

City of Seattle Office of City Auditor



Susan Cohen, City Auditor

To: Bill Schrier, Director and Chief Technology Officer

From: Susan Cohen 

CC: Stan Wu, Dianne Hanna, Greg Klump, John Franklin, Regina LaBelle, Doug Carey, Councilmembers, Rick Thorson

Date: August 17, 2006

Re: Review of Internal Controls Related to the Accounts Receivable System in the Department of Information Technology's (DoIT) Fiber Optics Program

In July 2005 we began an audit of external funding sources for capital projects. As part of this larger project, we examined whether DoIT had appropriate internal controls for relying on potentially unreliable funding sources for its capital projects related to DoIT's Fiber Optics Program. The Fiber Optics program relies on full and timely payments from participating external project partners.

We enjoyed working with DoIT and are appreciative of their spirit of cooperation and collaboration. We believe this resulted in a number of good findings that are helping improve the internal controls for this endeavor.

Overall Conclusions

Overall, we found the legal framework provides adequate controls to mitigate the risks that the Department of Information Technology will not obtain payment from their Fiber Program partners. However, we found internal controls related to the Fiber Program's Accounts Receivable System could be improved to support financial information accuracy, integrity, and security to ensure that the City fully bills and recovers project-related costs from their partners.

DoIT management and the DoIT Fiber Optics Team developed a detailed plan of action that responds to each audit recommendation and many actions are underway. DoIT's reply to each recommendation and status is noted in blue. OCA recommended DoIT take additional steps related to timekeeping and invoice coding to strengthen controls and will conduct a follow-up audit.

Background

DoIT and other participating government agencies share the cost of constructing and maintaining the City's fiber optics network. As the lead agency, DoIT is responsible for the project's overall management (planning, budgeting, scheduling, construction, and maintenance) as well as tracking and ensuring that all project costs are distributed to, billed to, and recovered from participating project partners.

Scope of Review

We reviewed compliance with the enabling legislation and internal controls for the Department of Information Technology's Fiber Optics Program. We sought to determine whether the controls help ensure that funds collected from partners are valid, accurate, and collected in a timely manner. We worked closely and collaboratively with DoIT staff to identify internal control concerns and develop necessary action items to address these concerns.

Methodology

Our methodology included interviews with key Fiber Optics project management and accounting personnel, documentation of key business processes and systems, review of electronic data, and review of a sample of fiber transactions from the last ten years.

Findings and Action Items Summary

We found six improvement areas and associated action items summarized as follows:

1. Overall Fiber Project Accounts Payable and Accounts Receivable Policies and Procedures, Including Processes for Project Timekeeping and Billing

The City has overarching written accounting policies and procedures, and the City Council passed a resolution and several ordinances that define the type of partner agreements, the payment criteria, and collection steps for the Fiber Optics Project. However, DoIT has not adopted formal written policies and procedures related to the DoIT Fiber Optics project management; nor are there formal DoIT policies and procedures for all Fiber accounts payable (A/P) and accounts receivable (A/R) processes. As a result, DoIT may not be fully recovering all project and project-related costs because timekeeping methods do not ensure that all billable project time is being recovered from project partners. DoIT also does not consistently bill partners on a quarterly basis, and does not account for carrying costs by charging interest on delayed payments.

Action Items:

- Create policies and procedures for A/P, A/R, project management and other related Fiber administration processes.

DoIT Response: Action Underway

- Establish a timekeeping system that accurately tracks all billable staff time for each project:

DoIT Response: Action Completed;

OCA Comments: OCA recommends additional improvements to DoIT's timekeeping system and will follow-up

- Establish a billing process that ensures all partners of active projects are consistently billed on a quarterly basis.

DoIT Response: Action Underway

- Relative to charging carrying costs to partners on delayed payments, prepare legislation that clarifies the appropriate process for retroactive billing of fiber sales.

DoIT Response: Preparing legislation

2. **Accounts Receivable System**

The procedures and processes established to transfer project data for the conversion to the Summit A/R system in Summer, 2005 did not ensure that all data were transferred accurately. Assignment of project numbers, customer numbers, and accounting codes for Fiber-related projects do not follow an established, consistent numbering protocol. There is no formal process for reviewing and reconciling multiple DoIT invoice numbering systems.

Updates to partner information (e.g. changes in address, project manager, etc.) between the Fiber Program and Accounting staff are not always communicated in a timely, accurate manner. Due to coding of fiber transactions, financial statements do not accurately reflect DoIT's financial condition. (DoIT has shown an operating loss in its financial statements for four out of the last five years. However, DoIT has not actually had an operating loss. This initial perception of a loss is due to the coding DoIT uses to record fiber transactions.)

Action Items:

- Verify that beginning balances were accurately transferred for the Summit conversion.

DoIT Response: Action Underway

- Provide adequate staff training on the new version of Summit A/R.

DoIT Response: Action Underway

- Establish protocols for assigning Summit project and customer codes.

DoIT Response: Action Underway

- Provide additional training for DoIT staff on Summit A/R system and coding protocols.

DoIT Response: Action Underway

- Gather all invoice numbering methods used for DoIT lines of business; reconcile them to invoices sent, and search for missing and duplicate invoice numbers.

DoIT Response: Action Completed

- Create a department-wide invoice numbering convention.

DoIT Response: Action Underway

- Increase communication between work units and establish a process for ensuring that both Accounting and Fiber Project management have the same, updated information.

DoIT Response: Action Underway

- Use revenue coding appropriate for an internal service fund or consult with the Fund Accountant assigned to DoIT to determine the best coding to increase financial statement transparency.

DoIT Response: Action Completed

3. Cash Receipting

The Incoming Check Log is not consistently and correctly utilized as an internal control to check the accuracy of and to log in payments received from Fiber partners. Payments received from Fiber partners are not consistently deposited in a timely manner.

Action Items:

- Establish protocols for entries in Check Log.
DoIT Response: Action Completed
- Add column in Check Log for Accounting to sign or initial receipt of check(s) when the check is picked up.
DoIT Response: Action Underway
- Ensure legibility of the date.
DoIT Response: Action Underway
- Management must ensure that the check log is properly used and that pick up, deposit and reconciliation occur in accordance with established policy.
DoIT Response: Action Completed
- DoIT management must enforce the City's cash receipting policies (deposit within 48 hours of receipt).
DoIT Response: Action Completed

4. Financial Spreadsheet

The Fiber Optics Project's current financial project management system is not adequate to ensure the accuracy, integrity, and security of its financial data. The Fiber Optics Project currently relies on one Excel spreadsheet (the "Fiber Spreadsheet") to account for all project costs (from project inception in 1996 to date) and to calculate partner invoice amounts. Additionally, the Fiber Spreadsheet is at capacity and cannot create fundamental reports.

Action Items:

- Investigate alternative project management systems that might better meet the needs of the Fiber Optics Project.
DoIT Response: Action Underway
- Controls need to be strengthened to provide better assurance that the integrity of the financial information is accurate, secure, and valid.
DoIT Response: Action Underway
- We recommend that a credit memo system be used to track adjustments to the Financial Spreadsheet. Critical components of this system would include that credit memos be pre-numbered, tracked and reconciled, and tied to the spreadsheet and Summit system.
DoIT Response: Action Underway
- Audit the Fiber Spreadsheet on a regular basis.
DoIT Response: Action Underway
- Strengthen the Fiber Project's segregation of duties by documenting and increasing management's role in verifying costs and partner invoice totals.

DoIT Response: Action Underway

- Establish a system such as an “Electronic Evidence Binder” for the Financial Spreadsheet.

DoIT Response: Action Underway

5. Project Tracking and Management of Billings and Amounts Owed; Project Closeout

DoIT does not have a system for producing invoices to partners with clear information about services provided and amounts owed. DoIT Accounting is not able to quickly verify amounts billed to Fiber Partners. A formal process for collecting past due amounts to ensure that all billed costs are recovered in a timely manner is not established. A formal closeout process is not established for the Fiber Optic Project.

Action Items:

- DoIT Accounting invoices should show the following: date; quarter and year of billing charges; invoice number; project number; customer name, number, address, and contact; amount due for each project; and total amount due.

DoIT Response: Action Underway

- Each customer should have one customer number assigned in the A/R system. Detailed coding should be established using the project, contract, and activity fields in the Summit A/R system.

DoIT Response: Action Underway

- The invoice should be the document that gives the proper coding for the payment.

DoIT Response: Action Completed;

OCA Comments: OCA recommends additional improvements and will follow-up

- Project reporting for each fiber project should be consistently completed and should contain information on project progress including the percentage completed for both the project work and the budget.

DoIT Response: Action Underway

- Consult with fiber partners regarding the information needed on invoices. Advise partner fiber managers and partner accountants on how to read the fiber bills.

DoIT Response: Action Underway

- In order to maintain the separation of duties, Accounting should be the source of answers to questions from customers about billings. To be able to do this, the billing support needs to be more transparent and user friendly.

DoIT Response: Action Underway

- Establish a collection process to ensure all billed costs are recovered within 30 days.

DoIT Response: Action Underway

- Create and communicate formal project closeout procedures that include formal project acceptance, management sign-offs, complete project documentation, and measurements of project success.

DoIT Response: Action Underway

6. Timely Collection of Amounts Owed from External Funders

The partner contracts provide good assurance for the City that most fiber costs will be recovered from external funders (i.e. fiber partners). However, the agreements do not allow DoIT to charge carrying costs for fronting the funding of the projects.

Action Item: Submit to City Council an update of Ordinance #117981 so that DoIT can charge carrying costs.

DoIT Response: Partially Completed (some carrying costs are billed and legislation is under development);

OCA Comments: Action Underway, OCA will follow-up

If you have any questions or comments, please contact me at 233-1093.