



Lexington-Fayette Urban County Government  
OFFICE OF INTERNAL AUDIT

## **MANAGEMENT ACTION PLAN PROGRESS REPORT**

DATE: September 5, 2014

TO: Jim Gray, Mayor

CC: Sally Hamilton, Chief Administrative Officer  
Glenn Brown, Deputy Chief Administrative Officer  
Aldona Valicenti, Chief Information Officer  
William O'Mara, Commissioner of Finance & Administration  
David Holmes, Commissioner of Water Quality & Public Works  
Charles Martin, Director of Water Quality  
Rusty Cook, Director of Revenue  
Phyllis Cooper, Director of Accounting  
Susan Straub, Communications Director  
Urban County Council Members  
Internal Audit Board Members

FROM: Bruce Sahli, CIA, CFE, Director of Internal Audit  
Teressa Gipson, CFE, Internal Auditor

RE: Tap-On Desk Permit Collections Management Action Plan Progress

### **EXECUTIVE SUMMARY**

On June 3, 2011 the Office of Internal Audit issued the Division of Engineering Permit Collections Process Audit Report. The 2011 audit report contained several findings related to improvement in the Tap-On fee receipt process, the timely adjustment of Tap-On rates, late deposit activity, allocation of franchise fees to the ROW fund, reconciliation of mainframe to PeopleSoft, segregation of duties for Jessamine County collections, payment of the AGP fee by utility, and timely implementation of written procedures.

The Tap-On Desk moved from the Division of Engineering to the Division of Water Quality effective July 16, 2012.

This review is provided for management information only. It is not an audit and no opinion is given regarding controls or procedures. The period of review included procedures and processes for the Tap-On collections in Fayette County and Jessamine County occurring during January 1, 2014 through May 31, 2014 and June 2014 respectively.

A summary of the findings and risk observation from the original audit report and a summary of the results of our follow-up are provided in the table below. The original findings and risk observation, management's original responses, and details of the results of this follow-up are contained in the **ORIGINAL AUDIT RESULTS AND FOLLOW-UP DETAILS** section of this report.

<b>Finding or Risk Observation</b>	<b>Summary of Original Finding</b>	<b>Follow-Up Results</b>
Finding 1 High Priority	Tap-On Fee Receipt Process Needs Improvement	All previous issues resolved, except for receipts being generated in sequential order. The current program only generates sequential numbers by user. This should be resolved with the implementation of Accela.
Finding 2 High Priority	Sewer Tap-On Rates not Adjusted Timely	Revenue is using e-mail as their formal process to inform departments about fee increases approved by Council. E-mails were sent out for Sewer rate increases from 2010 through 2013 to the appropriate Tap-On personnel. This finding has been resolved.
Finding 3 High Priority	Late Deposit Activity	We tested a total of 40 Tap-On Permits and noted that 10 of 40 (25%) were not deposited within two days as required. Deposits should be made timely as required by CAO Policy #40.

Finding 4 High Priority	ROW Franchise Fees not Allocated to ROW Fund	Management provided the current process used to ensure that going forward the ROW adjustments will be posted. However, there was no adjustment to correct the misallocation of Right-of-Way funds noted in the prior audit. If made in FY 2015, the adjustment would increase Right-of-Way Fund revenue by approximately 9%.
Finding 5 High Priority	Mainframe to PeopleSoft Reconciliation Needed	Permits are reconciled to the daily deposits. However, we noted some segregation of duties issues and recommend that collection duties be separated when possible, and that the Tap-On desk supervisor increase monitoring by reconciling PeopleSoft permit revenues to permit fees in the mainframe on a monthly basis.
Finding 6 High Priority	Jessamine County Collections Segregation of Duties Issue	We examined all the billings and payments from January to June 2014. It appears adequate separation of the billing and deposit duties now exist. This finding has been resolved.
Finding 7 Moderate Priority	AGP Fee not Paid by Utility	We obtained a copy of the court ruling and verified that AT&T is exempt from paying the annual general permit fee (AGP) for performing work in the Right of Way. This finding has been resolved.
Risk Observation	Written Procedures not Implemented Timely	We determined that Division of Water Quality management had no knowledge of the written Tap-On Collection procedures established by the Division of Engineering in 2011. These procedures are now outdated and should be updated pending the Accela implementation.

## **ORIGINAL AUDIT RESULTS AND FOLLOW-UP DETAILS**

### **Original Finding #1: Tap-On Fee Receipt Process Needs Improvement** **Priority Rating: High**

#### **Condition:**

During Fiscal Year 2010, 866 tap-on permits were issued using a highly manual receipt process. As a result of this manual process, our test work identified several issues with tap-on receipts, including (1) payments for multiple properties on one receipt, (2) the type of property (i.e. apartment or single residence) not identified, (3) individual property fees not evident, (4) absence of payee names on receipts, (5) absence of identifiers within PeopleSoft with which to match reported collections to related manual receipts, (6) receipts not consistently issued in sequential order, (7) duplication of effort in the production of manual receipts, and (8) the efficient reconciliation of permits issued to related collections is problematic, largely due to the other issues noted above.

In addition, two manual permit receipts examined during the audit did not agree with the amount collected per related entries into PeopleSoft, highlighting the necessity for automated receipts to be generated directly from the mainframe whenever payments are received.

#### **Effect:**

The weaknesses and limitations of the manual receipt process identified above create multiple internal control issues in the collection process, resulting in increased risk of undetected collection errors and irregularities.

#### **Recommendation:**

An automated receipting process should be implemented that requires the entry of each property location and the type of property receiving a permit, the individual property fee, payee information, the automated issuance of payment receipts in sequential order, and reports for management review that provide a detailed accounting of collection activity. When related deposits are entered into PeopleSoft, a unique identifier should be established that will enable management to readily associate specific permit collections to the related deposit. If implemented, these controls will significantly improve management's ability to detect and correct errors and irregularities that could occur at various points in the collection process.

#### **Director of Engineering Response:**

The Division of Engineering will work with the Divisions of Computer Services and Revenue to implement the recommendations for automating the tap-on fee receipts. We will also work with Internal Audit during this process to keep them informed of the schedule for implementation and any limitations encountered in implementing the recommendations.

**Commissioner of Environmental Quality & Public Works Response:**

I agree that the tap on process must be automated. I plan to have this program work through DWQ (Division of Water Quality) to assure proper rates and changes are incorporated and that the payments are recorded, tracked, and allocated to the appropriate funds.

**Follow-Up Detail Results:**

We selected a sample of Tap-On Permits for testing and noted that all previously mentioned issues have been resolved except for the sequential numbering of receipts. All receipts are being generated by the mainframe; however, mainframe programming for Tap-On receipts only issue receipts in sequential order by user. Water Quality management indicated that they are in the process of implementing another program, Accela, that will encompass the Tap-On collection activity.

We recommend that Water Quality continue to move expeditiously to the Accela program to provide a comprehensive report of all permit activity.

No management response required.

**Original Finding #2: Sewer Tap-On Rates not Adjusted Timely**  
**Priority Rating: High**

**Condition:**

Per Ordinance 34-2008, the Urban County Council approved a rate fee increase for tap-on fees effective May 1, 2008, with a second rate increase effective July 1, 2009. However, through September 2010 these rate increases were not applied by Division of Engineering personnel responsible for tap-on fee collections, resulting in substantial tap-on fees being collected at lower rates. Division of Engineering personnel indicated that they were not aware of the increase in fees and therefore did not adjust for the new fees. A conservative estimate of lost revenue during this period totals \$369,678. Engineering management became aware of this loss in revenue prior to commencement of our audit fieldwork.

**Effect:**

Failure to adjust authorized fee increases in a timely manner will result in lost revenue for LFUCG.

**Recommendation:**

LFUCG should develop a formal process to immediately notify appropriate Commissioners and Directors whenever the Council authorizes fee rate changes affecting collection activities under their management.

**Commissioner of Finance & Administration Response:**

The appropriate Finance staff will discuss this issue with the Council Administrator and the Council Clerk to arrive at a feasible solution to ensure rate changes are clearly communicated to Directors responsible for their implementation.

**Follow-Up Detail Results:**

The Revenue Department is informing each department about Council approved fee increases prior to the start of the next fiscal year through e-mails. We were provided e-mails that were sent to individuals responsible for collecting tap-on fees in Engineering/Water Quality for June 3, 2010; June 1, 2011; June 4, 2012; and May 31, 2013. We reviewed the e-mails and they appeared to contain adequate details for adjusting the permit fees. Additionally, during test work all fees reviewed were accurately applied.

No management response required.

**Original Finding #3: Late Deposit Activity**

**Priority Rating: High**

**Condition:**

During fieldwork the employee responsible for tap-on fee collections stated he was depositing collections about once per week. Our detail testing of a sample of tap-on fee collections occurring between July 2009 and June 2010 noted 11 of 16 deposits were from three to six business days late, thereby verifying this statement by the employee. Late deposit activity was also noted in the July 2004 audit of this function.

**Effect:**

Funds may be lost or misappropriated if not deposited in a timely manner. In addition, timely deposit activity results in funds being available for LFUCG use as expeditiously as possible.

**Recommendation:**

All funds received by Departments and Divisions making deposits via the Revenue collection counter should be immediately endorsed and presented to the collection counter within one business day of receipt for locations in the downtown campus, and within two business days for the outlying locations as stipulated by CAO Policy #40 Check and Cash Handling Procedures.

**Director of Engineering Response:**

Currently all funds are being deposited at the Revenue collection counter daily or within 24 hours of receipt. This procedure has been in place since August 23, 2010.

**Commissioner of Environmental Quality & Public Works Response:**

I support the plan for all funds to be deposited on a daily basis.

**Follow-Up Detail Results:**

We tested a total of 40 Tap-On Permits and noted that 10 of 40 (25%) were not deposited within the two day requirement as stipulated by CAO Policy #40. We recommend deposits be consistently made in a timely manner as required by CAO Policy #40.

**Director of Water Quality Response:**

A new Tap Desk Supervisor was hired in 2013 and is implementing procedures that will require delivery of deposits to Revenue within 24 hours on all operating days except Friday. Friday deposits will be delivered to Revenue by the following Monday unless it is a holiday.

**Commissioner of Environmental Quality & Public Works Response:**

CAO Policy #40 will be followed.

**Original Finding #4: ROW Franchise Fees not Allocated to ROW Fund**

**Priority Rating: High**

**Condition:**

Kentucky American Water Company (KAWC) has a franchise agreement with LFUCG that stipulates a portion of the franchise fee (.289%) shall be allocated to the ROW fund for installation and surface cut permits issued to KAWC. This fee is collected by the Division of Revenue, which is responsible for its allocation to the ROW Fund. However, we found no evidence that the ROW fee for the quarter ending June 2008 was posted to the ROW Fund. It appears that funds were submitted by KAWC but the ROW portion was never allocated to the ROW Fund, thereby remaining in the General Fund. In addition, a review of the ROW fees for Quarters Ended June 2008 through September 2010 indicated that an incorrect allocation percentage of .288% was used by Revenue in calculating the ROW portion of the franchise fee. The combined effect is \$36,109 of additional funds that should be transferred from the General Fund to the ROW Fund.

**Effect:**

Without the correct and timely transfer of the ROW portion of the KAWC franchise fee, the ROW Fund will be understated.

**Recommendation:**

The Division of Revenue should develop procedures to transfer the correct allocation of KAWC's ROW fee to the ROW Fund on a timely basis.

**Director of Revenue Response:**

The Division of Revenue was requested to allocate a portion of Kentucky American Water Company's franchise fee to Right of Way by Bob Starkweather, the LFUCG franchise fee officer at the time. The request was given to a staff person in the Director's office. The manual allocation was overlooked and the duties were permanently reassigned to the processing area of Revenue. At the time of the transition, the .288% allocation was used. A journal entry was prepared to allocate dollars to Right of Way for all past periods. This correcting entry included all of fiscal 2008. It failed to allocate the quarter ending June 30, 2008.

**Commissioner of Finance & Administration Response:**

I concur with the Director of Revenue's response.

**Follow-Up Detail Results:**

Management stated that correcting entries were made to the percentage allocation of the ROW portion as soon as the error was discovered. We were provided with a journal entry indicating the correction, and management provided the current process used to ensure that going forward the ROW adjustments will be posted. However, we did not note any adjustments for prior period errors noted in the previous audit.

Accounting management indicated that since revenues were recorded in the appropriate year of receipt (FY 2008) it would not require a Prior Period Adjustment (PPA). Accounting management stated that a PPA would indicate a failure to recognize the revenue and the issue at hand is an internal allocation. Also, at issue is the passage of several years, as well as the amount in question, i.e. the \$36,109 appears to be immaterial to the correct reporting of the General Fund, but it does represent 9% of the \$400,000 in revenue budgeted for the Right-of-Way Fund in FY 2015. Accounting management indicated that the Division of Revenue could still correct this misallocation by adding the underfunded amount to the Right-of-Way Fund with the next allocation and an appropriate description as to the purpose of the correction.

We recommend the Directors of Revenue and Accounting confer with the Commissioner of Finance on the merits of correcting the misallocation identified in the prior audit. Although this misallocation occurred in 2008, the correction thereof would increase Right-of-Way Fund revenue as estimated 9% in FY 2015.

**Director of Revenue Response:**

We concur with the recommendation to correct misallocation of revenue from a prior period. The actual amount misallocated was \$34,856.95. Journal ID #79526 in the amount \$34,856.95 was made in June FY14 to move the revenue out of the General Fund to the Right-of-Way Fund.

**Commissioner of Finance & Administration Response:**

I concur with the Division's Response.

**Original Finding #5: Mainframe to PeopleSoft Reconciliation Needed**

**Priority Rating: High**

**Condition:**

The Division of Revenue is responsible for reconciling collections received at its counter collections office to permit collections posted in PeopleSoft. However, the reconciliation of permit collections per the mainframe (used to process fees and issue tap-on and ROW permits) to collections posted to PeopleSoft is performed in the Division of Engineering by employees who are also responsible for generating permits and collecting the related fees.

**Effect:**

This creates an incompatible series of duties regarding the collection process that should be segregated to reduce risk of asset misappropriation.

**Recommendation:**

A reconciliation between permit fees charged per the mainframe and permit fees collected per PeopleSoft should be performed by an Engineering employee who has no permit fee collection or recording duties. Included in this reconciliation process should also be a review of Engineering's receipt log for comparison to the related deposit.

**Director of Engineering Response:**

An Engineering employee who has no permit fee collection duties will be assigned to reconcile between permit fees charged per the mainframe and permit fees collected per PeopleSoft.

**Commissioner of Environmental Quality & Public Works Response:**

The process of collecting and reconciling permit fees between the mainframe and PeopleSoft should be eliminated in a properly designed automated collection system. This will be worked in partnership with DWQ (Division of Water Quality).

**Follow-Up Detail Results:**

Permits are currently reconciled to the deposits during the daily deposits and this reconciliation is also approved by the supervisor. However, we noted a segregation of duties issue that exists in the collection process. The Tap-On desk backup is primarily responsible for posting payments in PeopleSoft but sometimes this employee also processes permits. Additionally, the Engineering Technician indicated that he may also post payments to assist in the workflow. Since this is a small office, we noted that the Tap-On desk supervisor has implemented a review process by reconciling the permit/deposit information maintained in the mainframe with PeopleSoft receipts to help alleviate some of the risk previously mentioned.

We recommend that collection duties continue to be separated when possible and the Tap-On desk supervisor also reconcile PeopleSoft permit revenues to permit fees in the mainframe on a monthly basis. This additional step of monitoring would increase assurance that all fees and deposits are being recorded.

**Director of Water Quality Response:**

The division concurs with the follow-up recommendation and further recommends the implementation of daily reconciliation for permit/deposit information between PeopleSoft and mainframe.

**Commissioner of Environmental Quality & Public Works Response:**

I concur with the Director of Water Quality's response.

**Original Finding #6: Jessamine County Collections Segregation of Duties Issue  
Priority Rating: High****Condition:**

Certain properties located in Jessamine County use the LFUCG sanitary sewer system and must therefore pay the related tap-on fees. One employee in the Division of Revenue has the responsibility of invoicing Jessamine County for these tap-on fees, receiving the related payments, and processing the payments, the most recent payment posting occurring on May 10, 2011.

**Effect:**

This creates an incompatible series of duties regarding the collection process that should be segregated to reduce risk of asset misappropriation.

**Recommendation:**

The Division of Revenue should separate the processes so that one person is not responsible for the billing, collection, and payment processing duties for the Jessamine County tap-on fees.

**Director of Revenue Response:**

The billing and collection of tap-on fees related to the Jessamine County Water District is currently handled in the Division of Revenue in the sewer/landfill section, a three person work group. Prior to the issuance of the government wide Cash Handling Procedure in June of 2010, the administrative assistant in the sewer/landfill section issued bills based on information received from the tap-on desk and processed the payments. The process was changed after the Cash Handling Procedures were issued to have the one person issue the invoice and another person process the payment. A review of the procedure since June 2010 identified two instances where, due to absences in the work group, the same person issuing the invoice has also processed the payment. The emphasis was to protect government assets and deposit payments as soon as received. Additional remedial steps during staff absences will be implemented to ensure separation of duties between invoicing and payment application.

**Commissioner of Finance & Administration Response:**

I concur with the Director of Revenue's response that demonstrates a separation of duties does exist and that additional procedures will be implemented to ensure that in the event of absences in the work group that separation is maintained.

**Follow-Up Detail Results:**

**We examined all the billings and payments from January to June 2014. It appears that there are adequate separation of the billing and deposit duties.**

**No management response required.**

**Original Finding #7: AGP Fee not Paid by Utility**

**Priority Rating: Moderate**

**Condition:**

In addition to permit fees, Section 17C-22(b) of the Code of Ordinances assesses an annual general permit fee (AGP) of either \$3,000 or \$15,000 to certain registrants performing work

in the ROW, based on the amount of acreage the registrant's facilities occupies within Fayette County. On an annual basis, utility companies are therefore sent a registration packet for the AGP fee. We were informed that AT&T is the only utility that does not pay the registration fee, on the premise that their franchise agreement with the state of Kentucky is sufficient to dig within the Fayette County ROW.

**Effect:**

AT&T's non-payment of the AGP fee represents potential lost revenue for the LFUCG.

**Recommendation:**

This matter should be referred to the Department of Law to determine if AT&T is exempt from complying with Section 17C-22(b) of the Code of Ordinances regarding the AGP fee.

**Director of Engineering Response:**

The Division of Engineering will request from the Department of Law, through the Commissioner of Public Works and Environmental Quality, to determine if AT&T is, in fact, exempt from paying the AGP fee. AT&T claims that this exemption is based on its franchise agreement with the State of Kentucky.

**Commissioner of Environmental Quality & Public Works Response:**

I support the recommendation of the Director of Engineering

**Follow-Up Detail Results:**

**We obtained a copy of the court ruling and verified that AT&T is exempt from paying the annual general permit fee (AGP) for performing work in the Right of Way.**

**No management response required.**

**RISK OBSERVATION**

Standards for the professional practice of internal audit stipulate that it is the Office of Internal Audit's responsibility to inform management of areas where risk to the organization or those it serves exist. The following observation identifies a risk associated with the Division of Engineering Permit Collection process that is not a violation of statutes or policies, but that is considered to be of sufficient importance to deserve mention in this report to ensure senior management's awareness.

### **Written Procedures not Implemented Timely**

The July 2004 audit of this collection function noted the absence of written collection procedures and recommended such procedures be developed. Management concurred with this recommendation. It should be noted that the July 2004 report was issued to the previous Director of Engineering.

Written procedures are an important control that provides process instruction, performance standards, and a basis for measuring compliance with management expectations. In our initial meetings conducted during this audit with Division of Engineering personnel responsible for these collection processes, it was determined that no written collection procedures existed. Such procedures were subsequently developed by Engineering management during the early stages of audit fieldwork.

#### **Director of Engineering Response:**

I agree with the recommendation of the audit report. A written procedure for the collection and deposition of permit fees for the Tap-on and Right-of-Way permits was prepared and put into effect in August 2010. Commissioner: The procedures implemented in August 2010 need to be revisited to assure they meet the recommendations of this audit. This needs to occur in conjunction with the automation of the collection process.

#### **Follow-Up Detail Results:**

**We determined that written Tap-On Desk procedures were presented as part of the Division of Engineering's management response to the prior audit. However, since that audit, the Tap-On function has moved to the Division of Water Quality and current management had no knowledge of the written tap-on desk financial procedures developed by the Division of Engineering.**

**Water Quality management has indicated that they are in the process of transitioning to a new Accela program that will impact the Tap-On Desk collection process currently in place. We recommend that the current written tap-on desk financial procedures be updated to reflect the collection processes at the Tap-On window until the Accela program is fully implemented.**

#### **Director of Water Quality Response:**

**The Division of Water Quality concurs with the follow-up recommendation.**

#### **Commissioner of Environmental Quality & Public Works Response:**

**I also concur with the follow-up recommendation.**