

**Performance Audit 13-09:  
Collections Agency Contract**

**January 2014**

**City Auditor**

Stan Sewell, CPA, CGFM, CFE

**Internal Auditor**

Meghan Petty, CIA





# OFFICE OF INTERNAL AUDIT

## Stan Sewell, City Auditor

January 14, 2014

To: Mayor Andy Berke  
City Council Members

Subject: Collections Agency Contract (Report #13-09)

Dear Mayor Berke and City Council Members:

The attached report contains the results of our audit of the City's Collection Agency Contract with Nationwide Recovery Services. Our audit found that Nationwide Recovery Services had difficulty meeting contract requirements in some instances due to their computer system. We found errors in calculating commission rates and commissions taken on accounts not paid in full. We also found NRS was complying with requirements that partial payments be credited to interest, then principal, but was unaware of the requirement to credit oldest years prior to newer ones. City employees did not detect the errors for a variety of reasons, as noted in our report.

However, we also found that City processes should be improved to maximize recovery of delinquent receivables. The City Attorney's Office may wish to utilize NRS litigation services (with the potential to collect \$100,000 of current receivables). Additionally, City and NRS procedures for closing accounts should be improved to reduce potential for fraud and loss of revenues. While this is outside the scope of the current review, we noted there may be other potential areas that could benefit from use of the collections agency contract (e.g., sewer fees).

During the course of this review, our office found City Court was including collection fee costs as a fee charged to defendants. While the fee was added in good faith and notice was provided that this fee was being added, the addition of this fee appears to be a violation of City Code Section 12-21.

We thank the management and staff of the City Attorney, Finance and Administration, and Information Services departments for their cooperation and assistance during this audit. We also thank the management and staff of Nationwide Recovery Services, whose cooperation during this audit was essential to its completion.

The City Court Clerk's Office and the Office of the City Attorney are already working to resolve some of the findings identified in this report.

Sincerely,

Stan Sewell, CPA, CGFM, CFE  
City Auditor

Attachment

cc: Travis McDonough, Chief of Staff  
Audit Committee Members  
Daisy Madison, Chief Finance Officer  
Barry Teague, City Treasurer  
Ron Swafford, City Court Clerk  
Wade Hinton, City Attorney  
Jeff Cannon, Chief Operating Officer  
Nationwide Recovery Services

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## AUDIT PURPOSE

This audit was conducted in accordance with the Office of Internal Audit's 2013 Audit Agenda. The objectives of this audit were to determine if:

- Commissions are calculated and invoiced properly by Nationwide Recovery Services;
- Partial payments are credited according to City Code;
- Account suspensions are authorized by City personnel; and
- Nationwide Recovery Services is pursuing collections to the fullest extent allowed by its contract.

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## BACKGROUND

The City collects taxes, fines, fees, and other revenues from a variety of sources. When accounts are grossly delinquent, the City is authorized to pursue certain payments through a third-party contractor. In 2010, the Finance and Administration Department (on behalf of the City) entered into an agreement with Nationwide Recovery Services (NRS) for collection servicing. The contract had the option to renew for three additional years. In 2013, the City renewed the contract through February 28, 2014.

NRS currently provides collection services for water quality fees and amounts assessed defendants by City Court. As payment for its services, NRS receives a commission calculated as a markup on amounts owed the City. Commission rates are as follows:

Type of Account	Commission Rate
New Business	16.75%
Transferred from Previous Collection Agency	27.00%
Recovered by Litigation	22.00%

Source: NRS Contract

NRS applies a standard collection procedure to all accounts referred to it by the City. These procedures require adherence to the Fair Debt Collection Practices Act.

## Financial and Performance Information

As shown in Exhibit 1, NRS recovered a total of \$540,295 in delinquent receivables in fiscal year 2012, and \$941,973 in fiscal year 2013. Average commission rates on these collections were 17%.

### Exhibit 1: Gross Collections and NRS Commission, Fiscal Years 2012-2013

Revenue Source	2012		2013	
	Gross Collections	Commissions	Gross Collections	Commissions
Water Quality Fees	278,748	46,005	431,220	72,314
City Court Fines and Fees	261,547	42,834	510,753	84,332
<b>Total</b>	<b>540,295</b>	<b>88,839</b>	<b>941,973</b>	<b>156,646</b>

Source: NRS Records

NRS reported 41,723 accounts referred them amounting to \$12.7 million in delinquent receivables placed with the agency over the past two fiscal years. As shown in Exhibit 2, NRS reported recovery rates for City accounts ranging from 9-27% in the past two fiscal years.

Fiscal Year	No. Referrals	Net Placements	Recovery Rate	
			Water Quality	Courts
2012	20,251	\$9,195,818	23%	9%
2013	21,472	\$3,488,393	27%	10%

Source: NRS Reports

Contracted commission rates and reported account recovery rates are within benchmarked industry standards according to Association of Credit and Collection Professionals.

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## FINDINGS AND RECOMMENDATIONS

**City Court has allowed defendants to incur the cost of commissions for delinquent accounts, in violation of City Code Section 12-21.**

Currently, City Court applies a fee to delinquent accounts prior to placing the accounts with Nationwide Recovery Services (NRS). We observed this practice pre-dated the contract with NRS. Once the account is paid in full by the defendant/debtor, NRS applies its commission to the original balance and invoices the City for commissions due.

According to City Code Section 12-21 (d), the collection agency fee shall not be deemed a portion of the judgment entered against a defendant. However, by placing the fee on the account prior to referring the account to the collections agency, the fee has, in effect,

become a portion of the judgment against the defendant. This practice was in place prior to the appointment of the current City Court Clerk. Our interviews with the City Court Clerk indicate he was unaware of the fee being added to a defendant's balance prior to placement with the agency. Key members of his staff were aware of the fee and believed it was done in good faith. In fiscal year 2013, we identified a total of \$160,700 collected to cover the City's collection agency fees.

In addition, Section 19 of the NRS contract requires commissions to be calculated *as a markup* on the amount owed to the City and collected by NRS. As a result, NRS has received overpayments in commissions due to the fee being added to the original referral balance. We estimate the overpaid commission to be approximately \$36,000 in fiscal year 2013.

### **Recommendation 1:**

We recommend City Court discontinue the practice of adding collection agency fees to the amounts entered against the defendant prior to placing accounts with NRS.

***Audit Client Response (Finance):** We concur. However, the practice will continue upon an appropriate determination by the City Attorney and/or passage of an ordinance as stated in Recommendation 3 below.*

### **Recommendation 2:**

We recommend the City Finance Officer consult with the City Attorney regarding any necessary actions related to the collection fees.

***Audit Client Response (Finance):** We concur.*

### **Recommendation 3:**

We recommend the City Attorney prepare an ordinance to amend City Code Section 12-21 to allow the addition of collection agency fees, subject to legal research to ensure there will be no violation of federal or state laws.

***Audit Client Response (City Attorney):** We concur.*

**The City has the potential to recover approximately \$100,000 by litigating delinquent debtor accounts.**

According to NRS records, the City has approximately \$127,000 in receivables outstanding for accounts that have a minimum balance of \$250, not had a payment in the last six months, and are within the six year statute of limitations. City Attorney's Office has never pursued litigation against debtors for court fees or water quality fees, and has

one settlement arrangement with a debtor who had numerous parking citations for an amount of \$7,800.

Section 4 of the NRS contract stipulates NRS has no authority to, and will not initiate, legal suit against any person to recover sums owed to the City without the City's consent. No account referred to NRS will be compromised or settled for less than the full amount without written consent of the City.

If the City uses NRS litigation services, NRS will provide a contracted attorney and retain a commission of 22% on amounts recovered. Considering the commission rate, the City could recover up to \$100,000 in receivables with no administrative cost to the City. The City Attorney could provide minimum criteria for pursuing litigation and offer options for debtors to settle outside of court.

***Recommendation 4:***

We recommend the City Attorney's Office establish minimum criteria for litigating accounts in collections and authorize NRS to make the collections on the City's behalf. In addition, the City Attorney's Office should provide standard guidance to NRS regarding settlements.

***Audit Client Response (City Attorney):*** *We concur. The Office of the City Attorney has already been working to establish such guidance.*

**City agencies should designate certain individuals to suspend accounts in collections and require written documentation of requests.**

Section 15 of NRS' contract requires NRS to suspend collection efforts on any account when requested by the City, either orally or in writing. Multiple city representatives may request account closure and it appears the typical medium is via email. The City Treasurer and the City Court Clerk are not notified of the account suspensions.

Given the potential for fraud and lost revenue, we tested a sample of 68 suspended accounts (of the 247 total suspended accounts) for fiscal year 2013. We identified five accounts closed in error (an 8% error rate). The five accounts mentioned above amount to approximately \$2,000.

***Recommendation 5:***

We recommend the City Treasurer and City Court Clerk authorize all suspended accounts via a signed letter to NRS that details a cause for suspension. The letters should be filed for review.

***Audit Client Response (Finance):*** *We concur.*



**Recommendation 6:**

We recommend the City Court Clerk and City Treasurer's offices investigate account suspensions during the contract period on a one-time basis to identify any accounts still within the statute of limitations that were not closed for cause. All accounts found to be closed in error (including the five identified by our office) should be reinstated. In addition, we recommend the City Court Clerk and City Treasurer's offices review account suspensions for cause on a periodic basis thereafter.

*Audit Client Response (Finance): We concur.*

**Recommendation 7:**

We recommend the City Finance Officer amend the contract with NRS to require written authorization from designated City officials prior to suspending an account.

*Audit Client Response (Finance): We concur.*

**NRS applied incorrect commission rates and received commissions on accounts not paid in full.**

Lax review by City officials and poor system invoicing capabilities at NRS enabled the agency to apply incorrect commission rates and take commissions on accounts not paid in full. The NRS contract Section 3A requires gross amount of funds collected to be electronically transmitted to the City. We found commissions on water quality fee payments are netted from the accounts (in violation of the contract), and City employees did not detect the error. In addition, City Court is invoiced daily, resulting in an excessive administrative burden being placed on NRS and City staff to process daily invoices. No other NRS client requires such frequent invoicing.

The NRS contract also requires NRS to provide the City with a detailed report of collections in a format that will include, among other things, the amount of original balance referred to NRS and the date placed with NRS. However, reports provided by NRS do not show original balances. According to NRS staff, their computer system is not capable of providing this information on current invoices. Without this, City Court staff is unable to easily determine whether commission rates are proper for its accounts.

**Commissions Received on Accounts Not Paid in Full**

Though required by contract to take its commission only when accounts are paid in full, NRS has applied commission to each payment made by water quality fee debtors. While NRS was aware that they could only receive commission amounts on court accounts

paid in full, staff informed OIA they were not aware that the provision applied also to water quality fees. Within the sample of four months we selected (September 2012, December 2012, March 2013, and June 2013), NRS received \$1,350 in commission on accounts with balances. We did not attempt to determine whether the accounts are currently paid in full.

This practice is in breach of contract and has the potential for NRS to receive commission on accounts that will never be paid in full. It is important to note that NRS' computer system is unable to program commissions to be taken only when accounts are paid in full. As a result, NRS employees manually enter commission amounts to be paid for courts. According to NRS staff, remediation of this issue in their system could be cost-prohibitive.

### **Incorrect Commission Rates Applied**

While NRS was properly classifying accounts as primary or secondary placements, we found 31 instances in our four month sample of invoices where NRS improperly applied commission rates. The effect was a small net gain to the City in these months (\$60); however, we did not determine the impact over the course of the contract. The majority of incorrect rates were applied to court accounts, and as noted in the previous finding, court accounts are calculated manually.

#### **Recommendation 8:**

We recommend City Finance Officer, in consultation with the City Treasurer's Office, determine the full cost of commissions paid on accounts not paid in full over the contract period and seek reimbursement from NRS.

*Audit Client Response (Finance): We concur.*

#### **Recommendation 9:**

We recommend City personnel in the City Treasurer's Office and City Court verify commissions payable to NRS prior to payment. In addition, the City Treasurer's Office should request NRS remit gross collections and invoice them on a periodic (not daily) basis.

*Audit Client Response (Finance): We concur.*

**Recommendation 10:**

We recommend the City Finance Officer require NRS to adhere to contract and provide reports with original balances.

*Audit Client Response (Finance): We concur.*

**NRS was unaware of the requirement to credit oldest year accounts prior to newer accounts.**

City Code Section 2-110 d(4) requires partial payments for water quality fees to be applied to interest first, then to principal. It also requires payments be applied to the oldest year first for current owners. We identified accounts with partial payments from an NRS account inventory and reviewed a sample of the accounts to determine whether credited payments complied with City Code. Our review demonstrated NRS applies payments first to interest, then principal. However, we found instances where NRS credited newer accounts rather than older accounts. As a result, NRS is not currently optimizing recovery of water quality fees prior to reaching statute of limitations.

After being informed by audit staff of the requirement, NRS has revised its operating procedures to instruct collectors to apply payments to the oldest account, unless specifically requested to do otherwise by the debtor. NRS is required by the Fair Debt Practices Act to credit accounts as requested by the debtor.

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## APPENDIX A: SCOPE, METHODOLOGY AND STANDARDS

Based on the work performed during the preliminary survey and the assessment of risk, the audit covers Nationwide Recovery Services (NRS) obligations under the City's contract from July 1, 2012 to June 30, 2013. When appropriate, the scope was expanded to meet the audit objectives. Source documentation was obtained from NRS, City Court Clerk, City Treasury, and Information Services departments. Original records as well as copies were used as evidence and verified through physical examination.

To determine whether commissions are calculated and invoiced properly, we reviewed relevant laws, rules and regulations, industry benchmark studies, and conducted interviews with City and NRS personnel. We examined four months of invoices, one per quarter of the last fiscal year (September 2012, December 2012, March 2013, and June 2013) to identify instances where commissions were taken on accounts not paid in full and where incorrect commission rates were applied. We also interviewed staff at the City Court Clerk's Office to identify fees entered against court defendants. We printed examples of where the collection agency fee was passed on to court defendants as part of the referred balance. We also tested a statistically valid sample of accounts coded by NRS as subject to the higher commission rate of 27% (secondary placements) and determined that accounts were coded properly based on placement date.

To determine whether NRS is crediting partial payments according to City Code Section 2-110, we interviewed NRS staff about their payment crediting practices. We pulled a statistically valid sample of accounts with partial payments and reviewed NRS' record of transactions and credits to determine whether the accounts were credited first to oldest accounts, then newer accounts. Also, that they were posting to interest, then principal on those accounts.

To determine whether account suspensions were authorized by City personnel, we pulled a statistically valid stratified random sample of account suspensions made in fiscal year 2013. We reviewed information in INCODE (City Court database) and PTAX (City Treasury database) to ensure closures were made for cause. We interviewed City personnel in both offices and requested screen-prints from NRS to verify statements.

To determine whether NRS is pursuing collections to the fullest extent allowed by its contract, we interviewed staff at the City Attorney, City Treasurer and City Court Clerk's offices as well as NRS. We requested

reports from NRS with defined criteria to show accounts that could be recovered via litigation.

Sample sizes and selections 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 NRS system as well as INCODE and PTAX. We assessed the reliability of the data contained in the NRS 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. Data contained in the INCODE and PTAX systems were previously determined to be reliable.

We conducted this performance audit from October 2013 to December 2013 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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