



City of Houston

Annise D. Parker
City Controller

City-Wide Accounts Receivable and Billings Internal Audit

Public Works and Engineering Department

Report No. 04-40



OFFICE OF THE CITY CONTROLLER
CITY OF HOUSTON
TEXAS

ANNISE D. PARKER

December 2, 2004

The Honorable Bill White, Mayor
City of Houston, Texas

SUBJECT: City-Wide Accounts Receivable and Billings Internal Audit
Public Works and Engineering Department (Report No. 04-40)

Dear Mayor White:

In accordance with the City's contract with Jefferson Wells International (JWI), JWI has completed an Accounts Receivable and Billings Internal Audit pertaining to the Public Works and Engineering Department (Department). The purpose of the audit was to assist management with an assessment of the adequacy and effectiveness of the internal controls and reporting related to the City's accounts receivable and billing processes. Additionally, the audit determined if the Department has developed and implemented written accounts receivable policies and procedures which address the requirements of Executive Order No. 1-38 (Accounts Receivable Policy).

The report, attached for your review, noted that the City's financial system generally includes accounting for the Department's significant receivables, however various contract payments, such as inter-government contributions or rents, when late are not reflected as receivables within the City's financial system. Various recommendations were made to improve the Department's controls over the accounting and reporting of receivables. Draft copies of the matters contained in the report were provided to Department officials. The views of the responsible officials as to actions being taken are appended to the report as Exhibit A.

We commend the Department for taking immediate steps to implement the recommendations. Also, we appreciate the cooperation extended to the JWI auditors by Department personnel during the course of the engagement.

Respectfully submitted,

Annise D. Parker
City Controller

xc: City Council Members
Anthony Hall, Chief Administrative Officer
Michael Moore, Chief of Staff, Mayor's Office
Michael S. Marcotte, P.E., Director, Public Works and Engineering Department
Judy Gray Johnson, Director, Finance and Administration Department

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September 20, 2004

Ms. Annise D. Parker
City Controller
City of Houston
901 Bagby, 8th Floor
Houston, TX 77002

Dear Controller Parker:

We have completed the internal audit of the Accounts Receivable and Billings for the Public Works and Engineering Department (Department) as outlined in our engagement letter dated October 10, 2003, under Contract No. 51783. This report documents our final report for the Department. A report summarizing significant issues identified across the departments will be issued at the conclusion of the City-wide engagement when the internal audit procedures have been completed for all City departments.

Our observations and recommendations noted during the performance of the procedures are presented in this report and views of responsible officials are attached as Exhibit A. Our procedures, which accomplished the project objectives, were performed through January 19, 2004 and have not been updated since that date. Our observations included in this report are the only matters that came to our attention, based on the procedures performed.

Jefferson Wells International is pleased to have assisted the City Controller and we appreciate the cooperation received during this engagement from the Public Works and Engineering Department as well as your office.

This report is intended solely for the information and use of the City, the Department and the City Controller's Office, and is not intended to be used for any other purpose.





Project Scope & Objectives

Scope:

This internal audit was performed to assist City management with an assessment of the adequacy and effectiveness of the internal controls and reporting related to the City's accounts receivable and billing processes. The scope of this report is the revenues and receivables managed by the Public Works and Engineering Department.

Objectives:

- ✍ Determine whether all receivables managed by the Department are recorded in the City's financial records.
- ✍ Determine whether there are receivables that are not recorded in the City's books.
- ✍ Review and evaluate the type of records that are maintained to support the receivables.
- ✍ Determine what steps, if any, are being performed to collect the outstanding receivables.
- ✍ Determine whether billing systems are in place to bill timely those persons/entities that may owe the City monies.
- ✍ Determine whether the Department has developed and implemented written accounts receivable policies and procedures, which address the requirements of Executive Order No. 1-38 (Account Receivable Policy).



Procedures Performed

- ✍ Requested and gathered pertinent documents related to the Department's revenue sources, including written accounts receivable procedures applicable to each of its sources of revenue.
- ✍ Compiled a preliminary list of revenue sources for the Department.
- ✍ Identified and scheduled interviews with key financial personnel for the Department.
- ✍ Interviewed key Departmental personnel and obtained an understanding of the Department's process, as applicable, related to:
 - ✍ Capturing each transaction that results in a source of revenue/receivable;
 - ✍ Timing of revenue/receivable recognition;
 - ✍ All applicable accounting entries;
 - ✍ Billing systems for monies owed the City; and
 - ✍ Monitoring and collection of accounts receivable, including supporting documentation.
- ✍ As applicable, for each of the Department's revenue/receivable source that involves the generation of a bill for monies owed the City:
 - ✍ Traced each receivable source to the City's financial system;
 - ✍ Determined whether the applicable billing system had been designed to mitigate the risk of bills not being generated on a timely basis; and
 - ✍ Determined whether the described billing system is in-place and operating effectively.



Procedures Performed (continued)

- ✍ As applicable, reviewed the Department's written policies and procedures and determined compliance with Executive Order No. 1-38, Accounts Receivable Policy, specific to:
 - ✍ Appropriate Authorization;
 - ✍ Cost Recovery;
 - ✍ Transaction Processing;
 - ✍ Physical Safeguards;
 - ✍ Substantiation and Evaluation;
 - ✍ Determination of net realizable value;
 - ✍ Identification of accounts to be recommended to the Mayor and City Council for write-off approval;
 - ✍ Determination of appropriate allowance for doubtful accounts;
 - ✍ Preparation of accounts receivable aging analysis, aged cash receipts, and cash collections percentage reports; and
 - ✍ The use of the reports mentioned above to evaluate collectibility, target accounts requiring more aggressive collection efforts, and target accounts that yield better collections results.



Revenues & Receivables Overview

Background

- ✦ The Public Works and Engineering Department generates the majority of its revenue by providing water and sewer services to the City's citizens, businesses and certain other intergovernmental entities. The Department records its revenue on an accrual basis recognizing receivables as they are billed or the revenue is earned.
- ✦ Other revenues recognized on a cash basis, consist of the following:
 - ✦ *Contributions of Assets* -full payment for the purchase of surface water in 2010
 - ✦ *Sales of Assets - auction, direct sales and insurance recovery proceeds for used/surplus assets or utility easements*
 - ✦ *Rental Fees* - rentals of various facilities and other infrastructure assets
 - ✦ *Grants* - recoveries arising from specific state and federal programs
- ✦ Revenues out of scope of this internal audit include inter-fund recoveries and interest earnings.

Summary

- ✦ The City's financial system generally includes accounting for the Department's significant receivables, however various contract payments, such as inter-government contributions or rents, when late are not reflected as receivables within the City's financial system.
- ✦ The Department's collection and monitoring efforts result in past due amounts to be promptly pursued and resolved.
- ✦ A balance for non-sufficient fund (NSF) returned check receivables is reflected within the City's financial system, however it has not been reconciled with detail listings of such checks being pursued for collection.
- ✦ The Department has a large outstanding receivable with METRO which is unresolved and unrecorded.



Revenues & Receivables Overview

	<u>2004 Annual Budget</u>	<u>Are Receivables Generated</u>	<u>Are Receivables Recorded</u>	<u>Recording is in Accordance with GAAP</u>
Revenues:				
✍ Utility Customer Services	\$ 553,928,000	X	X	X
✍ Contributions of Assets	11,319,000	X	n/a	X
✍ Sales of Assets/Recoveries	1,691,000	X	†	X
✍ Rental Fees	5,624,000	X	No	No
✍ Grants	1,516,000	X	No	No
✍ Other Services	689,000	No	n/a	X
✍ Inter-fund Recoveries	41,932,000	*	*	*
✍ Interest Earnings	14,653,000	*	*	*

Definition of Terms:

- ✍ **X** – Represents a Yes answer related to determining if each identified revenue stream results in a receivable.
- ✍ **†** – Receivable is recorded when the amount is determinable.
- ✍ ***** – No within the scope of this internal audit.
- ✍ **Receivables** – The asset that results when revenue has been earned but no payment is made at the point the service or good is provided (normally the result of a bill being generated).



Compliance Analysis Overview - EO #1-38

Compliance Area	Controls Noted	Issues Noted	Risk
Appropriate Authorization	<ul style="list-style-type: none"> ✍ The City has established all fees charged by the Department through City Ordinances and/or approved contracts with the customer. ✍ Responsibilities and authorizations for the recording of receivables is defined, communicated and understood. ✍ The Department's formal policies and procedures does not cover all receivables and/or all provisions required by the Executive Order. 	<ul style="list-style-type: none"> ✍ Recommend, for improved controls and long-term consistency of established procedures, that formal policies and procedures be expanded to cover all receivables and all compliance provisions required by the Executive Order. 	Low
Cost Recovery	<ul style="list-style-type: none"> ✍ The Department has cost recovery grants, and as such, generates a receivable as reimbursable grant expenditures are incurred. Grant receivables are not recorded as amounts are requested for reimbursement. 	<ul style="list-style-type: none"> ✍ Risks - All receivables are not recorded, and disallowed expenditures could be charged to the grant and not be detected for a period of time. ✍ Recommend, for improved accountability, that a receivable be recorded as a reimbursement request is submitted. Collection of an amount other than the receivable could then enable a timely reconciliation /follow-up. 	Moderate



Compliance Analysis Overview - EO #1-38

Compliance Area	Controls Noted	Issues Noted	Risk
Transaction Processing	<p data-bbox="732 553 1119 581"><i>Water and Sewer Utility Revenue</i></p> <ul style="list-style-type: none"> <li data-bbox="732 605 1297 695">✎ The Department has a utility billing system to record water and sewer billings and revenues on an accrual basis. <li data-bbox="732 719 1314 776">✎ Meters are read with electronic scanners which upload reads into the utility billing system. <li data-bbox="732 800 1226 857">✎ Cash receipts are matched and recorded directly against the related receivable. <li data-bbox="732 881 1314 1003">✎ Utility deposits are taken for new customers or those that can not demonstrate credit worthiness. Such deposits are used to offset unpaid amounts on that account balance. <li data-bbox="732 1027 1314 1084">✎ Receivables arising from insufficient funds are followed-up on promptly for collection. <li data-bbox="732 1109 1289 1198">✎ Utility receivable activity is reconciled to the general ledger monthly and reviewed for reasonableness. <p data-bbox="732 1222 974 1250"><i>Non-Utility Revenue</i></p> <ul style="list-style-type: none"> <li data-bbox="732 1274 1314 1331">✎ Since non-utility revenues are contractual and received timely, they are recorded as collected. <li data-bbox="732 1356 1314 1412">✎ Non-utility revenue amounts are monitored on various spreadsheets. 	<p data-bbox="1341 553 1738 748">✎ Insufficient check receivables for non-utility revenue is not tracked in detail and is not reconciled to a control account in the City's financial reporting system.</p>	Moderate



Compliance Analysis Overview - EO #1-38

Compliance Area	Controls Noted	Issues Noted	Risk
Physical Safeguards	<ul style="list-style-type: none"> ✍ The Department’s segregated the duties of related to utility billing, collection, depositing and cash application. ✍ Utility receivable balances are reconciled monthly. ✍ Non-utility rental revenue is monitored for completeness through the use of an electronic spreadsheet. 	<ul style="list-style-type: none"> ✍ Segregation of duties and monitoring of receivables could be enhanced for non-utility receivables. 	Moderate
Substantiation and Evaluation	<ul style="list-style-type: none"> ✍ Receivables are substantiated with executed supporting records, contracts, etc. ✍ Routinely an aged receivable summary is generated and reviewed to work collection of past due amounts. 	<ul style="list-style-type: none"> ✍ A large (\$999,000) inter-government receivable with METRO remains unrecorded due to the uncertainty of collection. Such amounts should generally be recorded with a contra-valuation account to enable on-going monitoring and resolution. 	Moderate



Compliance Analysis Overview - EO #1-38

Compliance Area	Controls Noted	Issues Noted	Risk
Determination of Net Realizable Value <i>(Minimum of Annually)</i>	<ul style="list-style-type: none"> ☞ Based on the Department's records, the utility collection rate is 99.57%. ☞ The Department pursues collection on past-due accounts and checks that have been returned due to insufficient funds. ☞ Water is turned off within 90 days, minimizing a build-up of a receivable. ☞ Monthly an aged utility receivable listing is generated and reviewed for determination of realizable values and potential allowances for doubtful accounts. ☞ The Department has utility deposits, which serve offset past due amounts as accounts are closed. ☞ Based on detail schedules provided, non-utility revenues are historically either collected at the time of service or on a timely basis to avoid having a receivable. 	☞ None Noted	Low
Identification of Accounts to be Written-off / Determination of an Appropriate Allowance for Doubtful Accounts <i>(Minimum Annually)</i>	☞ See determination of realizable value.	☞ None noted.	Low



Compliance Analysis Overview - EO #1-38

Compliance Area	Controls Noted	Issues Noted	Risk
Preparation of Reports & Analysis	<ul style="list-style-type: none"> ✍ Reports are routinely prepared monthly by the Department to monitor total receivables. ✍ All reports are reconciled to the supporting systems and reviewed by someone independent of the preparation process. 	<ul style="list-style-type: none"> ✍ Tracking and routine monthly reporting on non-utility receivables including returned check receivables should be done monthly to Department management for overall internal control enhancement. 	Moderate
Use of Reports to Evaluate and Improve Collections	<ul style="list-style-type: none"> ✍ As noted above, the Department has a utility billing and collection system with adequate collection efforts are made on these receivables supported by use of available reports. 	<ul style="list-style-type: none"> ✍ See preparation of reports above. 	Moderate

EXHIBIT A



CITY OF HOUSTON

Public Works and Engineering
Department

Interoffice

Correspondence

To: Annise D. Parker, City
Controller

From: Director, Department of
Public Works & Engineering

Date: November 1, 2004

Subject: CITY-WIDE ACCOUNTS RECEIVABLE
AND BILLINGS INTERNAL AUDIT

04 NOV 11 AM 2:02
CONTROLLER'S

We are pleased your audit found our system for recording Utility Customer Services (UCS) receivables in compliance with Generally Accepted Accounting Principles. We have reviewed the Issues Noted in the report and are offering the following responses:

Appropriate Authorization

Recommendation:

The Department's formal policies and procedures do not cover all receivables and/or all provisions required by the Executive order. Recommend, for improved controls and long-term consistency of established procedures, that formal policies and procedures be expanded to cover all receivables and all compliance provisions required by the Executive Order.

Response:

We agree with the recommendation and are in the process of establishing departmental policies and procedures in compliance with Executive Order # 1-38. We expect completion of the policies and procedures on or before December 31, 2004.

Cost Recovery

Recommendation:

The Department has cost recovery grants, and as such, generates a receivable as reimbursable grant expenditures are incurred. Grant receivables are not recorded as amounts are requested for reimbursement. Recommend, for improved accountability, that a receivable be recorded as a reimbursement request is submitted. Collection of an amount other than the receivable could then enable a timely reconciliation/follow-up.

Response:

We agree with the recommendation. Receivables are now being recognized at the time the project is approved by Council action. Commercial Paper lines of credit have been established to advance fund certain capital projects with subsequent reimbursement from outside agencies such as TxDot, FEMA, and METRO at completion of the project.

*Views of Responsible
Officials*

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EXHIBIT A

Physical Safeguards

Recommendation:

Segregation of duties and monitoring of receivables could be enhanced for non-utility receivables.

Response:

We agree with the recommendation. We will revise the department's Accounts Receivable policy to record all non-utility receivables as they are billed.

04 NOV -2 PM 8:02
CONTROLLER'S

Substantiation and Evaluation

Recommendation:

A large (\$999,000) inter-government receivable with METRO remains unrecorded due to the uncertainty of collection. Such amounts should generally be recorded with a contra-valuation account to enable on-going monitoring and resolution.

Response:

We agree with the recommendation. The revenue and receivable will be recorded as it is billed. This receivable was collected during the first calendar quarter of 2004.

Preparation of Reports and Analysis

Recommendation:

Tracking and routine monthly reporting on non-utility receivables, including returned check receivables, should be done monthly to Department management for overall internal control enhancement.

Response:

We agree with the recommendation. The department is in the process of analyzing the returned check account receivable account and will prepare and submit monthly a report to the Deputy Director of Resource Management of non-utility receivables.

To ensure appropriate authorization controls are in effect, UCS will review branch policies and procedures regarding the financial reporting of UCS receivables and update if needed. Though no specific deficiencies were noted periodic reviews of policies and procedures will become routine.

Please contact Sara S. Culbreth at (713) 837-0282 at your earliest convenience if additional information is required.


Michael S. Marcotte, P.E., DEE

CC: Sara Culbreth
Robert Fiederlein
Waynette Chan

*Views of Responsible
Officials*