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# **Accounts Receivable Process Review**

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# Accounts Receivable Process Review

## 1. Introduction

The Office of the City Auditor (OCA) included the Accounts Receivable Process Review in the list of projects planned for 2004. This review focused on the Corporation's Corporate Billing & Accounts Receivable (CB & AR) unit which provides a centralized billing service to business units (with the exception of Assessment and Taxation, Police, and Library) throughout the Corporation. Accounts receivable represent monies due to the Corporation for a variety of services rendered to the citizens. A significant portion of the receivable billings represent cost recovery for the benefit of the Corporation.

## 2. Background

The CB & AR unit provides billing and collection services for the following business units:

Description	Outstanding Balance as at December 31, 2004
Ambulance	\$4,646,054
Cemeteries	541,608
Community Services	1,560,090
Corporate Services	763,162
Dangerous Goods	206,764
Drainage	2,083,043
Mobile Equipment Services	492,014
Non-Profit Housing	35,887
Parking/Space Rent/Custodial	204,192
Planning	1,620
Rent - Commercial and Residential	57,473
Risk - Insured Properties (Transportation & Streets)	419,412
Risk - Uninsured Properties (Transportation & Streets)	1,298,314
Snow and Weed Removal *	1,664
Transportation and Streets	3,085,566
Waste Management	282,929
<b>Total</b>	<b>\$15,679,792</b>

\* Outstanding amounts not paid are included on the tax roll for collection purposes.

As at December 31, 2004, \$9.4 million of the total accounts receivable balance (\$15.7 million) was past due. Of the \$9.4 million in receivables past due, \$4 million was overdue by more than 120 days.

Two separate information systems (SAP and CLASS) are used to process customer billings. Account processing includes initial customer invoicing, payment processing and follow up.

The annual actual expenditures for the CB & AR unit are noted in the following table:

<b>Fiscal Year</b>	<b>2001 Actual</b>	<b>2002 Actual</b>	<b>2003 Actual</b>	<b>2004 Budget</b>
Expenditure	\$812,000	\$1,189,000	\$1,043,000	\$1,096,000

The CB & AR unit has 20 full time equivalent positions, 6 of which are temporary to backfill for employee absences (1 employee on maternity leave; 2 employees on long-term illness leave; 3 employees on secondments).

### 3. Objective

The objective of the review was to determine whether the internal controls in the CB & AR unit are adequate to ensure that monies owed to the Corporation are properly accounted for and collected on a timely basis.

### 4. Scope and Methodology

The scope and methodology was determined after conducting a series of interviews with management and reviewing selected documentation to address some key risk areas facing the CB & AR unit.

#### 4.1. Transportation and Streets, Risk - Uninsured Properties

As at December 31, 2004 the outstanding accounts receivable balance for the Risk - Uninsured Properties area was \$ 1,298,314, representing 8.3 % of the total accounts receivable balance outstanding in the amount of \$ 15,679,792. Except for Ambulance receivables (which are anticipated to be transferred to Provincial jurisdiction in the near future), the Risk - Uninsured Properties area incurred the largest value of accounts past due by more than 120 days - \$ 603,415, representing 34.4 % of accounts past due by more than 120 days. After discussing these figures with management, it was agreed that the OCA would focus its testing on transactions in the Transportation and Streets, Risk - Uninsured Properties account.

#### 4.2. Employee attitude survey

In 2003 an employee attitude survey was conducted of the Corporate Services department. The survey results indicated that the employees of the CB & AR unit suffered from low morale. As a result management engaged a consulting firm to conduct an organizational assessment of the CB & AR unit to determine the cause for the low employee morale. The consulting firm's report was issued on April 30, 2004. The report contained nine recommendations, which the OCA followed up to determine their current status.

### 4.3. Collection risk

The OCA assessed the business unit's controls for managing doubtful and slow paying accounts, including a review of the collection agencies used by the CB & AR unit to pursue delinquent accounts.

### 4.4. Performance measurement

The OCA reviewed current performance measurement reports to determine their completeness and effectiveness.

## 5. Observations and Analysis

The OCA developed the following eight recommendations after completing the process review of the CB & AR unit's internal controls:

### 5.1. Transportation and Streets, Risk - Uninsured Properties

The OCA focused specific testing for receivables in the Transportation and Streets Branch's Risk - Uninsured Property account where management indicated that billing performance issues existed.

The OCA obtained the outstanding receivable invoices for the Risk - Uninsured Property account (street lights, signals, signage and other traffic control assets that are not insured) as at November 3, 2004. The following summary profile of the outstanding invoices for the Risk - Uninsured Property account is provided in order to gain a high level understanding of the average number of days required to issue and collect an invoice.

Description	Status
Total amount of outstanding uninsured property accounts receivable as at Nov. 3, 2004	\$1,119,828
Total number of customer accounts	469 accounts
Average number of days between the incident date and the customer invoice date	142 days
Average number of days customer billing remains outstanding after customer invoicing	294 days
Average number of days between the date incident occurred and the date customer billing remains outstanding	436 days

The potential exists to significantly reduce the number of days it takes to generate a customer invoice from the current 142 days. A general guideline is that customer invoices are normally issued within 30 days after services are rendered. In general, invoices should not remain outstanding more than 90 days (invoices are typically due within 30 days of issue).

The OCA selected a sample of Risk - Uninsured Property invoices for further detailed testing to: (1) determine if adequate supporting documentation existed; (2) verify if the account was paid; (3) verify if the invoice was accurate.

The following observations were noted in connection with a fairly typical invoice that was selected for testing:

#### **5.1.1. Invoice not generated on a timely basis**

From March 2, 2004 (the date that the motor vehicle collision occurred) until July 15, 2004, the Transportation and Streets unit collected the necessary data from various 3<sup>rd</sup> parties in order to provide the CB & AR unit with the necessary information to generate a customer invoice. On July 29, 2004 an invoice in the amount of \$ 2,651.00 was issued - 149 days after the motor vehicle collision occurred.

#### **5.1.2. Invoice not sent to the correct party**

The “Damage Claims Billing Advice” is prepared by the Transportation and Streets department in order to provide the necessary information to the CB & AR unit to generate a customer invoice. The “Damage Claims Billing Advice” indicated that the driver of the vehicle (not the insurance company) was to be invoiced. The CB & AR unit invoiced the driver on July 29, 2004. A two-month delay then ensued between the invoice date and the date the insurance company sent a letter to the Corporation requesting a detailed analysis of the costs contained in the invoice in the amount of \$2,651.00). The invoice should have been sent to both the driver (owner) of the vehicle and the insurance company on July 29<sup>th</sup> to avoid this delay.

### **5.2. Work process**

#### **5.2.1. Roles and responsibilities**

The OCA was pleased to observe that CB & AR management is working with Transportation & Streets management to improve work processes in connection with Risk - Uninsured Property accounts. However, the OCA observed that the work processes require further improvement to ensure the scope of activities, role, and responsibilities between the Transportation & Streets unit and the CB & AR unit is defined clearly. For example, the OCA noted that information requests for motor vehicle collision claims are received from multiple external parties (EPCOR, the Edmonton Police Service, insurance company, driver of the vehicle, registered owner of the vehicle, etc.), and multiple internal parties within the Corporation (Transportation and Streets, CB & AR, Risk Management, Law Branch, etc.). Effective co-ordination between these parties is essential in order to ensure the information requests are processed in an efficient manner. Inadequate co-ordination results in additional time delay which increases the number of days the account remains outstanding, thereby increasing the risk of non-payment.

**5.2.2. Billing performance**

Improving work process will result in improved billing performance. For example, as noted above in the Risk - Uninsured Property area, there is an average of 142 days between the incident date and the date a customer invoice is generated. By improving work processes, the OCA anticipates that the average number of days to generate a customer invoice could be reduced from 142 days to 30 days, thereby reducing the risk of non-payment. The CB & AR unit has started working with Transportation and Streets to improve the work processes. The improvements identified in that review need to be implemented for all client accounts with the goal of reducing the typical incident to invoicing cycle time to 30 days.

<b>Recommendation #1</b>	<b>Management Response and Action Plan</b>
<p>The OCA recommends that the CB &amp; AR unit continue to work with Transportation and Streets, Risk - Uninsured Property to enhance the business processes for billings, invoices, and accounts receivable in order to significantly reduce the cycle time required to generate a customer invoice after an incident.</p>	<p>Accepted                      CB &amp; AR have ongoing discussions with Transportation and Streets, and these were taking place prior to the audit. In addition to this, process changes were implemented prior to the audit. A/R will continue to enhance work processes as opportunities arise.                      Planned implementation: Ongoing                      Responsible Party: Director Treasury Management &amp; A/P A/R Coordinator</p>

**5.3. Employee attitude survey**

A consulting firm was engaged in early 2004 to conduct an organizational assessment and determine the cause of low employee morale. The firm’s report was released on April 30, 2004. The report indicated that CB & AR’s work environment has been reported as undesirable, so much so, that five permanent employees have transferred out of the area to remove themselves from what they perceive as a very negative workplace.

**5.3.1. Issues identified by the consultant**

The consultant report went on to discuss the following five issues that needed to be resolved:

1. Leadership
2. Productivity
3. Work Environment
4. Customer Relations
5. Technology

The OCA observed that the following three issues have improved significantly since the consultant's report was released in April 2004 (further work is being done on Customer Relations and Technology):

**Leadership** A new coordinator was assigned to manage the CB & AR unit. This coordinator uses positive strategies to enhance teamwork and improve employee morale, recognizing that people are social beings motivated by a desire to achieve and behave responsibly. As a result, the supervisors that report to the coordinator are listening to what their people have to say, share information, and offer ideas towards problem resolution.

**Productivity** The new coordinator has emphasized productivity improvements. For example, as a result of work process improvements, the receivable balance for a major customer account was reduced from \$1,879,733 as at January 1, 2004, to \$580,082 as at December 1, 2004. The OCA believes that further emphasis to improve productivity is required.

**Work Environment** A healthy work environment is one essential component towards ensuring efficient work processes. Significant efficiency gains in an unhealthy work environment are unlikely. The OCA observed that supervisors are genuinely interested in listening to what their people have to say in connection to problem resolution. As a result, the work environment has improved significantly since the consultant's report was released.

Within the five identified issues, the consultant made nine recommendations. The OCA observed that management has made progress towards addressing all nine recommendations contained in the consultant's report. Six of the nine recommendations have been implemented in a satisfactory manner. Implementation of the other three recommendations is in progress and being monitored by management.

## 5.4. Collection Risk

The CB & AR unit sends doubtful customer accounts to one of two collection agencies after the account is greater than 120 days old. As indicated in the following table, the existing process has not produced significant recoveries.

Description	Amount Sent to Collection Agency	Amount recovered	Collection Agency Fees and Other Charges	Net Recovery
Billings sent to Collection Agency "A" from April 1, 2004 to August 31, 2004.	\$ 76,215	\$ 17,662	\$ (4,725)	\$ 12,937
Collection Agency "A" %		23.2 %	(6.2) %	17.0 %
Billings sent to Collection Agency "B" from April 1, 2004 to August 31, 2004.	\$ 1,987,331	\$ 137,205	\$ (32,082)	\$ 105,123
Collection Agency "B" %		6.9 %	(1.6) %	5.3 %
<b>Total Billings sent to Collection Agencies</b>	<b>\$ 2,063,546</b>	<b>\$ 154,867</b>	<b>\$ (36,807)</b>	<b>\$ 118,060</b>
<b>Total %</b>		<b>7.5 %</b>	<b>(1.8) %</b>	<b>5.7 %</b>

The OCA noted the following in connection with accounts sent to the collection agencies for the period from April 1, 2004 to August 31, 2004:

1. The SAP system was not able to provide the correct information about which accounts were sent to collection agencies. As a result the OCA obtained third party information to determine which accounts were sent to collection agencies for the period from April 1, 2004 to August 31, 2004. The SAP system was not able to provide these reports because not all SAP modules have been installed. As a result, manual techniques are required in order to track customer information within the SAP system, such as customer accounts sent to collections. The information is only as good as the manual information being input by the CB & AR staff. Occasionally the staff input incorrect dunning level data (dunning level indicates how many times the customer was sent a payment reminder invoice) for some customer accounts that were not sent to the collection agency. As a result the SAP system was not able to accurately identify which customer accounts were sent to a collection agency.

2. The OCA noted that one particular customer account was not sent from the Risk Assessment section to the Law Branch within the two year time limit required to file a legal claim. As a result, it is less likely that the Corporation will be able to recover damages in the amount of \$12,279.81 from the insurance company. This was due in part to the large volume of uninsured property files that were at several stages of collection when they were provided to the CB & AR unit at the end of 2003. CB & AR staff had to manually review each file to determine its collection status. As a result, some sensitive time limits were missed. This process has since been adjusted so that all uninsured property billings are sent to the claims adjusters after the items are over 60 days old.
  
3. During the period from April 1, 2004 to September 30, 2004, the Corporation sent \$2,063,546 to collection agencies and recovered \$118,060, after collection agency fees, for a net recovery rate of 5.7%. The CB & AR unit has limited in-house resources to perform pro-active collection account work processes. As a result most doubtful accounts are sent to a collection agency. The CB & AR unit needs to determine if in-house resources vs. collection agencies could be used to improve the 5.7 % net recovery rate.

Also the OCA noted that the CB & AR unit has not documented their current accounts receivable procedures to provide specific direction for staff employees and supervisors when managing receivable accounts.

The impact of the above mentioned work process deficiencies for collection of doubtful accounts include:

1. Inadequate follow up with slow paying customers at the early stage of their life cycle, thereby increasing the likelihood of non-payment.
2. Inadequate co-ordination of customer billing information between the AR & CB unit and the operating unit responsible for the billing (Transportation & Streets, Cemetery, Risk Management, Law Branch, etc).
3. The high number of days an invoice remains outstanding. For example Risk - Uninsured Property customer invoices remain outstanding for an average of 294 days (as noted in this report). Normally, invoices should not remain outstanding for more than 90 days.

<b>Recommendation # 2</b>	<b>Management Response and Action Plan</b>
<p>The OCA recommends that management determine the most effective solution to resolve the problem where the SAP system is not able to provide the correct information about which accounts were sent to collection agencies.</p>	<p>Accepted                      Preliminary discussions have taken place with the Business Support team. Procedures will be reviewed to determine the most effective method for dunning and transfer of delinquent account to collection agencies.                      Planned implementation: April 2005                      Responsible Party: Director Treasury Management &amp; A/P A/R Coordinator</p>
<b>Recommendation # 3</b>	<b>Management Response and Action Plan</b>
<p>The OCA recommends that management determine if the doubtful accounts collection process could be performed more effectively using in-house employees rather than collection agencies.</p>	<p>Accepted                      Planned implementation: June 2005                      Responsible Party: Director Treasury Management &amp; A/P A/R Coordinator</p>
<b>Recommendation # 4</b>	<b>Management Response and Action Plan</b>
<p>The OCA recommends that the accounts receivable procedures be documented in order to provide staff with adequate direction when managing receivable accounts.</p>	<p>Accepted                      Existing procedures are outdated; these will be updated to reflect current practice.                      Planned implementation: September 2005                      Responsible Party: Director Treasury Management &amp; A/P A/R Coordinator</p>

**5.5. Segregation of Duties**

**5.5.1. Organizational structure**

The CB & AR unit is tasked with the following two functions:

1. Record, adjust and process accounts receivables billings and
2. Process customer receipts (cash or cheque) for the same accounts.

The existing structure of the CB & AR unit has resulted in some employees having the ability to adjust a customer’s accounting record in a manner that could potentially conceal the theft of cash or other negotiable instrument. There are eight employees within the CB & AR unit that have systems access profiles that permit them to: (1) record, adjust and process accounts receivable billings and (2) process customer receipts (cash or cheque).

It is essential that employees do not have access to both the accounts receivable billing function and the cashiering function.

**5.5.2. Physical security**

While reviewing the controls over the customer receipts process, the OCA observed where one employee from another department was physically couriating cash and cheques by walking (unescorted) from her office (located in another building) to the CB & AR’s office. This occurs approximately three to five times per week.

**5.5.3. Impact**

The impact of these control deficiencies is as follows:

1. The lack of segregation of duties increases the potential for fraud to occur when employees are able to control both the cashiering function and cover for missing funds by inappropriately altering customer accounts.
2. The risk of physical harm to the employee that is transferring (unescorted) cash from one location to another.

<b>Recommendation # 5</b>	<b>Management Response and Action Plan</b>
<p>The OCA recommends that the cashiering function be removed from the CB &amp; AR unit in order to ensure that no responsibility to process cash or any other negotiable instruments exists.</p>	<p>Accepted                      A preliminary review has been completed. An action plan will be submitted to the Finance Branch Manager.                      Planned implementation: June 2005                      Responsible Party: Director Treasury Management &amp; A/P A/R Coordinator</p>
<b>Recommendation # 6</b>	<b>Management Response and Action Plan</b>
<p>The OCA recommends that all employees within the CB &amp; AR unit have their system access to the cashiering system revoked.</p>	<p>Accepted                      Planned implementation: June 2005                      Responsible Party: Director Treasury Management &amp; A/P A/R Coordinator</p>
<b>Recommendation # 7</b>	<b>Management Response and Action Plan</b>
<p>The OCA recommends that the practice of physically couriating cash unescorted to the CB &amp; AR unit be eliminated as soon as possible.</p>	<p>Accepted                      The Corporate Cash Handling procedures are currently being revised, and this item will be considered as part of the review.                      Planned implementation: June 2005                      Responsible Party: Director Treasury Management</p>

**5.6. Performance Measurement**

The OCA reviewed CB & AR’s performance measurement reports, which are used to monitor and track accounts receivable and billing performance. The OCA noted that the performance reports provided a good financial overview of the outstanding accounts receivable balances by department on a monthly basis. However, the reports do not provide key performance indicators by department. For example, the average number of days required to generate an invoice after the incident date or the average number of days an invoice remains outstanding. It is important to use key performance indicator reports in order to track, monitor, and take the necessary mitigating action to improve customer account performance.

The inadequate performance measurement reports means that it is more difficult to:

1. Track, monitor, and take necessary actions to improve customer account performance.
2. Measure the impact on customer account performance as changes are made to work processes. For example, if a performance report was generated to indicate the number of days it takes to issue an invoice (by department); then management would be able to determine the impact of changes to work process on the number of days it takes to issue an invoice.

<b>Recommendation # 8</b>	<b>Management Response and Action Plan</b>
<p>The OCA recommends that performance measurement reports be enhanced to improve reporting of key performance indicators by department in order to more effectively track and monitor customer billing performance.</p>	<p>Accepted                      This information is available albeit on a manual basis.                      Planned implementation: December 2005                      Responsible Party: Director Treasury Management &amp; A/P A/R Coordinator</p>

## 6. Conclusion

The CB & AR unit has made significant progress since April 2004 to improve leadership, productivity, work processes, and customer relations. However, further improvements will ensure that the CB & AR unit is able to significantly improve its performance. A significant portion of these billings represent cost recovery on behalf of the Corporation (for example, customer billings to recover costs to repair infrastructure damage due to motor vehicle collisions). In the event that the Corporation is not able to recover these costs, the losses must be covered by funds from the tax levy. The Corporation incurred an estimated \$1.3 million of bad debt write off in 2003. Improvement to work processes will lead to improved customer account performance, thereby leading to significant reductions in the amount of bad debt write off.

The recommendations contained in this report will significantly enhance the control environment. These recommendations focus on internal controls, bad debt and collection procedures, work process, and segregation of duties.

The OCA thanks the management of the CB & AR unit for its co-operation and insight provided during the course of this review.