

GOVERNMENT OF THE DISTRICT OF COLUMBIA
Office of the Chief Financial Officer



Office of Integrity and Oversight

MEMORANDUM

TO: Stephen Cordi, Deputy Chief Financial Officer
Office of Tax and Revenue

FROM: Robert G. Andary, Executive Director
Office of Integrity and Oversight

DATE: May 29, 2009

SUBJECT: Management Alert: Internal Control Weaknesses Identified in OTR's Processing of Receipts from the Collections Division's Post Office Box (IA:OTR:2907:C12(1))

The Office of Integrity and Oversight (OIO) is currently performing a review of the Office of Tax and Revenue (OTR) Compliance Administration Collections Division's (CD's) monthly collections data reported for the period October 1, 2005 through October 31, 2008. As part of this review, we conducted a "walk-through" of the collections receipts process within CD. In our walkthrough, we identified several weaknesses in the system of internal controls for the processing of receipts by CD. This management alert provides our findings and four recommendations to improve the system of internal control for these receipts.

OIO determined that CD did not have functioning internal controls to safeguard the receipts from the CD Post Office Box (POB). Further, controls were not in place to assure that the revenue officers (ROs) and tax examiners (TEs) processed POB receipts in compliance with the Office of the Chief Financial Officer's (OCFO's) policy of two days from the date of receipt of the funds.

Background

CD maintains a separate POB from that of the Returns Processing Administration (RPA) to collect tax receipts from individuals who have: (i) been referred to CD for delinquent payment of taxes,¹ and (ii) assigned to a specific RO or TE for collection action. Further, the POB takes in receipts from those taxpayers whose delinquent accounts have been assigned to a debt collector, under contract with CD. Additionally, the POB provides a location for taxpayers to mail correspondence to CD or a specific RO or TE.

The CD asserts that the POB allows them to better track the progress of their collection efforts, as a whole, and the collection efforts of a specific RO or TE. They further assert that the POB allows them to ensure that the funds received are identified as collections and credited to the proper taxpayer account, in cases where a taxpayer has multiple delinquent accounts. Furthermore, CD asserts by having the RO or

¹ The term tax, for this memorandum, does not include taxes on real property; which are processed through the Real Property Tax Administration.

TE complete the payment posting voucher (PPV) this reduces the time necessary to process individual payments within RPA, as the research work is already done and the RO or TE identified the proper account(s) for crediting.

The POB is the largest single receipt point for collections. With the exception of late returns CD asserts that the majority of the delinquent tax receipts come through the POB.

Absence of Controls for POB Receipts

OIO found the absence of a functional system of internal controls and procedures for the in-coming receipts and tracking of tax payments received through the POB. Taxpayer payments were not separately identified and tracked until the RO or TE delivered the payment to RPA for processing. We found that there was no system in place to ensure that all payments received on a specific date were distributed to the collection teams, processed as a contractor collection, or referred to a team or specific individual for resolution of a payment issue or question.

A sole clerical assistant (CA) is responsible for the pickup of the mail receipts, sorting and delivering those receipts to the respective collection teams, and processing the payments generated by the CD debt collection contractors. This function is rotated on a weekly basis among the CA's assigned to the Collections Division.

The current system does not follow the receipts from collection at the post office through final processing in the integrated tax system (ITS). Envelopes containing potential receipts are not logged or opened to: (i) determine whether they contain taxpayers' receipts, and (ii) the amount of the receipts. CD does not restrictively endorse checks² as they are received. Instead the checks are not endorsed until they reach RPA for processing. The current process may require the check to pass through five different individuals before it is endorsed and tracked in RPA. This significantly increases the chances for the payment to be lost, manipulated, or diverted by a number of different individuals. The current system does not provide accountability for the receipts, and the only individuals that CD can reasonably assure were involved in the processing, are the CAs who sort and distribute the receipts from the POB.

Internal controls over cash receipts are fundamental to management's accountability over cash and a basic requirement to "best practices" of management oversight. Without controls in this area, an organization's management has no assurance that it is receiving all of the payments directed to it. The U.S. Government Accountability Office (GAO), in its publication *Internal Control Standards in the Federal Government (Standards)*, discusses the objectives of a system of internal controls. They state in part:³

"A subset of these objectives is the safeguarding of assets. Internal control should be designed to provide reasonable assurance regarding the prevention of or prompt detection of unauthorized acquisition, use, or disposition of agency's assets."

GAO also addresses the issue of controls for vulnerable assets in stating that:⁴

² The term checks for the purposes of this memorandum include personal and business checks, money orders, cashier and treasurer's checks, certified checks and other negotiable instruments. It does not include payments made in currency and coin.

³ U.S. Government Accountability Office, formerly the U.S. General Accounting Office; *Internal Control Standards for the Federal Government*; Report Number: GAO/AIMD-00.21.3.1; November 1999, page 5.

⁴ Ibid; page 15.

"Access to resources and records should be limited to authorized individuals, and accountability for their custody and use should be assigned and maintained. Periodic comparison of resources with the recorded accountability should be made to help reduce the risk of errors, fraud, misuse, or unauthorized alteration."

Based on the system in place in May 2009, CD cannot provide a reasonable assurance that all POB receipts are properly safeguarded, that the ROs and TEs process the receipts provided to them in accordance with OCFO policy, and that all other receipts received through the POB are processed timely. We found a more than remote possibility that payments could be lost, or manipulated with only a very limited possibility of detection by another CD employee.

The following describes the weaknesses we noted during our "walk-through" of the POB receipts process:

1. Absence of Documentation to Support the Controls of Taxpayer Receipts

OIO found that CD does not effectively document its POB receipts until the RO or TE sends the individual receipt and payment to RPA for processing. As noted before, this may take several days and the payment may pass through as many as five individuals without documentation. Only the CA who is responsible for the sorting and delivering of mail can be definitively determined, through the CD assignment sheet. The current CD process relies on the veracity of the individuals who receive the payments and the subsequent timely processing of those payments. The current practices provide more than a remote opportunity for payments to be lost, delayed in processing, or intentionally diverted.

The CA is not required to enter the payment data into a paper or electronic log or to identify specific payments that are sent to ROs and TEs within the various teams. This entire process is generally done solely by the individual CA with limited oversight. Sole responsibility for assuring that all POB receipts received that day are processed by the close of their tour of duty.

Once the mail has been delivered to the CA who supports the specific collection teams, the CA distributes the mail to the respective individual RO or TE for processing and preparation of a PPV for the payment they received. The RO or TE may make copies of the payments received and the resulting PPV for their records; however, this is not required by CD. The RO or TE may return the check and PPV to the CA or deliver it directly to RPA for processing. The only records maintained to this point are those voluntary records held by the individual RO or TE for the delinquent accounts they have been assigned. Further, until the receipt is entered into ITS by RPA, there is no formal record of the payment.

A basic tenet of a functional system of internal control for taxpayer checks is that control and tracking of the checks be established as soon as feasible and that controls for the handling and processing of the receipts be documented throughout the process. These controls provide an accountability trail of the individual(s) responsible for processing the receipt and provide a reasonable assurance of the time it takes to process an individual receipt. Accountability for payments is a critical component of any internal control system for cash receipts. Further, restricting access to the payments and the processing for those payments minimizes the chances for inadvertent or intentional loss of the payment or errors identifying the payment and the correct account to which it should be charged.

2. *Inadequate Separation of Duties*

OIO notes that the duties for processing the payments received from the POB rests solely with the CA who picks up the mail. Currently, a CA from CD is assigned on a weekly basis to:

- pick-up the mail from the POB;
- sort the mail for processing by the collection teams;
- deliver the sorted mail to the CA who supports the specific collection team;
- open the mail whose destination cannot be determined from the envelope and sort the mail to the appropriate collection team;
- open the mail from collection accounts, prepare PPVs for the payments received from taxpayers, and deliver the payments to RPA for processing; and
- resolve, with a supervisor, any questions regarding to whom a payment or correspondence should be referred.

It appears that no other individual verifies that all the payments received during a specific day have been appropriately distributed or that the PPVs are prepared. When a large number of payments are received, it appears that the CA is responsible for notifying a supervisor and requesting assistance to process the payments. The current process places almost exclusive reliance on the CA and does not account for errors in the processing of the mail which may significantly delay the processing of a taxpayer's payment. Further, the process does not provide reasonable assurance that all the payments received have been processed.

Separation of duties is a critical component of any system of internal control. GAO in its *Standards* publication states⁵:

"Key duties and responsibilities need to be divided or segregated among different people to reduce the risk of error or fraud. This should include separating the responsibilities for authorizing transactions, processing and recording them, reviewing the transactions, and handling any related assets. No one individual should control all key aspects of a transaction or event."

By separating duties CD management can provide reasonable assurance that all payments received through the POB are initially recorded and distributed to the collection teams for further processing. The separation allows for the responsibility for sorting and processing payments over a number of individuals, effectively spreading the workload among several individuals and not placing it solely in the hands of a single individual.

3. *Restrictive Endorsement of Taxpayer's Payments*

CD's POB receipt processing does not require the restrictive endorsement of a taxpayer's payment upon receipt. OIO found that payments were not endorsed until the check was processed by RPA in some cases this could be several days later. As we previously stated, a payment received through the POB may pass through up to five individuals without being restrictively endorsed. This process increases the potential for the check to be negotiated by an individual, who is not authorized to do so, and increases the possibility that should a check be lost or misplaced it could be negotiated by an unauthorized individual.

⁵ Ibid: page 14.

One of the fundamental principles of a sound system of internal controls is to protect vulnerable assets from unauthorized use or manipulation, or being unaccounted for. Placing restrictive endorsements on individual checks limits the ability of an individual to improperly negotiate a payment.

Recommendations

We recommend that the Director of the Compliance Administration implement the following recommendations to establish a reliable system of internal controls over OTR's POB receipts:

1. Develop a system that tracks the taxpayer's payments from the initial receipt from the POB through turning over the checks and related PPV to the RPA for processing. This system should provide for a separation of duties so that no single individual can control the entire transaction stream.
2. Develop a database or spreadsheet application to log receipts from the POB. This application should contain fields to capture the (i) taxpayer's name, (ii) taxpayer identification number or account number, (iii) the specific account that the payment is to be credited to, (iv) amount of the payment; (v) date the payment was received; and (vi) the RO, TE, or team to whom the payment was given.
3. Require that the CA sorting the mail from the POB to enter the payments into the database spreadsheet as the mail is being sorted.
4. Require that all checks be restrictively endorsed at the point of initial receipt by the CA processing the POB receipts.

Please provide a response to this Management Alert within fifteen (15) business days of receipt of this memorandum report. If you have any questions, please contact Mohamad Yusuff, Internal Audit Director at 442-8240, or Tisha Edwards, Audit Manager, at 478-9143.

cc: Glen Groff, Director of Operations, OTR
Bedell Terry, Director of Compliance, OTR
Portia Perry, Chief of Collections, OTR
Mohamad Yusuff, Internal Audit Director, OIO
Nelson Alli, Senior Manager, OIO
Tisha Edwards, Audit Manager, OIO