

# CITY OF PHILADELPHIA PENNSYLVANIA

## OFFICE OF THE CONTROLLER

*Promoting honest, efficient, and fully accountable government*

**PHILADELPHIA WATER DEPARTMENT**

**AUDITOR'S REPORT**

**FISCAL YEAR 2009**



City Controller  
**ALAN BUTKOVITZ**



# CITY OF PHILADELPHIA

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ALAN BUTKOVITZ  
City Controller

GERALD V. MICCIULLA  
Deputy City Controller

October 11, 2012

Mr. Howard M. Neukrug, P.E.  
Water Commissioner  
Philadelphia Water Department  
ARAMARK Tower, 5<sup>th</sup> Floor  
1101 Market Street  
Philadelphia, PA 19107

We have examined the financial affairs of the Philadelphia Water Department for fiscal year 2009 pursuant to the requirements of Section 6-400 (c) of the Philadelphia Home Rule Charter. A synopsis of the results of our work is provided in the executive summary to the report. The conditions giving rise to the findings and recommendations contained in this report occurred under the administration of the previous Water Commissioner.

We have discussed our findings and recommendations with you and your staff at an exit conference and included your written response to our comments, along with our evaluation of your response as part of the report. Our recommendations have been numbered to facilitate tracking and follow-up in subsequent years. We believe that, if implemented by management, these recommendations will improve internal controls and the effectiveness and efficiency of your agency's operations.

We would like to express our thanks to you and your staff for the courtesy and cooperation displayed toward us during the conduct of our work.

Very truly yours,

A handwritten signature in black ink, appearing to read "Alan Butkovitz".

ALAN BUTKOVITZ  
City Controller

cc: Honorable Michael A. Nutter, Mayor  
Honorable Darrell L. Clarke, President  
and Honorable Members of City Council  
Members of the Mayor's Cabinet



# PHILADELPHIA WATER DEPARTMENT

## EXECUTIVE SUMMARY

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### Why The Controller's Office Conducted the Examination

Pursuant to the requirements of Section 6-400 (c) of the Philadelphia Home Rule Charter, we examined the financial affairs of the Philadelphia Water Department (PWD) as part of our audit of the City of Philadelphia's basic financial statements. The focus of our examination was limited to determining if department management had suitably designed and placed in operation internal controls and complied with any laws and regulations related to its cash, accounts receivable, inventory, personal property, revenue, payroll and other expenditure activities.

### What The Controller's Office Found

Delinquency and Restoration Services (DRS) crews were not issuing receipts for all payments collected from customers. This deficiency in the DRS collection process created opportunities for the misappropriation of monies.

Additionally, since City Council enacted legislation during fiscal year 2008 prohibiting the shut-off of water service for delinquent residential customers on weekends and holidays, revenues collected by PWD's DRS unit declined \$1.7 million. This represented a 31 percent decrease from the unit's prior year collections.

Some of the other, more serious deficiencies we observed are listed below.

- The PWD did not verify that all revenue collections were properly deposited, increasing the risk for misappropriation of monies.
- Duties of employees charged with maintaining the PWD's \$13 million materials and supplies inventory were not adequately segregated. Stores workers received and issued supplies, maintained the records, and conducted physical inventory counts.
- The PWD was still not consistently enforcing the city's sick leave policy.
- A clerk for the department's \$30,000 Consent Decree account performed several incompatible duties, such as preparing and signing checks, and preparing bank reconciliations.
- Other prior year findings remained uncorrected. These included problems with the department's reconciliation procedures for its cash accounts, and payroll procedures that gave the appearance of incompatible duties.

The PWD did take corrective action on a number of matters that included: (1) safeguarding monies collected by water shut-off crews; (2) better accounting for materials and supplies; and (3) using the prescribed reconciliation forms for fund and bank reconciliations.

### What The Controller's Office Recommends

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

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## *INTRODUCTION*

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### **BACKGROUND**

#### Powers and Duties

The Philadelphia Home Rule Charter established the Philadelphia Water Department (PWD) which is one of the 10 operating departments under the direction of the Managing Director. The department's responsibilities include:

- Operating and maintaining the city's water supply and stormwater system. This includes constructing, maintaining, repairing and improving the city's water supply facilities.
- Operating and maintaining the city's sewage system and wastewater treatment plants.
- Investigating and adopting methods for improving the quality of the water supply.
- Fixing and regulating rates and charges for supplying water and sewage disposal services.

#### Management

A Commissioner and three Deputies manage the department. PWD management directs a staff of approximately 2,000 employees, most of whom were appointed through the civil service system. For budgetary purposes, the PWD's operations are divided into six divisions. They are Human Resources, Finance and Administration, Planning and Engineering, Operations, Public Affairs, and Information Science and Technology.

#### Financial Resources

For fiscal 2009, management of the PWD was accountable for the following appropriations, estimated revenues and assets (exclusive of real property and infrastructure):

	<u>2009</u>
<b>Appropriations:</b>	
Water Fund	\$ 316,825,623
Capital Fund	<u>551,701,000</u>
Total Appropriations	\$ <u>868,526,623</u>
<b>Estimated Revenues:</b>	
Non-Tax Revenue	\$ 34,997,000
From Other Governments	2,500,000
From Other Funds	<u>18,860,000</u>
Total Estimated Revenues	\$ <u>56,357,000</u>
<b>Assets (Reported Balances):</b>	
Petty Cash and Imprest Funds	\$ 60,006
Accounts Receivable	3,846,789
Materials and Supplies Inventory	12,799,775
Personal Property Inventory	<u>81,742,134</u>
Total Assets	\$ <u>98,448,704</u>

Internal Control

Management has responsibility for establishing and maintaining internal controls to safeguard the financial resources for which it is accountable. Internal controls are designed to (1) prevent or timely detect unauthorized acquisition, use, or disposition of assets, (2) ensure the reliability of financial reporting and (3) help make certain there is compliance with applicable laws and regulations.





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GERALD V. MICCIULLA  
Deputy City Controller

## **REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS**

We annually audit the basic financial statements of the City of Philadelphia, Pennsylvania, as of and for its June 30 fiscal year end and issue a report thereon. Those statements include financial transactions of various city agencies. We conduct our audit in accordance with 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.

### **Internal Control Over Financial Reporting**

In planning and performing our audit, we consider the City of Philadelphia's centralized and agency internal controls over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the City of Philadelphia's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the City of Philadelphia's internal control over financial reporting.

A control deficiency 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 misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects an agency's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the city's financial statements that is more than inconsequential will not be prevented or detected by the agency's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by an agency's internal control.

C I T Y O F P H I L A D E L P H I A  
O F F I C E O F T H E C O N T R O L L E R

Our consideration of the Philadelphia Water Department's internal control over financial reporting was limited to determining if its internal control components for cash, accounts receivable, inventory, personal property, revenue, payroll, and other expenditure activity were suitably designed and placed in operation during fiscal year 2009, and would not necessarily identify all deficiencies in the internal control over financial reporting that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as described above.

**Compliance and Other Matters**

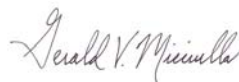
As part of obtaining reasonable assurance about whether the City of Philadelphia's financial statements are free of material misstatement, we perform centralized and agency tests of compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could 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.

Our consideration of the Philadelphia Water Department's compliance with certain provisions of laws, regulations and contracts was limited to tests of cash, accounts receivable, inventory, personal property, revenue, payroll, and other expenditure activity during fiscal year 2009. Grant compliance was tested and reported on as part of our single audit in accordance with Office of Management and Budget Circular A-133. Our agency tests disclosed no instances of noncompliance or other matters by the Philadelphia Water Department that are required to be reported under *Government Auditing Standards*.

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

The Philadelphia Water Department's response to our findings is included in the accompanying agency response section of the report. We did not audit the Philadelphia Water Department's response and, accordingly, we express no opinion on it. However, where we believe the Water Department's response did not adequately address our findings and recommendations, we have included our comments.

This report is intended solely for the information and use of the management of the City of Philadelphia, the Philadelphia Water Department, and City Council and is not intended to be and should not be used by anyone other than these specified parties.



GERALD V. MICCIULLA, CPA  
Deputy City Controller

October 8, 2010



## ***FINDINGS AND RECOMMENDATIONS***

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### **SHUT OFF COLLECTION PROCEDURES IMPROVED BUT OPPORTUNITIES STILL EXISTED FOR MISAPPROPRIATION**

The Delinquency and Restoration Services Unit (DRS) of the Philadelphia Water Department (PWD) shuts off the water service of delinquent customers who meet the PWD's shut-off criteria and restores service when customers satisfy their debt to the city or receive an extension for payment (e.g., delay granted due to a medical condition). The DRS crews who visit the delinquent properties can either observe payment receipts presented by the customers, or collect payments directly from them in order to avoid shut-off or have their water service restored. We previously commented<sup>1</sup> on conditions related to DRS procedures regarding: (1) determining the validity of customer receipts; and, (2) issuing receipts for payments received by the DRS.

When a crew visits a customer's property to shut off water service, the customer may present a payment receipt to show the delinquent balance was paid. If the crew accepts the customer's payment receipt, the crew will not perform the shut-off and will assign the account a completion code of "P3" (meaning the customer presented a payment receipt) on the crew's work assignment listing. However, numerous instances of accounts coded as "P3" were found for which there was no actual customer payment and, therefore, the shut off of these delinquent customers was unnecessarily delayed.

To reduce the instances of "P3" coded accounts where there was no customer payment, we recommended PWD management establish a written procedure for DRS crews to use in determining whether a payment receipt is valid, including criteria regarding standard city payment receipt formats and an acceptable payment date and amount. We also recommended that PWD management limit the number of times an account can be coded as "P3" [12807.05].

We determined during our current examination that PWD had put written procedures in place that instruct crews to only assign a "P3" code to an account when the customer's payment receipt was in a correct format, recent, and represented at least half of the delinquency. We therefore consider this condition resolved.

We also reported that DRS crews do not issue receipts for all payments received from customers. Customer payments by check are processed using a check verification machine that generates two receipts – one for the customer and one retained by the crew. For payment transactions which cannot be processed by the check verification machine, such as payments by money order or a check payment made by a customer who does not have a photo identification card, receipts are only issued upon customer request. In this case, the receipt issued is a single copy form which is not pre-numbered and a copy of the receipt is not retained by the crew. In addition, we found that a reconciliation of the receipts generated by the check verification machine to the corresponding payments was not performed.

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<sup>1</sup> See Water Department Auditor's Report, Fiscal Years 2007 and 2008.

We determined that the lack of issuing and accounting for pre-numbered receipt forms along with an inadequate reconciliation of collections, increases the risk that crews could be collecting payments from customers and not remitting them. Our current review found that the above procedures remained unchanged.

Recommendations:

To minimize opportunities for misappropriation of monies collected from customers by DRS crews, we continue to recommend that PWD management do the following:

- Require that crews use multi-copy pre-numbered receipt forms for collection payments that cannot be processed by the check verification machine. A copy should be issued to the customer with another copy retained by the crew [12807.01].
- Designate someone independent of the collection process to (1) reconcile the amounts recorded on these pre-numbered receipt forms and the amounts printed on the check verification machine receipts to the checks and money orders turned in by crews, and (2) account for the numerical sequence of the pre-numbered receipt forms [12807.02].

**CITY COUNCIL BILL RESTRICTING SHUT-OFFS IMPACTED COLLECTIONS**

One of the city’s most effective enforcement tools for collecting on delinquent accounts is the shut-off of water service. In March 2008, City Council enacted Bill No. 080005 (Bill), which prohibits the PWD from shutting off the water service of any residential property on Fridays, Saturdays, Sundays, legal holidays, and any day immediately preceding a legal holiday. Shut-off restrictions were later imposed for excessive heat days or snow emergency days. The Bill’s restrictions are in addition to the winter moratorium which does not allow shut-off of service for any residential property for four months from December 1 through March 31. With these scheduled restrictions, the PWD was only permitted to shut off service during 129 days or approximately one-third of calendar year 2009 (see Exhibit I, page 16).

During our prior engagement<sup>2</sup> we found that, by placing further restrictions on the PWD’s ability to perform shut-offs, the Bill has had a significant negative impact on DRS collections. When we compared DRS performance after the bill took effect, we observed a significant decrease in the number of checks received and dollar amounts collected, as depicted in Table I below.

**Table I: Impact of Bill No. 080005 on DRS Collections**

	<b>Fiscal 2008</b>	<b>Fiscal 2009</b>	<b>Decrease</b>	<b>Percentage Decrease</b>
Number of Checks	16,795	14,949	1,846	11.0%
Dollar Amount Collected	\$5,570,697	\$3,864,825	\$1,705,872	30.6%

Source: Prepared by the Office of the Controller from collection data of the DRS Unit.

<sup>2</sup> Ibid.

Our analysis of DRS collection statistics for the three years before the implementation of Bill No. 080005 (fiscal years 2005 through 2007) revealed that 34 percent of the DRS' revenue receipts were collected on days where shut-off is now prohibited.

During fiscal year 2009, the water and sewer accounts receivable outstanding over 90 days grew from \$120 million to \$132 million, a 10.0 percent increase.<sup>3</sup> In fiscal year 2010, these receivables grew to \$144 million, a 9.4 percent increase over 2009. In addition, water and sewer rates have risen 47.4 percent from fiscal years 2002 through 2010 with additional increases scheduled in future years. Given this growing delinquent receivable and the increasing water and sewer rates, the restrictions placed by Bill No. 080005 on one of the PWD's most effective enforcement tools appear counterproductive.

Because the Bill had a significant negative impact on enforcement of delinquent accounts and DRS collections, we recommended that PWD management request that City Council revisit the legislation. PWD management informed us that it did not act on our recommendation stating that City Council clearly felt the Bill was necessary because it passed unanimously.

**Recommendation:**

We continue to recommend that PWD management request that City Council revisit this legislation to determine whether these additional shut-off restrictions can be eliminated or modified as part of a comprehensive review of the water billing, collection and enforcement process [12807.06].

**FAILURE TO VERIFY THAT REVENUE COLLECTIONS WERE DEPOSITED**

Our prior year testing<sup>4</sup> of the PWD's procedures governing revenue collections, which total over \$30 million annually, found that a receipts log was used to record all checks received through the mail, but no one verified that all checks recorded on the log had been deposited. This condition increases the risk that check collections could be misappropriated, particularly because the logged checks are forwarded to another employee who is responsible for both deposit preparation and maintenance of accounts receivable records.

During our current engagement, we again found instances of checks included in the log without a corresponding indication of deposit. We selected a sample of eighteen such checks and observed that seventeen were properly deposited and one check was pending deposit. Although our testing found no exceptions, the department continues to be at risk for misappropriation until a formal comparison of checks received against checks deposited is performed and documented.

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<sup>3</sup> When the PWD's DRS unit collects payments from delinquent customer accounts, it does this on behalf of the Water Revenue Bureau (WRB), which is a division of the city's Revenue Department that is responsible for billing and collecting water and sewer charges from the residential and commercial customers of the PWD. The WRB is responsible for collecting the water and sewer accounts receivable related to these charges.

<sup>4</sup> See Water Department Auditor's Report, Fiscal Years 2007 and 2008.

**Recommendation:**

To strengthen controls over revenue collections, we continue to recommend that all validated deposit documents be directly forwarded to the employee who maintains the receipts log for comparison to ensure that all checks received have been deposited. If the employee's comparison uncovers a check without a recorded deposit, the employee should investigate to determine whether the check has been properly deposited. Any instances of undeposited checks should be referred to management for further action [12807.07].

**CONTROL WEAKNESSES AGAIN NOTED AT FIELD INVENTORY OPERATIONS**

The PWD maintains a \$13 million materials and supplies inventory that is located at seven field points and is administered by the department's Materials Management Unit. Our prior engagement<sup>5</sup> disclosed the following weaknesses in the PWD's internal controls over this materials and supplies inventory:

- Duties were not adequately segregated, with incompatible functions performed by the stores workers who maintained the inventory. Stores workers received the inventory and prepared material receipt forms, issued the inventory, entered inventory receipts and issuances into the computerized inventory tracking system, and conducted the physical inventory counts.
- Materials Management Unit personnel were not provided with copies of various Standard Accounting Procedures (SAPs) governing the administration of materials and supplies inventory as issued by the city's Office of the Finance Director (Finance Office).

Our current engagement found that these prior year deficiencies had not been corrected.

**Recommendations:**

We continue to recommend that PWD management do the following:

- Evaluate whether duties currently performed by the stores workers can be assigned to other personnel. If management deems it impractical to reassign duties performed by stores workers, it should institute a procedure whereby someone independent of the inventory function periodically visits each field point on a rotating basis and performs a test count for a sample of inventory items, comparing the recorded inventory balance to the actual quantity on hand [12807.12].
- Obtain copies of the applicable SAPs for materials and supplies inventory from the Finance Office and distribute them to unit personnel [12807.14].

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<sup>5</sup> Ibid.

## **SEGREGATION OF DUTIES NEEDED FOR THE CONSENT DECREE ACCOUNT**

The PWD maintains a \$30,000 Consent Decree imprest account, which is used to cover various supply and equipment expenditures for the water pollution control plants. In our prior report,<sup>6</sup> we noted several internal control deficiencies over the administration of this account which increased the risk for misappropriations or errors to occur and not be detected:

- A lack of adequate segregation of duties. The custodian prepared the checks, signed the checks, processed the reimbursement requests, and prepared the fund and bank reconciliations [12807.08].
- An independent supervisory review of the account's disbursement documentation was not performed [12807.09].
- There were no written guidelines regarding the purpose of the Consent Decree account and allowable expenditures [12807.10].
- Safeguards over the account's checkbook were inadequate, as it was stored in an unlocked file cabinet in the custodian's cubicle [12807.11].

During the current engagement, auditors observed that management had reassigned some of the duties of the former custodian, prepared written guidelines, and required the checkbook to be secured in a safe. Although there were now written guidelines and the checkbook appeared adequately secured in a safe, some of the duties involving the fund still required better segregation. Widely accepted practice for imprest accounts suggests that the fund custodian prepare and sign checks based on supervisory approved invoices. In addition, the custodian may also process supervisory approved reimbursement requests. Under no circumstances should the custodian prepare the monthly bank or fund reconciliations.

Our observations revealed that the same employee (the former custodian) prepared reimbursement requests, prepared and signed checks, and prepared bank reconciliations. Another employee prepared fund reconciliations. In our opinion, the duties being performed by the former custodian continue to compromise the security of the fund by enabling that employee opportunity to misappropriate funds and avoid detection by manipulating amounts presented on the bank reconciliations.

### Recommendation:

Controls over the account would be improved if the duties of preparing and signing checks, as well as processing reimbursement requests remained with the custodian. The checks should be based on approved invoices and the reimbursement requests should be reviewed and approved by a supervisor. All bank and fund reconciliations should be assigned to a different employee

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<sup>6</sup> Ibid.

[102809.03].

### **SICK LEAVE POLICY NOT CONSISTENTLY ENFORCED**

In our last two reports,<sup>7</sup> we commented on the department's inconsistent enforcement of the city's sick leave policy for civil service employees. Some PWD units enforced the policy while others did not. Noncompliance with the sick leave policy increases the risk that employees will abuse sick leave.

Our fiscal year 2009 testing disclosed that one of fifteen sampled employees had exceeded five undocumented sick days but did not receive a warning letter until we brought the matter to management's attention. We then extended our review by testing an additional forty-four employees. The extended test identified four additional employees who exceeded five undocumented sick days and did not receive a warning letter.

#### Recommendation:

We continue to recommend that PWD management consistently enforce the city's sick leave policy, including employee counseling and any subsequent sanctions set forth in it [12805.03].

### **PAYROLL PROCEDURES GAVE APPEARANCE OF INCOMPATIBLE DUTIES**

We previously reported,<sup>8</sup> that PWD processing procedures for payroll suggested that there was no segregation of duties between payroll data entry and the approval functions. This situation occurred because payroll clerks at the PWD's various field locations would exit the payroll system after they had completed data entry without closing their work for the pay period. Then when the payroll supervisor logged onto the system to approve the payroll, prior to approving it, she would have to close out the initial data entry work.

The above situation makes it difficult to maintain accountability over the various phases of payroll preparation. If errors or irregularities occur, it might be difficult to identify who caused or perpetrated them. If, for example, the payroll supervisor would make unauthorized entries prior to closing out a payroll clerk's data entry session, it might appear that the clerk made the unauthorized entries instead of the supervisor.

Our current review found that the payroll clerks at the PWD's various field locations were still not closing out their own data entry work at the end of each pay period. For ten judgmentally selected pay periods covering the period from December 20, 2009 through August 15, 2010, the majority of the units' payroll postings were closed out by an employee who was not the payroll clerk for those units.

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<sup>7</sup> See Water Department Auditor's Reports, Fiscal Years 2005 through 2008.

<sup>8</sup> Ibid.



Recommendation:

We continue to recommend that PWD management increase their efforts to require that all unit payroll clerks close out their payroll postings at the end of each pay period [12805.02].

**NO INDEPENDENT CHECK OF PAYROLL DATA ENTRY**

Our prior period testing<sup>9</sup> of payroll disclosed that the PWD had not established a procedure requiring someone independent of payroll preparation to periodically spot check data entry to the on-line payroll system against the daily attendance records. Daily attendance records are retained by the payroll clerks at the PWD's various field locations and are only requested by the payroll supervisor when an investigation of an employee's recorded attendance is initiated.

On our current engagement, we found that payroll data entries were still not subject to independent spot checks. Failure to perform such checks increases the risk that errors could occur and not be detected. Our testing of randomly selected payroll entries did disclose one instance where leave time was incorrectly entered.

Recommendation:

To improve control over payroll, we continue to recommend that PWD management consider assigning someone independent of payroll preparation the task of periodically selecting a sample of entries made to the electronic payroll system for comparison to daily attendance records kept at field locations [12807.16].

**LEAVE TIME NOT PROPERLY APPROVED**

During our payroll testing of 15 randomly selected employees, we noted 10 occasions where formal employee requests for paid leave were not obtained by management. SAP E-9011, titled *Daily Timekeeping Source Documents and Attendance Record-keeping*, issued by the city's Finance Office, requires a properly completed leave request form be obtained by the unit supervisor from the employee and submitted to the departmental personnel office.

Management informed us that formal leave request forms are not routinely required. Employees could request leave by informing their supervisors by e-mail or verbally. We believe that failure to obtain formal leave requests may result in misclassified leave balances and increases the chance of erroneously failing to recognize leave time taken.

Recommendation:

We recommend that management require employees to formally submit leave request forms for supervisory review and approval in accordance with the SAP of the Finance Office [102809.01].

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<sup>9</sup> See Water Department Auditor's Report, Fiscal Years 2007 and 2008.

### **OVERTIME NOT PROPERLY AUTHORIZED**

Our limited tests of payroll transactions found no evidence that overtime paid (in the form of compensatory time) to one employee was pre-approved. Good internal control requires that overtime be requested and approved in advance and in writing. Management advised us that its policy requires that overtime be approved in advance; however, the request and approval need not be in writing. Management also asserted that the supervisor's subsequent approval of the time sheets provide authorization for the overtime recorded. We believe that the lack of formal documentation increases the risk that employees could be paid for overtime that was not authorized.

#### Recommendation:

We recommend that management enhance controls over payroll by ensuring that all overtime worked is pre-approved and documented in writing by supervisory personnel [102809.02].

### **EMPLOYEE PERFORMANCE EVALUATIONS NOT PREPARED**

In our last several reports,<sup>10</sup> we commented that employee performance evaluations were not always being prepared as required by Civil Service Regulation 23.033. This procedure provides city agencies with a tool to assess the competency and attitudes of employees. During the current engagement, we reviewed personnel files for fourteen employees and found that nine did not have a current annual performance evaluation on file.

#### Recommendation:

We continue to recommend that management comply with Civil Service Regulations by requiring unit supervisors to submit performance evaluations annually and designate someone to track the receipt of performance reports from supervisors to ensure compliance [12801.05].

### **UNNECESSARY ENCUMBRANCES REMAINED OPEN**

Our test of open encumbrances during the prior engagement<sup>11</sup> disclosed instances of unnecessary encumbrances that were not liquidated in a timely manner. During the current engagement, of 20 prior period encumbrances, we observed two that had no activity from the beginning of fiscal year 2009 through August 2010. When we inquired about them PWD officials stated that one encumbrance for \$559,000 remained valid because it was associated with an active project. However, they concurred that the other encumbrance for \$760,342 should have been liquidated.

#### Recommendation:

Unnecessary encumbrances that remain open needlessly reserve budgetary funds that can be used for other purposes. We continue to recommend that the department exercise greater care when

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<sup>10</sup> See Water Department Auditor's Reports, Fiscal Years 2001 through 2008.

<sup>11</sup> See Water Department Auditor's Report, Fiscal Years 2007 and 2008.

reviewing open encumbrances to ensure that only those representing valid purchase commitments remain open [12807.17].

### **CASH ACCOUNT CONTROLS STILL NEEDED IMPROVEMENT**

In prior auditor's reports<sup>12</sup> we have commented on a number of control weaknesses regarding the department's reconciliation procedures for its \$30,000 petty cash fund. The department has split the fund among nine separate locations. Our prior review of the fund and bank reconciliations found the following:

- Overages existed in many accounts as a result of canceling payments after having received reimbursement. Many of the overages exceeding \$50 were carried on the accounts for several months in violation of SAP No. E-4401, titled *Petty Cash Funds*, which requires that overages of \$50 or more be promptly deposited with the Department of Revenue.
- Fund and bank reconciliations were not routinely signed and/or dated by the preparer, and many lacked evidence of an independent review.
- The department could not locate many of the fund and bank reconciliations.

In addition to finding many of the same conditions in our current review, we also observed an inadequate separation of duties as the fund custodian also prepared the reconciliations. We also noted that independent reviews of the reconciliations were not always performed in a timely manner, and that outstanding check dates, numbers, and amounts were not documented, making it difficult to track and reconcile outstanding checks.

#### Recommendations:

We continue to recommend that: petty cash custodians only request reimbursements for disbursements that were made [12803.06]; overages or shortages be resolved in a timely manner [12803.07]; the importance of signing, dating, and reviewing bank and fund reconciliations be emphasized to the responsible employees [12803.09]; and accounting personnel ensure that all cash account fund and bank reconciliations are retained and properly filed [12807.20].

To promote good internal control we also recommend that PWD management reassign the duties of preparing the bank and fund reconciliation from the custodian to another employee [102809.04].

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<sup>12</sup> See Water Department Auditor's Reports, Fiscal Years 2003 through 2008.

## **CORRECTIVE ACTIONS TAKEN BY THE DEPARTMENT**

As part of our current review, we followed up on the conditions brought to management's attention during our last review.<sup>13</sup> We routinely monitor uncorrected conditions and report on them until management takes corrective action or until changes occur that resolve our recommendations. These uncorrected conditions have been addressed in the preceding pages.

Our follow-up has disclosed that the Water Department made progress addressing several prior issues. The issues are discussed below. We commend the department on its efforts. Corrective action taken by management has made the department more compliant with city policies, strengthened internal controls, and improved accountability.

### Monies Collected by Crews Were Now Adequately Safeguarded

In our last report we commented that the DRS supervisor was storing checks and money orders collected by crews in an unlocked desk drawer overnight. In addition, the checks and money orders were not restrictively endorsed for deposit only to the city. We recommended that DRS store customer checks and money orders in a more secure location such as a locked cabinet or safe which is accessible only to limited personnel [12807.04], and institute a procedure whereby all checks and money orders are restrictively endorsed for deposit only to the city [12807.03].

On the current engagement, we observed that a locking file cabinet was added to the DRS office and that monies were stored in a minisafe. Access to the office and cabinet was restricted to the Conveyance Supervisor and the Office Manager. Auditors also observed that the DRS restrictively endorsed money orders and checks for deposit only to a city bank account. We consider these conditions resolved.

### Accounting for Materials and Supplies Receipt and Issue Forms Resolved

The PWD maintains a \$13 million materials and supplies inventory that is located at seven different field points and is administered by its Materials Management Unit. Our prior review of the PWD's internal controls over this inventory disclosed that while pre-numbered material receipt and issue forms were used to control the receiving and dispensing of the supplies, no one independent of their preparation accounted for the numerical sequence of the forms. Failure to do this, can allow someone who has stolen supplies to escape timely detection of their unauthorized act. To improve controls over the inventory, we recommended that PWD management assign someone independent of the preparation of material receipt and issue forms the task of accounting for their numerical sequence.

Management informed us that all requests for materials and supplies are made on pre-numbered material receipt and issue forms; however, it did not account for the numerical sequence of these forms because materials and supplies can be issued from several different locations. Instead, the

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<sup>13</sup> See Water Department Auditor's Report, Fiscal Years 2007 and 2008.

department uses MAXIMO, a computerized materials management system, for tracking transactions in sequential order, and maintaining inventory.

Since material receipt and issue forms are entered into MAXIMO, and MAXIMO controls the materials and supplies transactions and updates perpetual inventory balances, we consider accounting for the numerical sequence of the forms to be mitigated and the condition resolved [12807.13].

Prescribed Fund and Bank Reconciliations Forms Were Now Used

In our previous report we noted that the PWD did not use fund and bank reconciliation forms prescribed by SAP Nos. 7.1.3.a, *Fund Reconciliations for Petty Cash and Imprest Funds* and 7.1.3.b, *Reconciliation of All Bank Accounts In All City Agencies*. For example, the fund reconciliation form used by the department did not contain a block for the preparer and reviewer to indicate the date of when the work was performed. We recommended that PWD accounting personnel use the fund and bank reconciliation formats prescribed by the SAPs [12807.19].

Prior to the completion of this engagement, we found that management, beginning with its November 2009 fund and bank reconciliations, started using forms that met the SAP guidelines. We therefore consider this condition resolved.

**EXHIBIT I**

**2009 MORATORIUM/SHUT-OFF CALENDAR**

JANUARY						
S	M	T	W	T	F	S
				1	2	3
4	5	6	7	8	9	10
11	12	13	14	15	16	17
18	19	20	21	22	23	24
25	26	27	28	29	30	31

FEBRUARY						
S	M	T	W	T	F	S
1	2	3	4	5	6	7
8	9	10	11	12	13	14
15	16	17	18	19	20	21
22	23	24	25	26	27	28

MARCH						
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1	2	3	4	5	6	7
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15	16	17	18	19	20	21
22	23	24	25	26	27	28
29	30	31				

APRIL						
S	M	T	W	T	F	S
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MAY						
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24	25	26	27	28	29	30
31						

JUNE						
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28	29	30				

JULY						
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AUGUST						
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23	24	25	26	27	28	29
30	31					

SEPTEMBER						
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13	14	15	16	17	18	19
20	21	22	23	24	25	26
27	28	29	30			


OCTOBER						
S	M	T	W	T	F	S
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25	26	27	28	29	30	31


NOVEMBER						
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29	30					

DECEMBER						
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13	14	15	16	17	18	19
20	21	22	23	24	25	26
27	28	29	30	31		

 Winter moratorium (121 days)

 Weekend and holiday moratorium (113 days)

 Excessive heat day moratorium (2 days)

 Shut-offs allowed (123 days)

Source: Water Department



*AGENCY RESPONSE*

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CITY OF PHILADELPHIA

WATER DEPARTMENT  
ARAMARK Tower  
1101 Market Street  
Philadelphia, PA 19107-2994

HOWARD M. NEUKRUG, P.E.  
Water Commissioner

October 11, 2012

Honorable Alan Butkovitz  
City Controller  
1230 Municipal Services Bldg.  
1401 J.F.K. Boulevard  
Philadelphia, PA 19107

Dear Mr. Butkovitz:

Thank you for the opportunity to comment on the findings and recommendations of the Fiscal Year 2009 Auditor's Report of the Philadelphia Water Department. I sincerely appreciate the thorough efforts and professionalism of your staff. I take these recommendations very seriously and have asked staff to review and provide comments, as appropriate.

As noted in your report, the findings and recommendations occurred under the administration of the previous Water Commissioner. Nevertheless, the importance of correct and adequate internal controls for my Finance Division – whether related to its cash, accounts receivable, inventory, personal property, revenue, payroll and/or other expenditure activity – is vital to the strong operational performance of this utility. Your oversight is appreciated.

The following are our responses to the findings and recommendations:

**SHUT OFF COLLECTION PROCEDURES IMPROVED BUT OPPORTUNITIES STILL EXIST FOR MISAPPROPRIATION**

Thank you for recognizing improvements made as a result of previous years' audits. The remaining issue involves a concern that the Delinquency and Restoration Services Unit (DRS) does not issue pre-numbered receipts for all transactions.

We will review and discuss this finding further with WRB management and with the City's Finance office to see whether there is sufficient merit to this proposal to offset the added costs in time and efficiency to the unit's operations.

"AN EQUAL OPPORTUNITY EMPLOYER"

Please note that the DRS is not permitted to accept cash and that all checks, money orders and credit card transactions must have the City of Philadelphia as the sole payee and ALL transactions are tabulated enroute by the employees, double checked at the DRS office for accuracy and are then transmitted to WRB for final accounting and deposit, where they are checked again and recorded and credited to each customers account. Such reconciliation is done daily by both DRS and the WRB for every account referred to shutoff and the results are fairly evident: the account is shutoff, or there is money received or an exception noted. While there is always concern over the potential for persons gaming the system, based on the procedures already in-place, it is unclear that pre-numbered receipts would provide added protection to the City or enhance accountability.

### **CITY COUNCIL BILL RESTRICTING SHUT-OFFS IMPACTED COLLECTIONS**

Absolutely agree. Even though we do not want to shut-off service to any customer, the most effective tool available to utilities to ensure payment is the threat of shut-off of service. City Council imposed restrictions on shut-offs for Fridays, Saturdays, Sundays, holidays, the day preceding a holiday, excessive heat days and snow days, adding to the winter moratorium where there are no shut-offs for 4 months (from Dec 1 to March 31), taking away our greatest tool in helping customers remain current on their bills -- for 2 out of every 3 days. This has a very significant impact on our revenues, encourages some customers to delay payments until their bills grow out of their ability to pay, and increases our costs for labor for the remaining few days we are permitted to use this tool.

I am very happy to speak with anyone who will listen of the costs incurred by these restrictions. Please be aware, however, that despite my predecessor's testimony in opposition to these ordinances, the original bill was passed 17-0. Also please note that a similar ban is in place for PUC regulated utilities so the limitations required by this bill are not without precedent.

Most concerning to all of us, the unintended consequence of restricting shut-offs to mid-week has resulted in a significant reduction in the likelihood of customer response and payment, increasing terminations and termination and restoration fees for some of our most needy customers.

Of course, this matter is not as straightforward as it appears. City Charter provides City Council with the authority to set standards for Water and Sewer rates and collection procedures, and this legislation was an appropriate use of their authority. And most importantly, it is not our desire to shut-off any customer at any time.

### **FAILURE TO VERIFY THAT REVENUE COLLECTIONS WERE DEPOSITED**

We agree and have revised our procedures to provide for proper segregation of duties between check deposit and accounts receivable reconciliation.



**CONTROL WEAKNESSES AT FIELD INVENTORY OPERATIONS**

We agree that additional oversight would strengthen our internal controls over our materials and supplies inventories. Our first step, as requested, was to evaluate whether the duties currently performed by stores workers in our Materials Management Unit could be further segregated and assigned to other personnel in order to separate the functions of the ordering of goods, their storage and dispersal and inventory control. Unfortunately, given the nature of the civil service job titles available to us, my staff has concluded that the personnel costs for such segregation would be too high.

However, we have a re-organization plan for the Finance Division that would, among other things, provide for an independent unit to periodically visit each field location and perform a test count of inventory items. I believe that meets the spirit and intent of this recommendation and look forward to collaborating with you further on this matter.

**SEGREGATION OF DUTIES NEEDED FOR THE CONSENT DECREE ACCOUNT**

We agree with your findings and recommendations and – as noted in your report – have made certain procedural changes and provided for additional segregation of duties. We also have provided for supervisory oversight and established written guidelines documenting the fund’s purpose and allowable expenditures and instructed the custodian to keep the account’s checkbook in a secure, locked location as recommended. We will work with your staff to provide for additional segregation of the consent decree petty cash administration duties as recommended to provide for adequate internal controls.

**SICK LEAVE POLICY NOT CONSISTENTLY ENFORCED**

It has always been, and it remains, the Department’s policy to strictly enforce the City’s Sick Leave abuse policy. Where we believe there have been abuses, we aggressively investigate and take appropriate disciplinary action. Your audit indicates that out of 59 employees who exceeded 5 days undocumented sick leave, 54 were found to have received the appropriate warning letter. Clearly this shows a generally working system that still requires some additional attention (5 employees did not receive the warning letter). Given your findings, we will re-double our efforts to train and remind our unit supervisors on the City’s Sick Leave abuse policy to ensure it is followed as recommended in your report.

**PAYROLL PROCEDURES GAVE APPEARANCE OF INCOMPATIBLE DUTIES**

Based on the recommendations in your previous audit report, we have reviewed the log-on security system with our Payroll Supervisor and our General Manager of Human Resources

and believed we had instituted the necessary safeguards. We will again instruct our payroll supervisor to follow those recommendations.

**NO INDEPENDENT CHECK ON PAYROLL DATA**

Our proposed re-organization plan for the Finance Division will, among other things, provide for an independent unit to periodically visit field locations and spot check on-line payroll data with daily attendance records.

**LEAVE TIME NOT PROPERLY APPROVED**

In an effort to reduce paper, and improve efficiencies and communications, we permit our supervisors to approve leave in advance either orally, via phone or email or via a formal leave slip. We require the supervisors to note the approved leave time on the timesheet and noting such approval on the time sheet. This policy will be re-enforced through memo to all supervisors to ensure consistency in application.

**OVERTIME NOT PROPERLY AUTHORIZED**

In an effort to reduce paper and improve communications, we permit supervisors to pre-approve overtime in advance either orally, via phone or email or via a formal memo. We require the supervisors to note the approved overtime on the timesheet and noting such approval on the time sheet. This policy will be re-enforced through memo to all supervisors to ensure consistency in application.

**EMPLOYEE PERFORMANCE EVALUATIONS NOT PREPARED**

I absolutely agree that employee performance evaluations should be issued every year. This requirement has stressed again to all supervisors this year as in past years. I will direct our General Manager of Human Resources to assign staff to follow up with PWD supervisors who have not completed their employee's evaluations.

**UNNECESSARY ENCUMBRANCES REMAINED OPEN**

We recognize the need to minimize open encumbrances and have strived to emphasize the need to limit the number of encumbrances retained. As encumbrances are liquidated much needed funds are returned to our fund balance that can be used for other purposes or to reduce customers rates in the future. As a matter of course, our accounts payables units and the project manager review each and every open encumbrance for activity. We will review the facts and circumstances of the encumbrance in question to see if it offers insight to further improvements that can be made.

**CASH ACCOUNT CONTROLS STILL NEED IMPROVEMENT**

We agree and have improved our petty cash controls, oversight and compliance. The custodian of the Administration Petty Cash Fund now processes all requests. The supervisor prepares the reconciliations. The manager reviews the work for accuracy. The custodian maintains a schedule of received reconciliations and ensures timely processing.

In addition, the review of the reconciliations includes a verification of the signature of the preparer and the date the reconciliation was prepared, as recommended by your report. In the rare instance a petty cash check is issued and not cashed, the check is returned and the funds repaid to the Water Fund

To date, this procedure has been very successful.

**CORRECTIVE ACTIONS TAKEN BY THE DEPARTMENT**

We work hard to address and resolve any and all of the concerns raised in the Controller's Annual Audit Reports, past and present. My staff and I deeply appreciate your recognition of our good efforts to ensure compliance with standard accounting practices and procedures. Your oversight of our operations is an integral part of our checks and balances.

Very truly yours,



Howard M. Neukrug, P.E., BCEE, Hon.D.WRE  
Water Commissioner

Cc: Joseph Clare, Deputy Commissioner, Water Finance  
Rina Cutler, Deputy Mayor



## CONTROLLER'S OFFICE EVALUATION OF AGENCY'S RESPONSE

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Government Auditing Standards require auditors to report instances where the auditee's comments to the auditor's findings, conclusions, or recommendations are not, in the auditor's opinion, valid or do not address the recommendations. We believe this to be the case with certain comments made in management's response to our findings and recommendations about the form of approval and authorization of leave time and overtime, respectively.

### Management's Response

On page 20, management has indicated that in an effort to reduce paper, and improve efficiencies and communications, the Water Department permits its supervisors to approve leave in advance either orally, via phone, or email or via a formal leave slip. It follows a similar practice for overtime, allowing the approval to be accomplished by a formal memo. In both instances (leave time and overtime), the Water Department requires the supervisors to note the approved leave time or authorized overtime on the timesheet.

### City Controller's Office Evaluation

We appreciate the Water Department's concerns of wanting to reduce paper [usage], and improve efficiencies and communications. While these are admirable goals, they need to be accomplished within the context of good internal control practices and the guidelines prescribed by the city's Finance Office, which is responsible for setting citywide accounting policies and procedures. Those practices and guidelines emphasize the importance of documenting approvals and authorizations of leave time and overtime in advance. To reduce paper usage, improve efficiencies and communication, as well as promote good internal control and follow the spirit of city SAPs, we suggest that Water Department management contact the Office of Innovation and Technology (OIT) and inquire about software it has developed that provides users with electronic versions of the "leave request" and "overtime authorization" forms. While many city agencies use the hardcopy forms to document the pre-approval of leave time and pre-authorization of overtime, OIT has developed electronic versions of these forms, which interface with the city's e-mail system. The software provides electronic documentation of approvals and authorizations and allows for viewing the documentation in a variety of formats, such as by date, by employee, by type of leave, etc.