SUBJECT: Follow Up of Audit Report 2006-02 – Accounts Receivable (CM07030) (City Wide)

RECOMMENDATION:

That Report CM07030 respecting the follow up of Audit Report 2006-02, Accounts Receivable, be received.

Ann Pekaruk
Director, Audit Services
City Manager's Office

EXECUTIVE SUMMARY:

Audit report 2006-02, Accounts Receivable, was originally issued in July, 2006 and management action plans with implementation dates were included in the report. In August, 2007, Internal Audit followed up the report to determine that appropriate and timely actions had been taken. Regarding the implementation of the nine (9) recommendations made in the original report, six (6) have been completed while three (3) remained in progress at the time of the follow up but were very close to their expected completion.

BACKGROUND:

Audit report 2006-02, Accounts Receivable, was originally issued in July, 2006. The report indicated nine (9) recommendations to strengthen the controls, improve system security, ensure compliance with policy and provide for timely collection and deposit of funds.
BACKGROUND (Continued):

It is normal practice for Internal Audit to conduct follow up reviews within a 12-18 month period following issuance of the original report in order to determine whether action plans committed to by departmental management have been implemented. In August, 2007, Internal Audit followed up the report to confirm appropriate and timely actions had been taken.

ANALYSIS/RATIONALE:

The report attached as Appendix “A” to Report CM07030 contains the first three (3) columns as originally reported in Audit Report 2006-02 along with an added fourth column indicating Internal Audit’s follow up comments.

Six (6) of the original recommendations have been completed. Implementation of a more aggressive collection effort has resulted in lesser dollars of write offs. Processes for dealing with disputed invoices and finance charges have been documented. System compliance with the late payment finance charge rates has also been implemented.

The remaining three (3) recommendations are in progress and include: additional review of security access to the Accounts Receivable system to implement further limitations; the redesign of agreements to enable the netting of receivables from amounts payable (if the circumstances exist); and the securing of registers and payment records. All three (3) of these items are expected to be completed by early 2008 or sooner.

ALTERNATIVES FOR CONSIDERATION:

Not applicable.

FINANCIAL/STAFFING/LEGAL IMPLICATIONS:

Financial

More aggressive collection efforts as well as the ability to offset receivables from amounts payable reduces the write off of outstanding balances owing.

Staffing

None.

Legal

Legal Services is being consulted in the redesign of agreements to allow the offset of receivables against amounts payable.

POLICIES AFFECTING PROPOSAL:

None.
RELEVANT CONSULTATION:

The results of the follow up were discussed with Accounts Receivable staff and management.

CITY STRATEGIC COMMITMENT:

By evaluating the “Triple Bottom Line”, (community, environment, economic implications) we can make choices that create value across all three bottom lines, moving us closer to our vision for a sustainable community, and Provincial interests.

Community Well-Being is enhanced. ☐ Yes ☑ No

Environmental Well-Being is enhanced. ☐ Yes ☑ No

Economic Well-Being is enhanced. ☑ Yes ☐ No

City Council’s strategic commitment to “Best Practices – Best Value” under “A City That Spends Wisely and Invests Strategically” is addressed through audits and reviews and their subsequent follow up to ensure controls are in place to protect the assets of the City and promote efficient, effective and economic services and programs.

Does the option you are recommending create value across all three bottom lines? ☐ Yes ☑ No

Do the options you are recommending make Hamilton a City of choice for high performance public servants? ☐ Yes ☑ No

:dt
Attachment
<table>
<thead>
<tr>
<th>#</th>
<th>OBSERVATIONS OF EXISTING SYSTEM</th>
<th>RECOMMENDATION FOR STRENGTHENING SYSTEM</th>
<th>MANAGEMENT ACTION PLAN</th>
<th>FOLLOW UP (AUGUST 2007)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>While accounts receivable staff have well defined roles, their PeopleSoft access privileges do not ensure an adequate segregation of duties. All four (4) members of the staff have, to a large degree, unlimited system access privileges, enabling them to process transactions from start to finish. For example, all four (4) accounts receivable staff have the capability to set-up customers, generate invoices, raise and reverse finance charges, write off customer balances, process customer payments and set transactions for posting without peer or supervisory intervention. Also, there is no evidence that PeopleSoft system logs and transaction trails are regularly reviewed by the Supervisor to detect unauthorized system access and changes to transaction and master files.</td>
<td>That management consider restricting system access to only those functions of the accounts receivable system that are within each employee’s area of responsibility. An adequate segregation of duties should be considered in this exercise.</td>
<td>Agreed. Security access to the Accounts Receivable (A/R) system will be reviewed for possible system restrictions. Permanent access privileges to multi job functions in A/R will be restricted. Segregation of duties will be followed, where possible, giving temporary access only when required due to vacation or illness. This will be completed by September 2006.</td>
<td>In progress. Security Access for Accounts Receivable (A/R) staff has been reviewed. The ability to write off amounts has now been limited to the more senior staff and their write off limits without supervisor approval have been reduced to $20. At the time of the follow up, steps were being taken to implement further limitations. These include limiting the ability to apply payments and to set up new customers only to staff who are required to do so as part of their job functions. Completion was scheduled by the end of the third quarter 2007.</td>
</tr>
<tr>
<td>2.</td>
<td>As approved by Council, the City charges customers late payment finance charges at the prevailing prime rate plus 2% adjusted quarterly. A review of amounts charged to selected customers indicates that the PeopleSoft financial system is not always updated for rate changes. For example, between July 8, 2002 and December 31, 2005, customers were charged at a set rate, regardless of the fact that the prime rate changed five times during this period. Although the amounts are not considered material, non-compliance to policy is indicated.</td>
<td>That the Accounts Receivable Supervisor ensure that the accounts receivable system is updated in a timely manner with each change in quarterly prime interest rates.</td>
<td>Agreed. The percentage on the PeopleSoft system is updated on January 1, April 1, July 1 and October 1. However, the rate has been over-ridden by a constant rate at another location in the system. While it was thought that the policy was being followed, the system was not reacting in the manner expected. Over the past several years, the rate has been fairly constant and has not changed significantly. Thus, resulting errors were minor. The system has now been fixed to reflect the changes made to the interest rate.</td>
<td>Completed. The A/R system is updated quarterly to reflect the changes in the prime interest rate.</td>
</tr>
</tbody>
</table>
### Observation of Existing System

<table>
<thead>
<tr>
<th>#</th>
<th>Observations of Existing System</th>
<th>Recommendation for Strengthening System</th>
<th>Management Action Plan</th>
<th>Follow Up (August 2007)</th>
</tr>
</thead>
<tbody>
<tr>
<td>3</td>
<td>There does not appear to be consistency in the practice of waiving finance charges, raising concerns that, if not closely monitored, the practice could be abused. A considerable amount of discretion is left to the Collections Co-ordinator to decide whether or not to waive and/or reverse late payment finance charges without seeking the supervisor's authorization. For example, there was no evidence that the supervisor’s authorization was obtained before waiving finance charges relating to a customer with an account balance of over $90,000. The reasons given for waiving the charges are that the likelihood of payment was remote as the customer was in financial distress. In other cases, verbal arrangements to reverse charges in return for prompt payment were made with customers. Some customers have still not honoured their payment obligation despite the reversal of the charges. In a further situation, a customer with a seven year old debt, whose recovery is doubtful, continues to be charged interest regardless of numerous communications to the City disputing the balance.</td>
<td>That, in addition to recommendation #1 above, documented authorization be obtained from the supervisor, clearly stating the rationale for waiving or reversing finance charges, at or above a certain level. In addition, there should be regular, periodic supervisory reviews of the finance charges account to detect unauthorized reversals and also provide general oversight of amounts reversed.</td>
<td>Agreed. Currently, all significant write-offs are discussed with the supervisor and are not arbitrarily removed without permission. However, a process will be instituted whereby a written report will be validated/authorized by the supervisor and kept in the customer’s file. This is to be implemented by September 2006. In addition, procedures for staff to follow when submitting items for write-off will be written.</td>
<td>Completed. Documented authorization for the removal of finance charges is obtained from the supervisor and retained. The Policies and Procedures relating to write-offs have been updated. A spreadsheet summarizing the finance charges written off is reviewed at least twice per year (January and July). This helps the supervisor monitor unauthorized reversals and any unusual trends that may be evident.</td>
</tr>
<tr>
<td>4</td>
<td>Thirteen percent (13%) ($56,000) of the balances written off in 2005 were due to failure by departments to provide documentation to customers to substantiate disputed amounts. Some of the balances had been argued from as far back as the 1990’s (pre-amalgamation). Collection efforts could be negatively affected by unresolved customer disputes, especially when Accounts Receivable does not co-ordinate the resolution of the issues with the originating department.</td>
<td>That the Accounts Receivable section work with departmental management to formulate a comprehensive process for the timely resolution of disputed invoices.</td>
<td>Agreed. Amalgamations, internal restructuring, staff turnovers and the collection position being vacant for months have diminished communication flow from departments resulting in a volume of unresolved issues and arrears which were eventually written off and adjusted over time. As a remedy, a dispute resolution process has already been instituted and A/R is current with all outstanding issues. All issues were addressed in a timely manner and reviewed by both the Supervisor and Manager on a quarterly basis for follow up.</td>
<td>Completed. A process has been developed in which A/R staff work with departmental managers to help resolve disputed invoices. The process consists of documented correspondence (usually e-mails) between departmental and A/R staff. The process is expected to be formalized in writing by the end of the third quarter 2007.</td>
</tr>
</tbody>
</table>
### Appendix “A” to Report CM07030
Page 3 of 5

**ACCOUNTS RECEIVABLE**
**FOLLOW UP - AUGUST 2007**

<table>
<thead>
<tr>
<th>#</th>
<th>OBSERVATIONS OF EXISTING SYSTEM</th>
<th>RECOMMENDATION FOR STRENGTHENING SYSTEM</th>
<th>MANAGEMENT ACTION PLAN</th>
<th>FOLLOW UP (AUGUST 2007)</th>
</tr>
</thead>
<tbody>
<tr>
<td>5.</td>
<td>There is a delay in aggressively pursuing customers for payment until the likelihood of recovery is remote. This could be the reason why as much as 55% ($237,000) of balances written off in 2005 related to customers who either could no longer be located or had subsequently been declared bankrupt. The timely use of external debt collection professionals such as collection or factoring agencies in conjunction with more aggressive management efforts could help recover much of the balances owing. Presently, Accounts Receivable does not have any internal guidelines or a contract for external debt collection. The City last used a collection agency in November 2004. However, most of the customers whose balances were written off in 2005 had not been directed to this agency, raising concerns about the adequacy of internal collection procedures and guidelines for external referrals. Opportunities to collect outstanding amounts can be lost without continued customer contact and the use of other collection methods.</td>
<td>That management consider the use of more timely and aggressive methods of debt collection.</td>
<td>Agreed. During the past few years, many old items inherited from amalgamation and restructuring have been dealt with. Collection procedures were developed to improve collection rates during that time. Written collection procedures will be formalized by October 2006. The services of a collection agency have recently been retained and A/R will begin using the agency immediately.</td>
<td>Completed. Management has taken more aggressive action with the use of two collection agencies and the formalization of a collection procedure. The dollar value of write offs in 2006 was significantly less than in 2005.</td>
</tr>
<tr>
<td>#</td>
<td>OBSERVATIONS OF EXISTING SYSTEM</td>
<td>RECOMMENDATION FOR STRENGTHENING SYSTEM</td>
<td>MANAGEMENT ACTION PLAN</td>
<td>FOLLOW UP (AUGUST 2007)</td>
</tr>
<tr>
<td>---</td>
<td>---------------------------------</td>
<td>----------------------------------------</td>
<td>------------------------</td>
<td>------------------------</td>
</tr>
<tr>
<td>6.</td>
<td>The City does not appear to be using its leverage to recover amounts owed by customers with whom the City also has purchasing contracts. Certain businesses engaged by the City to supply goods and services have large unpaid balances for services provided by the City's departments. Balances relating to some of the companies were written off as uncollectible when the City should have considered offsetting the outstanding amounts from payments made from Accounts Payable. Further, the City could have recovered unpaid balances through surety bonds held by contractors in respect of the contracts they undertook for the City.</td>
<td>That a payment withholding system be considered for long, overdue customers with whom the City also has purchasing contracts. That, where feasible, the Legal Services section be consulted on a timely basis in order to attempt the recovery of outstanding amounts from contractors’ surety bonds.</td>
<td>Agreed. Accounts Payable (A/P) cross-referencing was instituted several years ago. It resulted in settlements and payment arrangements with many vendors and it helped to minimize the arrears. Going forward, investigations with Legal Services will be carried out for a possible re-design of new agreements which would automatically/legally allow the offset of outstanding items against vendors who are owed money by the City. This would also include freezing accounts payable and modifying purchase documents. This consultation with Legal Services will be done by October 2006. The A/R section was instrumental in prompting the Road division to collect on surety bonds and letters of credit established by contractors. A/R has also spearheaded a process whereby delinquent contractors are not issued any new permits unless their accounts are in good standing.</td>
<td>In progress. Payment withholding has been implemented and A/R’s policies and procedures have been updated to reflect the withholding of payments from Accounts Payable vendors delinquent in submitting payments to the City. The section has begun to redesign agreements so as to facilitate netting receivables from amounts payable. This is being done with the assistance of Purchasing and in consultation with Legal Services. It is expected that the redesigned agreements will be in use by early 2008. Completed. The A/R procedures have been updated to include a provision for the Collections Co-ordinator to determine the feasibility of drawing on any securities or bonds held from a debtor company through legal avenues and departmental communication when amounts owed are long outstanding.</td>
</tr>
<tr>
<td>7.</td>
<td>Filing practices are less than satisfactory, subjecting customer payment and invoicing information to the risk of loss and unauthorized access and possibly leading to administrative inefficiencies. In February 2006, Invoice Registers and Payment Batches relating to November and December 2005 had not been filed. On many occasions during the audit, records were left unsecured on an employee’s desk overnight and during weekends, subjecting information, some of which is proprietary, to the risk of loss and theft.</td>
<td>That management enforce secure filing practices.</td>
<td>Agreed. The audit was performed during the year end accounting period which is normally the busiest time of the year. Filing will be maintained on a daily basis. Locks will also be installed on essential filing cabinets to minimize any risks associated with theft.</td>
<td>In progress. The Invoice Registers and Payment Batches for the current and prior year have all been filed in a cabinet accessible to the staff in the A/R section. All information used by staff is returned to the filing cabinet at the end of the work day. However, locks have yet to be installed on the cabinet. At the time of the follow up, staff expected the ordering and installation of locks by the third quarter 2007.</td>
</tr>
</tbody>
</table>
### ACCOUNTS RECEIVABLE
**FOLLOW UP - AUGUST 2007**

<table>
<thead>
<tr>
<th>#</th>
<th>OBSERVATIONS OF EXISTING SYSTEM</th>
<th>RECOMMENDATION FOR STRENGTHENING SYSTEM</th>
<th>MANAGEMENT ACTION PLAN</th>
<th>FOLLOW UP (AUGUST 2007)</th>
</tr>
</thead>
<tbody>
<tr>
<td>8.</td>
<td>Customers’ payments are sometimes deposited before being recorded in the City’s records or being restrictively endorsed. For example, to avoid making exchange rate estimates on foreign currency cheques, the Senior Accounts Receivable Clerk gives these cheques to the Rents and Loans Clerk who makes a bank deposit. The bank stamped deposit slips, with the Canadian dollar conversion are then given to the Senior Accounts Receivable Clerk for further processing. As the Senior Accounts Receivable Clerk does not retain any record of cheques given to the Clerk, payments could remain unrecorded in the accounting system, resulting in customer disputes and the inappropriate charging of interest for late payment. As the cheques are not restrictively endorsed, there is also a risk that the cheques could be misappropriated. The same practice of pre-depositing is used for large cheques that the Senior Accounts Receivable Clerk wishes to deposit prior to a week-end. There are also instances where the Senior Accounts Receivable Clerk, unable to match payments due to unrecognized issuers, will hand over unendorsed cheques to the Rents and Loans Clerk for investigation without keeping a record of such referrals.</td>
<td>That all customers’ cheque payments be restrictively endorsed and recorded in the CLASS POS system and the PeopleSoft financial system before being deposited. Any payments requiring further investigation or reconciliation can be posted to a suspense account which should be reviewed and cleared on a regular basis.</td>
<td>Agreed. Most of the cheques are processed through the POS system and are automatically endorsed by the machine. It will now be ensured that all cheques are endorsed upon receipt. Payments requiring further investigation will be deposited and posted to a suspense account which will be reviewed on a regular basis. The few cheques that are sent for banking before being processed through the POS system will be endorsed manually and tracked by the Senior AR Clerk to ensure that they get deposited into an AR account.</td>
<td>Completed. Currently, cheques received that require further investigation are noted in an unidentified payments spreadsheet and posted to a suspense account. This account is reviewed and cleared regularly. Cheques sent to the bank before being processed through the POS system are manually endorsed as “for deposit only”. The Senior A/R Clerk retains a photocopy of foreign currency cheques to ensure that they are deposited properly. Management is in the midst of formally documenting the process for a more encompassing log of all “wayward payments”. This is expected to be in place by September 2007.</td>
</tr>
</tbody>
</table>