



City of Houston

Annise D. Parker
City Controller

City-Wide Accounts Receivable and Billings Internal Audit

Legal Department

Report No. 04-37



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
Legal Department (Report No. 04-37)

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 Legal 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 directly accounts for the City's actual recoveries arising from activities of the Department. Due to the fact that the legal process of appeals or solvency issues bring doubt to the recoverable amount from such settlements and judgments, this revenue is not accrued or estimated but rather recognized as received. Also, there is no tracking of pending judgment 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.

It is the Legal Department's opinion that Executive Order 1-38 does not apply to legal settlements, judgments and recoveries pursued by the Department. It is their opinion that funds associated with these activities do not fall under accounts receivable guidelines because subrogation claims are disputed unliquidated matters. They represent funds that the City believes it is owed on the basis of certain facts that are raised in the course of litigation and negotiation. The Department's position is that treating such claims as accounts receivable is inaccurate, unwise and contrary to conservative accounting practice to the extent that the amounts involved are so imprecise and their collection so highly unpredictable.

JWI's report pointed out that internal reporting over pending receivables could be improved if pending judgments and settlements were recorded in the financial system and fully reserved with an allowance for doubtful accounts until collected. The Department does not formally report the status of pending judgment and settlement receivables or its collection experience. Such reporting could improve oversight and control over these receivables.

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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
Arturo Michel, City Attorney
Judy Gray Johnson, Director, Finance and Administration Department

September 13, 2004

Ms. Annise D. Parker
City Controller
City of Houston
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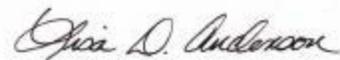
Dear Controller Parker:

We have completed the internal audit of the Accounts Receivable and Billings for the Legal 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 31, 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 Legal 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 Legal 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 Legal Department primarily monitors the progress of the City's litigation and handles the collection of legal settlements or judgments. Upon collection of a settlement, Legal sends the check to the respective department. In addition, the Department collects fees for copies made and employee reimbursements for phone or use of other assets, which are recorded on a cash basis.
- ✍ Other inter-fund recoveries for legal services to the City's capital funds is outside the scope of this internal audit.

Summary

- ✍ The City's financial system directly accounts for the City's actual recoveries arising from activities of the Legal Department.
- ✍ Due to the fact that the legal process of appeals or solvency issues bring doubt to the recoverable amount from such settlements and judgments, this revenue is not accrued or estimated but rather recognized as received.
- ✍ There is no tracking of pending judgment receivables within the City's financial system.



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:				
⌘ Recoveries and refunds	\$ 10,000	no	n/a	X
⌘ Miscellaneous other	7,000	no	n/a	X
⌘ Inter-fund reimbursements	600,000	no	n/a	X

Definition of Terms:

- ⌘ **X** – Represents a Yes answer related to determining if each identified revenue stream results in a receivable.
- ⌘ **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 policies and procedures for approving legal settlements. ☞ All settlements or judgments are documented by specific court documents or agreements. ☞ The Department does not have formal policies and procedures over receivables and related collections 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. 	Moderate
Cost Recovery	<ul style="list-style-type: none"> ☞ The Department recovers costs for other City Departments through legal services provided on behalf of the City. ☞ The Department has a litigation system that tracks claims and cases and the related activities and costs incurred on each claim or case. Recovery of these costs is dependent on the results of the settlement or judgment. 	<ul style="list-style-type: none"> ☞ None 	Low
Transaction Processing	<ul style="list-style-type: none"> ☞ Departments communicate issues to the Legal Department for determination as to whether legal action should be taken for recovery. ☞ Each legal settlement or judgment is evidenced by an approved agreement or court document. ☞ The Department collects amounts due. ☞ Upon receipt Legal documents the receipt and forwards the check to the appropriate department for recording. 	<ul style="list-style-type: none"> ☞ Controls over receipts could be improved if Legal confirmed collection with the Controller's Office to verify timely deposit by the appropriate department or if all such recoveries were centrally handled for deposit and recording, perhaps by the Finance and Administration Department. 	Moderate



Compliance Analysis Overview - EO #1-38

Compliance Area	Controls Noted	Issues Noted	Risk
Physical Safeguards	See Transaction processing for the segregation of duties related to the Legal receivables.	None noted.	Low
Substantiation and Evaluation	See the controls noted under transaction processing above.	None noted.	Low
Determination of Net Realizable Value <i>(Minimum of Annually)</i>	<p>Validation of realizable value is determined based on the actual amounts collected through the Legal Department.</p> <p>Respective departments record collections as deposits are made.</p> <p>Cash and related bank accounts are reconciled monthly by the Controller's Office.</p>	None noted.	Low



Compliance Analysis Overview - EO #1-38

Compliance Area	Controls Noted	Issues Noted	Risk
Identification of Accounts to be Written-off / Determination of an Appropriate Allowance for Doubtful Accounts <i>(Minimum Annually)</i>	Since Since the Legal Department does not record pending judgments and claims in the City's financial system, there are no recorded accounts needing to be assessed for an allowance for doubtful accounts.	Controls Controls over pending receivables could be improved if pending judgments and settlements were recorded and fully reserved with an allowance for doubtful accounts until collected.	Moderate
Preparation of Reports & Analysis	Legal Legal has a monitoring system related to such receivables. Due to the nature of confidential legal information, this system provides no reporting to the Department for which the recovery is being sought or to Finance and Administration or Controller's Office, the departments responsible for monitoring the City's budget and financial results.	None None noted.	Low
Use of Reports to Evaluate and Improve Collections	Collections Collections are processed through the legal, court system, which is a lengthy process.	The The Department does not report the status pending judgment and settlement receivables or its collection experience. Such reporting could improve oversight and control over these receivables.	Moderate

EXHIBIT A



CITY OF HOUSTON

Legal Department

Interoffice

Correspondence

To: Annise Parker
City Controller

From: Arturo G. Michel 
City Attorney

Date: October 6, 2004

Subject: Jefferson Wells International's
Audit

In the audit of the Legal Department's accounts receivable and billings, Jefferson Wells noted that "the Department does not have formal policies and procedures over receivables and related collections as required by the Executive Order."

It is the Legal Department's opinion that Executive Order 1-38 "Accounts Receivable Policy" does not apply to legal settlements, judgments and recoveries pursued by the City Attorney's Office. Accounts receivable represent money owed to the City for goods and services provided while the funds associated with underlying settlements, judgments and recoveries do not fall under these guidelines. Moreover, accounts receivable represent liquidated debts for goods or services while subrogation claims are disputed unliquidated matters. They represent funds that the City believes it is owed on the basis of certain facts that are raised in the course of litigation and negotiation. We submit that the classification and subsequent treatment of such claims as "accounts receivable" is inaccurate, unwise and certainly contrary to conservative accounting practice to the extent that the amounts involved are so imprecise and their collection so highly unpredictable.

*Views of Responsible
Officials*

The auditors also indicated that "controls over receipts could be improved if Legal confirmed collection with the Controller's Office to verify timely deposit by the appropriate department or if all such recoveries were centrally handled for deposit and recording, perhaps by the Finance & Administration Department."

The Legal Department disagrees with the auditors' recommendation that it should follow up with the various department fiscal representatives to ensure that the subrogation recoveries have been timely deposited. The Legal Department, however, will forward the subrogation recoveries to F & A for deposit if that department wishes to assume that function on behalf of all City departments.

Finally, the auditors noted "the Department does not report the status pending judgment and settlement receivables or its collection experience."

The Department will create a tracking system to include affirmative judgments (the responsible party, the amount thereof, the date, and collection efforts).

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