



Lexington-Fayette Urban County Government

Division of Internal Audit

INTERNAL AUDIT REPORT

DATE: October 22, 2004

TO: Teresa Ann Isaac, Mayor

CC: Milton Dohoney, Chief Administrative Officer
Donna Counts, Commissioner of Finance
William O'Mara, Director of Revenue

FROM: Bruce Sahli, Director of Internal Audit

RE: Division of Revenue Front Counter Collections

Background

The Division of Revenue operates a collection office on the second floor of the Government Center. The overall objective of this office is to serve the public by providing a walk-in payment function. In that office, citizens can make payments for numerous types of fees, including licenses, parking citations, sewer user fees, landfill fees, property taxes, occupational taxes, and child support payments (generally referred to as Domestic Relations payments). In addition, other divisions within the Lexington Fayette Urban County Government (LFUCG), such as Engineering, Building Inspection, and Law, who collect fees for various purposes, also deliver those collections to this office for deposit. Revenue Division management estimates that as much as 30% of LFUCG's daily revenue collection activity occurs in this walk-in office.

Scope and Objectives

The general control objectives of the audit were to determine that:

- Payments accepted by front counter personnel are properly safeguarded prior to deposit
- Payments accepted by front counter personnel are accurately deposited on a timely basis
- Payments accepted by front counter personnel are accurately recorded and reported

Statement of Auditing Standards

We conducted our audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to afford a reasonable basis for our judgments and conclusions regarding the organization, program, activity or function under audit. An audit also includes assessments of applicable internal controls and compliance with requirements of laws and regulations when necessary to satisfy the audit objectives. We believe that our audit provides a reasonable basis for our conclusions.

Audit Opinion

In our opinion, the controls and procedures provided reasonable assurance that the general control objectives were being met. Opportunities to enhance existing controls are included in the Summary of Audit Findings.

SUMMARY OF AUDIT FINDINGS

Written Procedures Need Updating

Written procedures addressing collection recording, reporting, security, and deposit activity are several years old and need to be updated to reflect current practices. In particular, new processes that supercede the existing written procedures include credit card transactions, domestic relations collections and the related software programs, and the operation of the new cash registers. Written procedures are an important control that provides process instruction, performance standards, and a basis for measuring compliance with management expectations. A complete set of updated written procedures should be developed for the front counter collection process.

Division of Revenue Management Response: We agree that current and updated written procedures are a good business practice. Reductions in staff and turnover in the area over the past two years, along with increased assignments such as domestic relations collections, have stretched the capacity of the staff. During peak seasonal demands, writing updated procedures will be difficult. Given the time of the year, a realistic timeframe for completion of new written procedures would be August 2005.

Collection Adjustments Not Consistently Reviewed

The normal method for correcting errors made on the cash registers is to use the Return Key then re-ring the transaction into the correct category or for the correct amount. A review of the December 2003 cash register Z Tapes for evidence of collection adjustments noted 26 Returns totaling \$21,218. Examination of the support for two of the days having significant Return activity found no evidence of Return documentation or other management review. Discussions with management indicated they do not consistently receive the Return slips for review, and that printouts of re-rings (the correcting entry posted into the cash register) are not required. Returns

represent collection adjustments that will reduce the amount of cash collections reported in the registers if no correcting entry is made. It is recommended Returns be examined by management on a consistent basis to determine they are reasonable and appropriate, including an examination of applicable re-rings to ensure correcting entries are made to account for all cash collections.

Division of Revenue Management Response: Management review of collection corrections to the cash register will be incorporated in division procedures.

Collection Receipts Not Properly Controlled

Front counter collections (excluding Domestic Relations payments) are recorded on pre-numbered receipts which act as the primary document providing proof of collection activity. Although the receipts are pre-numbered, they are not issued in a manner that provides for effective sequential number control. Portions of a receipt book are issued to various personnel responsible for collection activity throughout the Division of Revenue without maintaining the integrity of the number sequence. During FY 2004 a monthly average of 32 sequence breaks were identified on collection activity reports. These breaks often represented a significant variance between the ending and beginning receipt numbers. For example, during the month of June 2004 the difference between the end of one series of sequential pre-numbered receipts and the start of another series averaged 81 receipts. It is recommended a method be established that will ensure the continuity of the receipt number sequence, thereby enabling the Division of Revenue to quickly identify any potentially missing receipts and related collections.

Division of Revenue Management Response: Issuance of pre-numbered receipts will be formalized with a sign out sheet and controlled at a single source.

Manual Domestic Relations Collections Controls Need Enhanced

The Revenue Division receives substantial amounts of over the counter payments for Domestic Relations (child support payments), often in the form of cash. When payors arrive after the 4:30 PM daily posting cutoff, payments are accepted but the transactions cannot be recorded in the Domestic Relations system until the following business day. The primary control mechanism for such transactions is a manual receipt issued to the payors with a copy retained in Revenue as proof of the transaction. These manual receipts are not pre-numbered, which limits management's ability to ensure all transactions are accounted for. It is recommended pre-numbered manual receipts be obtained to record these transactions and procedures be developed to ensure all manual transactions are posted to the Domestic Relations system on the next business day. Management should also ensure that the receipts are used sequentially with any breaks in the number sequence properly accounted for on a timely basis.

Division of Revenue Management Response: Domestic relations payments are processed and then checks are issued to dependent children the same evening. In order to meet this quick turn around, all payments received after 4:30pm are placed on the following day's business. To strengthen controls for these payments, the division of revenue will begin using pre-numbered receipts with all

receipts accounted for and reconciled. Procedures will be added to verify that transactions received each day after 4:30pm are input the next morning.

Excessive Cash in Tills

Significant amounts of cash are collected by front counter personnel on a daily basis, with cash collection amounts possibly tripling at the height of the property tax season in October and November. During the audit it was noted that one register contained \$4,265 in the till. In addition, the August 16 2004 daily reports indicated that the two front counter registers had combined cash totaling \$5,093 in their tills at the end of that day. Management stated that cash is typically removed only at the end of the day when the registers are closed out. Management also stated the registers are programmed or programmable to accept and record cash drops (the removal of cash from the till to be secured in a safe). It is recommended procedures be established to require cash drops when the till reaches a significant amount in order to provide greater security of funds. The drops should be recorded in the register and the cash removed from the till and placed in a safe until a deposit is prepared. It is also recommended that random verifications be conducted to determine that till balances are kept to a reasonable level.

Division of Revenue Management Response: The largest amounts of cash are received when experiencing a high volume of customers. These occur at the end of each month when the majority of domestic relations payments are received, at property tax deadline dates, and occupational tax deadline dates. The division will begin cash drops from the registers to the division safe each day after the mid-day peak activity, at approximately 1:30pm. This procedure will decrease the risk of cash loss and maintain customer service levels at the counter.

Cash Balancing Sheet Not Consistently Reviewed

For cash transactions other than Domestic Relations, cashiers are required to complete a Balancing Sheet at the end of each day to identify variances between collections per the cash register Z-Tape and actual cash in the till. It was determined that this report is not reviewed by management on a consistent basis. The Balancing Sheet and related Z-Tape represents the daily record of such cash collection activity occurring at the front counter. Division of Revenue management should therefore examine them for accuracy and reasonableness on a daily basis.

Division of Revenue Management Response: Review of register balancing sheets will be reviewed daily along with collection adjustments.

Cash Variances Charged to Operating Supplies

Variances occurring between recorded and actual cash collected by the front counter are charged against the Division of Revenue's Operating Supplies. It is recommended a cash over/short account be established for the Division of Revenue to record cash variances, and that the practice of applying cash variances to an unrelated expense account be discontinued.

Division of Revenue Management Response: Cash overages or shortages have been recorded to the division operating supplies account according to historical procedures. The division supports the recording of these cash variances to a cash over/short account and will work with accounting to implement.

Automated Collection Processing System Recommended

Division of Revenue front counter collection personnel process a substantial amount of payments, both in terms of the amounts received and the volume of transactions. With the exception of Domestic Relations, all such payments must be processed using an antiquated system. This system is completely manual and paper driven down to the production of hand written customer receipts, the daily balancing process, posting to accounts, etc. While the sample of collection transactions tested during the audit did not identify any processing errors, such a system is inherently more error prone than an automated collection processing system, and requires time consuming review and edit processes. It is recommended Division of Revenue management personnel purchase and install the hardware and software necessary to create an automated collection processing system.

Division of Revenue Management Response: The current cash processing procedures are dependent on a manually prepared receipt. This process requires multiple reviews by revenue, accounting, and computer services, and is open to error at each of these review points. An integrated cashiering software package, along with support hardware, would automate the cashiering process. Receipts would be computer generated, edit the proper classification of deposits at the time of the transaction, produce balancing reports, and reduce or eliminate the key punch of deposit transactions by computer services. The division of revenue has requested budget for cashiering software in the past. A government wide review of the core financial systems is planned for FY2005 and will include recommendations to address this issue.