CITY OF PHILADELPHIA
PENNSYLVANIA

OFFICE OF THE CONTROLLER

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**REPORT ON INTERNAL CONTROL
AND ON COMPLIANCE AND
OTHER MATTERS**

**SCHOOL DISTRICT OF
PHILADELPHIA**

FISCAL 2014

City Controller
ALAN BUTKOVITZ

CITY OF PHILADELPHIA

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ALAN BUTKOVITZ
City Controller

GERALD V. MICCIULLA
Deputy City Controller

May 18, 2015

Marjorie Neff, Chair
and Members of the School Reform Commission
440 N. Broad Street
Philadelphia, PA 19130

Dear Chair and Members:

In accordance with the Philadelphia Home Rule Charter, the Office of the City Controller conducted an audit of the basic financial statements of the School District of Philadelphia, Pennsylvania as of and for the fiscal year ended June 30, 2014, and has issued its Independent Auditor's Report dated February 13, 2015.

In planning and performing our audit, we considered the School District of Philadelphia, Pennsylvania's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the School District of Philadelphia, Pennsylvania's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the School District of Philadelphia Pennsylvania's internal control over financial reporting.

Attached is our report on internal control over financial reporting and on compliance and other matters, dated February 13, 2015 and signed by my deputy who is a Certified Public Accountant. The findings and recommendations contained in the report were discussed with management at an exit conference. We included management's written response to the findings and recommendations and our comments on that response as part of the report. We believe that, if implemented by management, these recommendations will improve the School District of Philadelphia, Pennsylvania's internal control over financial reporting.

We would like to express our thanks to the management and staff of the School District of Philadelphia for their courtesy and cooperation in the conduct of our audit.

Respectfully submitted,

ALAN BUTKOVITZ
City Controller

cc: William R. Hite, Jr., Ed.D., Chief Executive Officer and Superintendent of Schools
Matthew E. Stanski, Chief Financial Officer
Marcy F. Blender, CPA, Deputy Chief Financial Officer and Comptroller

SCHOOL DISTRICT OF PHILADELPHIA

REPORT ON INTERNAL CONTROL AND ON COMPLIANCE AND OTHER MATTERS

EXECUTIVE SUMMARY

Why The Controller's Office Conducted the Examination

We conducted an examination of the School District of Philadelphia's (District) basic financial statements as of and for the fiscal year ended June 30, 2014 for the purpose of opining on their fair presentation. As part of this audit, we reviewed the District's internal control over financial reporting to help us plan and perform the examination. We also examined compliance with certain provisions of laws, regulations, contracts, and grant agreements to identify any noncompliance which could have a direct and material effect on financial statement amounts.

What The Controller's Office Found

The Controller's Office found that the District's financial statements were presented fairly, in all material respects, in accordance with accounting principles generally accepted in the United States of America and issued a separate report that accompanies the District's Comprehensive Annual Financial Report for the fiscal year ended June 30, 2014. The audit procedures used to arrive at our conclusion regarding these financial statements led us to identify a number of matters involving the District's internal control over financial reporting that need management's attention. Some of the more important matters include:

- Despite improvements achieved by District management over furniture and equipment directly under its control, school principals again failed to adequately prioritize accountability over their equipment. Thirty percent of the equipment we selected from District accounting records could not be found and was presumed either missing or misplaced. Schools regularly disregarded many of the policies and procedures designed to ensure accountability over the District's $246 million equipment inventory.

- Management needs to improve its maintenance of human resource files as documentation supporting salaries and job titles of employees was frequently missing. Failure to maintain such documentation could pose risks of payroll irregularities or violations of federal and/or state employment regulations. In a related payroll issue, the District had made steady improvement in complying with its online payroll approval policy. Unapproved payrolls have declined from 4,200 each payroll in fiscal year 2011 to 477 a pay in fiscal year 2014.

- The District was still holding over $5 million in unclaimed compensation owed to some 1,900 former employees who separated from employment, some as far back as 10 years ago. At least $3.5 million should have been deposited with one of the District's 403(b) retirement plan providers, but as of June 30, 2014 only about $.8 million had been released. Little was also done to decrease the remaining $1.6 million, of which at least $1 million of it should have been escheated to the Commonwealth of Pennsylvania.

What The Controller's Office Recommends

The Controller's Office has developed a number of recommendations to address the above matters. These recommendations can be found in the body of the report.

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GERALD V. MICCIULLA
Deputy City Controller

INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

To the Chair and Members of
The School Reform Commission of the
School District of Philadelphia

We have audited in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the School District of Philadelphia, Pennsylvania (District), a component unit of the City of Philadelphia, Pennsylvania, as of and for the year ended June 30, 2014, and the related notes to the financial statements, which collectively comprise the District's basic financial statements, and have issued our report thereon dated February 13, 2015.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the District's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the District's internal control. Accordingly, we do not express an opinion on the effectiveness of the District's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the District's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards.*

We noted certain conditions that are not required to be reported under *Government Auditing Standards*, but nonetheless represent deficiencies in internal control that should be addressed by management. These other conditions are listed in the table of contents and described in the accompanying report.

The District's written response to the other conditions identified in our audit is included as part of the accompanying report. We did not audit the District's response and, accordingly, we express no opinion on it. We have also included our comments to the District's responses that we believe do not adequately address our findings and recommendations.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the District's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the District's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

GERALD V. MICCIULLA, CPA
Deputy City Controller
Philadelphia, Pennsylvania
February 13, 2015

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SCHOOL PRINCIPALS FAILED TO ADEQUATELY PRIORITIZE ACCOUNTABILITY OVER THEIR EQUIPMENT

During our prior-year examination, we observed that District management had made notable improvements to key aspects of accounting for furniture and equipment directly under its control. For instance, we noted proper documentation was available to support the deletion of equipment from accounting records. Additionally, at two District storage facilities, furniture and equipment were separated by type of equipment, properly tagged, and appropriately accounted for in storage facility records. We observed that no furniture and equipment was left unattended at closed school locations. District management had also developed a "Personal Property Checklist for Transitioning Schools" that provided guidance on the appropriate handling of equipment and records at individual schools designated for closing.

As part of the current audit, we observed that District management continued with its efforts to improve accounting over school-located equipment. It issued a memo and letter to school principals and their appropriate designees that described the responsibilities for maintaining an accurate and updated equipment inventory. Moreover, it reiterated to school officials that an on-line link to the policies and procedures existed on the District's website.[1]

Despite the actions of management, individual schools we visited[2] during the current audit did not always adequately account for their equipment. For instance, of the 125 sampled items of equipment listed in the District's accounting records as of April 2014, for the schools we visited, 30 percent (37 out of 125) could not be located and were presumed either missing or misplaced. The items in question, with a cost value of over $87,000, included computers, laptops, cameras, printers, audio visual supplies, a camcorder, a piano, a 52 inch HDTV, a food cutter, and a Powerheart cardiac machine. Additionally, in many instances, items we haphazardly observed at these same schools could not always be identified in the accounting records. Of 125 items observed at the schools, 18 percent (23 out of 125) could not be found in the records. These items included computers, a television, a piano, a freezer, and a steam table.

Our observations during the visits revealed that schools regularly disregarded many of the policies and procedures that management has designed to ensure accountability over the District's $246[3] million equipment inventory. Specifically we noted that:

- school personnel did not always accurately update their inventory equipment records,
- school personnel did not always affix school property tags to equipment, and
- equipment was removed from school premises without proper authorization or documentation.

We believe the conditions listed above , which are discussed below, significantly contributed to the missing, misplaced, and/or items of equipment that we could not account for in the District's accounting records. Table 1 below summarizes the conditions observed at each of the schools visited as part of the audit.

<u>School Personnel Did Not Always Accurately Update Their Inventory Records</u>

Principals and their designees are responsible for ensuring that all equipment assigned to their schools is

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[1] We considered this to have been the implementation of our prior year recommendation number 600113.02.
[2] We selected the following ten schools: Frankford High School, Swenson High School, Philadelphia High School for Girls, Penn Treaty High School, Bartram High School, Creative and Performing Arts High School, Franklin Learning Center, Roxborough High School, Martin Luther King High School, and Randolph Technical High School.
[3] The $246 million personal property value, as reported in the District's Comprehensive Annual Financial Report for the year ended June 30, 2014.

Table 1: Summary of Conditions Noted Regarding School Equipment

School	Items Selected from Records for Observation	Items Missing or Misplaced	Items Selected at Location	Items Not Found in Records	Inventory Not Updated	Equipment Not Tagged	Unauthorized Removal of Equipment
Frankford High School	10	1	10	0			✓
Swenson Arts Technical High School	15	1	15	1	✓		
Philadelphia High School for Girls	10	1	10	2	✓		✓
Penn Treaty School	15	1	15	0	✓		
Bartram High School	10	8	10	4	✓	✓	
Creative & Performing Arts High School	15	7	15	1	✓	✓	✓
Franklin Learning Center	10	2	10	2	✓	✓	
Roxborough High School	10	5	10	5	✓	✓	
Martin Luther King High School	15	5	15	5	✓	✓	
Randolph Technical High School	15	6	15	3	✓	✓	✓
Totals	125	37	125	23			

Prepared by the Office of the Controller based on observations at selected school locations

accurately accounted for. District policy requires schools to take an annual physical count of their equipment. Upon completion of the physical count, school officials are directed to make any necessary transfers, deletions, or modifications. School personnel failed to comply with the District's policy, and did not properly update their inventory records.

With the exception of Frankford High School, none of the schools we visited had accurately updated their inventory records of equipment as required by District policy. Consequently, school officials often could not always locate items we had selected from the records to observe. Two of the schools with the most significant number of missing or misplaced items were Bartram High School and the Creative & Performing Arts High School. Bartram, for example, could not locate eight of the ten items we had selected from the District's accounting records. Of the eight items not located, six were computers, including both desktops and laptops. The other two missing items included an audio visual piece of equipment and a lawnmower. The cost of these eight items totaled in excess of $11,000. At the Creative & Performing Arts High School, where we had selected 15 items to observe, seven were unlocated. These items included a 52" upright piano, two computers, a digital camera, and three items of what appeared to be recording-related equipment. Their costs totaled $19,000.

<u>District Personnel Failed To Affix School Property Tags To Some Equipment And Furniture</u>

For 12 of the 37 items we could not observe, school officials showed us at least one other item similar in description to the sampled asset. However, we could not positively identify those items as the sampled assets because there were no property identification tags affixed to them. Additionally, even though the District's inventory records included a field for the manufacturer's serial number, the field remained blank and we were unable to positively identify the selected items through use of this number.

District Policy 750.0, which establishes procedures over equipment security, requires that all District-owned furniture and equipment be properly identified by affixing a standard property identification tag to it. Property tags are used to track and identify District-owned equipment and serve as a safeguard against theft.

As in prior year audits, our visits to selected schools continued to disclose numerous instances of when District personnel failed to ensure that all eligible furniture and equipment were properly tagged.

<u>Equipment Was Removed From School Premises Without Proper Authorization Or Documentation</u>

District Policies 750.0 (for equipment other than computers) and 750.1 (for computers), require that before removing equipment from a school, employees must prepare and submit specific documentation to the principal for approval. The principal must then retain the documentation. We continued to find that school personnel did not always prepare and submit the required documentation and obtain appropriate authorization when removing equipment from school premises. Specific examples noted during the audit included:

- At Frankford High School, we could not locate a laptop computer selected from the school's equipment inventory records. The school's principal asserted that the laptop had been taken by a teacher who was out on sabbatical. However, he was unable to provide any supporting documentation for the approved removal of the laptop from the school premises.

- At both the Philadelphia High School for Girls, and at the Creative and Performing Arts High School, school personnel informed us that a laptop computer we asked to observe had been taken home by a teacher. Again, for both these schools, we determined that the required documentation for removing these computers was not available for our inspection.

- At Randolph Technical High School, the principal informed us that the laptop computer we could not locate had been taken home by him. However, once more we determined that the required documentation for removing the computer was unavailable for our inspection.

<u>Recommendations:</u>

To improve accountability over equipment at the schools, we recommend that District management:

- Contact the principals at the schools we visited and work with the appropriate school personnel to reconcile and account for differences noted during the audit [600112.02].

- Send principals a directive requiring them to contact the Office of Accounting Services and Audit Coordination to request identification tags for untagged equipment and instruct them to immediately affix identification tags to all equipment when acquired [600108.01].

- Require District personnel to enter manufacturer serial numbers into the appropriate field within the recordkeeping system when this information is available [600112.06].

- Require that School employees, including principals, comply with policies 750.0 and 750.1 and maintain proper documentation for the removal of all equipment from school locations [600114.01].

DOCUMENTATION FOR EMPLOYEE SALARIES IS NOT ALWAYS MAINTAINED IN HUMAN RESOURCE FILES

Proper management of human resources requires that documentation be maintained on file for all employees. Such documentation should include, for example, employee applications, offers and terms of employment, as well as evidence and justification for promotions. Failure to maintain such documentation could expose the District to risks of payroll irregularities or violations of federal and /or state employment regulations.

In our prior year report, we commented that the District could not provide supporting documentation or approval for changes made to employees Pay Progression Dates[4] (PPD) within the Advantage System.[5] When an employee is hired, among other personal information entered into the Advantage System, Human Resources (HR) staff enter an employee's starting date and initial salary amount. Our review of the system had revealed, however, that under certain circumstances the PPD was changed in order to adjust an employee's salary for any of the following reasons:

- position changes,
- re-hired employees,
- credit given for prior experience,
- contract changes or raises,
- additional degrees, or college credit obtained,
- reclassification of pay ranges, or
- the result of an employee pay challenge.

District HR personnel previously asserted that when one of the above circumstances occurred, backdating an employee's PPD in the Advantage system was the most efficient way to accomplish the necessary salary change. We observed there were sixteen staff members authorized to make such changes, but the changes were undocumented, and we saw no evidence that a supervisor had reviewed or approved them. Moreover, we noted that the Advantage System provided no approval history of the PPD changes that had occurred. For example, we observed one instance where an employee's PPD had been changed in the Advantage system to a date that was two years earlier than the employee's actual start date of employment at the District. There was no evidence of approval for that PPD change in the Advantage system, nor was there any documentation supporting the change in the employee's personnel file.

District management responded by indicating it would adopt certain measures by fiscal year 2015 to mitigate our concerns, including:

- an improved internal supervisory review process for documentation and retention of change information;
- a report showing viewable historical changes; and
- more specific Advantage personnel transaction change codes.

Through the end of our current-year fieldwork, District management had not yet adopted the above measures. Accordingly, during our current year audit, we continued to observe undocumented changes to employee pay rates and job titles. Of 110 randomly selected employees, we found 22 instances of when their employee files did not contain adequate documentation to substantiate their current pay rates, job titles, or employment start dates. Authorized PPD Change Forms, New Appointment Forms, or Prior Experience Verification forms should have been in the employees' files to document this employment-related information. District personnel eventually provided us with some alternate forms of documentation to satisfy our audit objectives with respect to the 22 employees referred to above. For instance, we observed original employee applications, letters of employment offers, and some internal transfer documents. However, according to the District's policy, a "New Employee Information Form," which includes the employee's education, certifications, job title, and starting salary should have been completed for each employee. That form, along

[4] A Pay Progression Date generally represents the start date of a union represented employee and becomes the basis for when annual salary increments occur.
[5] ADVANTAGE is the District's financial and human resources database.

with any documenting changes in rates and titles should have been readily accessible in the employees' files for our review.

Recommendations:

To improve control over the District's payroll, we recommend management implement the planned system changes that will provide:

- documentary evidence of individuals that have initiated, reviewed and approved changes to PPDs;
- a history of all PPD changes that occur; and,
- documentary evidence for the reason(s) changes to employee PPDs were necessary [600113.01].

DISTRICT MAKING STEADY IMPROVEMENT IN COMPLYING WITH ONLINE PAYROLL APPROVAL POLICY

In several prior reports, dating back to fiscal 2011, we have commented that the District processed its bi-weekly payroll regardless of whether responsible administrators had approved their units' online payroll entries as required by the District's established procedures for authorizing payroll. Prior to processing the payroll, the District's Payroll Department did not hold unit administrators who had failed to approve their payrolls accountable. Instead, the District's computerized payroll system automatically approved the payroll entries for those units with no administrator approval. District management asserted that the practice was necessary because of time constraints associated with the schedule for processing payroll, the large volume of pay locations, staff shortages in the payroll department, and system limitations.

In response to our previous comments, and in an effort to improve compliance with the established online approval policy, District management had implemented certain corrective actions. Those actions included developing a payroll report that identified administrators who had not approved payroll along with the affected locations and the numbers of employees for each pay period. The reports were monitored and non-compliant administrators and their managers were sent notifications when a payroll had not been approved, as required by policy. Subsequent to the corrective actions implemented, the incidents of noncompliance decreased. For instance, in fiscal 2011, an average of 4,200 payrolls per pay period was processed without the required administrative approval. However, in fiscal years 2012 and 2013, the average number of unapproved payrolls decreased to 2,400, and 647 respectively.

Our current year audit for compliance with the District's online payroll approval procedure continues to exhibit improvement. We observed that the average number of employees whose payrolls were processed without the unit administrator's approval declined to 477 employees per pay period. The number of employees with unapproved payrolls for the entire fiscal year 2014 totaled 12,396.

The review and approval of employee payroll by responsible individuals each pay period is an integral part of the integrity of the payroll process. Without it, the risk of employees being paid for unearned time increases. District management must persist in its efforts to achieve total compliance with its established payroll approval policy.

Recommendations:

We commend the District's improved compliance with its established procedures for authorizing payroll, and continue to recommend that management continue with its review of reports each pay period to identify non-complying administrators, and to hold violators accountable. Management should document all follow-up telephone calls and notices to non-complying administrators and their supervisors. We also suggest that management consider establishing some form of progressive disciplinary action for administrators who regularly and consistently violate the policy [600111.01].

DISTRICT STILL HOLDING MILLIONS OWED TO FORMER EMPLOYEES FROM 2001 TO 2013

When employees separate from District employment, they are entitled to termination pay for unused leave time. The District accounts for the unused leave in its Vacation, Personnel and Illness Leave (VPIL) report. Termination pay to separated employees aged 55 and over is required to be deposited directly with one of the District's 403(b) retirement plan providers as "employer contributions."

As summarized in Table 2 below, our current audit of District records revealed that as of June 30, 2014, the District was holding over $5 million in unclaimed compensation owed to some 1,900 former employees who had been separated from employment for more than a year. As many as 1,200 of those employees have been separated for over four years, and some as far back as 13 years. Yet, the former employees have still not received monies owed to them. Additionally, by our estimate more than $1 million of the total amount owed should have been escheated to the State's Unclaimed Monies Fund.

Table 2: Employee Termination Pay Outstanding for More Than One Year as of June 30, 2014

Column A	Column B	Column C	Column D	Column E
Fiscal year of separation	**Number of employees owed termination pay**	**Termination pay owed to those age 55 and over at separation (in millions)**	**Termination pay owed to those under age 55 at separation (in millions)**	**Total Termination Pay owed (in millions) (Col. C+D)**
2013	263	$ 1.1	$0.3	$1.4
2012	348	0.8	0.3	1.1
2011	101	0.3	0.1	0.4
2010 and prior	1220	1.3	0.9	2.2
Totals	1932	$ 3.5	$1.6	$5.1

Source: Prepared by the Office of the Controller based on analysis of the District's VPIL Report

Of the $5.1 million shown above, outside counsel for the District has advised management that $3.5 million — the amount of termination pay owed to those former employees whose age at separation was 55 and over (Column C) — is not subject to the Pennsylvania's Abandoned and Unclaimed Property Law (escheat law). Counsel indicates that because the District's 403 (b) Plan requires that termination pay for any employee severing employment at age 55 or older must be contributed by the District to the Plan as an employer contribution, the amounts may not be paid to the employees in cash and represent plan assets, which under the law are not subject to escheatment. Based on outside counsel's advisement to the District, we will no longer recommend that management seek an opinion from the Treasury Department and consider our previous recommendation [600111.11] as resolved.

In a matter related to the $3.5 million associated with the 55 and older group, the District took little action with respect to resolving the outstanding amounts. During fiscal year 2013 the District entered into an agreement with one of its 403(b) Plan providers to begin actively accepting the unclaimed termination pay, establishing individual accounts, and attempting to locate the former employees. However, since July 2013, the District had transferred to the provider only $.8 million of termination pay for 153 employees.

Little action also appears to have been taken with respect to termination pay applicable to the group of employees who were under age 55 when they separated. Pennsylvania's escheat law requires that unclaimed wages or other compensation for personal services that have remained unclaimed by the owner for more than two years after it becomes payable or distributable is presumed unclaimed. The law further states that all abandoned and unclaimed property is subject to the custody of the Commonwealth. However, as of March 2015, the District had still not escheated any unclaimed termination pay to the state for those employees in the group who separated from the District prior to calendar year 2012. At June 30, 2014, that amount totaled $1.0 million.[6]

Recommendation:

To ensure the accuracy of the VPIL report, as well as the liability for termination compensation, and to reduce long outstanding termination pay amounts, the District should:

- Begin actively increasing referral amounts to 403 (b) plan providers so as to complete the termination process for all employees who separated when they were 55 and older. District management should make certain that Plan providers, who agree to accept the unclaimed termination pay, establish individual accounts for the former employees and provide detailed reports on efforts that have been taken to locate any former employees that are missing. [600112.14].

- When required, remit to the Treasury Department for escheatment all unclaimed termination pay for the group of former employees who separated when they were under 55 years of age [600108.08].

SCHOOLS INADEQUATE MANAGEMENT OF PETTY CASH FUNDS CONTRIBUTED TO THOUSANDS OF DOLLARS IN LOST FUNDS

In several of our past audit reports, we commented on numerous control weaknesses and instances of non-compliance with established control procedures involving operations of the District's petty cash funds. Our current year testing disclosed that management of these funds continued to be inadequate and in need of improvement. Our audit of petty cash funds disclosed the following conditions: (1) petty cash shortages in the thousands of dollars at 60 locations were written off; (2) of five selected schools visited, four had shortages or overages; (3) petty cash funds for over 30 schools exceeded the authorized amounts; (4) dormant accounts remained open; and (5) two schools had not assigned anyone as petty cash custodians. We believe these findings, discussed in more detail below, continue to adversely affect the District's ability to properly safeguard and account for its remaining 120 accounts, which totaled close to $180,000 at June 30, 2014.

Petty Cash Shortages in the Thousands Written Off

In previous reports we remarked about significant shortages in some of the District's petty cash accounts. We recommended that the District work with the affected schools' personnel to investigate the causes of these shortages and resolve the discrepancies appropriately. We further recommended that if adequate documentation could not be found to account for the shortages, then District management should request that responsible school personnel reimburse the District for those shortages, and that accounting records be adjusted accordingly to reflect the correct petty cash balances for the affected schools.

Our current year examination revealed that the District reconciled some of the petty cash accounts, identified the shortages, and then recorded a loss of some $53,000 in petty cash write-offs related to those shortages.

[6] This amount is derived from the sum of rows for fiscal years 2011, and 2010 and prior in Column D.

Personnel at 60 school locations were unable to provide the appropriate documentation to support the distribution of the unaccounted for petty cash funds, which created the resulting shortages. Management provided no evidence that, any of the responsible parties had reimbursed the District for the missing funds.

Most Schools Visited Had Shortages or Overages

In our last several audits, we reported on significant unresolved shortages in many of the District's petty cash accounts. For instance, in our fiscal 2012 report, for four of the six schools selected for testing, we noted over \$14,000 in shortages, which remained unresolved in fiscal 2013. During our fiscal 2013 testing, additional shortages were also noted. Subsequent review of petty cash accounts at those six locations found that three locations were closed, and portions of the balances were written-off.

District accounting records indicated that the five schools we visited during our current year audit should have had total authorized petty cash funds of \$25,957 in their custody. However, our review of those schools' supporting bank and disbursement records only accounted for \$20,100 of this amount. Accordingly, the funds were short by \$5,857, as detailed in Table 3 below.

Table 3: Petty Cash Fund Discrepancies Noted for Selected Schools Visited

School	Balance Per District Records as of April 15, 2014[7]	Balance Accounted For By Auditor	Account Overage (Shortage)
Randolph Technical High School	\$ 7,000	\$ 446	(\$ 6,554)
Martin Luther King High School	6,000	5,825	(175)
Frankford High School	6,000	6,861	861
CAPA High School	1,957	1,968	11
Girls High School	5,000	5,000	0
Total	\$25,957	\$20,100	(\$5,857)

Source: Prepared by the Office of the Controller based on analysis of s petty cash records

Many Schools Had Petty Cash Funds Exceeding Authorized Amounts

In fiscal year 2008, District management announced plans to reduce the authorized amount of the petty cash funds held at various schools. To reduce each school's authorized amount, management decided it would process, but not repay the schools' petty cash reimbursement requests until the individual fund balances equaled the revised lower amounts. This practice proved to be ineffective in achieving the desired reductions because of the large number of funds with low turnover. Therefore, in November 2009, District management issued a directive instructing principals at schools with petty cash funds higher than the desired authorized amount, to draw and submit checks to the District's Central Accounts Payable Unit in the amount needed to reduce the balances to the desired reductions. That policy also proved to be ineffective, as not all the schools complied with the District's directive. We observed that as of March 2013 and April 2014, there were 72 and 46 District locations, respectively, where the petty cash balance still exceeded the desired authorized amount.

As part of our fiscal 2013 report, we again recommended that for all petty cash funds where the planned reduction in the authorized amount had not been completed, District management should enforce its November 2009 directive instructing school principals to reduce their petty cash funds by paying those monies directly over to the District via a check drawn on the bank account of the school's petty cash fund. We further suggested that the District review the remaining petty cash funds for infrequent activity and

[7] Balances as of April 15, 2014 were the most current figures made available to auditors.

reduce the authorized amounts accordingly. District management acknowledged the need to improve controls over, and the reporting of its petty cash funds. As a result, in fiscal year 2013, the District closed 200 petty cash accounts where the petty cash account balance exceeded the desired authorized amount by a total of $67,658, developed a new accounting and compliance model, reconciled most petty cash accounts, and expressed a plan to discontinue the use of all petty cash accounts at the school level by the end of the 2013/2014 school year.

During fiscal year 2014, management's continued efforts to make improvements by closing an additional 109 petty cash accounts, and discontinuing the use of petty cash at the school level. However, despite these actions, our current year examination revealed there were still 32 locations where petty cash account balances exceeded the desired authorized amount by a total of $41,125, and 120 accounts that remained opened.

<u>Selected Schools' Accounts Were Dormant for Entire Fiscal Year</u>

Of the five schools selected for our current year examination, we observed that four locations had not used their petty cash accounts at any time during fiscal year 2014. At one school, Randolph Technical High School, one check was written in March 2014. However, according to the school's principal, it was written in error, and should have actually been written from the student activities fund instead. As part of the District's plan to close all petty cash accounts, the five schools selected for audit were all subsequently closed by June 30, 2014.

<u>Absence of Assigned Custodian At Selected Locations</u>

At two of the five locations selected for audit — Frankford and Randolph — there was no petty cash custodian assigned to manage the accounts, and no one else could provide the auditors with the requested documentation.

<u>Recommendations</u>:

With regard to the petty cash shortages found by our audit, we continue to recommend District management work with personnel of the affected schools to investigate the causes of the shortages and resolve the discrepancies appropriately. If adequate documentation cannot be found to account for the shortages, then District management should request that responsible school personnel reimburse the District for the shortages [600112.08]. Additionally, adjust District accounting records accordingly to reflect the correct petty cash balances for the affected schools [600112.09].

For all petty cash funds where the planned reduction in the authorized amount has not been completed, District management should enforce its November 2009 directive instructing location administrators to reduce their petty cash funds by paying those monies directly over to the District via a check drawn on the fund's bank account [600112.10].

To enhance control procedures and minimize the risk of undetected errors or misappropriation of petty cash funds, we again recommend that the District monitor and enforce policies and procedures relating to the management and reconciliation of all petty cash imprest funds, including a requirement that individual schools maintain adequate segregation of duties over the funds [600108.04].

FAILURE TO FOLLOW PROCEDURES FOR STUDENT ACTIVITY FUNDS HAS PLACED MILLIONS AT RISK FOR THEFT AND MISUSE

In several prior reports, we have commented on certain procedural deficiencies we observed over the administration and accounting of student activity funds at individual schools visited as part of our audits. These deficiencies have placed the funds, which at May 31, 2014 totaled $5 million, at greater risk for fraud or misuse.

The District has developed a comprehensive, written *School Fund Manual* (Manual) for Student Activity Funds (SAF). This manual, which is accessible on the District's website, provides guidance for school personnel and contains both specific responsibilities and detailed procedures required to properly maintain the funds. SAFs are private, student owned funds collected from students for a specific educational purpose. However, at the school locations we examined, we continued to find a lack of compliance with the established procedures contained in the Manual designed to safeguard those funds.

In May 2014, as part of the current audit, we examined compliance with procedures outlined in the Manual at the following three high school locations: Swenson High School, Roxborough High School, and Franklin Learning Center High School. Additionally, we selected 17 other schools and examined their fiscal year-end student activity funds financial reports on file in the District's Office of Accounting Services and Audit Coordination. The combined fund balances at May 31, 2014 for the 20 schools tested was $3 million, 58 percent of the $5 million balance for all Student Activity Funds. During our audit of the 20 schools, we noted the following control deficiencies:

- non-compliance with bidding requirements;
- finance committees not being established;
- activity funds with negative account balances;
- inactive account balances not closed;
- very old outstanding checks listed on bank reconciliations; and
- improper retention of school-related funds.

Each of these deficiencies, which are discussed below, continues to adversely affect the District's ability to properly safeguard and report on the funds.

<u>Non-Compliance With Bidding Requirements</u>

Bidding requirements, as described in the Manual, direct school personnel to obtain, and retain on file, at least three competitive bids for any purchase exceeding $4,000, and for all photography and yearbook contracts. Our audit revealed that two of the schools did not comply with those procedures. According to the school operations officer at Roxborough, bids for purchases over $4,000 were not solicited. At the second school, Swenson, the operations officer stated he did not know if the biding process for contracts over $4,000 was used and could provide no other evidence to suggest that it was. Although operation officers are not the activity sponsor, their responsibility requires them to maintain and review the records of each activity sponsor, and ascertain that sponsors have complied with the Manual. Failure to seek bids may prevent schools from obtaining the most competitive prices. Moreover, it can also give the appearance that the selection process may not have been fair and unbiased.

<u>Schools Did Not Establish Finance Committees</u>

The Manual requires school principals to establish finance committees for SAFs. These committees are to advise principals on investing excess cash and ensure that minutes are issued documenting the investment decisions made by the committees. The SAFs' balances at the three high schools we visited totaled over $230,000 at May 31, 2014. Because of the significance of this sum, we believe finance committees should have been established. However, our observations revealed this had not occurred.

Activity Funds With Negative Account Balances

Our observations of the fiscal year-end financial reports for the SAFs indicated 12 of 20 schools we examined reported negative equity for at least one type of student activity fund included in the report. This negative equity ranged from ($25) to ($10,823) and totaled ($58,948). Manual procedures require that school operations officers are responsible for processing expenditures, and they may not process any expenditure if the balance of the activity fund is insufficient. The existences of negative balances for individual activities suggest that disbursements were made even though there were insufficient funds on hand to cover those disbursements. It also implies that the 12 schools used monies from other activities with positive balances, thus commingling funds, which is strictly prohibited.

Inactive Account Balances Were Not Closed

Observations of the year-end financial reports also revealed that 17 of the same 20 schools had 330 inactive accounts totaling close to $430,000. All 330 accounts were inactive for at least one year. According to the Manual, student groups are to decide on the dispositions of any funds remaining after each program's conclusion. In the absence of such designation, after one year, the excess funds are to be transferred to the school's student body activities account (SBAA), and used for the general benefit of students. Dormant accounts provide the opportunity for funds to be used for unauthorized purposes

Very Old Outstanding Checks Listed on Bank Reconciliations

For six of the 20 schools we examined, 80 checks totaling some $9,300 had been outstanding for over one year. At one location, South Philadelphia High School, a check had been outstanding for over nine years. The Manual requires both the principal and school operations officer to monitor outstanding checks as part of the bank reconciliation process. If a check is outstanding for longer than six months, the operations officer is instructed to contact the payee and determine if he/she intends to cash the check, if the check should be reissued, or if it should be written off. Failure to properly resolve long outstanding checks unnecessarily complicates the bank reconciliation process, and indicates non-compliance with the state's escheat laws.[8]

School-Related Funds Were Improperly Retained

Our observations of financial reports of SAFs for selected schools disclosed that at May 31, 2014, 13 of 20 schools had improperly retained over $98,000 of the District's school-related funds in their SAF accounts. Although these funds are deposited, maintained, and disbursed from a school's SAF checking account, they are not SAFs. Instead, school-related funds represent monies collected by a school and held temporarily until remitted to the District. Examples of such funds include grant funds, transcript fees, lost book and equipment repayments, identification card replacement fees, and vocational education shop proceeds. Procedures require that school-related funds be temporarily deposited into SAF accounts, and later remitted to the District's Office of Management and Budget (OMB).

[8] The Commonwealth of Pennsylvania's escheat laws require that unclaimed property (other than payroll checks) be turned over to the state after remaining unclaimed for five years.

Recommendations:

To prevent misuse of SAFs, we continue to recommend that principals and school operations officers comply with the guidance described in the Manual. District management should reinforce the importance of compliance with Manual guidance at the annual training session for principals [600108.03]. Additionally, management should ensure that other school employees who are responsible for management or control of SAFs are also properly trained, and held accountable for compliance with the Manual's guidance [600114.02].

SCHOOLS FAILURE TO COMPLY WITH MANAGEMENT'S PROCEDURES HAVE CONTRIBUTED TO HUNDREDS OF UNACCOUNTED FOR TRANSPASSES

School personnel are not complying with the District's established distribution procedures for the $36.5 million student TransPass Program. During our audit of fiscal year 2014 TransPass activity for a one-week period at five different schools,[9] school personnel could not account for 230 of the passes valued at $4,200.[10]

Since fiscal year 2008, the District's student "TransPass" program has provided free transportation to Philadelphia public and non-public school students through the issuance of weekly student TransPasses.[11] The TransPasses are issued to:

- students living 1.5 or more miles from school;
- special education students;
- students participating in desegregation programs and living one mile or more from assigned schools; and
- students who must cross hazardous roads on their commute to school.

District wide procedures for the TransPass Program require that weekly, school personnel print a list of students eligible for free student transpasses from the school computer network. After viewing a student's identification card, school personnel are to hand the students their TransPass and then check off each of the recipients' names on the eligibility list. The school employee performing this function is then to sign and date the bottom of the eligibility list verifying that those students whose names are checked off actually received the passes. At the end of each month, school personnel must complete a "Summary of Free Student Transpasses" form, which for each week account for the number of transpasses available for distribution, the number of them distributed, and the number of them remaining undistributed. Leftover TransPasses are to be stored in a safe place in the school until picked up by the District's Transportation Services Department.

In prior reports we have commented on weaknesses and breakdowns in the District's procedures for distributing and accounting for student TransPasses at individual schools. For example, school personnel regularly determine the number of distributed Transpasses on the "Summary of Free Student Transpasses" form by plugging it. They simply take the number of TransPasses to have been distributed and subtract from it the number of TransPasses they assert remain in their possession. Such a practice defeats the District's procedures designed to ensure accountability and prevent theft and irregularities.

During the current audit, we observed an increase in the number of missing TransPasses as compared to the prior year. In fiscal year 2013, we observed 13 of the passes unaccounted for, while in fiscal year 2014, the number of missing passes totaled 230.

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[9] The five high schools where we reviewed TransPass procedures were the following: Martin L. King High School, Frankford High School, Sewnson High School, Philadelphia High School for Girls, and Penn Treaty High School.

[10] Price of a week-day TransPass ($3.62) x 5 days x 230 missing TransPasses = $4,163 rounded to $4,200.

[11] The District purchases student TransPasses from the Southeastern Pennsylvania Transportation Authority (SEPTA).

For the five schools visited, we examined TransPass activity for one selected week. Using records provided by each school and the District's Transportation Services Department, we recalculated the number of undistributed TransPasses. We compared our recalculated amount for undistributed TransPasses to the undistributed amount shown on the "Summary of Free Student Transpasses" form. Penn Treaty High School did not prepare the summary form and therefore, we could not compare our results to those claimed by the school. Table 4 below identifies the schools and the missing number of transpasses at each.

Table 4: Audit Results of TransPass Activity by School[12]

Column A High School	Column B Number of TransPasses Received Per Auditor	Column C Number of TransPasses Distributed Per Auditor	Column D Number of TransPasses Unclaimed Per Auditor (Col. B –C)	Column E Number of TransPasses Unclaimed Per School District	Column F Number of TransPasses Unaccounted For (Col. D –E)
M. L. King High School	520	390	130	55	75
Frankford High School	493	413	80	80	0
Swenson High School	650	607	43	49	-6
Girls High School	1,080	984	96	90	6
Penn Treaty High School	380	225	155	CND	155
Total	3,123	2,619	504	274	230

CND = Could Not Determine – Summary of Free Student TransPass form was not prepared.
Source: Prepared by the Office of the Controller based on analysis of the data from the sources listed in footnote 12 below.

In addition to the ongoing practice of plugging the number of TransPasses distributed, as we have previously commented on in at least one prior report, we observed the following conditions as part of our current year examination:

- At four high schools – Martin L. King, Frankford, Swenson, and Penn Treaty – we observed that the eligibility lists were not signed by the school employees who gave out the TransPasses to attest that all students whose names were checked off actually received the passes.

- At two high schools – Girls and Penn Treaty - we observed that the "Summary of Free Student TransPasses" form was not always in use. The school principal and the person responsible for the TransPasses at Penn Treaty High School asserted they were unaware of the requirement to use the form. At Girls High School, the last summary prepared was for the month of September 2013.

- At Frankford and Swenson high schools, personnel who prepared the monthly "Summary of Free Student TransPasses" form did not properly calculate the number of distributed TransPasses.

At all five high schools, we found that undistributed TransPasses were not regularly picked up by the District's Transportation Services Department. That department uses an armored vehicle company to

[12]Sources of information for the TransPass reconciliation presented in Table 4 were as follows:
- Figures in columns B were obtained from the auditor's review of TransPass receipt/delivery records at the school and the District's Transportation Services Department.
- Amounts in column C represented the auditor's count of checkmarks and/or student initials or signatures appearing on the distribution listings provided by school personnel.
- Figures in column E were obtained from the auditor's review of the Summary of Free TransPass form at the school.

make the pick-ups, but ongoing disputes between the company and the District over terms of the company's contract have impacted the regular pick-up schedule. According to District management, it is considering terminating the contract with the uncooperative vendor.

<u>Recommendations:</u>

To improve accountability over TransPass activity and reduce the risk of theft and irregularities, we continue to recommend that District management monitor and better enforce designed procedures over the distribution of student TransPasses [600111.08]. In particular, school personnel responsible for preparing the monthly "Summary of Free Student TransPasses" form should be instructed to prepare the form properly. Rather than plugging the number of passes distributed, they should review the TransPasses actually given out as evidenced by student names on the eligibility list that have been checked off as having received the passes. The difference between the number of TransPasses received and those distributed should agree to the number of TransPasses still on hand and undistributed. Any discrepancies noted during this process should immediately be brought to the attention of the principal and investigated [600111.09].

To ensure regular monthly pick-ups of undistributed Transpasses, District management should determine if it can reconcile its differences on contract terms with the armored vehicle company. If reconciliation cannot be accomplished, management should discontinue the relationship and seek another vendor more amiable towards its needs [600113.03].

MANY DISTRICT EMPLOYEES NOT COMPLYING WITH STATEMENT OF FINANCIAL INTERESTS FILING REQUIREMENTS

Nearly 10 percent of District employees required under state law to disclose their financial interests failed to do so for calendar year 2013. Some of the employees were upper management officials from both the District's central administration and schools, including a deputy, and numerous principals.

Under the Pennsylvania Public Official and Employee Ethics Act (PA Act 93 of 1998), (Act), District employees responsible for taking or recommending official action of a non-ministerial nature must annually file Statement of Financial Interest form (SFI). Examples of these employees include members of the School Reform Commission, District management (e.g. chief executive officer and chief financial officer), office heads, and principals. The Commonwealth of Pennsylvania may impose penalties, such as a fine and/or imprisonment, upon any person subject to the Act who fails to make a complete, accurate, and timely filing.

Our examination of calendar year 2013 SFI forms, on file at the District's Office of Human Resources, revealed that 42 (8.9 percent) of the 472 employees required to file SFI forms, did not submit them. Although improved over last year's 14.3 percent non-compliance rate, nearly 60 percent of the employees failing to file were active School District employees. The remaining 40 percent of non-filers were no longer employees, but under the law are still required to file since they were active employees some time during calendar year 2013.

Annual SFI forms can be useful in recognizing potential conflicts of interests or identifying related party transactions involving employees that may require special disclosure in the financial statements. In previous audit reports, we have suggested to management that it review these forms for those purposes. In its response to our fiscal year 2012 and 2013 reports, the District indicated that it intended to implement a review process starting in fiscal year 2014. Our follow-up during the current audit disclosed this process had yet to be performed.

Recommendation:

We continue to recommend that the District persist in its efforts to achieve full compliance with SFI filing requirements, particularly with regard to active District employees and top District management. In addition, management should ensure that all SFIs submitted are independently reviewed to determine whether any financial statement disclosures are required [60107.05].

IMPROVEMENTS EVIDENT IN THE DISTRICT'S EFFORTS TO PUBLISH MINUTES OF PUBLIC MEETINGS

In our prior year report, we commented on District management's non-compliance with the Pennsylvania Consolidated Statutes Title 65, Section 706, titled "Minutes of Meetings, Public Records and Recording of Meetings," (commonly referred to as the Sunshine Act) requiring written minutes of all open meetings of agencies, including school governing bodies to be produced and published. The Act requires minutes to include the following:

- date, time and place of meeting;
- names of members present;
- substance of all official actions and a record by individual member of the roll call votes taken; and,
- names of all citizens who appeared officially and the subject of their testimony.

Although the District has improved its efforts, it is not yet in complete compliance with the Sunshine Act. Our audit disclosed that as of the end of our fieldwork, for a public meeting held by the School Reform Commission (SRC) on May 16, 2013, the District still had not prepared or published minutes of the meeting. Audit procedures require that we review minutes of SRC meetings to determine the existence of undisclosed transactions, subsequent events, or related party transactions. Because all SRC meeting minutes were not available, auditors had to use time consuming alternate procedures, such as reviewing agendas, proposed summary resolutions, and voting cards from meetings to satisfy audit requirements. In addition, failure to comply with the Sunshine Act could subject the District to fines and prosecution in accordance with provisions of the law.

Recommendation:

We continue to recommend that District management comply with state law by ensuring written minutes are produced and published for all public meetings of the SRC. If District personnel are unable to perform this function in a timely manner, consideration should be given to hiring an outside service to transcribe the minutes [600112.15].

MANAGEMENT IMPLEMENTED MAJORITY OF PRIOR RECOMMENDATIONS FOR IMPROVING GENERAL CONTROLS OVER INFORMATION TECHNOLOGY

During the prior audit, we conducted, with the assistance of a consultant, an evaluation of the School District's ADVANTAGE[13] information technology (IT) general controls. In May 2013, we issued a separate report to the School District detailing various general IT control weaknesses in the following primary areas: organization and management controls; administration over software and applications; and IT operations and support. As part of the current audit, we reviewed the School District's remediation efforts to address the identified control deficiencies.

[13] ADVANTAGE 2000 Financial Management and Human Resources/Payroll application

Out of seven prior noted conditions, the District's Office of Information Technology (OIT) resolved five findings. Specifically, the District had corrected five deficiencies involving: (1) access to production libraries of the ADVANTAGE systems; (2) periodic reviews of access rights to ADVANTAGE user accounts; (3) privileged acces to the Resource Access Control Facility (RACF); (4) the termination of RACF user accounts for separated employees; and (5) the RACF password setting to lock out access to accounts. For the remaining two findings, the District made certain remediation efforts, but had not completed corrective action. These areas involved: (1) IT risk assessment, and (2) the automatic revoking of RACF ID's. Details regarding each of the seven prior noted conditions and their current remediation status are presented in Appendix I.

As part of our current review, we followed up on the conditions brought to management's attention during our last audit. We routinely monitor uncorrected conditions and report on them until management takes corrective action or until changes occur that resolve our recommendations.

MANAGEMENT ELECTS TO NO LONGER REPORT ART COLLECTION IN THE ANNUAL FINANCIAL REPORT.

Due to the lack of adequate records to establish a proper carrying value, and the immateriality of the District's reported value of its art collection (0.3 percent of total assets for Governmental Activities), management decided to implement our prior year recommendation and no longer report the collection in its financial statements [600113.04]. While we continue to believe the District should maintain an accurate inventory of its artwork, we will no longer comment on the matter as part of this report in future years.

Condition	Risk/Potential Effect	Recommendation	Remediation Status (Complete or Incomplete)
ORGANIZATIONAL AND MANAGEMENT CONTROLS **1. IT Risk Assessment:** A comprehensive IT risk assessment had not been performed since 2007. While the District's OIT had a process to monitor technical risks through vulnerability scanning and had engaged a consultant to perform an operational risk assessment, a formal plan to identify and address business and compliance risks did not exist.	Without a current and comprehensive risk assessment, IT resources may be used ineffectively in addressing risk affecting the District.	Develop formal procedures to perform periodic risk assessments and monitor gaps identified. This should be a component of an enterprise wide risk management program [320112.01].	**Incomplete:** The District did not provide a copy a formal integrated risk assessment plan as requested. However, the District did provide a summary of the Application Vulnerability Assessment performed by Verizon. A copy of the Statement on Standards for Attestation Engagements (SSAE) 16 performed by Verizon and Fidelity National Information Services (FIS) was provided to the Office of the Controller.
SOFTWARE ADMINISTRATION **2. Access to Production ADVANTAGE Libraries:** Alter access to the production ADVANTAGE libraries, code, job language and data were granted to individuals that also have alter access to non-production libraries, including Fidelity National Information Services (FIS) support groups and authorized production control individuals at the District. This reduces the ability of OIT to maintain adequate segregation of duties between those individuals performing application development and maintaining the production code.	Having alter access to the production and non-production ADVANTAGE libraries could allow certain individuals to circumvent OIT implemented change management controls to introduce unauthorized application changes to the production environment.	OIT review the groups and users that have alter access to the production ADVANTAGE libraries and restrict access where appropriate and implement a monitoring report of production changes and review for unauthorized activity [320112.02].	**Complete:** OIT instructed Verizon / FIS to remove system-level "alter" access to various components of the ADVANTAGE environment.

Condition	Risk/Potential Effect	Recommendation	Remediation Status (Complete or Incomplete)
APPLICATION ADMINISTRATION			
3. Periodic Access Rights Review: A process had not been implemented to periodically review active RACF or ADVANTAGE user accounts, associated access rights, and group membership.	While OIT had implemented processes to perform and approve granting of user access, and removal of access rights, there is a risk that over a period of time access rights will not be updated due to oversights.	OIT, along with departments / schools, should develop a procedure to periodically review active users and their associated access rights for appropriateness [320112.03].	**Complete:** Management implemented Policy *IT.INFOSYS.002*, which requires a periodic review of user account and associated rights.
IT OPERATIONS AND SUPPORT			
4. Privileged Resource Access Control Facility (RACF) Access: RACF privileged accounts with the SPECIAL and OPERATOR attributes had not been segregated from those with the AUDITOR attribute. The SPECIAL attribute allows users to perform system administrator functions, including adding and removing users, granting access to datasets and resources and setting RACF configuration settings. The OPERATOR attribute permits users to alter any dataset that they are not specifically restricted from in the dataset access rule. The AUDITOR attribute allows users to control the logging functionality of RACF. The accounts of concern are either system accounts or those controlled by FIS.	Privileged users could remove logging requirements from RACF and enhance their ability to perform unauthorized activity undetected.	OIT should work with FIS to review these permissions and segregate where possible. [320112.04].	**Complete:** OIT followed up with Verizon/FIS and confirmed the access attributes that were assigned to the eight (8) privileged accounts at issue, were in fact required as a function of FIS's administration of the District's RACF environment. One of the privileged accounts is not necessary and was deleted.

Condition	Risk/Potential Effect	Recommendation	Remediation Status (Complete or Incomplete)
5. <u>Termination of RAC IDs:</u> RACF accounts for terminated employees were not removed or disabled in a timely manner.	Users may be able to access system resources after employment with the District has been terminated.	OIT should work with FIS to enhance the communication of employee terminations and implement procedures to validate that FIS has acted upon notifications delivered. [320112.05].	**Complete:** The District's OIT reiterated that while this condition posed no direct operational risk given existing ADVANTAGE security procedures, they have instituted a bi-weekly review of RACF accounts for terminated employees.
6. <u>Automatic Revoking of RACF IDs:</u> The RACF setting to automatically revoke (disable) user IDs after a period of log-in inactivity has not been enabled.	User may be able to access system resources after employment with the District has been terminated.	OIT should review this setting and enable automatic revoking after an appropriate period of time. [320112.06].	**Incomplete:** OIT conducted a follow up conversation with Verizon/FIS and determined that the maximum inactivity period for having idle accounts automatically suspended within the RACF environment is 255 days. The District maintains that an idle RACF account poses no risk given other processes and procedures ensure that accounts belonging to terminated employees are suspended, and that multiple failed login attempts would automatically suspend an account. If the maximum inactivity period were greater than 365 days, the District would consider such a recommendation, but given that many authorized staff only have a need to access the system on an annual basis (i.e. for reconciling personal property inventory), enabling such a feature is neither feasible nor advisable.

Condition	Risk/Potential Effect	Recommendation	Remediation Status (Complete or Incomplete)
7. **<u>Account Lockouts:</u>** The RACF password setting to lock out accounts is currently set to five (5) attempts, while the District's password policy states it should only allow three (3) attempts.	Password configurations that do not meet the District's policy could lead to unauthorized access to system resources.	OIT update the District's password policy to reflect currently approved setting. [320112.07].	**Complete:** The District changed the password policy to reflect current approved settings to (5) attempts to lock out.

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May 15, 2015

Mr. Alan Butkovitz, City Controller
City of Philadelphia
Office of the City Controller
12th Floor, Municipal Service Building
1401 John F. Kennedy Boulevard
Philadelphia, PA 19102

Re: Response to City Controller's Report on Internal Control and on Compliance and Other Matters – Fiscal Year 2014

Dear Mr. Butkovitz:

The attached document contains the School District of Philadelphia's formal response to the issues raised in the draft audit report issued on May 14, 2015, with respect to internal control, compliance and other related matters.

I would like to thank you and your staff for your efforts with respect to this audit.

Sincerely,

Matthew E. Stanski
Chief Financial Officer

C: Marjorie Neff, Chair and Members of School Reform Commission
Dr. William R. Hite, Chief Executive Officer and Superintendant of Schools
Gerald V. Micciulla, Deputy City Controller, City of Philadelphia
Bill Rubin, First Deputy City Controller, City of Philadelphia
Beverly Martin, Audit Director, City of Philadelphia
Marcy F. Blender, Comptroller, School District of Philadelphia

Encl.

SCHOOL DISTRICT OF PHILADELPHIA RESPONSE TO AUDITOR'S REPORT FISCAL YEAR 2014

The School District of Philadelphia's (SDP) new management team is pleased to report that there have been notable improvements over District-level financial controls around financial reporting and all Fiscal Year 2014 financial audit findings were considered as "Other Conditions". Although there needs to be a continued focus to tighten controls and compliance with District policies and processes in program offices and in particular at the schools, much progress has been made at documenting processes and promulgating clearly articulated mandated financial policies and procedures throughout the organization.

School Principals Failed To Adequately Prioritize Accountability over Their Equipment

Summary of Finding: *The current audit cited notable improvements to key aspects of District-level accounting policies, procedures and controls regarding personal property directly under management's control and their continued efforts to improve the accounting for school-located equipment. Despite management's efforts, individual schools in the audit sample did not always adequately account for their assets and follow these policies. Discrepancies were noted in the sample schools' accounting records versus the physical inventory, and the personal property tagging process and 30 percent of their assets could not be located.*

Response: District management, as stated in the audit report, has made "notable" progress in improving controls over personal property within its direct control and has articulated to the schools through communication of polices and training the importance of safeguarding and accounting for the assets located at their locations. To further improve this progress, District management will continue its focus on improving adherence to all District financial policies through increased communications, training and accountability through allowable consequences. In addition, central office Finance personnel will work with the specific school Principals and Inventory Designees to ensure that all discrepancies identified in the audit report are properly corrected and that all schools are assuring the accuracy of their records throughout the year.

Although the District agrees that inventory asset accounting at the schools is still not at an acceptable level, it should be noted that the items in question valued at cost in the audit report of $87,000 represents the original purchase price of the assets and not the current value of the assets. In reality, the total book value after is approximately $22,000 of which one item (where a similar one was observed but not tagged) represents $16,000. It should also be noted that items in the sample date as far back as 1982 with several dating back 6-15 years and have no value. The District has many very old assets with no or little value which are still at the schools due to the budget crisis and the inability to replace older assets once they are obsolete.

Also, reporting discrepancies may exist because the District's annual inventory reporting process occurs in June, after the May audit testing at the school locations and therefore, it is possible, that some of the discrepancies identified in the audit report have already been addressed. Also, as noted in the audit report, a number of assets at the school were identified based on the inventory report description and appeared to be at the school, but because there was not an asset tag it was not possible to verify it was the same asset. Or, as was the instance of the 52" upright piano mentioned as a missing item at the CAPA School, the piano could not be located the day of the auditors visit, but was later located in the school in a different area.

Beginning in Fiscal Year 2013, as a means to ensure that District property is tagged with asset numbers and schools are properly accounting for their assets, the Grants Compliance Monitor (GCM) assigned to each school hand delivers property tags for new purchases directly to the Inventory Designee which each school is required to have. Further, the GCM also performs random checks of all inventories to ensure that the tags are affixed to the proper asset and that assets per the inventory list can be identified at the school. As a consequence of instances of noncompliance, a school is banned from spending grant funds on purchasing additional assets until they come into compliance. Untagged equipment observed during the audit may also be attributed to either a timing difference between the issuance and delivery of tags to the school or tags being intentionally removed by students. To improve controls over technology assets and further automate the process, subsequent to November 2013, all Apple laptop and desktop computers are delivered to schools with an etched personal property number to address this issue. This process will also be expanded to include Dell laptop and desktop computers. This expansion is planned for late fiscal year 2015.

The importance of adding serial numbers to the individual property record is stressed during the personal property training sessions held annually for Principals and Inventory designees. To facilitate this process of adding serial numbers to further accurately track and identify equipment, schools are given the option and encouraged to provide this information in upload format to eliminate the need for manual entry. As part of the new process for Apple, serial numbers for desktop and laptop computers are added at the time the record is loaded into the SDP inventory system and the same process will be used for Dell technology in the near future.

In accordance with District policies 750.0 and 750.1 relating to personal property security, all equipment removed from school premises is required to be documented, signed by the borrower and authorized by the administrator/principal. In an effort to ensure compliance, the Form S-800, Property Removal Pass, is available on The Office of General Accounting website along with all other related personal property information. Principals/Administrators are also reminded of this requirement as part of the year-end physical inventory process instructions and it is part of the year-end cut-off guidance which goes out from the CFO in February.

As is the District's policy, an annual physical inventory is to be conducted at each school/office location with a complete and accurate physical inventory report submitted to the Office of General Accounting which must be signed by the responsible Principal/Administrator to indicate accountability for its content. All necessary information relating to the physical inventory is communicated to the school/office via email using the Advantage financial users' mailing list and posted to the Principals Information Board. It should be further noted that schools that did not submit the required fiscal year 2014 annual inventory were prohibited from making purchases with grant funds in fiscal year 2015 until an accurate and complete inventory was received and this process will continue.

Documentation for Employee Salaries is not Always Maintained in Human Resource Files

Summary of Finding: *Support for changes to employee pay rates and job titles were not in the documentation maintained in the human resource employee files.*

Response: SDP's new HR Management team recognizes the importance of maintaining appropriate documentation and approval information for an employee's job and salary information. Much of Fiscal Year 2014 and Fiscal Year 2015 to-date has been spent reviewing existing HR processes for improvements, documenting new policies and procedures, upgrading the SMS system (used for controlling positions available and hiring at the schools) to contain a workflow approval process and researching the purchase of a new job applicant system which went live for all District positions in Fiscal Year 2015.

The focus now and into the next fiscal year will be to implement the improvements and new policies and procedures and to add more controls and management oversight over payroll/salary information as follows:

1) The implementation of an improved internal HR supervisory and peer review process for payroll/salary change information, including changes to pay progression dates. This will include the bi-weekly production of a new report for tracking historical salary actions (see no. 2 below). In addition, there will be peer monitoring and review of the entry and changes to salary information and the supporting documentation to ensure that the proper information is supported by the documentation in the employee's file. This will include a form for new hires and a check-list for existing employees to ensure the proper information has been retained to support the salary actions.

2) A report showing historical changes which includes the HR employee who made the change and the date the change was made has already been developed. Beginning with the new Fiscal Year on July 1, 2016, HR Supervisors will review the report bi-weekly to identify compliance issues and sign-off that they have completed this review. This report takes information already found in a table in the HR System accessed through an inquiry and provides a historical view in a report format.

3) The District's HR System already has the capability to add reason codes (PART) for personnel transaction changes (PACT). A new PACT code was added in Fiscal Year 2014 to identify salary step level freezes for represented employees and the District will continue to evaluate the need for additional PACTs. A pay progression change code already exists and will continue to be used by HR staff to indicate a change was made to an employee's pay progression date (for reasons such as credit given for prior experience).

District Making Steady Improvement in Complying with Online Payroll Approval Policy

Summary of Finding: *The current audit revealed that the District implemented corrective actions to improve this condition which resulted in a significant improvement in payroll authorization within the Advantage System from the time of the implementation of corrective actions beginning in Fiscal Year 2012 and continued to show steady* *improvements through Fiscal Year 2014. However, the District should strive for 100% compliance. In addition, progressive disciplinary action should be implemented for individuals consistently in violation of policy.*

Response: The District has significantly improved payroll approvals and oversight within the Advantage System and continued with the strengthened internal control and compliance processes as follows: 1) automated bi-weekly monitoring reports of Administrators/Principals not approving payroll with frequency tracked, 2) strengthened guidance and training, 3) notified offenders of the need to approve payroll, and 4) escalated notification to their Chief/Assistant Superintendent for persistent offenders. This has resulted in a significant improvement in Fiscal Year 2014 to only 447 employees on average per pay period versus the Districts total FTE of 17,332. Notifications are first sent to the individual, and if the non compliance with payroll approval policy persists, their Chief/Assistant Superintendent. This has resulted in very few repeat offenders. The District will take progressive actions as necessary and contractually allowable if these managers/Principals continue to violate the SDP's payroll approval policy.

District Still Holding Millions Owed to Former Employees from 2001 to 2013

Summary of Findings: *As of June 30, 2014 the District was reporting as a liability $5.1 million in termination pay for some 1,900 former employees who have been separated from the District for more than one year. In addition, more than $1 million of the amount should have been escheated to the State's unclaimed monies.*

Response: Of the $5.1million in termination pay liabilities identified by the auditors, $3.5 million relates to employees who were age 55 or over when they separated from service and who have not established a 403(b) account with one of the Plan providers in accordance with District policy. These amounts for employees over 55 are not considered compensation but are considered retirement benefits and therefore go through a different process than the District's normal payroll escheatment process. The District takes exception to the statement that the District has taken little action to resolve the outstanding amounts. The report (VPIL) that the auditors rely on is a snapshot report that captures the status as of the day of the report but does not track the number of employees that are added to or removed from the report daily. The School District has put in a systematic process to address the older termination pay cases (as further discussed below) while continuing to process the current termination pay cases as they arise more timely.

To address the older cases for employees over 55 the District worked with one of its 403(b) Plan providers, VALIC, to establish individual accounts for these former employees, to accept the employer contributions of termination pay, and to research the current address and to locate the former employees. This process was established in July 2013 and the first transfer was completed on July 19, 2013 in the amount of $0.80M related to 153 employees. A subsequent transfer was completed on July 18, 2014 in the amount of $0.14 million for 23 employees from 2010 and prior, and on July 17, 2015 the District will transfer $0.73 million which represents 57 employees separated in 2010 and prior as well as 63 employees who termed in 2011. The transfers will continue to occur annually each July. The dollar amounts of the transfers are not indicative of the number of cases as the individual amounts may range from hundreds of dollars to tens of thousands of dollars. Also, due to budget constraints, there are only two employees to process and audit all termination pay, therefore, these amounts indicate serious efforts made by the District to research and process termination pay more quickly. The District began a project in Fiscal Year 2012 to research leave balances for those who separated from the District in prior years and to liquidate the balances as appropriate. That process remains ongoing.

As further evidence of actions taken, the District has made a considerable investment to improve the timeliness and accuracy of the leave accrual for personal illness and personal leave calculations at the time of retirement. As the result of this effort, the District launched, in September 2013, an automated annual process (replacing the manual process done only at the time of retirement) for calculating leave accruals (unused vacation, personal illness and personal leave). In addition, a report has been developed which is available on-line any time for employee viewing of their accrual leave balances. Employees may access their current leave balances (dating back to 1999) by accessing the internal Employee Payroll Information web page, then selecting Employee Leave Balances. In Fiscal Year 2014, 3,355 term cases for a total amount of $60.2 million were processed; this includes employees who separated from the District in Fiscal Year 2014 as well those who separated in prior years.

The District complies with Pennsylvania unclaimed property laws and has a process in place that every calendar year by April 15th any unclaimed payroll checks are escheated to the Pennsylvania Treasury Department for the previous calendar year. Of the $1.6M, $0.3M in termination pay owed to employees under age 55 who separated in 2013 is not yet eligible for the escheatment process. In April 2015, the amount escheated to the Treasury Department was $660,370 for payroll checks that were unclaimed as of December 2012. Some termination pay amounts were included in this amount however, because termination pay for under age 55 employees are processed with regular pay checks, there is no available report that separates termination pay from regular pay.

Schools Inadequate Management of Petty Cash Fund Contributed to Thousands of Dollars in Lost Funds

Summary of Finding: *There continued to be numerous control weaknesses and instances of non-compliance with established control procedures regarding petty cash funds. Write-offs were made in the amount of approximately $53,000 which related to 60 accounts.*

Response: Recognizing that there were instances of control weaknesses and non-compliance with regard to the operation of the District's petty cash process; particularly at the school level, the District management took action to eliminate the associated risks. A new accounting oversight model was established in March 2013 and the position of Accounting Control Compliance Monitor (ACCM) was established. The individuals in this position have the responsibility to ensure that the schools comply with the District's petty cash process, as well as provide assistance with the reconciliation of the petty cash accounts at the schools. Furthermore, it was determined that in most instances there was no need for the schools to have petty cash accounts; since the policy had tightened what type of expenses could be processed via petty cash versus the District's normal accounts payable and procurement processes. A decision was made by District Finance management that all petty cash accounts at the schools would be closed out.

It continues to be the District's overall objective to eliminate petty cash accounts, not only at the schools, but also within most of the program offices. Closing most petty cash accounts will eliminate any adverse affect on the handling and safeguarding of the Districts funds via the petty cash process. However, it is taking more time to reconcile and close out the petty cash accounts than originally anticipated date of June 30. 2014. This is because: personnel have changed at the schools and program offices, a record twenty six schools have closed at the end of Fiscal Year 2013, in some instances records are difficult to locate, and, knowledgeable individuals have either been laid off due to a budget crisis or left the District. As of April 30, 2015 there are 100 open petty cash accounts with a total dollar value of $145,565 representing a small financial risk at each school. The goal is to complete the process of closing all but necessary petty cash accounts in the early part of Fiscal Year 2016.

Audit Disclosed (Specifics):

1. **Petty Cash shortages (write-offs):** In order to close out petty cash bank accounts, there were a number of petty cash account balances that needed to be written-off in Fiscal Year 2014, subsequent to the accounts reconciliations. The analysis of the petty cash accounts that were written-off, determined that most of the deficits were a result of missing receipts at the schools, schools no longer in existence and in some cases, financial accountability for the petty cash accounts were that of the former principal, who is no longer employed by the District. The write-offs were therefore the only resolution to rectifying the long standing petty cash account issues and closing the accounts entirely. Even though, some schools petty cash accounts had to be written-off, the District has recouped some funds from principals via withholding from their term pays as there is a District policy now in existence to allow this if it can be positively determined that the principal violated the SDP policies and their termination pay has not as yet been paid out.

2. **Schools petty cash accounts exceed the authorized amounts:** Since the schools' petty cash accounts are being eliminated, a decision was made that there was no need to rigorously enforce the matter of authorized amounts – it was better to concentrate limited resources on reconciling and closing the accounts altogether. Although, as noted, some schools petty account balances still exceed the desired authorized amount, numerous petty cash accounts have been reconciled and closed out. As discussed, the process of reconciling and closing out these accounts take considerable time.

3. **Inactive petty cash accounts remain open at the schools:** While some schools petty cash accounts are currently dormant, all of the schools petty cash accounts are flagged to be closed-out, after the reconciliation process; therefore, the Accounting Office is not promoting the usage of the petty cash accounts at schools. The Accounting Compliance and Control Monitors assigned to each of these schools are diligently working to close these accounts as soon as possible.

4. **Schools without petty cash custodians:** In view of the fact, that schools petty cash accounts are being eliminated and staffing at the schools are limited, there is not a strong argument for the schools spending valuable resources assigning and training personnel to perform a job duty that will no longer be relevant. However, Principals are

responsible for the open petty cash accounts at their schools and are provided guidelines as to their proper usage – although it is highly discouraged to use the funds during the transition process.

<u>Failure to Follow Procedures for Student Activity Funds Has Placed Millions at Risk for Theft and Misuse</u>

Summary of Findings: *Several past audit reports as well as the current findings, have commented that certain procedural deficiencies in the administration and accounting for student activity funds at the schools has placed the funds at a greater risk for potential fraud and abuse.*

Response: The School District recognizes that the internal control policies already in place that are meant to safe guard the Student Activity Fund (SAF) assets are not always being followed by our schools. This resulted from a lack of resources to oversee the requirements, as well as manually intensive reporting processes. The School District recognizing these issues, has already embarked on two major initiatives to mitigate exceptions to the internal control policy and they are as follows:

1) As of February 1, 2015, all schools were required to account for their SAF funds using *School Funds Online*, a web-based application that writes checks, records deposits, accounts for cash receipts, performs bank reconciliations and prepares monthly reports among other things. All schools SAF funds were converted to this automated accounting and reporting platform, and via their "Financial Designee", were trained on this product and it is now the only allowable method of accounting for SAF funds at the District. This provides for consistency among schools, ease and automation of reporting and bank reconciliation processes and monitoring from Central Office among many other benefits.
2) Along with implementing the new accounting and reporting requirements, the Student Activity Fund Manual is being rewritten to correspond with the new application and will be rolled out at the Principal Training this summer. In addition, a summary version of the Student Activity Manual, highlighting key requirements, will be available as part of the Principals Training materials, reinforced at the training sessions and posted on-line along with the more detailed revised Manual. Also, hands-on training on the use of the web-based application will continue to be offered through the District's PD processes to both Principals and their Financial Designees.

In response, to specific findings within the audit report, the following addresses the corrective actions to be implemented. Three of the six specific findings have already been remedied through the implementation of the new SAF web-based tools:

- **Non-compliance with Bidding Requirements** – This will be reinforced at the Principal Financial Training. As principals need to approve every purchase by signing the check, they are responsible for compliance with this policy.
- **Schools Did Not Establish Finance Committees** – This is policy and it will be reinforced at the summer training as well. Fortunately, no significant investment decisions were made during the year at the three schools noted, therefore no risks were incurred.
- **Activity Funds With Negative Balances** – This happens, in most instances, either because of errors in postings or an unrecorded transfer from the Student Body Activities Account fund. With the conversion to the new SAF platform, all negative accounts were eliminated. In addition, the new system provides for a warning when this occurs and it also allows for monitoring of this type of activity from Central Office.
- **Inactive Account Balances Were Not Closed** – With the conversion to the new system, all opening balances, including inactive accounts, were reviewed to determine if the activity was needed. In many cases, the funds were eliminated and closed into another activity or the SBAA account.
- **Very Old Outstanding Checks Listed on Bank Reconciliations -** With the conversion to the new system, very old outstanding checks were not carried over to the new system. They were investigated to the extent possible and either the check was voided in the old system and another check was written or the funds were added back to the cash balance.
- **School Related Funds Were Improperly Retained** – The new manual will include specific policy details as to what types of funds collected by a school (e.g., lost book fees) need to be returned to the District and the timing.

Schools Failure to Comply with Management Procedures Have Contributed to Hundreds of Unaccounted for Transpasses

Summary of Findings: *Audit findings show an increased number of unaccounted for transpasses compared to prior audit results; there continue to be problems noted with schools' management of the program. In addition, there continue to be reports that the outside courier hired to transport the unused transpasses was not honoring the District's reporting requirements.*

The School District agrees with the current recommendations regarding accounting for Transpasses at the schools and has also implemented the recommendations from prior years' audit reports. Prior to the start of the year, detailed instructions are mailed to all School Principals; instructions are also posted on the School Computer Network (SCN) and the Principals Information Board (PIB) and reinforced as part of summer Principal Financial Training sessions.

Transpass pick-up by the courier has been a problem in the past; however, we are confident we have reconciled our differences. The District has reiterated to the courier that their drivers must pick up unused transpasses when the school presents them. The courier is honoring our reporting requirements and picking up unused transpasses when they are packaged and ready upon the courier's arrival at the school. It's important to note that our dollar exposure is minimal as SEPTA does not charge the District for undistributed transpasses even if the transpasses are not picked up from schools.

To further strengthen controls at the schools, beginning with the 2015/2016 school year the Finance Office staff who visits the schools will periodically verify that the "Summary of Free Student Transpasses" reports and the Eligibility lists are accurately completed and signed. The names of schools that fail to complete the required forms in accordance with District policy will be communicated to the Transportation Office and the school, and additional reinforcement of the District's policy along with any needed training will be provided. If non-compliance continues after remediation actions, it will be elevated to the Learning Network Assistant Superintendents for corrective action. The District will also post a message at the end of each month on School Computer Network (SCN) and the Principals Information Board (PIB) to remind all principals of the required monthly tasks including completing, signing and filing the required transpass forms and reconciling and packaging unused transpasses so that they are readily available for pickup by the courier.

Many District Employees Not Complying With Statement of Financial Interest Filing Requirements

Summary of Finding: *Nearly 10% of District employees failed to disclose their financial interests for 2013 as required under state law; some of these included upper management from both the schools and central administration.*

For the 2014 Statements of Financial Interests forms (SFIs), due by May 1, 2015, an initial mailed notice was sent by the Office of Talent to covered employees and former employees on 2/1/15. A reminder notice was mailed to those who had not submitted the forms by 4/1/15. Personal reminders were sent or delivered to certain employees during the week of 4/27/15, prior to the filing deadline of 5/1/15. OGC provided advice and assistance to employees in covered positions on timely completion of SFIs.

The Office of General Counsel (OGC) will review all submitted SFIs by 6/1/15 to ensure that all employees in covered positions comply with the financial disclosure requirements. OGC or the Office of Talent will notify officials and employees in covered positions of their non-compliance and of the requirement to submit an SFI within 10 days of the notice. If a completed SFI has not been submitted within 10 days after the notice, OGC will notify covered officials and employees that they are in violation of the State Ethics Act. OGC will also notify department heads and supervisors of any failures by employees in their departments to comply.

By 6/1/15, OGC and the Office of Talent will review the filed SFIs for any actual or potential conflicts of interest, will notify department heads and supervisors of any such conflicts and will refer any such conflicts to OGC, with all the information necessary and pertinent to resolve any conflicts of interest.

The review of SFIs for the 2013 calendar year will also be completed by 6/1/15

Improvements Evident in the District's Efforts to Publish Minutes of Public Meetings

Summary of Findings: *Although the District has improved its efforts in Fiscal Year 2014, the District as required by the Sunshine Act of the Commonwealth of PA, did not publish minutes from its governing board for the meeting held on May16, 2013.*

Response: The District currently records all public meetings of the School Reform Commission (SRC). In compliance with the Sunshine Act, minutes are then transcribed, approved by the SRC, posted on the District's website and made public. The District has posted all the minutes with the one exception being the meeting on May 16th, which is in process of being transcribed and should be completed by the end of May 2015. This meeting was an exceptionally challenging meeting because it lasted approximately six (6) hours with an extremely high number of speakers.

Management Implemented Majority of Prior Recommendations for "Improving General Controls Over Information Technology", and the accompanying APPENDIX I.

Summary of Findings: *It is noted that the remediation status of two (2) of the seven (7) observations as noted by the 2012 IT General Controls Review, performed by ClifionLarsonAllen, LLP ("CLA") under the direction of the Office of the City of Philadelphia Controller, remain incomplete.*

Response:

Observation 1: IT Risk Assessment. As noted in our previous response, the District's interpretation of this observation is that CLA's assessment specifically targeted District-wide business and compliance risks, and not general IT controls operational risks. The risk assessment that was referred to as having been performed in 2007 was a District-wide initiative, and not specific to the Information Technology (IT) Office or functions. The District concedes that the organization as a whole has not conducted a recent business risk analysis. Accordingly, there is no risk plan that can be provided. The District annually provides complete and comprehensive SSAE-16 reviews, both SOC-1 and SOC-2, from its mainframe and Advantage hosting providers, and has had the benefit of stable senior leadership within the IT Office for over ten consecutive years. As such, the District believes that it is adequately managing business risk within the domain of the IT General Controls review. Additionally, as noted, the IT Office has carried out several recent internal as well as independent reviews of its systems and services, including a comprehensive application, systems, network, and physical security vulnerability assessment that was conducted in 2012, with a remediation and retesting performed again in 2013. The IT Office will continue to perform independent risk and vulnerability assessments of its systems and services as frequently as resources allow.

Observation 6: Automatic Revoking of RACF ID's. As noted by the Office of the City of Philadelphia Controller, the District concurs that it has not enabled this technology in the RACF environment, but disagrees with both the stated risk and recommended action. As the District has previously stated, a limitation exists in the legacy RACF environment which allows for a maximum automatic inactivity revocation period of 255 days, or roughly 8.5 months. The District has asserted that enabling this feature would in fact create a significant and unnecessary administrative burden to re-enable inactive accounts for those employees and roles that use the system on an occasional basis. A very practical example would be those school-based employees responsible for the annual personal property inventory system reconciliation who interact with the Advantage system on an annual basis – a process that we believe should have the least amount of barriers for schools to participate. The risk of not enabling inactive account revocation has been asserted by CLA as, "User may be able to access system resources after employment with the District has been terminated." – for which the District disagrees. The District has a process for terminating access to the RACF environment for employees who have separated from the District, and thus revocation of inactive RACF accounts would add no value or reduction of risk. Additionally, the District employs a rigid five (5) failed attempt lockout policy on all accounts, thus preventing "brute force" attacks on any RACF account, inactive or otherwise. Accordingly, the District believes it is not necessary to take any further action on this recommendation.

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Government Auditing Standards require auditors to report instances where the auditee's response to the findings, conclusions, or recommendations are not, in the auditor's opinion, valid or do not address the recommendations. We believe that to be the case with certain statements made in the District's response to our comments regarding the comment titled **<u>District Still Holding Millions Owed to Former Employees from 2001 to 2013</u>**.

In its response on page 25 of the report, District management indicates it takes exception to our comment that the District "…has taken little action to resolve…." outstanding termination pay amounts. We stand by our stated position because as discussed in the report on page 6, as of June 30, 2014, there were some 1,900 former employees who had been separated from District employment for more than a year. As many as 1,200 of these employees separated over four years ago, and some as far back as 13 years. Yet, in fiscal year 2014, the District reviewed for correctness only 153 cases of those employees over 55 at separation and transferred them to the selected 403(b) Plan provider. No cases were reviewed for the group of employees who were under age 55 when they separated.

For the $3.5 million due to employees who were age 55 or over when they separated, the District's response suggests the reason this liability is still outstanding is the result of those employees failing to establish a 403(b) account with one of the Plan providers. However, as it indicates later in its response, and as explained to us during the audit process, prior to September 2013, a manual review process was in place, and a staffing shortage existed. This manual process and staff shortage (and not the employees failing to establish a 403(b) account) created the 13-year back log of unprocessed termination pay reviews and payouts.

Finally, management attempts to divert attention to the real issue (at the top of page 7) of the District failing to remit $1.0 million of unclaimed termination pay for those employees in the under 55 age group that separated from service prior to calendar year 2012. Management introduces irrelevant facts when it focuses on the $0.3 million of termination pay not eligible for escheatment at June 30, 2014 and when it indicates that it made a payment of $660,370 to the Commonwealth in April 2015 for payroll checks remaining unclaimed as of December 2012. We never indicated the $0.3 million should have been escheated, and the $660,370 of unclaimed payroll checks has nothing to do with the $1.0 million of unclaimed termination pay that should have been escheated to the Commonwealth.