

**METROPOLITAN GOVERNMENT OF  
NASHVILLE AND DAVIDSON COUNTY**

**OFFICE OF INTERNAL AUDIT**

**Professional Audit and Advisory Service**

**AUDIT REPORT – September 10, 2008**

**Audit of the Law Department's  
Cash Handling Procedures**

Date Issued: September 10, 2008

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*The Office of Internal Audit is an independent audit agency reporting directly to the  
Metropolitan Audit Committee*

# EXECUTIVE SUMMARY

September 10, 2008

## Audit of the Law Department's Cash Handling Procedures

Results in Brief	Recommendations
<p>We performed an audit of the processes and controls in place pertaining to cash inflows at the Law Department. Key audit objectives and conclusions are as follows:</p> <ul style="list-style-type: none"><li>• Does the Law Department have policies and/or procedures in place to ensure that all cash inflows are properly and accurately received and safeguarded?</li></ul> <p>Generally yes. However, business process reviews indicated a control weakness at the initial receiving point. (See Observations A and B, page 8).</p> <ul style="list-style-type: none"><li>• Does the Law Department ensure that all cash inflows are properly deposited and entered into the accounting system in accordance to Metro policies?</li></ul> <p>Generally yes. Initial audit tests indicated instances of non-compliance. However, subsequent remedial actions executed by management were effective in correcting the problem.</p> <ul style="list-style-type: none"><li>• Does the Law Department properly account for the payments by the bankruptcy trustee and allocate them to the appropriate individual accounts?</li></ul> <p>Yes. No material weaknesses or significant issues were noted.</p> <p>Are there mechanisms in place to ensure that the Law Department receives all claim recoveries due Metro?</p> <p>Yes. No material weaknesses or significant issues were noted.</p> <ul style="list-style-type: none"><li>• Are recovery claim collection procedures adequate, aligned with Metro policies, and in line with sound business practices?</li></ul> <p>Yes. No material weaknesses or significant issues were noted.</p>	<p>Key recommendations of this report for the Metro Law Department are listed below.</p> <ul style="list-style-type: none"><li>• Develop a check receipts log that itemizes and identifies the monetary inflows into the Law Department.</li><li>• The Department of Law should institute a two-person mail opening system.</li></ul> <p>Additional observations of lesser significance, if any, were communicated to the Director of the Law Department.</p>

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## INTRODUCTION

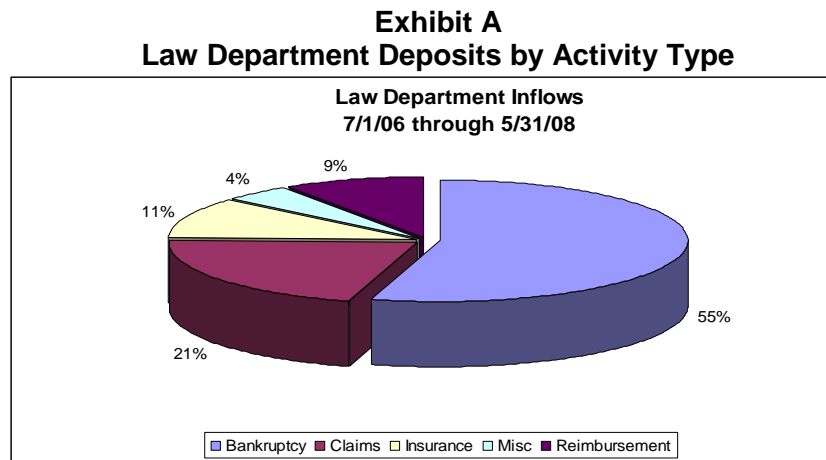
### BACKGROUND

The Department of Law was created in Article 8, Chapter 6, of the Metropolitan Charter. The responsibilities of the Department are organized into three main areas: legal services, claims, and insurance. The powers and duties of the Department as set out in the Charter or by ordinance are:

- Supervise, direct and control all the law work of the Metropolitan Government
- Furnish legal advice to the Mayor, the Council, all officers, departments, boards and commissions concerning matters related to their official powers and duties
- Represent the Metropolitan Government in all litigation
- **Collect all debts, taxes, and accounts due the government**
- Prepare or approve all written instruments including contracts, bonds, deeds, and leases
- Prepare or assist with the preparation of any proposed ordinance upon request of the mayor or any member of the council
- **Investigate and handle all claims**
- **Handle all insurance**

Metropolitan Government is self-insured for most potential losses. Therefore, the Department's work may include the review and settlement of a small claim and extend to complicated litigation carried through an entire appellate procedure. The great majority of the Department's work, both litigation and client services, is handled in-house. The functions listed in bold represent activities that include processing cash receipts. As a part of handling these cash receipts, significant cash inflows are received by the Law Department that pertain to insurance recoveries, payments to cover damages to Metro vehicles and properties, and monetary inflows from the bankruptcy trustee.

### SOURCES OF CASH INFLOWS



According to the data provided by the Finance department, total cash inflows from the Law department from July 1<sup>st</sup> 2006 through May 31<sup>st</sup> 2008 totaled

\$2,591,801. The largest source of cash inflows pertain to bankruptcy payments. Bankruptcy collections totaled \$1,409,746 representing 55% of total inflows for the period examined. A majority of the monetary inflows from bankruptcy proceedings pertain to monies sent by the bankruptcy trustee. The Law Department periodically receives payments from the bankruptcy trustee as part of property taxes due from an individual or business that has filed for Chapter 13 bankruptcy. These payments are applied to an individual account set-up for each person and the payments are subsequently deposited into a non-interest bearing account. Payments are accumulated until such time that funds in escrow are enough to cover the individual's tax deficiencies. Once enough funds are in place, a judge orders the release of the funds for resolution of the tax deficiency. It must be noted that until an individual escrow account is settled, the payments represent a liability for Metro. The account is accordingly accounted for as such by the Finance department.

Claim recovery payments are the second largest source of inflows. From the period examined, claim recoveries totaled \$550,374 and comprise 21% of the total. Monetary inflows from claims arise from subrogation, direct recovery payments from entities or individuals, and payments received from the collection agency. These payments represent monetary recoveries for damages to Metro vehicles and/or personnel, and other Metro property.

Insurance payments are another source of inflow. These represent property insurance premium payments and come mainly from two sources: the Nashville Electric System and the Metro Transit Authority. Occasionally, this fund will receive refunds from helicopter insurance as a discount when no claims are filed. Insurance premiums represented \$278,707 or 11% of total inflows for the period examined.

Reimbursements and miscellaneous inflows account for 9% and 4% of the remaining transactions respectively. Reimbursements represent payments for expenses incurred for certified mail, costs to advertise tax sales, and title searches. Reimbursements account for \$237,281 of the total transactions reviewed. Miscellaneous transactions account for the remaining \$115,693. These transactions vary from payment for copies, tip fees, subscription refunds, and reimbursements for unserved warrants.

## **PROCESSES OVER CASH INFLOWS**

There are multiple variations of the cash inflow processing procedure within the Law department. The processing procedure depends on the purpose of the payment. The procedures enumerated below only describe the general features of the cash processing procedures, steps specific to a particular transaction have been omitted.

- Bankruptcy, claim recovery, litigation, and insurance inflows are received at the Law Department
- Items received are date stamped and forwarded to the appropriate process owner
- The corresponding process owners review the amounts received for propriety prior to depositing

- A deposit slip is prepared and the payments are subsequently deposited at the bank
- Amounts deposited are posted into the Corporate Legal Management System (CLMS), the legal department's internal management system
- Amounts deposited are posted into the official accounting system Enterprise Business Solutions (EBS)
- Copies of the transaction and the deposit slip are sent to the Deputy Director for review and approval
- Copies of the approved transactions are collated and filed within the department

## **OBJECTIVES AND CONCLUSIONS**

1. *Does the Law Department have policies and/or procedures in place to ensure that all cash inflows are properly and accurately received and safeguarded?*

Generally yes. The Law Department has instituted a number of measures designed to ensure that all cash inflows are received and safeguarded. They are as follows:

- Date stamping checks as the mail is opened
- Segregation of incompatible duties for receiving, depositing, and posting payments
- Lockboxes with limited access for payments that are kept overnight
- A viable accounts receivable system in the CLMS
- Supervisory approval procedures for transactions posted into the accounting system

However, business process reviews performed by OIA indicated areas where existing controls can be enhanced to further decrease the risks associated with receiving monetary inflows. (See Observations A and B, page 8).

2. *Does the Law Department ensure that all cash inflows are properly deposited and entered into the accounting system in accordance to Metro policies?*

Generally yes. OIA randomly selected a sample of 119 deposit transactions from the bankruptcy files obtained from the Law Department These transactions represented deposits from July 2006 through May 2008. The results of the audit tests indicated that 49 transactions, from the period July 2006 through March 2007, were not deposited in a timely manner. Management became aware of this deviation in Metro policy and installed corrective action. The results of the tests indicated that this situation was indeed corrected because 70 of the remaining 119 deposits from May 2007 to the present were deposited in a timely manner.

3. *Does the Law Department properly account for the payments by the bankruptcy trustee and allocate them to the appropriate individual accounts?*

Yes. OIA traced 119, (100%), randomly selected transactions back to EBS. OIA also matched the individual deposits to the report furnished by the bankruptcy trustee. In both cases, all 119 (100%) transactions were confirmed to have been posted to the correct account.

*4. Are there mechanisms in place to ensure that the Law Department receives all claim recoveries due Metro?*

Yes. When there is an accident that involves Metro property, a claim form is filled out. If Metro is not at fault, the Claims department sends out recovery letters to the at-fault party. Within this process, the first letter request that the claimants acknowledge the accident and pay monies that is due to Metro. The second letter is a follow-up to the first letter and the last letter threatens to revoke the claimant's license.

*5. Are recovery claim collection procedures adequate, aligned with Metro policies, and in line with sound business practices?*

Yes. The practices that the Law Department uses to collect monies due to Metro are in line with departmental policies and procedures. The OIA traced 222 sample items from the CLMS data provided by the Law Department into the official accounting records, EBS, and found no material exceptions. During the process of understanding their policies and procedures, the OIA noted that their collection procedures appear to be adequate. Multiple notices and attempts are performed to collect the monies and as a last resort, a collection agency is employed for non-responsive debtors. The test-work performed by OIA showed that the estimated amounts for the damages reflected the payments that were collected respectively. Results indicated that, 163 out of 222 (73%) claims processed received payments for the exact estimated amount for damages. 54 out of 222 (24%) were sent to Professional Adjustment Service (PAS) for collections and the remaining 5 out of 222 (2%) were negotiated down with approval from the Mayor and Council.

## **OBSERVATIONS AND RECOMMENDATIONS**

### **A – Nonexistent Mail/Check Log System**

When receiving mail in the Law Department, the receptionist collects and stamps mail and distributes it accordingly. By stamping the mail, this is an indicator only that stamped mail which include checks and other payments is received in the Law Department, but does not ensure all mail received is stamped, processed, and recorded. Merely stamping mail with a date does not protect whatever payment might be inside from later removal.

#### **Criteria**

The COSO Internal Control-Integrated Framework established a common definition of internal controls, standards and criteria by which organizations can assess their internal control systems. Logging mail and checks to reduce the risk of theft is critical in ensuring an organization has established and designed a strong internal control framework.

#### **Risk**

Checks, money orders and correspondence relating to payments due to Metro may be removed before entry into the finance and accounting system.

#### **Recommendation**

The Department of Law should institute a mail and check log for all mail received. All incoming mail, other than junk mail and advertisement, should be logged in (sender, addressee, and date) and any checks inside should additionally be logged in with sender, amount, and check number. This mail and check log would provide an audit trail of transactions and decrease the likelihood that a payment will not be entered into the accounting system.

### **B – Absence of Two Person Mail Opening System**

The Law Department's mail opening system is designed with one person (receptionist or supervisor) receiving and opening the incoming mail. Incoming mail that may contain checks, money orders or correspondence relating to payments represents a significant risk area.

#### **Criteria**

The COSO Internal Control-Integrated Framework established a common definition of internal controls, standards and criteria by which organizations can assess their internal control systems. Mail that may contain negotiable instruments should be safeguarded just as cash or blank checks

### **Risk**

Mail that is delivered and opened by only one person creates a control weakness and increases the risk for potential theft since there is no protection or control to prevent immediate removal.

### **Recommendation**

The Department of Law should initiate a two-person mail opening system. This mail opening system, coupled with the mail/check log, would strengthen the control environment pertaining to cash receipts. Until such time that all mail and checks are logged on the mail and check log, two person integrity should be maintained.

## **C – Need to Implement an Electronic Funds Transfer Arrangement**

The Office of Internal Audit noted that a majority of cash receipts were received from the primary Bankruptcy Trustee. Cash handling could be more appropriately and efficiently handled if the Law Department initiated an Electronic Funds Transfer (EFT) arrangement with the Bankruptcy Trustee.

### **Criteria**

- *The COSO Internal Control- Integrated Framework* establishes a common definition of internal controls, standards, and criteria by which organizations can assess their internal control systems. Making deposits in a timely manner is critical in ensuring an organization has established and designed a strong internal control of framework. Also, making deposits enhances the control activities components of a strong internal control framework.
- *Treasury Policy #9* - states that cash receipts (deposits) should be deposited within one business day of receipts and deposits should be posted into the accounting records within two business days.

### **Risk**

Deposits not made in a timely manner increases the risk of potential theft and loss.

### **Recommendation**

The OIA believes that initiating an EFT arrangement would alleviate some of the conditions encountered during the testwork. The EFT would expedite the receipt of funds and lessen the cash handling duties within the Law Department. Lessening cash handling duties also limits opportunities for fraud and strengthens the control environment. OIA believes that this arrangement would facilitate and enhance the Law Department's ability to comply with Treasury Policy #9.

## **D – Absence of Periodic Reconciliations**

Based on interviews and process reviews performed for the Bankruptcy transactions at the Department of Law, the OIA noted that reconciliations between bank records, EBS, and CLMS are not performed on a periodic basis.

### **Criteria**

*The Committee of Sponsoring Organizations Internal Control - Integrated Framework* establishes a common definition of internal controls, standards, and criteria by which organizations can assess their internal control systems. Having periodic reconciliations of the inflows and outflows of revenue is critical in ensuring an organization has established and designed a strong internal control framework.

### **Risk**

Law Department management and staff personnel would not know the checking account balances and the presence or absence of imbalances within individual accounts.

### **Recommendation**

OIA recommends that Law Department staff perform a periodic reconciliation of the amounts that were deposited to the escrow account and the amounts that were subsequently released by the court. We also recommend that on a periodic basis staff should reconcile individual accounts within CLMS and EBS. Prudent business practice requires performing periodic reconciliations when separate computer systems share related information.

## **GENERAL AUDIT INFORMATION**

### **STATEMENT OF COMPLIANCE WITH GAGAS**

We conducted this performance audit from May to July 2008 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 observations and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our observations and conclusions based on our audit objectives. Our audit included tests of management controls that we considered necessary under the circumstances.

### **SCOPE AND METHODOLOGY**

The audit period focused primarily on the period July 1, 2006 through May 31, 2008 financial balances, transactions, and performance on the processes in place during the time of the audit.

The methodology employed throughout this audit was one of objectively reviewing various forms of documentation, including written policies and procedures, financial information and various forms of data, reports and information maintained by the Department of Law administrative office. Management, administrative and operational personnel, as well as personnel from other Metro departments and other stakeholders were interviewed, and various aspects of the Department of Law's office were directly observed.

### **CRITERIA**

In conducting this audit, the existing Law Department operations and processes over cash receipts were evaluated for compliance with:

- *Department of Finance Treasury Policy #9.*
- *The Committee of Sponsoring Organizations Internal Control-Integrated Framework*

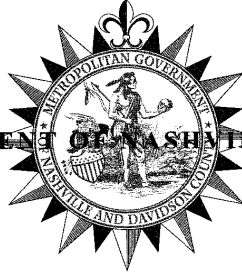
### **STAFF ACKNOWLEDGEMENT**

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## **APPENDIX A. MANAGEMENT RESPONSE**

- Management's Responses Starts on Next Page -

METROPOLITAN GOVERNMENT OF NASHVILLE AND DAVIDSON COUNTY



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September 10, 2008

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222 3<sup>rd</sup> Avenue North, Suite 401  
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RE: Department of Law -  
Cash Handling Procedures

Dear Mr. Swann:

This letter acknowledges that the Metropolitan Department of Law received the report entitled, Audit of the Law Department's Cash Handling Procedures. The Department of Law has evaluated all of the observations raised in the report. Each suggestion and corrective action has been considered. Wherever possible, changes have been or will soon be implemented. Specific concerns that prevent implementation of some recommendations are expressed in the attached response.

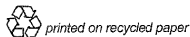
The Department of Law would like to express its appreciation for your assistance and cooperation during this process. Any improvement that this department can make toward increasing the efficiency of the Metropolitan Government is always welcomed.

Sincerely,

A handwritten signature in cursive script that reads "Sue B. Cain".

Sue B. Cain  
Director of Law

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**Law Department's  
Management Response to Audit of Cash Handling Procedures Recommendations  
September 10, 2008**

Report Item and Description	Response to Recommendation / Action Plan	Assigned Responsibility	Estimated Completion
<b>A.1</b> The Department of Law should institute a mail/check log system for all mail received.	The Department of Law is in agreement with the need for a log system for all incoming cash and checks. A process is being developed that will record these payments upon the opening of the mail.	Karen Carver, Lisa Creech, John Houston, Sharon Mayo, and Mike Safley	It is the goal of the Department for a log system to be implemented by September 15 of this year.
<b>B.1</b> The Law Department should institute a two-person mail opening system.	The Department of Law agrees that a two-person mail opening system would be desirable. However, limited staff to devote to this duty, and the lack of necessary funds to employ additional staff to perform this function, prevents implementation of this recommendation.	N/A	This recommendation will not be completed.
<b>C.1</b> OIA recommends that the Law Department initiate an Electronic Funds Transfer procedure with the Bankruptcy Trustee.	The Department of Law contacted the Chapter 13 Trustee's office concerning this suggestion. We were informed that, at least at the current time, such a process is not offered by the Trustee.	N/A	Until such time as the Chapter 13 Trustee's Office provides this service, this recommendation will not be completed.
<b>D.1</b> OIA recommends that Law Department staff perform a periodic reconciliation of the amounts that were deposited to the escrow account and the amounts that were subsequently released by the court. We also recommend that on a periodic basis staff should reconcile individual accounts within CLMS and EBS.	The Department of Law agrees that the recommended periodic reconciliations should be conducted. A reconciliation of the bankruptcy escrow account is currently being performed. To facilitate the reconciliation of individual accounts within CLMS and EBS, a request has been made to the Finance Department to create a new bankruptcy escrow account. The Finance Department has agreed to this request.	Karen Carver, Lisa Creech, Melissa Milleman and Mike Safley	This recommendation is already being implemented.