



Greg Fischer
Mayor

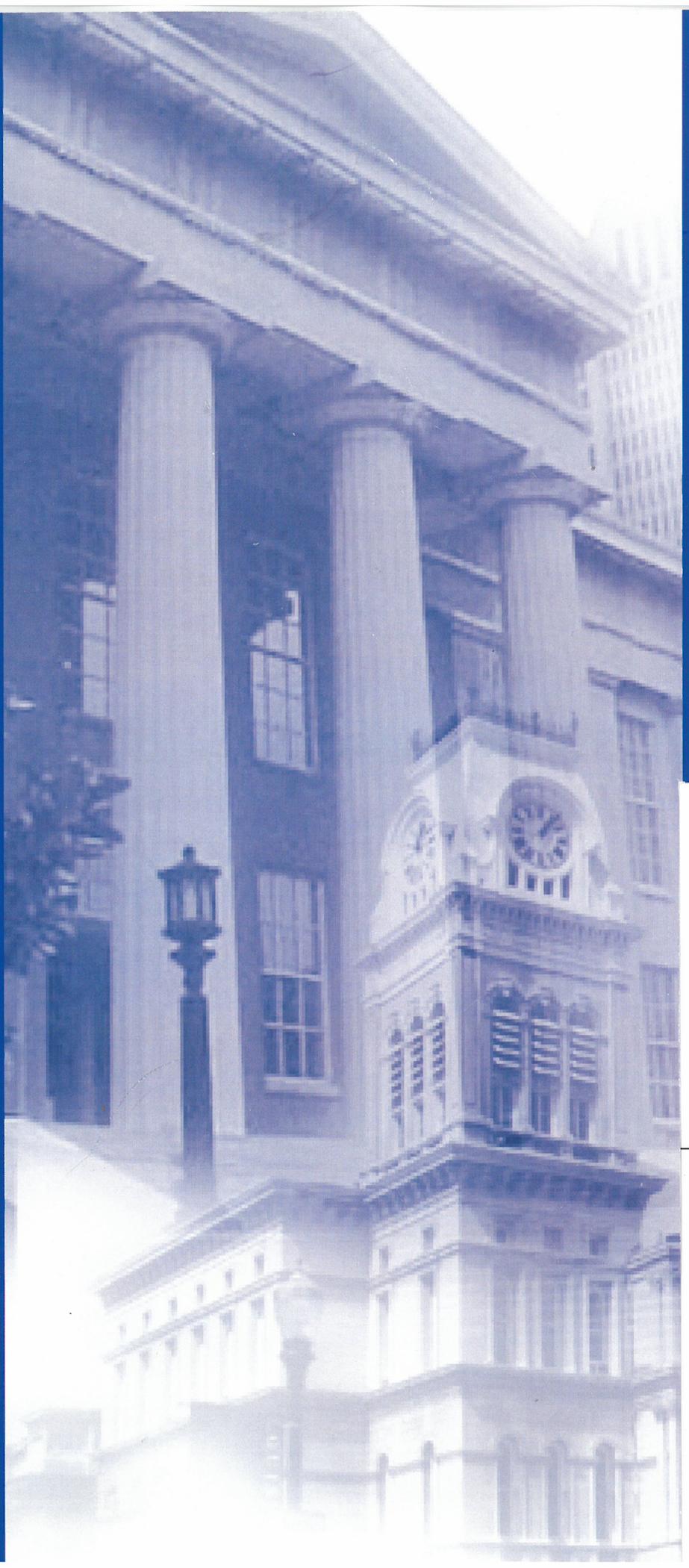
Louisville Metro Council

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

Louisville Metro Government

Procurement Policy



Audit Report

Louisville Metro Government Procurement Policy

Audit

August 2016



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Executive Summary

PROJECT TITLE

Louisville Metro Government – Procurement Policy

OBJECTIVE AND SCOPE

The objective was to perform a review of the Louisville Metro Government Procurement Policy. The operating policies, procedures, and records related to the Procurement Policy were reviewed. The primary focus was the operational and fiscal administration of the activity. This includes how activity was processed, recorded, and monitored. The objective was to obtain assurance that the risks are adequately mitigated.

This was a compliance review based on policies and procedures for the operational and fiscal administration of the Louisville Metro Government Procurement Policy. The review included activity during fiscal year 2015 through the first quarter of fiscal year 2016 (July 1, 2014 through September 30, 2015). All contracts executed during the review period were identified for analysis and testing purposes. The details of the scope and methodology of the review are addressed in the Observations and Recommendations.

INTERNAL CONTROL ASSESSMENT

SECTION

Needs Improvement

Procurement Policy

RESULTS

Opportunities exist for improving the internal control structure related to the Louisville Metro Government Procurement Policy. Examples include the following.

- **Sales Tax Exemption Provision.** There were issues regarding the fiscal and operational administration of a contract due to usage of a provision for Sales and Use Tax exemption.
- **General Administration.** The Purchasing Policy, in regards to competitive procurement, does not provide adequate detail to aid in evaluating proposals and documenting negotiations.
- **Procurement Documentation.** There were issues noted regarding the adequacy of documentation related to procurement activities.
 - There were instances in which the documentation related to the evaluation of competitive procurement proposals was not sufficient to support the contractual award.
 - There were instances in which supporting documentation was not included in the procurement file.
- **Procurement Activities.** There were issues noted regarding procurement activities.
 - There were instances in which contracts were not awarded or renewed in a timely manner.
 - There were instances in which goods and/or services were procured using an inappropriate procurement method.
- **Contractual Compliance and Expenditure Activity.** There were issues noted regarding contractual compliance and expenditure activity including, but not limited to, payment of erroneous invoices, a duplicate payment, and instances of non-compliance with contractual terms.



OFFICE OF INTERNAL AUDIT
LOUISVILLE, KENTUCKY

GREG FISCHER
MAYOR

MAY R. PORTER, CHIEF AUDIT EXECUTIVE

DAVID YATES
PRESIDENT METRO COUNCIL

Transmittal Letter

August 19, 2016

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

Subject: Audit of the Louisville Metro Government – Procurement Policy

Introduction

An audit of the Louisville Metro Government Procurement Policy was performed. The primary focus of the review was the operational and fiscal administration of the activity. This included how activity was processed, recorded, and monitored. Policies, procedures, and records related to the Louisville Metro Government Procurement Policy were reviewed. The objective was to obtain assurance that the risks are adequately mitigated through 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 audit, 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 Louisville Metro Government Procurement Policy was obtained in order to evaluate the internal control structure. This was achieved through interviews of key personnel and examination of supporting documentation. This included obtaining an understanding of the policies and procedures for processing, recording, monitoring, reconciling, and reporting of activity. Testing of activity was also performed to determine the effectiveness of the controls.

This was a compliance review based on policies and procedures for the operational and fiscal administration of the Louisville Metro Government Procurement Policy. The review included activity during fiscal year 2015 through the first quarter of fiscal year 2016 (July 1, 2014 through September 30, 2015). All contracts executed during the review period were identified for analysis and testing purposes. The details of the scope and methodology of the review are addressed in the Observations and Recommendations section of the report. The examination would not identify all weaknesses because it was based on a selective review of data.

Opinion

It is our opinion that the internal control structure for the Louisville Metro Government Procurement Policy needs improvement. The internal control rating is on page 7 of this report. The rating quantifies our opinion regarding the internal controls, and identifies areas requiring corrective action. Opportunities to strengthen the internal control structure were noted. Examples include the following.

- **Sales and Use Tax Exemption Contract.** There were issues regarding the fiscal and operational administration of a contract due to usage of a provision for Sales and Use Tax exemption.
 - There were instances in which sales tax, in the approximate amount of \$20,000, was not deducted from the lump sum contract price, as required by the terms of the contract.
 - There were instances in which, due to the unique provision of Sales and Use Tax exemption, there were excessive quantities of change orders and purchase orders.
- **General Administration.** The Purchasing Policy, in regards to competitive procurement, does not provide adequate detail to aid in evaluating proposals and documenting negotiations.
- **Procurement Activities.** There were issues noted regarding various procurement activities.
 - There were instances in which contracts were not awarded or renewed in a timely manner.
 - There were instances in which the required documentation was not uploaded to DemandStar, which is the online system used to broadcast bid events and documents to interested vendors.

- There were instances in which goods and/or services were procured using an inappropriate procurement method.
- **Procurement Documentation.** There were issues noted regarding the adequacy of documentation related to procurement activities.
 - There were instances in which the documentation related to the evaluation of competitive procurement responses was not sufficient to support the contractual award.
 - There were instances in which supporting documentation was not included in the procurement file.
- **Contractual Compliance and Expenditure Activity.** There were issues noted regarding contractual compliance and expenditure activity including, but not limited to, payment of erroneous invoices, a duplicate payment, and instances of non-compliance with contractual terms.

Corrective Action Plan

Representatives from the Office of Management and Budget have reviewed the results and are committed to addressing the issues noted. Corrective action plans are included in this report in the Observations and Recommendation section. We will continue to work with the Office of Management and Budget to ensure the actions taken are effective to address the issues noted.

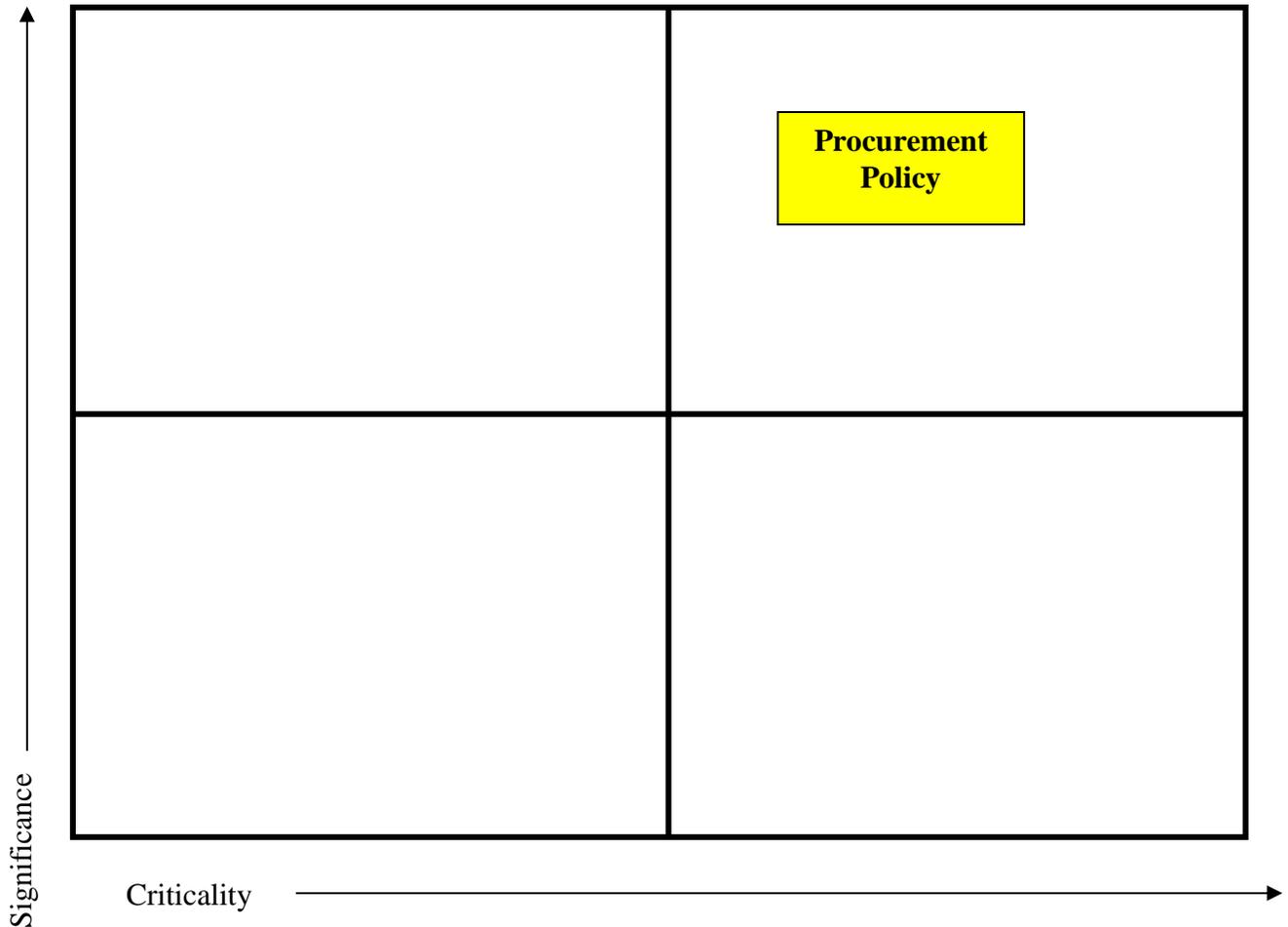
Sincerely,



May R. Porter, CIA
Chief Audit Executive

cc: Louisville Metro Council Government Accountability and Ethics Committee
Chief Financial Officer
Director of Finance
Louisville Metro External Auditors
Louisville Metro Council President

Internal Control Rating



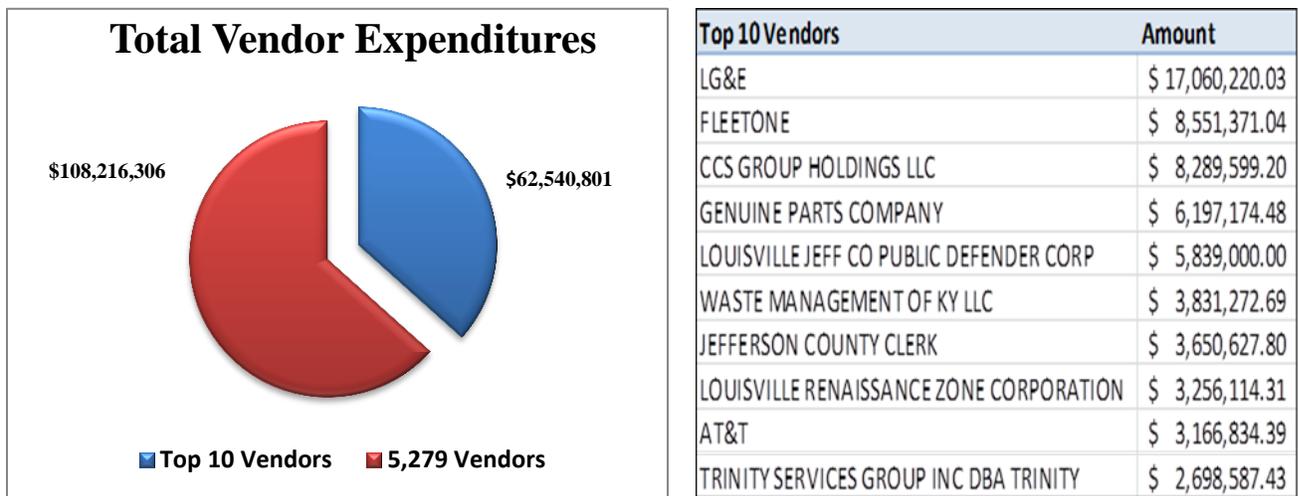
<u>Legend</u>			
<i>Criteria Issues</i>	<u>Satisfactory</u> Not likely to impact operations.	<u>Needs Improvement</u> Impact on operations likely contained.	<u>Inadequate</u> Impact on operations likely widespread or compounding.
<i>Controls</i>	Effective.	Opportunity exists to improve effectiveness.	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

The Louisville Metro Government Office of Management and Budget Purchasing Division (Purchasing Division) is responsible for the administration of the Louisville Metro Government Procurement Policy (Purchasing Policy). The Purchasing Policy is based upon the provisions of Kentucky Model Procurement Code (KRS) 45A.343-460, KRS 45A.180-200 and KRS 67C.119 (6). The policies are designed to promote sound business practices and are intended to provide a system that ensures fairness and integrity. The Purchasing Division and Louisville Metro Government departments have specific responsibilities with regard to purchasing. All persons making purchases on behalf of Louisville Metro Government are responsible for following the Purchasing Policy.

There were over 92,000 expenditures from 5,289 vendors totaling more than \$170,000,000 during the review period, fiscal year 2015 and the first quarter of 2016. The graph below shows the top ten vendors, representing more than 1/3 of expenditures, receiving the most money for goods and/or services provided to Louisville Metro Government.

Graph 1: Total Vendor Expenditures Jul 2014 – Sept 2015



**Payments to Louisville Jefferson County Public Defender Corp, Jefferson County Clerk, and Louisville Renaissance Zone Corporation are the result of various agreements and may not include a purchase of goods or services. The payments to external agencies adhere to Louisville Metro Government’s Purchasing Policy and were included in the population of vendors.*

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 conducted a comprehensive review of the Louisville Metro Government Purchasing Policy. However, reviews of various aspects of the Purchasing Policy including Supplier Payment Thresholds (2005 and 2013), Contract Change Order Administration (2006), Bogus Suppliers (2006), Intent to Purchase Services Contracts (2006), Supplier Payment Timeliness (2007), and Professional Services Expenditures (2009) have been conducted. Unless otherwise noted, all prior issues have been satisfactorily addressed.

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 on June 27, 2016. An exit conference was held at the Office of Internal Audit in the City Hall Annex on July 29, 2016. Attending were Daniel Frockt, Monica Harmon, and Joel Neaveill representing OMB and May Porter, Jason Byrd, and Brandon Booth representing Internal Audit. Final audit results were discussed.

The views of OMB officials were received on August 15, 2016 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.”

OMB’s response was provided within this required timeframe.

Observations and Recommendations

Scope and Methodology

A review of the Louisville Metro Government Procurement Policy was performed. The primary focus of the review was the operational and fiscal administration of the activity. This included how activity was processed, recorded, and monitored. Policies, procedures, and records related to the Louisville Metro Government Procurement Policy were reviewed. The objective was to obtain assurance that the risks are adequately mitigated through internal controls in the process.

The review included activity that occurred during fiscal year 2015 through the first quarter of fiscal year 2016 (July 1, 2014 through September 30, 2015). All contracts executed during the review period were identified for analysis and testing purposes. Samples of transactions were selected for testing accuracy, completeness, contractual compliance, and timeliness. Testing of activity related to the Purchasing Policy included the following:

- A Benford's Law Analysis was performed on 92,249 invoices to assess the reasonableness of the population of invoices.
- A sample of 419 employee's addresses was compared to vendor's addresses to assess the potential for conflicts of interest.
- A review of 613 vendors receiving more than \$20,000 in FY 15 or 16 was performed to assess compliance the Purchasing Policy.
- A sample of 35 contracts was selected to assess compliance with the Purchasing Policy to include: accuracy, completeness, appropriateness, and contractual compliance.
- A sample of 44 invoices and 12 change orders was selected to assess accuracy, completeness, timeliness, and contractual compliance.
- A sample of 10 vendors with expenditures between \$2,500 and \$20,000 was selected to verify compliance with the Purchasing Policy.
- A sample of 10 sets of invoices with similar numbers was selected to assess the potential for duplicate payments.

The examination would not reveal all non-compliance issues because it was based on selective review of data.

Observations

Issues were noted with the Louisville Metro Government Procurement Policy. As a result, the effectiveness of the internal control structure needs improvement. Areas in which there are opportunities to strengthen the controls include the following.

- 1) Sales Tax Exemption Provision
- 2) General Administration
- 3) Procurement Documentation
- 4) Procurement Activities
- 5) Contractual Compliance and Expenditure Activity

Details of these begin on the following page.

1) Sales Tax Exemption Provision

- **Sales and Use Tax Exemption Contract.** One of sixteen contracts reviewed included an uncommonly used provision for Sales and Use Tax exemption. Under the provision, the construction contract required Louisville Metro Government to purchase materials necessary to complete the project directly from sub-contractors in an effort to capture tax savings on small purchases made over the course of the project. The lump sum contract amount, which includes sales tax, must be adjusted to deduct the amount of the direct purchases plus six percent sales tax. There were issues regarding the fiscal and operational administration of the contract.
 - There were eleven of twelve instances in which sales tax, in the approximate amount of \$20,000, was not deducted from the lump sum contract amount.
 - There were four of thirty-six instances in which direct purchases from a single sub-contractor exceeded a vendor payment threshold for competitive procurement. As a result, there is an increased risk that Louisville Metro Government may not have received the most advantageous price for the materials purchased. Further, the sub-contractors were able to circumvent the aspects of the Purchasing Policy which require compliance with the Human Relations Commission and the Revenue Commission.
- **Change Order Usage.** The provision for Sales and Use Tax exemption requires deductions of direct purchases from sub-contractors plus the six percent sales tax to be made using change orders. There were issues regarding the use of change orders.
 - Due to the unique provision for Sales and Use Tax exemption included in the contract, there were excessive quantities of change orders and purchase orders. As of February 2016, fifteen change orders and forty purchase orders were issued. The quantity of change orders and purchase orders increase the amount of time required to track and process transactions related to the contract. The inherent risk of human error stemming from manually tracking activity coupled with the involved terms of the contract increase the compliance and financial risk of administering the contract.

Recommendations

Appropriate personnel should take corrective actions to address the issues noted. Recommendations include the following.

- ✓ Discontinue the use of the Sales and Use Tax exemption in competitively bid contracts. As currently written, the exemption creates instances that are noncompliant with the Louisville Metro Government Purchasing Policy. Additionally, the exemption creates inefficiencies and reduces transparency in the administration of the construction project.
- ✓ If the Sales and Use Tax exemption is to continue to be used then procedures specific to administering contracts that include the exemption should be developed. Additional considerations for the administering such contracts include the following:
 - Identify documentation required to be completed and reviewed by vendors, sub-contractors, departmental staff, and the applicable Purchasing Division staff.

- Applicable staff should receive training regarding the procedures.
- Continuous management review should take place to ensure the policy is applied and monitored.

Office of Management and Budget's Corrective Action Plan

The Office of Management and Budget does not concur with and will not implement the recommendation to discontinue the use of the sales and use tax exemption. In addition, the Office of Management and Budget stated the following:

As noted, there were issues related to the administration of this provision. We are seeking solutions to address the administration in an effort to take advantage of cost savings related to certain capital projects. Further, we will ensure that processes align with LMG purchasing policy.

The Office of Management and Budget does concur with and will implement the recommendations related to continuing the use of the sales and use tax exemption. In addition, the Office of Management and Budget stated the following:

Given the potential cost saving benefits to LMG allowed by Ky Department of Revenue, OMB is exploring new processes and controls to address issues identified by IA.

2) General Administration

- **Competitive Procurement Procedures.** Louisville Metro Government's Purchasing Policy does not provide adequate guidance regarding evaluation team composition, documentation of evaluation team discussions, and final scoring guidelines. This increases the risk of inconsistent processing as well as noncompliance with intended policies and statutory regulations.
- **Conflicts of Interest Policy.** The Purchasing Policy does not provide adequate guidance regarding applying the proper safeguards in the event a conflict of interest, real or in appearance, is identified. Although, the Purchasing Policy identifies what constitutes a conflict of interest, there are no procedures that aid in determining if a real or potential conflict of interest exists.
- **Conflicts of Interest.** Issues regarding real and/or perceived conflicts of interest are as follows.
 - There was one of four hundred and nineteen instances in which an employee worked in a managerial role, for a department, while simultaneously owning a company contracted to provide services to the same department. Louisville Metro Government Personnel Policies Standards of Ethical Conduct 1.6(5) prohibits anyone from using their official position to secure or create privileges, exemptions, advantages, contracts or treatment for one's self. It cannot be determined if the employee used his/her position to influence the contract with his/her company. However, the activity creates a conflict of interest. The conflict of interest was not identified or disclosed. There has been no current activity with the vendor since 2013.
 - There were two of four hundred and nineteen instances in which an employee shared an address and/or had a direct relation to a vendor providing goods/services in the same department. Personnel Policy 1.6(2)(D) defines a personal advantage as a financial interest or some other personal interest, whether present or potential, whether direct or indirect. The activity creates an appearance of a conflict of interest. The appearance of a conflict of interest was not identified or disclosed.
- **Documentation of Acceptance and Acknowledgement.** There were instances in which it could not be determined if contractual requirements, and guidelines were properly accepted or acknowledged as required by the Purchasing Policy.
 - There was one of sixteen instances in which there was no evidence of acknowledgement and acceptance of the terms of the Request for Proposal (RFP). Section 1.A.4 of the RFP document requires that all submittals address and acknowledge all criteria noted in the RFP. Acknowledgement is usually documented by way of the bidder signature on the RFP cover sheet.
 - There were five of five instances in which use of an outdated Contract Data Sheet created the appearance that Risk Management did not certify that insurance requirements had been satisfied, because the required signature was not present in the designated area on the Contract Data Sheet. However, Risk Management certification has not been required to be evidenced by way of signature on the Contract Data Sheet since 2014.

- **Purchase Approval Authorization.** There is no evidence to support the authorization to approve purchases on behalf of a department. Evidence typically consists of written notification from the department director or a designee. However, the written notification is not maintained by the Purchasing Division.

Recommendations

Appropriate personnel should take corrective actions to address the issues noted. Recommendations include the following.

- ✓ The Purchasing Policy should be revised to include detailed guidelines for evaluating proposals and documenting negotiations. Additional considerations for ensuring the policy promotes consistent compliance include the following:
 - Identify and clearly communicate responsibilities of departmental staff and the staff of the Purchasing Division as it relates to reviewing and evaluating proposals.
 - Upon completion, the policy should be distributed to applicable staff. The policy should be maintained in an accessible location such as SharePoint or MyMetro.
 - Applicable staff should receive training regarding the policy.
 - The policy should be reviewed and revised as needed, at least annually.
- ✓ Develop a Procurement Conflict of Interest Policy. The policy should serve as a cohesive and comprehensive tool to aid in identifying and making appropriate decisions when dealing with potential conflicts of interest. Additional considerations include the following:
 - Policy development should be a coordinated effort between the appropriate departments to ensure alignment with Personnel Policies, Ordinances, Kentucky state laws, and federal laws.
 - The policy may require a Conflict of Interest Disclosure form that is required to be completed as part of the procurement process. The form should have sufficient detail as to relationships required to be disclosed as well as penalties for falsification.
 - Upon completion, the policy should be distributed to applicable staff. The policy should be maintained in an accessible location such as SharePoint or MyMetro.
 - Applicable staff should receive training regarding the policy.
 - The policy should be reviewed and revised as needed, at least annually.
- ✓ In regards to documentation of acceptance and acknowledgement, appropriate personnel should perform a review of RFP proposals to ensure all required forms are accurately completed. In addition, a checklist or desktop procedures may be developed to aid in the review.
- ✓ Authorization and threshold documentation should be retained and easily accessible in order to ensure purchases are initiated and approved for payment by appropriate personnel.

Office of Management and Budget's Corrective Action Plan

The Office of Management and Budget concurs with and will implement the recommendations related to guidelines for evaluating proposals and documenting negotiations. In addition, the Office of Management and Budget stated the following:

A comprehensive review and revision of Louisville Metro Government's Purchasing Policy is underway. As part of this review, guidelines for evaluating proposals are being drafted and will be incorporated into the new policy.

The Office of Management and Budget does not concur with and will not implement the recommendations related to conflict of interest disclosure. In addition, the Office of Management and Budget stated the following:

As noted in the audit, all Metro employees are subject to Government Personnel Policies Standards of Ethics: Responsibility as a Public Employee 1.(5) and Ethics: Conflict of Interest 1.6(1). These policy place the responsibility on the employee to notify Human Resources if there is a question whether or not a violation may occur. Violation of any section of this policy may result in disciplinary action up to and including termination. We will note that without such a explicit restatement of these policies within the Purchasing Policy, OMB and LMG personnel are very conscientious in their efforts to avoid conflicts of interest. The Auditor's own review found only 1 in 419 instances or 0.23% where there was a perceived conflict of interest. There was no evidence that this instance was a deliberate attempt to utilize their position within LMG to influence the contract with his/her company. However, OMB is exploring solutions to enhance this policy that allow for metro employees involved in the evaluation of solicitation responses to affirmatively confirm that they have no conflict of interest (perceived or real) in their evaluation duties.

The Office of Management and Budget concurs with and will implement the recommendations related to contractual acceptance and acknowledgements. In addition, the Office of Management and Budget stated the following:

A comprehensive review is being conducted of the solicitation documents required in all bids. In cooperation with the County Attorney's Office, Purchasing staff is revising documents to include all necessary language. Review is also being conducted to provide clarity to both vendors and purchasing staff of expected document submission.

The Office of Management and Budget concurs with and will implement the recommendations related to purchase authorization documentation. In addition, the Office of Management and Budget stated the following:

This has been remedied since brought to the attention by Auditor. Delegated purchasing approvals from Directors and/or designee are kept updated on SharePoint site.

3) Procurement Documentation

- **Competitive Procurement Evaluation Documentation.** There were issues regarding the documentation related to the evaluation of competitive procurement proposals.
 - There were three of sixteen instances in which documentation included in the contract file was not sufficient to support the contractual award.
 - In one instance, there was not enough documentation to support the accuracy of changes or negotiation of prices for goods and/or services compared to the original proposal.
 - In two instances, there was not enough documentation to allow another reviewer to understand how proposals were evaluated and the basis of how the proposals were scored.
 - There were four of sixteen instances in which the bid tabulation sheet contained an error and was not corrected. None of the errors would result in an award to a different vendor.

- **Procurement Files.** Sufficient documentation is required to demonstrate compliance with Louisville Metro Government's Purchasing Policy, as well as, statutes included under the Kentucky Model Procurement Code (KRS 45A). There were instances in which sufficient documentation was not included in the procurement file.
 - There were three of sixteen instances in which a completed bid opening sign-in sheet was not included in the procurement file. The sign-in sheet provides documentation as to who was present during the bid opening.
 - There were four of twenty-one instances in which documentation regarding the bidder's ability to meet insurance requirements was not included in the procurement file. The use of an outdated Contract Data Sheet coupled with missing documentation decreases the ability to determine compliance with insurance requirements at the time of contract execution.
 - There were two of twenty instances in which procurement files did not include documentation regarding compliance with the Human Relations Commission (HRC).
 - In one instance the file was missing a complete Human Relations Commission Vendor Questionnaire, which allows vendors to identify if they are a Minority, Female, or Handicapped Business Enterprise.
 - In one instance a Good Faith Efforts Evaluation Summary report from the Human Relations Commission was not included in the file.
 - There were four of ten instances in which contract renewal documentation did not include compliance confirmations from the Revenue Commission or the Human Relations Commission.
 - There were ten of ten instances in which current contractual information was not included in Louisville Metro Government's electronic document repository, IPM, or in the financial system.

Recommendations

Appropriate personnel should take corrective actions to address the issues noted. Recommendations include the following.

- ✓ Develop desktop procedures or a detailed checklist to provide guidance regarding the documentation related to evaluation of contract proposals. The objectives of the guidelines should include the following:
 - Ensure consistent and adequate documentation of evaluations and maintenance of such documentation.
 - Ensure that the evaluator or the evaluation team is qualified to understand all complexities related to the goods and/or service being procured.
 - Ensure that a representative from the Purchasing Division is either a part of the evaluation team or directly involved in the evaluation process. Involvement may include facilitating the evaluation to ensure compliance with the Purchasing Policy.
 - Establish a timeline for communications between the evaluators and proposers (i.e. requests for additional information, etc.) to ensure the evaluation is completed within the required time, in accordance with the Purchasing Policy.

- ✓ Develop desktop procedures or a detailed checklist to provide guidance regarding the documentation that must be maintained within the procurement files. The desktop procedures or detailed checklist should be reviewed and revised at least annually. The guidance may include the following:
 - Implement a documented supervisory review to ensure all applicable documents are included in each file.
 - Develop checklists specific to each type of procurement method to ensure all documentation is included in the file.
 - Designate a centralized location to retain a complete record of contractual information. By centralizing all contractual documents, applicable staff can be sure they are reviewing the most current version of the contract, as well as, amendments, change orders, and previous contracts.

Office of Management and Budget's Corrective Action Plan

The Office of Management and Budget concurs with and will implement the recommendations related to the evaluations of competitive procurement proposals. In addition, the Office of Management and Budget stated the following:

A comprehensive review and revision of Louisville Metro Government's Purchasing Policy is underway. As part of this review, guidelines for evaluating proposals are being drafted and will be incorporated into the new policy.

The Office of Management and Budget concurs with and will implement the recommendations related to the documentation included in the procurement file. In addition, the Office of Management and Budget stated the following:

A comprehensive review and revision of Louisville Metro Government's Purchasing Policy is underway. As part of this review, guidelines for evaluating proposals are being drafted and will be incorporated into the new policy.

4) Procurement Activities

- **Contract Renewal Timeliness.** There were ten of ten instances in which the annual renewal of contracts was not performed in accordance with the Purchasing Policy. The Purchasing Policy states that departments will be notified approximately 120 days in advance of the contract expiration date, with a response required within 30 days. Additionally, renewal years 2-5 will require a memo to purchasing from the department director indicating why the renewal should be granted.
 - In seven of the ten instances the department was not notified in advance that the contract was nearing expiration.
 - In one of the seven instances the department did not respond with a memo indicating why the renewal should be granted.
 - In three of the ten instances the department was notified less than 120 days before the contract expiration date. The 120 day lead time allows for specifications to be developed in the event the department chooses to re-bid the contract.
- **Contract Award Timeliness.** The Purchasing Policy requires a department to evaluate proposals within 15 days after receipt. The contract must be awarded within 15 days of receiving the department's recommendation.
 - There were eight of sixteen instances in which the department did not return a scoring sheet that evaluated all proposals, a recommendation, and concurrence from the department director to the Purchasing Division within 15 days of receiving the proposals.
 - There were four of sixteen instances in which the contract was not awarded within 15 days of the department's recommendation.
- **DemandStar Notification.** There were eight of sixteen instances in which DemandStar was not updated with required information. DemandStar is used to publish all competitive procurement opportunities. Additionally, DemandStar aids in compliance with KRS 45A.365(4) which requires each bid and bidder name to be recorded and open for public inspection.
- **Verification of Bid Preferences.** There is no verification of the Living Wage Preference Certification. Bid offerings and requests for proposals allow for a 5% deduction in price or 5 points added to evaluations if a business certifies that its' employees are paid at least \$9.00 per hour. In addition, falsification of the Living Wage Preference Certification subjects the vendor to penalties up to 30% of the amount of the contract awarded.
- **Price Quote Method.** The Purchasing Policy requires non-contract purchases of goods of more than \$2,500 but not exceeding \$20,000 to be made using the price quote method. Using the price quote method, three written price quotes are to be obtained prior to making the purchase. Additionally, departments shall use the certified MFHBE listing on the Human Relations website as part of their effort in obtaining quotes.
 - There were two of ten instances in which a non-contract purchase of goods in an amount greater than \$2,500 but less than \$20,000 was made without obtaining three quotes or attempting to get a quote.

- There was one of ten instances in which a purchase of goods exceeding \$2,500 but less than \$20,000 was approved without submission of at least one quote from a vendor certified by the Human Relations Commission as being an MFHBE. A search of the Human Relations Commission compliance website identified vendors capable of providing the good(s) requested.
- **Intent to Purchase Services Contract (ITPS).** There was one of ten instances in which services in an amount less than \$20,000 were procured without the proper contract. The Purchasing Policy requires purchases of services from a supplier, who has not exceeded \$20,000 Metro-wide, to be made using the Intent to Purchase Services (ITPS) contract.
- **Competitive Procurement Contracts (+\$20,000).** The Purchasing Policy requires all purchases exceeding \$20,000 to be made using one of the following four methods: competitive bid (CSB), competitive negotiation (RFP), non-competitive negotiation (PSC or SS), or by use of an approved state or cooperative contract.
 - There were four of six hundred and thirteen instances in which purchases exceeding \$20,000 were not made using one of the four methods allowed by the Purchasing Policy.

Recommendations

Appropriate personnel should take corrective actions to address the issues noted. Recommendations include the following.

- ✓ A system to ensure notifications are sent 120 days before contract expiration and a method of follow up with the departments should be implemented to avoid delays or loss of services. Options include, but are not limited to, the following:
 - Use the workflow functionality within SharePoint to notify departments of contracts expiring 120 days in advance. The SharePoint notification should be setup to allow for multiple users to receive the notification and an ability to monitor outstanding department notifications. Additionally, if a second notification is needed consider including the department director.
 - Explore the option of purchasing “off the shelf” software to track and monitor the expiration of contracts. The software selected should possess the functionality to automate notifications to departments regarding the status of their contract(s).
 - Until a system is selected, applicable staff should adhere to the Purchasing Policy, by manually monitoring contract expiration dates and notifying the responsible parties.
- ✓ Develop standard templates for use in evaluations. Also include a listing or a checklist of documentation that must be submitted with the department’s recommendation. The use of templates and a standardized documentation requirement would allow for a more efficient review of the evaluations and could help to ensure a timely contract award.
- ✓ Include a directive to upload the required documentation into DemandStar to the Buyer’s Checklist to ensure all required documentation is included in DemandStar.

- ✓ Consider periodically requesting Living Wage Preference documentation from vendors for verification. Additionally, verification may be performed when contracts are amended or renewed.
- ✓ In regards to usage of the price quote method for purchases of goods of more than \$2,500 but not exceeding \$20,000, consider the following:
 - When multiple quote attempts are to be used in procuring goods under the price quote method, ensure proper documentation is included. Additionally, based on the type of goods being requested, consider requiring additional quotes.
 - When setting up new vendors for purchases, conduct a secondary review of all documentation prior to approval of the purchase order.
- ✓ The aggregate amount of payments to a supplier for the fiscal year should be verified through the financial system to determine if a payment threshold will be exceeded, prior to approval for the purchase. This could be in the form of existing financial system reports, or developing new reports to use as monitoring tools. Additionally, consider the following:
 - Establish a lower threshold (e.g. \$15,000) to begin actively monitoring purchases made with vendors to ensure the \$20,000 threshold is not exceeded without a valid contract.

Office of Management and Budget's Corrective Action Plan

The Office of Management and Budget concurs with but will not implement the recommendations related to annual renewal of contracts. The Office of Management and Budget will implement the following alternative corrective action:

While we appreciate the Auditor's options within the recommendation for addressing the non-compliance of the existing policy of 120 day notification, Purchasing is reviewing whether the governing policy is appropriate. Certainly there needs to be an established timeframe for renewal/expiration notification to ensure Louisville Metro avoids delays or the inability to acquire goods and services on contract. In the interim, staff will continue to manually monitor contract expiration and provide regular notifications to departments through OMB Fiscal Administrators.

The Office of Management and Budget concurs with and will implement the recommendations related to contract award timeliness. In addition, the Office of Management and Budget stated the following:

A comprehensive review and revision of Louisville Metro Government's Purchasing Policy is underway. As part of this review, evaluation guidelines and procedures are being drafted and will be incorporated into the new policy.

The Office of Management and Budget concurs with and will implement the recommendations related to updating DemandStar with required documentation.

The Office of Management and Budget concurs with but will not implement the recommendations related to the verification of the Living Wage Preference certification.

The Office of Management and Budget will implement the following alternative corrective action:

After a comprehensive review of bid documents, it was discovered there is no authorization for a "living wage" preference. However, the referencing language in the solicitation cites LMCO 37.55 which relates to a minimum wage preference. This preference is provided only as a means to evaluate bids and proposals. While Purchasing staff can ask for verification at renewal or amendment as the audit recommends, once vendor selection is made there is little that LMG can do to compel the vendor to maintain that status over the course of the contract term. However, we will explore any legal authority that would allow OMB to require the vendor to report if they become non-compliant at any time during the term of the contract.

The Office of Management and Budget concurs with and will implement the recommendations related to the use of proper procurement methods. In addition, the Office of Management and Budget stated the following:

A comprehensive review and revision of Louisville Metro Government's Purchasing Policy is underway. As part of this review, guidelines for procuring goods are being drafted and will be incorporated into the new policy.

The Office of Management and Budget concurs with and will implement the recommendations related to purchases exceeding \$20,000. In addition, the Office of Management and Budget stated the following:

While we agree that there is always room for improvement in ensuring that purchases follow the appropriate procurement methods, we are encouraged by the effort of OMB and LMG employees to avoid intentionally circumventing purchasing policies. The Auditor's finding that 4 of 613 instances tested or only 0.6% where purchases were made not using the appropriate purchasing method reveals that this is a statistically insignificant issue. However, Procurement staff will implement scheduled processes to monitor and take corrective action with identified.

5) Contractual Compliance and Expenditure Activity

- **Noncompliance with Contractual Terms.** There were eight of forty-four instances in which purchases of goods and services were not in compliance with contractual terms. As a result of the audit, refunds were requested for three of the instances, in which Louisville Metro Government was overcharged. The remaining five instances resulted in underpayments.
- **Noncompliance with the Louisville Metro Government Purchasing Policy.** There were three of forty-four instances which included the procurement of goods/services that were not included in the itemized listing of items authorized for purchase per the terms of the respective contract. The Purchasing Policy requires an amendment to the existing contract or a new contract for add-ons.
- **Inadequate Supporting Documentation.** There were fifteen of forty-four instances in which it could not be determined if an expenditure was in compliance with contractual terms due to inadequate supporting documentation. Inadequate supporting documentation impairs the ability to verify that the goods and services were procured in accordance to the contractual terms and price agreement.
- **Invoices not paid within 30 Days.** There were ten of fifty-four instances in which invoices were not paid within 30 days of receipt. Kentucky Revised Statue 65.140 requires that all bills for goods or services shall be paid within thirty (30) working days of receipt of a vendor's invoice.
- **Erroneous Invoices.** There were three of forty-four instances in which an invoice containing an erroneous calculation of the "total amount due" was paid. As a result of the audit, issues related to the erroneous calculations were resolved.
- **Public Purpose Intent to Purchase Form.** There was one of forty-four instances in which a Public Purpose Intent to Purchase form (PPIP) should have been submitted based on the Purchasing Policy. The policy requires a PPIP form for any purchase in which the public purpose could be deemed questionable. The purchase included refreshments solely for the benefit of Louisville Metro Government employees, which is prohibited by the Purchasing Policy.
- **Duplicate Invoice.** There was one of twenty-two instances in which an invoice was paid twice. Louisville Metro Government issued two checks to the vendor for identical invoices. As a result of the audit one of the checks was voided.

Recommendations

Appropriate personnel should take corrective actions to address the issues noted. Recommendations include the following.

- ✓ In regards to non-compliance with contractual terms appropriate personnel should consider the following :

- Clearly indicate the department and staff responsible for comparing purchase orders and/or invoices to contractual terms.
 - Clearly identify what constitutes adequate supporting documentation.
 - Periodically perform a supervisory review of approved purchase orders to ensure information is accurate to include: vendor name, vendor address, item numbers match contractual price sheet if applicable, and verify correct procurement method was utilized.
- ✓ Any negotiations agreed upon by parties subsequent to the bid award should be thoroughly documented and approved through the appropriate channels as defined in the Purchasing Policy. In an effort to increase compliance with the policy, departmental staff should receive training regarding the Purchasing Policy.
 - ✓ Appropriate personnel should review all supporting documentation to ensure the expenditure is in compliance with contractual terms prior to the approval of payment. The documentation should be explicit as to the services/work performed or goods provided. Sufficient documentation should be provided to allow a reasonable person to independently verify the expenditure agrees to the contractual terms. Further actions include the following.
 - Develop or update departmental procedures to require review and maintenance of supporting documentation prior to approving payment of applicable invoices.
 - Supporting documentation should be included with the corresponding purchase order request using the Office of Management and Budget's SharePoint site. This will ensure the supporting documentation is reviewed along with the purchase order prior to approval of the purchase. Further, the supporting documentation will be maintained in SharePoint.
 - ✓ Care should be taken to ensure that invoices are processed and paid within thirty days of receipt. Additionally, any instance in which a payment is intentionally delayed (e.g., dispute with vendor) should be properly documented. This documentation should be submitted to the Purchasing Division with the payment document.
 - ✓ In regards to issues related to erroneous invoices, internal procedures should clearly indicate the staff responsible for reviewing the invoice for comparison to purchase order, accuracy of goods ordered, discounts applied or eligible, calculation of line items, and calculation of total amount due.
 - ✓ Enough documentation should be provided to allow a reasonable person to determine the public purpose of expenditures. In addition, the Public Purpose Intent to Purchase Form should be used, as required by the Purchasing Policy.
 - ✓ In regards to issues related to duplicate invoice payments, appropriate personnel should review the check register(s) over a defined period of time (i.e. a week, month, etc.) for multiple payments in the same amount to a vendor. Additionally, a periodic review of the Potential Duplicate Invoices Report should be reviewed.

Office of Management and Budget's Corrective Action Plan

The Office of Management and Budget concurs with and will implement the recommendations related to compliance with contractual terms. In addition, the Office of Management and Budget stated the following:

The Office of Management and Budget concurs with and will implement the recommendations related to purchases of items not included in the itemized listing of goods/services authorized for purchase per the terms of the respective contract.

The Office of Management and Budget concurs and will not implement the recommendations related to inadequate supporting documentation. The Office of Management and Budget will implement the following alternative corrective action:

With over 90,000 invoices processed per year, it is not practical for staff to review or attach supporting documentation to every invoice that is processed. However, we agree that contractual compliance is important to ensure LMG is being appropriately invoiced according to the agreed upon terms. OMB will explore the implementation of a regularly scheduled (weekly/monthly/quarterly) review of select annual contracts. The AP Fiscal manager will assign appropriate staff with the responsibility of implementing a review of contracts and propose corrective actions. This does not preclude staff from addressing contract compliance issues that may be identified outside of a scheduled review.

The Office of Management and Budget does not concur and will not implement the recommendations related to invoices not being paid within 30 days of receipt. The Office of Management and Budget will implement the following alternative corrective action:

If an invoice is intentionally delayed (either by OMB or the agency), our process is to add a sticky note to the invoice (in IPM) stating the reason, and move the invoice to the "Merchandise Not Received" queue. We (OMB staff) monitor this invoice until the matter is resolved by moving the invoice to various queues within IPM. Our documentation is through electronic annotation on the invoice. For example: If the issue is a purchase order problem, we move it to Issues 1 and work with the agency to obtain a purchase order. If it is a contract issue, we move it to the Fiscal Administrator queue and work with the Fiscal Administrator and the Purchasing Division, etc... Accounts Payable management has instructed the staff to add more notes and to be more clear regarding the status of invoices (especially late invoices).

The Office of Management and Budget concurs with and will implement the recommendations related to the accuracy of invoice calculation. In addition, the Office of Management and Budget stated the following:

Accounts Payable recently hired two new supervisors and implemented a new workflow within the IPM system. We are currently determining the most efficient methods of electronically processing and reviewing purchase orders and invoices among our staff. Once this is determined, we will document the procedures.

The Office of Management and Budget concurs with and will implement the recommendations related to the use of public purpose intent to purchase form. In addition, the Office of Management stated the following:

If it is determined that the Public Purpose Intent to Purchase Policy Form is necessary to determine the public purpose of a purchase, the Business Accountant II s will not approve the invoice for payment. However, Purchasing is currently reviewing this section of the Purchasing Policy.

The Office of Management and Budget concurs with and will implement the recommendations related to an invoice being paid twice. In addition, the Office of Management and Budget stated the following:

The Fiscal Manager will review the check register report monthly for multiple payments made to the same vendor in the same amount. The Business Accountant II staff will run a "Duplicate Payment" report in LeAP at the end of each month and research any payments that appear to be duplicates.

Appendix

The following data summarizes procurement activities reviewed as part of the audit. This is included for informational purposes only.

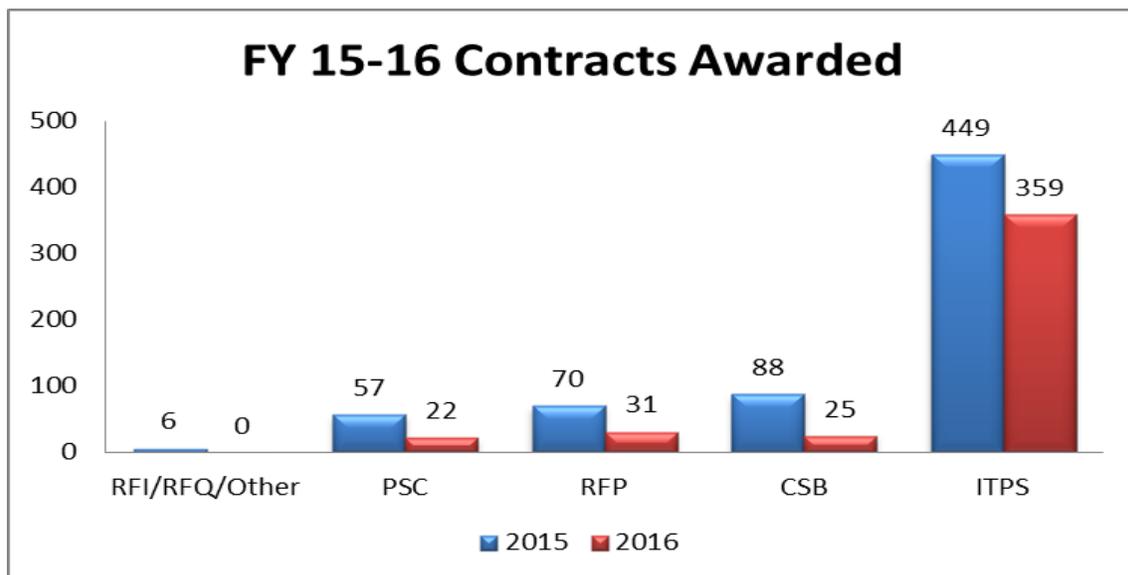
There are three thresholds for the purchase of goods.

1. Non-contract purchases of \$2,500 or less may be purchased directly from the supplier, provided total expenditures with the supplier do not exceed \$20,000 for the fiscal year.
2. Non-contract purchases between \$2,500 and \$20,000 can be made using the price quote method, provided total expenditures with the supplier do not exceed \$20,000 for the fiscal year.
3. Purchases exceeding \$20,000, and not exempt, must be made using one of the following four methods: competitive bid (CSB), competitive negotiation (RFP), non-competitive negotiation (PSC), or by use of an approved state or cooperative contract.

All purchases for service must be made using a contract regardless of amount. Purchases that do not exceed \$20,000 in aggregate are made using Intent to Purchase Services (ITPS) contract. Purchases exceeding \$20,000 are made using a Professional Service Contract (PSC).

The total number of contracts awarded during the review period (July 1, 2014 - September 30, 2015) is graphically depicted below in Graph 2: FY 15-16 Contracts Awarded.

Graph 2: FY 15-16 Contracts Awarded

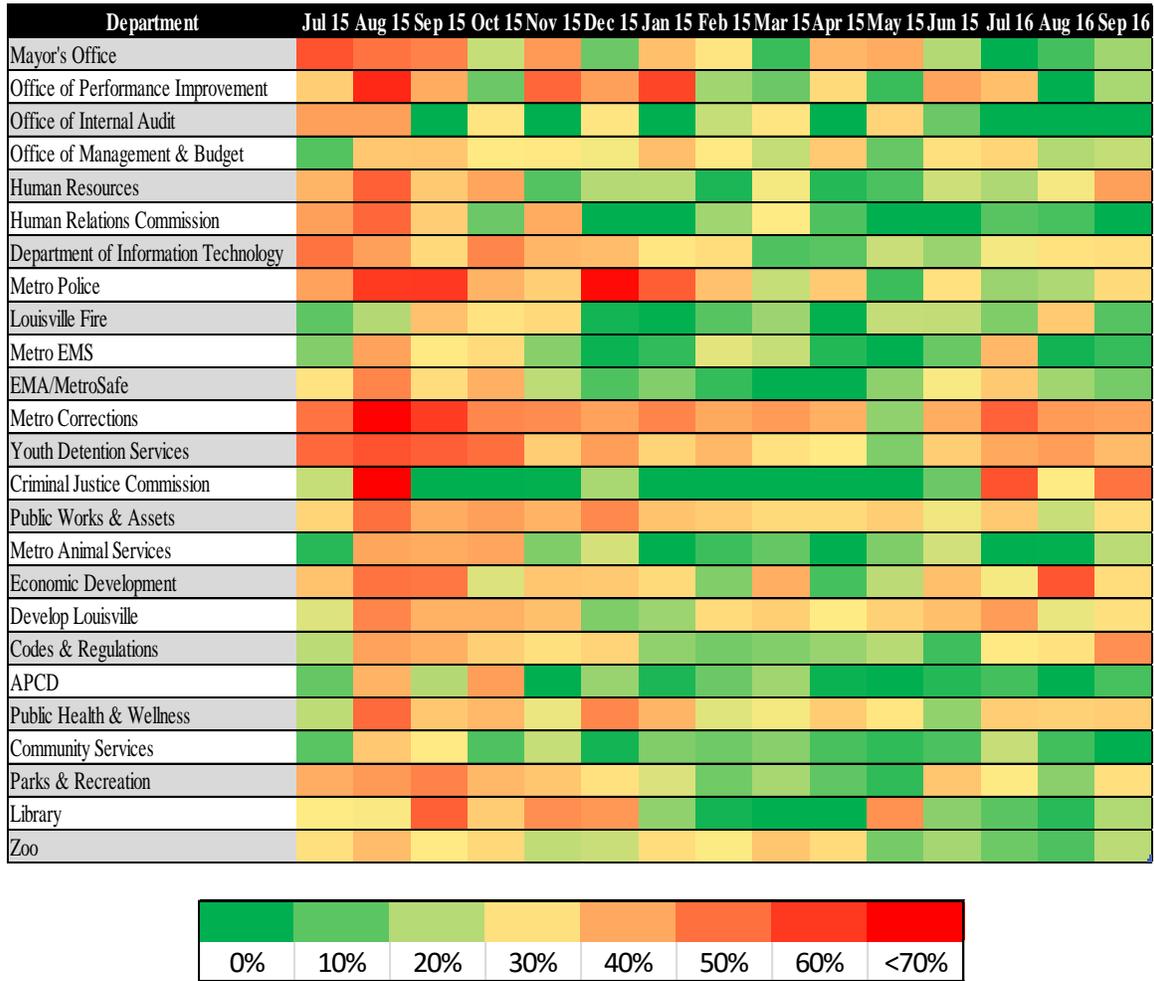


Request For Information (RFI), Request For Quotation (RFQ), and "Other" are not contracts. These items are used to solicit vendor interest or capabilities.

Late Invoices

Louisville Metro Government is required, by KRS 65.140, to pay vendors within 30 days of receipt of the vendor’s invoice. KRS 65.140 also requires local government to pay an interest penalty of one percent (1%) of any amount approved and unpaid for each month or fraction thereof after unless a written disapproval has been submitted to the vendor. The Office of Management and Budget monitors the percentage of late invoices not paid within 30 days as a key performance indicator (KPI) for OMB Strategic Plan Goal 6. The chart below shows the percentage of invoices paid late for each department during the review period (July 1, 2014 - September 30, 2015).

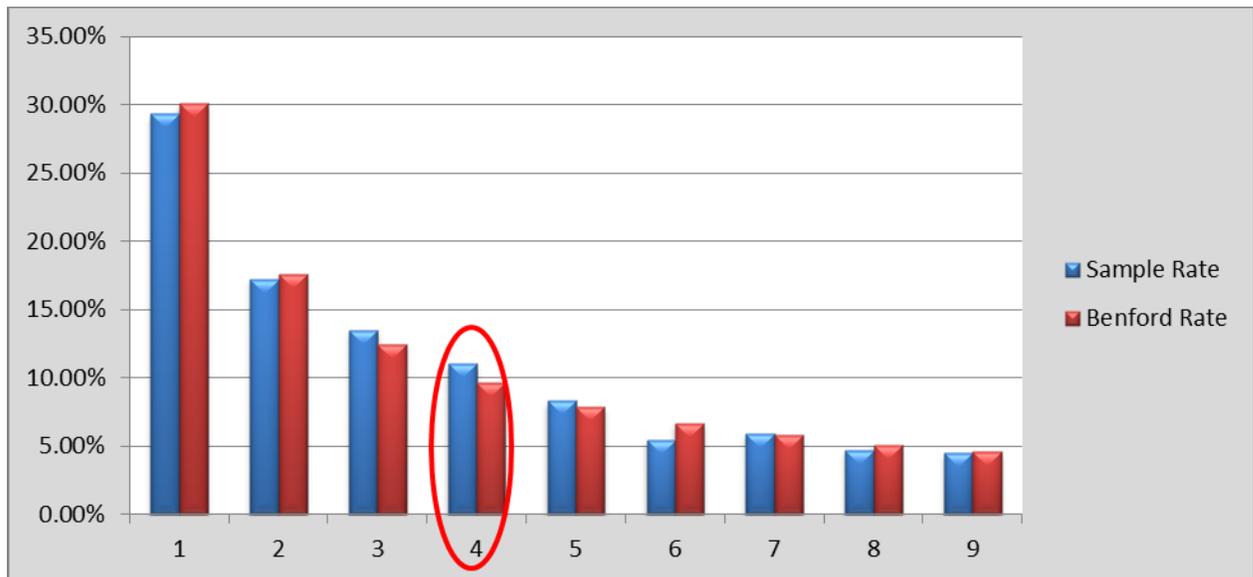
Graph 3: Percentage of Late Invoices by Department



Benford's Law Analysis

In accordance with the Institute of Internal Auditors' International Professional Practices Framework (IPPF) 2120.A2- the internal audit activity must evaluate the potential for the occurrence of fraud and how the organization manages fraud risk. One of the highest risks for this audit is the potential for fraudulent invoices both from external as well as internal parties. Utilizing Benford's Law allows the auditor to identify potential areas to examine more closely in effort to identify potential fraud areas were errors are occurring at a consistent rate.

Graph 4: Benford's Law



There were no issues noted as a result of the Benford Analysis based on payment amounts. The results of the analysis included the following.

- The analysis identified occurrence levels for some activity that indicated additional review was warranted. Vendor activity for a sample of these occurrences was reviewed. Based on the nature of the vendor activity and explanations from user staff, it was determined that the variances were not indicative of inappropriate activity. As seen in the chart above, the payment amounts beginning with 4 (i.e. \$400) occur more frequently in the sample than should in naturally occurring numbers. Further analysis revealed that the activity identified is the result of frequent client assistance payments in the amount of \$400, issued by Community Services.



The purpose of this survey is to solicit your opinion concerning the quality of the **Louisville Metro Government – Procurement Policy Audit Report**. Please feel free to expand on any areas that you wish to clarify in the comment area at the end. Please return the completed survey electronically to IAUDITIMB@Louisvilleky.gov or to ATTN: Internal Audit 609 W. Jefferson St Louisville, KY 40202. We sincerely appreciate your feedback. The survey can also be completed online at the following link: <https://louisvilleky.wufoo.com/forms/audit-report-satisfaction-survey/>

Survey

1. The audit report thoroughly explained the scope, objectives, and timing of the audit.

 Strongly Agree
 Agree
 Neither Agree or Disagree
 Disagree
 Strongly Disagree

2. The audit report reflects knowledge of the departmental/governmental policies related to the area or process being audited.

 Strongly Agree
 Agree
 Neither Agree or Disagree
 Disagree
 Strongly Disagree

3. The audit report is accurate and clearly communicated the audit results.

 Strongly Agree
 Agree
 Neither Agree or Disagree
 Disagree
 Strongly Disagree

4. The audit recommendations were constructive, relevant, and actionable.

 Strongly Agree
 Agree
 Neither Agree or Disagree
 Disagree
 Strongly Disagree

5. **Was there anything about the audit report that you especially liked?

6. **Was there anything about the audit report that you especially disliked?

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