

**Performance Audit 14-05:
Wood Recycling Center Cash
Collections**

December 2014

City Auditor

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OFFICE OF INTERNAL AUDIT

Stan Sewell, City Auditor

December 29, 2014

To: Mayor Andy Berke
City Council Members

Subject: Wood Recycling Center Cash Collections, Audit 14-05

Dear Mayor Berke and City Council Members:

The attached report contains the results of our audit of the Wood Recycling Center Cash Collections. Our audit found that Public Works lacks adequate segregation of duties due to limited staff. We also found policies and procedures should be implemented to ensure accounts receivable are properly accounted for and collected timely.

In order to address the noted areas for improvement, we recommended actions to improve segregation of duties including additional supervisor review and enhanced policies and procedures. We also recommended the Department consult with the City Attorney's Office to determine the legal requirements needed for extending credit to customers of the Wood Recycling Center.

We thank the management and staff of the Public Works and Finance departments for their cooperation and assistance during this audit.

Sincerely,

Stan Sewell, CPA, CGFM, CFE
City Auditor

Attachment

cc: Travis McDonough, Chief of Staff
Audit Committee Members
Daisy Madison, Chief Finance Officer
Lee Norris, Administrator Public Works

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AUDIT PURPOSE

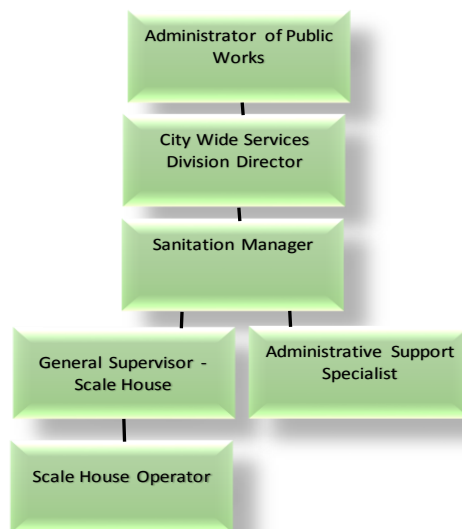
This audit was conducted in accordance with the Office of Internal Audit's 2014 Audit Agenda. The objectives of this audit were to determine if:

- Proper internal controls are in place for accounts receivable; and,
- Proper internal controls are in place for the cash collection process.

BACKGROUND

The Public Works Department is responsible for the operations and administrative support of the Wood Recycling Center. The facility has three scale house operators and a general supervisor that report to the City Wide Services' Sanitation Manager. Scale house operators handle daily customer transactions, reconcile collections to scale house reports and forward the collections to the Administrative Support Specialist. The Administrative Support Specialist is responsible for preparing and submitting collections for daily receipts as well as accounts receivable payments.

Exhibit 1: Organization Chart



The Wood Recycle Center is located at 3925 North Hawthorne Street behind the Police Services Center. The center accepts raw natural wood, brush and leaves. City residents are allowed to bring wood, brush, leaves, etc. to the center free of charge as long as these items are from their primary residence and their load is in a standard sized

pick-up truck or a comparably sized trailer. Mulch is also available free to City residents and for purchase at standard rates to non-city residents and businesses.

Financial Information

Per City Code Sec. 18-106, the center charges \$20.00 per ton with a minimum charge of \$20.00 to dispose of wood, brush and leaves. City residents may dispose of wood products and leaves at no charge. Wood chips are available at a rate of \$10.00 per ton with a minimum charge of \$5.00. For amounts greater than 10 tons, the charge shall be \$5.00 per ton. Residents of the City are entitled to wood chips at no charge. The Director may authorize the sale of wood chips or leaves in bulk quantities of more than five tons at market rates.

As shown in Exhibit 2, prior to fiscal year 2013, the sale of mulch was misclassified as tipping fees. In December 2012, City Council increased tipping fees from \$13.00 per ton to \$20.00 per ton with the minimum increasing from \$6.50 to \$20.00.

Exhibit 2: Wood Recycling Center Revenues

Fiscal Year	2012*	2013	2014
Sale of Mulch	14,320	84,104	119,209
Tipping Fees	240,093	159,282	190,579
Total Revenues	254,413	243,386	309,788

* Classifications of payments were incorrect.

Sources: Oracle Financials

FINDINGS AND RECOMMENDATIONS

Procedures should be implemented to address the lack of segregation of duties.

The current process for Wood Recycling collections lacks several key areas of segregation. We observed the Scale House Operator controls the collection process from issuing receipts to voiding tickets in the WasteWorks system. We also found the Administrative Support Specialist receives money collected at the scale house, makes adjustments to customer accounts, sets up customers and credit limits, prepares collection reports, invoices customers, voids tickets and invoices and receives payments by mail.

Internal Control and Compliance Manual for TN Municipalities requires officials to separate duties so that no one employee has control over a complete transaction from beginning to end. Segregation of duties is vital in a high risk area such as the revenue collection process. When adequate segregation of duties is not

possible, management oversight should be increased to provide reasonable assurance that errors, irregularities and fraud are detected and corrected in a timely manner.

Recommendation 1:

We recommend the Administrative Support Specialist review the daily scale house reports and verify the amounts collected.

***Auditee Response:** We concur with the audit finding and recommendation.*

Recommendation 2:

We recommend, where possible, the employees who receive cash collections (cashiers) should be different from those who maintain the books and records (bookkeepers). Since it may not be possible to fully segregate duties, we recommend a Public Works supervisor periodically perform an independent review of collections and accounts receivable.

***Auditee Response:** We concur with the audit finding and recommendation.*

Recommendation 3:

To assist with the independent review, we recommend daily receipts from the scale house be reported on a separate collection report from the checks received in the mail.

***Auditee Response:** We concur with the audit finding and recommendation.*

A supervisor should review and approve daily voided transactions and adjustments to accounts receivable.

Tickets Voided by Scale House Operators

Voiding tickets is sometimes necessary in day-to-day transactions. A staff member should not have the capability to record cash receipts and to void those transactions. Having this ability gives the scale house operators opportunity to manipulate transactions.

Currently, scale house operators have the ability to void tickets because of limited staff. The scale house operator notates the justification for voiding the ticket. Although no written policies are in place, the scale house supervisor is required to review and verify (by

signature) daily voided tickets. The voided tickets should be sent with the daily reports to the Administrative Support Specialist for records retention.

All tickets voided during the audit period were reviewed. Of the 310 voided tickets, 102 (33%) were not retained. Of the tickets reviewed, 5% were missing the required supervisor's signature. We also noted some tickets were missing a written justification. Based on the results of our work, the division does not have proper procedures in place to ensure voided tickets are properly approved and retained.

Recommendation 4:

We recommend Public Works update its policies and procedures to require the scale house supervisor to review the written explanation and approve all voided tickets. We also recommend the Scale House Supervisor verify all voided tickets are attached to the daily scale house report and submitted to the Citywide Services' Administrative Office.

***Auditee Response:** We concur with the audit finding and recommendation.*

Recommendation 5:

We recommend the Administrative Support Specialist perform a daily review of voided tickets. The review should include, but not be limited to: Verifying all voided tickets are present; explanations are provided and signed by the supervisor. We recommend the voided tickets be retained in accordance with Municipal Technical Advisory Service Record Retention policies.

***Auditee Response:** We concur with the audit finding and recommendation.*

Adjustments made by Administrative Support Specialist

Because the Administrative Support Specialist has complete control of customer accounts, the accounts receivable process lacks the necessary segregation of duties. We reviewed all the adjustments made during the audit period and found customer accounts received credits simply based on a phone call from the customer. Further, an explanation was not present on all adjustments. The current policies do not address the criteria for making adjustments and the appropriate approval needed. To ensure adjustments are valid, adequate support for the adjustment should be retained and reviewed by a supervisor.

Recommendation 6:

We recommend Public Works develop written policies and procedures for adjustments which would include, but not be limited to: Proper support documentation for all adjustments and a supervisory review and authorization of the adjustment.

***Auditee Response:** We concur with the audit finding and recommendation.*

Transfer of funds should be documented each time funds transfer between employees.

*The Internal Control and Compliance Manual for Tennessee Municipalities 5-14-2 states anytime custody of money changes from one employee to another, the money **should** be counted by **both employees** and a signed document should be prepared. Further, *Finance Policies and Procedures-Collections (Revised April 2012)* states funds must be tracked by a signature receipt each time funds are transferred. “Both individuals should count, note the amount and sign for the transfer.”*

Currently, the scale house operator reconciles collections to the daily scale house reports. The daily funds and reports are placed in a tamper-proof bag which is stored overnight in a secure location. The next day, the mail runner delivers the bag to the Assistant Director of Public Works, who then delivers it to the Administrative Support Specialist for preparation of the collection report. Neither the scale house operator nor Administrative Support Specialist has a witness present while counting the money. The transfer of funds is not documented between any of the employees.

When fund transfers are properly documented, management has the necessary tools to easily identify the source of any missing funds. However, each collection process is unique and management should identify and implement internal controls that fit its unique process.

Recommendation 7:

We recommend Public Works implement new procedures that ensure accountability for funds collected. The procedure could include a dual witness either at the scale house (when cashier performs daily close out) or the next day (when the sealed bag is opened). Transfers between staff should be minimal and adequately documented. A log should be maintained by each employee who transfers funds.

Auditee Response: *We concur with the audit finding and recommendation. It should be noted as of January 2, 2015, the Wood Recycling Center will no longer accept cash.*

The Division should implement a daily mail log for payments on account.

Checks are received in the mail for payments on account. Although the Administrative Support Specialist receives the mail from another staff member, a daily mail log is not prepared. *Internal Control and Compliance Manual for Tennessee Municipalities (5.14.4)* requires all mail be delivered intact to a designated employee who should immediately open the mail and prepare a list of all money/checks received in the mail.

Since the Administrative Support Specialist has authority to post payments and make adjustments to accounts, a mail log coupled with a supervisor's review of collections would greatly enhance the internal controls.

Recommendation 8:

We recommend someone, other than the Administrative Support Specialist, open the mail and list the payments received in a mail log. When transferring checks between employees, the mail log should be signed by each to document the exchange. The mail log should be maintained by the employee designated to open the mail.

Auditee Response: *We concur with the audit finding and recommendation.*

Contracts should be executed for all agreements.

The *Internal Control and Compliance Manual for Tennessee Municipalities (4.2.4)* states "Municipal officials must obtain a written contract for all agreements with other entities or individuals for services received or provided, regardless whether payment is involved." Copies of contracts entered into by municipal officials should be included in the official minutes.

In addition, City Code Section 2-756 requires officials to have a written contract that is approved by Council before authorizing the use of municipal facilities or supplies by outside organizations or individuals. The Public Works Administration has extended credit to several Wood Recycling customers. The Department has no written agreements with these organizations to address credit limits, late fees and penalties for non-payment.

Recommendation 9:

We recommend Public Works consult the City Attorney on requirements for setting up charge customers (agreements) and credit limits, late fees and penalties. If determined necessary, the Department should receive appropriate approval from City Council. Based upon the advice of the City Attorney, we recommend policies and procedures be implemented for this process.

Auditee Response: We concur with the audit finding and recommendation.

Policies and procedures are needed for the accounts receivable process.

As discussed in the previous finding, the Public Works Department has extended credit to several customers using the Wood Recycling Center. Monthly invoices requesting payment are forwarded to these credit customers. Because the Department has provided a service, proper processes are needed to ensure all funds due to the City are collected and outstanding receivables are properly reported.

Currently, the Department has no procedures in place to ensure charge accounts are paid in a timely manner. We reviewed the detail accounts receivable aging report and verified balances through confirmation letters sent to the customers. We found customers did not always receive statements, payments were not properly applied to account balances, customers had balances in excess of their credit limits, and accounts lacking regular payments. We also found some delinquent customers were allowed continued use of the facility/purchases, thus incurring additional charges.

Recommendation 10:

We recommend Public Works Administration implement policies and procedures to reconcile accounts receivable balances regularly and to follow up with any balance older than 90 days. The policies and procedures should include sending monthly statements to every customer with outstanding balances, and prohibiting use of the facility when account balances are past due or exceed credit limits. We also recommend Public Works Administration develop a process for addressing customers with outstanding balances.

Auditee Response: We concur with the audit finding and recommendation.

Recommendation 11:

We recommend Public Works develop a notification in the WasteWorks system, if available, to flag customers with balances over their credit limit.

***Auditee Response:** We concur with the audit finding and recommendation.*

Management should ensure compliance with all policies and procedures.

Both the *Internal Control and Compliance Manual for Tennessee Municipalities* and the *Finance Policies & Procedures-Collections* (April 2012) require adequate support to document all transactions. During our review of the collection reports, we found the majority of payments received in the mail did not have copies of invoices or pre-numbered receipts attached to the collection report. In particular, the purpose of the payment was not identified as required by Finance's policy.

Other minor exception areas noted were: Three of the forty-four collection reports reviewed were not submitted within three business days, and two collection reports had overages/shortages that were not properly explained and signed by a supervisor. Although the violations noted above were minimal, management should ensure staff receive proper training and copies of current policies and procedures.

Recommendation 12:

We recommend checks received in the mail have appropriate documentation to verify payment was applied to the appropriate account in WasteWorks.

***Auditee Response:** We concur with the audit finding and recommendation.*

Recommendation 13:

We recommend Public Works follow all *Finance Policies and Procedures- Collections*.

***Auditee Response:** We concur with the audit finding and recommendation.*

APPENDIX A: SCOPE, METHODOLOGY AND STANDARDS

Based on the work performed during the preliminary survey and the assessment of risk, the audit covers Wood Recycling operations from September 1, 2013 to August 31, 2014. When appropriate, the scope was expanded to meet the audit objectives. Source documentation was obtained from Finance and Public Works departments. Original records as well as copies were used as evidence and verified through physical examination.

To determine whether internal controls were in place for collections, we reviewed scale house written policies/procedures and interviewed staff to gain an understanding of the collections process at the Center. In addition, we reviewed the *Internal Control and Compliance Manual for Tennessee Municipalities*, the Chattanooga City Code and Finance and Administration Department accounting policies and procedures. To determine if adequate controls were in place for accounts receivable, we sent confirmation letters to Wood Recycle customers, reviewed aging reports and interviewed staff to gain an understanding of the accounts receivable process.

We reviewed a sample of collection reports and supporting documentation to determine whether collections were properly documented and timely submitted to Treasury. The sample size and selection were statistically generated using a desired confidence level of 90 percent, expected error rate of 5 percent, and a desired precision of 5 percent. Statistical sampling was used in order to infer the conclusions of test work performed on a sample to the population from which it was drawn and to obtain estimates of sampling error involved. When appropriate, judgmental sampling was used to improve the overall efficiency of the audit.

To achieve the audit's objectives, reliance was placed on computer-processed data contained in the WasteWorks system. We assessed the reliability of the data contained in the system and conducted sufficient tests of the data. Based on these assessments and tests, we concluded the data was sufficiently reliable to be used in meeting the audit's objectives.

We conducted this performance audit from October 2014 to December 3, 2014 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

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