



CITY OF PHILADELPHIA

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INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE FOR EACH MAJOR FEDERAL PROGRAM, REPORT ON INTERNAL CONTROL OVER COMPLIANCE, AND REPORT ON SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS REQUIRED BY THE UNIFORM GUIDANCE AND THE PENNSYLVANIA DEPARTMENT OF HUMAN SERVICES SINGLE AUDIT SUPPLEMENT

To the Honorable Mayor and Honorable Members
of the Council of the City of Philadelphia

Report on Compliance for Each Major Federal Program

We have audited the City of Philadelphia, Pennsylvania's compliance with the types of compliance requirements described in the *OMB Compliance Supplement* and the *Pennsylvania Department of Human Services (DHS) Single Audit Supplement* that could have a direct and material effect on each of the City of Philadelphia, Pennsylvania's major federal and DHS programs for the year ended June 30, 2017. The City of Philadelphia, Pennsylvania's major federal programs are identified in the summary of auditor's results section of the accompanying Schedule of Findings and Questioned Costs.

The City of Philadelphia, Pennsylvania's basic financial statements include the operations of the School District of Philadelphia, Community College of Philadelphia, Philadelphia Redevelopment Authority, Philadelphia Authority for Industrial Development, and Philadelphia Housing Authority, which expended a total of \$825,397,495 in federal awards which is not included in the City of Philadelphia, Pennsylvania's Schedule of Expenditures of Federal Awards for the year ended June 30, 2017. Our audit, described below, did not include the operations of these component units because they had separate audits performed in accordance with the *Uniform Guidance*.

Management's Responsibility

Management is responsible for compliance with federal and DHS statutes, regulations, and the terms and conditions of its federal and DHS awards applicable to its federal and DHS programs.

**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**

Auditor's Responsibility

Our responsibility is to express an opinion on compliance for each of the City of Philadelphia, Pennsylvania's major federal and DHS programs based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; the audit requirements of Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance); and the DHS Single Audit Supplement. Those standards, the Uniform Guidance, and the DHS Single Audit Supplement require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal or DHS program occurred. An audit includes examining, on a test basis, evidence about the City of Philadelphia, Pennsylvania's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our qualified and unmodified opinions on compliance for major federal and DHS programs. However, our audit does not provide a legal determination of the City of Philadelphia, Pennsylvania's compliance.

Basis for Qualified Opinion on CFDA 16.751 Edward Byrne Memorial Competitive Grant Program

As described in the accompanying Schedule of Findings and Questioned Costs, the City of Philadelphia, Pennsylvania did not comply with requirements regarding CFDA 16.751 Edward Byrne Memorial Competitive Grant Program as described in finding number 2017-013 for Subrecipient Monitoring. Compliance with such requirement is necessary, in our opinion, for the City of Philadelphia, Pennsylvania to comply with the requirements applicable to that program.

Qualified Opinion on CFDA 16.751 Edward Byrne Memorial Competitive Grant Program

In our opinion, except for the noncompliance described in the Basis for Qualified Opinion paragraph, the City of Philadelphia, Pennsylvania complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on CFDA 16.751 Edward Byrne Memorial Competitive Grant Program for the year ended June 30, 2017.

Unmodified Opinion on Each of the Other Major Federal Programs

In our opinion, the City of Philadelphia, Pennsylvania complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its other major federal programs identified in the summary of auditor's results section of the accompanying Schedule of Findings and Questioned Costs for the year ended June 30, 2017.

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Other Matters

The results of our auditing procedures disclosed other instances of noncompliance which are required to be reported in accordance with the Uniform Guidance and the DHS Single Audit Supplement and which are described in the accompanying Schedule of Findings and Questioned Costs as items 2017-014, 2017-015, and 2017-016. Our opinion on each major federal and DHS program is not modified with respect to these matters.

The City of Philadelphia, Pennsylvania's response to the noncompliance findings identified in our audit is described in the accompanying Schedule of Findings and Questioned Costs. The City of Philadelphia, Pennsylvania's response was not subjected to the auditing procedures applied in the audit of compliance and, accordingly, we express no opinion on the response.

Report on Internal Control over Compliance

Management of the City of Philadelphia, Pennsylvania is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered the City of Philadelphia, Pennsylvania's internal control over compliance with the types of requirements that could have a direct and material effect on each major federal and DHS program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal and DHS program and to test and report on internal control over compliance in accordance with the Uniform Guidance and the DHS Single Audit Supplement, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the City of Philadelphia, Pennsylvania's internal control over compliance.

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

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal or DHS program on a timely basis. A *material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal or DHS program will not be prevented, or detected and corrected, on a timely basis. We consider the deficiencies in internal control over compliance described in the accompanying Schedule of Findings and Questioned Costs as item 2017-013 to be a material weakness.

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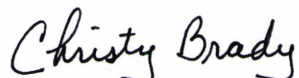
A *significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal or DHS program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance. We consider the deficiencies in internal control over compliance described in the accompanying Schedule of Findings and Questioned Costs as items 2017-014, 2017-015, and 2017-016 to be significant deficiencies.

The City of Philadelphia, Pennsylvania's response to the internal control over compliance findings identified in our audit is described in the accompanying Schedule of Findings and Questioned Costs. The City of Philadelphia, Pennsylvania's response was not subjected to the auditing procedures applied in the audit of compliance and, accordingly, we express no opinion on the response.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of the Uniform Guidance and the DHS Single Audit Supplement. Accordingly, this report is not suitable for any other purpose.

Report on Schedule of Expenditures of Federal Awards Required by the Uniform Guidance

We have audited 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, 2017, and the related notes to the financial statements, which collectively comprise the City of Philadelphia, Pennsylvania's basic financial statements. We issued our report thereon dated February 23, 2018, which contained unmodified opinions on those financial statements. Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the basic financial statements. The accompanying Schedule of Expenditures of Federal Awards is presented for purposes of additional analysis as required by the Uniform Guidance and is not a required part of the basic financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the Schedule of Expenditures of Federal Awards is fairly stated in all material respects in relation to the basic financial statements as a whole.



CHRISTY BRADY, CPA
Deputy City Controller
Philadelphia, Pennsylvania
December 31, 2018

CITY OF PHILADELPHIA

Schedule of Findings and Questioned Costs – June 30, 2017

Section I – Summary of Auditor’s Results:

Financial Statements:

Type of auditor’s report issued: Unmodified

Internal control over financial reporting:

Material weakness(es) identified? ☒ yes ☐ no
Significant deficiency(ies) identified? ☒ yes ☐ none reported

Noncompliance material to financial statements noted? ☐ yes ☒ no

Federal Awards:

Internal control over major programs:

Material weakness(es) identified? ☒ yes ☐ no
Significant deficiency(ies) identified? ☒ yes ☐ none reported

Type of auditor’s report issued on compliance for major programs:
Qualified

Any audit findings disclosed that are required to be reported in accordance with 2 CFR Section 200.516(a) ☒ yes ☐ no

Identification of major federal programs:

<u>Name of Federal Program or Cluster</u>	<u>CFDA Number(s)</u>
Child Nutrition Cluster:	
National School Lunch Program	10.555
Summer Food Service Program for Children	10.559
Community Development Block Grants/Entitlement Grants	14.218
Emergency Solutions Grant Program	14.231
Home Investment Partnerships Program	14.239
Housing Opportunities for Persons with AIDS	14.241
Continuum of Care Program	14.267
Edward Byrne Memorial Competitive Grant Program	16.751
Highway Planning and Construction	20.205
Child Support Enforcement	93.563
Community Services Block Grant	93.569
State and Local Public Health Actions to Prevent Obesity, Diabetes, Heart Disease and Stroke (PPHF)	93.757
Block Grants for Prevention and Treatment of Substance Abuse	93.959
Homeland Security Grant Program	97.067
Staffing for Adequate Fire and Emergency Response (SAFER)	97.083

Dollar threshold used to distinguish between Type A and Type B programs: \$3,000,000

Auditee qualified as low-risk auditee? ☐ yes ☒ no

CITY OF PHILADELPHIA**Schedule of Findings and Questioned Costs – June 30, 2017**

<u>Finding</u> <u>No.</u>		<u>Page</u>	<u>Questioned</u> <u>Cost</u>
<u>Section II - Financial Audit Material Weaknesses:</u>			
2017-001	Inadequate Staffing Levels, Lack of Technological Investment and Insufficient Oversight Led to Undetected Material Misstatements	X	
2017-002	Weaknesses in Treasurer's Cash Controls Create Potential for Significant Errors and Irregularities	X	
2017-012	Weakness in Controls Led to Inaccurate Subrecipient Expenditure Amounts Reported on the Schedule of Expenditures of Federal Awards (SEFA)	X	
<u>Section III - Financial Audit Significant Deficiencies:</u>			
2017-003	Payment Vouchers Approved Without Required Management Authorization	X	
2017-004	Allowing Unauthorized Individuals to Approve Bi-Weekly Payrolls Increases Risk for Improprieties	X	
2017-005	Failure to Segregate Payroll Duties Could Allow Fraud to Occur	X	
2017-006	Capital Asset Control Deficiencies Increase Risk of Reporting Errors	X	
2017-007	Failure to Timely Transfer Funds Between City Bank Accounts Could Result in Significant Reporting Errors	X	
2017-008	Lax Monitoring of Adjustments to Tax Accounts May Lead to Undetected Errors or Irregularities	X	
2017-009	SAPs Require Updating to Ensure Accurate and Consistent Application of Accounting Rules and Regulations	X	
2017-010	General Information Technology Controls Require Strengthening	X	
<u>Section IV – Financial Audit Reportable Instance of Noncompliance</u>			
2017-011	Noncompliance with Act 148 Grant Reporting Deadlines Delayed Receipt of Funds	X	
<u>Section V – Federal and PA Department of Human Services Findings and Questioned Costs</u>			
2017-013	Subrecipient Monitoring Edward Byrne Memorial Competitive Grant Program – CFDA #16.751	X	\$8,610,562

CITY OF PHILADELPHIA***Schedule of Findings and Questioned Costs – June 30, 2017***

<u>Finding</u> <u>No.</u>		<u>Page</u>	<u>Questioned</u> <u>Cost</u>
2017-014	Reporting Edward Byrne Memorial Competitive Grant Program – CFDA #16.751	X	
2017-015	Reporting Staffing for Adequate Fire and Emergency Response (SAFER) – CFDA #97.083	X	
2017-016	Reporting Edward Byrne Memorial Competitive Grant Program – CFDA #16.751 Community Development Block Grants/Entitlement Grants – CFDA #14.218 Block Grants for Prevention and Treatment of Substance Abuse – CFDA #93.959 Community Services Block Grant – CFDA #93.569 Emergency Solutions Grant Program – CFDA #14.231	X	

2017-001 INADEQUATE STAFFING LEVELS, LACK OF TECHNOLOGICAL INVESTMENT AND INSUFFICIENT OVERSIGHT 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 and grant-related data, as well as other information obtained from the city's accounting system (FAMIS¹), numerous city agencies, and assorted quasi-government units, such as the Philadelphia Gas Works and the Philadelphia Redevelopment Authority.² 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 completed CAFR without significant adjustments recommended by the City Controller's audit staff. More specifically, we observed that:

- Staff reductions and turnover in the Finance Office, as well as a lack of a comprehensive financial reporting system, have compromised the accurate preparation of the CAFR;
- Failure to use the full accrual Aviation and Water Funds established in FAMIS to post year-end journal entries resulted in significant financial statement errors; 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.

Staff Shortages and Turnover Along with Lack of a Comprehensive Financial Reporting System Have Contributed to Significant Financial Statement Errors

Condition: Errors totaling \$923.7 million were not detected by Finance Office accountants during preparation of the city's fiscal year 2017 CAFR.

Criteria: Financial statements should be prepared to communicate relevant and reliable information. Accordingly, the statements should be free of all errors that might affect a reader's ability to make confident and informed decisions.

Effect: Because Finance Office accountants agreed with and corrected most of the errors we identified, the city's publicly issued fiscal year 2017 CAFR can be relied upon for informative decision making.

Cause: Ongoing inadequate staffing and employee turnover in recent years, along with the lack of a comprehensive financial reporting system, have hindered the ability of the Finance Office to produce an accurate draft of the CAFR for audit. More specifically:

¹ Financial Accounting and Management Information System

² These quasi-government units are considered component units for purposes of the city's CAFR.

- The Finance Office has continued to operate with a reduced staff size. Since fiscal year 2000, the number of Finance Office accountants has declined by nearly 27 percent (from 64 full-time employees in fiscal year 2000 to 47 in fiscal year 2017). The Finance Office accounting division has also experienced considerable staff turnover since January 2016, with several new hires and various individuals promoted to supervisory and managerial positions. Inadequate staff size, combined with several employees still learning their duties, made the task of completing the CAFR more difficult and compromised the ability of Finance Office management to perform adequate reviews of the financial statements and related financial disclosures. Examples of errors that were not detected by Finance Office management include (1) \$338.6 million of misstatements in budgeted amounts reported on the budgetary comparison schedules, (2) \$127.7 million of misclassification errors between revenue categories on the Aviation Fund financial statements, and (3) a \$97.7 million overstatement of the governmental activities' net position restricted for capital projects because the financial statements presented for audit contained the prior year balance for this account.
- Accountants in the Finance Office lacked a comprehensive financial reporting system to prepare the CAFR. Instead, accountants produce the CAFR using numerous Excel, Lotus 1-2-3 (a program that has been discontinued and unsupported since 2014), and Word files with various links between the files. Using multiple linked files creates a cumbersome process which can adversely affect the accuracy and completeness of the CAFR.

Recommendations: Without sufficient and experienced accounting staff and a comprehensive financial reporting system to prepare and review information needed for the CAFR, the risk increases that significant errors can occur and not be timely discovered and corrected. We continue to recommend that Finance Office management either hire more accountants, or invest in a new comprehensive financial reporting system that will reduce the current labor-intensive procedures needed to prepare the city's CAFR. Additionally, we continue to recommend that management provide adequate training for new hires and employees performing new duties.

In response to last year's report, Finance Office management stated they planned to engage an accounting firm to help them compile the fiscal 2017 CAFR; however, this plan was not implemented. Our current year discussions with Finance Office management disclosed they have hired an accounting firm and plan to use them to assist with the preparation and review of the fiscal year 2018 CAFR, including the completion of a compilation package with detailed documentation supporting the financial statements. While we support the Finance Office's hiring of an accounting firm as a short-term remedy to improve the CAFR preparation and review process, we believe the appropriate long-term solution is to either hire more accountants or invest in a new comprehensive financial reporting system, as recommended above.

Views of the Responsible Officials and Corrective Action Plan: The Accounting Bureau (Accounting) is committed to producing an accurate and well-prepared CAFR. We believe that the loss of institutional knowledge over time has presented a challenge, as opposed to the reduction in the quantity of staff. Accounting is actively working with the Office of Human Resources on strategies aimed at retention of staff to reduce turnover and maintain the knowledge base. We have also increased our training efforts, with all senior management accountants now attending the National Government Finance Officers Association

(GFOA) conference and taking advantage of the City sponsored quarterly CPE classes. We will continue to look for additional effective training opportunities for our staff.

Accounting is pursuing several other paths that will assist in more reliable CAFR preparation. First, as you noted, we have retained an outside accounting firm to assist in the CAFR compilation efforts. This firm will replicate for Accounting the efforts currently undertaken by both the Division of Aviation (DOA) and Philadelphia Water Departments (PWD). We believe that a CAFR preparation system will improve the process and will be evaluating the timing for implementation of such a system as we move forward with our planning efforts around replacement of FAMIS.

Additionally, Accounting has received the GFOA Certificate of Achievement for Excellence in Financial Reporting for 37 consecutive years and has successfully addressed all GFOA recommendations presented in that process. Finally, and as always, Accounting will continue to critique the errors and adjustments resulting from the most recent (FY2017) CAFR audit with the entire accounting staff as a learning tool to produce improved financial statements going forward.

FAMIS Not Utilized for Posting Enterprise Funds' Year-End Journal Entries

Condition: As previously reported, accountants in the Finance Office, the Philadelphia Water Department (PWD), and the Division of Aviation (DOA) were still not utilizing the full accrual Water and Aviation Funds established in FAMIS to post year-end adjusting journal entries to prepare the financial statements. While the full accrual Water Fund has never been used, accountants have not updated the full accrual Aviation Fund since fiscal year 2014.

Criteria: The Finance Office, PWD, and DOA should be using the full accrual Water and Aviation Funds in FAMIS to post adjusting entries so as to provide a clear trail of adjustments between the modified and full accrual statements and decrease the risk of errors in the CAFR.

Effect: There is an increased risk of error in compiling the city's CAFR. For example, because the full accrual Aviation Fund in FAMIS reflects fiscal year 2014 amounts, the DOA accountants had to prepare additional journal entries to record the correct beginning balances in compiling the Aviation Fund financial statements. Our testing of the compilation supporting the fiscal year 2017 Aviation Fund financial statements found two instances where an account's beginning balance was not recorded, resulting in errors totaling \$13.7 million – a \$12.2 million overstatement of accounts receivable and revenues and a \$1.5 million understatement of deferred inflows of resources related to pensions.

Cause: Finance Office accountants indicated that the staff shortages and turnover they experienced in recent years, as well as other more urgent priorities, precluded them from working with the PWD and DOA to utilize the full accrual Water and Aviation Funds in FAMIS.

Recommendations: In order to decrease the risk of financial statement error, we continue to recommend that Finance Office management:

- Require that PWD accountants utilize the FAMIS full accrual Water Fund to post its year-end accrual adjustments.
- Work with the DOA to ensure that the FAMIS full accrual Aviation Fund is brought up to date.

Views of the Responsible Officials and Corrective Action Plan: Finance Accounting is committed to working with both PWD and DOA, who have indicated their willingness to utilize the FAMIS full accrual Water & Aviation funds to post year-end adjustments.

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

Condition: As we have reported for the last several years, late receipt of component unit financial reports continued to delay preparation and audit of the city’s CAFR. As shown in Table 1 below, eight of the city’s ten component units still did not submit their final reports by the due dates requested by Finance Office accountants.

The greatest challenge to the timely completion of the CAFR came from the School District of Philadelphia, the Philadelphia Housing Authority (PHA), and the Philadelphia Redevelopment Authority.³ These three agencies submitted their reports very late (February 16, 2018, February 9, 2018, and February 2, 2018, respectively), leaving the Finance Office accountants and the Controller’s Office auditors little time to ensure that they were accurately included in the city’s CAFR before it was issued on February 23, 2018.

Table 1: Late Submission of Component Unit Financial Reports

COMPONENT UNIT	<u>DUE</u> <u>DATE</u>	<u>DATE</u> <u>RECEIVED</u>	<u>DAYS</u> <u>LATE</u>
Community Behavioral Health	9/30/2017	10/18/2017	18
Pennsylvania Intergovernmental Cooperation Authority	9/30/2017	10/18/2017	18
Philadelphia Gas Works	11/30/2017	1/25/2018	56
Philadelphia Housing Authority	11/30/2017	2/9/2018	71
Philadelphia Municipal Authority	9/30/2017	1/23/2018	115
Philadelphia Parking Authority	9/30/2017	10/11/2017	11
Philadelphia Redevelopment Authority	9/30/2017	2/2/2018	125
School District of Philadelphia	9/30/2017	2/16/2018	139

Note: Community College of Philadelphia and Philadelphia Authority for Industrial Development submitted their financial reports timely.

Source: Prepared by the Office of the City Controller

³ While the Philadelphia Municipal Authority’s (PMA’s) final report was submitted 115 days late, it did not present as significant a reporting problem as some of the other late component units because PMA had submitted a draft report to the city in September 2017, early enough to be included in the first draft of the CAFR.

Criteria: An essential element of timely financial reporting is that it promotes management accountability and communicates information early enough to allow users of the financial statements to make informed decisions.

Effect: Failure to receive component unit financial statements on time increases the risk for errors or omissions, as the amount of time becomes limited for Finance Office accountants to adequately review the reports. The risk of error also increases as accountants must make significant changes to multiple 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. During the current year audit, we identified and the Finance Office corrected misclassification errors relating to the component units totaling \$12.6 million.

Cause: There is no incentive for component units to submit their final financial statements timely to the city and no consequences for those who do not meet the required deadline. The late submission of the PHA's financial report was due to the Finance Office not timely determining that PHA met the criteria for inclusion as a component unit and not requesting the PHA's financial statements until November 13, 2017.

Recommendations: 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 units' management in the timely submission of their respective final financial reports to the city's Finance Office. We also recommend that the Finance Office strive to more timely complete its evaluation of potential component units and its requests for financial statements for those entities determined to be component units.

Views of the Responsible Officials and Corrective Action Plan: 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 meetings with management and auditors of various component units concerning timely audit submission, as well as additional meetings to provide guidance and assist with problems in units experiencing issues that were delaying the preparation of their financial reports, we still had some trouble with timely receipt of final audit reports. Accounting will continue to communicate with the component units and emphasize the importance of timely submissions. As appropriate, Accounting will continue to reach out to key Administration officials to secure the cooperation of component unit management in the timely submission of their respective financial reports. Additionally, we agree that a timelier evaluation of potential component units would be beneficial to the process. To achieve this goal, Accounting has updated the year-end request for information form to determine component unit status, and for this year, has already sent requests to both the School District (due to the change in composition of the Board), the Free Library Foundation and the Fairmount Park Conservancy (due to potential additional Rebuild activities) so that we have ample opportunity to review their status.

2017-002 WEAKNESSES IN TREASURER'S CASH CONTROLS CREATE POTENTIAL FOR SIGNIFICANT ERRORS AND IRREGULARITIES

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 Office of the City Treasurer (Treasurer) with the responsibility for establishing controls to safeguard these assets and ensure the accuracy of reported cash balances. Our audit continued to disclose deficiencies in the Treasurer's bank reconciliation procedures for the city's primary depository account (i.e. consolidated cash account) where, as was the case for the entire fiscal year 2016, differences between book and bank activity were not readily identified or investigated for the first eleven months of fiscal year 2017. Also, we again noted that the Treasurer had not reconciled six of its accounts for several years, the most notable being the city's payroll and general disbursement accounts which had not been reconciled since September 2010 and January 2012, respectively. These deficiencies in the Treasurer's controls over its cash accounts, which collectively we consider to be a material weakness, increased the risk for significant undetected errors in these accounts and potentially invited fraud to occur without discovery. Each of these conditions is discussed in more detail below.

Treasurer's Failure to Properly Reconcile the Consolidated Cash Account Creates Possibility of Significant Undetected Errors and Improprieties

Condition: According to its accounting records, the city collected approximately \$9.9 billion in cash receipts during fiscal year 2017. With collections of such significant value, conducting a proper reconciliation of accounting records to bank statements which identifies discrepancies for subsequent investigation is essential to safeguard cash and detect errors and irregularities in the daily recording of receipts. For the first eleven months of fiscal year 2017, our testing continued to note the following deficiencies in the Treasurer's reconciliation procedures for its consolidated cash account:

- The Treasurer's reconciliation of the consolidated cash account was incomplete. Specifically, the reconciliation did not include a comprehensive list that readily identified each of the reconciling items making up the difference between the book and bank balance, which would assist the Treasurer and Finance Office in determining whether all receipts were deposited and all transactions recorded. Instead, Treasurer accountants only provided us with a large, complex spreadsheet that attempted to compare the account's receipt and disbursement transactions per the city's accounting system (FAMIS) to bank activity. However, this spreadsheet presented variances without further explanation or investigation and failed to account for all transactions.
- Also, as noted in our last two reports, the Treasurer's bank reconciliation process included neither (1) a comparison of all reported receipt amounts on the Revenue Department's daily report of city collections, also known as the Consolidated Summary of Deposits (CSD), to amounts deposited in the consolidated cash account nor (2) a subsequent investigation of differences between reported collections and bank deposits. This deficiency was evidenced by the results of our comparison of the CSD to city bank account statements for 24 selected dates where we found \$5,666,306 in reported collections for which Treasurer accountants could not provide a record of the monies ever being deposited.

Starting with the June 2017 activity, with the assistance of the Finance Office's accounting assistant director and a consultant, the Treasurer began reconciling the consolidated cash account's daily FAMIS activity to bank transactions, including a comparison of the CSD's reported collection amounts to bank deposits and the preparation of a list of reconciling items making up the difference between the book and bank balance. Also, Treasurer management informed us that, beginning with the July 2017 reconciliation, they send a monthly list of consolidated cash account reconciling items to related city departments requesting their assistance with investigating these items. However, the Treasurer had not yet formalized in writing these newly implemented reconciliation procedures.

The Treasurer continued the reconciliation of daily account activity in fiscal year 2018 and provided us with bank reconciliations for the months of July 2017 through November 2017 as of the end of our fieldwork in February 2018. Beginning with the July 2017 reconciliation, the Treasurer prepared the consolidated cash account bank reconciliation using the format prescribed by Standard Accounting Procedure (SAP) No. 7.1.3.b, *Reconciliation of All Bank Accounts in All City Agencies*. However, the reconciliations provided to us were not signed by the preparer and contained no evidence of supervisory review.

While the Treasurer started reconciling the consolidated cash account activity from June 2017 forward, Treasurer management acknowledged that there is a significant unknown variance between the account's book and bank balance for activity prior to June 2017. The Treasurer's July 2017 reconciliation initially reported this unknown variance to be \$40.1 million, where the consolidated cash account's book activity exceeded the bank activity by that amount. In subsequent months, the Treasurer identified \$6.8 million of this discrepancy, bringing the unknown variance down to \$33.3 million as of February 2018. In April 2018, the Treasurer hired an outside accounting firm to assist them with investigating the remaining unknown variance.

Criteria: SAP No. 7.1.3.b requires that monthly reconciliations of city bank accounts readily identify all of the specific transactions comprising the difference between the book and bank balance to allow city agencies to investigate these reconciling items and determine whether they represent errors or irregularities. To ensure the accuracy of the city's reported revenue receipts and cash balances and reduce the risk of fraud, the Treasurer's reconciliation process should include a comparison of all daily collections reported on the CSD to amounts deposited into the city's bank accounts and timely investigation of any differences noted. Also, SAP No. 7.1.3.b requires that bank reconciliations are signed and dated by the preparer and reviewed by a responsible supervisory employee, who should sign and date the reconciliations to provide evidence and affix responsibility for performance of this task.

Effect: Due to the Treasurer's failure to properly reconcile the consolidated cash account's activity prior to June 2017 and the resulting \$33.3 million unknown variance, there is the possibility that significant errors and fraud in this account may have gone undetected.

Cause: Prior to June 2017, Treasurer management had not made it a priority to allocate the necessary resources to ensure that (1) the consolidated cash account was properly reconciled in accordance with SAP No. 7.1.3.b and (2) there was a comparison of all daily collections reported on the CSD to bank deposit amounts and timely investigation of differences. Also, we previously commented that there had been an apparent lack of communication and coordination between the Treasurer and Revenue Department to ensure

that Treasurer's accounting staff had an adequate understanding of the reported collection amounts on the CSD, their related responsibilities when performing the comparisons, and the necessary steps to resolve any identified differences.

In January 2017, to assist with the matching of the CSD's reported collections to bank deposits, the Treasurer and Revenue Department instituted a procedure requiring city departments to submit proof of deposit (e.g. validated bank deposit slip or bank statement) before the Revenue Department will record the department's revenue transaction. While Treasurer management asserted that this new procedure has made it easier to compare CSD reported collections to bank deposits, they informed us the procedure did not resolve ongoing problems with reconciling revenue activity for the Department of Public Health (DPH). The DPH has a separate bank account from which amounts are automatically transferred daily to the consolidated cash account, but these transfers often do not match recorded revenue. For example, the Treasurer's June 2017 consolidated cash account bank reconciliation showed a \$4.2 million variance between DPH recorded collections and actual transfers into the consolidated cash account.

Recommendations: To ensure that the city's consolidated cash account is adequately safeguarded and reported cash and revenue amounts are accurate, we recommend Treasurer management:

- Continue to devote the necessary resources to perform a proper, complete, and timely reconciliation of the consolidated cash account, which should include (1) a comparison of the CSD's reported collections to bank deposits and (2) the preparation of a comprehensive list of the specific reconciling items making up the difference between the book and bank balance. The Treasurer should work with the Finance Office in investigating reconciling items to determine whether they represent errors in reported cash and/or revenue. Also, the Treasurer should continue its practice of sending the monthly list of reconciling items to city departments for their assistance with investigating the items. Any errors identified should be corrected accordingly.
- Ensure that all consolidated cash bank reconciliations are signed and dated by the preparer. Supervisory personnel should review the bank reconciliations, including the comparison of the CSD's reported collections to bank deposits, and evidence their review by signing and dating the reconciliations.
- Formalize the reconciliation procedures for the consolidated cash account in writing to ensure that they are consistently performed and documented.
- Continue to work with Revenue Department management in resolving problems noted when performing the comparison of the CSD's reported collections to bank deposits. In particular, Treasurer and Revenue Department management should work together to resolve the ongoing problems in reconciling DPH revenue activity.
- Move forward with using the outside accounting firm to investigate the \$33.3 million unknown variance related to consolidated cash account activity prior to June 2017. Any errors or improprieties discovered by this investigation should be addressed accordingly. Also, given the significance of the

unknown variance and the possibility of undetected fraud, it is essential that management formally establish a time frame for the investigation's completion.

Views of the Responsible Officials and Corrective Action Plan: As noted in the Controller's report, we have put in place steps to deal with this issue and we plan to continue with these steps until the reconciliations are completed. The steps we have taken to address the reconciliation issue include:

- Increased staffing in the Treasurer's Office to ensure that we stay current with all reconciliations going forward;
- Hired an outside accounting firm to identify the causes of the variance, which has decreased from \$40 million to \$28.6 million;
- Working with an outside consultant to develop additional internal controls to ensure that we don't fall behind again;
- Preparing weekly status reports so that we closely monitor progress not only on the Consolidated Cash Account, but on all accounts.

The City Treasurer will personally oversee this process until a new Deputy Treasurer for Cash Management is hired and then she will jointly oversee the process with the new deputy treasurer.

As noted in your report, the CTO has reinstituted the daily process to match all receipts on Revenue's Consolidated Summary of Deposits (CSD) to what is posted in FAMIS and the bank. The CTO has also reinstituted the monthly reporting of the reconciling items found as variances when comparing the CSD and bank reported transactions. This list continues to be sent out as monthly reconciliations are completed. As items are identified/explained by the various City departments, the proper journal entries or revenue validations are completed to clear the reconciling items from the list or funds are transferred as required. As monthly reconciliations are completed for Consolidated Cash and all accounts, they are being appropriately reviewed and signed off on in compliance with the City's Standard Accounting Procedure, number 7.1.3.b.

CTO is working to develop a revised process for handling the Department of Public Health's (DPH) revenue receipts, which has presented additional challenges because they are handled in a different manner through a different account than the other Revenue deposits. The process, estimated to be in place early in fiscal year 2019, will allow CTO to reconcile and report on DPH revenues with full transparency and allow easy identification of reconciling issues in the consolidated cash account.

Finally, the CTO has a preliminary schedule from the outside accounting firm who was retained to assist with the Consolidated Cash reconciliation backlog and processes. The firm anticipates making preliminary recommendations and providing trend analysis in late September 2018, completing its work by the end of November, and issuing a report in December 2018. The final report will include detailed discussion on the results of the reconciliations, recommendations to address any unresolved discrepancies, suggestions for changes to internal controls and corrective action plans to ensure that the City doesn't fall behind on reconciliations in the future. While the firm is doing its work, the CTO will have weekly meetings to get updates on its progress.

Treasurer's Failure to Reconcile Certain Accounts for Years Increases the Risk for Irregularities

Condition: While there was improvement noted in the timeliness of the Treasurer's bank reconciliations as compared to the prior year,⁴ we continued to find that the Treasurer had not reconciled six accounts for several years, as detailed in Table 2 below.

Table 2: Bank Accounts Not Reconciled by Treasurer's Office

Name of Bank Account	Month Last Reconciled
Payroll Account †	September 2010
Supplemental Payroll Account †	September 2010
General Disbursement Account	January 2012
Levy Account	June 2014
Pension Payroll Account	July 2014
Pension Payroll Deduction Account	December 2015

† The city's Payroll and Supplemental Payroll Accounts at Wells Fargo Bank have not been reconciled since September 2010. The city discontinued using these accounts for the city's payroll disbursements at the end of fiscal year 2017 and opened new accounts at Citizens Bank for fiscal year 2018.

Source: Prepared by the Office of the Controller based upon reconciliation information provided by the Treasurer's Office

A resulting condition from the Treasurer's failure to reconcile these accounts for several years is noncompliance with Pennsylvania's Disposition of Abandoned and Unclaimed Property Act (escheat act). As of March 2018, the city had \$1.6 million of unclaimed payroll checks from calendar years 2010 through 2015 and \$4.9 million of unclaimed general disbursement account (i.e. vendor) checks from calendar years 2012 through 2014 that should be escheated to the state.

Criteria: Effective internal control, as well as the city's SAP No. 7.1.3.b, require that book balances for city cash accounts be reconciled to the bank balances on a monthly basis. SAP No. 4.1.2, titled *Unclaimed Monies*, instructs city departments to remit all checks outstanding for over one year to the city's Unclaimed Monies Fund, which is administered by the Finance Office who is then responsible for remitting amounts to the state in accordance with the escheat act. The Pennsylvania escheat act requires that property which remains unclaimed by the owner for a specified dormancy period (depending on property type) be remitted to the Pennsylvania Treasury. The dormancy period is two years for unclaimed wages/payroll and three years for all other unclaimed property types.

Effect: The city is at an increased risk for undetected errors in reported cash balances and/or irregularities in account activity. Noncompliance with the Pennsylvania escheat act may subject the city to penalties.

⁴ The prior audit noted that, out of 75 Treasurer bank accounts, 51 accounts were reconciled less than two months after June 30th, 17 accounts were reconciled more than two months after June 30th, and seven accounts were not reconciled at all. During the current audit, out of 77 Treasurer bank accounts, 69 accounts were reconciled less than two months after June 30th, two accounts were reconciled more than two months after June 30th, and six accounts were not reconciled at all.

Cause: This continuing condition suggests that Treasurer management has not made the completion of the required bank reconciliation process a priority or allocated the necessary resources to perform this function effectively.

Recommendations: We continue to recommend that Treasurer management devote the necessary time and resources to ensure that all required bank reconciliations are timely prepared on a monthly basis. Bank reconciliations for any unreconciled accounts must be brought up-to-date. Management should consider hiring an outside accounting firm to assist in this effort.

In addition, Treasurer and Finance Office management should work together to ensure that all escheatable amounts are sent to the Pennsylvania Treasury. In the future, the Treasurer should comply with SAP No. 4.1.2 in remitting all checks outstanding over one year to the city's Unclaimed Monies Fund, and the Finance Office should send all unclaimed monies due to the Pennsylvania Treasury in accordance with the state escheat act.

Views of the Responsible Officials and Corrective Action Plan: Response: CTO acknowledges the finding regarding reconciliation timeliness. The CTO has established working plans to address the reconciliations of all the listed past-due accounts. The table below details the projected timelines to bring the noted accounts current.

<i>Account</i>	<i>Last Month Reconciled.</i>	<i>Projected Completion</i>
<i>Levy</i>	Jun-14	Dec-18
<i>General Disbursement</i>	Jan-12	Dec-18
<i>Employee Payroll-Wells Fargo Accts</i>	Sep-10	Jun-18
<i>Supplemental Payroll-Wells Fargo Accts</i>	Sep-10	Jun-18
<i>Pension Disbursement-BoA</i>	Jul-14	Sep-18
<i>Pension PDAA- BoA</i>	Dec-15	Oct-18

CTO transitioned the Payroll Account and Supplemental Payroll Account from Wells Fargo to Citizens Bank in July 2017. Since the account transfer to Citizens Bank, both the Payroll Account and Supplemental Payroll Account reconciliations have been completed each month. CTO is committed to having the Wells Fargo accounts reconciled by June 30, 2018. This will include the escheatment and disbursement of all outstanding checks and closing of the accounts.

For the City's General Disbursement account, the plan is to have the bank account reconciled by December 2018, at which time CTO will also have escheated and cleared all outstanding uncashed checks for years 2012 through 2015.

The Bank of America Pension Disbursement and Payroll Deduction Accounts were transferred to Citizens Bank in November 2017. Since the transfer, reconciliations have been completed each month. Both Bank of America accounts will be reconciled and closed out by October 2018.

CTO is committed to continued compliance with the City's Standard Accounting Procedure for Uncashed/Unclaimed checks.

2017-003 PAYMENT VOUCHERS APPROVED WITHOUT REQUIRED MANAGEMENT AUTHORIZATION

Condition: The Finance Office approved payment vouchers without the required management level of authorization. Our review of fiscal year 2017 expenditures approved by the Finance Office for payment vouchers exceeding \$500,000 disclosed 61 vouchers totaling \$211 million that were not authorized by the department head or their properly authorized deputy. Table 3 below provides a breakdown of these vouchers by department.

Table 3: Payment Vouchers Approved Without Required Management Authorization		
Department	# of Vouchers	Dollar Amount of Vouchers
Office of the Managing Director	1	\$1,079,350
Department of Public Health	37	186,872,438
Philadelphia Prison System	6	6,708,698
Office of the Director of Finance	5	4,612,648
Division of Aviation	12	11,715,603
Totals for All Departments	<u>61</u>	<u>\$210,988,737</u>

Source: Prepared by the Office of the Controller from review of fiscal 2017 payment voucher information extracted from the city's FAMIS and ADPICS⁵ systems

Criteria: The city's SAP No. E-0911, *Signature Authorization Cards*, requires that a payment voucher exceeding \$500,000 be approved by the department's commissioner, director, board chairman, or their properly authorized deputy.

Effect: While our sample testing of fiscal year 2017 expenditures did not reveal any irregularities, failure to verify the proper management authorization prior to approving payment vouchers increases the risk that unauthorized expenditures may be approved and not be detected in a timely manner.

Cause: The Finance Office's Financial Verification Unit, which has responsibility for approving payment vouchers, did not always ensure that, prior to approving payment vouchers exceeding \$500,000, the vouchers had the required level of departmental approval.

Recommendation: To reduce the risk of unauthorized expenditures, we recommend that the Finance Office's Financial Verification Unit only approve payment vouchers above the \$500,000 limit when there is proper departmental approval. Finance Office management has indicated that approval requirements have been reviewed and reinforced with Financial Verification Unit staff.

Views of the Responsible Officials and Corrective Action Plan: We agree that this process should be followed, and the requirements have been reviewed and reinforced with all Accounting Financial Verification staff.

⁵ **A**dvanced **P**urchasing **I**nventory **C**ontrol **S**ystem

2017-004 ALLOWING UNAUTHORIZED INDIVIDUALS TO APPROVE BI-WEEKLY PAYROLLS INCREASES RISK FOR IMPROPRIETIES

Condition: As reported over the last several years, we again noted instances where unauthorized employees approved the city's bi-weekly payrolls during fiscal year 2017. The official payroll signature files maintained by the Finance Office were not always consistent with the approval privileges assigned within the city's on-line payroll system. The city's on-line payroll process consists of the following three steps: data entry of payroll transactions, supervisory review, and executive approval. Our comparison of the payroll signature files for 57 city departments to individuals authorized in the on-line payroll system to perform the executive-level approvals revealed:

- Six departments (11 percent) had employees designated in the payroll system as authorized executive-level approvers who were not listed as such on the official payroll signature cards. For four of these six departments, we noted a total of 36 pay periods in fiscal year 2017 where the executive-level approval was performed by an employee not listed on the department's approved signature card. Two departments, the Atwater Kent Museum and the Mayor's Office of Labor Relations, accounted for 24 of the 36 pay periods where payroll was approved by an unauthorized employee. While Finance Office management provided a signature card for the Atwater Kent Museum which listed the employees in question, the card did not contain the required approvals of the department head, the Finance Office, and the City Controller's Office.
- Thirty-nine departments (68 percent) had employees who were authorized as executive-level approvers, but not designated as such in the payroll system. Eighty-seven of these employees did not have access to the system, but many of them were department heads and deputies who usually delegated this responsibility to other department officials in financial or personnel management positions.

Criteria: To reduce the risk of irregularities, effective internal control procedures dictate that only individuals who are properly authorized should approve the bi-weekly payrolls. Additionally, signature authorization records should be appropriately updated as required by the city's SAP No. E-0911 titled *Signature Authorization Cards*. This SAP requires the Finance Office to maintain a current signature file of employees authorized to enter executive-level approvals for their respective department's payroll.

Effect: For four of 57 city departments, unauthorized employees approved approximately \$6.3 million in payroll costs during fiscal year 2017. Although we found no improprieties, the city has exposed itself to a higher level of risk for such occurrences.

Cause: The Finance Office has instituted a procedure where, for each payroll period, Central Payroll Unit personnel compares a report listing department managers who perform the executive-level approvals in the on-line payroll system to the signature card files and investigates any discrepancies. However, the Finance Office's control procedures did not always timely identify instances of discrepancies between the signature authorization cards and executive-level approval privileges assigned within the on-line payroll system. Also, management has not yet updated SAP No. E-0911 to reflect the current control procedures and documentation requirements for payroll approvals.

Recommendations: We recommend that Finance Office management:

- Continue to compare the list of executive-level approvers in the on-line payroll system to the signature authorization cards to ensure that all individuals are properly authorized and have appropriate on-line access to the system.
- Send responsible personnel periodic notices throughout the year regarding signature card requirements.
- Revise SAP No. E-0911 accordingly to reflect the current control procedures and documentation requirements for payroll approvals.

Views of the Responsible Officials and Corrective Action Plan: While you identified this as a risk, we are pleased that you found no improprieties in your review. As noted in your report, the Payroll division has already implemented procedures to regularly compare officials who approve the on-line payroll to the signature card files. Payroll will work to improve the timeliness of these reviews. Additionally, Payroll will send periodic notices throughout the year to the Human Resource and Payroll communities regarding signature card requirements. In anticipation of the rollout of the OnePhilly system expected at the end of 2018, Payroll-related SAPS are currently under review for necessary revision.

2017-005 FAILURE TO SEGREGATE PAYROLL DUTIES COULD ALLOW FRAUD TO OCCUR

Condition: During fiscal year 2017, the duties concerning the data entry, review, and approval of bi-weekly payroll transactions were again not adequately segregated. Our testing of 57 city departments for 26 pay periods revealed 342 occasions (23 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. Employees in 28 departments performed duplicate functions for more than two pay periods, with the Mayor's Office, the Police Department, the Fire Department, the Board of Pensions and Retirement, and the Office of the Chief Administrative Officer being the most recurrent among the larger departments. While there had been some improvement in this condition when compared to the previous year's findings,⁶ a significant number of city departments were still not adequately segregating payroll duties.

Criteria: Effective internal control procedures require that payroll data entry, supervisory review, and executive-level approvals be performed by separate, authorized employees.

Effect: Failure to segregate duties and the combination of multilevel reviews increase the risk of undetected errors. Also, this situation provides opportunities for a person to perpetrate and conceal irregularities during the bi-weekly payroll preparation process, which may result in fraudulent payroll payments.

Cause: The city's current automated payroll system allows individuals with supervisory and executive-level approval authority to perform the work at their level, as well as the levels below them. Finance Office management asserted this system feature was intentional to ensure that payroll is processed in emergency situations that may occur when authorized individuals at all levels are not available to sign off on payroll. While the Finance Office sends annual reminders to city departments instructing them to segregate these payroll functions, many city departments do not always follow this directive. Also, the director of payroll informed us that, for several departments where employees performed duplicate functions, there was no individual assigned payroll data entry and/or supervisory level review privileges in the city's on-line payroll system.

Recommendation: We again recommend that the city's Finance Office continue to remind city departments of the importance of maintaining adequate segregation of duties for completing data entry, reviewing, and approving payroll each pay period. Finance Office management should identify the individual city departments who repeatedly fail to adequately segregate payroll duties and also periodically review the assigned privileges in the on-line payroll system to identify departments that do not have different individuals designated for all three payroll functions. Management should then send notices to the heads of these departments requesting that they ensure payroll duties are segregated each pay period and different employees are assigned to all three payroll functions. In response to this finding, Finance Office management started sending out such notices in March 2018. Lastly, since the city is in the process of implementing a new payroll system with a planned go-live date in December 2018, we recommend the Finance Office ensure that the new system is designed to limit the ability of one individual to perform two or more conflicting duties to a set number of occurrences. This control feature would incentivize department heads to ensure there are sufficient authorized, alternative employees to process payroll in emergency situations.

⁶ The prior year's testing disclosed 374 occasions during fiscal year 2016 (26 percent) in which these payroll functions were not separated. Also, we noted that, for 31 of 56 departments, employees performed duplicate functions for more than two pay periods.

Views of the Responsible Officials and Corrective Action Plan: We will continue to remind operating departments that the same employee should not be signing off on more than one level of payroll. As we have consistently stated, to ensure that employees will be paid on time, there will be instances where one individual signs off at more than one level when all employees at all levels are unable to do so. We will take into consideration your recommendation that the OnePhilly system limit the numbers of instances where this will be permitted.

2017-006 CAPITAL ASSET CONTROL DEFICIENCIES INCREASE RISK OF REPORTING ERRORS

As previously reported during the last several audits, 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. Each of these conditions is discussed in more detail below.

Lack of a Comprehensive Capital Asset System Hampered Reporting Process

Condition: The city still lacks a comprehensive capital asset management system to better manage and account for real property assets. Instead, Finance Office accountants continue to maintain a cumbersome series of Lotus 1-2-3 and Excel files, that together 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 city's CAFR. Real property addresses are only available in FAMIS by user code, which is identified in an Excel file called the "Proof".

Criteria: Philadelphia's Home Rule Charter⁷ requires management to maintain current and comprehensive records of all real property belonging to the city.

Effect: The use of multiple files creates a burdensome and onerous process that can affect the accuracy and completeness of capital asset amounts reported in the CAFR and causes extensive audit effort. For example, our current year testing found a \$15 million understatement of accumulated depreciation caused by a formula error in the spreadsheet file used to calculate depreciation. Also, we continued to find discrepancies between the "Proof" file and FAMIS – an \$8.5 million discrepancy in the accumulated depreciation balance for buildings, a \$1.6 million difference in the accumulated depreciation balance for other improvements, and a \$1.0 million variance between vehicle categories.

Cause: While Finance Office management agrees that it would be beneficial to have a comprehensive capital asset system, resources have not been identified to initially fund and continually maintain it.

Recommendation: To improve the accounting and reporting of the city's capital assets, we continue to recommend that Finance Office management secure the necessary resources to 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.

Views of the Responsible Officials and Corrective Action Plan: We agree it would be beneficial for the City to have a 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. In the meantime, the current process will continue to be used. It should be noted the current methodology used by Accounting

⁷ The Philadelphia Home Rule Charter, Section 6-501

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.

Failure to Inventory Real Property Assets Increases Risk of Inaccurate Accounting Records

Condition: Except for the PWD and the DOA, which both periodically check the physical existence and condition of their real property assets, this year's audit again disclosed no evidence that the city's other real property assets had been recently inventoried. Also, while we previously recommended that the Finance Office compare the Philadelphia City Planning Commission's master database of city-owned facilities to the city's fixed asset ledger to identify any discrepancies, the Finance Office had not yet performed this comparison.

Criteria: SAP No. E-7201, *Real Property Perpetual Inventory*, 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. Additionally, 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 at least every one to three years.

Effect: Continued failure to perform a physical inventory increases the risk that the city's recorded real property assets could be inaccurate and/or incomplete.

Cause: This issue has not been a priority for city management. The Finance Office, Procurement Department, and Department of Public Property (Public Property) – the agency responsible for acquiring and maintaining the city's real property assets – have not developed a coordinated process for physically inventorying all city-owned real property.

Recommendations: We continue to recommend that Finance Office management:

- Work with the Procurement Department and Public Property to 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.
- Develop and provide a plain language report on the condition of capital assets for the use of elected officials at least every one to three years. This report should also be made available to the general public.
- Obtain the master list of city-owned facilities and compare it to Finance's records to identify any discrepancies and ensure the completion and accuracy of Finance's records.

Views of the Responsible Officials and Corrective Action Plan: We agree that there is no formal written process to document that a physical inventory is occurring and no one system/report where data on all city property and conditions are stored. Departments do, however, inspect their properties regularly and develop their capital and maintenance budget requests based on the conditions they identify.

The Department of Public Property (DPP) maintains an asset management system that includes nearly 4,000 City assets including office buildings, picnic shelters, cell towers, recreation facilities, fire and police stations, and other city assets. This system, known as the Integrated Workplace Asset Management System (IWAMS) uses as its "backbone" the master facilities database originally prepared and maintained by the City Planning Commission. IWAMS was rolled out to City agencies in late 2017 and is operated and maintained by staff at DPP. It currently includes facility information for Parks and Recreation, Public Health, and facilities within DPP's purview. IWAMS also can track energy usage and capital spending data output from FAMIS.

Additionally, DPP is completing a master plan of public safety facilities that identifies capital needs for approximately 80 major Police and Fire facilities. The master plan will assess the physical condition and needs of those facilities and will include recommendations for investments in those facilities. The data for these facilities will be included in the IWAMS system.

While IWAMS does not yet include condition assessment data for all the city's real property assets, a comparison of the system records to Finance's records will help to ensure that Accounting's list of assets is complete and accurate. Accounting will explore with DPP a method to compare the inventory in the IWAMS database to that in FAMIS. While the system may aid in ensuring the list is complete and accurate, it is not able to be used to calculate depreciation and book value of City-owned assets that meet Accounting reporting requirements. I believe the longer-term solution would be to acquire a capital assets management and depreciation module when the FAMIS accounting system is replaced within the next few years.

**2017-007 FAILURE TO TIMELY TRANSFER FUNDS BETWEEN CITY BANK ACCOUNTS
COULD RESULT IN SIGNIFICANT REPORTING ERRORS**

Condition: Reported cash and investment amounts in the city's CAFR – specifically those reported under the account entitled Equity in Treasurer's Account – were at an increased risk for significant misstatement because the Finance Office's accountants frequently failed to timely transfer monies between city bank accounts to match activity recorded on the city's accounting system (FAMIS), which is the source of CAFR amounts.

All cash and investments in the bank accounts under the control of the Treasurer are reported under the Equity in Treasurer's Account, which represents each fund's share in the Treasurer's group of bank accounts. While many funds are members of the consolidated cash bank account, which pools monies to maximize the city's investment earnings, the city must also maintain separate bank accounts for certain funds such as the Water and Aviation Funds to comply with legal requirements (e.g. bond covenants and ordinances). Therefore, when there is activity in FAMIS that necessitates moving funds between the consolidated cash account and another city account, such as the transfer of expenditures from consolidated cash member funds to the Water or Aviation Funds, Finance Office accountants must prepare a cash transfer authorization (CTA) to authorize the Treasurer to move the funds.

Our current testing found that Finance Office accountants did not timely prepare CTAs for \$10.3 million of pending transfers due from the Water and Aviation Fund bank accounts to the consolidated cash account. These pending transfers were mostly related to transfers of expenditures from consolidated cash member funds to the Water and Aviation Funds that occurred in fiscal 2017 with one expenditure transfer dating as far back as June 2016. However, Finance Office accountants did not prepare the CTAs to authorize the \$10.3 million of transfers until February 2018, at the request of the Controller's Office. We observed that the Treasurer transferred the \$10.3 million from the Water and Aviation Fund bank accounts to the consolidated cash account in February 2018.

Criteria: The city's SAP No. I-4295, titled *Consolidated Cash Account*, requires that general ledger records are maintained setting forth the details of the daily transactions pertaining to the consolidated cash account and the member or non-member funds to which they apply. These records should reflect, on a daily basis, each member fund's equity balance of the consolidated cash account total and the amounts due from, or to, non-member funds. In addition, SAP No. 7.1.3.b, *Reconciliation of All Bank Accounts in All City Agencies*, requires that Finance Office accountants reconcile the funds' Equity in Treasurer's Account balances per FAMIS to Treasurer account book balances. Effective internal control demands that such a reconciliation be performed at least monthly. As part of this reconciliation, Finance Office accountants should determine if transfers between bank accounts are necessary and then prepare CTAs accordingly. For reported Equity in Treasurer's Account balances to be accurate, the FAMIS transactions comprising these account balances must be supported by actual bank activity.

Effect: As a result of this condition, there is an increased risk for significant undetected errors in the Equity in Treasurer's Account amounts reported in the city's CAFR. Also, if required transfers are not performed timely for funds that are legally mandated to maintain separate bank accounts, the city is at a greater risk for noncompliance with the applicable legal requirements and possible resulting penalties.

Cause: Finance Office management had not developed procedures to ensure that the reconciliation of FAMIS Equity in Treasurer's Account amounts to Treasurer account balances and the preparation of necessary CTAs were timely performed. Finance Office accountants were behind in reconciling the consolidated cash member funds' equity amounts to Treasurer account balances, failing to perform this function for five months during fiscal year 2017. Finance Office management attributed these reconciling delays to staff turnover and the training needed by the new employee performing this function.

Recommendation: To minimize the risk of undetected errors in reported Equity in Treasurer's Account balances, we recommend that Finance Office management ensure that the employee responsible for reconciling consolidated cash member funds' equity amounts to Treasurer account balances receives adequate training. Finance Office management should also develop procedures designed to ensure that the reconciliation is performed monthly and required CTAs are promptly prepared and submitted to the Treasurer. The Treasurer should immediately perform the requested transfers.

Views of the Responsible Officials and Corrective Action Plan: We agree with your finding and will work to timely reconcile and prepare necessary CTAs. Additionally, Accounting will follow-up with CTO to ensure the requested CTAs are effectuated.

2017-008 LAX MONITORING OF ADJUSTMENTS TO TAX ACCOUNTS MAY LEAD TO UNDETECTED ERRORS OR IRREGULARITIES

Condition: Previously, we reported that Revenue Department accountants did not perform timely reviews of adjustments made to taxpayer accounts, which on any given day can involve millions of dollars. Accountants did not review fiscal year 2016 adjustments until January 2017, and the review was very limited in scope. Our current audit found that accountants had not performed any reviews of fiscal year 2017 adjustment transactions. Also, our discussions with Revenue Department management indicated that, as of February 2018, there had been no reviews of fiscal year 2018 adjustments.

Numerous Revenue Department employees have the ability to post payment and receivable adjustments directly to taxpayer accounts on Revenue's Taxpayer Inquiry and Payment System (TIPS). TIPS is the department's computerized accounting system, which is the source for taxes receivable reported in the CAFR. Examples of payment adjustments include transferring payments within a taxpayer's account (i.e. between tax years and/or tax types), transferring payments from one taxpayer account to another, changing the dollar amount of a payment, and creating a new payment on the system. Receivable adjustments involve increasing, decreasing, or entirely deleting a taxpayer's liability. While employees only had the ability to perform adjustments up to an authorized dollar limit and supervisory approval was required for adjustments exceeding the established limits, the effectiveness of these system security controls was lessened by the fact that employees could have very high dollar limits. For instance, we observed dollar limits as high as \$1 million for non-supervisory personnel and \$100 million for supervisory personnel.

Criteria: To ensure that adjustments made to taxpayer accounts are accurate and proper, there should be a regular review of daily payment and receivable adjustment activity in TIPS by an independent supervisor.

Effect: Although our tests of selected TIPS adjustments disclosed no instances of inaccurate or improper activity, taxpayer accounts are at a higher risk for undetected errors and irregularities. Consequently, there is an increased risk for lost revenue and misstatement of the taxes receivable reported in the city's CAFR.

Cause: During fiscal year 2017, the employees assigned the duty of reviewing TIPS adjustments were transferred from the unit responsible for monitoring adjustments (Financial Reporting Unit (FRU)) to another Revenue Department unit. Revenue Department management informed us that, when these employees were transferred, the adjustment review was not reassigned to other employees because of staff shortages and other department priorities. Management has indicated that they plan to reinstitute the adjustment review once they obtain additional accounting staff. In February 2018, Revenue Department management hired an accounting manager for the FRU and stated that they plan to add an accountant in the coming months.

Recommendation: We continue to recommend that Revenue Department management reinstitute the practice of regularly monitoring daily payment and receivable adjustment activity in TIPS. Supervisory personnel independent of the adjustment process should review the daily adjustment reports for patterns of irregular activity and test a sample of adjustments for accuracy and propriety. To evidence that these checks are performed, the supervisor should sign and date the adjustment reports upon completion of the reviews.

Views of the Responsible Officials and Corrective Action Plan: Again, we are pleased that your testing found no instances of inaccurate or improper activity. To reduce the risk of any adjustments being made without proper authority or reliable and reasonable supporting documentation, the Department of Revenue has reinstituted control measures that include having an individual who has no control over the adjustment process regularly monitor daily payment and receivable adjustment activity. The monitoring of these adjustments is performed by randomly selecting transactions from the daily adjustment report and having the person or supervisor of the unit where the adjustment originated provide sufficient evidence and supporting documentation for the adjustment. The evidence, documentation and adjustment reports are kept by the independent reviewer and are available upon request. The random audits deter opportunities for a person to perpetuate and conceal irregularities.

2017-009 SAPs REQUIRE UPDATING TO ENSURE ACCURATE AND CONSISTENT APPLICATION OF ACCOUNTING RULES AND REGULATIONS

Condition: The city's SAPs, 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 practices currently in use. The Finance Office has established over two hundred SAPs to provide city departments and agencies with guidance on how to handle various accounting related activities, including proper procedures for ensuring the accuracy of transactions and the safeguarding of assets. Over the years, as new technologies were adopted and daily practices were enhanced, the existing SAPs have not been updated accordingly. While the Finance Office has updated eight SAPs since September 2015 – the most recent being the SAP pertaining to subrecipient monitoring in August 2017 – over 50 percent of the existing SAPs are more than half a century old.

Criteria: In accordance with Philadelphia's 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.⁸ Also, in its best practices publication, the GFOA recommends that governments perform an on-going review, evaluation, and update of accounting procedures to ensure they remain technically accurate, understandable, and compliant with current rules and regulations.

Effect: With the majority of SAPs not reflecting the automated processes and practices currently in use, there is an increased risk that critical control activities may be inconsistently applied or not performed at all, which could result in accounting errors and/or misappropriation of assets.

Cause: Over the years, the Finance Office experienced staff reductions that have compromised its ability to conduct periodic reviews and updates to the SAPs.

Recommendation: We continue to recommend that Finance Office management commit the resources necessary to perform a thorough review of its SAPs. Procedures no longer pertinent should be rescinded, and 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.

During fiscal year 2018, the Finance Office hired a consultant to assist in reviewing and updating the SAPs. We commend Finance Office management for this initiative and urge them to follow through with the planned review and update of SAPs.

Views of the Responsible Officials and Corrective Action Plan: Accounting is committed to continually review and update the SAPs. On a limited basis, and to ensure that we comply with any changes in accounting regulations or governmental regulations, these procedures have been updated, especially in areas that could be susceptible to irregularities and those that have been cited in prior audit reports. As you noted in your report, Finance contracted with an outside accounting firm to assist in a comprehensive update of our SAPs. Work by the consultant to date includes the development of new numbering system for the SAPs and the development of a template for a new SAP manual that will house all SAPS in a consistent format. Also,

⁸The Philadelphia Home Rule Charter, Section 6-101.

there is a preliminary plan that lists every SAP, a prioritization of each for updating and who will be responsible. Accounting has requested and received feedback from the Controller's Office on the prioritization of updates. More specifically, Accounting is currently working on updates to 4.1.1.i Automated Clearing House (ACH) and E-7201 Reporting on Donation of Capital Assets. We have also asked the OnePhilly team to review payroll-related SAPs as they continue their efforts to implement a new citywide payroll system.

Our next deliverable from the consultant will be a schedule for completion of the review of all SAPs.

2017-010 GENERAL INFORMATION TECHNOLOGY CONTROLS REQUIRE STRENGTHENING

Condition: The prior audit's review of the Office of Innovation and Technology's (OIT's) general information technology (IT) controls over key financial-related applications⁹ revealed several significant weaknesses.¹⁰ In response to our previous year comment, we observed that, for the two employees who had development and systems administrator access rights to three applications (Pension Payroll, Health and Welfare, and TIPS), OIT management removed their development rights to these applications, thereby resolving that condition. However, our current testing continued to note the following deficiencies:

- OIT's established change management procedures were still not consistently followed. Our testing of twelve requests for changes to the city's IT systems, from the period of July 2016 through October 2017, found that six requests were not supported by documented end-user testing, and three change requests had no backout plan specifying the processes required to restore the system to its original state in the event of failed or aborted implementation. Also, for two change requests where there was no clear evidence of management approval, OIT personnel told us that the approval was implied because the change request was initiated by a manager. Lastly, while the change management policy now included more detail on required approvals for the different change types, it did not specifically address how end-user testing should be documented.
- Three programmers with access rights to the Payroll system had the ability to enter payroll transactions and approve departments' bi-weekly payrolls.
- OIT's setup process for new users did not include a procedure to formally document new user access requests and approvals.

Criteria: Modifications to city IT systems should be supported by documented end-user testing, backout plans, and management approval of changes. In addition, change control procedures should clearly identify documentation requirements for end-user testing. Also, proper segregation of duties requires that only users – not programmers who can make application changes – should be responsible for transaction origination and approval. Lastly, access controls require that the approval of new user access be formally documented to ensure that it was appropriately authorized.

Effect: All of the above described weaknesses result in an increased risk that unauthorized and improper changes to the applications and their data could occur without detection.

Cause: OIT management had not performed sufficient oversight of the change management function to ensure that established procedures are routinely followed and that the policy clearly identifies documentation requirements for end-user testing. In addition, OIT management asserted that the approval function in its recently implemented system for processing change requests was not working correctly during the timeframe

⁹ The key financial-related applications included in the review were FAMIS, ADPICs, Payroll, Pension Payroll, Health and Welfare, TIPS, and BASIS2.

¹⁰ The prior review also disclosed other findings with lesser impact. The remediation status of those other findings is discussed on page 25 and Appendix I of this report.

when the sampled change requests occurred. Also, it appears that management did not periodically review the access rights assigned to its employees to ensure that duties were properly segregated or, if segregation was not feasible, that appropriate monitoring controls were in place. Regarding the granting of access to new users, OIT management informed us they were in the process of developing a procedure for formally documenting new user access requests and approvals.

Recommendations: To improve general IT controls over financially significant systems, we continue to recommend that OIT management:

- Review change control procedures and implement measures to ensure that required steps for application changes are performed and documented in accordance with the policy. Also, OIT should update its change management policy to include more detail related to documentation requirements for end-user testing.
- Revise the three programmers' access rights to the Payroll system so they do not have the ability to enter and approve payroll transaction data. If that option is not feasible, OIT should implement a monitoring procedure to confirm that the programmers' activities are authorized and appropriate.
- Review the new hire setup process and develop a procedure to document new user access requests and approvals so they can be easily retrieved for later review and audit.

Views of the Responsible Officials and Corrective Action Plan: OIT has provided the following responses to the Controller's findings & recommendations.

Change Control Procedures. OIT has a Change Control process in place for updates and code changes for all major IT systems. An IT manager/director submits a change control in the SysAid (help desk) system. A Change Control Board review meeting is initiated by the Chief Security Officer and includes the directors of divisions for Platform Engineering, Database, Networking, Web and Operations. The board members review the request and the IT director is asked to demonstrate testing plan, back-out plan, and need. Testing and back-out plans are amended based on input by Board members of associated impacts to other systems.

Currently OIT does not include all documentation of the Change Control Board review process in the SysAid record. OIT recognizes the value of amending its processes to record documentation associated to a change control and will look to institute these measures.

Programmer Access: The programmer access rights were requested by Finance-Payroll to ensure specific payroll processing tasks were completed during a short time frame where Finance staff were out of the office and experienced OIT staff were determined to be the best substitutes for the process. Access was limited to two programmers, with a full audit trail of actions in place. Permissions were revoked when the tasks were completed. Upon implementation of OnePhilly, this type of request is not expected to occur again, as the payroll processes in question will be automated, unlike the current process.

New Hire Setup: OIT formally receives requests for user access for IT systems through a web based help desk system (SysAid). Support Center staff review the request, verify the requestor and their authorization to

make the request through contact with the designated departmental administrator(s) for the system in question. Additional oversight occurs at the departmental level with a monthly review of personnel and system access changes.

2017-011 NONCOMPLIANCE WITH ACT 148 GRANT REPORTING DEADLINES DELAYED RECEIPT OF FUNDS

Condition: As previously reported, the city’s Department of Human Services (DHS) again failed to comply with reporting requirements related to the Act 148 grant, which represents the state share of the County Children and Youth Social Service Program. During fiscal year 2017, DHS was consistently late in submitting the Act 148 required quarterly reports, as summarized in the Table 4 below:

Table 4: Untimely Submission of Act 148 Quarterly Reports

<u>Quarter Ending</u>	<u>Report Due Date</u>	<u>Report Submission Date</u>	<u># of Days Late</u>
September 30, 2016	November 14, 2016	June 19, 2017	217
December 31, 2016	February 14, 2017	May 1, 2017	76
March 31, 2017	May 15, 2017	July 7, 2017	53
June 30, 2017	August 14, 2017	October 6, 2017	53

Source: Prepared by the Office of the Controller from review of fiscal year 2017 Act 148 quarterly reports provided by DHS

Criteria: Pennsylvania Code Title 55, Chapter 3140, § 3140.31 requires counties to submit quarterly reports of Act 148 grant expenditures within 45 days of the end of each quarter. Certain advance payments and reimbursements of net billable expenditures to counties are dependent upon the state’s receipt and approval of these quarterly reports.

Effect: DHS’ untimely submission of the Act 148 quarterly reports resulted in delays in receiving grant funding. For example, the state’s payment of the fourth quarter advance and second quarter reimbursement was due to the city upon the state’s approval of DHS’ report for the period ending December 31, 2016. Since DHS submitted that report 76 days late on May 1, 2017 and the state then required DHS to submit revisions to that report in July 2017, a \$57 million payment to the city was unnecessarily delayed until August 2017.

Cause: DHS management attributed fiscal year 2017 reporting delays to the following two factors: (1) ongoing staff shortages in DHS’ fiscal unit and (2) the conversion to an automated invoicing process, which required resolving certain technical issues. Management asserted that, going forward in fiscal year 2018, the automation of the Act 148 invoicing should improve the timeliness of report submission. Our review of DHS’ fiscal year 2018 Act 148 reports indicated improvement starting with the submission of the report for the quarter ended December 31, 2017, which was sent only one day late.

Recommendations: In order to comply with Act 148 reporting requirements and to accelerate the reimbursement process, we recommend that DHS management closely monitor the effect of the implementation of the automated invoicing process. If it is determined that the new process does not result in the continued timely submission of Act 148 reports, we also again recommend that DHS management:

- Address the staff shortage issue so that there is a sufficient number of adequately trained staff to assist in report preparation.
- Obtain a waiver or extension from the state on the 45-day reporting requirement when timely report submission is not possible.

Views of the Responsible Officials and Corrective Action Plan: DHS continues to improve the timeliness of submitting the Act 148 invoice. The FY17 fourth quarter invoice was 53 days late, which was an improvement over the FY16 fourth quarter submission, which was 180 days late. In FY18, DHS has dramatically reduced its tardiness in submitting the invoice. The FY18 second quarter invoice was submitted only five days late, and the third quarter invoice was submitted one day early on May 14, 2018. DHS plans to continue submitting invoices in a timely manner going forward, avoiding the need for extensions or waivers.

2017-012 WEAKNESS IN CONTROLS LED TO INACCURATE SUBRECIPIENT EXPENDITURE AMOUNTS REPORTED ON THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (SEFA)

Condition: GAAU did not accurately disclose the total payments to subrecipients in the preliminary SEFA provided for audit. Our review of records indicated that subrecipient expenditures for certain federal awards were either understated, overstated or not reported at all. The total net understatement of subrecipient expenditures in the preliminary SEFA amounted to \$114 million. GAAU concurred with our findings and corrected the amounts reported for subrecipient expenditures. Table 5 below summarizes a majority of the total net understatement.

Table 5: Summary of the Largest Subrecipient Expenditure Variances by Program				
	CFDA #	Amount Per Auditee (\$)	Amount Per Auditor (\$)	Difference Over/(Under)stated (\$)
Child Welfare Training or Demonstration	93.648	2,093,035	48,772,921	(46,679,886)
Temporary Assistance for Needy Families	93.558	5,503,543	27,926,855	(22,423,312)
Edward Byrne Memorial Competitive Grant Program	16.751	0	8,610,562	(8,610,562)
Medical Assistance Program	93.778	524	8,075,728	(8,075,204)
Social Services Block Grant	93.667	4,797,377	11,775,892	(6,978,515)
Community Development Block Grant Program	14.218	34,091,782	40,055,912	(5,964,130)
Block Grants for Community Mental Health Services	93.958	0	2,858,769	(2,858,769)
Chafee Foster Care Independence Program	93.674	0	1,458,588	(1,458,588)

Source: Office of the Controller

Criteria: OMB’s Uniform Guidance, Title 2, Part 200, Subpart F, paragraph .510(b)(4) requires the total amount provided to subrecipients from each federal program to be included in the SEFA.

Effect: Failure to completely and accurately report subrecipient expenditures can result in noncompliance with terms and conditions of federal awards. It could, for example, lead to the city not correctly identifying subrecipients for audits and monitoring. In addition, grantors will not have accurate information relating to the total amount of federal awards that were expended by subrecipients.

Cause: Certain city departments (departments), including the Department of Human Services, Managing Director’s Office, Department of Behavioral Health and Intellectual Disability Services, and Department of Planning and Development, did not provide complete and accurate subrecipient information to GAAU. The city generally uses the prefix “SBXX” in encumbrance documents to identify expenditures related to subrecipients. However, departments were not consistently identifying encumbrances relating to subrecipients by using the proper prefix when a vendor’s status was initially determined as a subrecipient. Also, GAAU requests departments to identify subrecipient expenditures from an expenditure listing. Those departments that used a prefix other than “SBXX” did not inform GAAU the encumbrances related to subrecipients.

Recommendations: We recommend that GAAU reinforce with departments the need to provide complete and accurate information to assist in reporting the correct amount for total payments to subrecipients. Also, when departments initially determine a vendor's status as a subrecipient, they should use encumbrances with the prefix SBXX to easily identify the subrecipient expenditures. Additionally, the departments should inform GAAU of subrecipient expenditures associated with encumbrances not denoted by the SBXX prefix.

Views of the Responsible Officials and Corrective Action Plan: We agree that it is important to accurately disclose payments to subrecipients, and GAAU will continue to work with departments to enforce its existing procedures to ensure accurate reporting. The Schedule of Federal Expenditures (SEFA) reported subrecipient spending as part of the total Federal Expenditures column but did not accurately disclose total payments to subrecipients in the Subrecipient Expenditures column because some of the responsible grantee departments failed to provide complete and accurate subrecipient information to GAAU.

The City's Standard Accounting Procedure G 5-1 covering Subrecipient Monitoring instructs departments to use the prefix "SBXX" on encumbrance documents for subrecipients as an internal control to produce accurate financial statement reporting. For the past two years, GAAU has provided citywide training to departments on OMB's Uniform Guidance, Title 2, Part 200, Subpart D paragraph .331 covering the responsibilities of the City as a Pass-Through entity. For Fiscal Year 2018 reporting and beyond, GAAU will also provide additional tools like customized reports from the accounting system so departments can better identify and quantify the federal subrecipients expenditures.

Contact Person: Leon Minka, Accounting Manager, Finance (215) 686-6172

2017-013 SUBRECIPIENT MONITORING
Edward Byrne Memorial Competitive Grant Program – CFDA #16.751

Condition: The Managing Director’s Office (MDO) failed to adequately perform after-the-award monitoring procedures by not ensuring its subrecipient, the Philadelphia 2016 Host Committee (Host Committee), had a single audit conducted. The City of Philadelphia (city) hosted the Democratic National Convention (DNC) in July 2016, and the Host Committee was established and subawarded \$8,610,562 of program funds to aid the city with various obligations in support of the DNC. The Host Committee ceased operations shortly after the DNC. Funding for this program was received from the U.S. Department of Justice, Office of Justice Programs, Bureau of Justice Assistance.

Criteria: OMB’s Uniform Guidance, Title 2, Part 200, Subpart D, paragraph .331 establishes pass-through entity responsibilities which include:

- Verifying that every subrecipient is audited as required by Subpart F—Audit Requirements of this part when it is expected that the subrecipient's federal awards expended during the respective fiscal year equaled or exceeded the threshold set forth in §200.501 audit requirements.
- Monitoring the activities of the subrecipient as necessary to ensure that the subaward is used for authorized purposes, in compliance with federal statutes, regulations, and the terms and conditions of the subaward; and that subaward performance goals are achieved by following-up and ensuring that the subrecipient takes timely and appropriate action on all deficiencies pertaining to the federal award provided to the subrecipient from the pass-through entity detected through audits and other means.
- Issuing a management decision for audit findings pertaining to the federal award provided to the subrecipient from the pass-through entity.

Also, the city’s Standard Accounting Procedures require the subrecipient to submit an audit, if expenditures exceed the federal audit threshold, within 120 days of the fiscal year ending date.

All of these compliance requirements were included in the Host Committee’s subaward agreement.

Effect: The MDO could not demonstrate that the required subrecipient single audit report was completed, timely received, and reviewed and that determinations were made regarding whether management decisions and corrective actions for findings were required. Additionally, the MDO was unable to confirm that any such potential findings had been resolved by the corrective actions. This resulted in the MDO having inadequate assurance that the Host Committee expended the federal award in compliance with laws, regulations, and the provisions of the subaward. As a result, we question as unallowable the entire \$8,610,562 of grant funds passed through to the Host Committee.

Cause: The MDO neglected to follow established OMB and city procedures pertaining to the pass-through entity’s receipt and review of the subrecipient single audit report.

Recommendations: We recommend that when the federal awards are passed through to subrecipients, the MDO monitor and confirm that all subrecipients comply with the OMB single audit requirements.

Views of the Responsible Officials and Corrective Action Plan: The City appreciates the Controller's acknowledgement of the special circumstances of the DNC Convention, namely that the Host Committee was established for a specific purpose relating to the delivery of the DNC Convention, and that the Host Committee was dissolved shortly after the DNC Convention occurred. Given the timing and circumstances, the City was unable to secure a Host Committee audit, per the Uniform Guidance and the City's policy and procedure regarding subrecipient monitoring.

The Managing Director's Office (MDO) implements the City's subrecipient monitoring policies and procedures per the City of Philadelphia, Pennsylvania Subrecipient Monitoring Guide (2017), and agrees to augment internal controls in the MDO, which will include adherence to any specifications of a federal award to ensure compliance and accountability of subrecipients. The City strives to continuously improve its policies, procedures and practices to manage federal grant awards with integrity and fidelity.

Contact Person: Julie Wertheimer, Director of Criminal Justice, MDO, (215) 686-2131

2017-014 REPORTING
Edward Byrne Memorial Competitive Grant Program – CFDA #16.751

Condition: The Managing Director’s Office (MDO), in conjunction with the Grants Accounting and Administrative Unit (GAAU) of the Finance Office, processed and approved all program transactions in the city’s Financial Accounting and Management Information System (FAMIS) under an incorrect Catalog of Federal Domestic Assistance (CFDA) number for the Edward Byrne Memorial Competitive Grant. This program supported the City of Philadelphia’s hosting of the Democratic National Convention (DNC) in July 2016, and the funding is received from the U.S. Department of Justice, Office of Justice Programs, Bureau of Justice Assistance.

Criteria: OMB’s Uniform Guidance, Title 2, Part 200, Subpart D, paragraph .302 (b)(2) requires that the grant recipient’s financial management system must provide accurate, current, and complete disclosure of the financial results of each Federal award.

Effect: GAAU prepares the Schedule of Expenditures of Federal Awards (SEFA) based on information generated by FAMIS. Since the CFDA error was never corrected by the MDO or GAAU in FAMIS, the initial SEFA reported the grant under the wrong CFDA number. While the final SEFA version reports the grant under the proper CFDA number, this error was not corrected until it was brought to GAAU’s attention by the auditors.

Cause: MDO management erroneously completed and approved the “Grant Profile” form, which GAAU utilized to set up the federal grant on FAMIS. While setting up the grant in FAMIS, GAAU did not have sufficient controls in place to detect and correct the CFDA number error. As a result, all subsequent grant transactions were processed and approved through FAMIS under an incorrect CFDA number.

Recommendations: We recommend that the MDO and GAAU ensure that sufficient controls are established to ascertain that federal awards are identified by the correct CFDA number and accurately reported in FAMIS.

Views of the Responsible Officials and Corrective Action Plan: The City accepts the finding that the CFDA was incorrect, but the City does have sufficient controls in place. The Managing Director’s Office implements the City of Philadelphia’s grant management policies and procedures and agrees to augment internal controls in the MDO, which will include a confirmation and cross-check process to ensure that the correct federal grant identifier is assigned. The MDO does note, however, that during the pre-award phase and for Federal Financial Reporting the correct CDFA number was used.

Contact Person: Julie Wertheimer, Director of Criminal Justice, MDO (215) 686-2131

2017-015 REPORTING
Staffing for Adequate Fire and Emergency Response – CFDA #97.083

Condition: The Philadelphia Fire Department (PFD) submitted semi-annual *Federal Financial Reports* (SF-425s) that were inaccurate for federal awards received under the Staffing for Adequate Fire and Emergency Response (SAFER) program. Our review of two SF-425s submitted in fiscal year 2017 disclosed that amounts reported for “*Cash Disbursements*” and “*Federal share of expenditures*” were incorrect. Both the “*Cash Disbursements*” and the “*Federal share of expenditures*” were overstated by \$569,973 for reporting period ended December 31, 2016 and understated by \$10,801,057 for reporting period ended June 30, 2017. For the latter report, the expenditures and disbursements were not reported cumulatively since the inception of the award through the end of the reporting period. As a result, any lines on the SF-425s that were calculated using these amounts were incorrect. Funding for this program is received from the U.S. Department of Homeland Security and administered by the Federal Emergency Management Agency (FEMA).

Criteria: OMB’s Uniform Guidance, Title 2, Part 200, Subpart D, paragraph 200.302 (b)(2) specifies that the recipient must disclose accurate, current, and complete financial results. The SF-425 requires that the recipient report cumulative amounts from the date of the inception of the award through the end date of the reporting period.

Effect: The SF-425 report tracks the status of financial data for this federal award. The PFD incorrectly reported \$11,745,424 of total federal share of expenditures and cash disbursements instead of \$11,175,451 on the SF-425 report for the reporting period ended December 31, 2016. The PFD also incorrectly reported \$7,002,776 of total federal share of expenditures and cash disbursements instead of cumulatively reporting \$17,803,833 on the SF-425 report for reporting period ended June 30, 2017. Failure to properly report the accurate information on the SF-425 report leads to noncompliance with reporting requirements. Also, federal grantors may not have complete and accurate information to make fiscal decisions on future federal awards.

Cause: The PFD staff who prepared the SF-425s were not familiar with grant reporting and did not properly follow the SF-425 instructions to report the accurate and cumulative amounts. Also, the staff received little technical oversight due to abrupt staff changes.

Recommendation: The Fire Department should ensure that its staff has proper training to prepare the SF-425 report. The instructions are available on the Office of Management and Budget website.

Views of the Responsible Officials and Corrective Action Plan:

Views:

The PFD understands the finding of the Office of the Controller for the FY17 portion of its FY14 SAFER grant. The PFD agrees that cumulative amounts were not properly entered as directed in the “expenditures” and “disbursement” lines of the SF425 report. However, SF-425s were also not rejected by FEMA and released back to the PFD for correction. This grant had a two-year performance period that extended from

January 23, 2016 through January 22, 2018; however, this audit only examined the FY2017 portion, which makes it difficult for a full-analysis. Due to abrupt staff changes, there was no transitional training from the employee who was responsible at the beginning of the performance period to the employee who took over the reporting responsibility as of the second SF-425 report. Since an estimate was used for the first SF-425 report, it would follow that all subsequent SF-425 reports would also be incorrect unless the PFD was able to make an adjustment (up or down as necessary) to reconcile the first report.

While the PFD did not complete accurate SF-425 reporting, this does not directly correlate to inaccurate draw-downs (i.e. federal dollars spent). The actual drawdowns of federal funds during FY 2017 were also examined by the Office of the Controller and found to be based on actual payroll data, accurate, and matched the federal award contract. The federal funding was spent only on permitted expenditures and no inappropriate spending was found. The cost of the project exceeded the award due to regular payroll increases plus other factors, but the PFD did not charge this to the grant. The total expenditures in the city's FAMIS accounting software match the total award.

Corrective Action Plan:

The PFD has already ensured that its current staff now knows how to prepare the SF-425 report correctly. Current staff have had “after-action” discussions where they shared lessons-learned during the time this FY17 audit was being performed (mid-April 2018 through mid-October 2018). This was completed on or before October 16, 2018, when the audit was coming to a completion and/or final review. The PFD will continue to do accurate draw-downs for SAFER (as it had in the past) based on actual payroll data and it will now ensure that its SF-425 reporting correlates to its expenditures/draw-downs.

The instructions from the Office of Management and Budget website were downloaded into the PFD's grants server (on or before October 16, 2018) so that all future fiscal staff who get assigned grant reporting responsibilities will have direct and easy access to the SF-425 completion guidelines.

The PFD's fiscal unit will hold periodic (monthly or quarterly) meetings to check-in on grant reporting/spending and identify any questions/concerns. During these meetings, fiscal staff will review payroll records, FAMIS accounting records and performance reports. Any necessary expenditure transfers for ineligible expenses will be discussed, assigned and completed.

All SF-425 reports will be shared by the PFD fiscal staff member who is responsible for submission with another fiscal staff member who will perform a review of the document for checks and balances prior to submission. The periodic “check-in” meetings and report sharing will occur for the entire performance period of every future SAFER grant (typically now three years) and therefore no specific deadline for completion is available.

There will be an introductory “refresher” type of SF-425 meeting held at least one week prior to the start of the PFD's next SAFER (FY17) grant performance period (which is on or before February 18, 2019). Therefore, the PFD will hold its introduction to the SF-425 report meeting with all applicable fiscal staff by February 11, 2019. This meeting will identify the file location of the OMB SF-425 guidelines and will also review each line of instruction in the document to ensure understanding. Fiscal staff will be

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encouraged to ask questions if they are unclear on how to interpret the SF-425 guidelines. Examples of the errors that occurred in the FY14 SAFER SF-425 reports will be provided so they can be avoided in future SAFER grant reporting.

Contact Person: Natasha Nau, Assistant Deputy Commissioner for Management, Philadelphia Fire Department (215) 686-1371.

2017-016 REPORTING

Edward Byrne Memorial Competitive Grant Program - CFDA #16.751
Community Development Block Grants/ Entitlement Grants - CFDA #14.218
Block Grants for Prevention and Treatment of Substance Abuse - CFDA #93.959
Community Services Block Grant - CFDA #93.569
Emergency Solutions Grant Program - CFDA #14.231

Condition: GAAU did not accurately disclose the total payments to subrecipients in the preliminary SEFA provided for audit. Our review of records indicated that subrecipient expenditures for the major programs listed below in Table 6 were either understated, overstated, or not reported at all, which nets to \$14.7 million. GAAU concurred with our findings and corrected the amounts reported for subrecipient expenditures.

Table 6: Summary of the Largest Subrecipient Expenditure Variances by Major Program

	CFDA #	Amount Per Auditee (\$)	Amount Per Auditor (\$)	Difference Over/(Under)stated (\$)
Edward Byrne Memorial Competitive Grant Program ¹¹	16.751	0	8,610,562	(8,610,562)
Community Development Block Grants/Entitlement Grants ¹²	14.218	34,091,782	40,055,912	(5,964,130)
Block Grants for Prevention and Treatment of Substance Abuse ¹³	93.959	9,655,380	10,357,093	(701,713)
Community Services Block Grant ¹⁴	93.569	1,831,539	1,538,528	293,012
Emergency Solutions Grant Program ¹²	14.231	3,366,860	3,099,012	267,848

Source: Office of the Controller

Criteria: OMB's Uniform Guidance, Title 2, Part 200, Subpart F, paragraph .510(b)(4) requires the total amount provided to subrecipients from each federal program to be included in the SEFA.

Effect: Failure to completely and accurately report subrecipient expenditures can result in noncompliance with terms and conditions of federal awards. It could, for example, lead to the city not correctly identifying subrecipients for audits and monitoring. In addition, grantors will not have accurate information relating to the total amount of federal awards that were expended by subrecipients.

Cause: The Managing Director's Office, Department of Planning and Development, Department of Behavioral Health and Intellectual Disability Services, and Office of Community Empowerment and Opportunity and Office of Homeless Services did not provide complete and accurate subrecipient information to GAAU. The city generally uses the prefix "SBXX" in encumbrance documents to identify expenditures related to subrecipients. However, those departments were not consistently identifying encumbrances relating to subrecipients by using the proper prefix when a vendor's status was initially determined as a subrecipient.

¹¹ Funding for this program is received directly from the U.S. Department of Justice.

¹² Funding for this program is received directly from the U.S. Department of Housing & Urban Development.

¹³ Funding for this program is received as a pass through from the Pennsylvania Department of Human Services and the Pennsylvania Department of Drug and Alcohol Programs.

¹⁴ Funding for this program is received as a pass through from the Pennsylvania Department of Community and Economic Development.

Also, GAAU requests all city departments to identify subrecipient expenditures from an expenditure listing. Those departments that used a prefix other than “SBXX” did not inform GAAU the encumbrances related to subrecipients.

Recommendations: We recommend that GAAU reinforce with departments the need to provide complete and accurate information to assist in reporting the correct amount for total payments to subrecipients. Also, when departments initially determine a vendor’s status as a subrecipient, they should use encumbrances with the prefix SBXX to easily identify the subrecipient expenditures. Additionally, the departments should inform GAAU of subrecipient expenditures associated with encumbrances not denoted by the SBXX prefix.

Views of the Responsible Officials and Corrective Action Plan: We agree that it is important to accurately disclose payments to subrecipients, and GAAU will continue to work with departments to enforce its existing procedures to ensure accurate reporting. The Schedule of Federal Expenditures (SEFA) reported subrecipient spending as part of the total Federal Expenditures column but did not accurately disclose total payments to subrecipients in the Subrecipient Expenditures column because some of the responsible grantee departments failed to provide complete and accurate subrecipient information to GAAU.

The City’s Standard Accounting Procedure G 5-1 covering Subrecipient Monitoring instructs departments to use the prefix “SBXX” on encumbrance documents for subrecipients as an internal control to produce accurate financial statement reporting. For the past two years, GAAU has provided citywide training to departments on OMB’s Uniform Guidance, Title 2, Part 200, Subpart D paragraph .331 covering the responsibilities of the City as a Pass-Through entity. For Fiscal Year 2018 reporting and beyond, GAAU will also provide additional tools like customized reports from the accounting system so departments can better identify and quantify the federal subrecipients expenditures.

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