



City of Houston

Annise D. Parker
City Controller

City-Wide Accounts Receivable and Billings Internal Audit

Library Department

Report No. 04-42



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
Library Department (Report No. 04-42)

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 Library 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 does not account for the Department's receivables. The Department does have an automated system unique to their operations that enables detail tracking and substantiation of outstanding receivables. Various recommendations were made to improve the Department's controls over the accounting 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
Barbara Gubbin, Director, Library Department
Judy Gray Johnson, Director, Finance and Administration Department

October 11, 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 Library 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 April 30, 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 Library 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.

A handwritten signature in cursive script, appearing to read "Erica D. Anderson".



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 Library 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 Department 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 Library Department generates revenue by providing library facilities and other services to Houston citizens and visitors. The Department records its revenue as the amounts become determinable, which is generally on a cash basis.
- ✦ Revenues consist of the following:
 - ✦ *Service Charges and Fines*
 - ✦ *Grant Recoveries*
 - ✦ *Parking & Facility Revenue*
 - ✦ *Concessions*

Summary

- ✦ The City's financial system does not account for the Department's receivables.
- ✦ The Department has an automated system unique to their operations that enables detail tracking and substantiation of outstanding receivables.
- ✦ The Department's accounting process for recognizing and collecting receivables has segregation of duties and monitoring controls.



Revenues & Receivables Overview

	<u>2004 Annual Budget</u>	<u>Receivables are Generated</u>	<u>Receivables are Recorded</u>	<u>Accounting is in Accordance with GAAP</u>
Revenues:				
✍ Service Charges and Fines	\$ 1,242,000	X	†	X
✍ Grant Recoveries	343,000	no	n/a	X
✍ Parking Revenue	113,200	no	n/a	X
✍ Concessions	9,500	X	†	X

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.
- ✍ **Receivables** – The resulting asset 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 executed contracts with the customer. ☞ Responsibilities and authorizations for the recording of revenue / receivables is defined, communicated and understood. ☞ The Department does not have formal policies and procedures as required by the EO. 	<ul style="list-style-type: none"> ☞ While the department has existing policies and procedures in place, they do not address all issues included in the Executive Order. We recommend that formal policies and procedures be developed as required by the Executive Order. 	Moderate
Cost Recovery	<ul style="list-style-type: none"> ☞ The Department recovers costs of managing receivables through late payment fines. ☞ The Department's revenue is received in a number of checks from individuals and businesses, resulting in checks being returned due to insufficient funds (NSF). Finance and Administration receives the checks, records the receivable and returns the check to the Department for recovery. ☞ NSF receivables are tracked in detail and in total through a general ledger control account. ☞ The Department uses an outside collection firm for past due accounts over \$25. ☞ Grants are funded with advance requests rather than reimbursement requests. 	<ul style="list-style-type: none"> ☞ None noted. 	Low



Compliance Analysis Overview - EO #1-38

Compliance Area	Controls Noted	Issues Noted	Risk
Transaction Processing	<p>☞ <i>Service Charges and Fines</i> accrue in the Triple I system when an asset of the library is not returned by its due date. Amounts are posted against this accrual when the assets are returned or paid as lost.</p> <p>☞ If an item is not returned within 42 days after the due date, the replacement cost and processing fee are automatically posted to the customer account. A billing notice is mailed to the customer 42 days after the due date. In addition, the City periodically distributes statements of account to notify customers of balances due to the City. Accounts over \$25 and 60 days past due are remitted to an outside collection service.</p> <p>☞ Payments of receivables are matched and recorded directly against the specific receivable within the Triple I system.</p> <p>☞ <i>Concession Revenues</i> are based on vendor contracts and vary based on vending activity. As such, the revenue is only determinable when the payment is received with the required support. Upon receipt of these revenues they are recorded in the financial system.</p> <p>☞ <i>Building Space and Parking Revenues</i> are use fees at the time of service and are recorded daily as collected.</p>	<p>☞ The City could consider whether such fines could be billed along with other City services to improve collection.</p> <p>☞ Overdue items may be returned without the fines being paid at the time of return.</p> <p>☞ The Library conducts ongoing maintenance of the patron database. Expired patron records are purged on a monthly basis, however, if there are amounts owed on accounts that should be purged, they are blocked from the purge process and retained an additional three years. Three years after expiration, patron records with balances still pending are purged as uncollectible.</p>	Moderate



Compliance Analysis Overview - EO #1-38

Compliance Area	Controls Noted	Issues Noted	Risk
Transaction Processing (continued)		<i>The Triple I system cannot age receivables. Since the current purge process is based on the expiration date of the patron record, fines can remain in the database as receivables for up to six years. The City should evaluate whether this process should be shortened to more accurately reflect realizable value.</i>	Moderate



Compliance Analysis Overview - EO #1-38

Compliance Area	Controls Noted	Issues Noted	Risk
Physical Safeguards	<ul style="list-style-type: none"> ☑ The Department has cash handling controls that serve to improve segregation of duties and reconcile cash activity on revenues collected with the Triple I system. ☑ The Triple I system is only accessible to Library personnel and access to fine functions is restricted by password. ☑ All transactions are verified with a cash receipt. ☑ Concession revenues are managed through contracts with outside parties with the Department earning commissions for services. ☑ Parking revenues are collected by cash or credit card through an automated system. ☑ Receivable reports are reviewed monthly. 	<ul style="list-style-type: none"> ☑ None noted. 	Low
Substantiation and Evaluation	<ul style="list-style-type: none"> ☑ Receivables are substantiated through the Triple I system. Management reviews the outstanding receivable reports monthly. ☑ Management reconciles total deposits to total fines collected per the Triple I system monthly. 	<ul style="list-style-type: none"> ☑ Due to the volume of old accounts with small balances, which date back years – there is a risk that amounts could be adjusted without approval, waived, or collections not be recorded and the error remain undetected. Segregation of duties in collection and cash handling help mitigate the risk, however, additional spot checking of outstanding accounts would further mitigate the risk. 	Moderate



Compliance Analysis Overview - EO #1-38

Compliance Area	Controls Noted	Issues Noted	Risk
Determination of Net Realizable Value <i>(Minimum of Annually)</i>	✓ Validation of realizable value is determined only as receivables are collected and revenue recorded. Three years after expiration of patron accounts, accounts with balances still pending are purged as uncollectible. ✓ The Department pursues collection on past-due accounts including using an outside agency for amounts over \$25.	✓ Periodically receivables should be assessed as to their realizable value. This assessment should serve to prioritize collection efforts of on-going fees, late payment penalties, etc. ✓ The City should evaluate whether control accounts should be established and maintained within the City's financial system.	Moderate
Identification of Accounts to be Written-off / Determination of an Appropriate Allowance for Doubtful Accounts <i>(Minimum Annually)</i>	✓ See determination of realizable value.	✓ See determination of realizable value.	Moderate
Preparation of Reports & Analysis	✓ 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.	✓ None noted.	Low



Compliance Analysis Overview - EO #1-38

Compliance Area	Controls Noted	Issues Noted	Risk
Use of Reports to Evaluate and Improve Collections	As noted above, collection efforts are made for outstanding receivables supported by use of available reports.	None noted.	Low

EXHIBIT A



CITY OF HOUSTON

Library Department

Interoffice

Correspondence

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CONTROLLER'S

To: Annise D. Parker, City Controller

From: Barbara A. B. Gubbin Director

Date: November 9, 2004

Subject: **LIBRARY RESPONSE TO ACCOUNTS RECEIVABLE BILLING AUDIT**

Based on the internal audit performed by Jefferson Wells of the Accounts Receivable and Billings for the Library Department our responses to the compliance analysis of Executive Order # 1-38, Accounts Receivable Policy the Library's responses are itemized below.

(1) Compliance Area: Appropriate Authorization

- Recommend, for improved controls and long-term consistency of established procedures, that formal policies and procedures be developed as required by the Executive Order.

HPL Response:

- HPL will revise its departmental policy and procedures in accordance with Executive Order #1-38.

(2) Compliance Area: Transaction Processing

- The City could consider whether fines could be billed with other City services to improve collection
- Overdue items may be returned without fines being paid at the time of return
- Library conducts ongoing maintenance. After six year's activity balance still pending are purged.
- Triple I cannot age receivables and City should evaluate whether the process should be shortened to more accurately reflect realizable value.

HPL Response

- HPL agrees that the City could consider whether fines could be billed with other City services to improve collection. However, library materials are unique and require special collection efforts, such as those utilized by Unique Management Services. It should be noted that in the case of the library the Department is not only seeking the payment of fines and fees, but also seeking the return of actual library materials.
- Library book drops are open when the library is closed specifically to encourage and facilitate the return of library materials. The library would not want to deter the return of library materials by requiring return only when facilities are open and fines can be paid. It should also be noted that the majority of library transactions are handled with no charge incurred by our customers.
- HPL agrees that the City should evaluate whether the aging process of receivables should be shortened to more accurately reflect realizable value.

Views of Responsible Officials

(3) Compliance Area: Substance and Evaluation

- Due to the volume of old accounts with small balances, which date back years, there is a risk that amount could be adjusted without approval, waived, or collections not be recorded and the error remain undetected. Segregation of duties and collection and cash handling help mitigate the risk, however, additional spot-checking of outstanding accounts would further mitigate the risk.

HPL Response:

EXHIBIT A

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- HPL agrees with the additional internal control suggestion and will include in our departmental policies and procedures that steps be taken to verify outstanding amounts on a spot-checking basis.

(4) Compliance Area: Determination of Net Realizable Value

- Periodically receivables should be assessed as to their realizable value. This assessment should serve to prioritize collection efforts of on-going fees, late payment penalties, etc.
- The City should evaluate whether control accounts should be established and maintained within the City's financial system.

HPL Response:

- HPL agrees that receivable should be assessed as to their realizable value to prioritize collection efforts.
- HPL agrees that the City should evaluate whether control accounts should be established and maintained within the City's financial system.


Barbara A.B. Gubbin, Director

Cc: Sahira J. Abdool, Deputy Director of Library Administration
Jim Fontana, Financial Analyst IV
Steve Schoonover, City Auditor

*Views of Responsible
Officials*