



Greg Fischer
Mayor
Louisville Metro Council

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Office of Internal Audit

Public Works and Assets

Land Management Process

Audit Report

Public Works and Assets

Land Management Process

January 2011



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Executive Summary

PROJECT TITLE

Public Works and Assets Land Management Process

OBJECTIVE AND SCOPE

The objective was to obtain assurance that operational risks are adequately mitigated through the internal control structure. The focus was the policies and procedures for administering the acquisition and disposal of land facilitated by the Property Management Division of the Department of Public Works and Assets. This included how activity is processed, recorded, and monitored.

The policies and procedures were reviewed through interviews with key personnel. Tests of sample data were performed on land management activity from fiscal year 2009 and the first half of fiscal year 2010. Property transactions facilitated by the Louisville and Jefferson County Land Bank Authority, Inc. were excluded from the review.

INTERNAL CONTROL ASSESSMENT

Needs Improvement

RESULTS

Compliance with Right of Way Guidelines. Property Management acquires and disposes of land in accordance with the Commonwealth of Kentucky's Right of Way guidelines. Issues were noted with Property Management's compliance with these guidelines.

- Appraisals and Minor Acquisition Reviews were not performed as required for all of the properties in the sample reviewed.
- Some of the properties in the sample were sold or purchased at prices which were not equal to their fair market value as required.

General Administration. There were issues noted with the general administration of Public Works and Assets land management activity. Specifics include the following.

- There are no documented internal policies and procedures to guide the Property Management Division in facilitating property transactions.
- Properties were not added to or removed from the fixed assets data in the financial system in accordance with Louisville Metro's Fixed Assets policy.
- Proceeds from property transactions were not deposited in the bank in a timely manner. One case involved \$167,000 that was not deposited until three months after the closing.
- There were instances in which the Real Estate Sale and Purchase Agreement was not signed by the appropriate Public Works and Assets personnel. Signature authority had been verbally given by the Public Works and Assets Director to a designee, but it was not documented.



OFFICE OF INTERNAL AUDIT
LOUISVILLE, KENTUCKY

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Transmittal Letter

January 19, 2011

The Honorable Greg Fischer
Mayor of Louisville Metro
Louisville Metro Hall
Louisville, KY 40202

Subject: Audit of the Public Works and Assets Land Management Process

Introduction

An audit of the Public Works and Assets land management process was performed. The primary focus of the review was the operational and fiscal administration of the activity. This included how activity is processed, recorded, and monitored. 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

The policies and procedures for the administration of the Public Works and Assets land management activity were reviewed through interviews with key personnel. The focus of the review was the policies and procedures for administering the acquisition and disposal of land facilitated by the Property Management Division of the Department of Public Works and Assets. This included how activity is processed, recorded, and monitored.

Tests of sample data were performed on Public Works and Assets land management activity from fiscal year 2009 and the first half of fiscal year 2010. The purpose was to evaluate the adequacy of the policies and procedures in mitigating the operational risks associated with the activity. This review excluded property transactions facilitated by the Louisville and Jefferson County Land Bank Authority, Inc. 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 Public Works and Assets land management process needs improvement. The internal control rating is on page 6 of this report. The rating quantifies our opinion on internal controls, and identifies areas requiring corrective action. Opportunities to strengthen the internal control structure were noted.

- **Compliance with Right of Way Guidelines.** Property Management acquires and disposes of land in accordance with the Commonwealth of Kentucky's Right of Way guidelines. Issues were noted with Property Management's compliance with these guidelines.
 - Appraisals and Minor Acquisition Reviews were not performed as required for all of the properties in the sample reviewed.
 - Some of the properties in the sample were sold or purchased at prices which were not equal to their fair market value as required.
- **General Administration.** There were issues noted with the general administration of Public Works and Assets land management activity. Specifics include the following.
 - There are no documented internal policies and procedures to guide the Property Management Division in facilitating property transactions.
 - Properties were not added to or removed from the fixed assets data in the financial system in accordance with Louisville Metro's Fixed Assets policy.
 - Proceeds from property transactions were not deposited in the bank in a timely manner. One case involved \$167,000 that was not deposited until three months after the closing.
 - There were instances in which the Real Estate Sale and Purchase Agreement was not signed by the appropriate Public Works and Assets personnel. Signature authority had been verbally given by the Public Works and Assets Director to a designee, but it was not documented.

The implementation of the recommendations in this report will help improve the internal control structure and effectiveness of the Public Works and Assets land management process.

Corrective Action Plan

Representatives from Public Works and Assets have reviewed the results and are committed to addressing the issues noted. Public Works and Assets' corrective action plans are included in the Observations and Recommendations section of this report. We will continue to work with Public Works and Assets to ensure the actions taken are effective to address the issues noted.

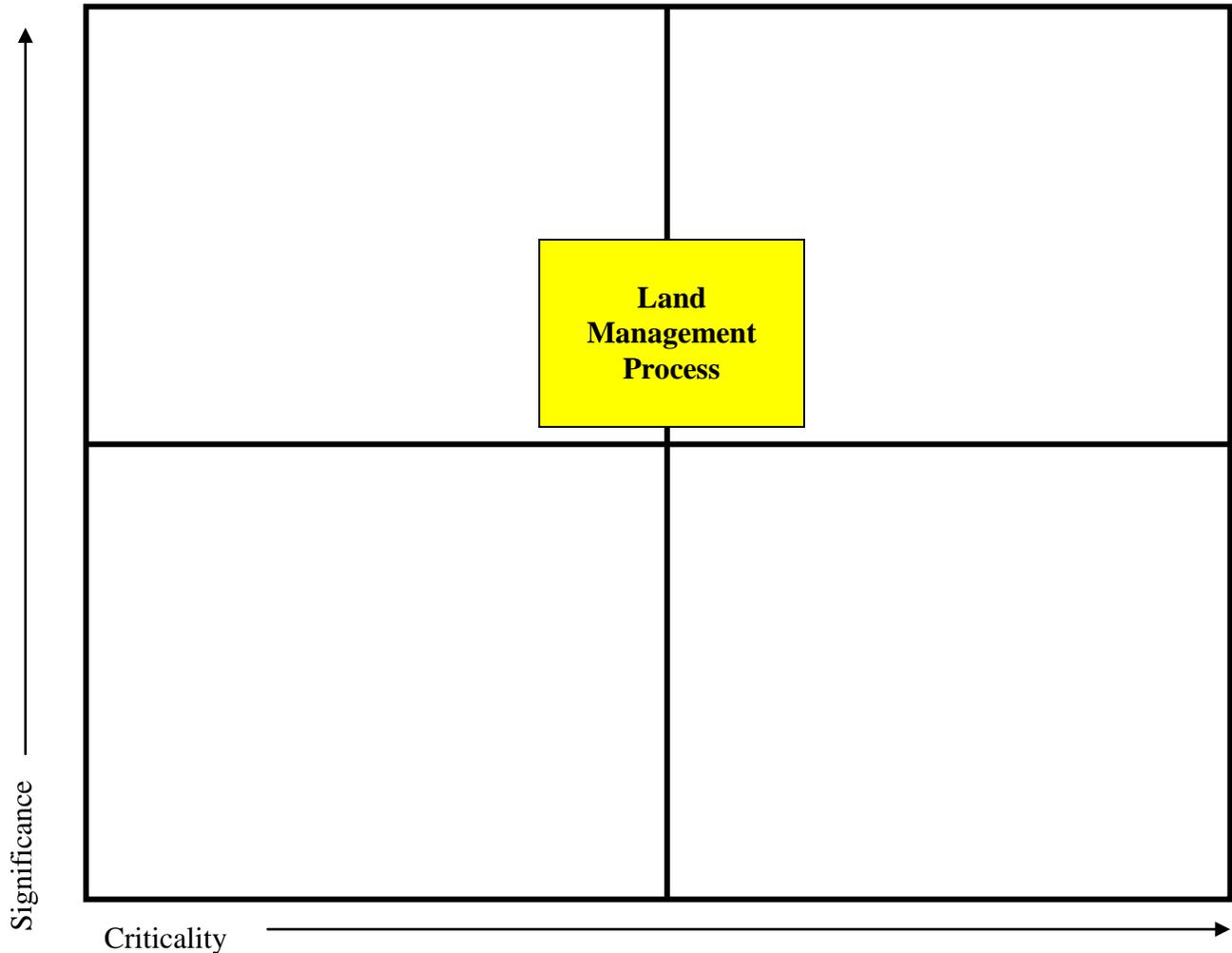
Sincerely,



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

cc: Louisville Metro Council Government Accountability and Oversight Committee
Director of Public Works and Assets
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

Property Management, a division within the Public Works and Assets Department, is responsible for facilitating the acquisition and disposal of land for Louisville Metro Government. The services of Property Management are available to all Louisville Metro departments. However, it is at the discretion of the individual department to use the services of Property Management. Generally, the facilitation of an acquisition or disposal is initiated by a Louisville Metro department expressing the need for additional space or a reduction of space. Disposals of real property may also be initiated by the identification of surplus property and acquisitions may also be initiated as a result of a right of way or an easement.

During fiscal year 2009 and the first half of fiscal year 2010, Property Management generated approximately \$438,000 in proceeds from the sale of properties. Property Management facilitated the sale of 25 properties and the acquisition of 17 properties during the review period.

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 performed previous reviews of the Public Works and Assets land management 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 Public Works and Assets (PWA) on December 13, 2010. It was determined that a formal exit conference was not necessary.

The views of PWA officials were received on January 12, 2011 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.”*

Public Works and Assets’ response was provided within this required timeframe.

Observations and Recommendations

Scope

A review of the Department of Public Works and Assets land management process was performed. The focus of the review was the policies and procedures for administering the acquisition and disposal of land facilitated by the Property Management division. This included how activity is planned, managed, processed, recorded, monitored, and reported.

The policies and procedures for the administration of the Public Works and Assets land management activity were reviewed through interviews with key personnel. Tests of sample data were performed on the land management activity from fiscal year 2009 and the first half of fiscal year 2010. The purpose was to evaluate the adequacy of the policies and procedures in mitigating the operational risks associated with the activity. This review excluded property transactions facilitated by the Louisville and Jefferson County Land Bank Authority, Inc.

Reviews of activity and applicable laws and regulations were performed. A sample of fifteen property transactions from the review period was judgmentally selected. Documentation reviewed included property deeds, appraisals, minor acquisition reviews, sale and purchase agreements, bank deposit forms, asset listing reports, and public records from the Jefferson County Clerk's Office and the Jefferson County Property Valuation Administrator's Office. The audit would not reveal all issues because it was based on a selective review of data.

Observations

Issues were noted with Public Works and Assets land management process. As a result, the effectiveness of the internal control structure is impaired and needs improvement. Opportunities to strengthen the controls include the following.

#1 – Compliance with Right of Way Guidelines

#2 – General Administration

Details of these begin on the following page.

#1 – Compliance with Right of Way Guidelines

The Property Management Division of Public Works and Assets acquires and disposes of land in accordance with the procedures in the Commonwealth of Kentucky Transportation Cabinet's Right of Way Manual. Issues were noted with compliance with these Right of Way guidelines.

- **Appraisal / Minor Acquisition Review.** Guidelines in the State's Right of Way Manual require an appraisal or Minor Acquisition Review (MAR) to be performed for property transactions. An appraisal is required when the fair market value of the property is over \$10,000. A MAR is required when the fair market value of the property is less than \$10,000. Property Management is required to maintain the original approved appraisal or MAR in the property file. The following issues were noted.
 - Two of the fifteen property transactions did not have the original approved appraisal in the corresponding property file. The fair market value for the property was over \$10,000 but there was not an appraisal or any other applicable documentation of the fair market value of the property prior to conveyance.
 - There was another case that did not have the original approved appraisal in the property file. However, another party to the transaction had a copy of the appraisal and provided it for this audit.
 - Two of the fifteen property transactions did not have the Minor Acquisition Review in the corresponding property file. The fair market value for the property was under \$10,000 but there was not an MAR or any other applicable documentation of the fair market value of the property prior to conveyance.
- **Purchase Price and Fair Market Value.** Guidelines in the State's Right of Way Manual require the property owner to receive an offer that reflects the current fair market value without the influence of any outside factors. The Real Estate Sale and Purchase Agreement should indicate that the total consideration received or given for the property is equal to the fair market value of the property. The following issues were noted.
 - For four of the fifteen transactions, the total consideration received for the property sold by Louisville Metro was less than the fair market value of the property. There was no documentation in the property files explaining the difference.

Recommendations

Appropriate Property Management personnel should take corrective actions to address the issues noted. Specifics include the following.

- ✓ Property Management personnel should be aware of the importance of compliance with all regulations and requirements. Appropriate personnel should review state and federal regulations and requirements on an ongoing basis to remain abreast of any changes. Business practices should be modified as needed to ensure compliance with regulations and requirements.

- ✓ In order to comply with the guidelines established by the Commonwealth of Kentucky, an appraisal or Minor Acquisition Review should be performed prior to the conveyance of a property. Documentation of the appraisal or MAR should be maintained within the property file.
- ✓ In order to comply with the guidelines established by the Commonwealth of Kentucky, the justification for any deviations between the purchase price and fair market value of the property should be documented in a memorandum located within the property file.
- ✓ Property Management should consider implementing a quality assurance checklist for the files. This checklist could list all required documentation. Appropriate personnel could use it to ensure all necessary documentation is in the property file. This type of control enhances consistency in the property files.

Public Works and Assets Corrective Action Plan

Appraisal / Minor Acquisition Review

It should be noted that all project files were handled by consultants, whom we contract to ensure that all policy and procedural guidelines, as established by the Commonwealth of Kentucky, Department of Transportation, are followed. Nevertheless, Property and Leasing has now taken steps to ensure that all files contain approved appraisals and/or Minor Acquisition Reviews. Public Works and Assets (PWA) has fully addressed this issue.

Purchase Price and Fair Market Value

As above, all project files were handled by consultants, whom we contract to ensure that all policy and procedural guidelines as established by the Commonwealth of Kentucky, Department of Transportation are followed. Nevertheless, Property and Leasing has now taken steps to ensure that all files contain a record that shows how administrative settlements are constructed, and all documentation of records of contact to be contained in all files. PWA has fully addressed this issue.

#2 – General Administration

Issues were noted with the general administration of the land management process. Specifics include the following.

- **Policies and Procedures.** Property Management does not have documented internal policies and procedures for the administration of the land management process. Property Management follows guidelines established by the Commonwealth of Kentucky for the acquisition and disposal of property. The absence of formally documented policies and procedures increases the risk of inconsistency in facilitating property transactions. Further, the absence of written policies and procedures increases the risk that activity will not be processed as intended.

- **Fixed Asset List.** Louisville Metro's Fixed Assets policy requires that departments notify the Office of Management and Budget of changes in asset holdings no later than the 10th day of the month following the completion of the property transaction. The fixed asset data is maintained in the financial system. The following issues were noted.
 - Nine of the fifteen properties were not on the fixed asset list prior to disposition. It could not be determined why the properties were not on the fixed asset list.
 - Two of the fifteen properties were not added to the fixed asset list when they were acquired, and had not been added at the time of the audit.
 - One of the fifteen properties sold was not removed from the fixed asset list, and had not been removed at the time of the audit.
 - Two of the fifteen properties were added to the fixed asset list when the check was printed instead of when the property transaction was complete. Policy requires the addition to the list when the property is actually acquired, not when the check is printed. For one property, the check was printed in January 2008 but the property closing was in September 2008. For the other property, the check was printed in May 2008 but the property closing was in August 2008. Adding these properties when the check was printed may have overstated the fixed assets for fiscal year 2008 since the property was not actually acquired until fiscal year 2009.

- **Timeliness of Deposits.** Deposits of payments received from the sale of property are made by the Public Works and Assets Business Office. Louisville Metro's Cash Management policy requires deposits to be made when cash and checks total \$1,000 or weekly, whichever occurs first. Four of ten transactions for the sale of property were in excess of the \$1,000 threshold but the receipts were not deposited within the specified timeframe.
 - For one property, the proceeds from the sale were not deposited until three months after the transaction was complete. The proceeds from the sale were comprised of two checks. One check, dated December 16, 2008 was for \$16,700 and appears to have been for the 10% good faith deposit. The other check, dated January 20, 2009, was for \$150,300 and appears to be for the actual closing (the deed on file with the Jefferson County Clerk's Office was recorded on January 20, 2009). Both checks were deposited on April 30, 2009. It could not be determined

why these checks were not deposited timely, or where the checks were during this period.

- Property management takes receipts to the Public Works and Assets Business Office for deposit. A signature is obtained to document the custody of the funds. For this transaction, a signature was not obtained. Therefore, it cannot be determine if the checks were held in Property Management, the Business Office, somewhere else, or if the checks were properly secured during this time.
- For three transactions (\$50,000, \$2,820, \$2,600), the deposits were made within 5 business days.
- **Approval Signature on Agreements.** The Real Estate Sale and Purchase Agreement is an agreement entered into by both parties in order to purchase and sell the property. It must be approved by the buyer, seller, Director of Public Works and Assets, and a representative from the Jefferson County Attorney’s Office.
 - Two of the fifteen transactions reviewed had Real Estate Sale and Purchase Agreements that were not signed by the Director of Public Works and Assets. The Director of Public Works and Assets had verbally authorized the Property and Leasing Manager to sign the agreements as designee. This authorization was not documented.
- **Filing of Deed.** In order to formally close a property transaction, a deed is prepared by the Jefferson County Attorney’s Office and filed with the Jefferson County Clerk’s Office. For one of the fifteen transactions, an incorrect deed type was completed and filed. The property transaction was a temporary easement so a Deed of Easement should have been filed. However, a Deed of Conveyance was filed, which is normally associated with the outright sale of property.
 - Property Management’s process does not include reviewing the type of deed prepared and filed for the property transactions it facilitates since the Jefferson County Attorney’s Office is responsible for this function.
- **Document Approval Form.** Property Management uses Louisville Metro’s Document Approval Form (DAF) for all real estate agreements. The DAF specifically states that its intended use is for the form to accompany documents requiring the Mayor’s signature. The form is used regardless if the Mayor’s signature is required. This may lead to inconsistency and confusion in processing.

Recommendations

Appropriate Property Management personnel should take corrective actions to address the issues noted. Specifics include the following.

- ✓ Internal policies and procedure should be documented for all Property Management personnel to use. This could be in the form of a desk-top manual that includes sufficient detail for personnel to perform their duties. Documented policies and procedures help ensure consistent adherence to the guidelines established by the Commonwealth of Kentucky for the acquisition and disposal of property. In

addition, they can be used for training of new personnel and allow for cross-training of existing personnel.

- ✓ Public Works and Assets should review the fixed asset list and make necessary updates to ensure that the financial system data is accurate. Any acquisitions or disposals of properties should be reported in accordance with Louisville Metro's Fixed Assets policy. In addition, Property Management personnel should continue efforts to reconcile Jefferson County Property Valuation Administrator's (PVA) data to the fixed asset list. This will help ensure that all properties identified by the PVA as owned by Louisville Metro Government are recorded on the fixed asset list.
- ✓ All funds should be deposited in accordance with Louisville Metro's Cash Management policy (weekly or when they reach \$1,000, whichever occurs first). Funds should be safeguarded when awaiting deposit.
- ✓ Property Management's policies and procedures should address the handling of checks received for good faith deposits. The assistance of the Office of Management and Budget may be necessary to ensure compliance with Metro's policy.
- ✓ It is a good business practice to obtain the signature of the personnel receiving funds from the sale of property. This provides a documented chain of custody and can also be used to help determine the reason if deposit delays are occurring. The chain of custody should be documented up to the point the funds are deposited in the bank.
- ✓ Authority to sign agreements on behalf of the Public Works Director should be documented. If this is a temporary designation, then it may be necessary to include the documentation in the applicable property files.
- ✓ Property Management should determine if the internal policies and procedures need to include procedures for ensuring that the appropriate type of deed is prepared and filed. Since this task is assigned to the Jefferson County Attorney's Office, it may not be feasible to place the accountability for this onto Property Management.
- ✓ Public Works and Assets should consider creating their own internal form to attach to documents instead of using the Document Approval Form.

Public Works and Assets Corrective Action Plan

Policies and Procedures

Policies and procedures for the disposition and acquisition were reviewed with Property Management staff. Property acquisition and relocation procedures are governed by constitutional law, specifically the Uniform Relocation Assistance and Real Property Acquisition Policies Act of 1970. This statute, along with legal advice from the County Attorney's office, is routinely referenced by staff. Staff also attends classes through the International Right-of-Way Association for formal training on the Uniform Act of 1970.

Property disposition procedures are mandated under Section 2(C) of Executive Order No. 3, Series 2007 of the Mayor. The staff is trained on these procedures. The staff also seeks procedural advice from the County Attorney's office, as necessary. PWA will continue these training and education efforts to strengthen its understanding of policies and develop safeguards against non-compliance. PWA has fully addressed this issue.

Fixed Asset List

In the Spring of 2010, PWA's fixed asset report was thoroughly reviewed. Many items were removed that had either been disposed of or had been fully depreciated. Conversely, Property Management staff was engaged to assist in properly identifying property that did belong on PWA's report or needed to be added. We continue to gather data specifically regarding vacant land property to have the most accurate and reliable information possible as to property department responsible and verifying recordable values. PWA will resolve this issue by April 2011.

Timeliness of Deposits

Cash management policies have been reviewed with Property Management staff. All real estate transactions involving a check deposit or full payment are submitted to the business office for immediate accounting and safe keeping in instances where it is too late to deposit that day. Further, all deposits are retrieved from our location by an armored car service. The one property transaction noted, we feel, is an aberration and not representative of our standard operating procedures. Nonetheless, we did take the opportunity to reiterate the importance of adhering to our cash management policies with all PWA operations. PWA has fully addressed this issue.

Approval Signature on Agreements

Approval/Signature policies were reviewed with Property and Management staff. Verbal authorizations will now be documented and put in the file with appropriate signatures. PWA has fully addressed this issue.

Filing of Deed

Property and Management staff reviewed procedures involving real estate documents prepared by the County Attorney's Office. Staff will work more closely with its legal advisors to safeguard against the execution of inappropriate conveyance documents. PWA has fully addressed this issue.

Document Approval Form

The Document Approval Form was reviewed with Property Management Staff. Where signatures/approvals are not warranted by policy, the Manager of Real Estate will assign "N/A" (not applicable) to avoid inconsistency and confusion in processing. PWA has fully addressed this issue.

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