfactory and appears to be effective in mitigating the risks associated with the TIF process. No observations were noted. Specific results are as follows.

- **Approval of TIF Projects.** It appears the internal controls within the TIF approval process, along with the nature of the activity, combine to mitigate the operational and compliance risks to a minimal level.
  - Documentation, including legal agreements, was available for all TIF projects in Louisville. The documentation appeared to indicate the projects were properly authorized and approved.
- **Administration of TIF Projects.** It appears the internal controls within the TIF administration process, along with the nature of the activity, combine to mitigate the operational and compliance risks to a minimal level.

- Only two TIF projects are receiving increment payments. The documentation for the increment payments appeared to indicate the activity was appropriately reviewed and authorized.
  - The Marriott Hotel TIF has resulted in approximately \$8.9 million in increment payments to the local agency.
  - The Renaissance Zone TIF has resulted in approximately \$775,000 in increment payments to the local agency.

**Recommendations**

No recommendations are necessary at this time.

### **Departmental Responses**

A corrective action plan was not necessary since there were no recommendations made. However, the Economic Development Department and the Office of Management and Budget were provided an opportunity to respond to the report. The responses are as follows.

#### **Economic Development Department's Response**

Tax Increment Financing (TIF) is a beneficial economic development incentive available for eligible projects. The Economic Development Department works with the State of Kentucky, the Office of Management and Budget, Jefferson County Attorney and other agencies on a regular basis regarding the TIF incentives.

#### **Office of Management and Budget's Response**

Office of Management Budget (OMB) appreciates the audit review of Metro's TIF process. It is helpful to confirm that our "internal control structure is satisfactory and appears to be effective in mitigating the risks associated with the TIF process" as this audit report notes. OMB continues to focus on our core mission of ensuring the fiscal integrity of Metro through dedicated and diligent staff, as evidenced by this report.

**Office of Internal Audit**  
**Phone: 502.574.3291**  
**[www.louisvilleky.gov/InternalAudit/](http://www.louisvilleky.gov/InternalAudit/)**