

City of Philadelphia
OFFICE OF THE INSPECTOR GENERAL



POLICY RECOMMENDATION REPORT
Processing of Returned Checks

March 25, 2013

POLICY RECOMMENDATION REPORT

Processing of Returned Checks

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I. INTRODUCTION

At the request of the City of Philadelphia (“City”) Department of Revenue (“Revenue”), the Office of the Inspector General (“OIG”) conducted an evaluation of the City’s processing of checks that were returned from the bank due to unsuccessful negotiation. At the outset, this investigation addressed only those returned checks initially submitted as payment for various Department of Licenses & Inspections (“L&I”) services and liabilities. After discovering significant discrepancies, the OIG expanded the scope of the evaluation to include the following City departments:

- Department of Licenses & Inspections
- Department of Public Health
- Department of Public Property
- Department of Streets
- Department of Records
- Housing & Code Enforcement Unit, Law Department
- Police Department
- Department of Procurement
- Office of Special Events, Managing Director’s Office
- Division of Animal Care & Control Services, Department of Public Health
- Employee Benefits Unit, Office of Human Resources

This evaluation focused only on a one-year period and is limited in scope to include only the above listed departments. As such, this evaluation does not address the City’s processing of returned checks that were initially submitted for services and liabilities associated with either the Department of Revenue or the Water Revenue Bureau.

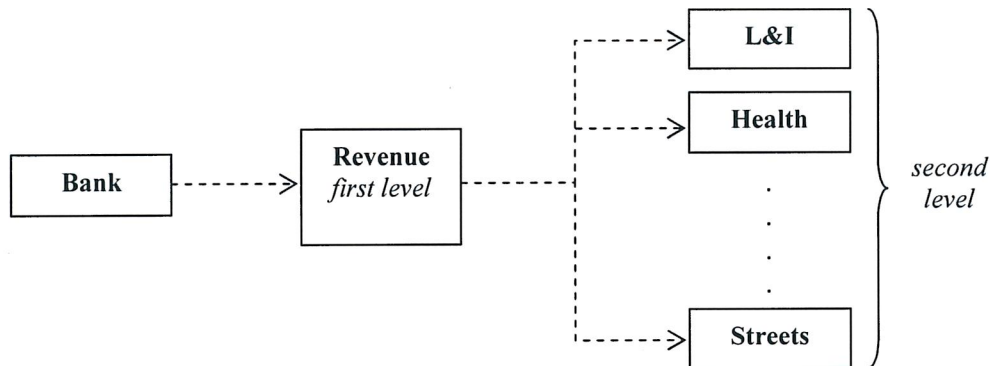
Between June 2011 and June 2012, the City failed to adequately address \$573,777.71 in returned checks and fees that the Bank Return Items Unit of the Revenue Department forwarded to individual City agencies for further action. This shortfall has resulted in a significant amount of uncollected revenue and is a direct consequence of: *(i)* poor inter-departmental communication and coordination; *(ii)* ineffective and inconsistent collection procedures; *(iii)* potential accounting inaccuracies; *(iv)* excessive administrative and transaction costs; and *(v)* reverse incentives for repeat offenders. Due to inconsistent record-keeping, unclear procedures and defective execution, the full scope of the loss remains in question. However, given the nature of the transactions at issue and the clear lack of adequate collection procedures, it is estimated that the City’s deficient processing of returned checks has resulted in approximately \$346,837.46 to \$511,134.99 of lost revenue per year.

This report substantiates the need for direct policies and initiatives designed to realize additional revenue, minimize the potential for financial loss and prevent others from taking advantage of a problem that has not been given the priority that it deserves. The OIG recommends improvement in every phase of the process, including: *(i)* improved check-screening procedures; *(ii)* stronger and more consistent collection efforts; *(iii)* enhanced inter-departmental communication; and *(iv)* back-end enforcement to aggressively pursue repeat offenders and increase deterrents. In addition, because the consequences of these failures could extend beyond the scope of this evaluation, the OIG recommends a comprehensive financial and programmatic audit of the Bank Return Items Unit of the Revenue Department.

II. BACKGROUND

On a daily basis, taxpayers and customers submit hundreds of checks as payment for a variety of City services, operations and fees. If the City’s bank is unable to deposit a check for some reason (account closed, insufficient funds, etc.), it is returned to the Revenue Department’s Bank Return Items Unit. This unit makes some initial collection efforts, and if these prove unsuccessful, the checks are forwarded to the individual City departments and agencies that held the initial liabilities. Following this transfer, the Revenue Department is not involved and the individual departments are responsible for all collection and record-keeping tasks.

Flow of Returned Checks



Part A of this section (“First Level”) presents the Revenue Department’s procedures with regard to returned checks. **Part B** of this section (“Second Level”) addresses the individual departments’ treatment of the returned checks, following transfer from the Revenue Department.

A. First Level: Revenue Department, Bank Return Items Unit

All the personal checks that are submitted to the City as payment for various municipal liabilities are first processed by a cashier and then transported to the bank for deposit. If the bank is unable to deposit a particular check for some reason, the City is charged a fee and the check is eventually returned to the City via mail. Periodically, all the checks that were not successfully negotiated are mailed first to the Water Revenue Bureau (“Water Revenue”), where the checks submitted as payment for water bills are removed and processed accordingly. The remaining checks, all those that were submitted to the City as payment for other bills, are then sent to the Revenue Department’s Bank Return Items Unit (“BRI Unit”).

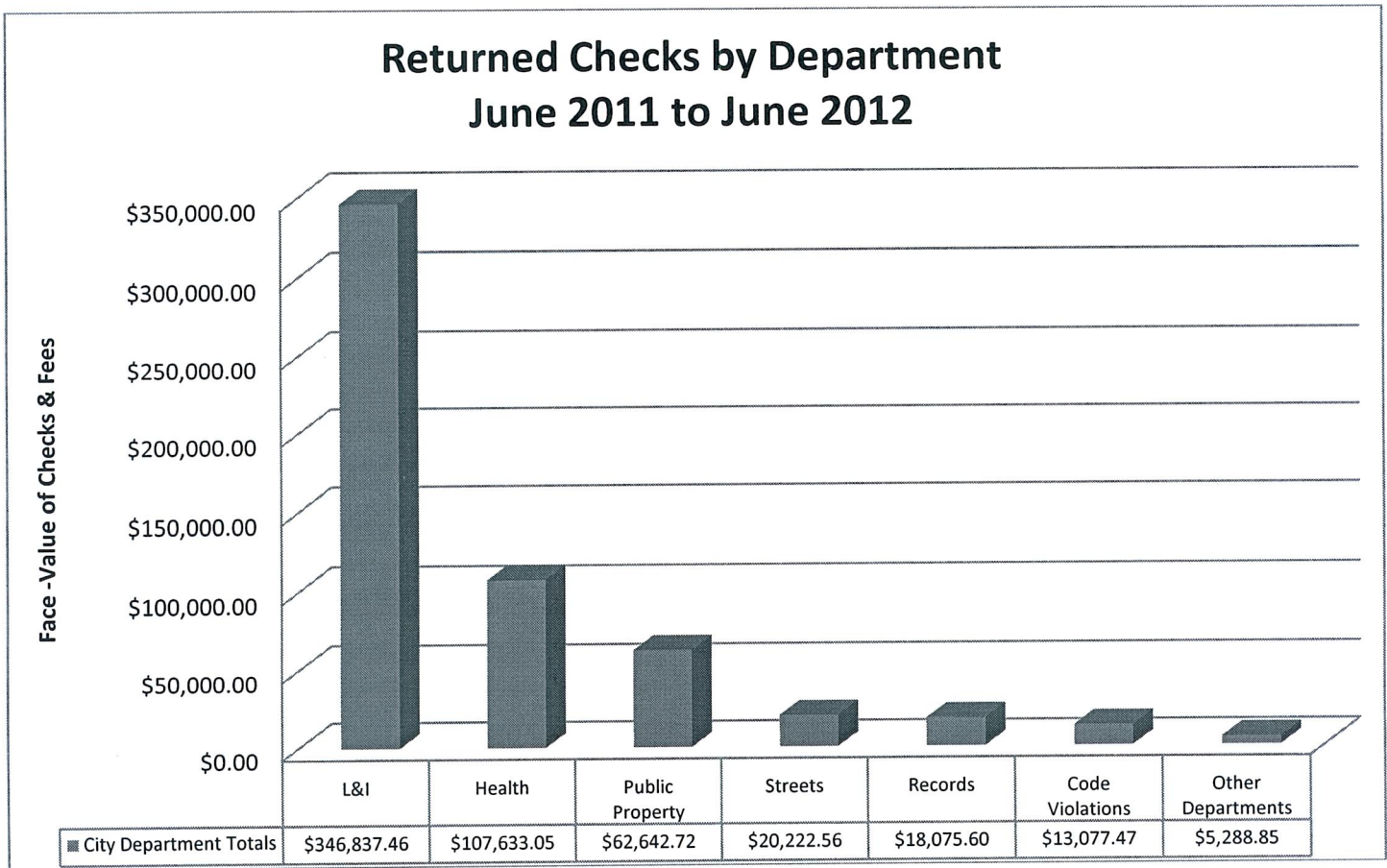
For each returned check, personnel in the BRI Unit create an entry in the Bank Return Items System, a software program that keeps track of all the returned checks but operates independently from the other Revenue Department accounting systems. The BRI entry assigns a unique number and memorializes the payor information (name and address) and the amount of the check. From this system, the Revenue Department issues a letter to the payor, informing him or her that the check was not successfully negotiated and demanding an additional payment. The letter also informs the payor that if the debt is not paid within ten days, the matter will be referred to an outside collection agency. In addition to the initial amount of the debt, the Revenue Department passes-on the incurred returned check fee, and the payor is charged an extra \$20 penalty.

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If the BRI Unit does not receive a replacement check from the payor after issuing the one letter, they initiate the “charge-off” process, by which FAMIS, the City’s internal accounting system, is updated to properly reflect the fact that no payment was ever received. Because City accounts are credited prior to the successful negotiation of funds, the charge-off process ensures that the Revenue Department has an accurate accounting in FAMIS. It should be noted, however, that the Revenue-level adjustment to FAMIS is not tied to any individual departmental accounts, meaning that other City databases could still reflect the bill as paid.

After this adjustment to FAMIS is completed, the BRI Unit periodically forwards lists of all the returned checks (for which no replacement check was submitted) to the individual departments. All the information regarding checks that were submitted as payment for L&I liabilities/fees is forwarded to L&I directly; information on checks for code violations is forwarded to the Code Enforcement Unit; and so on. Typically, the BRI Unit takes approximately 90 days to process returned checks, from time of receipt to the point when the checks are forwarded to the respective departments. Once these lists are forwarded to the proper departments, the BRI Unit makes no additional collection efforts. Any further collection efforts and/or adjustments of internal City accounts must be made at the departmental level.

According to Revenue Department records, between June 2011 and June 2012, the BRI Unit forwarded \$573,777.71 worth of returned checks and fees to the eleven revenue-generating City departments addressed in this investigation. The following graph breaks this figure down by department:



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B. Second Level: *Other Revenue-Generating Departments*

During the one-year period addressed in this evaluation, the BRI Unit forwarded returned check information to each of the following departments: L&I, Department of Public Health (“Health”), Department of Public Property (“Public Property”), Department of Streets (“Streets”), Department of Records (“Records”), Housing & Code Enforcement Unit of the Law Department (“Code Enforcement”), Police Department (“PPD”), Department of Procurement (“Procurement”), Office of Special Events at the Managing Director’s Office (“Special Events”), Division of Animal Care & Control Services at the Department of Public Health (“Animal Care”), and the Employee Benefits Unit of the Office of Human Resources (“Employee Benefits”). OIG investigators followed-up with each of these individual departments and interviewed those employees responsible for the further processing of returned checks, as identified by the BRI Unit.

The results were highly inconsistent and indicative of a severe breakdown in communication and a lack of formal procedures. Following transfer from the BRI Unit, the processing of returned checks varied greatly by department. Generally, each department fell into one of the following three categories: (i) those that were wholly unaware of any information sent by the BRI Unit and therefore never addressed the checks in any way; (ii) those that acknowledged the receipt of returned check information but took little action beyond isolated record-keeping with unclear and/or non-existent collection efforts; and (iii) those that acknowledged receipt of the information and engaged in some limited, but undefined, collection efforts.

Category One: No Action

Of the eleven City departments that were sent returned check information for further action, five of them denied receipt of this information altogether: Public Property, Code Enforcement, PPD, Special Events and Employee Benefits. Each of the departments in this category had no procedures or policies in place to address returned checks. And, of course, because they never acknowledged the receipt of any information from the BRI Unit, these departments never attempted to collect on this debt in any way.

For many of the departments within this category, when OIG investigators attempted to locate and interview those individuals identified by the BRI Unit as having received returned checks, these departmental employees were either non-existent, retired or wholly unaware of the alleged transfer of responsibility. In the cases of Public Property and Employee Benefits, the BRI Unit was unable to identify a specific contact person; rather, they forwarded the data to general addresses and floors of the Municipal Services Building with no further information. In the case of Code Enforcement, the relevant employee had since retired from service, and her supervisor denied receipt of anything from the BRI Unit.

With regard to Public Property, OIG investigators informed the relevant personnel that the BRI Unit forwarded the department two checks for a total of \$62,642.72. Upon further investigation, it was discovered that a company mistakenly submitted those checks to the wrong department and therefore stopped payment prior to processing (hence the BRI Unit’s involvement). The company later reissued the checks, payable directly to Public Property, and the City eventually collected these funds. Revenue and the BRI Unit, however, were never made aware of this correction prior to the OIG investigation. The charge-off process for this transaction ensured that FAMIS had an accurate accounting of this income, and an inspection of the relevant systems confirms this fact. But, if the BRI Unit had never been alerted to this later collection of income, the Revenue Department would continue to have an incorrect record of \$62,642.72 in outstanding debt associated with Public Property.

Category Two: Isolated Record-Keeping

Four departments acknowledged receipt of returned check information from the BRI Unit, but failed to substantively address the problem beyond basic record-keeping and reporting: L&I, Health, Streets and Animal Care. Employees from both Health and Streets confirmed that, upon receipt, the returned check information is recorded in an internal document that is distributed throughout the department periodically. For both of these departments, however, later efforts to collect the debt were unclear and undefined. In the case of Animal Care, the BRI Unit's contact person confirmed that the department had no system in place to address the issue, and Animal Care made no attempts to collect the debt or revoke the animal licenses that were issued to customers who presented checks that did not clear.

Most troubling is the case of L&I, having received over \$300,000 worth of returned checks (and fees) from the BRI Unit between June 2011 and June 2012. OIG investigators spoke with Kirk McClarren ("McClarren"), Administrative Services Director, who oversees the processing of these returned checks at L&I. McClarren informed OIG investigators that his unit maintains an isolated Microsoft Excel document to record all of the information regarding this debt. Despite McClarren's numerous attempts to bring the issue to the attention of the former Commissioner, no action was taken. L&I makes no additional collection attempts, and the information in the spreadsheet is not entered into Hansen, the department's internal database.

Category Three: Limited Collection Efforts

Two departments acknowledged receipt of returned check information and engaged in some additional collection efforts: Procurement and Records. However, in both cases, the additional efforts to collect the debt at the departmental level were uncoordinated and untested. With regard to Procurement, despite the fact that the BRI Unit forwarded the checks to an employee who retired from service in 2006, the department acknowledged that they had received some unknown amount of returned check information in the past. Procurement, however, had no procedures in place to process returned checks and they maintained no exact records relating to returned checks. Deborah Beatrice ("Beatrice"), Assistant to the Director of Finance, recalled at least one situation in 2011 when Procurement received a returned check in the amount of \$4,000. Beatrice believed, but was unable to confirm, that this debt was ultimately collected at a later point.

By far the most responsive department was Records. Following the receipt of returned check information from the BRI Unit, Joseph Gilorma ("Gilorma"), Accounting Clerk, attempts to contact the customers by mail and occasionally by phone for repayment of the original amount of the check plus a \$20 fee. Gilorma also maintains an Excel spreadsheet with the customer's name, date, result of the letter or phone call, check number, and amount. This record-keeping, however, is not integrated with any other internal systems, and Records' ultimate collection rate is unclear.

III. ISSUES & FINDINGS

This evaluation of the City's processing of returned checks presents a number of closely related issues that require immediate attention, including: (i) a staggering breakdown in inter-departmental communication and a lack of coordination and uniformity; (ii) ineffective and inconsistent collection procedures; (iii) potential accounting inaccuracies resulting from isolated record-keeping; (iv) excessive transaction costs and long delays; and (v) reverse incentives for repeat offenders. As a result, the City has left a significant amount of available revenue uncollected and unaddressed.

A. Poor Communication and Coordination

This investigation has identified a clear and ominous breakdown in inter-departmental communication and coordination as it relates to the identification, processing and collection of returned checks. First, and most obvious, is the need for a clear channel of communication, which must include accurate contact information. In many cases, the BRI Unit inexplicably forwarded returned checks to retired and/or non-existent departmental contacts. In some cases, the checks were forwarded to general addresses with no further specifics. As a result, several departments denied ever receiving information from Revenue, and the returned checks were therefore never properly addressed.

To compound this problem, following the forwarding of the checks, in all cases there was no further communication between the BRI Unit and the individual agencies. Thus, there is no mechanism in place to alert the BRI Unit to a later collection of revenue or the fact that the checks were never received. If an individual City department ultimately received a replacement check or otherwise collected on the returned check, the BRI Unit would have little opportunity to update their record-keeping accordingly, as was the case with Public Property. Not only do these communication discrepancies result in some unknown amount of lost revenue, they undoubtedly create great inconsistencies within the City's various internal accounting systems, discussed below in Part C.

B. Ineffective and Inconsistent Collection Procedures

Once the check is returned from the bank and received at Revenue, the BRI Unit creates an entry in the BRI system and sends the listed payor a single letter. The BRI system is not tied to any other City-system, and the collection letter is sent to the name and address on the face of the check. Of course, because this letter is generated from information printed on the check, there is a significant chance that the contact information is out-of-date and incorrect. Also, in cases where payors have submitted checks for liabilities on behalf of third-parties, collection efforts are focused on the payor and not the City-account holder.

Even assuming that the collection letter is sent to, and ultimately received by, the correct individual, this single contact attempt is the only effort made at the Revenue level before forwarding to the individual department. Because so many departments fail to make any additional collection efforts, the single letter from the BRI Unit may serve as the only attempt to collect a debt on the City's behalf. This is true despite the fact that the Revenue Department's letter notifies the customer that his or her debt could be referred to a collection agency. In those cases where the individual departments did make some collection efforts following the receipt of the returned checks, the activities were limited and inconsistent across the City. Some agencies made additional calls or sent additional letters, but the degree to which these steps were effective is unclear and untested.

Inconsistent collection procedures across the City and a lack of coordination between the BRI Unit and the respective departments allow for the possibility that an individual who has never paid his or her liability may be more forcefully pursued than a person who submitted a check drawn on a closed account. For example, assume that two individuals were issued fines for the same violation. One submitted a faulty check to pay the fine, while the other simply ignored the debt altogether. The responsible department surely has clear and well-defined procedures to pursue the individual who never paid, including escalated collection efforts over time. But, the department may never become aware of the fact that the second individual's debt remains outstanding, and, as a result, he or she may never face the same consequences as the person who ignored the fine outright.

C. Accounting Inaccuracies

If the BRI Unit fails to collect on the returned check, they make an adjustment to FAMIS, the City’s accounting system, to ensure that there is an accurate count of revenue received. This adjustment, however, is done in-bulk, and FAMIS is not fully integrated with additional departmental record-keeping systems. Most City departments generally maintain a separate internal system that must also be adjusted in addition to FAMIS. If these systems are never properly corrected, due to lack of communication and coordination between the BRI Unit and the respective department, then the individual departmental records will vary greatly from those maintained in FAMIS at the Revenue level.

For example, the BRI Unit received over \$300,000 in returned checks associated with L&I liabilities. After issuing the collection letter, but prior to forwarding to L&I for further processing, the BRI Unit adjusted L&I’s recorded revenue in FAMIS by this amount. This “charge-off” was necessary because income associated with L&I improperly included each of the returned checks at issue, and the City never received these funds. But, the \$300,000 adjustment for L&I represents many separate checks for smaller amounts. Each of these checks was submitted as payment for some sort of liability associated with a particular project or license holder. Because these individual accounts in Hansen, L&I’s internal database, are not set back in the same manner, L&I will still administer these accounts as if they were completely up-to-date. Thus, for each of the individual licenses purchased with a faulty check, L&I records continue to incorrectly reflect that the license was properly issued and the City received the fee.

Furthermore, as noted above, there is currently no mechanism in place to alert the BRI Unit to a later collection of revenue in cases where an individual department ultimately collected a replacement check. The \$62,642.72 in Public Property checks illustrates this problem, as the BRI Unit was never made aware of the fact that Public Property actually received those funds. If the BRI Unit is not made aware of these corrections, some Revenue systems will continue to record the relevant liabilities as unpaid, despite the fact that the funds were actually collected. This, of course, could result in a gross overstatement of outstanding debt.

D. Excessive Transaction Costs and Long Delays

Transferring the returned checks (from the bank to Water Revenue to Revenue and ultimately to the individual departments) costs the City valuable time and effort, with little payoff. At best, it takes approximately three months until the individual department is notified that a check has been returned from the bank, assuming that the current process functions properly. For many departments, this processing time makes collection efforts extremely costly, unproductive and often moot. In many cases, the City provides services or issues something of value immediately following the submission of the check, but prior to the transfer of any funds. Three months later, when the department is alerted to the fact that the service was provided free of cost, there may be much higher administrative and legal costs involved in obtaining proper payment. This is true for things like licenses/permits for short-term events or projects, reports that are issued to customers for a fee, and certain document recording fees. If the customer paid with a bad check, the City has to spend far greater time, effort and money to retract the already-completed transfer.

For example, customers may currently pay deed recording fees with personal checks. Upon presentment of a check for the applicable fee, the Department of Records officially records the document. If the check is later returned from the bank following unsuccessful negotiation, the prior transaction is unaffected and the deed still remains on-file. If later collection efforts prove unsuccessful, the City has provided a valuable service at no cost to the customer. Accordingly, the transaction should be retracted and the deed should somehow be “un-

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recorded.” This retraction, however, could raise some difficult administrative and legal issues at a significant expense. The act of removing a previously recorded deed could implicate due process concerns and possibly expose the City to the risk of civil liability.

It should be noted that the Revenue Department has recently announced a changeover to a new processing system called “Check 21.” This system allows for the electronic transfer of checks from the Revenue Department cashiers to the bank and, in the case of returned checks, back to the BRI Unit. Certainly, this new system will reduce processing time and the transaction costs associated with the current physical transfer of information. However, Check 21 will not fully eliminate the lag in processing time, and its use will still allow for the possibility that individuals may receive City services prior to the clearing of the check.

E. Reverse Incentives

Long lags in processing time and inconsistent collection and charge-off processes allow many individuals the opportunity to take advantage of a system that is not offering the proper deterrents. Even though the BRI Unit makes some effort to track repeat offenders, this information is not utilized and is not effectively shared with the individual agencies or those tasked with collecting revenue on-the-ground. If a person can obtain something from the City at no cost with essentially zero repercussions, there are few incentives to pay.

The following data, provided directly by the BRI Unit, illustrates this problem. For each listed payor, the chart below indicates the number and amount of checks submitted but ultimately returned (over the last six years) without any successful negotiation of funds.

Company	Address	Number of Bad Checks	Amount
Total Mechanical Concepts, Inc.	Philadelphia, PA 19124	87	\$92,551.50
Thomas Balfe	Philadelphia, PA 19137	42	\$37,241.00
Philly Gardens Rlty Corp.	Woodside, NY 11377	14	\$20,983.00
Adib Mahdi	Elkins Park, PA 19027	50	\$32,217.50
George Dutton	Philadelphia, PA 19121	87	\$27,786.50
MA-SA Construction LLC	Philadelphia, PA 19106	40	\$20,689.00
KJO Design & Planning	Philadelphia, PA 19125	18	\$8,735.50
KLF Electric	Washington, PA 19034	20	\$21,002.00
David Bell	Wyncote, PA 19095	59	\$12,711.00
Anthony Mattia	Philadelphia PA 19148	16	\$4,642.00
TP Work Inc.	Philadelphia, PA 19147	12	\$9,251.00
Dennis Watts	Philadelphia, PA 19149	50	\$63,924.00
Fire Protection Services	Wilmington, DE 19809	197	\$38,584.00
	TOTAL	692	\$390,318.00

Clearly, many of these businesses and individuals have habitually, and possibly intentionally, taken advantage of the City’s inconsistent administration in this area.

F. Scope of the Loss

Each of the issues addressed in this evaluation carries a significant cost for the City and taxpayers of Philadelphia. In some cases, where the City provided value without receiving the corresponding payment, the City's inadequate treatment of returned checks has resulted in a direct loss. In others, the severe lack of communication and coordination has resulted in an unknown amount of available but neglected revenue. Due to inconsistent record-keeping, unclear process and uncoordinated execution across the City, the exact costs incurred as a result of these failures remain in question. The ultimate scope of the loss and the availability of additional revenue will depend heavily on: (i) the type of transaction for which the check was initially submitted and (ii) the possibility of an increased collection rate. Even though an exact number is illusive, using these two variables to anchor the estimate, the City's inadequate processing of returned checks has likely resulted in approximately \$346,837.46 – \$511,134.99 of lost revenue per year.

1. Type of Transaction

The checks at issue in this evaluation were submitted for a great variety of City services and fees. Some of the returned checks were initially submitted to pay things like fines or other forms of previously incurred debt. These transactions are easily reversed. So, as long as the relevant City account is adjusted to reflect the fact that no payment was received, the returned checks associated with these liabilities do not represent straightforward losses for the City. For example, assume an individual was issued a fine for a violation of a code provision and then submitted a faulty check as payment. Even if the payment was credited prior to the clearing of the check, as long as the account is properly set-back following return from the bank, the City can simply continue its efforts to collect without incurring any loss (beyond administrative costs).

For the overwhelming majority of the returned checks, however, the City issued something of value or provided a service prior to the successful negotiation of funds. For these transactions, if the check is returned and later collection efforts fail, the City has incurred a cost but received nothing in return. As such, this portion of the returned checks and the associated fees represent direct and significant losses for the City. This is generally the case for things like licenses or permits and various document recording fees. If a customer presented a bad check as payment for a construction license, and the City never collects this fee and makes no attempt to revoke the license at a later point, he or she has effectively purchased something for free. The City has forever lost that revenue.

2. Uncertain Collection Rate

For some of the returned checks at issue in this evaluation, the City may have eventually received a replacement check to pay the outstanding debt, as was the case with the \$62,642.72 in Public Property checks discussed above. Unfortunately, the lack of communication between the BRI Unit and the respective departments is so severe that it is impossible to identify specific instances of replacement payments, and the ultimate collection rate is therefore uncertain. This communication breakdown is also clearly resulting in a loss of revenue for the City, because some portion of the debt is going wholly unaddressed and even minimal collection efforts could result in additional income. In so many cases, the individual departments made absolutely no effort to collect the debt, and the single letter from the BRI Unit served as the only attempt to recoup the funds. Given this fact, without question there are some additional tactics that the City can employ, either at the Revenue level or within the individual departments, that will ultimately and efficiently result in a net increase in revenue.

3. *Best Estimate*

According to Revenue Department records, between June 2011 and June 2012, the BRI Unit forwarded \$573,777.71 worth of returned checks and fees to the eleven City departments addressed in this investigation. For the reasons discussed above, this figure may not exactly represent the City's ultimate loss or the available amount of uncollected revenue, but it does serve an important function in determining the final impact of the City's inadequate process.

The bulk of this debt is associated with L&I, having received but ignored \$346,837.46 in returned checks and fees. Given the type of transactions that the department processes, this amount generally represents licenses and/or permits that were issued without proper payment. This \$346,837.46 of unaddressed debt, therefore, most likely marks the minimum tangible yearly loss for the City of Philadelphia. Of the remaining \$226,940.25 (\$573,777.71 less \$346,837.46), some unknown amount of additional savings can be realized with improved collection procedures. At most, all of this debt (with the exception of the \$62,642.72 related to Public Property) can be collected; and, on the low end, none of it will be available. Thus, the true and correct loss associated with the City's inadequate processing of returned checks conservatively lies somewhere between \$346,837.46 and \$511,134.99 (\$573,777.71 less \$62,642.72).

It should be noted, that this estimate corresponds only to a single year of returned checks, and this evaluation does not address the City's processing of checks associated with Revenue Department or Water Revenue Bureau services and liabilities. In the end, the issues identified in this evaluation are a manifestation of a systemic problem that could, in fact, prove to be larger and far more costly to the City and taxpayers of Philadelphia.

IV. RECOMMENDATIONS

As information and responsibilities shift from the bank to Revenue and on to the specific departments, the City should take steps to improve every phase of the process. On the front-end, this will require better check screening procedures to prevent the submission of faulty checks prior to processing. Then, stronger and more consistent collection efforts, coupled with enhanced inter-departmental communication, will likely capture additional revenue. On the back-end, the City must take targeted enforcement action to aggressively pursue repeat offenders and increase deterrents, including the revocation of appropriate licenses and possible criminal prosecution. Each of the recommendations below is designed to increase efficiency and realize additional income. Of course, as with all recommendations, the costs and practical limitations associated with implementation should be carefully weighed against the degree of potential gain, and for this reason a comprehensive financial and programmatic audit of the process is additionally recommended.

A. Improved Check Screening Procedures

First and foremost, the City must take significant action to limit the amount of bad checks that enter the system. For so many of the checks addressed in this investigation, the customer essentially purchased something from the City for no cost and walked away from the transaction with a tangible license or something else of significant value. Rather than incur the additional expense of revoking the license (or otherwise retracting the transfer) at a later point, it seems prudent to mitigate this loss up-front. If the Revenue Department can monitor the intake of personal checks and better screen them for validity, the City can more easily prevent this loss. Some options include:

1. Restrictions on Personal Checks

The most obvious solution to this problem is for the Revenue Department to simply require certified checks in all cases as a matter of procedure and policy. Certainly, this would result in a net-increase in total revenue received, as it would entirely prevent the City from providing something of value without a proper tender. It would also reduce administrative costs significantly, obviating the need for a BRI Unit to process returned checks. However, there would be clear costs incurred on the part of the general public, many of whom pay City-related liabilities on a regular basis with perfectly good personal checks.

If, as a matter of administration, this public cost proves to be an undue burden, there are several more limited restrictions that can be employed to mitigate the impact. For example, cashiering stations could provide for payment through other methods, such as credit and/or debit cards. Or, the Revenue Department can require certified funds for specific liabilities, like those involving an immediate transfer or service (e.g., recording-fees, licenses, permits, etc.). This would prevent a quantifiable loss in the case of a returned check, and it would limit the transaction costs associated with revoking these transfers at a later point. The Revenue Department could likewise require certified funds for payments in excess of a certain threshold amount, ensuring that significant revenue collection is not thwarted. Alternatively, the Revenue Department could require certified funds from certain repeat offenders, to prevent particular businesses and individuals from fraudulently avoiding payment. Of course, this would require a more sophisticated tracking system to flag various payors, discussed in more detail below.

2. Check Readers

So-called “check readers” or “check scanners” can assist the Revenue Department in limiting the amount of invalid checks that enter the system for processing. If employed at the cashier-level, these devices can be used in a variety of different capacities to evaluate the check upon presentment. Depending on the specific technology, check readers have the ability to (i) scan and store an image of the check for more efficient record-keeping and electronic transfer, (ii) read information using Magnetic Ink Character Recognition (“MICR”) and automatically debit funds from the corresponding account, and/or (iii) certify the check through a central clearinghouse to verify that it is not stolen or counterfeit.

The Revenue Department’s new “Check 21” system has part of this capability, as it will scan an image of the check for electronic storage and transfer, but the department could also employ additional anti-fraud and verification operations prior to processing. Depending on the cost of these additional functions, it may prove effective to use this technology for every personal check or in only limited cases, in the same manner discussed above. Certain checks for certain liabilities, or those issued by certain payors, could be scanned or verified in a more thorough manner to prevent the costs associated with later processing should the check prove faulty.

3. Statistical Tracking for Repeat Payors

Many of the issues identified in this investigation create clear opportunity for fraud and repeated submission of bad checks for various City services and fees. Some individuals and businesses have submitted well over one hundred checks that were later returned, with few consequences. To protect against this risk, the Revenue Department and the BRI Unit should implement well-defined procedures to better track activity in this area. This way, City departments can identify those parties who may have intent to defraud. Most of the information is currently available through the BRI system, but the BRI Unit must better interpret this data and make it more available to other City agencies, departments, and potentially the cashiers as well. The new “Check 21” system

could prove useful in this task, as its added functionality might allow for the tracking of repeat offenders and more efficient data-sharing. Once recurring delinquents have been properly identified and flagged, the City can better prevent against loss by requiring certified funds for future payments and initiating concerted collection and enforcement efforts to recover debt in bulk.

B. Stronger and More Consistent Collection Efforts

Taken on the whole, the City's effort to collect on returned checks is discouraging. The BRI Unit sends one single letter to the name and address listed on the face of the check. If this action fails to result in additional payment, the individual departments undertake spotty, undefined and sometimes non-existent action. While the costs of any additional attempts to collect must be weighed against the probability of eventual payment, the existence of un-captured revenue is conspicuous. Some options for improvement include:

1. Accurate Targeting

Any and all efforts to collect must be targeted at the correct individual. Currently, entries in the BRI system are generated from information printed on the face of the returned checks. This information is often dated and incorrect, meaning that the City's contact attempts will go unheard. To compound this problem, third parties often pay City liabilities on behalf of other taxpayers or customers. For example, many businesses pay certified agents or "runners" to pay liabilities or record various documents on their behalf. If the BRI Unit's collection efforts are focused on the payor alone, the responsible party may go without the proper notice. Without notice, collection is impossible.

At the very least, the City should be making some attempt to verify contact information and/or reach out to the specific City-account holder in cases where the payment was made by a third party. A cross-check of the various City databases could prove productive and might yield additional information regarding address, phone number and/or other responsible parties. Armed with better information, collection efforts could include additional letters, phone calls or a variety of other contact attempts. Depending on the availability of this information and the City systems at issue, this task can be done at either the Revenue level or within the specific divisions of the other City departments.

2. Centralization and Uniformity

The transfer of collection duties from the BRI Unit of the Revenue Department to the other income-generating agencies across the City has demonstrably resulted in significant delay and potentially damaging inconsistencies. The various transaction costs associated with the division of responsibilities are directly contributing to financial loss. Ideally, to mitigate the costs and minimize the need for synchronization, collection efforts on all returned checks should be initiated by only one group or department. If all collection and accounting responsibilities took place within the BRI Unit, for example, there would be no need to implement complex cross-departmental processing guidelines.

Recognizing, however, the wide variety of City liabilities, services, fees and systems, complete centralization is likely impractical. If collection responsibilities are to remain divided, then the Revenue Department must work to implement a comprehensive system of oversight and administration to ensure that every City department is processing returned checks in a uniform and efficient manner. Right now, the BRI Unit's failure to properly follow-up with the individual departments suggests a complete lack of interest in collecting outstanding debt. Furthermore, for those departments that have acknowledged receipt of returned checks, many have failed to

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adequately address the issue or otherwise interpret the data. As a result, outstanding debt could be pursued heavily, slightly or not at all, depending on the nature of the liability or City service. Inconsistent collection efforts clash with the strong and ominous tone of the BRI Unit's letter and severely weaken the necessary deterrents. The general public may correctly assume that if they disregard the letter, nothing will happen. Proper administration requires consistent treatment and follow-through across departments, and those charged with the vital task of income collection should therefore roll-out a uniform plan of action to be implemented City-wide.

Recently, FTI Consulting conducted a large-scale evaluation of the City's revenue collection process, highlighting a similar need to improve coordination and centralization. One of their key recommendations was the appointment of a "Chief Collections Officer," who would be responsible for increasing the overall collection rate across the City. With regard to returned checks, the clear need for consistent and efficient collection procedures further emphasizes the value of such a position. In this capacity, the Chief Collections Officer can identify the most efficient collection system and ensure that it is effectively implemented across the various departments that are collectively responsible for capturing revenue.

3. Debt Collection and Recovery Software: The Philadelphia Parking Authority Solution

The Philadelphia Parking Authority ("PPA") employs a remarkable and sophisticated solution to improve collection rates on returned checks. Every year, thousands of individuals pay parking fines and other PPA liabilities with personal checks that are later returned from the bank because of unsuccessful negotiation. Through the use of debt collection and recovery software, an external vendor monitors the checking accounts associated with these returned checks for a period of thirty (30) days. If, in that period of time, sufficient funds are deposited in the account, the recovery software automatically debits the accounts by the amount of the initial check plus a \$30 fee. According to the PPA's contract, the vendor retains the fee and the PPA recovers the full amount of the initial check. Because the vendor is paid directly by the individual payor, the service is essentially cost-free to the City (although the PPA must forgo charging the payor any additional fees). The following table summarizes the PPA's overwhelming collection results over the past three years:

Year	Returned Checks		Recovery of Returned Checks		Recovery Rate	
	Number	Amount	Number	Amount	Number	Amount
2010	3,703	\$238,279.67	1,845	\$115,486.97	49.8%	48.5%
2011	3,174	\$201,155.61	1,404	\$85,763.93	44.2%	42.6%
2012	2,683	\$199,525.64	1,366	\$84,844.27	50.9%	42.5%

Since 2010, the PPA has recovered a total of \$286,095.17 through this debt collection method, with an average yearly collection rate of 44.5%. Prior to this contract, using other methods, the PPA collected approximately 5% of the value of these returned checks on a yearly basis. As such, the PPA realized a net increase in revenue of approximately \$254,147.12 (\$286,095.17 less 5% of \$638,960.92) between 2010 and 2012.

Of course, this software cannot recover at a rate of 100% because some returned checks were likely drawn on closed accounts, non-existent accounts, or the accounts otherwise do not have sufficient funds prior to the thirty day deadline. Regardless, the decision to employ debt collection and recovery software has clearly paid dividends for the PPA and reflects efficient public administration. The Revenue Department and the BRI Unit can likely enjoy similar results with little downside, and the use of an equivalent system, at least on a trial basis, seems a sensible option to explore.

C. Enhanced Coordination and Communication – The Chief Collections Officer

As illustrated in this evaluation, the City’s processing of returned checks presents a staggering breakdown in inter-departmental communication and coordination. Misdirected information, incorrect contact lists and, in some cases, a total absence of dialogue between the BRI Unit and the individual departments, expose the City to critical risk of under-collection. If responsibilities are going to remain divided among several City agencies and departments (discussed above), the need for improved communication is urgent.

There must be a clear and actively monitored channel of communication between the BRI Unit and the departmental contact groups. Supervision and management must ensure that both sides of the network have accurate contact information and an opportunity for the proper sharing of data. Without precise synchronization, accounting inaccuracies will arise between various City systems and information can easily get lost. To assist in this task, a number of potential solutions can be utilized. First, electronic transfer of returned checks is preferable to the physical method currently used. Paper transfer allows for unverified delivery, while email or an integrated system of some kind can guarantee accurate receipt of the proper information. Check 21 can likely assist with this improvement. Second, there should be some affirmative reporting requirements placed upon both the BRI Unit and the individual departments with respect to returned check activity. When information is forwarded to individual departments for further action, a written confirmation should be required within a specified timeframe. In addition, a required reporting process could include: number and amount of checks forwarded/received; collection efforts initiated; collection results/rate; and accounting corrections. Without question, ongoing review of these reports and statistics will improve administration, increase accountability and more clearly identify areas that require improvement.

Discussed briefly above, the recently proposed position of Chief Collections Officer can greatly assist in improving coordination, communication and accountability. As presented in the FTI Consulting report, the Chief Collections Officer’s duty would be to (i) identify and implement best practices, (ii) develop central reporting systems and (iii) develop accountability and incentive structures to maximize collections. In relation to the processing of returned checks, not only can the Chief Collections Officer improve uniformity in collection efforts, but he or she can also provide needed structure and oversight for inter-departmental communication and synchronization. Ideally, the Chief Collections Officer can impose a structure that would include some of the affirmative reporting requirements identified above, as well as continuing review of returned check data and statistical information.

D. Robust Enforcement and Back-End Deterrents

The City must take affirmative steps to protect the integrity of its public services by strengthening the deterrents for those who may be taking advantage of the inefficiencies addressed in this evaluation. This is especially true with regard to the returned checks associated with L&I licenses and permits, representing the bulk of the loss. As noted above, certain individuals and businesses have repeatedly submitted faulty checks. Although the Law Department has recently initiated some targeted collection efforts, many repeat offenders have faced little consequences to date. In addition to the inconsistent and ineffective attempts to pursue the debt, in many cases, the City has taken no steps to revoke the licenses that were issued at no cost or otherwise retract the relevant transaction. A payor who repeatedly submits bad checks is strongly suggestive of intent to defraud the City, and this gap in enforcement creates clear incentives to continue this behavior on a larger scale.

If all of the City departments can improve their data collection and tracking ability, discussed above, then repeat offenders can be identified. Once this information is readily available and shared, the Law Department can and

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should aggressively pursue those who have submitted a significant number of checks that were later returned. Enforcement activity should also include the revocation of City licenses and permits that were issued at no cost, and all City cashiering stations should clearly warn taxpayers and customers of this eventual possibility. In situations where malicious intent is apparent, criminal enforcement is warranted as well, and the OIG has already referred one such case to the District Attorney for prosecution.


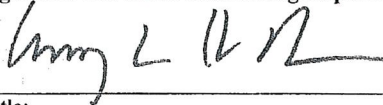
E. Financial and Programmatic Audit

Lastly, although this evaluation has flagged various issues that require immediate attention, there are many questions that remain unanswered. Inconsistent record-keeping, unclear process and uncoordinated execution continue to obscure the true extent of the loss associated with the City's inadequate processing of returned checks. It is important to recognize the possibility that the failures addressed here may extend beyond the scope of this evaluation, especially as they relate to the processing of returned checks initially submitted to pay other significant liabilities, such as property taxes and water bills. Furthermore, much of the data addressed in this evaluation was provided directly by the Revenue Department's BRI Unit, a division that has proven to be largely unreliable and highly defective.

To fully evaluate the efficiency and impact of the BRI Unit's current operations, an independent financial and programmatic audit is strongly recommended. Such an undertaking should be conducted by an external party to ensure objectivity, and it should ideally include a thorough tracking of the problem. For each and every returned check that the City has received from the bank, the audit should: (i) ensure the check is properly recorded in the BRI system; (ii) match the check back to the initial liability; (iii) determine whether the debt remains outstanding; (iv) confirm that the charge-off process has been accurately completed if necessary; and (v) verify that the City's accounting records have a complete and precise picture of realized revenue and outstanding debt. With a more extensive technical understanding of the problem, the City can better design efficient solutions and systems to fill the gaps.

V. CONCLUSION

In sum, the City's ineffective and unreliable processing of returned checks has resulted in the loss of considerable revenue and unjustified administrative costs. This evaluation has identified a number of issues and set forth varying potential solutions; however, the scope of the problem remains threatening and requires immediate attention.

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