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**Audit Report**

**AUSTIN ENERGY BAD DEBT**

**August 28, 2007**

Office of the City Auditor  
Austin, Texas

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# City of Austin

## Office of the City Auditor



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Date: August 28, 2007  
To: Mayor and Council  
From: Stephen L. Morgan, City Auditor  
Subject: Austin Energy Bad Debt

I am pleased to present this audit report on Austin Energy Bad Debt. The purpose of this audit was to analyze procedures in place to minimize bad debt, identify areas of improvement, and determine if charges from the collection agency are in accordance with the contract.

In our work, we found that AE tracks performance measures and is planning to implement additional best practices related to minimizing bad debt. These practices include implementing an automated outbound calling system and working to hire multiple collection agencies. AE could further their efforts to employ best practices by being more proactive regarding bad debt. The utility could implement a risk profiling system and offer incentives for automatic payments.

We also found that the majority of charges by the collection agency, Credit Systems International Inc. (CSII), were correct according to the contract. Because rates were not consistent for all transactions, practices by AE could be improved to prohibit over and under-charging by CSII.

We have issued four recommendations as a result of our work. We appreciate the cooperation and assistance we received from the Customer Care Division at Austin Energy during this audit.

Stephen L. Morgan, CIA, CGAP, CFE, CGFM  
City Auditor



## COUNCIL SUMMARY

This report presents the results of the audit of Austin Energy's Bad Debt Practices. The purpose of this audit was to verify procedures in place to minimize bad debt, identify areas of improvement, and determine whether the collection agency hired by AE is charging rates in accordance with its contract.

Bad debt is defined as money due to the utility that will likely remain uncollectible. AE's Customer Care division is responsible for handling the accounts collection process, including attempting to collect on past due balances. Once an account is inactive for a certain number of days and meets certain criteria, it is transferred to a collection agency.

We noted improving trends in the proportion of bad debt incurred by the utility. In addition, AE is planning to implement several best practices related to minimizing bad debt. These best practices include planning to hire multiple collection agencies and implementing an automated outbound calling system.

We did note additional ways AE could be more proactive regarding bad debt. AE could implement a risk profiling system that would allow them to tailor collection paths and customize security deposits based on the customer's past behavior and could offer incentives for automatic payments.

We also found that the collection agency, Credit Systems International Inc. (CSII), is charging the City the correct rate for a majority of all accounts. In addition, AE was able to transfer the majority of accounts to the collection agency in time to receive the lowest rate under the contract.





## ACTION SUMMARY AE BAD DEBT



<b>Recommendation Text</b>	<b>Management Concurrence</b>	<b>Proposed Implementation Date</b>
01. The Senior Vice President of Customer Care should go ahead with the plan to hire multiple debt collection agencies that can be measured and compared against each other concurrently.	CONCUR	December 2007
02. To reduce the risk of bad debt, Customer Care staff should formally explore using available information to tailor collections paths and to tier security deposits. In addition, the Senior Vice President of Customer Care should develop and communicate needed enhancements to the planned CIS upgrade team to implement a more comprehensive customer profiling system.	CONCUR	March 2008
03. To encourage customers to pay their bill on-time and save AE money, the Senior Vice President of Customer Care should formally explore the benefits of offering incentives for customers making payments using automatic electronic funds transfers.	CONCUR	March 2008
04. To prevent under and overcharging, the Customer Care Process Manager should review all transactions by the collection agency once a year to ensure that transactions are matched and that the correct rates are charged according to the terms in the contract.	CONCUR	December 2007



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## **BACKGROUND**

The Office of the City Auditor's approved FY 2007 Annual Service Plan included an audit of the Austin Energy (AE) delinquent account collections.

### **Utility Receivables**

Receivables are payments due from customers for utility services rendered. The receivables cycle includes customer billings, then payment collections, then payment processing. AE is responsible for managing the receivables cycle for City utility-related charges. These charges include electric, water, wastewater, solid waste, drainage, and transportation user fees. According to the respective CAFRs, the Accounts Receivable was \$181,784,000 in 2005 and \$163,818,000 in 2004.

For the purpose of this audit, we focused on the collections process of the utility receivables cycle. More specifically, the focus was on the effectiveness of methods used to protect the City's interests should accounts become delinquent and, once delinquent, methods used to collect such accounts. Bad debt is defined as accounts receivable that will likely remain uncollectible and will be removed from the utility's balance sheet.

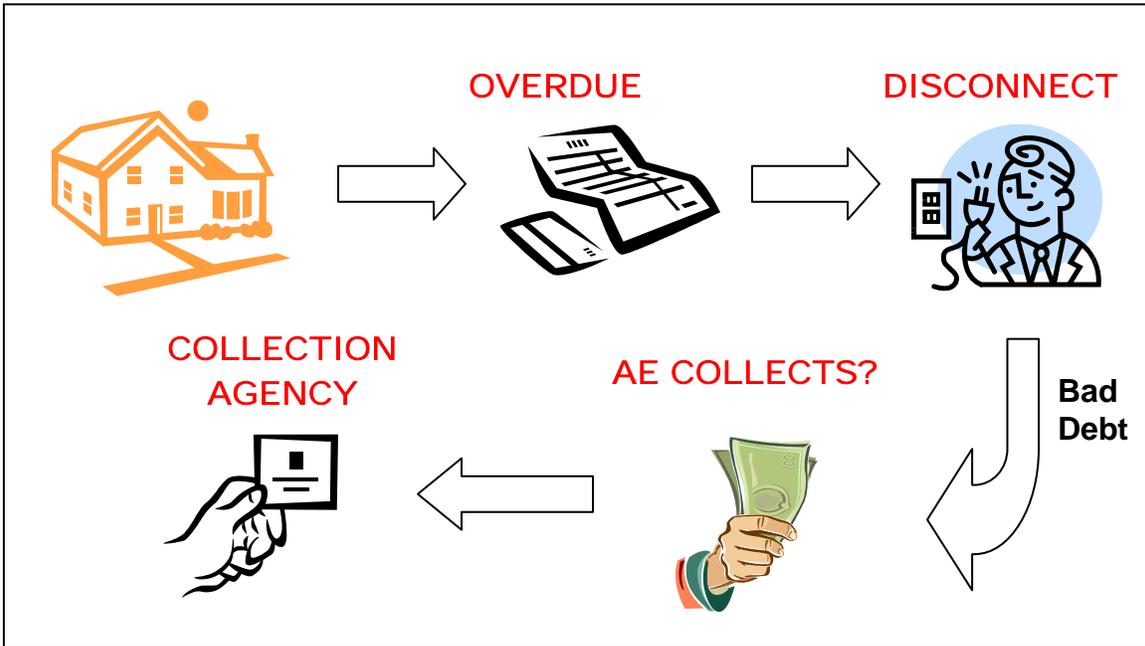
### **Organizational Structure**

The Customer Services group within the Customer Care Division is responsible for the collections process. This group is composed of 14 full-time positions, which include one Customer Services Manager, two Supervisors, and 11 Utility Billing Analysts. This group is responsible for three main functions: collecting on past due balances, transferring balances from inactive accounts to active accounts, and administering the contract between AE and a collection agency.

### **AE Collections**

Residential, commercial, and industrial customers are billed monthly for their utility usage. When the bill is delinquent and AE has repeatedly contacted the customer, services are disconnected. After the utility services are disconnected, the account begins the inactive collections process. During this part of the process, the Customer Services group attempts to collect the past due account balance and label it as bad debt. If AE cannot collect on the debt, the account is transferred to a collection agency. Since 1997, Austin Energy has contracted with Credit Systems International, Inc (CSII) to collect on these past due accounts. When the collection agency is able to collect on a delinquent balance, they charge AE a percentage of the amount collected using agreed upon rates. The earlier AE refers an account, the lower the charge to AE for the collection agency's services. Exhibit 1 shows the account collections process.

**EXHIBIT 1**  
**AE's Collections Process**



SOURCE: Austin Energy Customer Care

## **OBJECTIVES, SCOPE, AND METHODOLOGY**

### **Objectives**

Our objectives were to:

- Determine if AE is minimizing bad debt and identify areas for improvement.
- Determine if the collection agency, hired by AE to collect on accounts deemed uncollectible, is charging rates in accordance with its contract with the utility.

### **Scope**

The scope of work includes AE's collection processes, the transfer process between AE and the collection agency, and data from the collection agency's bimonthly invoices and AE's account information from the Customer Information System for the last four years (January 2004 – May 2007).

The Customer Services group was audited by the Office of the City Auditor in 2002 (a follow-up of a previous audit) and by Austin Energy's Internal Audit in 2007. Because the internal audit earlier this year focused on the collection agency's effectiveness at pursuing accounts on behalf of AE, we focused our work on the utility's overall strategies related to bad debt and all charges by the collection agency.

### **Methodology**

- Interviewed management and staff in the Customer Care Division of Austin Energy to understand the credit and collections process from the time the account is delinquent until the account is handed over to CSII.
- Researched best practices regarding debt collection and compared to AE's practices.
- Analyzed practices in place to minimize bad debt.
- Tested the contract with CSII and compared available data to ensure compliance with the contract.

This audit was conducted in accordance with generally accepted government auditing standards, with the exception of testing for fraud.

## AUDIT RESULTS

AE is following several best practices, but could implement additional best practices to decrease bad debt. In addition, the collection agency is not overcharging AE for collection services.

### **AE's bad debt indicators reflect an improving trend and AE is planning to implement additional best practices for collecting bad debt.**

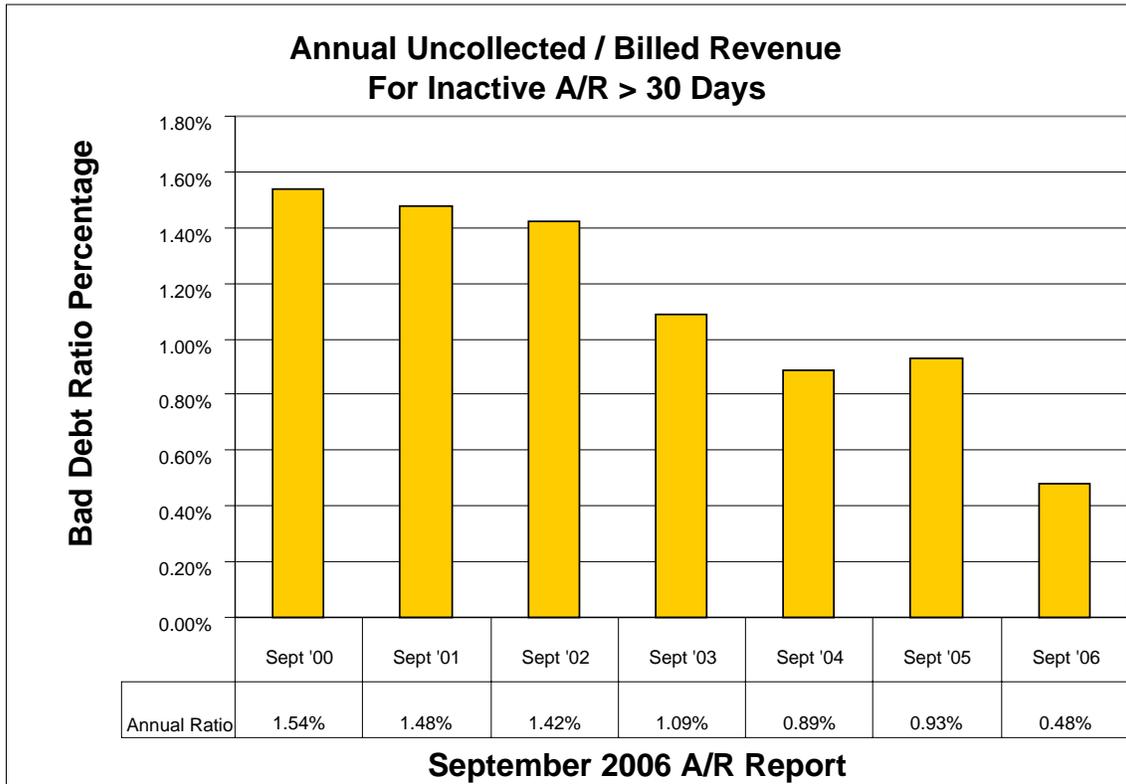
Over the last several years, AE's bad debt indicators show an improving trend. A best practice AE follows is tracking performance measures. AE is trying to implement an automated outbound calling system and has committed to hiring multiple collection agencies. These practices may help AE save on costs, help customers pay on time, allow them to compare collection agencies, and allow for comparisons to industry averages.

**AE tracks two helpful measures for capturing the utility's bad debt levels, days sales outstanding and the bad debt ratio, which are reflecting improving trends.** Days sales outstanding (DSO) is a gauge of credit-collection efficiency, with a low DSO meaning that the company is collecting its outstanding receivables quickly. The average DSO for US companies in 2005 was 40.5 days. The average DSO during the calendar year of 2005 for AE was 43 days.

Bad debt ratio is the ratio of annual uncollected revenue to total billed revenue. Uncollected revenue includes write-offs, delinquencies, and bankruptcies. A 2004 study by Chartwell Inc. showed that the percentage of write-offs to overall revenues for utilities was estimated at more than 0.5 percent. Individual ratios for utilities varied widely with some utilities having a ratio as high as 2 percent and as low as 0.15 percent.

Based on information reported by AE in 2000, AE's bad debt ratio was 1.54 percent. In 2006, AE's bad debt ratio fell to 0.48 percent. Exhibit 2 below demonstrates AE's net bad ratio improving over time. Having less bad debt means that the utility is collecting more revenue and is able to maintain low service costs for customers.

**EXHIBIT 2  
AE's Bad Debt Ratio**



SOURCE: OCA Auditor analysis of AE Customer Care data, February 2007

A new Deferred Payment Agreements (DPA) policy may have contributed to the positive trends related to bad debt overall. In October 2005, AE began following a new stricter policy for DPAs. The new policy restricted the maximum number of DPAs that a customer can have in a calendar year, restricted the number of months allowed to pay off the receivables balance, and required a higher minimum down payment to ensure continuity of the DPA program.

**AE is implementing an automated outbound calling system that could save on costs associated with using a live agent.** This system will place automatic phone calls to delinquent customers. AE is currently testing the system.

According to Chartwell Inc, some utilities using automated outbound calling technology are reporting good results. With auto dialers, the utility is able to reach a larger number of customers more frequently. AE plans to use the new automated outbound calling system to help AE prioritize customer phone calls based on the customer's past behavior with the utility.

**AE has committed to hiring multiple collection agencies, which will allow AE to measure and compare the agencies' performance against each other.** In 2007, AE Internal Audit performed a review of AE's collection agency (Credit Systems International Inc. or CSII) by reviewing a sample of transactions. The objective of the review was to determine whether CSII was effective in collecting bad debt for the utility. Although AE Internal Audit found CSII was effective, it recommended that the utility hire multiple collection agencies as a way to promote competition and have comparable data. This practice is listed as a best practice by a research firm in 2004. In other words, if two collection agencies are competing with one another, a utility is able to compare the two agencies with each other, because they have the relevant data from them.

Customer Care staff have committed to developing a new solicitation to receive proposals from multiple vendors.

#### **Recommendation**

01. The Senior Vice President of Customer Care should go ahead with the plan to hire multiple debt collection agencies that can be measured and compared against each other concurrently.

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**MANAGEMENT RESPONSE:** CONCUR. Customer Care staff is finalizing a new solicitation allowing for multiple vendors. Solicitation development involved meetings with key personnel beginning in the Fall of 2006 and included the hiring of a consultant who advised on industry best practices for multiple collection agencies.

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#### **Best practices indicate some areas where AE could be more proactive regarding bad debt.**

Implementing a risk profiling system could help AE to further decrease their bad debt. A risk profiling system allows utilities to decrease bad debt by modifying the collections path and utilizing a tier security deposit program based on customer risk. AE offers multiple payment options but does not offer incentives for automatic payments.

**A risk profiling system would allow the utility to create a collections path based on the customer's risk ranking.** Private utilities use risk profiling systems which are now being used by some public utilities to decrease bad debt. Such a profiling system would compile a risk score based on the customer's past behavior with the utility. High risk customers would have shorter collection cycles while low risk customers would have longer collection cycles, as they are more likely to pay their bill. If a customer makes a late payment or has to be disconnected, the customer's risk rating would be increased.

AE is not currently using risk profiling in the collections process. Although AE does use a tick mark system that is helpful for tracking customers that are persistently late with payments, a comprehensive risk profiling system is not being used to minimize bad debt.

**A risk profiling system would also allow for a tiered security deposit program.** A tiered security deposit program may help AE reduce bad debt. In such a program, if a customer does not pay their bill, the security deposit is applied toward the debt. Therefore, if a high risk customer pays a higher security deposit, the money can be used to pay off the balance and the utility does not incur the bad debt. Also, tiered security deposits can increase customer satisfaction. Low-risk customers could be rewarded for having good credit with the utility.

Two municipal utilities, Sacramento Municipal Utility District and Knoxville Utilities Board, have implemented an internal risk assessment tool, or profiling system, which allows them to utilize a tiered security deposit program.

### **Recommendation**

02. To reduce the risk of bad debt, Customer Care staff should formally explore using available information to tailor collections paths and to tier security deposits. In addition, the Senior Vice President of Customer Care should develop and communicate needed enhancements to the planned CIS upgrade team to implement a more comprehensive customer risk profiling system.

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**MANAGEMENT RESPONSE:** CONCUR. Customer Care staff will explore the available information to determine method of assessing risk level for our utility customer account status, including deposit requirements.

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**AE does not offer incentives for automatic payments although the utility does offer many payment options which give customers more ways to pay on time.** Because AE does not offer incentives for automatic payment, it may not be optimally minimizing its bad debt. Some utilities offer incentives to their customers such as waiving a security deposit in exchange for choosing automatic bank drafting. Offering such an incentive could help customers automatically pay their utility bill on time, and therefore reduce the likelihood of delinquencies or bad debt accumulation.

Payment options that AE offers include paying in person, by mail, at drop boxes, by phone (credit card, ATM/debit card, and electronic check), online, through automatic bank drafting, and using levelized billing. According to an AE representative, approximately 40 percent of AE customers pay by electronic means or at pay stations located at grocery stores, another 30 percent use stamp and envelope, and the rest use drop boxes such as at the East branch.

### **Recommendation**

03. To encourage customers to pay their bill on-time and save AE money, the Senior Vice President of Customer Care should formally explore the benefits of offering incentives for customers making payments using automatic electronic funds transfers.

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**MANAGEMENT RESPONSE:** CONCUR. Customer Care staff will study and review incentive strategies within the framework of city regulations and applicable laws.

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**Our work confirmed that, overall, the collection agency (CSII) was not overcharging the City but a portion of charges were not accurate.**

To verify the rates charged by the collection agency, we collected electronic invoices and matched them to account information in AE's billing system. While CSII is not overcharging AE when collecting bad debt, some transactions were inconsistent with contract rates. In addition, we found that AE transferred the majority of accounts early enough to qualify for the lowest contract rate.

**For multiple transactions, the rates charged by CSII were not always consistent with the terms and conditions in the agreement between AE and the collection agency.** Using the "last bill date" as the official date of disconnect for the account, the average rate charged by CSII equaled the contract's defined rate for 62.0 percent of the transactions we reviewed electronically. It appears that CSII overcharged the utility for 3.5 percent of the tested transactions and undercharged the utility for 34.5 percent of the tested transactions. Many of the undercharges are related to accounts from the previous Land Information System (LIS), which was replaced by the current Customer Information System (CIS) in 1999. The contract and rate schedules in effect during the previous system were beyond the scope of our assignment. AE has agreed to study these transactions to ensure CSII complied with the rate specified in the contract to prevent over and undercharging.

AE follows the same methodology we used to verify rates charged by CSII but only reviews a small sample of the transactions. Weekly, AE reviews CSII statements for irregularities, and calculates if the rate charged is correct for that account. While AE is doing some monitoring of the contract, AE staff may need to periodically review all transactions to ensure that rates charged are as specified in the contract.

**Recommendation**

04. To prevent under and overcharging, the Customer Care Process Manager should review all transactions by the collection agency once a year to ensure that transactions are matched and that the correct rates are charged according to the terms in the contract.

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**MANAGEMENT RESPONSE:** CONCUR. Customer Care has developed more stringent requirements for monitoring collection agency transactions for future contracts.

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**For the transactions we reviewed, AE transferred a majority of them early enough to qualify for the lowest rate charged by the collection agency, but did not reach their goal of 100 percent.** As the days of delinquency increase, the likelihood of collection decreases. Therefore, the collection agency charges a lower rate for transfers earlier in the collections cycle and a higher rate when the account is transferred later in the cycle. Overall, AE was able to transfer 95.3 percent of transactions in time to qualify for the lowest rate.

**EXHIBIT 3**  
**Transactions Charged Lowest Rate, January 2004 to May 2007**

<b>Year</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>Total</b>
Charged Lowest Rate	20,979	19,759	21,040	5,771	67,549
Total Transactions*	21,804	21,241	21,651	6,161	70,857
Percent Charged Lowest Rate	96.2%	93.0%	97.2%	93.7%	95.3%

SOURCE: OCA Analysis of reviewed transactions between CSII and AE.



**APPENDIX A**  
**MANAGEMENT RESPONSE**



**ACTION PLAN  
AE BAD DEBT AUDIT**

<b>Rec #</b>	<b>Recommendation Text</b>	<b>Concurrence</b>	<b>Proposed Strategies for Implementation</b>	<b>Status of Strategies</b>	<b>Responsible Person/Phone Number</b>	<b>Proposed Implementation Date</b>
01	The Senior Vice President of Customer Care should go ahead with the plan to hire multiple debt collection agencies that can be measured and compared against each other concurrently.	CONCUR	Customer Care staff is finalizing a new solicitation allowing for multiple vendors. Solicitation development involved meetings with key personnel beginning in the Fall of 2006 and included the hiring of a consultant who advised on industry best practices for multiple collection agencies.	UNDERWAY	Solicitation: Jawana Gutierrez 972-7572  Implementation Peggy Miller 972-7701	Strategy requires council approval of the RCA by December 2007 with a subsequent implementation beginning 30 days thereafter.
02	To reduce the risk of bad debt, Customer Care staff should formally explore using available information to tailor collections paths and to tier security deposits. In addition, the Senior Vice President of Customer Care should develop and communicate needed enhancements to the planned CIS upgrade team to implement a more comprehensive customer profiling	CONCUR	Customer Care staff will explore the available information to determine method of assessing risk level for our utility customer account status, including deposit requirements.	UNDERWAY	Research: Jawana Gutierrez 972-7572  Implementation Peggy Miller 972-7701	AE will complete the risk assessment research and deposit policy revision by March 1, 2008.  Tiered deposit requirement has been currently included in CIS requirements as part of the CIS Minimum

system.					Requirements Proposal.
03 To encourage customers to pay their bill on-time and save AE money, the Senior Vice President of Customer Care should formally explore the benefits of offering incentives for customers making payments using automatic electronic funds transfers.	CONCUR	Customer Care staff will study and review incentive strategies within the framework of city regulations and applicable laws.	PLANNED	Peggy Miller 972-7701	Recommendation for action will be completed by March 1, 2008.
04 To prevent under and overcharging, the Customer Care Process Manager should review all transactions by the collection agency once a year to ensure that transactions are matched and that the correct rates are charged according to the terms in the contract.	CONCUR	Customer Care has developed more stringent requirements for monitoring collections for agency transactions for future contracts.	UNDERWAY	Peggy Miller 972-7701	New contract based on under-way RFP requires council approval by December 2007. Transaction reviews will commence at the end of the first quarter of contract period and on an annual basis thereafter.

Concurrence: concur, partially concur, or disagree.  
Status of strategies: planned, underway, or implemented.

8/24/07  
Date

  
Department Director