



DATE: August 16, 2007

TO: NICK YOVINO, Director
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Planning & Development Department

THROUGH: RENENA SMITH, Budget Manager
Budget and Management Studies Division

FROM: BOB KOURY, Principal Internal Auditor
Budget and Management Studies Division – Internal Audit

SUBJECT: ACCOUNTS RECEIVABLE AND DRAW DOWN ACCOUNTS AUDIT

Attached is the Final Audit Report of the Planning and Development Accounts Receivable and Draw Down Accounts Audit. Internal Audit wishes to thank you and your staff for their cooperation and assistance in performing this audit.

City and Department Management has responsibility for implementation of Internal Audit recommendations and for establishing an effective system of internal controls. Internal Audit believes the implementation of our audit recommendations to the best of your department's ability will aid your Department and City Management in accomplishing the Key Objectives of Customer Satisfaction (citywide), Employee Satisfaction (internally) and Financial Management.

Internal Audit will perform a follow-up audit six to twelve months after this report is issued to verify that each recommendation has been implemented or that the issue documented in the finding has been resolved in a manner that addresses the weakness or risk identified. The follow-up audit is performed in accordance with AO 1-12 and Government Auditing Standards.

If you have any questions or we can be of any further assistance to you or your staff, please do not hesitate to contact Bob Koury, Principal Internal Auditor, at 621-7072.

Attachment

cc: Alan Autry, Mayor
Council Members
Andrew T. Souza, City Manager
Jon Ruiz, Assistant City Manager
Bruce Rudd, Assistant City Manager
Jerry Bishop, Assistant Director, Planning & Development
Craig Agabashian, Administrative Manager, Planning & Development
Jean Rousseau, Finance Director/City Controller

EXECUTIVE SUMMARY

Internal Audit performed an audit of the Planning and Development Department Accounts Receivable and Draw Down Accounts during the period May through June 2007. The audit objectives were to determine whether the Department's Accounts Receivable were being properly and accurately maintained, documented, monitored, and billed and collected for enhanced cost recovery revenue, and in accordance with established Departmental policies and procedures. Draw Down Accounts were also audited to determine compliance with established Department policies and procedures and to verify that these accounts were being properly maintained and accounted for accurately. While performing the audit, we considered whether improvements could be made to strengthen the existing processes and procedures and/or to strengthen internal controls related to Accounts Receivable and Contractor Draw Down Accounts.

Risk is the degree of or the lack of internal controls, management oversight and fiscal responsibility. Based upon Internal Audit's findings, risk is considered in the medium to high range for the audited areas of the Department.



Key Findings Identified:

- Inadequate segregation of functions related to Accounts Receivable and non-formalized “payment arrangements” with customers owing monies to the Department
- No current, formalized contract between the Department and the outside collection agency for collection services
- Annual Draw Down Account Administrative Fee not assessed in accordance with the Master Fee Schedule resulting in under-assessed/uncollected fees of approximately \$12,750

Internal Audit has provided recommendations for Management to consider that will improve the Department's procedures, processes and internal controls related to Accounts Receivable and Draw Down Accounts that will enhance fiscal responsibility (cost recovery and record-keeping) and customer and employee satisfaction.

Internal Audit conducted this audit in accordance with Administrative Order 1-12 - Internal Audit – Authority, Responsibilities, and Audit Reports.



Internal Audit 07-0006-B

**Planning and Development Department
Accounts Receivable and Draw Down Accounts Audit**

**Performed By
Bob Koury, Principal Internal Auditor
Budget and Management Studies Division – Internal Audit**

August 16, 2007

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INTRODUCTION

Background

The Planning and Development Department – Administration Division, bills various costs and charges assessed by Code Enforcement related to Code violations, fines, penalties, citations, abatement services, etc. Accounts Receivable are appropriately established by the Department for these “customers” and are maintained on the Department’s HTE System. Customer Statements are automatically generated on a monthly basis by the Accounts Receivable HTE Module, and as payments are received, these accounts are properly updated and maintained. As of May 10, 2007, the total Accounts Receivable was approximately \$2,423,000 detailed as follows: a) Current Accounts Receivable - \$313,000, b) Accounts sent to County (Special Assessments) for collection on property tax bills - \$975,000, and c) Accounts sent to outside collection agency - \$1,135,000 since approximately August 1999.

Contractor “Draw Down” Accounts are established and approved by the Department on an ongoing basis based on the submission of an Application Form. Outside Contractors who do large volumes of business with the Planning and Development Department deposit funds “up front” which they can “draw” from as services are needed and provided to them by the Department. These deposits are maintained in the City’s Financial System in an interest bearing Trust Fund. As of May 21, 2007, the total Contractor deposits on hand in the Trust Fund was \$306,268, representing 53 separate Contractors.

Audit Objectives, Scope, and Methodology

The primary objectives of this audit were to determine whether adequate internal controls, documentation, recordkeeping and reporting practices were in place related to both Accounts Receivable and Draw Down Accounts maintained by the Department. Additionally, we attempted to identify any operational areas or functions within these areas of the Department where efficiency or effectiveness could be enhanced and internal controls strengthened.

This audit was performed during the period May through June 2007, in accordance with Administrative Order 1-12 and Generally Accepted Government Auditing Standards.

To accomplish our audit objectives, we:

- Conducted interviews and meetings with appropriate Department management and staff;
- Reviewed applicable City policies, procedures, Administrative Orders, and departmental policies and procedures related to accounts receivable and draw down accounts;
- Performed appropriate tests of accounts receivable and draw down account records and reports; and
- Evaluated the overall system of internal controls and oversight by the Department related to the charges and billings for services (accounts receivable), contractor draw down accounts, and related recordkeeping practices and financial reporting.

During the course of the audit, we discussed findings of a significant nature with Management and staff. An Audit Exit meeting was held with Department Management on August 1, 2007 to formally discuss the findings and recommendations included in this report.

Conclusion

Based on our audit, Planning and Development Department management and staff responsible for the billings and accounts receivable functions and contractor draw down accounts were noted as being very professional and dedicated individuals. However, Internal Audit has identified several areas related to this audit that we feel should be addressed by Department Management to strengthen internal controls, operational effectiveness and efficiencies, and for possible enhanced cost recovery related to accounts receivable. These areas are addressed throughout this Audit Report.

AUDIT FINDINGS AND RECOMMENDATIONS

ACCOUNTS RECEIVABLE

FINDING 1 – Inadequate Segregation of Functions

The Accountant-Auditor I in the Administration Division can perform several accounts receivable and recordkeeping functions which is not considered adequate segregation of functions for internal control purposes. This employee currently collects and prepares receipts for payments, establishes accounts receivable on the HTE system, posts payments to customer accounts within the HTE System, can adjust customer account balances, can verbally establish payment arrangements with customers who owe monies to the City, and generates and mails out customer statements. All of these functions are performed by the Accountant-Auditor I without supervisory or management review and approval.

Although no improprieties have been noted or discovered by Management due to the above, this is not good internal control and should not continue as structured.

Recommendation 1

Department Management should review, evaluate and modify Accounts Receivable related functions and HTE access/functionality for adequate segregation of functions and strengthened internal controls. Supervisory staff in the Department should also review and approve all Accounts Receivable related functions performed by the Accountant-Auditor I in the Administration Division. This review and approval process should be documented in writing for future reference and/or audit trail purposes.

MANAGEMENT RESPONSE

The Department recognizes that the Code Enforcement cashiering/accounts receivable section (two employees) is not adequately staffed to properly support its workload and to provide proper internal controls. The Department anticipates it will return to Council in the near future with a request to add employees through a PAR amendment.

For additional clarification - “Inadequate Segregation of Functions” was also noted in the Code Enforcement Cashiering Audit (March 2007) in relation to this same section’s functions. This section, which performs Code Enforcement Cashiering, Code Enforcement Accounts Receivable functions and related Assessment processes, as well as Home and Citywide CDBG fund draw functions, had been stretched to cover a significant workload. Although these employees worked very hard and diligent to perform all of their functions, the historic drawback was that they could not perform their functions on a timely basis, nor can the functions of the two employees be adequately segregated.

The Code Enforcement Division has significantly increased its administrative fee billings. This has in turn significantly increased the workload of the cashiering section, as the increased billings funnel directly into the cashiering and accounts receivable functions.

Given the results of Code Enforcement Cashiering Audit (March 2007) suggesting “Inadequate Segregation of Functions”, the Senior Accountant Auditor in the Cashiering section had already begun reviewing and approving all of the Accountant Auditor I’s cashiering/accounts receivable functions. This also had the result of further diluting the ability of this section to timely perform its functions.

Given this section was already stretched to cover a significant workload, the growth in Code Enforcement Cashiering and Receivable functions, as well as the need for increased focus in these areas and on cost recovery; Planning and Development Department Management anticipates returning to Council in the near future with a request for a PAR amendment to add employees to the Code Enforcement Cashiering and Accounts Receivable section.

FINDING 2 – Payment Arrangements With Customers Verbal – Not Formalized

Any customer owing money to the Department may be set up/approved for a “payment arrangement” i.e. installment payment plan, by the Administration Division accounting staff. The policy and procedures related to the establishment of “payment arrangements” for customers is formalized; however, the “payment arrangements” themselves are all informal and verbal arrangements, i.e. nothing in writing. This lack of formalized “payment plans” without adequate written documentation, approvals, etc. is weak internal control and allows for inappropriate type payment arrangements to be set up for either personal friends or family members.

Although no improprieties have been noted or discovered by Management due to the above, this is not good internal control and should not continue as structured.

Recommendation 2

All “installment payment plans” established by the Administration Division accounting staff should be approved in writing by supervisory and/or management staff and adequately documented in the customer’s file for future reference and/or audit purposes. These “installment payment plans” should then be closely monitored and enforced by the Department.

MANAGEMENT RESPONSE

Concur - For additional clarification, there have been only two types of “verbal” payment plans; a 12 month plan (with absolute minimum payments of \$20) and a 24 month plan. The 24 month plan has only been allowed on balances greater than \$1,000. Administration, in conjunction with Code Enforcement, will review, create and insure payments plans are properly documented/approved in writing. Target completion date is October 31, 2007.

FINDING 3 – No Current Written Contract between the Department and Outside Collection Agency for Collection Services

Collection services have been and are currently being provided by Data Central Collection Bureau (DCCB) to the Department related to delinquent accounts receivable. Upon request by Internal Audit of a current contract between the Department and DCCB related to such collection services, terms and conditions, etc., it was noted that no current, executed contract exists.

The lack of a current, fully executed contract between the Department and DCCB for its collection services is considered of high risk and could result in possible legal and/or monetary exposure to the City of Fresno without such a contract.

Note: In further research and inquiry of DCCB, this collection agency is also providing collection services for other City Departments without a current written contract as well.

Recommendation 3

Department Management should immediately address the issue of not having a current, written contract with DCCB for their accounts receivable collection services. The assistance of the Purchasing Department and Finance Department should be requested in conjunction with addressing this matter as it appears to be a citywide issue. In the interim, at a minimum, a written “Memorandum of Understanding” should be immediately developed and executed between the Department and DCCB formalizing the terms and conditions related to the collection services currently being provided by DCCB for documentation and audit trail purposes.

MANAGEMENT RESPONSE

Concur - The Department will pursue an interim agreement with DCCB. Target completion is October 31, 2007.

FINDING 4 – Collection Fee of 24% by Outside Collection Agency

DCCB currently assesses the Department approximately 24% (collection fee) for each account they collect for the Department. Although this type collection fee/percentage by outside collection agencies may be considered normal and reasonable, the Department should consider having their delinquent accounts receivable (Non-Assessment Type Accounts) collected by the Finance Department for less cost than DCCB is currently charging. If Finance is unable to accommodate the collection function for the Department at this time, the Department should research and pursue other alternatives for more aggressive and timely collection of its delinquent accounts receivable for increased cost recovery. (See Recommendation 4 below)

FINDING 5 – Collection Efforts of Delinquent Accounts Receivable (Non-Assessment Type) Not Considered Sufficient

As of May 10, 2007, the Department's "Current Accounts Receivable" was approximately \$313,000 representing approximately 635 accounts/customers. Accounts that become "delinquent", as determined by the Department staff, are either pursued through the Special Assessment process (collected via property owner's tax bills) or are transmitted to DCCB for collection purposes.

During the audit, all accounts that had been transmitted to DCCB by the Department were requested independently by Internal Audits, with the following results:

Several thousand delinquent accounts receivable have been transferred to DCCB by the Department between August 1999 and March 2007. As of May 2007, the total outstanding balances due for all Department Accounts was approximately \$1,319,000 (less \$184,000 pulled from DCCB, collected or cancelled by Planning and Development), balance \$1,135,000, representing approximately 3,179 accounts. However, only 96 accounts (3% of 3,179) representing approximately \$51,220 (4.5% of \$1,135,000) are classified by DCCB as "Active – Being Pursued". In other words, all other delinquent accounts transferred to DCCB by the Department between August 1999 and March 2007 (\$1,083,780) are considered uncollectible by DCCB.

For a more current period perspective, 496 accounts were sent to DCCB by the Department between February 2005 and March 2007, representing total delinquent accounts receivable of \$179,912. As of May 2007, \$69,380 (38.6%) of the \$179,912 was either "paid in full" or was classified as "Active – Being Pursued" by DCCB. The remaining balance of \$110,532 (61.4%) was determined to be "uncollectible" by DCCB.

Based on the above, the Department should pursue more aggressive collection efforts for their delinquent accounts, either through the Finance Department or City Attorney's Office, or both, to enhance collections of delinquent accounts receivable and projected cost recovery revenue as budgeted by the Department.

Recommendation 4

Department Management should consider having their delinquent accounts receivable (Non-Assessment Type Accounts), currently being handled by DCCB, collected by the Finance Department for possibly less cost than DCCB is currently charging. If Finance is unable to accommodate the collection function for the Department at this time, the Department should research and pursue other alternatives for more aggressive and timely collection of its delinquent accounts receivable. The City Attorney's Office should also become more involved in the collection efforts of the Department's delinquent accounts receivable, as provided for in FMC 1-610, for enhanced cost recovery revenues.

MANAGEMENT RESPONSE

Concur – The Department will further research and evaluate potential alternatives for improved collection of delinquent accounts receivable.

For additional clarification - Code Accounts Receivables adds 25% to the delinquent account, per the Master Fee Schedule, if the account has to be sent to collections. Given the utilization of DCCB with its 24% collection charge, the on-paper cost of current collections is a net 1% gain to the City (25% charge to the customer account, per the MFS, less the 24% DCCB collection fee).

FINDING 6 – Special Assessments Process

The Planning and Development Department utilizes the “Special Assessments” process to pursue and collect certain delinquent accounts receivable. These particular accounts are transmitted to the County Auditor’s Office and are included on the property tax bills for collection and subsequent remittances to the City of Fresno. There were no exceptions noted in this area of the audit and the Department is commended for their efforts in this area of collecting these specific delinquent accounts receivable.

DRAW DOWN ACCOUNTS

FINDING 7 – Contractor Draw Down Applications

Upon review of the current Contractor Draw Down Application form being used by the Department, it was noted that the form is out of date and needs immediate revision, as follows:

- The form states that “Deposits will be held in a non-interest bearing trust by the City of Fresno.....” This is not correct as these deposits are maintained in Trust Fund 63533, which does earn interest on a monthly basis.
- The form states that “An annual administrative fee of \$100 will be required and will be collected on an annual basis at the beginning of each calendar year.” The \$100 annual fee is incorrect as this amount was increased to \$105 via the Master Fee Schedule, effective September 1, 1997.
- The form is completed and signed by the Contractor applying for the Draw Down Account and the Department approves the application; however, the approval is not formalized in writing on the form.
- The completed applications have not been consistently retained by the Department for ease of access and/or future reference or audit purposes for all Contractors who have current Draw Down Accounts with the City of Fresno.

Recommendation 5

The Contractor Draw Down Application form should be reviewed and revised immediately by the Department to address the above audit findings to make the form more accurate. An approval line and date should also be added to the form for Department Management signature as documented approval for all Draw Down Accounts.

MANAGEMENT RESPONSE

Concur – Target completion date is August 31, 2007.

Recommendation 6

All completed and approved Contractor Draw Down Application forms should be retained in an orderly and easily accessible file for future reference and/or audit purposes.

MANAGEMENT RESPONSE

Concur – Target completion date is August 31, 2007

FINDING 8– Draw Down Accounts Annual Administrative Fee

Per the City’s Master Fee Schedule, which is approved on an annual basis by the City Council, an annual “Draw Down Account Administrative Fee” is to be assessed to all Contractors who have been set up with a Draw Down Account by the Department. Prior to September 1, 1997, this annual fee per account was \$100. Effective September 1, 1997, this annual fee increased to \$105 per the Master Fee Schedule.

During the audit, the following was noted regarding the Draw Down Account Administrative Fee:

- The annual Draw Down Account Administrative Fee of \$105 effective September 1997 was not implemented but remained at \$100 per account from 1997 through 2005. The City’s Finance Department was responsible for the Draw Down Account Administrative Fee billings between 1997 and 2000 and the Development Department became responsible for these billings from 2001 to current. Result: \$2,250 was under-assessed/not collected between 1997 and 2005 by both the Finance Department and the Development Department (9 years x \$5 x 50 accounts on average).
- The last year that the Draw Down Account Administrative Fee was assessed/collected by the Development Department was in 2005. No Administrative Fee was assessed/collected by the Department in 2006 or 2007. Result: \$10,500 under-assessed/not collected (2 years x \$105 x 50 accounts on average).

Total under-assessed/not collected Draw Down Account Administrative Fees for the period 1997 through 2007 is approximately \$12,750.

Recommendation 7

The Department should immediately commence billing all Contractors with established Draw Down Accounts the \$105 annual Administrative Fee, in accordance with the City's Master Fee Schedule and for appropriate and enhanced cost recovery, as budgeted.

MANAGEMENT RESPONSE

Concur – Target completion date is August 31, 2007. The Department will bill the 2007 Administrative Fee which should result in approximately a \$4,100 (53 accounts x 75% active x \$105 fee) reduction in the \$12,750 under-assessed Administrative Fees noted above.

FINDING 9 – Inactive Draw Down Accounts – Deposits on Hand

Based on our audit of 20 sampled draw down accounts (38%) from 53 total accounts as of May 21, 2007, it was noted that 5 of the 20 (25%) Draw Down Accounts/Contractors had not utilized their deposits in over a year, two accounts almost four years. The following accounts were noted as still on deposit with the City as of May 21, 2007 - Deposit Amount, Last Activity date and Contractor noted below:

\$52.13 - 5/5/05 - Quality Electric
\$34.10 - 10/30/03 - Richard's Plumbing
\$57.88 - 4/15/05 - Nolte Sheet Metal Inc.
\$14.90 - 7/18/03 - B & L Mechanical Inc.
\$11.00 - 12/23/05 - Royal Air Conditioning Co.

Although most inactive Draw Down Accounts are immaterial, these accounts should be researched and, if appropriate, closed and refunded to the Contractors.

Recommendation 8

The Department should research all Draw Down Accounts/Deposits that are over 1 year old without any activity and take appropriate action, as necessary, e.g. contact Contractor and inquire if any further business to be conducted with the City, and/or close accounts and refund Contractor's deposit. This process should be adequately documented for future reference and/or audit purposes.

MANAGEMENT RESPONSE

Concur – Target Completion date is September 30, 2007