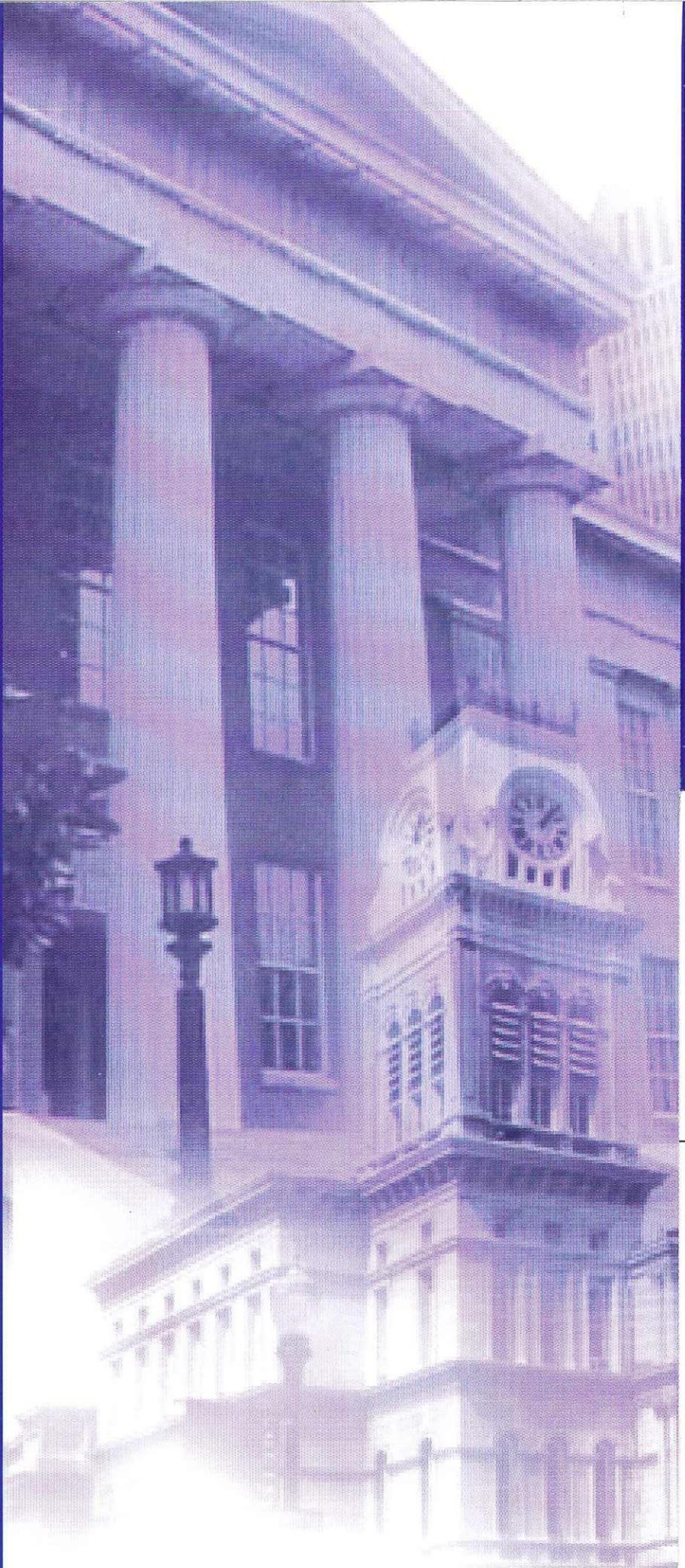




Greg Fischer
Mayor
Louisville Metro Council

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

Mayor's Office

Financial Operations

Audit Report

Office of Internal Audit



Mayor's Office

Financial Operations

April 2011

Mayor's Office

Financial Operations

Table of Contents

Executive Summary 2

Transmittal Letter 3

 Introduction..... 3

 Scope..... 4

 Opinion 4

 Corrective Action Plan..... 5

 Internal Control Rating 6

 Background..... 7

 Summary of Audit Results..... 7

Observations and Recommendations 9

 1) Custodial Assets 9

 2) Procurement..... 11

 3) Payroll..... 14

Executive Summary

PROJECT TITLE	
Mayor's Office Financial Operations Review	
OBJECTIVE AND SCOPE	
<p>The objective was to obtain assurance that operational risks are adequately mitigated through the internal control structure. The primary focus of the review was the fiscal and operational administration of the Mayor's Office activity regarding payroll, procurement, and custodial assets. This included how activity is processed, recorded, and monitored. This was a planned audit due to the mayoral transition. A financial operations audit is routinely performed to coincide with the change of administration in the Mayor's Office.</p> <p>Testing included activity occurring during the first half of fiscal year 2011 (July 1, 2010 to December 31, 2010). The details of the scope and methodology of the review are addressed in the Observations and Recommendations section of this report.</p>	
INTERNAL CONTROL ASSESSMENT	SECTION
Inadequate	Custodial Assets
Needs Improvement	Procurement
Satisfactory	Payroll
RESULTS	
<p>Custodial Assets. Custodial assets are defined as items purchased at \$1,500 or more but less than \$5,000 (i.e. computers, printers and office equipment). Issues were noted with the Mayor's Office activity regarding custodial assets.</p> <ul style="list-style-type: none"> • Custodial assets are not tracked and monitored as required by the Louisville Metro Custodial Assets Policy. <p>Procurement. There were issues noted with the Mayor's Office procurement activity. Specifics include the following.</p> <ul style="list-style-type: none"> • The public purpose for goods / services procured was insufficiently documented. • Several suppliers were either not registered or not in good standing with the Louisville Metro Revenue Commission. <p>Payroll. While the overall rating is satisfactory, some opportunities to strengthen the internal control structure were noted. Examples include the following.</p> <ul style="list-style-type: none"> • Prior period adjustments were not adequately documented, which impacted the accuracy and integrity of payroll activity. 	



OFFICE OF INTERNAL AUDIT
LOUISVILLE, KENTUCKY

GREG FISCHER
MAYOR

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

JIM KING
PRESIDENT METRO COUNCIL

Transmittal Letter

April 15, 2011

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

Subject: Audit of the Mayor's Office Financial Operations

Introduction

An audit of the Mayor's Office financial operations 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. This was a planned audit due to the mayoral transition. A financial operations audit is routinely performed to coincide with the change of administration in the Mayor's Office.

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 administration of the Mayor's Office payroll, procurement, and custodial assets was reviewed. The primary focus of the review was the operational and fiscal administration of the activity. Testing included activity occurring during the first half of fiscal year 2011 (July 2010 through December 2010). Examinations were performed to determine whether activity was complete, accurate, and in compliance with Louisville Metro policies. This includes how activity was processed, recorded, monitored, and reported. 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 reveal all issues because it was based on a selective review of data.

Opinion

The internal control rating for each area reviewed is on page 6 of this report. These ratings quantify our opinion on internal controls, and identifying areas requiring corrective action.

Our opinion for each area reviewed and examples of the issues identified include the following.

- **Custodial Assets.** It is our opinion that the internal control structure for the administration of the Mayor's Office custodial assets is inadequate. Opportunities to strengthen the internal control structure were noted. Specific results include the following.
 - Custodial assets are not tracked and monitored as required by the Louisville Metro Custodial Assets Policy.
- **Procurement.** It is our opinion that the internal control structure for the administration of the Mayor's Office procurement activity needs improvement. Opportunities to strengthen the internal control structure were noted. Specific results include the following.
 - The public purpose for goods / services procured was insufficiently documented.
 - Several suppliers were either not registered or not in good standing with the Louisville Metro Revenue Commission.
- **Payroll.** It is our opinion that the internal control structure for the administration of the Mayor's Office payroll activity is satisfactory. While the overall rating is satisfactory, some opportunities to strengthen the internal control structure were noted. Examples include the following.
 - Prior period adjustments were not adequately documented, which impacted the accuracy and integrity of payroll activity.

Corrective Action Plan

Representatives from the Mayor's Office have reviewed the results and are committed to addressing the issues noted. The Office of Management and Budget (OMB) responded on behalf of the Mayor's Office. OMB's responses / corrective action plans are included in this report in the Observations and Recommendations section. We will continue to work with the Mayor's Office and OMB to ensure the actions taken are effective to address the issues noted.

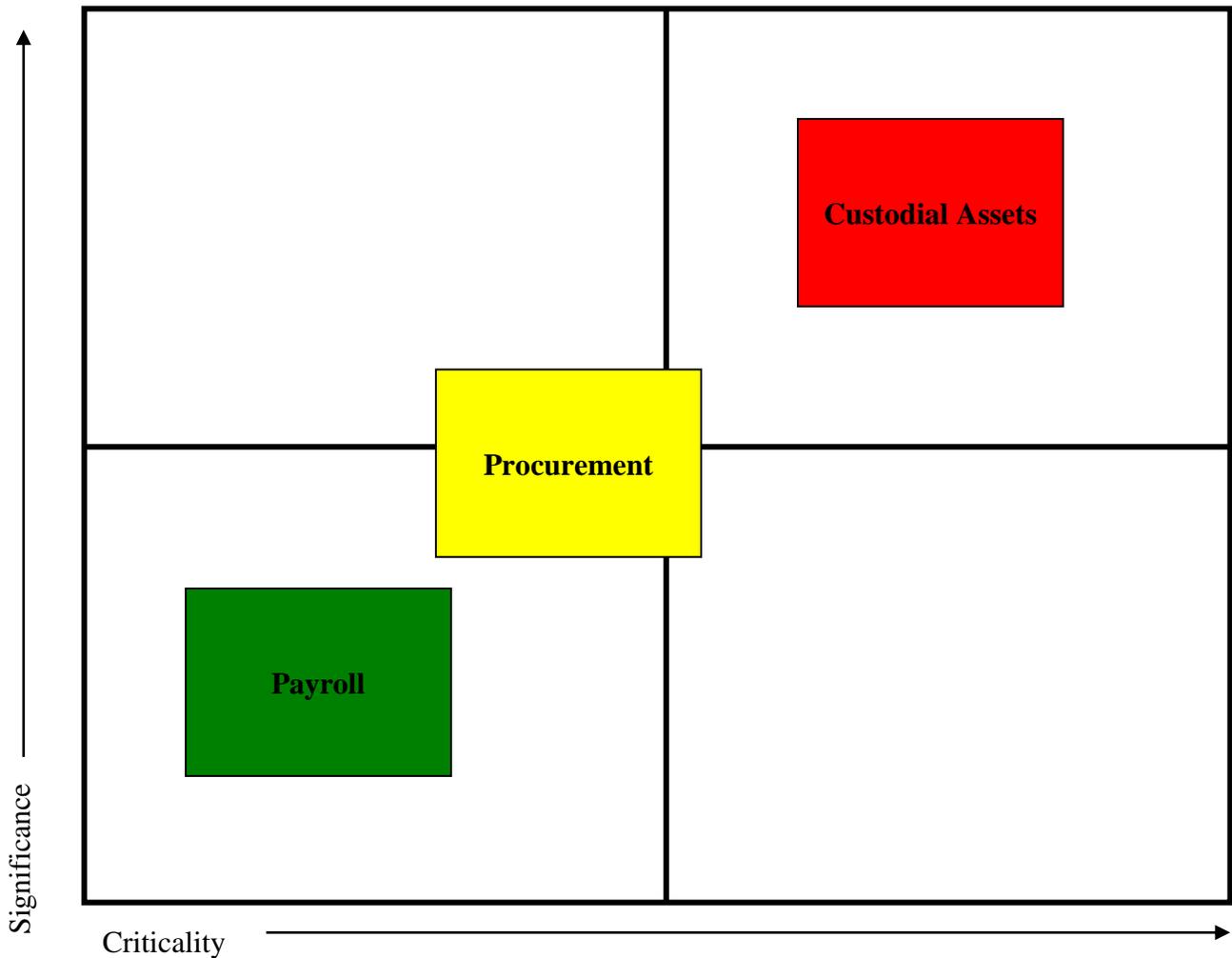
Sincerely,

Michael S. Norman by Scott A. Shelton

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

cc: Chief of Staff – Mayor's Office
Louisville Metro Council Government Accountability and Ethics 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.
Controls	Effective.	Opportunity exists to improve effectiveness.	Do not exist or are not reliable.
Policy Compliance	Non-compliance issues are minor.	Non-compliance issues may be systemic.	Non-compliance issues are pervasive, significant, or have severe consequences.
Image	No, or low, level of risk.	Potential for damage.	Severe risk of damage.
Corrective Action	May be necessary.	Prompt.	Immediate.

Background

The Mayor's Office provides vision and leadership to the community to improve the quality of life and economic health through effective and efficient delivery of public services.

During the first half of fiscal year 2011 the Mayor's Office payroll related expenditures were approximately \$1,348,000 and supplier payments were approximately \$96,000. The Mayor's Office had 29 positions during fiscal year 2011. This included an elected official, and full and part time employees.

This was a planned audit due to the mayoral transition. A financial operations audit is routinely performed to coincide with the change of administration in the Mayor's Office.

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 previously conducted a review of the Mayor's Office fiscal activity in June 2003. This coincided with the change of administration in the Mayor's Office.

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 Mayor's Office on March 10, 2011. It was determined that a formal exit conference was not necessary.

The views of the Mayor's Office and Office of Management and Budget officials were received on April 10, 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.”*

The Office of Management and Budget's response on behalf of the Mayor's Office was provided within this required timeframe.

Observations and Recommendations

1) Custodial Assets

Scope

A review of the Mayor's Office activity regarding custodial assets was performed. Custodial assets are defined as items purchased at \$1,500 or more but less than \$5,000 (i.e. computers, printers, office equipment, and such). The primary focus of the review was to ensure that custodial assets were being tracked in accordance with the Office of Management and Budget's Custodial Asset policy.

Testing of custodial assets was not performed due to the absence of a listing of custodial assets maintained by the Mayor's Office.

Observations

Issues were noted with the Mayor's Office activity regarding custodial assets. As a result, the effectiveness of the internal control structure is inadequate. Opportunities noted to strengthen the controls are as follows.

- **Tracking Custodial Assets.** The Mayor's Office does not track or maintain a listing of its custodial assets. This current practice increases the risk that misappropriation of custodial assets could occur and remain undetected. Further, there is an increased risk that the Mayor's Office custodial assets are not accurately included in estimated facility replacement costs used to insure the Mayor's Office facilities and equipment.
 - The Office of Management and Budget's (OMB) policy recommends that "each department maintain an adequate system of control and monitoring of its custodial assets."

Recommendations

Appropriate Mayor's Office personnel should take corrective actions to address the issues noted. Specifics include the following.

- ✓ The Mayor's Office should maintain a listing of custodial assets in accordance with the Office of Management and Budget's policy. The listing should be updated appropriately and monitored in order to ensure proper safeguarding of assets.
- ✓ The Mayor's Office should develop written policies and procedures for administering custodial assets. These should supplement the Office of Management and Budget's custodial asset policy, and be distributed to all applicable Mayor's Office personnel. The procedures should address custodial asset additions, deletions, and transfers.
- ✓ The Mayor's Office should ensure the annual report furnished to Risk Management is inclusive of all required information, specifically all information regarding the custodial assets within the Mayor's Office.

Response / Corrective Action Plan

The Mayor's Office will work with the Office of Management and Budget ("OMB") to identify items that meet the criteria of custodial assets and begin tracking these assets. Applicable OMB staff will review the current policies in place with the Mayor's Office staff and ensure they are reporting any additions, deletions, and transfers of custodial assets in a timely manner.

Custodial assets will be inventoried on an annual basis and reported to OMB Risk Management to ensure that all assets are included at their estimated replacement cost in case of loss or damage.

2) Procurement

Scope

The procedures for administering procurement activity for the Mayor's Office were reviewed. The primary focus of the review included the operational and fiscal administration of the procurement activity to ensure that the Mayor's Office is compliant with Louisville Metro policies. This included assessing whether activity was processed, recorded, and reported accurately and appropriately. The objective was to obtain assurance that the risks are adequately mitigated through the internal control structure.

Tests of sample data were performed on transactions from the first half of fiscal year 2011 (July 2010 through December 2010). Procurement data was obtained from Louisville Metro's financial system. The sample consisted of twenty transactions. Transactions related to out of town travel were excluded from this review.

In addition, all suppliers receiving more than \$10,000 from the Mayor's Office during fiscal year 2010 were identified. Activity for these suppliers was reviewed to ensure it was in compliance with requirements in Louisville Metro's Procurement Policies. The review would not reveal all issues because it was based on selective review of data.

Observations

Issues were noted with the Mayor's Office procurement activity. As a result, the effectiveness of the internal control structure is impaired and needs improvement. Opportunities noted to strengthen the controls are as follows.

- **Public Purpose.** Louisville Metro Government's expenditures should be for a public purpose, i.e., for the good of the citizens the government serves. Since some expenditure activity may appear to benefit individuals or groups more than the general public, it is important that the public purpose is clearly defined and documented. The public purpose should be established using the payment documentation and / or the description in the Louisville Metro financial system. There were issues noted involving the documentation of public purpose for the activity reviewed.
- **Insufficient Documentation.** Payment documentation for ten of the twenty transactions reviewed did not have sufficient documentation for the public purpose of the goods / services procured. Examples of the goods / services procured include the following.
 - Membership dues
 - Refreshments
 - Events
 - Mayoral Transitional Expenses
 - Sales Tax
 - Flowers
 - Decorations
 - Postage

- **Supplier's Revenue Commission Status.** Louisville Metro suppliers are required to register with the revenue commission and be in good standing. This helps ensure that suppliers doing business with Louisville Metro Government are paying applicable taxes and fees.
 - One of the Mayor's Office suppliers was registered but not in good standing with the Revenue Commission at the time of the audit. This indicates that although the supplier is properly registered with the Revenue Commission, the proper forms have not been filed with the Revenue Commission as required.
 - Three of the Mayor's Office suppliers were not registered with the Revenue Commission at the time of the audit. This indicates the supplier had not made payments to the Revenue Commission as required.

Recommendations

Appropriate Mayor's Office personnel should take corrective actions to address the issues noted. Specifics include the following.

- ✓ The public purpose of all expenditures should be sufficiently documented. Sufficient documentation should be provided to allow a reasonable person to determine the public purpose of expenditures solely by reviewing the supporting documentation. If the payment documentation and invoice do not clearly provide this level of detail, additional explanation should be provided.
- ✓ If there is any doubt to the public purpose of a proposed expenditure, a opinion should be obtained from legal guidance prior to ordering the goods / services. The legal opinion stating there is a legitimate public purpose to the proposed goods / services should be included with the payment documentation.
- ✓ Appropriate personnel should ensure invoices do not include sales tax that Louisville Metro is exempt from paying. In cases where an invoice includes sales tax, an adjustment should be made deducting the applicable amount.
- ✓ Appropriate personnel should request access to the Revenue Commission's internet - based site that allows verification of potential suppliers. The registration status and standing of suppliers should be verified prior to the procurement of goods / services. The verification should be documented.

Response / Corrective Action

The Mayor's Office will follow OMB's policy and work with OMB to ensure appropriate documentation of the public purpose for expenditures included with all payment documentation submitted for payment to OMB. This documentation may be contained in a memo attached to the payment document that is prepared and approved by appropriate parties in the Mayor's Office.

The Mayor's Office will ensure that Metro Government's procurement policy is followed and that all vendors used by the Mayor's Office are properly registered with the Revenue Commission prior to the procurement of goods or services. This verification will be documented internally on any purchase orders issued for small purchases or any

professional service contracts entered into. For large contracts the Mayor's Office will ensure this review is properly documented on the contract data sheet.

3) Payroll

Scope

A review of the Mayor's Office payroll activity was performed. The primary focus of the review was the operational and fiscal administration of the Mayor's Office payroll activity. Examinations were performed to determine whether fiscal activity is complete, accurate, and in compliance with Metro Payroll and Timekeeping Policies. This includes how activity is processed, recorded, monitored, and reported. Documentation reviewed included payroll documents, official forms, Louisville Metro personnel policies, and PeopleSoft records.

The audit review period included the first half of fiscal year 2011 (July 2010 through December 2010). A sample of two pay periods was judgmentally selected for review. All personnel were selected from each of the selected pay periods to review the validity and accuracy of the payroll. Employee addresses were compared to Louisville Metro supplier addresses, and any matches were reviewed. Bank accounts were examined to identify any payments made to fictitious employees. Also, the hours of regular part time employees were examined to ensure the proper contributions were paid to the retirement system, if applicable. The review would not reveal all issues because it is based on a selective review of data.

Observations

The internal control structure is satisfactory and appears to be effective in mitigating the risks associated with the payroll activity. While the overall rating is satisfactory, some opportunities to strengthen the internal control structure were noted. Specific results are as follows.

- **Prior Period Adjustments.** The Mayor's Office employs the use of PeopleSoft's self-service function. Under the self-service function an employee has the capability of entering time throughout the pay period and after the pay period closes. Entries made after the pay period closes are considered to be prior period adjustments, and can impact the accuracy of the respective timecard reports if new reports are not run after adjustments are made (or if documentation for the adjustments is not maintained).
 - **Insufficient Documentation.** There were two cases in which the employee's pay data (e.g., number and type of hours) did not agree to the timecard reports. These were all due to prior period adjustments. Documentation of the prior period adjustments were not included with the timecard reports. This made it appear that the timecard report, which is the official payroll record, was incorrect.
- **Timecard Report Signatures.** Louisville Metro policy requires that the timecard reports be signed by both the employee and their supervisor. The employee's signature indicates the time is reported accurately, and the supervisor's signature indicates authorization to process the employee's payroll. The timecard report is the official record of the payroll activity. Issues were noted with the timecard signatures.
 - There were two individual timecard reports for an elected official that were not signed. Louisville Metro policy does not address signature requirements for elected officials. This issue was addressed in a previous audit and there is currently no definitive guidance whether elected officials are required to sign their timecard report.

Recommendations

Appropriate Mayor's Office personnel should take corrective actions to address the issues noted. Specifics include the following.

- ✓ Prior period payroll adjustments should be properly documented. The documentation is needed so that any discrepancy between the timecard report and the actual pay is explained and justified. The Office of Management and Budget issued a directive in August 2010 requiring the generation of a new timecard report for any employee with a prior period adjustment. The timecard report with adjustments should be distributed for proper signature and maintained with the timecard reports for the effective period.
- ✓ The official timekeeper for the Mayor's Office should monitor prior period payroll adjustments made by employees. This should include verifying the adjustment is appropriate, and the proper earn codes are adjusted. Approval should not be given without this level of review.
- ✓ The necessity of elected officials signing their individual timecard report should be determined. Legal guidance and the assistance Louisville Metro Human Resources may be needed in order to ensure the practice is in compliance with applicable laws and regulations.

Response / Corrective Action Plan

Subsequent to the audit performed, OMB and Human Resources began the process to update the procedures for making prior period adjustments to time worked. These changes limit the time period in which a prior period adjustment may be made and will capture the sign off and review of the employee making the change, the employee's supervisor, and the department time keeper before the adjustment is processed. This finding will be corrected once the new procedures are implemented.

Under Metro Government's current timekeeping policy, employees paid on the basis of one (1) unit per day/five (5) units per week, are not required to use a time clock or complete a timesheet. The Mayor is the only elected office of the government that is paid in increments of one (1) unit per day/seven (7) units per week. All other elected officials are exempted from using a time clock or completing a timesheet under this policy. OMB will work with Human Resources to update the timekeeping policy to include individuals paid in seven (7) units per week to ensure the policy accurately reflects Metro Government's practice.

Office of Internal Audit

Phone: 502.574.3291

www.louisvilleky.gov/InternalAudit/