



CITY OF PHILADELPHIA

OFFICE OF THE CONTROLLER
1230 Municipal Services Building
1401 John F. Kennedy Boulevard
Philadelphia, PA 19102-1679
(215) 686-6680 FAX (215) 686-3832

REBECCA RHYNHART
City Controller

CHRISTY BRADY
Deputy City Controller

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, 2018. 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 \$882,223,277 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, 2018. 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
OFFICE OF THE CONTROLLER

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 opinion 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.

Opinion on Each Major Federal Program

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 major federal and DHS programs for the year ended June 30, 2018.

Other Matters

The results of our auditing procedures disclosed 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 2018-010, 2018-011, 2018-012, 2018-013, 2018-014, 2018-015, and 2018-016. 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

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

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 deficiency in internal control over compliance described in the accompanying Schedule of Findings and Questioned Costs as item 2018-014 to be a material weakness.

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 2018-010, 2018-011, 2018-012, 2018-013, 2018-015, and 2018-016 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.

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

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, 2018, 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 24, 2019, 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
October 31, 2019

CITY OF PHILADELPHIA

Schedule of Findings and Questioned Costs – June 30, 2018

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:

Unmodified

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>
Community Development Block Grants/Entitlement Grants	14.218
Home Investment Partnerships Program	14.239
Housing Opportunities for Persons with AIDS	14.241
Choice Neighborhoods Implementation Grants	14.889
Airport Improvement Program	20.106
Highway Planning and Construction	20.205
Immunization Cooperative Agreements	93.268
Social Services Block Grant	93.667
HIV Emergency Relief Project Grants	93.914
HIV Care Formula Grants	93.917
HIV Prevention Activities Health Department Based	93.940
National Urban Search and Rescue (US&R) Response System	97.025
Disaster Grants – Public Assistance (Presidentially Declared Disasters)	97.036
Assistance to Firefighters Grant	97.044

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, 2018***

<u>Finding No.</u>		<u>Page No.</u>	<u>Questioned Cost</u>
<u>Section II - Financial Audit Material Weaknesses:</u>			
2018-001	Inadequate Staffing Levels, Lack of Technological Investment and Insufficient Oversight Led to Undetected Material Misstatements	35-41	
2018-002	Untimely and Inaccurate Preparation of Schedule of Expenditures of Federal Awards Resulted in Late Submission of the Single Audit Reporting Package to the Federal Audit Clearinghouse	42-45	
<u>Section III - Financial Audit Significant Deficiencies:</u>			
2018-003	While Improved, Remaining Deficiencies in Treasurer's Bank Reconciliation Procedures Still Create Potential for Undetected Errors and Irregularities	47-55	
2018-004	Failure to Close Out Prior Year Grant Activity Increases Risk of Reporting Errors	56-57	
2018-005	Failure to Segregate Payroll Duties Could Allow Fraud to Occur	58-59	
2018-006	Capital Asset Control Deficiencies Increase Risk of Reporting Errors	60-62	
2018-007	Failure to Timely Transfer Funds Between City Bank Accounts Could Result in Significant Reporting Errors	63-64	
2018-008	Lax Monitoring of Adjustments to Tax Accounts May Lead to Undetected Errors or Irregularities	65-66	
2018-009	SAPs Require Updating to Ensure Accurate and Consistent Application of Accounting Rules and Regulations	67-68	
<u>Section IV – Federal and PA. Department of Human Services Findings and Questioned Costs</u>			
2018-010	Reporting – Significant Deficiency and Compliance Finding National Urban Search and Rescue (US&R) Response System – CFDA #97.025	70-71	
2018-011	Allowable Costs/Cost Principles - Significant Deficiency and Compliance Finding Disaster Grants – Public Assistance (Presidentially Declared Disasters) – CFDA #97.036	72	\$90,020
2018-012	Allowable Costs/Cost Principles - Significant Deficiency and Compliance Finding Disaster Grants – Public Assistance (Presidentially Declared Disasters) – CFDA #97.036	73	\$39,593

CITY OF PHILADELPHIA***Schedule of Findings and Questioned Costs – June 30, 2018***

<u>Finding</u> <u>No.</u>		<u>Page</u> <u>No.</u>	<u>Questioned</u> <u>Cost</u>
2018-013	Reporting - Significant Deficiency and Compliance Finding Community Development Block Grants/Entitlement Grants – CFDA #14.218 National Urban Search and Rescue (US&R) Response System – CFDA #97.025	74-75	
2018-014	Reporting – Material Weakness and Compliance Finding Highway Planning and Construction – CFDA #20.205	76	
2018-015	Reporting - Significant Deficiency and Compliance Finding Immunization Cooperative Agreements – CFDA #93.268	77	
2018-016	Subrecipient Monitoring - Significant Deficiency and Compliance Finding Social Services Block Grant – CFDA #93.667	78-79	

2018-001 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's) 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 in the Finance Office, as well as a lack of a comprehensive financial reporting system, have compromised the timely and accurate preparation of the CAFR;
- Untimely and inadequate review of Aviation Fund financial statements resulted in undetected material 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 Along with the Lack of a Comprehensive Financial Reporting System Have Contributed to Significant Financial Statement Errors

Condition: Errors totaling \$236 million were not detected by Finance Office accountants during preparation of the city's fiscal year 2018 CAFR.³

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 2018 CAFR can be relied upon for informative decision making.

Cause: Ongoing inadequate staffing, along with the lack of a comprehensive financial reporting system, have hindered the ability of the Finance Office to produce a timely and 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.

³ The \$236 million total includes the \$122.4 million of errors in the Aviation Fund financial statements discussed in more detail later in the finding.

- 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 over 28 percent (from 64 full-time employees in fiscal year 2000 to 46 in fiscal year 2018). Inadequate staff size has resulted in significant and complex parts of the CAFR, such as the preparation of the full accrual government-wide financial statements, being performed by Finance Office accounting management. These factors have 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.
- 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.

During the current audit, we observed that the Finance Office had taken steps to strengthen controls by hiring an accounting firm to help with the preparation and review of the fiscal year 2018 CAFR. Although the initial plan (as it had also been for the fiscal year 2017 CAFR) was for the accounting firm to assist with the preparation of a compilation package with detailed documentation supporting the financial statements, the Finance Office was again unable to implement that plan for the fiscal year 2018 CAFR. However, the accounting firm did assist the Finance Office with CAFR preparation and review by performing such tasks as tying FAMIS balances to CAFR exhibits and schedules, performing analytical comparisons between fiscal year 2017 and 2018 CAFR amounts, and researching the accounting treatment for a new lease agreement to determine the appropriate capital lease journal entries and footnote disclosures.

Despite the improvement noted, we still found that the Finance Office failed to detect significant errors in the CAFR submitted for audit and did not provide several significant footnotes until very late in the audit process. Examples of undetected errors included (1) a \$55.6 million understatement of General Fund cash held by fiscal agents resulting from the failure to record cash balances from the issuance of new conduit debt and (2) a \$21.5 million understatement of receivables and revenues in the Health Choices Behavioral Health Fund because of an error in the revenue accrual. Our testing also noted \$122.4 million of undetected errors in the Aviation Fund financial statements, which is discussed in more detail below. Examples of untimely provided footnotes included the disclosures for capital asset activity, lease commitments and leased assets, interfund receivables and payables, and prior period adjustments, all for which we did not receive a completed version for audit until February 11, 2019, just two weeks before we issued the audit opinion.

Recommendations: Without sufficient 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 recommend that, for the fiscal year 2019 CAFR, management follow through with its plan to use the accounting firm to assist with the preparation of a compilation package with detailed documentation supporting the CAFR. However, while we support the Finance Office's hiring of the 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: The Accounting Bureau (Accounting) is committed to continuing to produce an accurate and well-prepared CAFR and to continuously improving the City's financial reporting. As previously communicated, we believe that the loss of institutional knowledge over time had presented a challenge, as opposed to the reduction in the quantity of staff. Notwithstanding, we have actively worked with the Office of Human Resources and implemented staff retention and training strategies. Since FY15, we have worked to increase the Accounting office workforce. We added 4 employees in 2016 and we have already started the process of adding employees to the Finance Office for FY 20. We have also hired a Director of Compliance and Internal Controls, who will review the city's draft CAFR, and assess compliance with GASB to ensure financial statements are accurate and reliable. She will work with the Office of the Controller to address city-wide compliance matters. Where necessary, she will review city-wide policies, procedures and practices, identify areas of weakness, develop new procedures, and ensure all departments adhere to established policies and internal control measures.

Additionally, increased focus has been placed on training, with an emphasis on the CAFR preparation process. We continue to encourage all senior management accountants to attend the national Government Finance Officers Association (GFOA) conference so that management stays informed of current industry trends, regulatory updates, and best practices in government financial management. This year, we have added slots for 4 non-supervisory employees to attend the GFOA's Accounting Academy. Moving forward, we plan to rotate the involvement of non-supervisory staff in this academy. We will continue to look for additional effective training opportunities for our staff.

Thank you for acknowledging the improvements in our CAFR preparation and review due to the retention of an external accounting firm. We will maintain the services of an outside accounting firm to continue to assist in the CAFR compilation efforts. A new comprehensive financial reporting system would improve the CAFR preparation process, but we will need to evaluate the timing of implementation as we move forward with our planning efforts to replace FAMIS.

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. As always, Accounting will continue to critique the errors in the drafts sent to the Controller's Office and the adjustments resulting from the most recent (FY2018) CAFR audit with the entire accounting staff as a learning tool to produce improved financial statements going forward.

Auditor's Comments on Agency's Response: In its response, management states, "Since FY15, we have worked to increase the Accounting office workforce. We added 4 employees in 2016 and we have already started the process of adding employees to the Finance Office for FY20." Management's statement does not address the decrease in the total staff size of the Finance Office's accounting division from fiscal year 2016 to fiscal year 2018. As noted in our last three reports, the total staff size in the accounting division was 49 in fiscal year 2016, 47 in fiscal year 2017, and 46 in fiscal year 2018.

Management also states, “As always, Accounting will continue to critique the errors in the drafts sent to the Controller’s Office and the adjustments resulting from the most recent (FY2018) CAFR audit with the entire accounting staff as a learning tool to produce improved financial statements going forward.” We disagree with management’s use of the term “drafts” when describing the financial statements submitted to us for audit. Effective internal control requires that, before the Finance Office submits the CAFR to us for audit, accounting management should perform a review of those financial statements for accuracy and completeness. The \$236 million of CAFR errors cited in the report occurred because the city’s controls over the financial reporting process failed to prevent or detect and timely correct the misstatements. In fact, we found most of the \$236 million of CAFR errors very late in the audit process, proposing the majority of our audit adjustments within the one-month period prior to the issuance of the audit opinion.

Untimely and Inadequate Review Procedures for Aviation Fund Statements Resulted in Undetected Material Errors

Condition: The Division of Aviation’s (DOA’s) accounting management failed to detect material errors totaling \$122.4 million in the Aviation Fund financial statements submitted to the Finance Office for inclusion in the city’s fiscal year 2018 CAFR.

Criteria: The DOA’s accounting management is responsible for the preparation of the Aviation Fund financial statements and the submission of those statements to the Finance Office for inclusion in the city’s CAFR. The DOA uses a consultant to assist in preparing the Aviation Fund financial statements along with a compilation package containing detailed support for the statements. The DOA’s accounting management must ensure the accuracy of the Aviation Fund financial statements by performing a detailed review of the supporting compilation, and this review should be formally documented.

Effect: The Aviation Fund financial statements provided for audit were materially misstated, containing \$122.4 million of errors. The most significant misstatements involved:

- Calculation errors in the Statement of Cash Flows which caused a \$66.1 million overstatement of cash flows from operating activities and a corresponding \$66.1 million understatement of cash flows from capital and related financing activities.
- Several erroneous accounting entries which incorrectly recorded a total of \$44.2 million as adjustments of current year revenues and expenses instead of reporting them as prior period adjustments to beginning net position.
- Errors in the computation of accrued interest payable which understated the reported accrued expenses liability by \$9.8 million.

We proposed adjustments to correct these errors, and the Finance Office booked most of them. We, therefore, were able to issue an unmodified audit opinion on the Aviation Fund financial statements.

Cause: We observed a checklist for the review of the compilation, signed off by a DOA accounting manager. However, this review did not appear to have been adequately performed given the material amount

of undetected errors noted by our audit testing. Also, the DOA provided no documentation to indicate that the compilation was subjected to any additional levels of management review beyond that of the accounting manager. Furthermore, the checklist did not contain an assertion by management that the statements had been reviewed and approved, and that, to the best of management's knowledge, they were complete and accurate. We have observed that the Philadelphia Water Department's (PWD's) financial statement review checklist includes such an assertion. Lastly, we observed that the checklist did not contain any procedures for the review of the Statement of Cash Flows, where our testing noted material errors as discussed above.

Additionally, the compilation and the review checklist were completed very late, with the DOA not submitting them to the Finance Office until December 26, 2018. An earlier deadline for completion of the compilation and checklist may have allowed DOA management time to more thoroughly review the compilation and detect the errors.

Recommendations: To improve the accuracy of the Aviation Fund financial statements, we recommend that DOA management:

- Improve its financial statement review process by requiring that, in addition to the accounting manager's review, a higher-level management official review the compilation.
- Revise the review checklist to include documentation of the additional management review and an assertion by management that the statements have been reviewed and approved, and that, to the best of management's knowledge, they are complete and accurate. Also, procedures to determine the accuracy of the Statement of Cash Flows should be added to the checklist.
- Work with the Finance Office to establish an earlier deadline for the completion of the compilation and review checklist.

Views of the Responsible Officials: Thank you for noting the correction of all errors, and our receipt of an unqualified opinion, which demonstrates no material errors existed in our final reports. We agree with your recommendations for enhancements to the compilation and review process and will incorporate the recommended levels and scope of review as set forth above. The Division of Aviation will also work with the Finance Office to accelerate the deadline for completion of the compilation and review process so that an earlier timeline is in effect for Fiscal year 2019.

Auditor's Comments on Agency's Response: With regard to the errors that we found in the Aviation Fund financial statements submitted for inclusion in the city's fiscal year 2018 CAFR, management asserts in its response, "Thank you for noting the correction of all errors, and our receipt of an unqualified opinion, which demonstrates no material errors existed in our final reports." Management is inaccurate in its assertion that all errors found in the Aviation Fund financial statements were corrected. As stated in the report, we proposed adjustments to correct the errors noted by us, and the Finance Office booked most of them. In fact, the Finance Office booked adjustments for \$120.1 million of the \$122.4 million in errors found by us.

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

Condition: Previously, we recommended that the Finance Office strive to more timely complete its evaluation of potential component units (PCUs) and its requests for financial statements for those entities determined to be component units. The current audit noted that Finance Office accountants performed the PCU evaluation process in a timelier manner, sending out PCU questionnaires by July 12, 2018 and receiving all completed questionnaires by August 31, 2018. In the prior year, the Finance Office did not timely determine that the Philadelphia Housing Authority (PHA) was a component unit and consequently requested its financial statements very late. For the current year, Finance Office accountants sent the request for PHA's statements much earlier (March 28, 2018) so that PHA, whose fiscal year-end is March 31st, had adequate notice of the city's reporting requirements. The Finance Office requested all other component units' financial reports by September 7, 2018. Based on the improvement noted, we consider this condition resolved.

Despite the above noted improvement, 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, six 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 Philadelphia Redevelopment Authority (PRA), the School District of Philadelphia, and Philadelphia Municipal Authority (PMA). These three agencies submitted their reports very late (February 12, 2019 for PRA and the School District and February 13, 2019 for PMA), 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 25, 2019.

Table 1: Late Submission of Component Unit Financial Reports

COMPONENT UNIT	<u>DUE DATE</u>	<u>DATE RECEIVED</u>	<u>DAYS LATE</u>
Philadelphia Authority for Industrial Development	10/1/2018	11/13/2018	43
Philadelphia Gas Works	12/31/2018	1/7/2019	7
Philadelphia Municipal Authority	10/1/2018	2/13/2019	135
Philadelphia Parking Authority	10/1/2018	11/27/2018	57
Philadelphia Redevelopment Authority	10/1/2018	2/12/2019	134
School District of Philadelphia	11/1/2018	2/12/2019	103

Note: Community Behavioral Health, Community College of Philadelphia, Philadelphia Housing Authority, and Pennsylvania Intergovernmental Cooperation Authority submitted their financial reports timely.

Source: Prepared by the Office of the City Controller

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 chances for errors or omissions, as Finance Office accountants become limited in the amount of time available to adequately review the reports. The risk of error also increases as accountants must make significant changes to the financial statements and footnote disclosures each time a component unit's financial information is added to the report. Additionally, each series of changes requires considerable audit time to ensure that accountants have correctly changed previous amounts and footnotes presented for audit. During the current year audit, we identified, and the Finance Office corrected, a misclassification error relating to the component units totaling \$147.4 million.⁴

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.

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

Views of the Responsible Officials: Thank you for acknowledging the improvements in the evaluation of potential component units, the timely issuance and receipt of all PCU questionnaires, and the timely submission of requests for Financial Statements and other data. We are happy you noted this condition as resolved. We agree that the timely submission of all component unit reports is critical to the timely issuance and accuracy of the City's CAFR. We will continue to meet with management and auditors of various component units concerning timely submission of financial reports, as well as have additional meetings to provide guidance and assist with problems in component units that experience issues that delay the preparation of their financial reports. Accounting has initiated a process for fiscal year 2019 that will entail sending initial requests for component unit financial statements and data in as early as May for all entities with March 31 FYE, with required responses no later than June 30. Requests for all other Component Units will be sent out by end of June, with responses required by August 31. Follow-up requests will be sent out to component units, with an emphasis on the importance of timely submission of financial data highlighted in all communications. As appropriate, Accounting will continue to reach out to key Administration officials to secure the cooperation of component unit management on this matter.

⁴ This \$147.4 million error was a misclassification between liability categories and had no effect on net position. It was not included in the \$236 million error total discussed earlier in the finding.

2018-002 UNTIMELY AND INACCURATE PREPARATION OF SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS RESULTED IN LATE SUBMISSION OF THE SINGLE AUDIT REPORTING PACKAGE TO THE FEDERAL AUDIT CLEARINGHOUSE

Condition: Because the city expends more than \$750,000 of federal awards, Office of Management and Budget's (OMB) Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards (Uniform Guidance) requires a single audit of grant activities to be performed each year. The Finance Office's Grants Accounting and Administrative Unit (GAAU) is responsible for preparing the Schedule of Expenditures of Federal Awards (SEFA). GAAU personnel employ a manual process to enter grant expenditures from the city's accounting system into the SEFA through a fund schedule, which is adjusted based on mandatory grant reconciliations provided by the city departments responsible for grants (departments). For fiscal year ending June 30, 2018, a preliminary SEFA was not prepared and provided for audit until March 18th of the following calendar year, which was 13 days prior to the required deadline of March 31st, to submit the reporting package.

Also, for the past several years, we have reported that GAAU has provided an inaccurate SEFA for audit. In the preliminary fiscal year 2018 SEFA submitted for audit, we again observed the following errors made by GAAU and the Philadelphia Department of Human Services (DHS) concerning the Children and Youth Program:

- Total expenditures for Stephanie Tubbs Jones Child Welfare Services Program, Catalog of Federal Domestic Assistance (CFDA) #93.645 - Title IV-B were not reported. This error was discovered during the auditor's review of the grant reconciliations and the Act 148 invoice, which were prepared by DHS.
- As reported in the prior year, the Temporary Assistance for Needy Families (TANF), CFDA #93.558 – Title IV, Part A program reported expenditures for the fiscal year 2017 award which, when totaled from prior year SEFAs through the current year, exceeded the award amount.

However, the total expenditures for TANF, CFDA #93.558 – Title IV, Part A program which were significantly understated in fiscal year 2017 were materially correct for fiscal year 2018.

Additionally, the preliminary SEFA did not include the required amount provided to subrecipients from each federal program. Since the preliminary SEFA had no subrecipient information, we were not able to follow up on the prior year finding #2017-012 *Weaknesses in Controls Led to Inaccurate Subrecipient Expenditure Amounts Reported on the Schedule of Expenditures of Federal Awards* included in Section II of the Schedule of Findings and Questioned Costs reported in the fiscal year 2017 Schedule of Financial Assistance.

Criteria: OMB's Uniform Guidance, Title 2, Part 200, Subpart F Audit Requirements, paragraph .512 requires the single audit to be completed and the data collection form and reporting package to be submitted within the earlier of 30 calendar days after receipt of the auditor's report(s), or nine months after the end of the audit period.

OMB Uniform Guidance sets forth the city's grant responsibilities, which include maintaining an accurate

record of all federal awards received, expended, and identified by the federal program under which grant amounts were received.

In addition, 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: GAAU's untimely and inaccurate preparation and submission of the SEFA, as well as the missing subrecipient information, caused delays in planning the audit and subsequent testing of the SEFA and major programs. As a result, the city did not submit a Single Audit reporting package to the Federal Audit Clearinghouse by the federally required deadline. Non-compliance with the reporting requirements is a violation of federal grant terms and conditions. The city's continued failure to meet this filing requirement could affect future federal funding.

Cause: GAAU uses reconciliations of expenditures recorded in the city's FAMIS accounting system and amounts reported to grantor agencies, prepared by various departments, to verify the accuracy of the SEFA and make necessary adjustments. For fiscal year 2018, GAAU sent requests for these reconciliations in November 2018 – two months earlier than the prior year. However, a second request was not sent to departments who failed to submit those reconciliations by the due date of December 14, 2018, until February 28th of the following year.

With regards to the errors noted on the preliminary SEFA submitted for audit, our observations suggest that GAAU failed to include total expenditures for the Title IV-B program in the draft SEFA due to DHS not providing complete and accurate grant reconciliations in a timely manner. The Title IV-B reconciliation was not prepared. In addition, the state reconciliation which included federal amounts due to comingled expenditures did not agree to the Act 148 invoice or contain a reconciling line for Title IV-B expenditures.

Recommendations: We recommend that GAAU allocate adequate resources to ensure timely preparation and submission of the SEFA for audit purposes. We also recommend the proactive enforcement of the existing policies and procedures requiring departments to complete the FAMIS expenditure reconciliations by the due date, including a more timely follow up request for unsubmitted reconciliations.

Views of the Responsible Officials: Finance recognizes the importance of submitting a timely and accurate federal awards and major programs schedule (SEFA) to our auditors. More importantly, there is a crucial need for the timely completion of our audits, and the timely submission of an accurate Single Audit Reporting pack to the Federal Audit Clearing House to prevent a violation of federal grant terms and conditions and to prevent the elimination of federal funding for the City's grants and programs.

Several factors contributed to the delay in preparation of the FY 2018 SEFA. The most notable factor was the delay in the completion of the FY2017 Single Audit report. GAAU staff were engaged in evidence gathering activities to close out the FY 2017 Single Audit up until January 2019, which meant that there was limited ability to devote all resources toward the completion of the 2018 SEFA.

The GAAU staff undergo a meticulous process involving numerous departments and requiring multiple follow-ups to produce a complete and accurate SEFA. Our department has taken steps and continues to

explore additional ways to provide a completed SEFA to our auditors in a timelier fashion. You are aware of our communications sent to departments during February 2019, emphasizing the need for departments to provide complete and accurate subrecipient data. We have also strengthened our controls around the accuracy of the preliminary SEFA and implemented new reconciliation procedures, including the receipt of a confirmation from the Commonwealth of Pennsylvania on pass-through grant funding to reconcile against the preliminary SEFA data. To accelerate the department's responses, we created a new schedule, detailing department spending balances in our accounting records, and requiring prompt responses to identify variances. We will continue to communicate the importance of providing complete and accurate information to the departments and we will emphasize the need to provide timely data. GAAU has emphasized the need for timely review and follow up with departments internally.

Another step to accelerate audit completion, if accepted by the Controller's Office, would involve providing a SEFA Version A in the SEFA format to our audit team in early November. This will contain preliminary subrecipient spending data. This subrecipient data will be expected to change for certain key departments and other one-off departments, including DHS, when revisions are made. The audit team would rely on this schedule to perform most of their testing, with the expectation that follow-up testing would be required for some selections. Finance will continue to work with DHS and all departments so that we obtain accurate and timely FAMIS reconciliations and subrecipient expenditure data, so that the audit can be completed ahead of schedule. We met with the HHS Cabinet members on May 30, 2019, including representatives from DHS, DBHIDs, Health, OSH, and HHS Contracts Audit staff, and discussed possible solutions and collaboration to obtain timely audit reports from subrecipients and to accelerate submission of FAMIS reconciliations.

In exploring other ways to accelerate our audits, we discussed with the auditors of major cities, (including Los Angeles and Chicago,) best practices for a smooth and timely audit. Some recommended practices that would be extremely helpful to the process would include 1) The provision of a "provided by client list" with a schedule of all required support for the audit with target due dates and dates of receipt from Finance for tracking purposes 2) The establishment of multiple planning meetings, to iron out expectations for all parties 3) Weekly audit status update meetings to identify any constraints and to monitor audit progress 4) The completion of audit testing for the CAFR and Single Audit at the same time and 5) The acceleration of the audit testing timeline, including cross-cutting procedures, where applicable, to ensure that the audits are completed in an accelerated timeline and reporting packages are submitted ahead of time.

Auditor's Comments on Agency's Response: In its response, management suggests, "Another step to accelerate audit completion, if accepted by the Controller's Office, would involve providing a SEFA Version A in the SEFA format to our audit team in early November. This will contain preliminary subrecipient spending data. This subrecipient data will be expected to change for certain key departments and other one-off departments, including DHS, when revisions are made. The audit team would rely on this schedule to perform most of their testing, with the expectation that follow-up testing would be required for some selections."

For Single Audit purposes, the SEFA serves as the primary basis for the auditor's major program determination. If the SEFA includes errors or is subject to change, it could result in inefficiencies, duplicate audit effort, the potential for audit reinstatement, and/or additional audit costs.

Rather than request the auditor to accept a preliminary document for audit that is subject to change, Finance should focus on our recommendations to allocate adequate resources to ensure timely preparation and submission of an accurate SEFA. This includes proactively enforcing their existing policies and procedures requiring departments to complete the FAMIS expenditure reconciliations by the due date and reinforce with departments the need to provide complete, accurate and timely subrecipient information.

2018-003 WHILE IMPROVED, REMAINING DEFICIENCIES IN TREASURER'S BANK RECONCILIATION PROCEDURES STILL CREATE POTENTIAL FOR UNDETECTED 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. Previously, we reported that the Treasurer did not properly reconcile the city's primary depository account (i.e. consolidated cash account) during fiscal years 2015 through 2017, and the Treasurer had not reconciled six of its accounts for several years. Our current year review found that, while the Treasurer's efforts to correct these conditions resulted in considerable improvement, some deficiencies still remained in the Treasurer's bank reconciliation process. Specifically, with regard to the reconciliation of the consolidated cash account, there remained an unreconciled difference for fiscal years 2015 through 2017 as well as the need to formalize reconciliation procedures. Additionally, while the Treasurer asserted that the six unreconciled accounts were now fully reconciled, for four of the six accounts, the Treasurer was unable to provide bank reconciliations that covered a large portion of the unreconciled period. These remaining deficiencies, which collectively we consider to be a significant deficiency, still created the potential for undetected errors and irregularities. Each of these conditions is discussed in more detail below.

While Reconciliation of Consolidated Cash Account Has Improved, There Remains a \$529,000 Unreconciled Variance and Need for Formal Reconciliation Procedures

Condition: In the last three reports, we noted that the Treasurer had not properly reconciled the consolidated cash account during fiscal years 2015 through 2017, with differences between book and bank activity not readily identified or investigated and no comparison of reported revenue collections to bank deposits. The prior audit disclosed that, starting with the June 2017 activity, the Treasurer began reconciling book and bank activity, comparing reported collections to bank deposits, preparing a detailed list of reconciling items, and sending this list to city departments for investigation. However, for activity prior to June 2017, there was an unknown variance of \$33.3 million, where book activity exceeded bank activity.

Our current audit found that the Treasurer made considerable efforts to correct this condition. In January 2018, the Treasurer hired an accounting supervisor whose main responsibility was reconciling the consolidated cash account. We observed that all fiscal year 2018 reconciliations for the consolidated cash account were prepared and reviewed in a timely manner, with the June 2018 reconciliation completed and reviewed by early August 2018. Also, we noted that the reconciliations included a detailed list of the items making up the difference between the book and bank balance, and the Treasurer continued its practice of sending the monthly list of reconciling items to city departments for their assistance with investigating the items. Based upon the improvement noted, we consider these conditions resolved. However, the current review noted that the Treasurer had not yet formalized in writing its reconciliation procedures for the consolidated cash account.

As for the \$33.3 million unknown variance, the Treasurer hired an accounting firm to assist with this issue. The accounting firm performed a reconciliation of consolidated cash account activity for fiscal years 2015 through 2017, performing a match of bank deposits and disbursements to the book activity per the city's

CITY OF PHILADELPHIA

Financial Audit Significant Deficiencies – June 30, 2018

FAMIS accounting system. When the firm completed its review and issued its report in January 2019, most of the \$33.3 million difference had been identified, with the unknown variance down to \$529,000, where book activity still exceeded bank activity. While the firm noted no remaining unmatched disbursements, there were still some bank receipt transactions that could not be matched to FAMIS – seven deposits totaling \$2.2 million and 15 wire transfers from other city bank accounts totaling \$11.3 million, which the Treasurer asserted were valid transactions due to their internal nature. The Treasurer noted that, as it investigates these unmatched receipt transactions, the amount of the variance will continue to fluctuate.

In a related matter, we followed up on the status of the ongoing problems with reconciling revenue activity for the Department of Public Health (DPH), as last year's report noted there were variances between the DPH's recorded collections and the amounts transferred daily to the consolidated cash account from the DPH's separate bank account. The June 2018 consolidated cash bank reconciliation showed a \$435,000 variance between DPH's recorded collections and actual transfers from DPH's bank account. The Treasurer informed us that they began working with the DPH to develop a revised process for handling the DPH's revenue receipts and plan to finalize and implement the revised process by the end of fiscal year 2019.

Criteria: Standard Accounting Procedure (SAP) No. 7.1.3.b, *Reconciliation of All Bank Accounts in All City Agencies*, 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.

Effect: With a remaining unknown variance of \$529,000 which could fluctuate as the remaining unmatched transactions are investigated, there is still the possibility that errors and irregularities may have gone undetected. Failure to develop formal written policies and procedures increases the risk that critical control activities may be inconsistently applied or not applied at all and thus creates the potential for errors.

Cause: Treasurer management indicated that a formal reconciliation procedure for the consolidated cash account was not developed because of accounting personnel turnover, with a deputy treasurer leaving in May 2018. With regard to developing a revised process for DPH revenue receipts, Treasurer management indicated that the process was not finalized because of the focus on cleaning up the unreconciled accounts.

Recommendations: To further improve the reconciliation process for the consolidated cash account, we recommend Treasurer management:

- Formalize the reconciliation procedures for the consolidated cash account in writing to ensure that they are consistently performed and documented. Management should formally establish a timeline for the completion of these procedures.
- Move forward with investigating the remaining \$529,000 unknown variance and unmatched receipt transactions related to consolidated cash account activity for fiscal year 2017 and prior. Any errors or improprieties discovered by this investigation should be addressed accordingly. Management should formally establish a time frame for the investigation's completion.

- Continue with the plan to develop a revised process for handling DPH revenue receipts in order to eliminate the problems with reconciling the DPH's recorded collections to bank transfers.

Views of the Responsible Officials: Thank you for acknowledging the timely reconciliation of the consolidated cash account for fiscal year 2018, and the implementation of a standard practice of sending a monthly list of reconciling items to city departments for investigation. Thank you for confirming this finding as resolved for the current year.

The amount of the consolidated cash variance will fluctuate up and down as the identification of bank deposits that have been deposited in the bank and not yet validated in FAMIS, as well as, transactions validated in FAMIS and not yet deposited into the bank continues. As CTO continues to work on reconciling these items it is anticipated that the resulting treatment of any remaining variance will be determined by the City.

The CTO agrees that it is essential to have a formal policies and procedures manual to both (a) ensure uniformity in procedures department-wide, and (b) ensure continuity and smooth transition of duties and responsibilities across multiple administrations and when there is employee turnover. CTO will have a formal policies and procedures manual implemented by July 2019, including standardizing the bank reconciliation. CTO has already begun to cross-train employees for the various accounting responsibilities to ensure that vacation or other leave, or job vacancies, do not result in a delay or stoppage in work product.

We began the process of working with the Department of Health (DPH) to develop a revised process for handling DPH's revenue receipts. However, the process is not finalized because of the CTO's focus on cleaning up the unreconciled accounts. CTO plans to re-engage DPH to finalize the process that will allow the CTO to reconcile and report DPH revenues with full transparency and allow easy identification of reconciling issues in the consolidated cash account. We plan to have this process fully implemented by the end of the fiscal year.

Auditor's Comments on Agency's Response: In its response, management states the following: "The amount of the consolidated cash variance will fluctuate up and down as the identification of bank deposits that have been deposited in the bank and not yet validated in FAMIS, as well as, transactions validated in FAMIS and not yet deposited into the bank continues. As CTO continues to work on reconciling these items it is anticipated that the resulting treatment of any remaining variance will be determined by the city."

In the report, we discussed the results of the outside accounting firm's review of the unreconciled consolidated cash account variance and noted that there was still \$13.5 million of bank receipt transactions that could not be matched to the city's FAMIS accounting system (seven deposits totaling \$2.2 million and 15 wire transfers from other city bank accounts totaling \$11.3 million). At the May 15, 2019 exit conference, we inquired about the status of the CTO's investigation of the \$13.5 million of unmatched bank receipt transactions. CTO management asserted to us that they had now matched and closed out the \$13.5 million of receipt transactions, and there was no resulting effect on the consolidated cash account variance, which remained at \$529,000. As part of the audit of the city's fiscal year 2019

financial statements, we will follow up on this matter and request supporting documentation to verify the CTO's assertion.

Failure to Review Prior Year Activity for Certain Long Unreconciled Accounts Could Allow Errors or Irregularities to Remain Undetected

Condition: In the prior audit, we reported that the Treasurer had not reconciled six city checking accounts for several years. The current audit noted that the Treasurer made considerable efforts to bring these accounts' reconciliations up to date. However, while the Treasurer asserted that all six accounts were now fully reconciled, for four of the six accounts⁵ the Treasurer was unable to provide bank reconciliations for all of the unreconciled months, as detailed in Table 2 below. Therefore, for the months where bank reconciliations were not provided, there was no documented evidence that a detailed review of account activity for those months was performed to identify errors or unusual transactions that required further investigation. We did note that, for the Payroll and General Disbursement Accounts, the bank generated a report listing unpaid checks, the dates for which ranged back to the periods with no available reconciliations. While the bank's unpaid checks report allowed the Treasurer to identify and transfer unclaimed payroll checks to the city's Unclaimed Monies Fund (as discussed below), the report did not represent a complete review of transactions for the unreconciled months.

Table 2: Unavailable Reconciliations for Long Unreconciled Accounts

Name of Bank Account	Month Last Reconciled Per Prior Report	Months for Which Bank Reconciliations Were Provided (through June 2018)	Months for Which Bank Reconciliations Were Not Provided (through June 2018)
Payroll Account (at Wells Fargo Bank) †	September 2010	July 2016 through June 2017 May 2018 *	October 2010 through June 2016 July 2017 through April 2018 *
Supplemental Payroll Account (at Wells Fargo Bank) †	September 2010	July 2014 through March 2018 **	October 2010 through June 2014
General Disbursement Account	January 2012	January 2013 through June 2018	February 2012 through December 2012
Levy Account	June 2014	July 2016 through June 2018	July 2014 through June 2016

† 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.

* Treasurer management informed us that, since the Payroll Account at Wells Fargo Bank was not used after June 2017, they did not prepare monthly reconciliations for the period of July 2017 through April 2018. Upon the account's closure, the Treasurer prepared a final reconciliation for May 2018.

** The Supplemental Payroll Account at Wells Fargo Bank closed in March 2018.

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

⁵ For the other two unreconciled accounts (the Bank of America Pension Payroll Account and Pension Payroll Deduction Account), the Treasurer provided bank reconciliations that covered the unreconciled period.

CITY OF PHILADELPHIA

Financial Audit Significant Deficiencies – June 30, 2018

A resulting condition from the Treasurer's failure to reconcile these accounts for several years was noncompliance with Pennsylvania's Disposition of Abandoned and Unclaimed Property Act (escheat act). In February 2019, the Treasurer transferred \$894,612 of unclaimed payroll checks from the closed Wells Fargo Payroll Account into the city's Unclaimed Monies Fund. \$825,638 of the amount transferred related to unclaimed payroll checks from calendar years 2010 through 2016 that should already have been escheated to the state, and the other \$68,974 pertained to outstanding payroll checks from calendar year 2017. With regard to the General Disbursement Account, the January 2019 unpaid checks report from the bank showed \$6.7 million of outstanding vendor checks for calendar years 1999 through 2015 – years for which the unclaimed funds should have been escheated to the state. However, we observed that the bank's unpaid checks report erroneously included a \$2.4 million vendor check from 2005, which the city's FAMIS accounting system listed as voided.

As of March 2019, none of the unclaimed payroll or vendor checks had been escheated to the state. According to our inquiry of the Finance Office accounting supervisor who oversees the city's Unclaimed Monies Fund, the unclaimed payroll checks will most likely be escheated to the state by April 2019.

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: With no documented evidence that the activity for all prior year unreconciled months has been subjected to a detailed review, a risk still exists that errors and/or irregularities occurred in the four unreconciled checking accounts and remain undetected. Also, noncompliance with the Pennsylvania escheat act may subject the city to penalties.

Cause: Treasurer personnel informed us that they were unable to prepare the four accounts' bank reconciliations for the months listed in Table 2 above because either the bank and/or the supporting city records for those months were not available to enable preparation of the reconciliations.

Recommendations: For the four unreconciled checking accounts, we recommend that Treasurer management request the assistance of the bank and Finance Office management to retrieve the bank and city supporting records needed to complete the reconciliations. When the missing records are located, Treasurer personnel should prepare the remaining reconciliations, and review account activity for errors and unusual activity.

In addition, Treasurer and Finance Office management should work together to ensure that all escheatable amounts are sent to the Pennsylvania Treasury. When determining the escheatable amount from the General Disbursement Account, the Treasurer should perform a detailed review of the bank's unpaid checks report to

CITY OF PHILADELPHIA

Financial Audit Significant Deficiencies – June 30, 2018

identify erroneous checks that should be excluded. 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: The City Treasurer Office ("CTO") is pleased to note that there are no noted bank reconciliation deficiencies for the audit period FY 2018, which this report covers. For the FY 2015-2017 reconciliations, CTO met with members of the Controller's audit team on multiple occasions to discuss CTO's approach, and to gain the audit team's insight on reconciling the prior years' unreconciled accounts. During these meetings, CTO explained our process for reconciliation in detail, answered all questions and provided the audit team with copies of all our documentation. In addition, the CTO Staff Accountant responsible for reconciling these accounts sat with an audit staff member from the Controller's Office and walked him through the reconciliation process. CTO finalized its approach after obtaining feedback from the Controller's audit team. As such, CTO considers the aforementioned accounts to be reconciled. See below for further details on process used to reconcile accounts in question (Levy account, etc.).

The City Treasurer Office ("CTO") acknowledges the successful reconciliation of two of the city bank accounts referenced above. For the remaining 4 accounts, the CTO communicated that there was little to no electronic and hard copy records. For these accounts, aggregate reconciliations were performed, and the procedures utilized were documented and conveyed to the auditors. The following three accounts were successfully reconciled using established procedures:

Payroll and Supplemental Payroll (Sept 2010 – June 2014) – In July of 2017, Payroll and Supplemental Payroll were moved from Wells Fargo Bank to Citizens Bank. By March 2018, all unreconciled items in the Wells Fargo Account were researched and reconciled collectively so the account could be closed. While there are no individual monthly bank reconciliations for fiscal years 2011, 2012, 2013 & 2014, the Supplemental Payroll and the Payroll accounts are fully reconciled. This information was sent to the Controller's Office.

General Disbursement (Jan--Dec 2012) – When the current treasury accounting team was asked to reconcile activity for these previous years, they discovered that there were no records available prior to January 2013 in the CTO archives (electronic or hard copy). After extensive conversations with Wells Fargo Bank, they confirmed that they are unable to assist as 2012 bank statements were no longer available. Since the General Disbursement Account is funded by the Wells Fargo Funding Account, the accounting team used the Wells Fargo Funding Account (1608) and reconciled each individual funding transaction from the Funding Account to the General Disbursement Account to obtain a valid starting balance. With a valid January 2013 starting balance and an Outstanding Check List from the bank, the treasury accounting team was able to reconcile 2013 to present, cleaning up any variances in calendar year 2012.

Levy (July 2014 - June 2016) – There were no Levy Account records available for fiscal years 2015 and 2016. Therefore, the treasury accounting team started with the last completed reconciliation for the Levy Account (June 2014). Then, working with PNC Bank to obtain prior year bank statements and searching transactions in FAMIS; the treasury accounting team was able to reconcile this account "en-masse" closing

out variances during this time period while doing the monthly reconciliations beginning July 2016. Although there are no individual monthly bank reconciliations for fiscal years 2015 and 2016 the Levy account activity is fully reconciled.

Finance has entered into a Voluntary Disclosure Agreement with Pennsylvania Treasury to escheat all outstanding unclaimed funds in 2019. Revenue and CTO have also developed annual review and notification procedures to stay in compliance with City's Standard Accounting Procedures for Uncashed/Unclaimed funds going forward.

Auditor's Comments on Agency's Response: In its response, management asserts, "For the FY 2015-2017 reconciliations, CTO (City Treasurer's Office) met with members of the Controller's audit team on multiple occasions to discuss CTO's approach, and to gain the audit team's insight on reconciling the prior years' unreconciled accounts. During these meetings, CTO explained our process for reconciliation in detail, answered all questions and provided the audit team with copies of all our documentation. In addition, the CTO Staff Accountant responsible for reconciling these accounts sat with an audit staff member from the Controller's Office and walked him through the reconciliation process. CTO finalized its approach after obtaining feedback from the Controller's audit team. As such, CTO considers the aforementioned accounts to be reconciled."

At no time in our interactions with the CTO staff during the audit did we offer insight or feedback on the procedures the Treasurer should employ in reconciling the six long unreconciled accounts. In December 2018, on the city's Reconciliation Task Force⁶ website, there was a statement that all but one of the Treasurer's 77 bank accounts were now fully reconciled. On January 25, 2019, the CTO provided an update for the six long unreconciled accounts and stated that all of those accounts were now fully reconciled, except for the General Disbursement Account, the reconciliations for which were expected to be completed shortly thereafter. Therefore, on February 7, 2019, for each of those six accounts, we then requested from the CTO all bank reconciliations covering the time period from June 2017 back to the earliest outstanding month for each account. From that initial request date of February 7, 2019 until April 5, 2019, we sent several follow-up requests and met with CTO staff at various times for the sole purpose of determining and obtaining all available documentation to support the CTO's assertion that the six long unreconciled accounts were now fully reconciled.

For the Payroll, Supplemental Payroll, General Disbursement, and Levy Accounts, the CTO did not provide us with sufficient, documented evidence that they had performed bank reconciliations for all of the unreconciled months, as shown in Table 2 in the report. Therefore, we disagree with management's assertion that these four accounts have been fully reconciled.

With regard to management's statements on the documentation provided by the CTO for these four accounts, we have the following comments:

⁶ The city's Reconciliation Task Force was established in June 2018 to oversee the reconciliation of city cash accounts.

Payroll and Supplemental Payroll Accounts (Well Fargo Bank)

In its response, management states, “By March 2018, all unreconciled items in the Wells Fargo Account were researched and reconciled collectively so the account could be closed. While there are no individual monthly bank reconciliations for fiscal years 2011, 2012, 2013, & 2014, the Supplemental Payroll and the Payroll accounts are fully reconciled. This information was sent to the Controller’s Office.”

For the Payroll Account, management’s statement regarding the fiscal years for which there were no monthly bank reconciliations was inaccurate. As noted in the report, for the Payroll Account, which was last reconciled in September 2010, the CTO was unable to provide monthly bank reconciliations for fiscal years 2011 (from October 2010 forward), 2012, 2013, 2014, 2015, and 2016. CTO management indicated to us that the bank and/or supporting city records were not available for those fiscal years to enable preparation of the monthly reconciliations. The only monthly bank reconciliations provided to us covered fiscal year 2017 and May 2018. CTO management informed us that monthly reconciliations were not performed for July 2017 through April 2018 since the account was no longer used after June 2017.

As stated in the report, we did observe that the bank generated a report for the Payroll Account that listed unpaid checks, the dates for which ranged back to the periods with no available reconciliations. While the bank’s unpaid checks report allowed the CTO to identify and transfer unclaimed payroll checks to the city’s Unclaimed Monies Fund, the report did not enable a complete review of the transactions posted to the Payroll Account for the unreconciled months in order to ascertain whether there were any errors or irregularities in account activity.

As noted in the report, with regard to the Supplemental Payroll Account, which was last reconciled in September 2010, the Treasurer only provided monthly reconciliations for the period of July 2014 through March 2018 when the account closed. On April 3, 2019, we did meet with CTO management and the staff accountant who prepared the account’s reconciliations to obtain any available documentation for reconciliation of the account prior to July 2014. The only documentation that the CTO provided to us for months prior to July 2014 was an Excel file, which the staff accountant indicated was inherited from a previous CTO employee. While this Excel file contained a schedule of outstanding checks dated prior to July 2014, the schedule only listed outstanding check information for 15 of the 45 months in the period from October 2010 through June 2014. The CTO provided no other documentation to show us that there was a detailed review of account activity for the period of October 2010 through June 2014.

General Disbursement Account

In its response, management states, “When the current treasury accounting team was asked to reconcile activity for these previous years, they discovered that there were no records available prior to January 2013 in the CTO archives (electronic or hard copy). After extensive conversations with Wells Fargo Bank, they confirmed that they are unable to assist as 2012 bank statements were no

longer available. Since the General Disbursement Account is funded by the Wells Fargo Funding Account, the accounting team used the Wells Fargo Funding Account (1608) and reconciled each individual funding transaction from the Funding Account to the General Disbursement Account to obtain a valid starting balance. With a valid January 2013 starting balance and an Outstanding Check List from the bank, the treasury accounting team was able to reconcile 2013 to present, cleaning up any variances in calendar year 2012.”

As stated in the report, for the General Disbursement Account, which was last reconciled in January 2012, the CTO did not provide bank reconciliations for the months of February 2012 through December 2012. In early April 2019, we requested and obtained the CTO’s analysis of funding transactions from the Funding Account to the General Disbursement Account. Per the documentation provided to us by CTO, this analysis was performed only for the months of November and December 2012 and represented only a reconciliation of the transfers of funds between the two accounts and the General Disbursement Account’s resulting share of the Funding Account’s balance. The funding transactions analysis was not a detailed review of all activity in the General Disbursement Account for the months of February 2012 through December 2012. While, as noted in the report, the bank generated a report of unpaid checks, the dates for which ranged back to calendar 2012, this report did not enable a complete review of the transactions posted to the General Disbursement Account for the unreconciled months in order to ascertain whether there were any errors or irregularities in account activity.

Levy Account

In its response, management states the following: “There were no Levy Account records available for fiscal years 2015 and 2016. Therefore, the treasury accounting team started with the last completed reconciliation for the Levy Account (June 2014). Then, working with PNC Bank to obtain prior year bank statements and searching transactions in FAMIS; the treasury accounting team was able to reconcile this account “en-masse” closing out variances during this time period while doing the monthly reconciliations beginning July 2016. Although there are no individual monthly bank reconciliations for fiscal years 2015 and 2016 the Levy account activity is fully reconciled.”

In response to our follow-up request for the fiscal year 2015 and 2016 Levy Account reconciliations, CTO management asserted to us in a March 27, 2019 e-mail that there was an “en-masse” reconciliation for the Levy Account covering that time period. On March 28, 2019, we requested this “en-masse” reconciliation from the CTO. Later that same day, CTO management responded back by sending us the June 2014, July 2016, and August 2016 bank reconciliations for the Levy Account and instructing us to note the decrease in outstanding reconciling items when comparing the June 2014 reconciliation to the July and August 2016 reconciliations. Such a comparison does not document the reconciliation of Levy Account activity for fiscal years 2015 and 2016. Also, we noted that the July 2016 bank reconciliation had a reconciling item labeled as “outstanding checks before FY 17 – previous years”. However, the CTO staff was unable to supply supporting documentation for this reconciling item.

2018-004 FAILURE TO CLOSE OUT PRIOR YEAR GRANT ACTIVITY INCREASES RISK OF REPORTING ERRORS

Condition: The Finance Office along with the Department of Behavioral Health and Intellectual Disability Services (DBHIDS) failed to timely identify and close out remaining account balances for completed DBHIDS grants. Specifically, per our review of the city's FAMIS accounting system records for the Grants Revenue Fund as of June 30, 2018, the city's books still showed \$31 million of cash balances related to completed DBHIDS grants for prior fiscal years ranging from 2005 to 2015.

Criteria: The city's SAP No. G 1-1, titled *Grant Closeouts*, provides a uniform procedure for city departments and the Finance Office's GAAU to follow for the purpose of closing the books and records on grants that have been completed or discontinued. SAP No. G 1-1 instructs city departments to notify GAAU when a grant is completed and send the final reimbursement request and/or closeout report to GAAU. SAP No. G 1-1 also requires GAAU to monitor grant expenditure activity in FAMIS at least twice a year to identify inactive grants for closeout.

Effect: Failure to timely close out remaining account balances for completed grants increases the risk of reporting errors in the city's CAFR. The \$31 million of remaining cash balances for completed DBHIDS grants was part of the reported Equity in Treasurer's Account balance for the Grants Revenue Fund in the city's fiscal year 2018 CAFR. These remaining cash balances resulted because DBHIDS grant expenditures were charged to the city's General Fund, but the General Fund was not reimbursed by the Grants Revenue Fund, which was the fund where the grant monies were deposited. To determine the amount payable to the General Fund, the \$31 million of DBHIDS cash balances was reduced by \$25.7 million of other city departments' grant receivable write-offs, which would be charged against the General Fund. The net interfund payable due from the Grants Revenue Fund to the General Fund was \$5.3 million. As a result, the Grants Revenue Fund's fund balance was overstated by \$5.3 million, and the General Fund's fund balance was understated by \$5.3 million. We proposed an adjustment to correct the city's CAFR for these errors, but the Finance Office elected not to book our adjustment. However, we combined this \$5.3 million proposed adjustment with other uncorrected CAFR errors and determined that the resulting total was immaterial to the city's fiscal year 2018 financial statements.

Cause: Neither the GAAU nor the DBHIDS followed the requirements of SAP No. G 1-1, both failing to adequately monitor grant activity in FAMIS and coordinate with one another to timely identify and close out cash balances for completed grants.

Recommendations: To ensure the accuracy of the city's accounting records and reduce the risk of reporting errors, we recommend that Finance Office management:

- Instruct Finance Office accountants to complete the necessary adjustments to close out the remaining DBHIDS cash balances in the Grants Revenue Fund and transfer the amount payable from the Grants Revenue Fund to the General Fund.

CITY OF PHILADELPHIA

Financial Audit Significant Deficiencies – June 30, 2018

- Reinforce SAP No. G 1-1 requirements with both city departments and GAAU. Management should remind city departments of the requirement to notify GAAU of completed grants and submit the grants' final reports to GAAU. GAAU should monitor grant activity in FAMIS to identify and close out inactive grants in accordance with SAP No. G 1-1 requirements.

Views of the Responsible Officials: We agree with your recommendation to perform grant closeouts and the Finance accountants are working on all relevant proposed adjustments to transfer grant revenue fund cash balances related to general fund spending from FY 2005 – FY 2015.

A training was held by the GAAU during FY 2019 which included the topic *SAP No. G 1-1; Grant Close-out*. This topic was also discussed in the Grants Process training held in FY 2018. It was emphasized in the training that the Grantee department has the fiduciary responsibility to administer, manage and close-out their grants in accordance with the Grantor's requirements and procedures. The GAAU reviews the Grant Fund's fund schedules for expired and inactive grants, and on an annual basis, sends a memo to City departments to review the grant's balances and determine whether to return to the grantor (credit balance) or have the balances written-off to the general fund (debit balances). Going forward, GAAU will also run a report of grants that shows expired expenditure activity which will enforce the grant close-out procedures as established in the SAP.

2018-005 FAILURE TO SEGREGATE PAYROLL DUTIES COULD ALLOW FRAUD TO OCCUR

Condition: During fiscal year 2018, the duties concerning the data entry, review, and approval of bi-weekly payroll transactions were again not adequately segregated. Our testing of 55 city departments for 26 pay periods revealed 257 occasions (18 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 23 departments performed duplicate functions for more than two pay periods, with the Mayor’s Office, the Police Department, the Fire Department, and the Board of Pensions and Retirement being the most recurrent among the larger departments. While there had been improvement in this condition when compared to the previous year’s findings,⁷ a significant number of city agencies 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 automated payroll system that was in place during fiscal year 2018, allowed 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 previously 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: In March 2019, the city implemented the new OnePhilly payroll system. We recommend that Finance Office management ensure that the new OnePhilly payroll system includes controls to adequately segregate incompatible duties, particularly the functions of entering, reviewing, and approving payroll transactions.

Views of the Responsible Officials: Thank you for acknowledging the decline in the number of occurrences where there is a lack of segregation of payroll duties. We continue to circulate a letter annually and in conjunction with major system updates, reminding operating departments that multiple sign-offs at different levels by the same person should be avoided where possible. As we have consistently stated, to ensure that employees will be paid on time, there will be instances where one individual sign-offs at more than one level when all employees at all levels are unable to do so. Our SAPs clearly state the ability for authorized signers

⁷ The prior year’s testing disclosed 342 occasions during fiscal year 2017 (23 percent) in which these payroll functions were not separated. Also, we noted that, for 28 of 57 departments, employees performed duplicate functions for more than two pay periods.

CITY OF PHILADELPHIA

Financial Audit Significant Deficiencies – June 30, 2018

to transfer “Temporary signature authorizations” where necessary. This delegation can occur electronically via an email authorization.

2018-006 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 real property 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 Charter⁸ 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, we continued to find discrepancies between the "Proof" file and FAMIS – an \$8.3 million discrepancy in the accumulated depreciation balance for buildings, a \$1.5 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: 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, we will continue to use the current mix of applications and methodology used by Accounting for capital asset management, as these provide financial information that is accurate and auditable, despite not providing the level of detail that a capital asset system might provide. We are working with OIT to develop a process in which we can reconcile the city's fixed asset ledger with the IWAMs system as well as collect inventory counts from each

⁸ The Philadelphia Home Rule Charter, Section 6-501

department, at least annually. As we examine comprehensive financial reporting system options for the replacement of FAMIS, we will ensure that our selected software enables us to accurately capture our complete population of capital assets, and allow us to fulfill our maintenance and reporting needs.

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, we previously recommended that the Finance Office compare the Philadelphia City Planning Commission's (PCPC's) master database of city-owned facilities to the city's fixed asset ledger to identify any discrepancies. In its response to last year's report, management stated that, during fiscal year 2018, the Department of Public Property (Public Property) implemented the Integrated Workplace Asset Management System (IWAMS), which contains various data on the city's real estate assets, including maintenance and improvement costs, and uses as its "backbone" the PCPC's master facilities database. In its prior year response, management indicated that it would explore whether the assets in the IWAMS database could be compared to the city's fixed asset ledger. During the current audit, Finance Office management informed us that they met with the Office of Innovation and Technology (OIT) in September 2018 to discuss obtaining a database of city-owned property to enable such a comparison; however, as of March 26, 2019, no further action has been taken.

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 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.

CITY OF PHILADELPHIA

Financial Audit Significant Deficiencies – June 30, 2018

- Develop and provide a plain language report on the condition of capital assets at least every one to three years. This report should be made available to elected officials and the general public.
- Obtain the most current database 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: Thanks for noting our efforts to collaborate with the Office of Innovation and Technology (OIT) to obtain a database of city-owned property for comparison with the city's fixed asset ledger. We continue to work with OIT to develop a process that allows us to perform fixed asset reconciliations to the IWAMS system, and thus, enables us to periodically validate the completeness and accuracy of the city's fixed asset inventory. To enhance the current manual process utilized by Finance, we have decommissioned the use of Lotus, thereby reducing the cumbersome nature of our current process and reducing the risk of inaccurate accounting records. We agree that the need exists for a more efficient process and we will review our process of obtaining confirmation of assets from the departments and research best practices to develop a periodic physical inventory process.

**2018-007 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 – continued to be at an increased risk for significant misstatement because the Finance Office's accountants still did not always 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 city bank accounts, 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 noted the following instances when Finance Office accountants did not timely prepare and submit CTAs to the Treasurer:

- For \$6.6 million of pending transfers due from the Water and Aviation Operating Fund bank accounts to the consolidated cash account – which related to interfund expenditure transfers processed in June 2018 – Finance Office accountants did not prepare the CTA to authorize the transfers until February 2019, at the request of the Controller's Office. The Treasurer transferred the monies in February 2019. We noted a similar instance in the prior audit.
- A CTA prepared in late June 2018 to transfer \$4 million from the Aviation Operating Fund and consolidated cash bank accounts to the Aviation Capital Fund account was not approved by Finance Office management until September 2018. Finance Office management asserted that this CTA was delayed because it required additional review by them. The Treasurer made the corresponding transfer in September 2018.
- In September 2018, Finance Office accountants posted an entry in FAMIS to record a \$1.6 million transfer from the Water Revenue Bond Sinking Fund Reserve to the General Fund (a member fund of the consolidated cash account). However, it was not until November 2018, approximately two months later, that the Finance Office prepared the CTA and the Treasurer processed the bank transfer.

Criteria: The city's SAP No. I-4295 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 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.

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 six months during fiscal year 2018 and only providing the June 30, 2018 reconciliation to us on January 7, 2019.

Recommendation: To minimize the risk of undetected errors in reported Equity in Treasurer's Account balances, we continue to recommend that the Finance Office management develop procedures designed to ensure that the reconciliation of FAMIS Equity in Treasurer's Account amounts to Treasurer account balances 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: The Finance office continues to examine the CTA process to identify opportunities for enhancement, and to enable timely reconciliation and preparation of CTAs. We will work to minimize the time span for the creation and review of CTAs involving complex and unusual activity and we will continue to follow-up with CTO to ensure the requested CTAs are completed timely.

2018-008 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 only performed a very limited review of fiscal year 2016 adjustments in January 2017 while there was no review of fiscal year 2017 adjustments. Our current audit found that accountants had not performed any reviews of adjustment transactions for the majority of fiscal year 2018 – July 2017 through mid-April 2018 – until the responsibility was assigned to the newly hired Financial Reporting Unit (FRU) accounting manager. For adjustment activity posted since mid-April 2018, the FRU accounting manager selected a small sample of adjustments for review each week from the daily adjustment listings. The adjustment review process consisted of the following steps: requesting support from the employee who posted the sampled adjustment, reviewing the support to ensure the adjustment was valid, and retaining each sampled adjustment’s documentation to evidence this review. However, Revenue Department management informed us that, as of January 2019, a formal written policy for the adjustment review process had not yet been established.

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 \$25 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 (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. In February 2018, Revenue Department management hired the new FRU accounting manager and eventually assigned the responsibility of reviewing TIPS adjustments to that manager as discussed above.

Recommendation: We recommend that Revenue Department management continue the practice of having supervisory personnel, independent of the adjustment process, regularly monitor daily payment and receivable adjustment activity in TIPS. Management should formalize the procedures of the adjustment review process in writing to ensure that they are consistently performed and documented. Formalized procedures should require that the supervisor test a sample of adjustments for accuracy and propriety, review daily adjustment reports for patterns of irregular activity, and evidence that these checks are performed by signing and dating the adjustment reports upon completion of the reviews.

Views of the Responsible Officials: We are pleased that your review of selected TIPS adjustments disclosed no instances of inaccurate or improper activity. We routinely monitor TIPS user access and authority levels and are continuously working to improve our policies and procedures for monitoring TIPS account adjustments. Thank you for acknowledging our efforts to enhance our adjustment review process during FYE 2018 through the hiring of a Financial Reporting Unit accounting manager, independent of the adjustment process, to perform adjustment reviews. We have continued these enhancement efforts, and earlier this year, we formed an adjustment review team to periodically assess our current procedures and make recommendations. As a result, two additional accountants in the Financial Reporting Unit, were trained to perform post adjustment reviews. The Accounting Manager is responsible for reviewing their adjustments to ensure selection procedures are being followed, and proper documentation is retained. We have also engaged an independent trainer and technical writer to help ensure we have documented clear and comprehensive policies & procedures for those performing the post adjustment reviews by target date July 2019.

2018-009 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, with over 50 percent of them still being more than half a century old.

Since September 2015, the Finance Office has updated 11 SAPs, with the most recent being the following two SAPs issued on April 10, 2019 in conjunction with the implementation of the new OnePhilly payroll system:

- SAP No. E-9011, *Daily Timekeeping Source Documents and Attendance Record-Keeping* – This SAP discusses the forms and methods that departments are to use in preparing daily records of employee attendance.
- SAP No. E-0911, *Signature Authorization Form* – This SAP – which, in the last three reports, we had specifically recommended that the Finance Office update – establishes requirements regarding the signature authorization forms used to verify the propriety of departmental approvals for bi-weekly payrolls and payment vouchers.

Also, during fiscal year 2018, the Finance Office hired a consultant to assist in reviewing and updating the SAPs. In addition to assisting with the update of the two most recently revised SAPs, the consultant has prepared a draft version of a manual which will serve as the single document warehousing all SAPs and generated an archived listing of the old SAPs that will be incorporated into the manual and used as a crosswalk to the updated SAPs. The consultant is also working with the Finance Office to revise the SAP numbering format. Per discussion with Finance Office management, their goal for calendar year 2019 is completing the update of the SAPs for the payroll and grant areas.

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.⁹ 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.

⁹The Philadelphia Home Rule Charter, Section 6-101.

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

Recommendation: We recommend that the Finance Office continue to work with the consultant to complete the review and update of the 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.

Views of the Responsible Officials: 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, governmental regulations, and software implementations these procedures have been updated, hence the 11 updated SAPs noted in your internal control narrative. Further, as you noted in your report, Finance contracted with an outside accounting firm which has begun a comprehensive update of our SAPs. The consultant will continue to development an SAP manual, which will include updated SAPs with a new numbering system and a consistent format. SAPs that are no longer relevant will be eliminated. Our newly appointed Director of Compliance and Internal Controls will review all changes and make additional recommendations for improvements in both the department processes followed and the SAP manual. She will establish a routine timeline for updating SAPs at the completion of this project in 2019.

2018-010 REPORTING - SIGNIFICANT DEFICIENCY AND COMPLIANCE FINDING**National Urban Search and Rescue (US&R) Response System- CFDA #97.025**

Condition: The Pennsylvania Task Force 1 (PA-TF1), on behalf of the city's Philadelphia Fire Department (PFD), submitted quarterly *Federal Financial Reports* (SF-425s) and Semi-Annual Performance Reports that were inaccurate for federal awards received under the National Urban Search and Rescue Response System - Readiness Cooperative Agreement. Our review of SF-425s submitted in fiscal year 2018 disclosed that amounts reported for "*Cash Disbursements*", "*Federal share of expenditures*" and "*Federal share of unliquidated obligations*" were understated. Auditee's SF-425s were prepared on a cash basis. Under the cash basis, cash disbursement amounts should be equal to the federal share of expenditure amounts. The understated amounts for "*Federal share of expenditures*" and "*Federal share of unliquidated obligations*" reported on the SF-425s are listed in the tables below:

Table 3 - Summary of the Federal Share of Expenditures Understatements for lines 10(b) and 10(e)				
	Reporting Period Ended Date	Amount Per Auditee (\$)	Amount Per Auditor (\$)	Difference Over/(Under)stated (\$)
FY 15 US&R Response System Readiness Cooperative Agreement	6/30/2018	676,424	973,433	(297,009)
FY 16 US&R Response System Readiness Cooperative Agreement	6/30/2018	564,868	879,706	(314,838)
FY 17 US&R Response System Readiness Cooperative Agreement	6/30/2018	56,338	254,697	(198,359)
Total Per Reporting Period Ended	6/30/2018	1,297,630	2,107,836	(810,206)

Table 4 - Summary of the Federal Share of Unliquidated Obligations Understatements for line 10(f)				
	Reporting Period Ended Date	Amount Per Auditee (\$)	Amount Per Auditor (\$)	Difference Over/(Under)stated (\$)
FY 16 US&R Response System Readiness Cooperative Agreement	6/30/2018	0	5,088	(5,088)
FY 17 US&R Response System Readiness Cooperative Agreement	6/30/2018	0	73,925	(73,925)
Total Per Reporting Period Ended	6/30/2018	0	79,013	(79,013)

As a result, any lines on the SF-425s that were calculated using the auditee amounts listed above were incorrect. Additionally, the "*Federal share of expenditures*" totals that were reported on the two fiscal year 2018 Semi-Annual Performance Reports were identical to the sums reported on the SF-425 Reports. Therefore, the Semi-Annual Performance Reports submitted for fiscal year 2018 were also erroneous. Funding for this program is received from the U.S. Department of Homeland Security and administered by the Federal Emergency Management Agency under Federal Award Identification Numbers: EMW-2015-CA-00018, EMW-2016-CA-00010, and EMW-2017-CA-00076.

CITY OF PHILADELPHIA

Federal and PA. Department of Human Services Findings and Questioned Costs – June 30, 2018

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. Also, the SF-425 instructions require that the recipient report:

- the sum of actual cash disbursements for direct charged for goods and services, the amount of indirect expenses charged to the award, and the amount of cash advances and payments made to subrecipients and contractors on line 10b.
- the federal share of expenditures for direct charges for property and services; the amount of indirect expenses charged; and the cash advance payments and other payments to subrecipients that have been disbursed by the grantee for the grant on line 10e, if reports are on a cash basis.
- the obligations of federally authorized funds which are incurred, but not yet paid as of the end of the reporting period on line 10f, if reports are on a cash basis.

Effect: The SF-425s and Semi-Annual Performance Reports track the status of financial data for the federal grant awards. Understated amounts on these reports results in noncompliance with reporting requirements. Also, federal grantors will not have complete and accurate information to make fiscal decisions on future federal awards. Understating the SF-425 makes it difficult to reconcile to the SEFA which is prepared on a modified accrual basis.

Cause: The personnel who prepared the reports did not follow the SF-425 instructions to report the amounts properly. They only reported disbursements and expenditures for which they received the reimbursement from the grantor and no unliquidated obligations were reported.

Recommendation: The PA-TF1 should prepare the federally required reports in accordance with reporting requirements.

Views of the Responsible Officials: The PA Task Force agrees that it should prepare all federally required reports in accordance with reporting requirements. The Task Force has found erroneous charges in the past or charges that are not associated with the project, i.e. a member who is charged to the grant that has been detailed out of the unit for training or works outside of the unit on overtime. These types of situations need to be reconciled prior to reporting to ensure accuracy and report integrity. Another issue impacting the numbers on the FFR is the payment review process. Until a payment voucher is paid out, there are a number of reviews that occur within the Philadelphia Fire Department (PFD) and outside of the PFD. These reviews can affect what is actually paid. We recognize that there is a timing difference between the Cooperative Agreement reporting and FAMIS. This is related to coding errors that cause the issues as described above. The Fire Department is working to address understaffing issues in its finance unit in order to help fix this issue going forward.

Contact Person: Cpt. Brian Booth, Grant Program Manager, Philadelphia Fire Department PA-Task Force 1, (215) 683-9245

2018-011 ALLOWABLE COSTS/COST PRINCIPLES - SIGNIFICANT DEFICIENCY AND COMPLIANCE FINDING

Disaster Grants – Public Assistance (Presidentially Declared Disasters) CFDA #97.036

Condition: The Office of Emergency Management (OEM) and Division of Aviation (DOA) could not provide adequate documentation to support \$121,361 in materials costs they charged for the snow removal project under the Disaster Grants – Public Assistance program. The DOA’s support for materials listed a total amount used for each type of material by location but did not provide usage records. As a result, the auditors could not verify the accuracy of the use of materials and related costs. Funding for this program is received from the U.S. Department of Homeland Security and pass-through the Pennsylvania Emergency Management Agency. The Federal Award Identification Number for the Public Assistance program is FEMA-4267-DR-PA-101-60000-00.

Criteria: OMB’s Uniform Guidance, Title 2, Part 200, Subpart E, paragraph 200.403 (g) requires recipients and subrecipients to adequately document costs that they claim under federal programs.

Effect: Because the city is reimbursed at 75 percent of the expenditures claimed, the \$121,361 of unsupported materials costs caused the city to improperly receive an additional \$90,020 in grant funds, which are considered to be questioned costs. Also, the Schedule of Expenditures of Federal Awards is overstated by the same amount.

Cause: DOA management did not adequately document materials taken from existing inventories for use under the Public Assistance program by failing to maintain inventory withdrawal slips and usage records.

Recommendation: OEM management should provide adequate guidance to departments to ensure that expenditures on program worksheets are adequately documented in accordance with program requirements.

Views of the Responsible Officials: It is Aviation’s policy to document the usage of contractor time, the usage of materials and supplies, food vouchers disbursed and accommodations used for all inclement weather events. Since we have learned through this audit that our current recording document is insufficient in capturing the necessary information to substantiate the items used and claimed, we are working with our staff to update the recording document and accompanying instruction guidelines and procedures to ensure that all items used during inclement weather events will be captured and recorded in a detailed and accurate manner.

However, the Airport believes that the amount in this finding should be prorated over the number of storm days as these materials and supplies were used daily in this weather event. Also, the documents previously submitted to FEMA disclosed there were no use logs for materials during the storm and the amount requested by the City was well considered, approved and reimbursed by FEMA.

Contact Person: Brandon Lapsley, Homeland Security Grant Program Manager, Office of Emergency Management, (215) 686-1450

2018-012 ALLOWABLE COSTS/COST PRINCIPLES - SIGNIFICANT DEFICIENCY AND COMPLIANCE FINDING

Disaster Grants – Public Assistance (Presidentially Declared Disasters) CFDA #97.036

Condition: The Office of Emergency Management (OEM), on behalf of the Division of Aviation (DOA) incorrectly claimed \$67,477 for overtime fringe benefits based on a fringe rate of 54.92 percent. However, the rate included the cost of worker's compensation, legal fees, employee disability, life insurance, and medical insurance, which are not applicable to overtime. OEM should have based its claim on a rate of 11.953 percent determined by the city for the overtime fringe benefits, which would have resulted in charges of \$14,686. Funding for this program is received from the U.S. Department of Homeland Security and pass-through the Pennsylvania Emergency Management Agency (PEMA). The Federal Award Identification Number for this grant is FEMA-4267-DR-PA-101-60000-00.

Criteria: According to 44 CFR 206.228(a)(2)(iii), straight- or regular-time salaries and benefits of permanent employees engaged in emergency work (other eligible emergency protective measures) are not eligible for Public Assistance funding under section 403 and 502 of the Stafford Act.

Effect: Because the city is reimbursed at 75 percent of the expenditures claimed, inclusion of the regular time fringe benefit rate resulted in overstatement of expenditures by \$52,791 and caused it to improperly receive an additional \$39,593 in grant funds, which are considered to be questioned costs. Also, the Schedule of Expenditures of Federal Awards is overstated by the same amount.

Cause: The summary sheet of payroll expenditures submitted by DOA improperly included the regular time fringe benefit rate of 42.97 percent. Additionally, OEM did not identify the error during their review of submitted expenditures.

Recommendation: We recommend that the city strengthen its report preparation and review procedures for future Public Assistance grants to ensure that expenditures submitted to PEMA are calculated in accordance with program requirements.

Views of the Responsible Officials: The Division of Aviation acknowledges the use of the 54.92% fringe benefit rate, which is a combination of regular time = 42.97% and overtime = 11.953% as calculated by the City's Finance Department. As an agency of the City, whenever we reimburse, or get reimbursed from, a fellow agency, we only calculate the hours of overtime labor worked, and assume that the associated fringe benefits rate in our force account labor totals are appropriate. We were unaware that straight- or regular-time salaries and benefits of permanent employees engaged in emergency work were not eligible for Public Assistance funding under the regulations covering the awarded grant. In the future, we will note this fringe benefits rate cap requirement and will work closely with Central Finance and OEM to ensure the appropriate rate is used.

Contact Person: Brandon Lapsley, Homeland Security Grant Program Manager, Office of Emergency Management, (215) 686-1450

2018-013 REPORTING - SIGNIFICANT DEFICIENCY AND COMPLIANCE FINDING**Community Development Block Grants/Entitlement Grants - CFDA #14.218****National Urban Search and Rescue (US&R) Response System – CFDA #97.025**

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 5 were overstated by \$10.2 million. GAAU concurred with our findings and corrected the amounts reported for subrecipient expenditures. This condition was reported as finding number 2017-016 for the Community Development Block Grants/Entitlement Grants (CDBG) in the prior year report.

Table 5: Summary of the Subrecipient Expenditure Variances by Major Program				
	CFDA #	Amount Per Auditee (\$)	Amount Per Auditor (\$)	Difference Over/(Under) stated (\$)
Community Development Block Grants/Entitlement Grants ¹⁰	14.218	38,048,657	29,461,094	8,587,563
National Urban Search and Rescue (US&R) Response System ¹¹	97.025	1,623,030	0	1,623,030
Total		39,671,687	29,461,094	10,210,593

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: For the CDBG program, GAAU incorrectly included the department's payroll and other non-subrecipient expenditures in their calculation of total subrecipient expenditures. With regards to the National Urban Search and Rescue Response System program, GAAU incorrectly included contractor expenditures in the subrecipient expenditures. Additionally, the Philadelphia Fire Department did not timely respond to the GAAU's request for departments to identify subrecipient expenditures.

Recommendations: We recommend that GAAU reinforce with departments the need to provide complete, accurate, and timely information to assist in reporting the correct amount for total payments to subrecipients. Also, the departments should inform GAAU when expenditures are denoted by the incorrect document prefix. Additionally, GAAU should strengthen its SEFA preparation procedures to ensure that only payments to subrecipients are reported as subrecipient expenditures on the SEFA.

¹⁰ Funding for this program is received directly from the U.S. Department of Housing & Urban Development.

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

CITY OF PHILADELPHIA

Federal and PA. Department of Human Services Findings and Questioned Costs – June 30, 2018

Views of the Responsible Officials: We agree with the finding that the subrecipient spending for the two programs was not completely accurate. We will reinforce with the affected departments the need to review the new accounting expenditure reports provided by GAAU to make accurate subrecipient determinations for financial reporting purposes in accordance with the Uniform Guidance.

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

2018-014 REPORTING – MATERIAL WEAKNESS AND COMPLIANCE FINDING

Highway Planning and Construction– CFDA #20.205

Condition: The internal control procedures at the city’s Department of Streets failed to detect fiscal year 2019 expenditures being recorded as fiscal year 2018 expenditures. Our testing of 33 significant transactions covering 95.24% of the total expenditures for the Highway Planning and Construction program revealed that four transactions with amounts totaling \$3,967,374 should have been recorded in fiscal year 2019 instead of fiscal year 2018. Consequently, GAAU incorrectly included the amount in the fiscal year 2018 preliminary SEFA until detected by the auditors. Funding for this program is received from the U.S. Department of Transportation and is pass-through Pennsylvania Department of Transportation.

Criteria: OMB’s Uniform Guidance, Title 2, Part 200, Subpart F, paragraph 200.510 (b) specifies that the auditee must also prepare a SEFA for the period covered by the auditee’s financial statements which must include the total federal awards expended as determined in accordance with §200.502 Basis for determining Federal awards expended. Section 200.502 specifies that the determination of when a Federal award is expended must be based on when the activity related to the federal award occurs.

Effect: Failure to detect incorrect coding of expenditures results in overstatement of reported expenditures. The improper reporting of expenditures would have caused the fiscal year 2018 SEFA to be overstated by \$3,967,374.

Cause: The payments were incorrectly coded as prior year expenditures and internal controls were not sufficient to detect the errors. This caused those expenditures to be improperly included in fiscal year 2018 as accrued expenditures.

Recommendation: We recommend that the department improves its internal controls over year-end transactions. Specifically, ensuring that expenditures are coded correctly as to the period the expenditures occurred, before submitting to Finance Office’s General Accounting.

Views of the Responsible Officials: We agree with the finding that the expenditure should be reported in the fiscal year 2019 SEFA. For the Highway Planning and Construction Grant, Streets Department will review the fiscal year 2019 accounts payable accrual with the Finance Department during the year end verification process to ensure the expenditures are reported in the year the services were rendered.

Contact Person: Deborah Mckee, Fiscal Officer, Department of Street, (215)686-5466

2018-015 REPORTING - SIGNIFICANT DEFICIENCY AND COMPLIANCE FINDING

Immunization Cooperative Agreements – CFDA #93.268

Condition: The city's Department of Public Health (DPH) failed to file the annual SF-425 Federal Financial Report (SF-425) for the Immunization and Vaccines for Children Program during fiscal year 2018. The annual SF-425 report of expenditures serves as documentation of the financial status of grants according to the official accounting records of the recipient. This program is funded through the U.S Department of Health and Human Services – Center for Disease Control (CDC). The Federal Award Identification Number for the Immunization and Vaccines for Children Program is 6NH23IP000735-05-02.

Criteria: The HHS requires that recipients periodically submit financial reports. According to Title 45 Code of Federal Regulations (CFR) Part 75.341, the Federal Financial Report (FFR) must be submitted no less frequently than annually. The HHS requires the report be submitted for each budget period no later than 90 days after the close of the budget period or applicable 12-month period.

Effect: Failure to file the SF-425s results in noncompliance with reporting requirements. The grantor may not have complete and accurate information to make fiscal decisions on future federal awards. Failure to submit complete, accurate, and timely reports may indicate the need for closer monitoring by the grantor or may result in possible award delays or enforcement actions.

Cause: There was miscommunication between the CDC and management of the DPH. The CDC's Office of Grant Services initially waived the annual report filing requirements, but subsequently rescinded that waiver. The management at the Department of Health was not aware of the change.

Recommendation: We recommend the DPH verify the reporting requirements with the grantor agency and comply with the federal reporting requirements to submit the proper reports on an annual basis.

Views of the Responsible Officials: The Department of Public Health (DPH) did not submit annual (interim) FFR's to the grantor due to a systemic problem with Grant Solutions and CDC policy which disallowed the submission of these documents. DPH has received an e-mail from the grantor acknowledging this problem.

Contact Person: Andrea Jordan, Administrative Services Director III, Department of Health

2018-016 SUBRECIPIENT MONITORING - SIGNIFICANT DEFICIENCY AND COMPLIANCE FINDING

Social Services Block Grant (SSBG) – CFDA #93.667

Condition: The city's Department of Behavioral Health and Intellectual Disability Services (DBHIDS) failed to provide documentation evidencing program monitoring of its subrecipient agencies during fiscal year 2018. We selected 21 subrecipient agencies for testing the program monitoring compliance, of which 11 were from DBHIDS and 10 were from the Office of Homeless Services (OHS). During the audit, we obtained evidence for all 10 subrecipient samples tested for OHS. However, after numerous requests to management, DBHIDS failed to provide evidence of subrecipient monitoring for the remaining 11 sampled subrecipient agencies paid out of the Social Services Block Grant. Despite this, we relied on evidence of program monitoring for four of the 11 subrecipient agencies obtained during our fiscal year 2018 City of Philadelphia CAFR audit. We still have not received evidence of program monitoring for the remaining seven sampled agencies. Funding for this program is received from the U.S. Department of Health and Human Services (HHS) and passed through the Pennsylvania Department of Human Services (PaDHS).

Criteria: Title 45 CFR Part 75.352 – Requirements for pass-through entities states that a pass-through entity must monitor 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. Pass-through entity monitoring must include:

- 1) Reviewing financial and performance reports required by the pass-through entity.
- 2) Following up and ensuring that the subrecipient takes timely and appropriate actions on all deficiencies pertaining to the federal award provided to the subrecipient from the pass-through entity detected through audits, on-site reviews and other means.

Additionally, Title 45 CFR Part 75.508 states that as part of the auditee's responsibilities, they must provide the auditor with access to personnel, accounts, books, records, supporting documentation, and other information as needed for the auditor to perform the audit.

Effect: DBHIDS, as a pass-through entity, is responsible for oversight of the operations to assure that performance expectations are being achieved. The lack of monitoring of its subawards may result in service providers failing to comply with program requirements or meet performance goals without being detected. The fiscal year 2018 subrecipient expenditures amounted to approximately 80 percent of the total SSBG program expenditures, DBHIDS' portion of the expenditures, which were 100 percent subrecipients, represented 60 percent of the total subrecipient expenditures charged to the program. During the audit, we noted that DBHIDS did perform pre-award monitoring activities and verified that subrecipient agencies were audited as required. Therefore, no costs will be questioned.

Cause: DBHIDS management did not respond to auditor's multiple requests for monitoring reports.

CITY OF PHILADELPHIA

Federal and PA. Department of Human Services Findings and Questioned Costs – June 30, 2018

Recommendation: We recommend that DBHIDS maintain proper records of subrecipient monitoring in order to timely respond to auditor's documentation requests.

Views of the Responsible Officials: DBHIDS acknowledges that, while we provided some documentation of our subrecipient monitoring efforts, the evidence provided was not sufficient for your purposes. The lack of documentation provided does not indicate that such documentation does not exist. In fact, you were provided with the documentation of monitoring performed by the HHS Audit Unit on our behalf.

During the course of the audit, several events occurred that may have contributed to the insufficiency of documentation provided. Recently, new leadership came on board and is in transition. While the new CFO has a vast professional background, becoming familiar with the many activities, regulations and processes at DBHIDS is a steep learning curve. In addition, this audit began as DBHIDS was closing its fiscal year and developing year-end reports. Further, Community Behavioral Health was in the midst of rate negotiations with the State.

Since receiving the draft report of findings, the DBHIDS has been working to retrieve the documentation requested and will make them available to you for your records.

Contact Person: Joe Lowry, Chief Financial Officer, Department of Behavioral Health and Intellectual Disability Services (DBHIDS)