



City of Houston

Annise D. Parker
City Controller

City-Wide Accounts Receivable and Billings Internal Audit

Police Department

Report No. 04-36



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
Police Department (Report No. 04-36)

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 Police 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 significant receivables; grant receivables are not recorded within the City's financial system until received; and the Department would benefit from enhanced technology to monitor, record, assess, and report receivables. 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
Harold L. Hurtt, Chief of Police
Judy Gray Johnson, Director, Finance and Administration Department

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September 17, 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 Police 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 15, 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 Police 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 Police 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 Police Department generally provides its services from general tax revenues. However, the Department generates revenue arising from the following revenue streams:
 - ✦ **Police Special Events Services** – Charges for Police services to work special events, such as “fun runs” or other events. Charges are based on the cost incurred and advance deposits are taken based on a preliminary estimate with the actual revenue being determined upon completion of the event.
 - ✦ **Alarm Permits and Penalties** – Revenue pursuant to home and business burglar alarm permits and penalties for false alarm calls. Alarm penalties are billed and collected by a third party.
 - ✦ **Asset Forfeiture** – Value received from assets confiscated during policing activity.
 - ✦ **Other Permits and Fees** – Fees related to police safety reports, sexually oriented business licenses, wrecker licenses, auto dealer licenses, vehicle storage notification fees, etc.
 - ✦ **Recoveries and Refunds** – Funds received from the various federal or state grantor agencies for the reimbursement of allowable costs and insurance or sales recoveries from the retirement of assets.
- ✦ Further, significant recoveries are generated related to the Department’s services provided to other City funds which including routine service and special event coverage. Such revenue is not within the scope of this internal audit.

Summary

- ✦ The City’s financial system does not account for the Department’s significant receivables.
- ✦ Grant receivables are not recorded within the City’s financial system until received.
- ✦ Other service receivables for false alarm penalties are not recorded as billed or earned, but rather when received. Special police service advance payments are also tracked off-balance sheet.
- ✦ The Department would benefit from enhanced technology to monitor, record, assess and report receivables.



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:				
⌘ Police Special Events Services	\$ 1,820,000	no	†	†
⌘ Alarm Permits and Penalties	4,700,000	X	no	no
⌘ Asset Forfeiture	6,145,000	X	†	n/a
⌘ Other Permits and Fees	6,185,000	no	n/a	X
⌘ Refunds and recoveries	5,812,000	X	no	no
⌘ Inter-fund charges/recoveries	4,218,000	*	*	*

Definition of Terms:

- ⌘ **X** – Represents a Yes answer related to determining if each identified revenue stream results in a receivable.
- ⌘ ***** – This revenue is out-of-scope of this internal audit.
- ⌘ **†** – Receivable is not recorded due to the final amount not being determinable until received or the final service is performed.
- ⌘ **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 non-interfund service fees charged by the Department through City Ordinances. ☞Interfund service revenues are supported by an approved cost allocation plan. ☞Responsibilities and authorizations for the recording of receivables is defined, communicated and understood. ☞The Department does not have formal policies and procedures as 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 developed as 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. However, grant receivables are not recorded, rather revenue is recognized upon receipt of the 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. 	Low



Compliance Analysis Overview - EO #1-38

Compliance Area	Controls Noted	Issues Noted	Risk
Transaction Processing	<ul style="list-style-type: none"> ⚡ Billings and collections for the Department's services generating false alarm receivables are outsourced and recognized as paid. \$4.4 million remained unpaid as of Dec. 31, 2003. ⚡ All revenues are recognized as received or final amounts are generally determined with outstanding amounts/advances tracked through various Excel? spreadsheets. ⚡ Reimbursable costs through grants are tracked on a schedule. Payments are received via wire transfer. The recording of the wire transfer triggers recording of the grant revenue. ⚡ Revenue trends and transactions are monitored through a review of recorded amounts within the City's financial system. 	<ul style="list-style-type: none"> ⚡ The Department's receivables are not recorded within the Department's fund accounting. Controls over receivables/ advances would be enhanced if receivables were recorded in the City's financial system. ⚡ The Department would benefit from enhanced system capability for the maintenance of detail subsidiary ledgers, generation of aging and monitoring reports, integration with the City's financial system and controls over receivable adjustments. 	Moderate
Physical Safeguards	<ul style="list-style-type: none"> ⚡ The Department has segregation of duties through the use of a third party related to billing and collection of alarm receivables, a separate division for the collection of wrecker and auto dealer licenses and Municipal Courts for other miscellaneous fines. ⚡ For other receivables, including special service, amounts are tracked in detail using Excel? worksheets, but are not recorded in the City's financial system. 	<ul style="list-style-type: none"> ⚡ Risk Noted: As described above, the Department's systems for tracking receivables does not mitigate the risk of theft or misappropriation. ⚡ See recommendations above. 	Moderate



Compliance Analysis Overview - EO #1-38

Compliance Area	Controls Noted	Issues Noted	Risk
Substantiation and Evaluation	<p>See the controls and issues noted under transaction processing above. Further, based on a review of one month's activity – detail support exists for receivables, even if they aren't recorded in the financial system.</p>	<p>See recommendations noted under transaction processing above.</p>	Moderate
Determination of Net Realizable Value <i>(Minimum of Annually)</i>	<p>Validation of realizable value is determined only as receivables are collected and revenue recorded. As such, all recorded revenue is realizable, but no determination is made on unrecorded receivables.</p> <p>The Department pursues collection on past-due accounts.</p>	<p>Periodically receivables should be assessment as to their realizable value. This assessment should serve to prioritize collection efforts and on-going fees, late payment penalties, etc.</p>	Moderate
Identification of Accounts to be Written-off / Determination of an Appropriate Allowance for Doubtful Accounts <i>(Minimum Annually)</i>	<p>See determination of realizable value – procedures do not include determination of allowances for doubtful accounts since revenue is recorded on a cash basis.</p>	<p>Although not recorded in the general ledger, false alarm penalties and NSF receivable detail should be periodically reviewed for amounts to be “written-off” or no longer pursued.</p>	Moderate



Compliance Analysis Overview - EO #1-38

Compliance Area	Controls Noted	Issues Noted	Risk
Preparation of Reports & Analysis	<ul style="list-style-type: none"> Revenue trends are monitored using financial statement and budget to actual reports. 	<ul style="list-style-type: none"> No formal or regular receivable monitoring reports are prepared. The outsourced vendor handling alarm permits and false alarm fees is currently unable to provide the City a monthly aged report of outstanding receivables. 	Low
Use of Reports to Evaluate and Improve Collections	<ul style="list-style-type: none"> As noted above, the Department has outsourced Alarm permit processing and false alarm penalty billing and collection activities. The Department records substantially all its revenue on a cash basis. 	<ul style="list-style-type: none"> As recommended above, the Department would benefit from a system that could track and age report receivables. 	Moderate

EXHIBIT A

CITY OF HOUSTON INTER OFFICE CORRESPONDENCE



TO: Annise D. Parker
City Controller

FROM: Harold L. Hurtt
Chief of Police

DATE: October 14, 2004

SUBJECT: **City-Wide Accounts Receivable and
Billings Internal Audit**

The following is the response of the Houston Police Department regarding the City-Wide Accounts Receivable and Billings Internal Audit performed by your agent, Jefferson Wells International.

Appropriate Authorization

- **Controls Noted**

- The City has established all non-interfund service fees charged by the Department through City Ordinances.
- Interfund service revenues are supported by an approved cost allocation plan.
- Responsibilities and authorizations for the recording of receivables is defined, communicated and understood.
- The Department does not have formal policies and procedures as required by the Executive Order.

- **Issues Noted**

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

- **Risk**

Low

- **Response**

The Budget & Finance Division recommends the creation of a General Order requiring standard procedures be used throughout the Department.

Cost Recovery

- **Controls Noted**

The Department has cost recovery grants and as such, generates a receivable as reimbursable grant expenditures are incurred. However, grant receivables are not recorded, rather revenue is recognized upon receipt of the reimbursement.

- **Issues Noted**

- Risks – All receivables are not recorded and disallowed expenditures could be charged to the grant and not be detected for a period of time.

*Views of Responsible
Officials*

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- 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.

- **Risk**
Low

- **Response**
The Budget & Finance Division will accrue all receivables at year-end for grant and Memorandum of Understanding (MOU) related reimbursable items starting with FY 2005.

Transaction Processing

- **Controls Noted**
 - Billings and collections for the Department's services generating false alarm receivables are outsourced and recognized as paid. \$4.4 million remained unpaid as of December 31, 2003.
 - All revenues are recognized as received or final amounts are generally determined with outstanding amounts/advances tracked through various Excel spreadsheets.
 - Reimbursement costs through grants are tracked on a schedule. Payments are received via wire transfer triggers recording of the grant revenue.
 - Revenue trends and transactions are monitored through a review of the recorded amounts within the City's financial system.
- **Issues Noted**
 - The Department's receivables are not recorded within the Department's fund accounting. Controls over receivables/advances would be enhanced if receivables were recorded in the City's financial system.
 - The Department would benefit from enhances system capability for the maintenance of detail subsidiary ledgers, generation of aging and monitoring report, integration with the City's financial system and controls over receivable adjustments.

- **Risk**
Moderate

- **Response**
Budget & Finance Division has been in contact with EDS, our third party contractor that handles Alarm Permits and False Alarm Billings. It is estimated that they will have a reconcilable accounts receivable subsidiary ledger in place by December 31, 2004. At that time the department will approach the Controller's office on guidance regarding the outstanding receivables and how to record them in the Advantage system.

Physical Safeguards

- **Controls Noted**
 - The Department has segregation of duties through the use of a third party related to billing and collection of alarm receivables, a separate division for the collection of wrecker and auto dealers licenses and Municipal Courts for other miscellaneous fines.

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- For other receivables, including special service, amounts are tracked in detail using Excel worksheets, but are not recorded in the City's financial system.
- **Issues Noted**
 - Risk Noted: As described above, the Department's system for tracking receivables does not mitigate the risk of theft or misappropriation.
 - See recommendations above.
- **Risk**
Moderate
- **Response**
The City does not have an Accounts Receivable System with which the Department can interface on a regular basis. However, the department will accrue the grants receivable at least on an annual basis.

Substantiation and Evaluation

- **Controls Noted**
 - See the Controls and Issues Noted under Transaction Processing above.
 - Further, based on a review of one month's activity – detail support exists for receivables, even if they aren't recorded in the financial system.
- **Issues Noted**
See recommendations noted under Transaction Processing above.
- **Risk**
Moderate
- **Response**
See the response under Transaction Processing above.

Determination of Net Realizable Value (Minimum of Annually)

- **Controls Noted**
 - Validation of realizable value is determined only as receivables are collected and revenue recorded. As such, all recorded revenue is realized, but no determination is made on unrecorded receivables.
 - The Department pursues collection on past-due accounts.
- **Issues Noted**
Periodically, receivables should be assessment as to their realizable value. This assessment should serve to prioritize collection efforts and on-going fees, late payment penalties, etc.
- **Risk**
Moderate

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- **Response**

- The third party vendor, EDS, is making changes to their system so that this assessment will be possible by December 31, 2004.
- The department will start recording all outstanding accounts to revenue at year-end until the City can provide an Accounts Receivable System.

Identification of Accounts to be Written-off/Determination of an Appropriate Allowance for Doubtful Accounts (Minimum Annually)

- **Controls Noted**

- See Determination of Net Realizable Value
- Procedures do not include determination of allowances for doubtful accounts since revenue is recorded on a cash basis.

- **Issues Noted**

Although not recorded in the general ledger, false alarm penalties and NSF receivable detail should be periodically reviewed for amounts to be "written-off" or no longer pursued.

- **Risk**

Moderate

- **Response**

The third party vendor, EDS, is making changes to their system so that this periodic review will be possible by December 31, 2004.

Preparation of Reports & Analysis

- **Controls Noted**

Revenue trends are monitored using financial statement and budget to actual reports.

- **Issues Noted**

- No formal or regular receivable monitoring reports are prepared.
- The outsourced vendor handling alarm permits and false alarm fees is currently unable to provide the City a monthly aged report of outstanding receivables.

- **Risk**

Low

- **Response**

The third party vendor, EDS, is making changes to their system so that this periodic review will be possible by December 31, 2004.

Use of Reports to Evaluate and Improve Collections

- **Controls Noted**

- As noted above, the Department has outsourced alarm permit processing and false alarm penalty billing and collection activities.

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➤ The Department records substantially all its revenue on a cash basis.

- **Issues Noted**

- As recommended above, the Department would benefit from a system that could track and age reports receivables.
- The outsourced vendor handling alarm permits and false alarm fees is currently unable to provide the City a monthly aged report of outstanding receivables.

- **Risk**

Moderate

- **Response**

The third party vendor, EDS, is making changes to their system so that the Department will be able to track and age reports receivable by December 31, 2004.

If you have any questions regarding the issues discussed in this management response, please contact Paula Gerstle at 713-308-1771.


Harold L. Hurtt
Chief of Police

HLH:pjg

*Views of Responsible
Officials*