CITY OF PHILADELPHIA
PENNSYLVANIA

OFFICE OF THE CONTROLLER

Promoting honest, efficient, and fully accountable government

REPORT ON INTERNAL CONTROL
AND ON COMPLIANCE AND
OTHER MATTERS

CITY OF PHILADELPHIA

FISCAL 2014

City Controller
ALAN BUTKOVITZ

CITY OF PHILADELPHIA

OFFICE OF THE CONTROLLER
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ALAN BUTKOVITZ
City Controller

GERALD V. MICCIULLA
Deputy City Controller

July 2, 2015

Honorable Michael A. Nutter, Mayor
City of Philadelphia
215 City Hall
Philadelphia, PA 19107

Dear Mayor Nutter:

In accordance with the Philadelphia Home Rule Charter, the Office of the Controller conducted an audit of the basic financial statements of the City of Philadelphia, Pennsylvania as of and for the fiscal year ended June 30, 2014, and has issued its Independent Auditor's Report dated February 23, 2015.

In planning and performing our audit, we considered the City 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 City of Philadelphia, Pennsylvania's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the city's internal control over financial reporting.

Attached is our report on internal control over financial reporting and on compliance and other matters, dated February 23, 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 as part of the report. We believe that, if implemented by management, the recommendations will improve the City of Philadelphia, Pennsylvania's internal control over financial reporting.

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

Respectfully submitted,

ALAN BUTKOVITZ
City Controller

cc: Honorable Darrell L. Clarke, President
and Honorable Members of City Council
Rob Dubow, Director of Finance and other
Members of the Mayor's Cabinet

CITY OF PHILADELPHIA

REPORT ON INTERNAL CONTROL AND ON COMPLIANCE AND OTHER MATTERS

EXECUTIVE SUMMARY

Why The Controller's Office Conducted the Examination

Pursuant to Section 6-400 (c) of the Philadelphia Home Rule Charter we conducted an examination of the City of Philadelphia's (city) 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 city'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 city'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 city's Comprehensive Annual Financial Report (CAFR) 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 weaknesses and deficiencies in the process that city management uses to prepare the statements. These weaknesses and deficiencies contributed to nearly $2 billion in errors. Some of the more important matters requiring management's attention include:

- Inadequate oversight and review procedures over the city's financial reporting process that continue to impede the ability of city accountants to prepare a timely, accurate, and complete CAFR without significant audit adjustments.

- Unauthorized approvals for payroll and other types of expenditures. These circumstances increase the risk of improper expenditures.

- Bank account reconciliations that need to be completed more timely. Nearly 70 percent had not been reconciled until two or more months after year-end. In one instance, the last reconciliation on file for the city's payroll disbursement account was September 2010. Late preparation of reconciliations can prevent the timely detection of errors, or worse, irregularities.

- City agencies frequently fail to report new grant awards, correctly identify awards, and/ or properly record expenditures in grant accounting records. These conditions have hindered the ability of the city's grant accounting unit to accurately and timely report grant activity to the federal government.

What The Controller's Office Recommends

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

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City Controller

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 Honorable Mayor and Honorable Members
of the Council of the City 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, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information 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 City of Philadelphia, Pennsylvania's basic financial statements, and have issued our report thereon dated February 23, 2015. Our report includes a reference to other auditors. Other auditors audited the financial statements of the following entities, as described in our report on the City of Philadelphia, Pennsylvania's financial statements.

Primary Government
Municipal Pension Fund
Philadelphia Gas Works Retirement Reserve Fund
Parks and Recreation Departmental and Permanent Funds
Philadelphia Municipal Authority
Pennsylvania Intergovernmental Cooperation Authority

Component Units
Community College of Philadelphia
Delaware River Waterfront Corporation
Philadelphia Parking Authority

Component Units (Continued)
Philadelphia Redevelopment Authority
Community Behavioral Health
Philadelphia Authority for Industrial Development
Philadelphia Gas Works

This report does not include the results of the other auditors' testing of internal control over financial reporting or compliance and other matters that are reported on separately by those auditors. The financial statements of the Delaware River Waterfront Corporation and Philadelphia Parking Authority were not audited in accordance with *Government Auditing Standards*.

We have also audited the basic financial statements of the School District of Philadelphia, a component unit of the City of Philadelphia, in accordance with *Government Auditing Standards* and issued a separate report on the School District's internal control over financial reporting and on compliance and other matters.

Internal Control Over Financial Reporting

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

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as discussed below, we identified certain deficiencies in internal control that we consider to be a material weakness and significant deficiencies.

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. We consider the inadequate oversight and review procedures over the financial reporting process, described in the accompanying report, to be a material weakness.

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. We consider the following deficiencies, which are discussed in greater detail in this report, to be significant deficiencies:

- Unauthorized individuals are approving bi-weekly payrolls.

- Expenditures are being improperly authorized because the electronic authorization codes of retired employees are being used to approve payment vouchers.

- Controls over capital assets are deficient because (1) the city does not have a comprehensive capital asset system to facilitate accounting and reporting of these assets and (2) periodic physical inventories of the assets are not performed.

- Segregation of duties is not enforced for the automated payroll system.

- Controls over cash accounts are deficient because the Treasurer's Office neither timely reconciles bank accounts nor adequately monitors collateralization of city funds.

- Water customer account balances could be inappropriately reduced because account adjustments are not adequately reviewed.

- Errors occur in the Schedule of Financial Assistance because city agencies often (1) fail to identify all federal assistance received; (2) incorrectly record federal programs' Catalogue of Federal Domestic Assistance numbers; (3) do not include all invoiced expenditures in grant accounting records; and (4) record erroneous accruals or ineligible expenditures.

- The city's Standard Accounting Procedures, which serve as the basis for the city's system of internal control, continue to be long outdated and fail to reflect the automated processes and the practices currently in use.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the City of Philadelphia, Pennsylvania'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 other conditions that represent deficiencies in internal control that are listed in the table of contents and described in the accompanying report. We also identified other internal control and compliance deficiencies during our annual examination of the financial affairs of city agencies, which will be communicated to management in a separate report.

C I T Y O F P H I L A D E L P H I A
OFFICE OF THE CONTROLLER

City of Philadelphia, Pennsylvania's Response to Findings

The City of Philadelphia, Pennsylvania's written response to the findings identified in our audit is included as part of this report. The City of Philadelphia, Pennsylvania's written response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

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 entity'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 entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Gerald V. Micciulla

GERALD V. MICCIULLA, CPA
Deputy City Controller
Philadelphia, Pennsylvania
February 23, 2015

CONTENTS

MATERIAL WEAKNESS

INADEQUATE FINANCIAL REPORTING OVERSIGHT HAS LED TO UNDETECTED MATERIAL MISSTATEMENTS

Philadelphia's Home Rule Charter places responsibility for the City of Philadelphia's (city) accounting and financial reporting functions with the Office of the Director of Finance (Finance Office). In that capacity, the Finance Office prepares the city's Comprehensive Annual Financial Report (CAFR). To complete these tasks, Finance Office accountants collect, analyze, and summarize enormous amounts of financial data and grant data, as well as other information obtained from the city's accounting system, numerous city agencies, and assorted quasi-government units, such as the Philadelphia Gas Works and the Philadelphia Redevelopment Authority.[1] Our current audit again disclosed a number of conditions, which collectively we consider to be a material weakness, that impede the ability of accountants to prepare a timely, accurate, and a completed CAFR without significant adjustments recommended by the City Controller's audit staff. More specifically, we observed that:

- Reductions in the number of accountants in the Finance Office and other city agencies compromised timely and accurate preparation of the CAFR;
- Inadequate management oversight by the Revenue and Fire Departments resulted in misstated receivables reported in the financial statements presented for audit;
- Untimely review of Water and Sewer Fund financial statements increased the risk of errors;
- Deficient year-end receivable procedures resulted in misstated Water and Sewer Fund accounts receivable; and,
- Late submission of financial reports for some component units hampered preparation of the CAFR.

Each of these conditions is discussed in more detail below.

<u>Staff Reductions Continue to Compromise CAFR Preparation Process</u>

Over the last several years, we have commented that continual staff reductions in the Finance Office, and other city agencies, have made the task of preparing the CAFR more difficult to complete and compromised the ability of accountants to perform adequate reviews and approvals of the financial statements and related footnote disclosures.

During our current audit, we observed this condition continued to exist. Ongoing inadequate staffing in the Finance Office and other city agencies, such as the Department of Revenue (Revenue Department), still contributed to errors in the financial statements presented for audit. Our audit work revealed several large undetected errors in the agency receivables, allowance for doubtful

[1] These quasi-government units are considered component units for purposes of the city's CAFR.

accounts, indemnity claims liability, and component unit amounts that were submitted to the Finance Office for inclusion in the CAFR.

We also found numerous significant errors in financial statement amounts prepared by Finance Office accountants that were not detected by accounting managers. While these errors had no net effect on the financial statements, if they had remained uncorrected, reported CAFR activity would have been inaccurate. Examples of these errors included:

- A $506 million misclassification error between restricted cash and restricted other assets for the business-type activities, which created a $506 million inconsistency in reported cash between the statement of net position and statement of cash flows.

- $191 million of misclassification errors in reported component unit activity.

- An unrecorded $117.3 million debt refunding.

- A $71.8 million overstatement in the governmental activities' net position category of net investment in capital assets, along with a corresponding $71.8 million understatement in unrestricted net position.

In total, we proposed $1.8 billion in adjustments to correct errors we found in the draft financial statements presented for audit. These misstatements occurred primarily because the Finance Office lacked adequate staff to timely identify all errors in the draft financial statements.

Since fiscal year 2000, we have noted that the number of Finance Office accountants has declined by nearly 25 percent (from 64 full-time employees in fiscal year 2000 to 48 in fiscal year 2014). Likewise, since fiscal year 2008, the Collections Division of the Revenue Department, responsible for processing revenue receipts and preparing financial reports on all revenue and receivable activity, lost 21 percent of its accounting positions. Without sufficient staff to prepare and review the CAFR, the risk increases that significant errors can occur and not be timely discovered and corrected.

In a related issue to staffing, we previously commented that the Revenue Department and the Office of Innovation and Technology (OIT) did not have a succession plan to replace an OIT technical program manager, who performed key duties such as maintaining the Revenue Department's Taxpayer Inquiry and Payment System (TIPS) and producing daily revenue/receivable reports used by the department. The manager planned to retire in April 2014, and his replacement was hired only two months before his planned departure. Our current audit noted that, while the manager deferred his retirement until July 2014, his replacement left ten days later, leaving the manager position vacant. Our discussions with OIT management disclosed that only in December 2014 was another individual hired to assume some of the duties previously performed by the retired manager.

Recommendations:

To ensure an accurate, complete, and timely prepared CAFR, we recommend that Finance Office management:

- Either hire more accountants, or invest in new information technology that will reduce the current labor-intensive procedures needed to prepare the city's financial reports [50107.01].

- Provide adequate funding to all city agencies currently experiencing difficulty in accumulating and providing timely, accurate, and complete financial data to the Finance Office for inclusion in the CAFR [500113.01].

- Require a succession plan from agencies with key employees essential to the complete and accurate presentation of information in the city's CAFR [500113.02].

<u>Inadequate Management Oversight Resulted in Misstated Year-End Receivables</u>

Section 6-200 of the Philadelphia Home Rule Charter specifies that the Revenue Department is responsible for the collection of all monies payable and due to the city. When revenue is collected by other city agencies with regularity and in sufficient volume, employees of those agencies are to act as agents for the Revenue Department [2] to facilitate accountability. The Revenue Department is then responsible for the accurate accounting of city revenue and receivables, and estimating amounts deemed uncollectible at year-end, for inclusion in the CAFRs of the School District of Philadelphia and the city.

In prior reports, we have commented about the Revenue Department's need for better oversight of city receivables. We found misstatements of accounts receivable balances, as well as discrepancies in estimates of the uncollectible portion of the receivables. This lack of oversight appeared largely due to an inadequate managerial review, insufficient guidance provided to accountants in other agencies generating significant revenue, and outdated procedures regarding how to account for estimated uncollectible amounts. Also, we noted too little oversight within the Fire Department acting as Revenue's agent for the billing and collection of Emergency Medical Services (EMS) fees.[3] For example, the responsible Fire Department accountant appeared to have no understanding of the procedures utilized by the contracted vendor handling EMS fee billing and collection and could not explain why he wrote-off $389 million in receivables without the Accounts Review Panel's approval.[4]

During our current audit, we continued to observe evidence of inadequate oversight within the Revenue Department as well as with the Fire Department's accounting for EMS receivables. Once again, the Fire Department accountant wrote-off EMS receivables without obtaining the Accounts Review Panel's approval, this time $275 million. The Revenue Department's review of the Fire Department's EMS receivables calculation failed to detect this error. Additionally, after the Fire Department's accountant retired in November 2014, our discussions with the new accountant clearly suggested a lack of adequate succession training in the area of EMS fees and related receivables. The new accountant, who started in August 2014, informed us that he was not yet familiar with accounting procedures for EMS receivables.

[2] The Philadelphia Home Rule Charter, Section 6-204.
[3] EMS fees are charged for ambulance transport and other medical services provided to citizens and visitors of the city.
[4] The Accounts Review Panel, which was established in 1966 by Bill No. 1938, is responsible for approving all write-offs of city receivables. No receivables are to be written off without first being approved by the Accounts Review Panel.

We also observed that the Revenue Department's written procedures regarding how to account for estimated uncollectible accounts remained outdated and failed to provide adequate instruction on how to calculate estimated uncollectible amounts. As a result, there was an increased risk of financial statement errors. For example, we again found that the Revenue Department miscalculated the allowance for doubtful accounts associated with taxes receivable because it applied an uncollectible rate that was inconsistent with established methodology. Consequently, we had to propose $13.6 million of adjustments to correct both the city and school district's financial statements presented for audit.

Recommendations:

To ensure an accurate CAFR, we continue to recommend that the Revenue Department:

- Develop detailed written procedures to guide their accountants on: (1) accurately establishing year-end receivable balances; (2) performing an independent review of related activity; and (3) annually updating the estimated basis for determining uncollectible accounts receivable amounts [500110.01].

- Provide adequate training to employees performing new duties [500111.01].

- Provide better guidance to accountants in other agencies, especially those generating significant revenue [500112.01].

We recommend that Fire Department management make certain that the new accountant responsible for EMS fees and related receivables receive training to obtain an understanding of the accounting procedures used by the agency's contracted billing/collection vendor [500113.03]. Also, management should ensure that the accountant:

- Analyzes the EMS receivables to identify the portion determined to be uncollectible for appropriate disposition by the Accounts Review Panel [500113.04].

- Collaborates with the Revenue Department to accurately report the Fire Department's year-end EMS receivables and allowance for doubtful accounts [500113.05].

Untimely Review Procedures in the Philadelphia Water Department Hampered CAFR Preparation

As one of the city's business-type activities, the Philadelphia Water Department (PWD) is responsible for preparing the full accrual financial statements of the Water and Sewer Fund (Water Fund) and submitting those statements to the Finance Office for inclusion in the city's CAFR. Since our fiscal year 2005 report, we have commented on deficiencies and inconsistencies in the review process for these financial statements. The PWD's procedure checklist for its financial statements appeared ineffective as it did not show detailed and meaningful information with regard to procedures that PWD accountants performed to ensure the accuracy of the Water Fund financial statements. Moreover, this checklist was never provided to the Finance Office. Additionally, the PWD submitted the Water Fund financial statements to the

Finance Office without any supporting documentation, which, in our opinion, increased the risk for undetected errors in reported Water Fund amounts.

The current audit revealed that the PWD procured the services of an accounting firm to prepare a compilation package with detailed documentation supporting the Water Fund financial statements, similar to the compilation submitted by the Division of Aviation (DOA), also reported as a business-type activity. The PWD's compilation package contained a more comprehensive checklist detailing the procedures performed to check the accuracy of the Water Fund financial statements and also included a certification signed by management asserting that the statements were reviewed and approved and met accepted standards of presentation and disclosure. Unfortunately, the compilation package was not completed and submitted to the Finance Office until February 23, 2015, when the CAFR was finalized and we issued our audit opinion. While we commend the PWD for taking this action, we believe that, given the untimely submission, the PWD's compilation package and its associated checklist were not effective in the preparation of the fiscal year 2014 Water Fund financial statements. For instance, we found two errors totaling $5.5 million in the financial statements presented for audit, consisting of a failure to record the change in fair value of a derivative instrument and an error in the calculation of the net position, net investment in capital assets account. In our opinion, if the compilation package and review checklist had been completed by the PWD much earlier and submitted to the Finance Office accountants to allow them sufficient review time, the PWD or Finance Office accountants could have detected and corrected these errors.

In a related matter, we observed that the Finance Office and the PWD were not utilizing the full accrual Water Fund established in the city's accounting system (FAMIS) [5] to post year-end journal entries to prepare the financial statements. Posting these adjusting entries into FAMIS could provide a clear trail of adjustments between the modified and full accrual statements, and decrease the risk of errors in the city's CAFR. Finance Office management informed us that they had not required the PWD to use the FAMIS full accrual fund until the PWD had developed its compilation package. Given the PWD's late submission of its compilation, the full accrual Water Fund was not used for fiscal year 2014. However, for fiscal year 2015, Finance Office management plans to require that the PWD accountants utilize the fund to post its year-end accrual adjustments.

Recommendations:

To improve review procedures for the financial statements of the Water Fund, we recommend that PWD and Finance Office management work together to establish an earlier deadline for the completion of the Water Fund compilation and checklist, as well as the submission of those items to the Finance Office [500114.01].

Management and accountants of the PWD must ensure that the following actions are completed by the established deadline:

- Perform the procedures, now detailed in the compilation checklist, to ensure the accuracy and completeness of the Water Fund financial statements. The checklist should be submitted to the Finance Office along with the Water Fund financial statements. It should include an assertion by management that the statements

[5] **F**inancial **A**ccounting and **M**anagement **I**nformation **S**ystem.

have been reviewed and approved, and that to the best of management's knowledge, are complete and free from material misstatements [50105.01].

- Review and approve the Water Fund financial statements for accuracy and completeness [500111.02].

- Provide detailed and organized supporting documentation for the Water Fund financial statements to the Finance Office [500113.06].

Additionally, once the Finance Office has incorporated the Water Fund financial statements into the CAFR, a responsible PWD official should review the CAFR for accurate inclusion of the statements [500113.07].

Lastly, we recommend that Finance Office management require that the PWD accountants utilize the FAMIS full accrual Water Fund to post its year-end accrual adjustments [500114.02].

<u>Deficient Year-End Receivable Procedures Resulted in Misstated Water Fund Accounts Receivables</u>

In our prior year report, we commented that the Water Revenue Bureau (WRB) and the PWD did not accurately calculate their revenues, the year-end Water Fund accounts receivable balance, or the related allowance for doubtful accounts, associated with water services to their customers. Amounts for these accounts were significantly overstated in the draft financial statements, primarily due to PWD accountants failing to record a $129 million write-off of accounts receivable and neglecting to timely post a prior year $5.3 million adjusting entry into the city's accounting system. Neglecting to update the methodology for estimating the uncollectible portion of the receivable balance and an apparent lack of communication between the WRB and PWD accountants also contributed to the misstatements.

Our current year audit noted that certain corrective actions were taken. The WRB updated its methodology for estimating uncollectible receivables, and the PWD accurately recorded write-off amounts approved by the Accounts Review Panel. We, therefore, considered these findings resolved [500113.09, 500113.10, and 500113.11].

Despite those corrective actions, our audit this year revealed that other problems affecting the calculation of Water Fund revenues and receivables continued to exist. The reported Water Fund accounts receivable is primarily based upon the WRB's statement of activity in accounts receivable (SAAR), a monthly report which summarizes the beginning receivable balance, activity such as billings, payment postings, and billing adjustments, and the resulting ending balance. A critical procedure to check the SAAR's accuracy is reconciling the report's ending receivable balance to the total receivable amount in the city's water billing system, BASIS2. However, we found that WRB accountants did not perform this step until we requested that it be done. Once WRB accountants completed the reconciliation on January 30, 2015, it was revealed that the amounts reported for revenues and accounts receivable in the draft financial statements were overstated by $7.1 million and $1.4 million, respectively, while the allowance for doubtful accounts was understated by $5.7 million. This condition hindered the PWD's ability to timely post adjusting entries into the city's accounting system, and subsequently, finalize the Water Fund financial statements for the city's

CAFR. They also highlight the need for better communication between accountants in the WRB and the PWD. Without detailed, complete, and timely information, the PWD has no assurance that the year-end accounts receivable balances are valid, accurate, and complete.

Recommendations:

To ensure accurate, consistent, and timely CAFR reporting, we recommend that:

- WRB accountants perform a detailed and timely reconciliation between the SAAR and BASIS2 system receivable balances at the end of the fiscal year and communicate the results immediately to the PWD [500114.03].

- All financial statement adjustments be posted into the city's accounting system in a timely manner [500113.08].

- PWD and WRB accountants should establish communication channels to improve the financial statement preparation process [500113.12].

Late Receipt of Component Unit Financial Reports Still Delayed Preparation and Audit of CAFR

For several years, we have commented about the late submission of financial reports by some of the city's component units. These late submissions have resulted in considerable delays in timely completing the financial reporting and auditing processes for the city's CAFR. While this condition improved slightly for fiscal year 2014, six of the city's ten component units still did not submit their reports by the due dates requested by Finance Office accountants, as shown in Table 1 below.

Table 1: Late Submission of Component Unit Financial Reports

COMPONENT UNIT	DUE DATE	DATE RECEIVED	DAYS LATE
Delaware River Waterfront Corporation	9/30/2014	12/30/2014	91
Pennsylvania Intergovernmental Cooperation Authority	9/30/2014	12/16/2014	77
Philadelphia Gas Works	11/30/2014	1/6/2015	37
Philadelphia Municipal Authority	9/30/2014	12/10/2014	71
Philadelphia Redevelopment Authority	9/30/2014	2/6/2015	129
School District of Philadelphia	11/30/2014	2/13/2015	75

Note: Community Behavioral Health, the Community College of Philadelphia, the Philadelphia Authority for Industrial Development, and the Philadelphia Parking Authority submitted their financial reports timely.
Source: Prepared by the Office of the City Controller

As in the prior year, the Philadelphia Redevelopment Authority (PRA) continued to submit its final financial report much later than other component units. PRA's fiscal year 2014 report was submitted to the Finance Office on February 6, 2015, only two weeks before our audit opinion date, 129 days past the requested due date and, on the average, 50 days later than other component units with a similar June 30th fiscal year-end date.

Failure to receive component unit financial statements on time increases the chances for errors or omissions, as Finance Office accountants become limited in the amount of time available to adequately review the reports. This became evident when we found the following undetected errors in component unit financial statements:

- In the Philadelphia Municipal Authority's report, the schedule reconciling the modified accrual and full accrual income statements, which was incorporated into the city's CAFR, contained $162 million of errors in reconciling items.

- While governmental accounting standards[6] require that a component unit's reported amounts also include the activity of its own component units, PRA's report did not contain a schedule combining its financial activity with that of its own component unit. Consequently, the PRA amounts reported in the city's CAFR were misstated because they did not include the financial activity of PRA's component unit.

The risk of error also increases as accountants must make significant changes to the financial statements and footnote disclosures each time a component unit's financial information is added to the report. Additionally, each series of changes requires considerable audit time to ensure that accountants have correctly changed previous amounts and footnotes presented for audit.

In an attempt to provide more timely information, some component units submitted draft versions of their financial statements. However, this practice was not always helpful.

Recommendation:

We again recommend that early in the CAFR preparation process, Finance Office accountants solicit the assistance of the mayor and/or other administrative officials, to secure the cooperation of all component unit management in the timely submission of their respective final financial reports to the city's Finance Office [50102.01].

[6] Governmental Accounting Standards Board Statement (GASB) No. 14, *The Financial Reporting Entity*.

SIGNIFICANT DEFICIENCIES

UNAUTHORIZED INDIVIDUALS ARE APPROVING BI-WEEKLY PAYROLLS

Previously, we reported that unauthorized employees were approving the city's bi-weekly payrolls. The city's on-line payroll procedures include a three-step process whereby an agency employee posts payroll transactions to the system, a responsible administrative employee performs a supervisory-level review and approval, and a commissioner, deputy, executive administrative officer or an employee of similar rank reviews the postings and applies an executive-level approval. City standard accounting procedures (SAPs)[7] require the Finance Office to maintain a current signature file of employees authorized to enter executive-level approvals for their respective agency's payroll. However, the prior audit found that, for a large percentage of city agencies, the official signature files maintained by the Finance Office did not agree with the approval privileges assigned within the on-line payroll system. As a result, millions of dollars in payroll costs were approved by unauthorized employees.

Our current examination disclosed that this deficiency in the payroll approval process continued. During the current audit, we compared the payroll signature files for 55 city agencies to the individuals designated as authorized in the on-line payroll system to perform executive-level approvals for the bi-weekly payrolls. Our testing again revealed inconsistencies between the signature files and the on-line payroll system, as follows:

- Twenty-four agencies (44 percent) had employees designated in the payroll system as authorized executive-level approvers who were not listed as such on the official payroll signature files. For 6 of the 24 agencies, unauthorized employees approved more than $65 million in payroll costs during fiscal year 2014.

- Thirty-six agencies (65 percent) had employees who were authorized as executive-level approvers, but not designated as such in the payroll system. Seventy-three of these individuals did not have access to the system.

<u>Recommendation:</u>

We continue to recommend Finance Office management review the executive-level approvers in the on-line payroll system to ensure that all individuals are properly authorized and have appropriate on-line access to the system [500113.13].

EXPENDITURES ARE BEING IMPROPERLY AUTHORIZED

The city's Finance Office is responsible for the electronic accounting systems (i.e. FAMIS and ADPICS) [8] used to record, track and approve all expenditures for goods and services. As such, they grant, change, and revoke access to these systems as required. The Finance Office and the individual city agencies share responsibility to ensure that only current and authorized employees provide the necessary approvals for expenditures processed through these systems. Moreover, it is the responsibility of the individual city agencies to originate the proper signature authorization

[7] See SAP No. E-0911, *Signature Authorization Cards.*
[8] **<u>Ad</u>**vanced **<u>P</u>**urchasing **<u>I</u>**nventory **<u>C</u>**ontrol **<u>S</u>**ystem

cards[9] that support the electronic approvals, when an employee separates from city service or an individual's job duties change.

Our audit of expenditure approvals in both FAMIS and ADPICS revealed numerous instances of when the electronic authorization codes of retired employees were used to approve payment vouchers. Specifically, we observed a total of 282 payment vouchers amounting to $8.7 million that were approved using the authorization codes of two employees who had previously retired – a Department of Behavioral Health and Intellectual Disabilities Services (DBH/IDS) accounting supervisor who retired in July 2013 and a Free Library of Philadelphia administrative services director who separated in September 2013. The access codes for these two employees continued to be used to approve payment vouchers in FAMIS and ADPICS for five to seven weeks after their retirement. Additionally, we noted that, after the DBH/IDS employee's retirement, his authorization code was used as the first-level approver on three vouchers totaling $38.5 million.

The improper authorization of payments causes concern since it challenges the integrity and authenticity of the approval process, eliminates the audit trail, removes accountability for taxpayer funds, and could lead to misappropriation of assets. While our sample testing of fiscal year 2014 expenditures did not reveal any significant irregularities, we question why other individuals were permitted to have access to these authorization codes, a significant deficiency in any electronic system of controls. We are also uncertain as to why higher ranking officials did not approve the expenditures themselves, or anticipate for the employees' retirement by assigning this task to other qualifying individuals, each having their own unique authorization codes.

In a separate report we issued in November 2013 on our evaluation of OIT's general information technology controls, we reported that system access rights for terminated employees were not being removed in a timely manner. The current audit disclosed that OIT had instituted a procedure whereby it produces a bi-weekly list of employees who have separated or changed city agencies. OIT now sends this list to the Finance Office personnel responsible for granting and removing user access in the FAMIS and ADPICS applications.

Recommendations:

To ensure that unauthorized individuals do not have access or approval capability within FAMIS or ADPICS, we recommend that Finance Office management:

- Ensure that responsible personnel, using the OIT's bi-weekly list of terminated employees, timely revoke the FAMIS and ADPICS access codes for individuals separated from the city [500114.04].

- Reinforce to all city agencies the requirement to prepare and submit new signature authorization cards to the Finance Office immediately upon authorized employees separating or changing job responsibilities [500114.05].

[9] Signature authorization cards, as required by SAP # E-0911, are used to document who is authorized to approve payment vouchers for each city agency.

CAPITAL ASSET DEFICIENCIES REQUIRE CORRECTIVE ACTION

Management is required by Philadelphia's Home Rule Charter to maintain current and comprehensive records of all real property belonging to the city; however, as we noted in our prior reports, the city does not have a comprehensive capital asset management system. For the past several years, we have emphasized the need for the city to acquire a comprehensive capital asset system to better manage and account for real property assets. Management has asserted that although it would be beneficial to have such a system, resources have not been identified to initially fund and continually maintain it.

Lack of a Comprehensive Capital Asset System Hampered Reporting Process

During our current year audit, we again noted no improvement in the capital asset reporting process. Finance Office accountants continue to maintain several Lotus 1-2-3 and Excel files that with FAMIS constitute the current fixed asset ledger. Various spreadsheet files accumulate the cost of capital assets and work in progress, while other spreadsheet files are used to calculate depreciation expense and accumulated depreciation reported in the CAFR. Real property addresses are only available in FAMIS by user code, which is identified in an Excel file called the "Proof". The use of multiple files creates a burdensome and onerous process that can affect the accuracy and completeness of amounts reported in the CAFR and causes extensive audit effort. For example, we continued to note a $1.0 million discrepancy between the "Proof" file and FAMIS for vehicle balances, and also found a $5.4 million discrepancy between the "Proof" file and FAMIS in the accumulated depreciation balance for buildings. Additionally, our testing revealed $10 million of misclassification errors in the CAFR's capital asset footnote disclosures, which were subsequently corrected by Finance Office accountants.

A comprehensive capital asset system can provide the city with detailed asset information that would eliminate a significant amount of labor-intensive record keeping duties, and improve efficiency in accounting for these assets. Such a system could facilitate the annual depreciation expense calculation and aid in preventing or detecting errors in a timely manner.

Real Property Assets Were Not Subject to Physical Inventory

SAP No. E-7201 specifies that the Procurement Department shall physically inspect all city-owned real property on a cyclical basis and check against the inventory listing to determine actual existence, condition and propriety of use. In addition, the Government Finance Officers Association (GFOA) recommends that governments periodically inventory tangible capital assets, so that all assets are accounted for, at least on a test basis, no less often than once every five years. It also recommends governments periodically inventory the physical condition of all existing capital assets so that the listing of all assets and their condition is kept current. Furthermore, the GFOA recommends that a "plain language" report on the condition of the government's capital assets be prepared, and that this report be made available to elected officials and the general public every one to three years.

Except for the PWD and the DOA, which both periodically check the physical existence and condition of their real property assets, our current year testing again disclosed no evidence that the city's other real property assets had been recently inventoried. This continued failure to perform a physical inventory increases the risk that the city's recorded real property assets could be inaccurate and/or incomplete. For example, we found that the Love Park parking garage, which the city constructed in 1964 and sold during fiscal year 2014 for $28.6 million, was not readily identifiable in the city's fixed asset ledger.

In December 2013, the Mayor's Facilities Task Force[10] issued its report on city-owned facilities with recommendations on how to better manage city facilities. According to the report, "the single greatest finding is the lack of systematic and coordinated data tracking by the city with regard to facility management. The complete cost of facility operations is not recorded in a manner that provides for optimal allocation of funding or the maintenance, repair and the capital investment in city facilities." As such, it hampers the city's ability "to develop a true strategic plan for making informed facility decisions." One of the report's top ten recommendations was to "implement an integrated, citywide asset management program to manage all data on city-owned facilities in a uniform and consistent manner." In our opinion, this report reinforces our belief that the benefits of a comprehensive capital asset system outweigh the costs of such a system.

To assist the Mayor's Facilities Task Force in its analysis, the Philadelphia City Planning Commission created a master database of city-owned facilities. Previously, we recommended that the Finance Office obtain this list in order to compare it to the city's fixed asset ledger to identify any discrepancies and update records accordingly. During the current audit, our inquiries of Finance Office accountants disclosed that this recommendation had not yet been implemented.

<u>Recommendations</u>:

To improve the accounting and reporting of the city's capital assets, we continue to recommend that management:

- Design or purchase a computerized capital asset management system that will provide accurate and useful information such as the book value and related depreciation for each city owned asset [50104.01].

- Periodically take physical inventories of all real property assets, ascertain their condition and use, and ensure that related records are timely and appropriately updated to reflect the results of this effort [50106.04].

- Develop and provide a plain language report on the condition of capital assets for the use of elected officials every three years. This report should also be made available to the general public [500109.02].

- Obtain the master list of city-owned facilities and compare it to Finance's records to identify any discrepancies and ensure completion and accuracy [500113.14].

[10] The Facilities Task Force was established by Executive Order No. 8-11. Its mission was to make recommendations to the Administration related to ensuring that the city obtains the best financial terms for housing city operations in facilities and for leasing city facilities; that city facilities are clean, safe and code compliant; that facilities with complimentary uses are co-located; and that any underutilized facilities are merged.

SEGREGATION OF DUTIES NOT ENFORCED FOR THE AUTOMATED PAYROLL SYSTEM

In the last several reports, we have commented that the duties concerning the data entry, reviewing, and approving of bi-weekly payroll transactions were not adequately segregated. We found that the same individual performed data entry and reviewed the on-line payroll time records, completed both the supervisory review and executive-level approval, or performed all three functions. Effective control procedures require that these duties be performed by separate authorized employees.

Our current audit examined the electronic signatures for payroll entry, supervisory review and executive-level approval for all city agencies during fiscal year 2014. Our testing of 55 city agencies for 26 pay periods revealed 422 occasions during the fiscal year (30 percent) in which the same individual posted and approved the on-line payroll time records, applied both the supervisory and executive-level approvals, or performed all three duties. Thirty-five of the agencies showed employees performing duplicate functions for more than two pay periods, with the City Commissioners Office, City Council, and the District Attorney's Office being the most recurrent among the larger agencies. While these observations when compared to the previous year's findings[11] indicated some improvement in the condition, a significant number of city agencies were still not adequately segregating payroll duties. Consequently, there remains an increased risk of error or fraud occurring without being detected during the normal course of employees performing their assigned functions.

During previous discussions with Finance Office accountants, they agreed that duty segregation of the above payroll functions was both necessary and important, and therefore, they would continue to remind city agencies to maintain adequate separation of duties. The city is also in the process of modernizing its administrative systems, including human resources and payroll, and the Finance Office planned to review these control procedures for implementation as part of the project.

<u>Recommendations:</u>

We continue to recommend that the city's Finance Office remind city agencies of the importance of maintaining adequate segregation of duties for completing data entry, reviewing, and approving payroll each pay period. Additionally, we suggest the Finance Office ensure that any new system is designed to prevent one individual from performing two or more conflicting duties [500111.08].

TREASURER'S CONTROLS OVER CASH ACCOUNTS REQUIRE STRENGTHENING

Section 6-300 of the Philadelphia Home Rule Charter designates the City Treasurer as the official custodian of all city funds, and thereby charges the Treasurer's Office with the responsibility for establishing controls to safeguard these assets and ensure the accuracy of reported cash balances. Our audit disclosed that the Treasurer's Office was not preparing bank reconciliations on a timely basis, noting that the city's two main checking accounts had not been reconciled for several years. Also, we again found that the Treasurer's Office did not adequately monitor the collateralization of city funds. These weaknesses in the Treasurer's controls over its cash accounts increased the risk for undetected errors or fraud and left the city vulnerable to loss.

[11] The prior audit's testing disclosed 494 occasions during fiscal year 2013 (35 percent) in which these payroll functions were not separated. Also, we noted that, for 44 of 55 departments, employees performed duplicate functions for more than two pay periods.

Treasurer Bank Accounts Were Not Timely Reconciled; Some Not Reconciled for Years

SAP No. 7.1.3.b requires that book balances for city accounts be reconciled to the bank balances on a monthly basis. Monthly bank reconciliations are a key control in order to promptly detect errors in reported cash balances or irregularities in account activity. Our current year examination disclosed that the Treasurer's Office did not timely prepare bank reconciliations. Specifically, we found that:

- For 42 of its 63 bank accounts (67 percent), the Treasurer's Office did not complete the June 30, 2014 bank reconciliations until two or more months after June 30th. Three of these bank reconciliations were not prepared until approximately five months after fiscal year-end.

- The Treasurer's Office had not prepared bank reconciliations for the city's payroll and general disbursement accounts since September 2010 and April 2012, respectively. While the payroll and general disbursement accounts have zero book balances for CAFR reporting purposes (i.e. deposits equal disbursements), they are the city's two main disbursement accounts so errors or irregularities may be occurring without detection.

This condition suggests that Treasurer's Office management has either not made the completion of required bank reconciliations a priority or not allocated the necessary resources to perform this function effectively.

SAP No. 7.1.3.b also requires that a responsible supervisory employee review bank reconciliations to ensure their accuracy and identify any reconciling items requiring investigation. The reviewer should sign and date the reconciliation to provide evidence and affix responsibility for the performance of this task. However, we observed that three of the Treasurer's fiscal year-end bank reconciliations contained no evidence of independent supervisory review.

Collateralization of City Funds Was Not Adequately Monitored

As further security for city deposits, Chapter 19-201(4)(a) of the Philadelphia Code specifies that banks or other financial institutions holding city money must provide pledged collateral at amounts equal to or in excess of the deposited amounts. The pledged collateral must be held by the Federal Reserve Bank or the trust department of a commercial bank.

Previously, we reported that the Treasurer's Office did not adequately monitor its banks to ensure that these institutions were in compliance with the above legal requirements. The Treasurer's Office lacked written procedures to instruct staff on how and when to perform monitoring procedures, and, while Treasurer's personnel asserted they compared bank collateral reports to deposits at the end of each month, they provided no support to document these reviews. Prior audit testing disclosed instances where deposits exceeded pledged collateral, sometimes significantly.

Our current audit found no improvement in this condition. The Treasurer's Office had still not developed written procedures for monitoring of collateral. Also, when we requested copies of the fiscal 2014 monthly bank collateral reports, Treasurer's personnel were unable to locate many of the reports and actually had to contact the banks to obtain them. It took approximately four months from the date of our initial request for the Treasurer's Office to supply all of the reports.

Additionally, our testing revealed that deposits at two of the banks used by the city were not adequately collateralized for five months during fiscal year 2014. In total for these five months, deposits exceeded collateral for the two banks by $81 million, with the most significant occurrence in April 2014 when deposits were under-collateralized by $28 million. Consequently, the Treasurer's Office did not know, from month to month, if its bank deposits were fully and properly secured, nor did the Finance Office, which is required to report on collateralized funds in the city's CAFR. Although these shortfalls were corrected in the next month, the Treasurer's Office should not rely on the banks to monitor themselves. Untimely review of the banks' monthly collateral reports could leave the city vulnerable to loss if market conditions decline.

Recommendations:

To comply with the city's SAP and enable timely detection of errors and irregularities, we recommend that Treasurer's Office management:

- Devote the necessary time and/or resources to ensure that all required bank reconciliations are timely prepared on a monthly basis. In particular, bank reconciliations for the payroll and general disbursement accounts must be brought up-to-date [500114.06].

- Require that the responsible supervisor timely review all bank reconciliations and sign and date the reconciliations to evidence performance of this task [500114.07].

To ensure that city deposits are adequately protected, we continue to recommend that the Treasurer's Office prepare monthly collateralization reports timely. Once prepared, the reports should be submitted to the Finance Office where they should then be promptly reviewed to identify any collateral shortages [500113.15]. Also, the Treasurer's Office should develop written procedures to direct staff on how and when to perform collateral monitoring procedures [500114.08].

WATER CUSTOMER ACCOUNT BALANCES COULD BE INAPPROPRIATELY REDUCED

In our last several reports, we commented that users[12] of the city's water billing system, BASIS2, had the ability to make inappropriate credit adjustments to customer accounts without detection. Despite restrictions on the amount of the credit adjustments users could make – from a minimum of $200 to a maximum of $75,000 – users could make unauthorized adjustments without detection because the $200 lower limit exceeded the $75 average customer bill. Additionally, an electronic authorization path for the supervisory approval of adjustments had not been

[12] Users are defined by employee title and authorization level.

implemented. While the WRB had instituted a procedure requiring review of quarterly credit adjustment reports to identify errors or improprieties, these reports were not always generated or reviewed in a timely manner. Furthermore, this review was limited in that only one type of credit adjustment was checked even though the quarterly report included several other credit adjustment types. Consequently, errors or irregularities in water customer account balances could occur without detection.

Our current audit disclosed there had been no improvement in this condition. While BASIS2 continued to lack an electronic authorization path for supervisory review of adjustments, WRB management indicated that implementing such a feature was not feasible so they have instituted alternative controls such as the adjustment dollar limits. However, while the WRB has established dollar limits for certain credit adjustment types, there was a significant amount of adjustment activity with no such restrictions on users. Adjustment types with no dollar limits on users included bill reversals (i.e. cancelled bills), rebills (i.e. replacement bills), and transfers of balances and payments between customer accounts. Out of $177.7 million in total fiscal year 2014 adjustment activity,[13] $110.2 million, or 62 percent, were adjustment types for which users had no dollar restrictions on the adjustment amounts they could make.

Additionally, the WRB was still unable to demonstrate that the quarterly reviews of adjustment activity were regularly performed. While the first two quarterly credit adjustment reports for fiscal year 2014 showed indications of supervisory review, the third and fourth quarter reports contained no evidence of review. Furthermore, the review of quarterly adjustment reports still only encompassed one adjustment type – credit billing adjustments, which amounted to only $10.9 million, or 6 percent, of total fiscal year 2014 adjustment activity.

Recommendations:

To improve controls over the adjustments process in the BASIS2 billing system, we recommend that WRB management:

- Incorporate into its quarterly review process significant adjustment types, such as bill reversals, rebills, as well as balance and payment transfers [500114.09].

- Ensure that the quarterly review pays particular attention to large dollar adjustments and instances of accountants performing multiple adjustments on the same customer account [500114.10].

- Require that accountants perform the review of quarterly adjustment reports on a timely basis. The reports should be initialed and dated by the reviewer to affix accountability for the task [50008.01].

[13] The figure of $177.7 million is the total absolute value of all fiscal year 2014 adjustment transactions. The figure of $110.2 million represents the total absolute value of all fiscal year 2014 transactions for adjustment types with no dollar limits.

BETTER TRAINING AND ENFORCEMENT OF EXISTING POLICIES AND PROCEDURES ARE REQUIRED TO IMPROVE GRANT ACCOUNTING BY CITY AGENCIES

The United States Office of Management and Budget (OMB) Circular A-133 sets forth the city's grant responsibilities, which include maintaining a record of all federal awards received, expended, and identified by the federal program under which grant amounts were received. Moreover, the circular requires preparation of a schedule of expenditures of federal awards (commonly referred to as the Schedule of Financial Assistance or SFA) for the same period covered by the city's financial statements. The impact of an unreliable SFA at the time of audit can impede the timely completion of the audit due to misidentified and/or unidentified major programs, as well as other types of grant accounting errors. In turn, the city may jeopardize future federal and state funding.

The Finance Office has established a dedicated grants accounting and administrative unit (GAAU) to co-ordinate the accounting for all federal and state grants received by the city. This unit has responsibility for preparing the city's annual SFA, which is submitted through a federal clearinghouse website for viewing by each of the city's grantor agencies.

To permit the GAAU to operate effectively, the Director of Finance has compiled and issued various policies and procedures that delineate duties and responsibilities for each city agency receiving grants. For example, grantee agencies must formally notify the GAAU of any new grant awards. They do this by submitting grant profile documentation to the GAAU, which then assigns the grant award a unique identifier number. This unique number enables the GAAU to keep track of receipts and disbursements relevant to the grant in the city's accounting system. Among other control procedures, the GAAU requests that city grantee agencies identify all grants within their administrative control and provide the GAAU with reconciliations of all grant expenditure activities from the city's accounting system to the reimbursement requests that agencies submit to grantors. Administrative control exercised by the GAAU is ongoing and comprehensive; however, the controls are dependent upon information received from grantee agencies. In particular, the GAAU's reliance on the grant profile documentation and annual reconciliations from city grantee agencies are critical to the GAAU's ability to compile and issue a reliable SFA.

Despite the above procedures, for the past several years, the GAAU has provided an inaccurate SFA for audit, because staff of city agencies responsible for the grants frequently:

- Failed to identify all federal financial assistance received;
- Misidentified federal awards by incorrectly recording the federal programs' Catalogue of Federal Domestic Assistance (CFDA) numbers, which the federal government uses to identify programs and the related compliance requirements;
- Failed to include all expenditures invoiced to federal awards in the grant accounting records; and / or
- Recorded erroneous accruals or ineligible expenditures.

Each of these deficiencies is discussed more fully below.

Federal Financial Assistance Not Always Identified

All too frequently city agencies do not follow required procedure for notifying the GAAU of their grant awards. In one instance, occurring late during the audit of fiscal year 2013 grant activities, the Commonwealth of Pennsylvania notified the city's GAAU that federal funds subgranted to the city had not been reported in the city's SFA for the fiscal years 2010 to 2012. Our inquiries revealed that this situation occurred because the grantee agency, the PWD, failed to properly notify the GAAU of the award. Consequently, the program was never properly identified in the city's accounting system and the GAAU did not include the program on the SFA for those years. Subsequently, the Commonwealth requested a separate audit of the program for fiscal years 2011 and 2012. In planning for the audit of the fiscal year 2013 SFA, we found that the program had again been left out of the SFA and revised our audit scope to properly include the program for audit during the engagement.

In addition, we also discovered other federal financial assistance mistakenly identified in the city's records as unaffiliated with any federal grant award. Subsequent research determined that the individual awards, when combined, exceeded the single audit's threshold for programs subject to audit. As such, the program had to be subsequently included within the scope of the fiscal year 2013 single audit.

Programs Misidentified with Improper CFDA Numbers

During the fiscal year 2013 single audit work, our examination of grant profiles submitted by city grantee agencies noted various profiles with CFDA numbers frequently changed by the GAAU subsequent to its review of the documentation. While in most instances the GAAU has been effective in detecting misidentified grants, its review was not fail proof. In one instance involving the Airport Improvement Program at Philadelphia International Airport which was a grant selected for audit, expenditures relevant to the program had been incorrectly recorded under another CFDA number. Airport management brought this misidentification to the attention of the independent public accountants (IPA) we had engaged to audit the program at the conclusion of the firm's fieldwork. Consequently, the contract with the IPA firm had to be amended so the firm could perform additional procedures necessary to satisfy the federal audit requirements.

As part of our fiscal year 2014 single audit, we again observed that the same Airport expenditures had been identified with an incorrect CFDA number. Although the GAAU had timely detected the error, our inquiry to the grant manager indicated a lack of knowledge concerning the importance of correctly identifying CFDA numbers associated with grant programs.

Invoiced Expenditures Not Always Included in Grant Accounting Records

As part of our fiscal year 2013 single audit procedures, we observed that the DBH/IDS invoiced expenditures to the Pennsylvania Department of Health for the Substance Abuse & Mental Health Care Services – Access to Recovery (ATR) Program which were not properly identified in the supporting grant accounting records. Instead, the agency had recorded the expenditures in an account associated with the city's Coordinating Office for Drug and Alcohol Abuse Program, comprised of state funded grants, although the underlying expenditure appeared to be otherwise eligible for reimbursement under the ATR program. For fiscal year 2014, DBH/IDS had again recorded the expenditures in the same manner.

In a related matter, the Office of Supportive Housing (OSH) has continually recorded ineligible costs in the accounting records for the Emergency Solutions Grant (ESG) and the Homeless Prevention and Rapid Re-Housing Programs. Time after time, the agency has responded that it made "off the book adjustments" to identify eligible reimbursement costs to substitute for those previously determined by the grantor agency to be ineligible. The "replacement" costs were previously identified with other program appropriations on the city's books and records and, in some instances even costs from prior fiscal years.

Erroneous Accruals or Ineligible Expenditures Recorded as Grant Related

DBH/IDS routinely and erroneously accrued expenditures in each of its grants to ensure that the budgeted expenditure amount was fully exhausted in each fiscal year. In one multiyear program with two grants totaling $6 million for the ATR program, for example, the department over reported the cumulative program expenditures by nearly $1.8 million covering the three-year period of the program term. DBH/IDS management justified the over accrual by indicating it was necessary because of uncertainty surrounding program expenditures by subrecipient agencies participating in the program.

Additionally, our review of the preliminary fiscal year 2014 SFA provided for audit found that reported expenditures for the Police Department's Port Security Grant (PSG) were overstated by $3.3 million. The overstatement occurred because reported PSG expenditures erroneously included an interfund transfer from the grants revenue fund to the capital improvement fund. This accounting error remained undetected until audit procedures noted the improper inclusion of the interfund transfer. Once notified of the error, Finance Office accountants corrected the SFA.

We believe that many city agencies are unaware or lack the understanding of the importance of sharing and providing their grant information to the GAAU for the SFA. The lack of accurate and timely information from the grantee agencies in conjunction with the lack of compliance with existing control procedures weakens the GAAU's ability to issue a reliable SFA on a timely basis. As a result, the GAAU cannot provide reasonable assurance that the SFA is fairly presented at the time of audit.

Recommendations:

We recommend that the Finance Office:

- Establish and maintain an aggressive continuing education program for all grant managers [500114.11].

- Aggressively enforce existing grant-related policies and procedures, especially those involving the correct identification of grants and the reconciliation of grant accounting records to grant reimbursement requests [500114.12].

STANDARD ACCOUNTING PROCEDURES NEED TO BE UPDATED

In accordance with the Philadelphia Home Rule Charter, the city's Finance Office is required to establish, maintain, and supervise an adequate and modern accounting system to safeguard city finances.[14] As such, the Finance Office has established over two hundred (200) SAPs to provide city departments and agencies with guidance on how to handle various accounting related activities, including the proper procedures for ensuring the accuracy of transactions and the safekeeping of assets. Over the years, as new technologies were adopted and daily practices were enhanced, the existing SAPs have not been updated accordingly, causing over 50 percent of them to be over half a century old.

Since these accounting procedures are an integral element of the daily transaction activities that affect financial reporting in each city agency, we have commented repeatedly over the past decade about the importance of updating them. Although numerous Finance Directors have previously agreed with our finding, limited staffing capacity has made corrective action difficult to implement. During our current year audit, Finance Office management stated that, while they were in the process of revising certain SAPs pertaining to the maintenance of cash accounts, no updates had been made to the SAPs as of March 2015. Therefore, the Controller's Office is now in its 13th year of reporting this condition.

In our opinion, the SAPs are essential to ensuring the accuracy of the various accounting related transactions and maintaining the safekeeping of assets for every city department and agency. In its best practices, the GFOA recommends that governments perform an on-going review, evaluation, and update of accounting procedures. This practice is essential to maintaining consistency and accountability among the numerous city agencies that account for transactions daily throughout the fiscal year.

Recommendation:

We continue to recommend that the Finance Office perform a thorough review of its SAPs. Accounting procedures need to be technically accurate and understandable to all employees and must be compliant with current rules and regulations. SAPs that are no longer pertinent should be rescinded. Those that are out-of-date should be revised to reflect the automated processes and practices in use today. Once this initial update is completed, the Finance Office should develop a schedule for periodically updating SAPs on a regular basis in the future [50102.16].

[14] City Charter Section 6-101, Accounts.

GENERAL INFORMATION TECHNOLOGY CONTROLS CONTINUE TO REQUIRE STRENGTHENING

During the prior audit, we conducted, with the assistance of a consultant, an evaluation of the OIT's general information technology (IT) controls over key financial-related applications.[15] In November 2013, we issued a separate report to the OIT detailing various general IT control weaknesses in the following primary areas: organization and management controls; technical infrastructure; administration over software, data, and applications; certain procedures over IT operations and support; and business continuity planning. As part of the current audit, we reviewed OIT's remediation efforts to address the identified control deficiencies.

Out of fifteen prior noted conditions, we observed that three had been resolved. Specifically, OIT had corrected two deficiencies involving user accounts for the security system that manages the operating systems' access control and auditing functionality and another finding regarding procedures for removing inactive users' access to the Payroll and FAMIS applications. For the remaining twelve findings, OIT made certain remediation efforts but had not completed corrective action. Our findings involved the following ten areas: (1) risk assessment, (2) vendor management, (3) IT policies and procedures, (4) domain administrators, (5) application change management, (6) BASIS2 System backup media, (7) periodic access rights review, (8) vendor support access, (9) password configurations, and (10) business continuity/disaster recovery planning. Details regarding the fifteen prior noted conditions and their current remediation status are presented in the table in Appendix I.

ACCESS AND CHANGE MANAGEMENT CONTROLS OVER TAXES RECEIVABLE SYSTEM REQUIRE IMPROVEMENT

As part of the current audit, we reviewed selected IT controls over the Revenue Department's TIPS application. TIPS is the Revenue Department's accounting system for the city's real estate and self-assessed taxes and the source for the taxes receivable reported in the city's CAFR, which totaled $597 million at June 30, 2014. The Revenue IT group, which consists of assigned employees from the OIT, maintains TIPS for the Revenue Department.

Our audit revealed certain weaknesses in controls over access to the system's data and the change management process. Specifically, we noted that consultants who provided programming services were performing incompatible duties, and TIPS access for separated employees was not always removed on a timely basis. Also, our review disclosed that the Revenue Department had not formally documented its procedures for making changes to the TIPS application. In our opinion, these deficiencies increase the risk that errors or intentional manipulation of taxes receivable data might occur without detection by management.

<u>Programming Consultants Were Performing Incompatible Duties</u>

The consulting firm who created the TIPS application for the city has continued to provide programming services to support TIPS. Our audit disclosed that six programmers from the firm

[15] The key financial-related applications included in the review were FAMIS, Payroll, Pension Payroll, TIPS, Health and Welfare, and BASIS2.

also had the ability to add, modify, and delete TIPS transaction data. Only users – not programmers – should be responsible for transaction origination and correction. When duties are not adequately segregated, there is increased potential for data to be erroneously added or modified and not be detected by management.

Access for Separated Employees Was Not Always Timely Revoked

Access controls require that management periodically review access authorizations for continuing appropriateness. Our review found that access for separated employees was not always disabled and removed in a timely manner. We haphazardly selected a sample of twenty individuals from the TIPS active users list as of October 14, 2014 and observed that five individuals were no longer city employees. While three of these five individuals separated between May and August of 2014, the other two had separation dates going as far back as 2002 and 2006. Unauthorized access to data not only increases the risk that data could be compromised but also presents opportunities for the possible abuse of confidential taxpayer information.

Change Management Procedures Were Not Formally Documented

Management did not provide us with formal written procedures documenting the process for making system modifications to the TIPS application. Failure to develop formal procedures increases the risk that employees may not be aware of the proper steps to perform during the process of making programming changes to TIPS. For example, our discussions with Revenue and OIT personnel found that there were no standard criteria for user testing of application changes or how the user's approval of the change was to be documented. A formalized change management policy would help ensure uniformity in the process and mitigate associated risks such as data being corrupted and/or destroyed and computer performance being disrupted.

Recommendations:

To improve controls over TIPS, we recommend that Revenue Department management working together with OIT:

- Segregate duties and responsibilities for system programmers. Specifically, the ability to add, change, or remove data should be delegated to individuals who are not responsible for programming activities [500114.13].

- Establish and implement a procedure to ensure mandatory and timely notification to responsible IT personnel of employee separations. Responsible IT personnel should disable and remove accounts for separated employees in a timely manner. Also, institute a procedure to periodically review access authorizations for continued appropriateness [500114.14].

- Develop formal written policies and procedures for the TIPS change management process [500114.15].

CONTROLS OVER AIRPORT'S COMPUTERIZED BILLING SYSTEM NEED STRENGTHENING

As part of our audit of the Aviation Fund's financial statements, we reviewed the DOA's general IT controls over its computerized billing system known as PROPworks. The DOA uses PROPworks, an off-the-shelf software program purchased from the vendor AirIT, to generate billings to airlines and other airport tenants, revenues from which totaled $315 million during fiscal year 2014. Our review found the DOA had not developed formal policies and procedures for critical control activities involving security access, application updates, and contingency planning. Additionally, we had concerns regarding controls over access to the system's data, noting that no one was periodically reviewing system access rights for continued appropriateness, the DOA had not adequately segregated the duties of the database administrator, and system audit trails were not being utilized to monitor for unusual activity. In our opinion, these weaknesses create the potential for errors or irregularities in airport billings.

Control Activities Were Not Formally Documented

The DOA had not formally documented its policies and procedures governing critical IT control activities, such as the following:

- Review and approval procedures for granting access to new users and changing or removing access rights.
- Management of passwords, such as assigning, changing, resetting passwords, and handling lost or compromised passwords.
- Process for testing and installation of software upgrades/changes from AirIT.
- Procedures for backing up of data files, including storage locations, retention period, and periodic testing of backups.
- Planning for contingencies to mitigate the impact of unplanned interruptions.
- Risk assessment of security threats.

In addition to providing no evidence of risk assessment procedures, management informed us that there was no assigned IT security officer. Executive Order No. 2-97 requires city agencies to designate an IT security officer to establish and enforce technology security policies and procedures. We believe this condition further increases the vulnerability of the system to security threats.

When policies and procedures have not been formally developed and adequately documented, there is an increased risk that critical control procedures may be inconsistently applied or not performed at all. Formal policies and procedures help prevent errors by ensuring uniformity in routine processes.

Access Rights Were Not Periodically Reviewed for Appropriateness

Access controls require that management periodically review an application's active users list to identify access authorizations that require removal or modification. Our audit found that the DOA had not implemented a process to review active PROPworks accounts and related access permissions periodically. In fact, our examination of the PROPworks active users list revealed that eleven inactive employee and contractor accounts were disabled on the date the list was provided to us. The dates of last activity for these eleven accounts, which were disabled on November 24, 2014, ranged from June 2011 through June 2013. Unauthorized access to data increases the risk that data could be compromised without management detection.

Duties Were Not Adequately Segregated and System Audit Trails Not Sufficiently Detailed or Monitored

Our review disclosed that the DOA did not adequately segregate the duties of a consultant who served as the PROPworks database administrator. The consultant, who was responsible for maintaining PROPworks, installing application changes from AirIT, and backing up system data, also granted and removed user access and had the ability to add, change, or delete transaction data and clear system audit trails. This combination of duties increases the risk of intentional manipulation of billing data without management detection.

The functions of granting and removing user access permissions and controlling the audit trails would be more appropriately performed by a security officer who had no ability to change the application software or its data. Also, there should be a periodic independent review of the system audit trails for unusual activity. However, our discussions with DOA management indicated there was no such monitoring of the audit trails. Furthermore, management stated that the current system audit trails lacked details on the specific data modified by users.

Recommendations:

To improve controls over PROPworks, we recommend that DOA management:

- Develop and document formal written policies and procedures for controls over granting, changing, and removing user access; managing passwords; testing and installing software upgrades/changes from AirIT; backing up of data files; planning for contingencies; and assessing and monitoring security threats [500114.16].

- Formally assign an IT security officer, whose duties should include assessing and monitoring the risk of system security threats [500114.17].

- Implement a procedure to periodically review the active users and their associated access rights for appropriateness [500114.18].

DOA management informed us that segregating the duties of the database administrator and adding more detail to the audit trails to show the specific data changed would require software modifications from the vendor. Therefore, we recommend that DOA management contact AirIT to request the software be modified to (a) permit an individual other than the database administrator to perform the duties of controlling user access permissions and the audit trails and (b) establish system audit trails that would detail the specific information changed by users [500114.19].

Additionally, management should require a periodic independent review of the audit trails to identify unusual activity. Someone with no ability to change the PROPworks system or its data, such as an independent security officer, should perform this review [500114.20].

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

Our follow-up has disclosed that the city made progress addressing several prior issues. We blended the status of some resolved prior-noted conditions[16] with new observations and reported upon these matters in the previous sections of this report. Other resolved prior year issues are discussed below. We commend city management on its efforts.

Finance Office's Accounting for Departmental Custodial Funds Improved

For the past several years, we have commented that cash balances reported for the departmental custodial (agency) funds were incomplete and inaccurate. SAP No. 7.1.3.b requires city agencies to prepare and submit monthly bank reconciliations to the city's Finance Office so that the account activity can be accumulated and correctly presented in the CAFR. However, certain city agencies failed to provide the Finance Office with year-end cash balances, and the accountants often did not follow-up to obtain the required reconciliations or perform the necessary level of review to ensure that all agency bank accounts were identified. Also, we noted that a Fire Department bank account was not previously approved by the Director of Finance as required by SAP No. 4.1.1.g.

Our current year audit noted significant improvement in the Finance Office's accounting for departmental custodial funds. We observed evidence that Finance Office accountants reminded agencies of the requirement to send monthly bank reconciliations and followed up with those who failed to submit the required reconciliations. As a result of these efforts, our testing found the reported cash balance as presented in the draft financial statements was only overstated by $429,000, which was a substantial decrease from the previous year's error amount of $12.1 million. Additionally, we were provided with a memorandum documenting that the Fire Department account had been approved by the Finance Office. Our current review disclosed no other instances of bank accounts not previously approved by the Finance Office. Based on the improvement noted, we consider these findings resolved [50106.05, 500111.03, and 500111.04].

Written Procedures and More Detailed Accounting Records Now Exist for Water Capital Assets

For the past several years, we reported that the PWD did not have written policies and procedures for the operation and review of its $2.0 billion capital asset inventory system, thereby increasing the risk that city accountants would not be able to effectively and efficiently manage and report on water capital assets. The current audit disclosed that the PWD has developed formalized written policies and procedures for its capital asset inventory system. We, therefore, consider this finding resolved [500109.01].

In the prior audit, we also commented on certain deficiencies in the PWD's accounting for its capital assets. We noted numerous instances where real property items were not uniquely identified in the water capital asset system so as to distinguish one asset from another. Also, the PWD was depreciating real property assets costing less than $5,000, the capitalization threshold established during the city's implementation of GASB Statement No. 34. Our current audit found that the

[16] The resolved prior-noted conditions involved the WRB's updating of its methodology for estimating uncollectible receivables and the PWD's recording of receivable write-off amounts approved by the Accounts Review Panel.

PWD's accounting records for fiscal year 2014 real property additions contained detailed descriptions of the assets. In fact, our examination of the PWD's current listing of capital assets revealed that only 20 of approximately 8,100 listed real property items were not uniquely identified as compared to several hundred items in previous years. Regarding the depreciation of assets costing less than $5,000, PWD accountants informed us that, although these items were listed separately on the capital asset records, each of them actually represented a portion of an asset whose total cost exceeded $5,000. Our examination of the PWD's records confirmed this statement. Based upon our observations, we consider these findings resolved [500110.03].

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. While the OIT had a process to monitor technical risks through vulnerability scanning, a formal plan to identify and address additional IT operational, business and compliance risks did not exist.	Without a current and comprehensive risk assessment, IT resources may be used ineffectively in addressing risk affecting OIT.	Develop formal procedures to perform periodic risk assessments and monitor gaps identified. This should be a component of an enterprise wide risk management program [300413.01].	**Incomplete:** OIT provided a two page "Vulnerability Management Strategy" document, which presented a general overview of methods OIT uses to identify and address potential security risks. However, as of October 9, 2014, OIT management stated they had not yet developed more detailed risk assessment procedures.
2. Vendor Management: Reports on the internal control environments at third-party service providers were not consistently obtained and reviewed. OIT had not obtained and reviewed a Statement on Standards for Attestation Engagements (SSAE) 16 Report for Official Payments, the city's vendor for credit card payment processing. Obtaining a SSAE 16 report would allow the city to monitor the effectiveness of the control environment in situations where financial transactions are processed on behalf of the city.	A lack of documented due diligence procedures by the city over the reliance on service providers could lead to critical risk being inadvertently inherited by the city.	Develop a process to periodically assess the internal control environments at third-party service providers. Also, coordinate with vendors, such as Official Payments, to obtain more structured and detailed internal control reports [300413.02].	**Incomplete:** OIT furnished a one page document which briefly discussed certain key indicators that OIT asserted it reviews in evaluating vendors' internal control environments, such as obtaining audit reports of vendors' controls. However, as of October 9, 2014, OIT management stated that more detailed process documentation was still underway. Additionally, when we requested copies of any available SSAE 16 reports for OIT's third-party service providers, OIT did not provide any such reports.

Condition	Risk/Potential Effect	Recommendation	Remediation Status (Complete or Incomplete)
3. IT Policies and Procedures: OIT did not consistently document the review and approval of governing IT policies and procedures.	Lack of clarity for OIT personnel on operating policies and procedures increases the risk that policies and procedures do not reflect current operating procedures.	Develop processes to periodically review, update, and approve operating policies and procedures and document these reviews [300413.03].	**Incomplete:** OIT provided a draft policy setting forth a standard process for the development, review, and approval of its operating policies and procedures. However, the policy was still awaiting final approval from executive management.
TECHNICAL INFRASTRUCTURE **4. Domain Administrators:** An excessive number of accounts were included in the membership of the domain administrators group within the Active Directory. Our current observations of the active domain administrators list as of June 20, 2014 revealed the following deficiencies: • Five active users were no longer city employees, two of which separated as far back as calendar year 2011. For 4 of the 5 accounts, the dates of the last logon and password change occurred after the employee separated. OIT was unable to explain these occurrences. • For two of the listed domain administrators, OIT was unable to furnish evidence to document that they had been either city employees or contractors at one time. • There were several generic user names, some not used since calendar year 2011. User names should identify specific individuals to ensure accountability.	Having excessive domain administrators increases the risk that unauthorized or undetected changes to settings or data will occur.	Review the current listing of domain administrators and restrict access where appropriate. Additionally, develop procedures to periodically review administrator access for appropriateness [300413.04].	**Incomplete:** OIT developed a draft procedure for granting domain administrator access, which included a requirement to annually review the domain administrators list for appropriateness. However, the procedure had not yet been formally approved by executive management.

Condition	Risk/Potential Effect	Recommendation	Remediation Status (Complete or Incomplete)
SOFTWARE ADMINISTRATION **5. Application Change Management:** While OIT had developed a change management procedure, the procedure was inconsistently applied when performing change requests for applications. Change requests were not consistently supported by documented end-user testing or management approval, including evidence of review and approval by the Change Advisory Board (CAB).	Inadequate compliance with established procedures to perform end-user testing and management approval increases the possibility that unauthorized or inadequately reviewed changes will be implemented in the production environment.	Review change management procedures and implement measures to ensure that required documentation and steps are performed and documented [300413.05].	**Incomplete:** Our review of OIT's current change management procedures (updated as of July 2014) found that, while they stated how the change requestor's supervisor should document his/her approval, there were no specific requirements addressing how end-user testing or the CAB's review and approval should be documented.
DATA ADMINISTRATION **6. BASIS2 Backup Media:** Media used to store backups of the BASIS2 application were not stored off-site.	In the event of a disaster, backup media may not be available.	Evaluate separate locations to store rotated backup media [300413.06].	**Incomplete:** OIT supplied a copy of a purchase order for the upgrading of its mainframe backup tape library. As of September 26, 2014, OIT management informed us that installation of the upgrade was in process with BASIS2 backup to follow.
APPLICATION ADMINISTRATION **7. Periodic Access Rights Review:** A process had not been implemented to periodically review active application user accounts, associated access rights, and group membership.	While OIT had implemented processes to perform and approve granting of user access, changes to user access, and removal of access rights, there is a risk that over time access rights will not be updated due to oversights.	Work with impacted departments to develop a procedure to periodically review the active users and their associated access rights for appropriateness [300413.07].	**Incomplete:** OIT provided a draft of a letter requesting that department IT managers create a process to review user access rights for appropriateness at least annually. However, OIT did not yet supply the final version of this letter or evidence that it was disseminated to department IT managers.

Condition	Risk/Potential Effect	Recommendation	Remediation Status (Complete or Incomplete)
8. Vendor Support Access: Vendor support accounts were provided full access to BASIS2 and were active.	There is an increased risk that unauthorized transactions or activities will be performed without the city's knowledge.	Ensure that vendor support accounts only be granted the access they need to provide ongoing support, and implement a process to activate vendor accounts only when the vendor is providing support [300413.08].	**Incomplete:** OIT management stated they do not believe the recommendation is a workable solution since it may prove detrimental to the service being provided to the city. Management asserted they will explore options where virtual private network access is not open-ended for vendors and consult industry standards to adopt a best practice for the city in this area.
9. Password Configurations: While passwords were required for access to the network, applications, and supporting technologies, configurations could be enhanced to strengthen authentication mechanics. Password configurations were inconsistently implemented and did not always comply with established policies at the network, application, and database levels.	Inadequate password configurations increase the possibility of unauthorized access to the system, including malicious or accidental data manipulation or breach of data confidentiality.	Review the available configurations of each authentication point and evaluate strengthening the configuration [300413.09].	**Incomplete:** Management indicated OIT's security group will perform a review of the financial systems' configurations to evaluate compliance with the established password policy. OIT had not yet provided a copy of that review.
IT OPERATIONS AND SUPPORT **10. 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	Privileged users would be able to remove logging requirements from RACF and enhance their ability to perform unauthorized activity undetected.	Remove the AUDITOR attribute from the identified RACF accounts [300413.10].	**Complete:** During the prior audit, the consultant who performed the general IT controls review reported that, upon notification, OIT removed the AUDITOR attribute from the identified accounts.

Condition	Risk/Potential Effect	Recommendation	Remediation Status (Complete or Incomplete)
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.			
11. <u>IBMUSER Account:</u> The default RACF account, IBMUSER, was not revoked when use was not required.	Compromise of the IBMUSER account would provide full access to the RACF environment.	Revoke the IBMUSER account and implement procedures to maintain the account as needed [300413.11].	**Complete:** During the prior audit, the consultant who performed the general IT controls review reported that, upon notification, OIT revoked the IBMUSER account.
12. <u>Termination of Payroll and FAMIS IDs:</u> Accounts of terminated employees were not removed or disabled in a timely manner for the city's Payroll and FAMIS applications.	A user may be able to access system resources after employment with the city has been terminated.	Review procedures to identify and take action on terminated employees [300413.12].	**Complete:** OIT has instituted a procedure whereby, on a bi-weekly basis, it produces a list of employees who have either separated or changed departments. This list is given to the Finance Office personnel responsible for granting and removing user access in the Payroll and FAMIS applications. In future audits, we will review the list of Payroll and FAMIS users to determine if the Finance Office is removing access for inactive employees in a timely manner.

Condition	Risk/Potential Effect	Recommendation	Remediation Status (Complete or Incomplete)
BUSINESS CONTINUITY			
13. Business Continuity Plan: A business continuity plan had not been developed for the applications reviewed (FAMIS, Payroll, Pension Payroll, TIPS, Health and Welfare, and BASIS2).	In the event of a disruption of service, city departments may not be able to provide required services or continue limited operations until service is restored.	Communicate with potentially impacted departments to convey the importance of establishing a business continuity plan. Also, provide guidance and assistance in helping the impacted departments when establishing plans [300413.13].	**Incomplete:** In March 2015, OIT personnel informed us that, during late calendar 2014, the city embarked on a Continuity of Operating Program (COOP), requesting all city agencies to submit COOP plans. With these plans currently under review, OIT management indicated that they have requested copies of the COOP plans and will be examining them to prioritize the system and application business needs with the intention of developing a disaster recovery plan.
14. BASIS2 Disaster Recovery: The disaster recovery plan and subsequent testing of the plan had not been formally documented or performed.	The recovery plan may not be available or known to key individuals or may not work as anticipated when faced with an unplanned outage.	Develop, document, and periodically test a disaster recovery plan for the BASIS2 application and infrastructure [300413.14].	**Incomplete:** OIT supplied a copy of the BASIS2 disaster recovery process; however, it did not provide any documentation to evidence periodic testing of the plan.
15. Disaster Recovery Plan: The disaster recovery plan established for the mainframe applications did not include all pertinent information needed to perform the restoration activities, including: (a) location of the off-site facility and (b) instruction to retrieve back-up media.	Lack of such plans could potentially reduce OIT's ability to restore services in a timely fashion.	Revise the disaster recovery plan to include the noted missing items [300413.15].	**Incomplete:** Our review of the current mainframe disaster recovery plan found that it now included the location of the off-site facility. However, while there was a general instruction to retrieve the back-up media, the plan did not include the specific locations where the back-up media were stored.

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ROB DUBOW
Director of Finance

July 2, 2015

The Honorable Alan Butkovitz
City Controller
1230 Municipal Services Building
1401 John F. Kennedy Boulevard
Philadelphia, PA 19102-1679

Re: Report on Internal Control and on Compliance and Other Matters – Fiscal 2014

Dear Mr. Butkovitz:

Thank you for the opportunity to discuss the contents of your draft report at the exit conference held on Wednesday, May 20, 2015. Before responding to the findings and recommendations, I would like to thank you for noting progress made in regards to prior year findings, including: efforts by the Philadelphia Water Department (PWD) to improve the quality of their financial statements, updates to the Water Revenue Bureau's methodology for estimating uncollectible receivables and the resulting accurate recording of write-off amounts by PWD, improvements in the on-time submission of financial reports by component units, and the Office of Innovation and Technology's progress removing inactive users from the payroll and accounting system applications. Additionally, you noted that corrective action has been taken on prior year findings regarding Finance's accounting for departmental custodial funds and the development of written procedures and more detailed accounting records for PWD capital assets.

We offer the following responses to the findings and recommendations found in the Controller's Office audit for Fiscal 2014.

Staff Turnover and Reductions Compromised CAFR Preparation Processes

Finding & Recommendation: You have repeated your finding that staff reductions in Finance as well as in other City agencies contribute to errors in the financial statements presented for audit. However, you do note that errors in the CAFR had no net effect on the financial statements. You continue to recommend that Finance consider hiring more accountants or invest in new information technology to assist with the labor-intensive procedures needed to prepare the city's financial reports; provide adequate funding to departments experiencing difficulty in providing accurate financial data for inclusion in the CAFR; and require succession plans for key employees in all departments who are essential to preparing information for the CAFR.

Response: The Accounting Bureau (Accounting) is committed to producing an accurate and well-prepared CAFR. As noted in your report, staff reductions have made the task of completing the CAFR more difficult. Despite the loss of experience, Finance believes we have a core of dedicated individuals presently in place to accomplish our mission, and we have made progress in our succession planning efforts. Additionally, we will continue to work with other departments within the Finance group on succession planning efforts.

Accounting recently re-organized to address succession planning and to improve and balance the responsibilities between its Grants Accounting and Administration Unit (GAAU) and General Accounting Unit. The Procedures Unit has been moved to the GAAU, now renamed the Grants Accounting and Procedures Unit, and a permanent supervisor position is being added in this unit. This realignment will result in cross training of key staff and enable Accounting to better manage the workload with existing resources. Further, to address management challenges resulting from employee retirements, Accounting is currently documenting staff functions and duties to assist managers in supervising staff accountants. This should strengthen internal controls and ensure duties are being completed in a timely fashion. By thoroughly understanding all of the functions and duties to be performed, Accounting managers and supervisors will be able to assign more tasks to the appropriate staff accountants, ultimately including them more in the year end process and facilitating better CAFR production. We will continue to critique the errors and adjustments resulting from the FY2014 CAFR audit with the entire accounting staff and fully expect to produce improved financial statements in the upcoming fiscal year.

Inadequate Management Oversight Resulted in Misstated Year-End Receivables

Finding & Recommendation: Your report noted a need for the Revenue Department to better oversee city receivables due to misstatements and discrepancies in accounts receivable balances as well as in the estimated uncollectible portion of receivables. You noted that Revenue did not provide guidance to departments performing billing and receivables duties or calculating uncollectible amounts and that Revenue's written procedures to account for estimated uncollectible amounts were outdated and failed to provide adequate instruction. You also noted a lack of oversight within the Fire Department for the billing and collection of Emergency Medical Services (EMS) fees. You recommend that the Revenue Department develop detailed written procedures to guide their accountants in these areas, train staff who are performing new duties, and provide better guidance to accountants in other agencies, especially those in departments that are generating significant revenue. You recommend that the Fire Department analyze the EMS receivables to identify the portion determined to be uncollectible for appropriate disposition by the Accounts Review Panel and collaborate with the Revenue Department to accurately report the Fire Department's year-end EMS receivables.

Response: Revenue is committed to working closely with departments that manage large agency receivables to provide better guidance and to ensure uncollectible receivables are calculated accurately. In order to improve oversight and provide guidance to accountants, Revenue has restructured its Financial Reporting Unit. The unit will be managed by a Financial Reporting Director who is a CPA, and this unit will provide improved guidance through enhanced training and updated documentation. In addition, the department has been working more closely with other departments including the Fire Department concerning their receivables. The Fire Department is committed to working on improving their processes around EMS collections and is working closely with Revenue to train their accountants and improve the reporting of EMS fees and receivables.

Untimely Review Procedures in the Philadelphia Water Department Hampered CAFR Preparation

Finding & Recommendation: Your report commended PWD for improvements in developing a detailed compilation package, including a comprehensive procedure checklist to check the accuracy of its financial statements. However, you note that this compilation package was not provided to Finance until after the CAFR was completed, thereby being ineffective in improving the CAFR presentation. Also, your report noted that Finance had not required PWD to utilize the City accounting system's (FAMIS) full accrual Water Fund to post year-end entries until the PWD had developed its compilation package. Given the late submission, the full accrual Water Fund was not used for fiscal year 2014. You recommend that PWD perform procedures to ensure the accuracy and completeness of the Water Fund financial statements and submit the checklist, along with supporting documentation for the financial statements, to Finance by the established deadlines.

Response: PWD appreciates the acknowledgement regarding improvements in the preparation of its FY2014 financial statement documentation. As noted in the report, PWD procured the services of an accounting firm to prepare the compilation package, including the procedures checklist and detailed documentation supporting the Water Fund financial statements. This was PWD's first attempt to provide the compilation package, and efforts to provide a complete product caused the submission to be untimely. However, PWD is confident that they will be able to submit the FY2015 financial statement compilation in a timely manner. As was included in the 2014 compilation, PWD will include a certification from management asserting that the statements are reviewed, approved, and free of material misstatement to the best of their knowledge.

Additionally, PWD will work closely with Finance personnel to ensure that the Water statements included in the CAFR are complete and accurate and will consult with Finance on utilizing FAMIS to post the year-end accrual adjustments to the Water Fund, providing a clear audit trail between the modified and full accrual statements.

Deficient Year-End Receivable Procedures Resulted in Misstated Water Fund Accounts Receivables

Finding & Recommendation: Your report indicated that the Water Revenue Bureau (WRB) did not perform a timely reconciliation between the Statement of Activity in Accounts Receivable (SAAR) and the city's water billing system, BASIS2. You recommend that WRB accountants perform a detailed and timely reconciliation between SAAR and BASIS2 at the end of the fiscal year and communicate results immediately to the PWD so that all financial statement adjustments may be posted into the city's accounting system in a timely manner. Additionally, you recommend that PWD and WRB accountants establish communication channels to improve the financial statement preparation process.

Response: WRB appreciates the acknowledgement regarding corrective actions taken to accurately estimate Water Fund uncollectible receivables, allowing for PWD to accurately record write-off amounts approved by the Accounts Review Panel. WRB accountants have continued to perform a reconciliation of the SAAR to the current billing system (BASIS2), as they have done since the migration in 2008 from the prior billing system (WATER1). This is a reconciliation of the SAAR with the fiscal year end Accounts Receivable Aging by Routes Report produced by the BASIS2 billing system. During this year's audit, the Controller's office requested that the WRB accountants perform a reconciliation of SAAR to the General Ledger Code report that is also produced by the Basis2 billing system, a reconciliation unable to be performed previously due to general code migration issues that occurred when transitioning from the prior billing system (Water1) to the existing billing system (BASIS2). Going forward, WRB will continue the reconciliation of SAAR to the General Ledger Code report and does not expect future code migration issues.

Late Receipt of Component Unit Financial Reports

Finding & Recommendation: Your report finds that despite improvements in FY2014, the late submission of financial data by some of the City's component units continues to result in delays to the financial reporting and auditing process, increasing the risk of errors or omissions. You recommend that Accounting request the assistance of the Finance Director or Mayor early in the CAFR preparation process to secure the cooperation of component unit management in the timely submission of their financial data.

Response: We agree that the timely submission of all component unit reports is critical to the timely issuance and accuracy of the City's CAFR. Despite meeting with management and auditors of various component units last year concerning timely audit submission, we still experienced difficulty expediting the receipt of final audit reports. On an individual basis, Accounting has had additional meetings with units that experienced difficulties to provide guidance and assist with problems that may be delaying submission of component unit reports. Accounting will continue to communicate the required timelines to the component units and emphasize the importance of timely submissions.

Unauthorized Individuals are Approving Bi-weekly Payrolls

Finding & Recommendation: Your audit noted discrepancies between the Finance official signature files and the approval privileges assigned within the on-line payroll system. You recommend that Finance review the executive-level approvers in the online payroll system to ensure that all individuals are properly authorized and have appropriate access to the system.

Response: Payroll will work with Office of Innovation and Technology (OIT) to explore a programmatic approach to remove authorized signers who have terminated or transferred to other departments. In the interim, Payroll will issue a reminder requesting that departments review employees currently on signature cards for accuracy and update where necessary. This will remind departments of their responsibility to notify the Payroll Unit of any changes to the existing signatures. Also, Payroll will conduct periodic audits to compare signature cards to the authorized signers in the system and notify departments of any inconsistencies in order for them to make changes.

Expenditures Are Being Improperly Authorized

Finding & Recommendation: Your report states that authorization codes of retired employees were being used to approve payment vouchers in both FAMIS and ADPICS. You also referenced your separate evaluation of OIT's general technology controls, wherein you found that system access rights for terminated employees were not being removed in a timely manner by OIT. You recommend that OIT's bi-weekly list of terminated employees be used to revoke access to FAMIS and ADPICS in a timely manner for individuals who separate from the city. You also recommend that the city reinforce requirements to prepare and submit new signature authorization cards to Finance immediately as employees separate from employment or change job responsibilities.

Response: To reinforce the process previously implemented, we will instruct responsible personnel who monitor FAMIS and ADPICS access and approval authority to utilize OIT's bi-weekly list of terminated employees to revoke access codes in a timely manner for individuals separated from the city. Also, we will reissue SAP E-0911 to reinforce to all city agencies the requirement to prepare and submit new signature authorization cards to Finance immediately when authorized employees separate or change job responsibilities.

Lack of a Comprehensive Capital Asset System Hampered Reporting Process

Finding & Recommendation: Your report states that Finance employs a burdensome, onerous and inefficient process to account for the City's real property capital assets. You recommend that the City design or purchase a comprehensive capital asset management system.

Response: We agree it would be beneficial for the City to a have capital asset system. Unfortunately, resources have not been identified to fund either the system or the ongoing operating costs for staff that may be required to maintain the system, including maintaining accurate cost history records, accurate depreciation history, and providing a detailed inventory of the major systems in all of the buildings that the City owns. In the meantime, the current system will continue to be used. It should be noted the current methodology used by Accounting provides financial information that is accurate and auditable, even though it does not provide the level of detail that a capital asset system might provide. The auditor's finding cited variances totaling $6.4 million against total capital assets of $2.2 billion, not a material variance. The footnote error of $10 million was the result of a data entry error and not due to the capital asset inventory process.

Real Property Assets Not Subject to Physical Inventory

Finding & Recommendation: You indicate that the City's real property assets have not been inventoried recently and that there is no type of "plain language" report on the condition of the City's capital assets. You recommend periodic physical inventories of all real property assets, along with timely updating of related property records, as well as the development of a plain language report on the condition of the City's capital assets. You also recommend comparing the list of capital assets created by the City Planning Commission (for the Mayor's Task Force on City-owned Facilities) to Finance's records in order to identify any discrepancies.

Response: We agree that there is no formal written process to document that a physical inventory is occurring and no one system/report where all of the data on property conditions is stored. However, we believe that a physical inventory of assets is being conducted as a matter of course by the departments and that information is the basis for their capital and maintenance budget requests. We will follow the Controller's recommendation and obtain City Planning's master list of city-owned facilities and compare to Finance's records to reveal any discrepancies. As you know, this will aid in ensuring the list is complete and accurate but will not assist in calculating depreciation and book value of the city owned capital assets.

Segregation of Duties Not Enforced for Automated Payroll Time Records

Finding & Recommendations: Your audit found that departments were allowing the same individual to both post and approve the on-line payroll time records or to approve at both the supervisory and executive levels. You recommend that City departments enforce the separation of duties and also that any new administrative system implemented prevent one individual from performing two or more conflicting duties.

Response: We agree that segregation of duties is an important internal control feature, and Accounting will remind the departments of the importance of good internal controls. The security in the current payroll systems lets a user with higher level do the work at their level, as well as the levels below them. This is intentional to ensure that employees are able to be paid in emergency situations that may occur when all employees at all levels are not available to sign off on payroll. The City's OnePhilly initiative to replace the HR and Payroll systems is underway, and these types of control features will be reviewed for implementation as part of that project.

Treasurer Bank Accounts Were Not Timely Reconciled; Some Not Reconciled for Years

Finding & Recommendation: Your report indicates that the Treasurer's Office did not complete June 30, 2014 bank reconciliations for some bank accounts until two or three months after the end of the fiscal year. You also found that the Treasurer's Office had not prepared bank reconciliations for the city's payroll and general disbursement accounts since September 2010 and April 2012, respectively. You recommend that the Treasurer's Office devote the time and resources necessary to ensure that all required bank reconciliations are prepared timely and that reconciliations for payroll and general disbursement accounts are brought up to date. Additionally, you recommend that a supervisor timely review, sign, and date all bank reconciliations to evidence performance of this task.

Response: The City Treasurer's Office (CTO) acknowledges the City Controller's findings regarding bank account reconciliations and since your review, has addressed staffing shortages and improved processes that have contributed to this delay.

Prior to discussing the staffing changes and process improvements, it is important to state that CTO believes the risk of fraud and vulnerability to loss noted in your report is minimal. CTO has controls on the City's main accounts, mainly in the form of Positive Pay and ACH Fraud Filters, to ensure that funds are not unknowingly withdrawn. The Positive Pay feature is a validation process for paper checks presented to the bank for payment. This service reviews all of the checks presented for payment and validates that the check number, payee name and dollar amount of the check match an electronic file that is sent via a secure process from the City to our banking partner on a weekly basis as paper checks are printed. If any of the three items on the check do not match the electronic file, an exception is created, which is then audited on a daily basis by CTO staff to determine if the check should be paid. The ACH Fraud Filter assists in preventing electronic fraud. This service blocks all attempts from outside parties to complete an ACH transaction without CTO's knowledge. The service is a firewall that only allows the completion of City-authorized ACH payments.

The CTO recently added a Deputy City Treasurer position and since the close of FY2014, has filled most of its vacancies and redesigned the job specifications of the Accounting Manager. CTO has been making improvements to processes around bank reconciliations, is working to develop staff knowledge of those individuals tasked with bank account reconciliation, and anticipates developing documentation for the reconciliation of approximately 80 bank and investment accounts. In addition, CTO is rebalancing the workload for the accountants responsible for bank reconciliations to ensure that current reconciliations are kept up to date. With new individuals working on the bank reconciliation process, there has been a renewed perspective on the priority of the bank reconciliations and a focus on improving the controls and efficiency of the process. CTO has developed a new Excel-based tracking spreadsheet that provides a summary of the Treasury Account Groups (TAG) to bank balance reconciliations and a record of which accountant is responsible for each reconciliation. As an additional control, an individual outside the Treasury Accounting Group will be assigned to spot audit the reconciliations to ensure completion and to confirm that review has occurred and has the sign-off of the appropriate individuals.

The Payroll and General Disbursement accounts reconciliation delay has been a long standing issue which will require a significant effort to address given the nature of these accounts and the number of transactions that occur in each. CTO is anticipating that it will take upwards of a year to catch up on the balancing of these accounts and that additional time will be needed to rectify any open reconciling items that are identified during the account balancing process. Aside from this catch-up process, CTO anticipates that the majority of reconciliations will be completed and reviewed in a timely manner.

Collateralization of City Funds Was Not Adequately Monitored

Finding & Recommendation: The audit found that the Treasurer's Office did not adequately monitor its banks to ensure these institutions were in compliance with Philadelphia Code requirements regarding collateral amounts, nor were there written procedures in place to instruct staff on how and when to perform monitoring procedures. You continue to recommend that the Treasurer's Office prepare timely monthly collateralization reports, submit reports to Finance for prompt review to identify any collateral shortages, and develop written procedures for the performance of collateral monitoring processes.

Response: We agree that it is important to review and monitor bank collateral reports on a timely basis, The City Treasurer's Office (CTO) believes the discrepancies cited in your report were related to timing issues. Collateral levels change daily based on the account balances. Collateral reports are compared to deposits at the end of each month. On certain days, matching of the deposit to collateral may be distorted as larger wires or deposits may come in later in the work day. In these cases, banks do not always have sufficient time to cover these deposits as financial markets where they purchase securities to collateralize deposits close before the banking day closes.

As previously stated, CTO hired several new employees to backfill vacant positions, including those that have responsibility for the collateralization review/reporting, and there is currently a Deputy Treasurer-Banking & Investments and Manager-Treasury Operations that are tasked with reviewing the collateralization processes. The objective of this review is to propose and implement efficiencies in the bank deposit collateral process. To better manage the process as well, CTO is hoping for authorization to implement a Treasury Management System, which would assist in building a portfolio of the collateral-backing deposits that can be market valued on demand, as well as display current bank account balances for the City's accounts to ensure the accounts are adequately collateralized at any point during a given period.

<u>Water Customer Account Balances Could Be Inappropriately Reduced</u>

Finding & Recommendation: The report notes that BASIS2, the City's water billing system, lacks an electronic authorization path for supervisory approval of adjustments and may allow for a user to make inappropriate credit adjustments without detection. Additionally, you commented that although credit adjustment reports have been created, they are not reviewed on a timely basis. You recommend that WRB should incorporate and pay particular attention to significant adjustment types in its quarterly review process such as bill reversals, rebills, balance and payment transfers, large dollar adjustments, and instances where accountants perform multiple adjustments on the same customer account. You also recommend that WRB have supervisors initial and date reviews to identify any questionable patterns of adjustment.

Response: WRB has worked diligently to identify and correct weaknesses in the BASIS2 system. The quarterly report was put in place initially to reflect large dollar adjustments and instances of accountants performing multiple adjustments on the same customer account. The Department has modified the review process for this quarterly credit adjustment report in several ways. Paper reports that were previously circulated have been replaced with electronic reporting and review to all responsible parties. Reviewing staff will make a notation in the billing system (BASIS2) of the accounts that have been reviewed during this quality review process, and the Accounting Manager has been added as an additional required signoff of the compiled report. Additionally, the quarterly review will be modified to include bill reversals, rebills, balance transfers, and payment transfers. In response to dollar limits, the system currently creates a strong audit trail because all adjustments include the name of those users completing the adjustments. We believe this establishes ample controls and provides additional approval protocols for such adjustments while not impeding the production of timely and accurate bills.

<u>Better Training and Enforcement of Existing Policies and Procedures Is Required to Improve Grant Accounting by City Agencies</u>

Finding & Recommendation: Your report noted that the Grants Accounting and Administrative Unit (GAAU) and the staff of city agencies responsible for grants have not identified all federal financial assistance received, misidentified federal awards by incorrectly recording the federal programs' Catalogue of Federal Domestic Assistance (CFDA) numbers, did not include all expenditures invoiced to federal awards in the grant accounting records, and mistakenly recorded erroneous accruals or ineligible expenditures. You cited specific instances where you thought these issues had occurred. You recommend that Finance establish and maintain a continuing education program for all grant managers and enforce existing grant-related policies and procedures, especially those involving the identification and reconciliation of grant accounting records to grant reimbursement requests.

Response: We agree it is important that departments are aware of recording/reporting requirements and the need to keep GAAU informed on all grant activity. GAAU will enforce its existing policies in compiling the grant profiles submitted by the Departments to ensure that complete and accurate grant profiles are being established, including proper identification of CFDA numbers and the reconciliation of grant accounting records to grant reimbursement requests.

Additionally, GAAU will fully collaborate in any training which may be necessary from the Finance/Accounting perspective. Many grantors assist grant recipients by offering training and helpdesk support in administering grant programs, and we will encourage City agencies to take advantage of any special training offered by Federal and State agencies.

In regard to the specific examples you cite, there were instances where a department submitted incorrect information (Water) or did not submit expenditures in a timely manner (OSH) in order for the SFA to capture the grant information accurately. The Water issue was corrected and is being properly reported beginning with the FY2013 Schedule of Expenditures of Federal Awards (SEFA) and the OSH issue was addressed in the response to your audit of the 2013 SFA. As for the overstatement of Police expenditures, this was initially recorded on the SFA incorrectly as both a Grants expenditure and a Capital expenditure, while it should have shown only once under Capital. As you stated, this has been corrected. GAUU will be more diligent in their review process to ensure proper expenditure recording.

Standard Accounting Procedures Need to Be Updated

Finding & Recommendation: You have repeated your finding that the City's Standard Accounting Procedures (SAPs) have not been revised to reflect automated processing applications and practices currently in use. You recommend that Finance conduct a thorough review of its SAPs and develop a schedule for periodic updates.

Response: Accounting is committed to continual review and updating of its SAPs. On a limited basis, and to ensure that we are in compliance with any changes in accounting regulations, these procedures are updated, especially in areas that have been cited in audit reports. In addition to those limited updates, we are currently working on updates to the SAPs related to Cash Accounts, which we believe are important for proper internal controls. These include the procedures for Petty Cash (4.1.1.d), Imprest Funds 4.1.1.e), Establishment of Agency Bank Accounts (Outside of the City Treasury) (4.1.1.g), Fund Reconciliation for Petty Cash and Imprest (7.1.3.a), Reconciliation of all Bank Accounts in all City Agencies (7.1.3.b), and Unclaimed Money (4.1.2.). We also expect to update the SAP related to Personal Property (E-72-002). We anticipate issuing these updates to City departments in summer of 2015. Going forward, Accounting will continue to update the SAPs as much as time and resources permit.

General Information Technology Controls Continue to Require Strengthening

Your report included your findings, as well as a progress update, from a previous audit of the Office of Innovation and Technology (OIT). We have forwarded those findings to OIT for their review.

Access and Change Management Controls over Taxes Receivable System Require Improvement

Finding & Recommendation: Your report notes that programmers of the Taxpayers Information Processing System (TIPS) were able to modify data, in addition to their programming rights; that user access rights were not timely revoked for separated employees; and that there is no formal procedure to document changes/modifications to the system. You recommend that Revenue segregate duties and responsibilities for system programmers from that of users, disable accounts for separated employees in a timely manner, and develop formal written policies and procedures for the TIPS change management process.

Response: Working with OIT, Revenue has implemented an approval process for system changes. This electronic process requires several electronic signatures prior to applications/modifications being moved to production. In addition, Revenue has instituted a Ticket Tracker Change control process which requires the requester to clearly define the request and requires the programmer to detail the changes made.

Over the past year, Revenue has made a concerted effort to remove all unused or inactive TIPS accounts, reducing the total number of accounts from several thousand to several hundred. Revenue now receives a bi-weekly feed from Human Resources, allowing for reconciliation and elimination of accounts for users no longer employed by the City. Additionally, the inactive period to disable an account has decreased from 90 to 30 days. It is expected that the department's new security staff person will continue to address this issue as part of his regular duties.

Controls Over Airport's Computerized Billing System Need Strengthening

Finding & Recommendation: Your report finds that control activities for the Division of Aviation's (DOA) computerized billing system, PROPworks, are not formally documented. You recommend that the DOA develop and document formal written policies and procedures for controls over user access, managing passwords, testing and installing software upgrades from the AirIT vendor, backup of data files, planning for contingencies, and assessing and monitoring security threats. You also recommend that the DOA formally assign an IT security officer to assess and monitor the risk of system security threats, and implement a procedure to periodically review the active users and their access rights for appropriateness.

Response: DOA is currently in the process of developing formal policies and procedures to improve controls over PROPworks as discussed with the auditors at the meeting on April 17, 2015. Regarding security, DOA will consult with OIT regarding the appropriate security measures and the possibility for assistance in assessing and monitoring system security threats. Currently, the Airport reviews all PROPworks users when new employees are given access to the system. To strengthen this control, the Accounting Manager will now review employees' access on a quarterly basis.

Finding & Recommendation: The audit found that the duties of the database administrator responsible for maintaining the system, installing application changes and backing ups system data also had the ability to grant and remove access, revise transaction data and clear system audit trails. You recommend that DOA management modify the software to permit an individual other than the database administrator to control user access permissions and audit trails and also establish system audit trails that would detail the specific information changed by users.

Response: Most of the PROPworks database tables contain "CHANGED BY" and "CHANGED WHEN" columns. Extracting that information requires someone with SQL programming skills and sufficient knowledge to determine from which tables to extract the data. Going forward, the Accounting

Manager will collaborate with the Departmental Computer Information Systems Director to periodically review the PROPworks tabular data to meet the internal audit standard.

Finding & Recommendation: The audit notes that PROPworks audit trails were not sufficiently detailed or monitored. You recommend that management require a periodic independent review of the audit trails to identify unusual activity, and that the review be performed by someone with no ability to change the PROPworks system or its data.

Response: The Accounting Manager is in the process of transferring all data entry work to the Accounting Supervisor. The Accounting Manager, who will not be inputting data, will perform quarterly reviews that should identify unusual activity.

Thank you for the observations provided in your report and for the opportunity to respond. We look forward to continued cooperation with your office.

Sincerely,

Rob Dubow
Director of Finance

cc: Josefine Arevalo, Accounting Director, Finance Department
Hope Caldwell, Chief Integrity Officer, Mayor's Office
Kathleen Duggan, Audit Director, City Controller's Office
Melissa LaBuda, Deputy Commissioner, Water Department
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