

**MIDLOTHIAN AUDIT SERVICES  
INTERNAL AUDIT REPORT**



**Subject:** Accounts Receivable

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(s95 officer)  
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## EXECUTIVE SUMMARY

### 1 Objective of the Audit

At the request of the Corporate Management Team, in 2012 Internal Audit undertook a consultative exercise to review the processes and controls within the Council's accounts receivable system. The report resulted in fourteen recommendations and was submitted to the Corporate Management Team in May 2012. The recommendations of the 2012 accounts receivable report were deliberately kept at a high level so management could tailor these to fit their individual service requirements.

The objective of this review was to determine the extent to which these recommendations have been adopted and to review the adequacy of any locally agreed actions.

### 2 Remit and Scope

The review focused on:

- the extent to which Internal Audit's previous recommendations have been adopted; and
- the adequacy of any locally agreed actions arising out of the previous recommendations made by Internal Audit.

#### Excluded from Scope

This was not a full audit of the accounts receivable system. Testing was limited to the remit and scope outlined above.

### 3. Background

A number of services within Midlothian Council charge for the services that they provide. These services are wide in nature and include: property repairs; care at home costs; residential costs; non domestic waste uplifts; Bonnyrigg District Heating Scheme; garden maintenance costs and rental charges for commercial property. The system is also used to recover business loan repayments.

The total collected through the accounts receivable system since the beginning of the current financial year (2013/14) year to the end of October 2013 amounts to £9.4M. As at the end of October 2013, the total debt outstanding was £3.27M with £1.832M outstanding for more than one year.

Two attachments are included at the end of this report for information:

- appendix 1 provides a split of the current debtors by directorate; and
- appendix 2 provides a summary of the debt outstanding by calendar year.

Services across the Council are responsible for raising invoices on the accounts receivable system following the supply of the service while the Control Team, located within Revenues, provides the system support and trains new users on how to raise invoices through the system.

If customers fail to pay the amounts due, standard letters are dispatched by the Control team on a pre-agreed cycle and where this fails to recover, cases are normally transferred to debt collectors.

A User Group has been re-established for accounts receivable debt which is chaired by the Arrears Controller, Customer Services and includes representatives from services across the Council. The group hold quarterly meetings and have arranged training for group members. The user group has also discussed accounts receivable updates submitted to the Corporate Management Team by the Head of Customer Services.

#### **4 Audit Conclusion**

The previous Internal Audit review noted that sundry debt arrears as at November 2011 was £2.78M while £1.66M of this debt was 12 months or more overdue. The report proposed a number of actions to attempt to improve on this level of outstanding debt including:

- allocation of appropriate resource to manage collection;
- devise local strategies to improve collection of aged debt;
- develop performance indicators and set target collection levels on sundry debt;
- report quarterly to CMT and the Performance Review and Scrutiny Committee on performance against collection targets; and
- improve the functionality of the current collection system to allow, for example, improved management of cases on hold, diary facilities etc.

Testing by Internal Audit identified:

- that not all the recommendations suggested by Internal Audit had been fully adopted; and
- outstanding debt as at the end of October 2013 and the debt outstanding over 12 months have increased to £3.270M and £1.83M representing a 10% and 9% increase respectively from 2011. This increase has arisen despite write offs during the period of approximately £322K.

We believe that there is a need for senior management to review the resourcing and accountability of accounts receivable as well as the current operational controls. We have raised a number of possible ways in which performance can be improved. Management need to take action to improve the collection performance. Upfront payment should always be the preferred option and where this is not possible services should be terminated for customers who do not pay to prevent future debts occurring (note - this may not be possible in some areas due to statutory requirements).

We are aware that there is an Income Maximisation Collections Review proposed as part of the business transformation programme which could be used to drive improvements in collection performance. However, management would need to be clear on time frames since we believe that the increase in debtors needs to be addressed within reasonable timescales. Adequate resource and performance reporting would also be required along with a senior manager to champion the review.

A number of these recommendations impact on Council policy. Where these actions are agreed they would need to be ratified by Cabinet.

As is normal Internal Audit practice, we have not rated this audit as it is a follow up of a previous review.

Internal Audit plans to undertake a full review of Accounts Receivable in Q3, 2014/15.

## MANAGEMENT ACTION PLAN

### Collection of Debt

Because of the current economic climate, many customers are under increasing financial pressure and as a consequence, there is a need for the Council to review its collection methods and supporting systems to try and maximise collection rates.

We are of the opinion that the following areas are key to improving collection performance.

### Allocation of Responsibility

Currently each section within the Council has responsibility for collection of their own debt with support being provided by the Arrears and Control teams within Revenues. There is however a lack of strategic direction, oversight and direct accountability across the Council to drive improvements in collection performance. It is therefore recommended that a Senior Officer within the Council is allocated responsibility for accounts receivable to improve collection performance and champion cultural change within the Council.

No	Recommendation	Priority	Manager	Target Date
1	<p>The Corporate Management Team should allocate responsibility for accounts receivable to a senior Council Officer. This individual should be tasked with driving improvements in collection and be measured on actual collection performance.</p> <p><u>Management Comment</u> Agreed. This task has been allocated to the Resources Directorate and a full scoping exercise is to be undertaken. Provisional dates have been allocated against the actions raised in the remainder of the report and these will be revisited after the scoping exercise is complete.</p>	High	Director, Resources	Complete

### Allocation of Staff Resource

The teams which currently raise invoices are often tasked with debt collection. Whilst the rationale for this is sound in that these sections have knowledge of their customers, teams have reported that they do not have sufficient resource to devote to collections and that they lack the necessary expertise in collections.

Consequently, there may be little or no personal interaction with the customer at the early stages of arrears and therefore opportunities for early collection are missed. Similarly there is a lack of regular communication with the debt collectors following transfer of cases and there is often uncertainty on the action to take when the debt collector returns cases to the Council where they have been unsuccessful in collection.

No	Recommendation	Priority	Manager	Target Date
2	In order to strengthen collection activity, Internal Audit recommends allocating specialist collectors to support the directorates who would report and be accountable to the officer responsible for the collection of the Council's sundry debt.	High	Director, Resources	31/10/14

No	Recommendation	Priority	Manager	Target Date
	<p>Duties of the collectors could include working with the directorates to: review the quality of invoicing; review opportunities to bill up front; contact customers where there is early default; categorise debt into types to drive collection strategy (for example those where future supplies may be prevented until payment is received); identify and liaise with existing points of contact with the debtor from within the Council who may be able to assist with collection; build working relationships with debt collectors and jointly review collection strategies; develop and produce management information on debtors and collection performance; and train and develop the collections skill base within existing teams. The collectors could, in addition, work closely with the Arrears team where debt is proving challenging to collect.</p> <p>These individuals would be key members of the Accounts Receivable User Group to allow dissemination of best practice across the Council. These duties could be built into the work related objectives and competencies of staff appointed to these roles with target collection figures established.</p>			

### Improving levels of collection

A number of steps could be taken to try and improve upon collections rates as follows:

No	Recommendation	Priority	Manager	Target Date
3	A program of work needs to be put in place to review services supplied by the Council and where possible require payment before supply of the service.	High	Director, Resources	31/10/14
4	For the remaining services, review the feasibility of requiring payment within 7 days rather than allowing 28 days credit. Limited research by Internal Audit has identified a number of Councils who have adopted this policy. This may require consultation and equality issues to be fully considered.	High	System Group Leader, Customer and Housing Services	Complete
5	Where possible, require services to identify and stop the provision of service where a customer is failing to pay to prevent the build up of debt.	High	Director, Resources	31/10/14
6	Consider including a statement on invoices to commercial organisations (businesses and other public sector organisations) that under the Late Payment of Commercial Debts Act 2013, the Council has the right to charge interest where	Medium	Director, Resources	31/10/14

No	Recommendation	Priority	Manager	Target Date
	<p>payment is late and to obtain compensation for recovery of costs where the Council incurs additional charges through having to employ debt collectors.</p> <p>Thereafter a cost benefit analysis should be undertaken to determine the potential financial advantage of charging penalties against the additional costs of administration, system re-design and the likelihood of recovery.</p>			
7	<p>Debtors who are having difficulty in meeting payments need to be made aware of the option to enter into payment arrangements with the Council.</p> <p>For example, the Council's website (under 'pay for it' which outlines methods for sundry debtors to pay) and other forms of communication (eg leaflets, notices etc) could be updated to include the Council's invoicing policy i.e. that the Council may agree to an arrangement for payment of debt. The website and communication leaflets should also provide relevant contact details to allow the customer to apply for this facility.</p>	High	Director, Resources	31/10/14

### 'Good Debtors'

Where Midlothian Council is owed money from perceived 'good debtors' for example other Councils and other public sector organisations, this debt is classed as relatively easy to collect. This is because the expectation is that money owed will eventually be recovered.

An analysis by Internal Audit of these 'good debtors' showed that there is material aged debt. For example, as at October 2013 there was circa £344K which had been outstanding for more than 1 year. These cases are not currently referred to the debt collector nor is there a Council-wide policy on how these debts should be pursued.

No	Recommendation	Priority	Manager	Target Date
8	<p>A Council wide strategy, policy and procedure should be developed for debt which is classed as 'good'. This could include, for example, a single point of contact to be established, the use of existing debt management arrangements and the offsetting of debts against credits where this is allowable under relevant legislation or through agreement with the third party.</p>	High	Director, Resources	31/10/14

### Management Reporting

Following adoption of previous Internal Audit recommendations, there has been reporting to the Corporate Management Team (CMT) on accounts receivable collection performance. This has provided an aged debt analysis by directorate and service.

There has also been specific reporting on areas of concern (for example use of 'holds' and aged debt).

Whilst this represents good progress, regular reports have not been provided to the Performance Review and Scrutiny Committee and, reporting to CMT has not been quarterly. Internal Audit believes that fuller and wider reporting is required with targets established to drive performance improvement. The Director, Resources has already commenced a review on how reporting can be improved including how invoices can be more clearly linked to responsible managers and services.

No	Recommendation	Priority	Manager	Target Date
9	<p>Internal Audit would therefore recommend:</p> <ul style="list-style-type: none"> <li>performance indicators be developed for accounts receivable; and</li> <li>that these performance indicators be regularly reported to CMT and the Performance Review and Scrutiny Committee.</li> </ul>	High	Director, Resources	31/10/14

### Financial Directives

The Financial Directives provide guides on income collection and include sections on accounts receivable. However these lack detail and do not always reflect current practice.

For example:

- they do not provide expectations at the key collections points (early, mid and late arrears);
- they do not detail the standards for invoicing (days from point of service to issue of invoice; the need to ensure that the correct business or person is invoiced; the correct postal address is obtained; purchase order number is obtained; provide a full description of the goods or services supplied; record name and contact details of the individual raising the order; check the accuracy of the invoice and that VAT is correctly treated and the service has been supplied). A naming convention also needs to be developed (for example use of first initial or surname first so that total exposure with a single customer is easy to identify). Some of this detail is contained within the Roles and Responsibilities Documentation available to Sundry Debt User Group, however there is a need to build this into the Financial Directives which provide the governance model for the financial affairs of the Council;
- they do not note that the raising of an invoice has the effect of lending Council money and where the invoice amount / service provided is significant the need to vet the customer prior to supply. For example credit searches (with permission of the debtor), the need to establish credit limits, requirement for references and the need to obtain proof of address etc; and
- the need to have a quality assurance process in place to check on the quality of invoicing and robustness of the collection process including application of required segregation of duties.

It was noted that reference is made to an "Accounts Receivable Recovery and Write Off Procedure" within the Financial Directives however there is no link to say where this



document can be found and it is not currently located under “Finance – Frequently Asked Questions”.

No	Recommendation	Priority	Manager	Target Date
10	Updates to the Financial directives should be made in relation to the polices and procedures for accounts receivable.	Medium	Director, Resources	31/10/14

### Collection System

Although the Accounts Receivable System is used to support the collection activity, there are limitations with its use within the Council and therefore it is not providing a fully effective support system for collection staff.

Weaknesses identified include the following:

- where a new debtor is updated to the Accounts Receivable System, certain key fields are not mandatory requirements (for example contact name / contact details) which may reduce the standard of invoicing. Without these details, recovering debt becomes more challenging;
- Revenues Control Team established instalment profiles which allows services to recover debt and set up repayment arrangements. However, there is no automated reporting on broken arrangements which would allow early contact with the debtor;
- the Accounts Receivable system allows users to place a hold on an account where, for example, there is a disputed invoice. Although an expiry date is input as part of this process, there is no flag where this is about to expire or has expired and therefore cases may not be passed out to debt collectors or followed up;
- the Accounts Receivable system allows users to update notes to the system and has a diary facility. However, it was noted that some users were not using the diary system on the system but instead retaining records in manual files etc. This increases the difficulty in providing a full audit trail of each case when communicating with debt collectors. It was reported that the diary facility is not used as there is no prompt to the user on the diary due date. An improved diary facility is available from the software provider but is chargeable; and
- there is a field on the Accounts Receivable system which allows the user to record the date that the service was provided as well as the invoice date. It was noted that not all services are using this date and consequently delays in invoicing are not being highlighted and reported.

No	Recommendation	Priority	Manager	Target Date
11	It is recommended that management put forward bid enhancement requests to the Product Enhancement Group to add additional functionality to the current software to allow: <ul style="list-style-type: none"> <li>• the use of mandatory fields such as the date of supply field and contact name details;</li> <li>• flagging of broken arrangements;</li> <li>• improved facilities for the diary system; and</li> <li>• improved management of ‘holds’ (this could include reducing the number of staff who can put a case on hold).</li> </ul>	High	Director, Resources	31/10/14

No	Recommendation	Priority	Manager	Target Date
	Regular quality assurance checks should be introduced to ensure that the system is used to its best advantage.			

#### Writing-off bad debt

Individuals working within the Arrears section of Revenues have the systems ability to write debts off on the system. However, there is no independent reconciliation of totals written off on the system to authorised forms to identify any instances where debt has been written-off without authority.

No	Recommendation	Priority	Manager	Target Date
12	It is recommended that regular reconciliations between amounts written off on the system to control totals on authorised forms be undertaken by an individual who does not have system access to write off balances on the Accounts Receivable System.	Medium	Arrears Controller, Customer and Housing Services	Complete

#### Segregation of duties and the authorised signatory system

Currently, although the authorised signatory system list those staff who are authorised to process credit notes, this is not system enforced and there is no routine quality control to identify whether the credit note has been raised for a genuine reason. Staff with this authority could therefore reverse a Council invoice inappropriately, effectively writing off the debt.

Also, the authorised signatory system does not detail those staff authorised to approve a re-schedule of debt with the debtor where they cannot meet current debt payments.

No	Recommendation	Priority	Manager	Target Date
13	Ideally the Accounts Receivable system should require two individuals to authorise a credit note. If this is not currently possible within the system, sample checking should be undertaken to validate the reason for the credit note by individuals who do not have this authority. Authority to raise credit notes could in addition be restricted to a small number of staff.	Medium	System Group Leader, Customer and Housing Services	31/05/14
14	List on the authorised signatory system those authorised to accept payment arrangements on the instalment profile where the customer cannot meet current commitments.	Medium	Director, Resources	31/10/14

### Sundry Debtor Group

Although there is a Roles and Responsibilities Document for the Sundry Debtor User Group, it does not state those individuals expected to attend, the need to send deputies and the required frequency of meetings.

No	Recommendation	Priority	Manager	Target Date
15	The Roles and Responsibilities Document for the Sundry Debtor User Group should be updated to include those individuals expected to attend, the need to send deputies and the required frequency of meetings.	Medium	Arrears Controller, Customer and Housing Services	31/05/14

### Service risk registers

Risk registers are maintained by all operational areas across the Council to flag risks, record controls and highlight where risk appetite is exceeded. Directorates have highlighted problems with income collection to Internal Audit but this was not always clear on each risk register.

No	Recommendation	Priority	Manager	Target Date
16	All services should include a risk within their register detailing the specific problems they are having with regards to income collection, debt recovery and the key controls they have to reduce the risk and improve collection performance.	Medium	Heads of Service	30/06/14

## APPENDIX 1

### Value of Outstanding Debt per Directorate

DIV	As at Dec 11			As at Mar 12			As at Mar 13			As at Oct 13		
	No	£M	%	No	£M	%	No	£M	%	No	£M	%
R (a)	2680	1.067	38	2930	2.082	55	2632	1.573	51	3071	1.430	44
ECE	611	0.172	6	559	0.138	4	652	0.215	7	635	0.142	4
C W	3463	1.540	56	3336	1.568	41	2849	1.296	42	4124	1.698	52
<b>Total</b>	<b>6754</b>	<b>2.770</b>	100	<b>6825</b>	<b>3.788</b>	100	<b>6133</b>	<b>3.084</b>	100	<b>7830</b>	<b>3.270</b>	100

Note (a) – Planning and Development and Customer Services arrears figures are reported under Resources (previous Council structure).

R – Resources

ECE – Education Communities and Economy

CW – Communities and Well Being

## APPENDIX 2

### Value of Outstanding Debt per Calendar Year

Year	Number Invoices	Balance (£)	Average (£)
1997	16	34,205	2,138
1998	8	41,313	5,164
1999	7	10,379	1,483
2000	9	7,861	909
2001	6	3,634	1,137
2002	24	26,284	1,095
2003	48	93,931	1,957
2004	56	79,019	1,411
2005	113	55,477	491
2006	137	98,013	715
2007	148	179,381	1,212
2008	136	85,710	630
2009	254	224,509	884
2010	647	356,232	551
2011	1090	290,622	267
2012	1608	447,727	278
At end of 31/10/13	3529	1,236,119	350
<b>Total</b>	<b>7830</b>	<b>3,270,415</b>	<b>418</b>