



Lexington-Fayette Urban County Government

Division of Internal Audit

INTERNAL AUDIT REPORT

DATE July 8, 2004

TO: Teresa Ann Isaac, Mayor

CC: Milton Dohoney, Chief Administrative Officer
Wayne Waddell, Commissioner of Public Works
David Uckotter, Director of Engineering

FROM: Bruce Sahli, Director of Internal Audit

RE: Engineering Division Cash Collection Controls Audit

Background

The Division of Engineering is responsible for significant cash collection activity, including fees for Sewer Tap-on Permits, Right of Way Permits, and Outer Perimeter Sewer System (OPSS) cost recoveries. The combined collections for these three major programs through June 4, 2004 were approximately \$2,062,000. Additional collection activity also exists for deposits made by contractors as collateral for curb cuts, road cuts, etc. which are refunded to the contractor after the project is completed and passes inspection. These deposits are recorded to a liability account due to their refundable status. It is estimated that checks comprise approximately 98% of payments made to Engineering, with the rest being cash and money orders. Engineering is not set up to process credit or debit cards.

Scope and Objectives

The general control objectives of the audit were to determine that:

- Collections are properly recorded and reported
- Collections are accurately deposited on a timely basis
- Voids are appropriate in nature and properly monitored
- There is sufficient management oversight of the various collection activities

- The overall fee collection process is efficient

Statement of Auditing Standards

We conducted our audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to afford a reasonable basis for our judgments and conclusions regarding the organization, program, activity or function under audit. An audit also includes assessments of applicable internal controls and compliance with requirements of laws and regulations when necessary to satisfy the audit objectives. We believe that our audit provides a reasonable basis for our conclusions.

Audit Opinion

In our opinion, the controls and procedures provided reasonable assurance that the general control objectives were being met. Opportunities to enhance existing controls are included in the Summary of Audit Findings.

SUMMARY OF FINDINGS

Late Deposit of Collections

We examined a sample of collection activity completed during Fiscal Year 2004 through May 4, 2004 and noted significant late deposit activity. While there was no indication of failure to deposit funds, we noted that late deposits for the period reviewed totaled \$559,623. Details of the late deposits have been provided to Engineering management. It is important that all deposits be made in a timely manner to provide appropriate safeguarding of assets and to ensure all collections are made available to LFUCG on a timely basis. It is recommended daily deposit procedures be developed and adhered to on a consistent basis.

Division of Engineering Management Response: The information reviewed on this item highlighted two comments. First, deposits have generally been made twice per week, at midweek and at the end of the week. It is also important to note that staff escort any applicant with a cash collection to Revenue for deposit of cash. No cash is kept in the division at any time. Sometimes a deposit is not made and the collections may stay in the division longer than normal. The second item is related to the way the mainframe system registers plumbers who send in an application without the check for deposit. The staff inputs the data into the system and does not issue a permit until the check is presented. This is done to reduce applicant waiting time for permits and allows staff to use time more effectively. In several cases that you reviewed the system may show a late deposit, but, in fact, the applicant had not submitted the check yet.

Changes in the process will include a deposit of collected funds by the end of the next business day after they were collected. This will insure that no funds collected will be stored in the division for long periods of time. Secondly, our sewer tap-on staff is meeting with the Division of Computer

Services to change the way the system records applications entered into the system but no permit issued. Staff is requesting to change the software program in a way that when the check for the tap-on fee is presented, the system will record that date as the date of fee collection, rather than the date the application was entered into the system. This will allow the proper tracking of the fund collection.

Written Procedures Should be Established

Engineering is responsible for the collection of more than 2,000 payments annually (nearly all in the form of checks) budgeted at \$1,664,000 for FY 2004. There are no written procedures addressing collection recording, reporting, security, or deposit activity. Written procedures are an important control that provides process instruction, performance standards, and a basis for measuring compliance with management expectations. A complete set of written procedures should be developed for the Engineering fee collection process.

Division of Engineering Management Response: There were no written procedures for the fee collection process at the time of the review. The Division of Engineering is in the process of preparing a written procedure for collection of fees in each of the areas where funds are collected. The procedures for all areas should be completed by the end of July.

Tap-on Fee Collections Not Secured

Sewer tap-on fees are almost always paid via check. These checks are kept in a cigar box in a file cabinet which is typically unlocked during normal business hours. In the detail testing conducted during the audit, we noted sewer tap-on payments ranging from \$47.66 to \$32,276.04, with the average payment for FY 2004 through May 4, 2004 being \$553.82. This clearly indicates payments of significant dollar amount are being received in Engineering on a regular basis. It is recommended all payments received by Engineering be properly secured in a lockbox similar to that recommended for petty cash funds, and that the lockbox be properly secured on a consistent basis.

Division of Engineering Management Response: Checks collected are deposited in a cigar box behind the counter in the tap-on area. The box is not locked in a secure location, although no cash is in the box at any time. As a result of the review, a new lockbox is being purchased and will be stored in a location where it can be locked and secured in a locked cabinet. A request for purchase of a lockbox has already been submitted.

University of Kentucky Sewer Tap-on Fees Not Paid

A review of sewer tap-on fees noted that the University of Kentucky had received several permits dating back to November 2002 for which LFUCG had not been compensated. After making a payment of \$10,000 on November 20, 2002 for partial payment of the UK Biological Sciences Building, UK protested payment of the remaining final cost on the premise that a state university should not pay a tax to local government. The protest was then referred to the Department of Law

for further review. Subsequent to this action, sewer tap-on permits were issued on June 24, 2003 for the UK Biological Sciences Central Utility Plant and the UK Biological Sciences Generator Building, while receipts in the amount of \$3,532.08 relating to these transactions were placed in an unpaid file. Additional sewer tap-on permits were issued on November 19, 2003 for four UK dorms, and a receipt in the amount of \$50,785.68 relating to this transaction was also placed in the unpaid file. Division of Engineering personnel has verified that LFUCG has still not received payment for these permits.

Division of Engineering management should consult with the Department of Law regarding the status of UK's protest. Barring any finalized agreement to the contrary, LFUCG should request full payment of the \$54,317.76 due for the issued permits. Additional compensation may also be due LFUCG for the balance of the completed UK Biological Sciences Building over and above the \$10,000 partial payment received in November 2002.

Division of Engineering Management Response: There is an ongoing dispute between LFUCG and the University of Kentucky regarding the payment of sewer tap-on fees. The LFUCG Department of Public Works and the LFUCG Department of Law recently revisited this matter with UK officials and there is now the expectation that a "friendly" lawsuit will be jointly draw up by both parties and submitted to a judge for final resolution of this matter. Within this lawsuit will be a concession on the part of LFUCG not to pursue any tap-on fee back payments for services previously rendered, but rather to only require consistent payment of future tap-on fees if the suit is settled in LFUCG's favor.

OPSS Fee Billing Error

The Outer Perimeter Sewer System (OPSS) project is designed to provide sanitary sewer services to undeveloped portions of land within the Urban Services Area. Through this project, private development pays for the cost of the sanitary sewer system, with the cost distributed to all benefiting properties. A review of OPSS fees collected during FY 2004 identified a \$5,007.61 underpayment for property located in the Lower Town Branch watershed. It is recommended the responsible contractor be notified of this billing error and payment requested to receive full compensation for sanitary sewer services provided.

Division of Engineering Management Response: The report identified a property that was not correctly charged. The files for the original project are being reviewed to determine the correct charge for the property. The Department of Law has been requested to review the original ordinance and other documents to interpret what can be done in this situation.

Collections Reconciliation Needed

Payments are collected in Engineering by various individuals who are also responsible for delivering these funds to Revenue. Any comparisons of recorded collections to deposited amounts are also typically performed by these same employees, representing insufficient segregation of duties. A reconciliation process to ensure agreement between collections recorded in Engineering

and actual proceeds received by Revenue should be performed by Engineering personnel with no recording or depositing responsibilities. It is recommended this reconciliation be performed on a monthly basis to ensure all collections are accurately recorded and deposited on a timely basis.

Division of Engineering Management Response: Comparisons of recorded collections to deposited amounts are performed by the same employees, representing insufficient segregation of duties. Duties to reconcile collections by staff and deposits to Revenue will be reconciled by other Engineering personnel who have no other responsibility for collecting or recording such transactions. The division's Program Specialist will perform these duties.

Permit Voids Need Systematic Review Process

In any process whereby cash is obtained for services rendered it is important to control void activity. In the Division of Engineering, voids typically occur when permits have been requested but are subsequently not picked up by the requestor. The audit determined there is no process or report for the review of void activity. A monthly void report should be generated by Computer Services and reviewed by Engineering management to ensure all voids are appropriate in nature.

Division of Engineering Management Response: In any process whereby cash is obtained for services rendered it is important to control void activity. The computer system in use does not provide an opportunity to report void activity. The tap-on staff are contacting the Division of Computer Services to request a modification of the system to create a monthly void report to be reviewed by Engineering management to ensure that all voids are appropriate in nature.

Tap-on Fee Collection Receipts Not Properly Controlled

Tap-on fee collections are recorded on pre-numbered receipts. One copy of the receipt is given to the customer, another is sent to Revenue, and a third is retained in Engineering. Although the receipts are pre-numbered, they are not issued in a manner that provides for effective sequential number control, i.e. portions of a receipt book are issued to various personnel responsible for collection activity without maintaining the integrity of the number sequence. It is recommended a method be established that will ensure the continuity of the receipt number sequence, thereby enabling Engineering to quickly detect any missing receipts and related collections.

Division of Engineering Management Response: Tap-on fee collections are recorded on pre-numbered receipts, but receipts are not necessarily issued in a numerical sequence, i. e., multiple receipt books are being used at the same time. The tap-on group will purchase new receipt books and will begin using them in numerical order to insure a continuous receipt number sequence.

Holding of Entrance Deposits

Engineering is responsible for the collection of entrance deposits. These are deposits charged to contractors as collateral for the installation of an entrance to a property from the public right of way.

Once the work is completed and passes inspection, the deposits are returned to the contractor. We identified four deposits with a total value of \$14,000 relating to previously completed projects that were still being held in a liability account. This was reportedly being done at the contractor's request in order to cover the anticipated deposit for potential future projects.

Holding deposits for potential future projects unnecessarily inflates the liability account, and may create confusion regarding correct deposit amounts for a particular project. This practice should be discontinued with all deposits refunded upon completion and inspection of the related project. It is recommended each project stand on its own with a new deposit and supporting documentation.

Division of Engineering Management Response: Division personnel have held entrance deposits at the request of the applicant in anticipation of deposits for future projects. This process will be discontinued with the deposit returned at the end of each project. A new deposit will be required for each entrance request received.

Fees & Deposits Incorrectly Posted to the General Ledger

Engineering is responsible for the collection of street cut and right of way permit fees and the related deposits held as collateral until the contractor's work is completed and passes inspection. It was noted that \$2,420 in street cut permit fees had been incorrectly posted to the liability account designed to record street cut deposits. In addition, two deposits for right of way contractor work totaling \$1,956 were incorrectly posted to the right of way permit fee revenue account. Correcting entries should be posted to adjust the affected accounts.

Division of Engineering Management Response: Some street cut permit fees have been incorrectly posted to the liability account for deposits. Some deposits for right of way contractor work were incorrectly posted to the right of way permit fee revenue account. These items have been reviewed and corrected. In addition, the division will request creation of a separate GL account to separate street cut deposits from right of way fees.

Check Identification Procedure Needed

It is estimated that payment by check comprises approximately 98% of annual collections in the Division of Engineering. If Engineering becomes aware of NSF checks written by a contractor, no additional permits are issued until the NSF items are cleared. In discussing NSF activity with Division of Revenue personnel, we were informed that Revenue often has difficulty identifying which Division an NSF check should be applied to due to lack of payment descriptions on the face of the NSF checks. Due to the very heavy volume of check activity in Engineering, it is recommended all checks received by this Division be stamped to identify them as an Engineering collection. This will increase Revenue's ability to inform Engineering of NSF activity on a timely basis.

Division of Engineering Management Response: The government collects large numbers of checks each month making it difficult to identify NSF activity. In the future, the Division of Engineering

will stamp all checks received by this division with a “Division of Engineering” stamp to identify the source of the check to the Division of Revenue.