

# CITY OF PHILADELPHIA PENNSYLVANIA

## OFFICE OF THE CONTROLLER

*Promoting honest, efficient, and fully accountable government*

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

**CITY OF PHILADELPHIA**

**FISCAL 2013**



City Controller  
**ALAN BUTKOVITZ**



# CITY OF PHILADELPHIA

OFFICE OF THE CONTROLLER  
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ALAN BUTKOVITZ  
City Controller

GERALD V. MICCIULLA  
Deputy City Controller

June 17, 2014

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

Dear Mayor Nutter:

In accordance with the Philadelphia Home Rule Charter, the Office of the Controller conducted an audit of the basic financial statements of the City of Philadelphia, Pennsylvania as of and for the fiscal year ended June 30, 2013, and has issued its Independent Auditor's Report dated February 24, 2014.

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

Attached is our report on internal control over financial reporting and on compliance and other matters, dated February 24, 2014 and signed by my deputy who is a Certified Public Accountant. The findings and recommendations contained in the report were discussed with management at an exit conference. We included management's written response to the findings and recommendations as part of the report. We believe that, if implemented by management, the recommendations will improve the City of Philadelphia, Pennsylvania's internal control over financial reporting.

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

Respectfully submitted,

A handwritten signature in dark ink, appearing to read 'Alan Butkovitz'.

ALAN BUTKOVITZ  
City Controller

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



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Deputy City Controller

## **REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

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

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the City of Philadelphia, Pennsylvania as of and for the year ended June 30, 2013, and the related notes to the financial statements, which collectively comprise the City of Philadelphia, Pennsylvania's basic financial statements, and have issued our report thereon dated February 24, 2014. Our report includes a reference to other auditors. Other auditors audited the financial statements of the following entities, as described in our report on the City of Philadelphia, Pennsylvania's financial statements.

### Primary Government

Municipal Pension Fund  
Philadelphia Gas Works Retirement Reserve Fund  
Fairmount Park Commission Departmental and Permanent Funds  
Philadelphia Municipal Authority  
Pennsylvania Intergovernmental Cooperation Authority

### Component Units

Community College of Philadelphia  
Delaware River Waterfront Corporation  
Philadelphia Parking Authority

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O F F I C E O F T H E C O N T R O L L E R

Component Units (Continued)

Philadelphia Redevelopment Authority

Community Behavioral Health

Philadelphia Authority for Industrial Development

Philadelphia Gas Works

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

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

**Internal Control Over Financial Reporting**

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

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

*A deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the inadequate oversight and review procedures over the financial reporting process, described in the accompanying report, to be a material weakness.

*A significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with

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

- Unauthorized individuals are approving bi-weekly payrolls.
- Controls over capital assets are deficient because (1) the city does not have a comprehensive capital asset system to facilitate accounting and reporting of these assets and (2) periodic physical inventories of the assets are not performed.
- Segregation of duties are not enforced for the automated payroll system.
- Water customer account balances could be inappropriately reduced because credit adjustments are not adequately reviewed.
- The city's Standard Accounting Procedures, which serve as the basis for the city's system of internal control, continue to be long outdated and fail to reflect the automated processes and the practices currently in use.

**Compliance and Other Matters**

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

We noted certain other conditions that represent deficiencies in internal control that are listed in the table of contents and described in the accompanying report. We also identified other internal control deficiencies during an assessment of information technology general controls conducted by an independent accounting firm engaged by us, which have been communicated to management in a separate report.

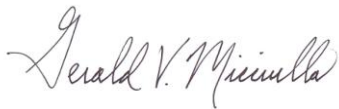
**City of Philadelphia, Pennsylvania's Response to Findings**

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

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O F F I C E O F T H E C O N T R O L L E R

**Purpose of this Report**

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

A handwritten signature in cursive script, reading "Gerald V. Micciulla".

GERALD V. MICCIULLA, CPA  
Deputy City Controller  
Philadelphia, Pennsylvania  
February 24, 2014



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## **MATERIAL WEAKNESS**

### **INADEQUATE OVERSIGHT OVER THE FINANCIAL REPORTING PROCESS**

Philadelphia's Home Rule Charter places responsibility for the City of Philadelphia's (city) accounting and financial reporting functions with the Office of the Director of Finance (Finance Office). In that capacity, the Finance Office prepares the city's Comprehensive Annual Financial Report (CAFR). To complete these tasks, Finance Office accountants collect, analyze, and summarize enormous amounts of financial data and grant data, as well as other information obtained from the city's accounting system, numerous city agencies, and assorted quasi-government units, such as the Philadelphia Gas Works and the Philadelphia Redevelopment Authority.<sup>1</sup> 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:

- reductions in the number of accountants in the Finance Office and other city departments compromised timely and accurate preparation of the CAFR;
- a collective lack of diligent review and inadequate management oversight by several departments resulted in misstated receivables reported in the financial statements presented for audit;
- inadequate procedures over the preparation of financial statements pertaining to the city's Water and Sewer Fund increased the risk of errors;
- year-end receivable procedures failed to properly account for the Water and Sewer Fund Write-off;
- preparation of the CAFR by Finance Office accountants was hampered because financial reports for some component units were not received timely; and,
- some city agencies again provided inaccurate year-end balances for bank accounts under their custody to Finance Office accountants, creating the need for significant adjustments to the financial statements presented for audit.

Each of these conditions is discussed in more detail below.

#### **Staff Reductions Continue to Compromise CAFR Preparation Process**

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

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<sup>1</sup> These quasi-government units are considered component units for purposes of the city's CAFR.



During our current audit, we observed that the Finance Office had taken steps internally to strengthen controls over the preparation of the CAFR. Management is currently implementing a succession plan to replace two key employees expected to retire in the next fiscal year. They are training a manager to assume higher-level responsibilities, hiring a new employee to fill an anticipated managerial vacancy, and increasing the size of their professional staff by two.

However, continued inadequate staffing in the Finance Office and other city agencies, still contributed to errors in the financial statements presented for audit. Our audit work revealed several undetected errors in the agency receivables, year-end cash, and capital asset amounts that were submitted to the Finance Office for inclusion in the CAFR. Because of these errors, we proposed \$1.7 billion in adjustments to the financial statements presented for audit.

Since fiscal year 2000, we have noted that the number of Finance Office accountants has declined by nearly 27 percent (from 64 full-time employees in fiscal year 2000 to 47 in fiscal year 2013). Likewise, since fiscal year 2008, the Collections Division of the Department of Revenue (Revenue Department), responsible for processing revenue receipts and preparing financial reports on all revenue and receivable activity, lost 32 percent of its accounting positions. Without sufficient staff to prepare the CAFR, the risk increases that significant errors can occur and not be timely discovered and corrected.

In a related issue to staffing, during the audit we also became aware that an employee from the Office of Innovation and Technology (OIT), performing key duties for the Revenue Department, was planning to retire in April 2014. Since this employee was responsible for maintaining the Revenue Department's Taxpayer Information Payment System (TIPS) and producing many of the revenue/receivable reports used by the department on a daily basis, Revenue Department management should have anticipated this and worked with OIT to hire and train someone several months prior to his departure. However, the Revenue Department did not have a succession plan in place, and only in February of this year, did they fill the position.

**Recommendations:**

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

- Either hire more accountants, or invest in new information technology that will reduce the current labor-intensive procedures needed to prepare the city's financial reports [50107.01].
- Provide adequate funding to all departments currently experiencing difficulty in accumulating and providing timely, accurate, and complete financial data to the Finance Office for inclusion in the CAFR [500113.01].
- Prepare a succession plan for key employees who are essential to the complete and accurate presentation of information in the city's CAFR [500113.02].

Collective Lack of Due Diligence Resulted in Misstated Year-End Receivables

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

In prior reports, we have commented about the Revenue Department's need for better oversight of city receivables. We found misstatements of tax and other accounts receivable balances, as well as discrepancies in the estimates of the uncollectible portion of the receivables. This lack of oversight appeared largely due to an inadequate review, which occurred because of changes in supervisory personnel within the Revenue Department.

During our current audit, we observed evidence of inadequate oversight not only within the Revenue Department, but within the Fire Department acting as an agent for Revenue. The Fire Department, through a contracted vendor, bills and collects Emergency Medical Services (EMS) fees for ambulance transport and other medical services provided to citizens and visitors of the city. Responses by the Fire Department's accountant to our inquiries regarding how the department's billing/collection vendor was accounting for EMS fees clearly suggested he had no understanding of the procedures being utilized by the firm. For example, he could not explain adjustment information presented on the firm's monthly billing/collection report, nor could he confirm whether the outstanding receivables from the previous billing/collection vendor were transferred to the recently engaged new firm. Additionally, the accountant failed to reconcile collections presented on the vendor's receivable report to lockbox deposits presented in monthly bank statements. And most importantly, he was unable to explain why he wrote-off \$389 million in receivables without the approval of the Accounts Review Panel.

We also observed that Revenue Department management neglected to provide adequate oversight of the billing and receivable functions being performed in other city departments. For instance, the Revenue Department did not routinely provide guidance to the departments or regularly communicate with department personnel performing the billing and receivable duties, some of whom were not trained as accountants. And often, Revenue Department accountants just accepted the receivable amounts provided by department personnel without adequately scrutinizing them for anomalies and errors that might require correction. We observed, for instance, that Revenue Department accountants simply accepted the Fire Department's EMS receivable balances without adequate understanding of the significant amounts written off by the Fire Department's accountant.

Our observations also revealed that the Revenue Department's written procedures regarding how to account for estimated uncollectible accounts were outdated and failed to provide adequate instruction on how to calculate estimated uncollectible amounts. We believe this situation may have contributed to Revenue Department accountants applying an inaccurate uncollectible percentage to the Streets Department small commercial establishment fee, which in our opinion appeared too high based on the fee's collection history. This mistake resulted in a \$15.9 million overstatement in the allowance for doubtful accounts balance.

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<sup>2</sup> Philadelphia Home Rule Charter Section 6-204.

As to the allowance for doubtful accounts associated with taxes receivable, we again found that the Revenue Department miscalculated the allowance because it applied an uncollectible rate that was inconsistent with established methodology. Consequently, we had to propose an additional \$22 million of adjustments to correct both the city and school district's financial statements presented for audit.

Recommendations:

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

- Develop detailed written procedures to guide their accountants on: (1) accurately establishing year-end receivable balances; (2) performing an independent review of related activity; and (3) annually updating the estimated basis for determining uncollectible accounts receivable amounts [500110.01].
- Provide adequate training to employees performing new duties [500111.01].
- Provide better guidance to accountants in other agencies, especially those generating significant revenue [500112.01].

We also recommend that Fire Department management make certain that the accountant responsible for EMS fees and related receivables:

- Puts forth a better effort to understand the accounting procedures used by the agency's contracted billing/collection vendor [500113.03].
- Analyzes the receivables to identify the portion determined to be uncollectible for appropriate disposition by the Accounts Review Panel [500113.04].
- Collaborates with the Revenue Department to accurately report the Fire Department's year-end EMS receivables and allowance for doubtful accounts [500113.05].

Inadequate Preparation Procedures for the Water and Sewer Fund Financial Statements

As one of the city's business-type activities, the Philadelphia Water Department (PWD) is responsible for preparing the full accrual financial statements of the Water and Sewer Fund (Water Fund) and submitting those statements to the Finance Office for inclusion in the city's CAFR. Since our fiscal year 2005 report, we have commented on deficiencies and inconsistencies in the review process for the financial statements of the Water Fund. The statements again did not include a certification, signed by a responsible PWD official, attesting that the statements had been reviewed and approved, and to the best of the reviewer's knowledge, complete and free from material misstatements. Additionally, the review process performed by Finance Office accountants, has historically been further hindered by the lack of supporting documentation provided by PWD to support the accuracy of the Water Fund financial statements.

During the current audit, the PWD accountants provided us with a copy of their financial statement procedure checklist, signed and dated by the preparer and reviewer. Unfortunately, this checklist did not provide detailed and meaningful information in regards to the procedures performed to

ensure the accuracy of the Water Fund financial statements. Furthermore, according to Finance Office accountants, no checklist had been received from PWD when their statements were submitted or during any subsequent revisions. Consequently, in our opinion this checklist was ineffective in the preparation of the Water Fund financial statements. For instance, we found that a prior year accounts receivable adjusting entry totaling \$5.3 million was not properly reflected in the financial statements presented for audit. If the procedures on the checklist had been comprehensive, we believe that PWD accountants would have detected and corrected this error.

Additionally, the Water Fund financial statements were submitted to the Finance Office without any supporting documentation. The lack of supporting documentation is contrary to the amount of information provided to the Finance Office by the Division of Aviation (DOA), also reported as a business-type activity. The DOA provides a compilation package of detailed and organized support for their financial statements. We believe that supporting documentation, similar to the DOA's submission, would strengthen the report preparation process and would prevent and detect errors.

**Recommendations:**

We continue to recommend that management and accountants of PWD:

- Perform procedures to ensure the accuracy and completeness of the Water Fund financial statements. The current checklist should be strengthened to include specific and comprehensive preparation procedures that can be consistently applied. The checklist should be submitted to the Finance Office along with the Water Fund financial statements. It should include an assertion by management that the statements have been reviewed and approved, and that to the best of management's knowledge, are complete and free from material misstatements [50105.01].
- Review and approve the Water Fund financial statements for accuracy and completeness [500111.02].
- Provide detailed and organized supporting documentation for the Water Fund financial statements when submitted to the Finance Office, similar to the compilation package submitted by the DOA [500113.06].

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

**Year-End Receivable Procedures Failed to Properly Account for Water and Sewer Fund Write-off**

Our current year testing disclosed that the Water Revenue Bureau (WRB) and the PWD did not accurately calculate their revenues, the year-end Water Fund accounts receivable balance, or the related allowance for doubtful accounts, associated with water services to their customers. Additionally, the WRB did not update its methodology for estimating the percentage of uncollectible receivables. As a result, the amounts reported for revenues, accounts receivables, and allowance for doubtful accounts, in the financial statements presented for audit were overstated by \$10 million, \$133 million, and \$123 million, respectively.

The above overstatements were a direct result of PWD accountants failing to record a \$129 million write-off of accounts receivables and neglecting to timely post a prior year \$5.3 million adjusting entry into the city's accounting system. Failure to update the methodology for estimating the uncollectible portion of the receivable balance also contributed to these misstatements. Furthermore, a lack of communication appeared to exist between the PWD accountants responsible for preparing the Water Fund financial statements and the WRB accountants responsible for compiling receivables. PWD accountants claimed that they were not aware of the accounts receivable write-off, which was submitted by the WRB and approved by the Accounts Review Panel. However, our review indicated that PWD representatives were explicitly copied on the submission to the Accounts Review Panel. We also noted that the WRB accountants were not provided with the opportunity to review the Water Fund financial statements despite their responsibility for the amounts presented.

Recommendations:

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

- All financial statement adjustments be posted into the city's accounting system in a timely manner [500113.08].
- PWD accountants post all write-off amounts into the Water Fund financial statements once they are approved by the Accounts Review Panel [500113.09].
- PWD accountants actively participate in submissions to and meetings with the Accounts Review Panel [500113.10].
- The WRB, in conjunction with PWD, develop and implement a reasonable methodology for estimating the allowance for doubtful accounts for its receivables. These procedures should be officially adopted and put into writing for consistency purposes [500113.11].
- PWD and WRB accountants should establish communication channels to improve the financial statement preparation process [500113.12].

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

For several years, we have commented about the late submission of financial reports by some of the city's component units. These late submissions have resulted in delays in timely completing the financial reporting and auditing processes for the city's CAFR. This condition did not improve for fiscal year 2013. As portrayed in Table 1 below, eight of the city's ten component units did not submit their reports by the due dates requested by Finance Office accountants.

While the Philadelphia Authority for Industrial Development was submitted the latest, at 123 days past the requested due date, the most egregious was the Philadelphia Redevelopment Authority, which, despite repeated requests, did not submit its final financial report to the Finance Office until very late in the audit. Failure to receive component unit financial statements on time increases the chances for errors or omissions as accountants must make significant changes to the financial statements and footnote disclosures each time a component unit's financial information is added to

**Table 1: Late Submission of Component Unit Financial Reports**

COMPONENT UNIT	DUE DATE	DATE RECEIVED	DAYS LATE
Community Behavioral Health	5/31/2013	8/07/2013	68
Delaware River Waterfront Corporation	10/28/2013	1/16/2014	80
Pennsylvania Intergovernmental Cooperation Authority	10/28/2013	1/06/2014	70
Philadelphia Authority for Industrial Development	5/31/2013	10/01/2013	123
Philadelphia Municipal Authority	10/28/2013	12/20/2013	53
Philadelphia Parking Authority	8/30/2013	9/13/2013	14
Philadelphia Redevelopment Authority	10/28/2013	2/24/2014	119
School District of Philadelphia	12/23/2013	2/19/2014	58

**Note:** The Philadelphia Gas Works and the Community College of Philadelphia submitted their financial reports timely.

**Source:** Prepared by the Office of the City Controller

the report. Moreover, additional time is required for the audit process as each series of changes requires considerable audit time to ensure that accountants have correctly changed previous amounts and footnotes presented for audit.

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

#### Recommendation:

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

#### Certain City Agencies Inaccurately Reported Their Year-End Custodial Account Balances

For the past several years, we have commented that cash balances reported for the departmental custodial (agency) funds were incomplete and inaccurate. City departments failed to provide Finance Office accountants with year-end cash balances, and the accountants often did not follow-up or perform the necessary level of review to accurately report these accounts in the financial statements presented for audit.

Section 6-300 of the Home Rule Charter designates the City Treasurer as the custodian of city funds. However, fiduciary responsibilities often require that departments maintain custodial accounts separate from other city funds. To decrease the risk of abuse that could result from creating bank accounts not under control of the City Treasurer, the Finance Office issued Standard Accounting Procedure (SAP) No. 4.1.1.g, which requires city agencies to obtain approval from the Director of Finance before opening a new bank account. Furthermore, SAP No. 7.1.3.b requires the agencies to prepare and submit monthly bank reconciliations to the city's Finance Office so that the account activity can be accumulated and correctly presented in the CAFR. The Finance Office is

then responsible for reviewing the reconciliations, verifying their accuracy, and determining consistency with the previous month's submission.

Our current year audit again disclosed errors involving the custodial accounts. We found that certain city agencies such as the Sheriff's Office and the First Judicial District continued to ignore SAPs, failing to submit the required fiscal 2013 year-end cash balances to the Finance Office for eight of the ten omitted custodial accounts. Additionally, one of the custodial accounts belonging to the Fire Department, with a year-end balance of \$2.6 million, was not previously approved by the Director of Finance.

Furthermore, the Finance Office neglected to perform an adequate review of the cash balances reported and failed to ensure that all agency bank accounts were identified. Seven of the ten accounts omitted in the fiscal year 2013 financial statements presented for audit were previously reported in the fiscal year 2012 CAFR. The Finance Office also reported the incorrect beginning cash and investment balances for three agencies, misclassified a \$1.6 million investment as cash, improperly reported a \$300,000 Special Revenue Fund account as an agency custodial account, and erroneously reported the fiscal year 2013 year-end book balance for eight other accounts. As a result, a \$12.1 million adjustment had to be made to correct the financial statements presented for audit.

Recommendations:

To improve the reporting process over custodial accounts, we continue to recommend that the Finance Office:

- Instruct city agencies to prepare and submit monthly custodial bank account reconciliations to its Accounting Bureau. The Finance Office should develop and implement procedures to ensure that each month there is a concerted follow-up effort by its accountants to obtain the required reconciliations [50106.05].
- Require city agencies to report all custodial bank accounts and follow the proper procedures for the establishment of new bank accounts in accordance with the SAP 4.1.1.g [500111.03].
- Perform an adequate review to ensure that all custodial accounts are properly accounted for in the city's CAFR [500111.04].



**SIGNIFICANT DEFICIENCIES**

**UNAUTHORIZED INDIVIDUALS ARE APPROVING BI-WEEKLY PAYROLLS**

Our audit of payroll expenditures noted a deficiency in the approval process of the city's bi-weekly payroll. Specifically, we noted that the official signature files maintained by the Finance Office did not always agree with the approval privileges assigned within the on-line payroll system. As a result, more than \$89 million in payroll costs were approved by unauthorized employees during fiscal year 2013.

The city's on-line payroll system includes a three step process that begins with data entry to the payroll time records by an agency employee. A responsible administrative employee then reviews the posted payroll time record and enters a supervisory-level approval into the system. Lastly, a commissioner, deputy, executive administrative officer or an employee of similar rank, reviews the postings and enters an executive-level approval into the system.

SAP No. E-0911, *Signature Authorization Cards*, requires a signature verification process and establishes the appropriate employee rank that can be designated to approve an agency's bi-weekly payroll. This procedure also requires the Finance Office to maintain a current signature file of employees authorized to enter executive-level approvals for their respective agency's payroll.

During the audit, we compared the payroll signature files for 55 city agencies to the individuals designated as authorized in the on-line payroll system that had executive-level approvals for the bi-weekly payrolls. Our testing disclosed the following inconsistencies between the signature files and the on-line payroll system:

- twenty-five agencies (45 percent) had employees performing the on-line executive-level approval of bi-weekly payroll who had not been authorized to approve payroll; and,
- forty-nine agencies (89 percent) had employees who were authorized as executive-level approvers, but not designated as such in the payroll system. Thirty-six of these individuals did not have access to the system.

**Recommendations:**

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

**CAPITAL ASSET DEFICIENCIES REQUIRE CORRECTIVE ACTION**

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

### Lack of a Comprehensive Capital Asset System Hampered Reporting Process

Our current year testing again noted no improvement in the capital asset reporting process. Finance Office accountants continue to maintain several Lotus 1-2-3 and Excel files that along with FAMIS<sup>3</sup> constitute the current fixed asset ledger. Various spreadsheet files accumulate the cost of capital assets and work in progress, while other spreadsheet files are used to calculate depreciation expense and accumulated depreciation reported in the CAFR. Real property addresses are only available in FAMIS by user code, which is identified in an Excel file called the “Proof.” The use of multiple files creates a burdensome and onerous process that can affect the accuracy and completeness of amounts reported in the CAFR and causes extensive audit effort. For instance, we found a \$1.0 million discrepancy between the “Proof” file and FAMIS for vehicle balances, and a \$4.0 million discrepancy between the “Proof” file and the financial statements for the current year building and equipment depreciation expense, which was corrected once brought to the attention of the Finance Office. We also noted a \$2.0 million variance pertaining to building retirements that was also subsequently corrected by Finance Office accountants.

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

### Real Property Assets Were Not Subject to Physical Inventory

Except for the PWD and the DOA, which both periodically check the physical existence and condition of their real property assets, our current year testing again disclosed no evidence that the city’s other real property assets had been recently inventoried.

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

In December 2013, the Mayor’s Facilities Task Force<sup>4</sup> issued their anticipated report on city-owned facilities with recommendations on how to better manage city facilities. According to the report, “the single greatest finding is the lack of systematic and coordinated data tracking by the City with regard to facility management. The complete cost of facility operations is not recorded in a manner that provides for optimal allocation of funding or the maintenance, repair and the capital investment in City facilities.” As such, it hampers the city’s ability “to develop a true strategic plan for making

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<sup>3</sup> Financial Accounting and Management Information System.

<sup>4</sup> The Facilities Task Force was established by Executive Order No. 8-11. Its mission was to make recommendations to the Administration related to ensuring that the city obtains the best financial terms for housing city operations in facilities and for leasing city facilities; that city facilities are clean, safe and code compliant; that facilities with complimentary uses are co-located; and that any underutilized facilities are merged. The task force was expected to issue its report by July 2013.

informed facility decisions.” One of the report’s top ten recommendations was to “implement an integrated, citywide asset management program to manage all data on City-owned facilities in a uniform and consistent manner.” In our opinion, this report reinforces our belief that the benefits of a comprehensive capital asset system outweigh the costs of such a system.

Recommendations:

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

- Design or purchase a computerized capital asset management system that will provide accurate and useful information such as the book value and related depreciation for each city-owned asset [50104.01].
- Periodically take physical inventories of all real property assets, ascertain their condition and use, and ensure that related records are timely and appropriately updated to reflect the results of this effort [50106.04].
- Develop and provide a plain language report on the condition of capital assets for the use of elected officials every three years. This report should be made available to the general public [500109.02].
- Obtain the capital asset list created by the Mayor’s Task Force on City-owned Facilities and compare it to Finance’s records to identify any discrepancies and ensure completion and accuracy [500113.14].

**SEGREGATION OF DUTIES NOT ENFORCED FOR THE AUTOMATED PAYROLL SYSTEM**

In our previous reports, we commented that the duties pertaining to the posting, reviewing, and approving of payroll transactions were not adequately segregated. We found that the same individual either performed data entry and reviewed payroll time records or completed both the supervisory review and executive-level approval of payroll. Effective control procedures require that these duties be performed by separate employees.

Our current audit looked at the electronic signatures for payroll entry, supervisory review and executive-level approval for all city departments/agencies during fiscal year 2013. Our testing of 55 departments for 26 pay periods, disclosed 494 occasions during the year (35 percent) in which the same individual posted and approved the on-line payroll time records, applied the supervisory and executive-level approvals, or performed all three duties. Forty-four of the departments showed employees performing duplicate functions for more than two pay periods, with the Mayor’s Office of Community Empowerment and Opportunity, the Office of the City Commissioners, and the District Attorney’s Office being the most recurrent among the larger departments. Consequently, there is an increased risk of error or fraud occurring without being detected during the normal course of employees performing their assigned functions.

In previous discussions with Finance Office accountants, they agreed that duty segregation of these payroll functions was both necessary and important, and therefore, they would continue to remind

city agencies to maintain adequate separation of duties. The city is also in the process of modernizing its administrative systems, including human resources and payroll, and the Finance Office planned to review these control procedures for implementation as part of the project.

Recommendations:

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

**WATER CUSTOMER ACCOUNT BALANCES COULD BE INAPPROPRIATELY REDUCED**

In previous reports we commented that users<sup>5</sup> of the city's water billing system, BASIS2, had the ability to make inappropriate credit adjustments to customer accounts without detection. Credit adjustment limits in the BASIS2 system range from a minimum of \$200 to a maximum of \$75,000, while the average customer's monthly bill is approximately \$75. As a result, a motivated system user could routinely adjust water accounts each month. And since an electronic authorization path for supervisory approval of adjustments has not been implemented in the BASIS2 system, errors or irregularities could occur without detection.

Our current year testing disclosed that although the WRB provided us with some of the quarterly credit adjustment reports for the period July 2012 through December 2013, a check of the reports indicated that they were not reviewed in a timely manner.

<b>Table 2: Review of Quarterly Adjustment Audit Reports</b>		
REPORT QUARTER	RUN DATE	REVIEW DATE
September 2012	Not Provided	-
December 2012	04/11/2013	03/12/2014
March 2013	04/11/2013	03/12/2014
June 2013	Not Provided	-
September 2013	03/04/2014	03/04/2014
December 2013	03/04/2014	03/05/2014

**Source:** Prepared by the Office of the City Controller

As Table 2 above illustrates, the quarterly reports ending on December 2012 and March 2013, were generated on April 11, 2013 however, they did not appear to have been reviewed until March 2014. Untimely generation and review of control reports diminishes their effectiveness. WRB personnel informed us that the quarterly reports were reviewed timely, but they failed to properly document the review. We also noted that only one type of credit adjustment was reviewed even though the report includes at least 11 other credit adjustment types. As a result, the WRB is inadvertently

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<sup>5</sup> Users are defined by employee title and authorization level.

narrowing the scope of their review to only one type of credit adjustment. In our opinion, this limitation also detracts from achieving the control objective.

Recommendation:

We again recommend that WRB management continue its efforts to improve procedures over credit adjustments in the BASIS2 billing system by generating and reviewing system user reports on a periodic basis. The reports should be initialed and dated by the reviewer to affix accountability for the task [50008.01].

**STANDARD ACCOUNTING PROCEDURES NEED TO BE UPDATED**

In accordance with the Philadelphia Home Rule Charter, the city's Finance Office is required to establish, maintain, and supervise an adequate and modern accounting system to safeguard city finances.<sup>6</sup> As such, the Finance Office has established over two hundred (200) SAPs to provide city departments and agencies with guidance on how to handle various accounting related activities, including the proper procedures for ensuring the accuracy of transactions and the safekeeping of assets. Over the years, as new technologies were adopted and daily practices were enhanced, the existing SAPs have not been updated accordingly, causing over 50 percent of them to be over half a century old.

Since these accounting procedures are an integral part of the daily transaction activities in each city agency, we have commented repeatedly over the past decade the importance of updating them. Although numerous Finance Directors have previously agreed with our finding, limited staffing capacity has made corrective action difficult to implement. During our current year audit, the Finance Office management stated that no updates had been made to the SAPs, therefore, the Controller's Office is now in its 12<sup>th</sup> year of reporting this condition.

In our opinion, the SAPs are essential to ensuring the accuracy of the various accounting related transactions and maintaining the safekeeping of assets for each city department and agency. Additionally, we believe that an on-going review, evaluation, and update of the accounting procedures is essential to maintaining consistency among the numerous city agencies that account for transactions daily throughout the fiscal year.

Recommendation:

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

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<sup>6</sup> City Charter Section 6-101, Accounts.

**WRITTEN PROCEDURES DO NOT EXIST FOR THE WATER AND SEWER FUND CAPITAL ASSET SYSTEM**

Since our fiscal year 2009 audit, we have repeatedly commented that the PWD has failed to employ written policies and procedures for the operation and review of its \$2.0 billion capital asset inventory system. Failure to maintain and update written policies and procedures increases the risk that PWD accountants will not be able to effectively and efficiently manage and report on water capital assets.

During our current audit, we noted that formalized written policies and procedures had still not been developed. We continued to find that real property items were not uniquely identified in the capital asset system so as to distinguish one asset from another. Instead, the PWD identified each item using a combination of the completion date and a detailed work order number. Since there is no mechanism in place to adequately identify assets in the system or to document depreciable lives, the risk of errors or omissions is increased.

Furthermore, we again found that PWD is depreciating real property assets costing less than \$5,000, the capitalization threshold established during the city's implementation of GASB Statement No. 34. While the excess amount of depreciation charged each year is not material to the city's financial statements, including these items in the capital asset inventory is an inefficient use of resources.

Regarding furniture and equipment, we found that PWD accountants are now adequately identifying these assets in Excel spreadsheets. Doing so allowed for a reconciliation of asset additions to purchases. Likewise deletions were sufficiently identified to discern between assets that were lost, scrapped, or traded-in during that fiscal year. Therefore, we consider this part of the finding resolved [500111.09].

**Recommendations:**

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

- Develop written policies and procedures documenting the operation and review of the capital asset system [500109.01].
- Ensure that the capital asset system uniquely identifies real property by providing a complete description of the assets [500110.03].

**COLLATERALIZATION OF CITY FUNDS ARE NOT ADEQUATELY MONITORED**

The Philadelphia Home Rule Charter Section 6-300 designates the City Treasurer as the official custodian of city funds, and thereby charges the Treasurer's Office with ensuring that the city's bank accounts are adequately protected against theft or loss. As further security for city deposits, Chapter 19-201(4)(a) of the Philadelphia Code specifies that banks or other financial institutions holding city money must provide pledged collateral at amounts equal to or in excess of the deposited amounts. The pledged collateral must be held by the Federal Reserve Bank or the trust department of a commercial bank.

During our current audit, we found that the Treasurer's Office did not adequately monitor its banks to ensure these institutions were in compliance with the above legal requirements. Additionally, there are no written procedures in place to instruct staff on how and when to perform monitoring procedures. The Treasurer's Office informed us that bank collateral reports were compared to deposits at the end of each month; however, they provided no documentation to support this review. Our testing revealed that deposits at two of the banks used by the city were not adequately collateralized for four months during the year. Deposits exceeded pledged collateral for these two institutions by as much as \$123 million for one of the months in question. Consequently, the Treasurer's Office did not know, from month to month, if its bank deposits were fully and properly secured, nor did the Finance Office, which is required to report on collateralized funds in the city's CAFR. Although the shortfall was corrected on the first day of the next month, the Treasurer's Office should not rely on the banks to monitor themselves. Untimely review of the bank's monthly collateral reports could leave the city vulnerable to loss if market conditions decline.

Recommendations:

To ensure that city deposits are adequately protected, we recommend that the Treasurer's Office prepare monthly collateralization reports timely. Once prepared, the reports should be submitted to the Finance Office where they should then be promptly reviewed to identify any collateral shortages [500113.15].



## ***CORRECTIVE ACTIONS TAKEN BY MANAGEMENT***

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

Our follow-up has disclosed that the city made progress addressing the following prior issue. We commend city management on its effort.

### **Worker's Compensation Plan is Now Better Monitored**

We first reported in fiscal year 2009 that the Risk Management Division of Finance (Risk Management) did not adequately monitor the activities of the Third Party Administrator (TPA) responsible for managing workers' compensation claims. Risk Management was unaware that the TPA was not adequately performing file maintenance on workers' compensation cases and Independent Rating Examinations (IREs), as required by their contract. Consequently, costs for future claims reported on the city's financial statements had substantially increased because the TPA reserved a minimum of 600 weeks of compensation (the "worst case" scenario) on all indemnity claims. We recommended that Risk Management better monitor the TPA to ensure that all contracted services were being received and, in particular, that case files were periodically reviewed and updated as appropriate.

During fiscal 2013, we reassessed Risk Management's progress on the corrective action plan they instituted to monitor the TPA and limit the liability reported for workers' compensation claims. Our testing revealed that Risk Management continued to require performance of IREs and Independent Medical Exams to better estimate the adequacy of the claim reserves, and assigned staff specifically to ensuring the TPA contracted services were being received. We therefore, consider this finding resolved [500109.03].

## *RESPONSE TO AUDITOR'S REPORT*



### CITY OF PHILADELPHIA

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ROB DUBOW  
DIRECTOR OF FINANCE

June 17, 2014

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

Re: Report on Internal Control and on Compliance and Other Matters – Fiscal 2013

Dear Mr. Butkovitz:

Thank you for the opportunity to discuss the contents of your draft report at the exit conference held on Monday, May 19, 2014. First, we are pleased that you consider the finding resolved with regard to the work that Risk Management is doing to monitor the Third Party Administrator (TPA) responsible for managing worker's compensation claims. Risk Management will continue monitoring these services to ensure the most efficient and cost effective management of the workers' compensation program.

We offer the following responses to the findings and recommendations found in the Controller's Office audit for Fiscal 2013.

#### Staff Turnover and Reductions Compromised CAFR Preparation Processes

**Finding & Recommendation:** Your report acknowledges that Finance/Accounting has made progress in succession planning efforts to replace the number of long-term employees planning retirement. However, you have repeated your finding that staff reductions in Finance, and now in other City agencies, contribute to errors in the financial statements presented for audit. You also noted a situation in the Revenue Department and indicated it did not adequately plan for the retirement of an OIT employee integral for managing the Tax Payer Information System (TIPS). You continue to recommend that Finance Office management consider hiring more accountants or invest in new information technology to assist with the labor-intensive procedures needed to prepare the city's financial reports; provide adequate funding to departments experiencing difficulty in providing accurate financial data for inclusion in the CAFR; and prepare succession plans for key employees (in all departments) who are essential to preparing information for the CAFR.

**Response:** The Accounting Bureau (Accounting) is committed to producing a well-prepared CAFR that is accurate and properly reviewed. As noted in your report, staff reductions in recent years have made the task of completing the CAFR more difficult. Despite the loss of experience, the Finance Office has made progress in its succession planning efforts, and believes it has a core of dedicated individuals presently in place to accomplish our mission. We will continue to work with other departments within the Finance area on succession planning efforts. Within

Accounting, unit managers have assigned more tasks to the staff accountants for them to be more involved in the year-end process and to facilitate better review by supervisors and managers. Accounting leadership reviewed the errors and adjustments identified in the FY2012 CAFR audit with the entire accounting staff in an effort to improve future performance. In addition, we are encouraging all of the staff to participate in the CPE courses being offered by the city's CPA's. We anticipate an improved CAFR in future fiscal years as the staff becomes more experienced and internal improvements are made.

Collective Lack of Due Diligence Resulted in Misstated Year-End Receivables

**Finding & Recommendation:** Your report noted a need for better oversight of city receivables due to misstatements and discrepancies in tax and other accounts receivable balances, as well as in the estimated uncollectible portion of the receivables. You noted that Revenue did not provide guidance to departments performing billing and receivables duties or calculating uncollectible amounts and that Revenue's written procedures to account for estimated uncollectible accounts were outdated and did not provide adequate instruction. You recommend that the Revenue Department develop detailed written procedures to guide their accountants in these areas, train staff who are performing new duties, and provide better guidance to accountants in other agencies, especially those generating significant revenue.

**Response:** Revenue is committed to working closely with departments that manage large agency receivables to provide better guidance and to ensure uncollectible receivables are calculated accurately. The Revenue Department is completing a procedures manual with detailed instructions to guide its accountants in preparing supporting documents and reports used for the CAFR report. Upon completion, this manual will be provided to other departments that have employees involved in the year-end receivables process, and Revenue will provide training as needed.

Inadequate Preparation Procedures for the Water and Sewer Fund Financial Statements

**Finding & Recommendation:** You reported that the Philadelphia Water Department (PWD) did not include a certification attesting that information on financial statements had been reviewed and approved and that PWD failed to provide supporting documentation for the financial statements to the Finance Office. You also stated that the PWD checklist did not provide detailed, meaningful information necessary to ensure the accuracy of the Water Fund financial statements. You recommend that the PWD perform procedures to ensure the accuracy and completeness of the Water Fund financial statements; amend the checklist to include comprehensive preparation procedures that may be consistently applied; and provide the checklist, as well as detailed supporting documentation for the financial statements, when submitting to the Finance Office.

**Response:** Accounting and PWD work closely together to prepare the Water Fund financial statements and will continue to do so. PWD did implement the use of a procedural checklist to document steps performed in the preparation of the annual Water Fund financial statements and provided this document to the Controller's Office during the audit. We agree with the recommendation that the comprehensive checklist, as well as supporting documentation, from PWD would help Accounting review financial statements for accuracy and completion. Accounting and Water will work together to determine what documentation is necessary and will discuss the Controller's observations with PWD staff to improve the existing financial checklist and ensure it is provided to the Finance Office with future financial statements.

Accounting will also explore with PWD the possibility of implementing a process to provide entries that may be uploaded into FAMIS so that the general ledger would support amounts reported in the financial statements.

Year-End Receivable Procedures Failed to Properly Account for Water and Sewer Fund Write-off

**Finding & Recommendation:** Your report indicated that the Philadelphia Water Department (PWD) did not accurately calculate its revenues, the year-end Water Fund accounts receivable balance, or the related allowance for



doubtful accounts. In addition, you noted that the Water Revenue Board (WRB) did not update its methodology for estimating the percentage of uncollectible receivables and that WRB accountants weren't given the opportunity to review the Water Fund financial statements. You recommended that all financial statement adjustments be posted to the City's accounting system in a timely manner, that PWD accountants post write-off amounts into the Water Fund financial statements once they are approved by the Accounts Review Panel, that PWD accountants participate in meetings with the Accounts Review Panel, and that the WRB and PWD work to establish communication channels to improve the financial statement preparation process and develop and implement a methodology for estimating the allowance for doubtful accounts for its receivables.

**Response:** The methodology for estimating the percentage of uncollectible receivables was changed to write off all balances one year or older only after reports were sent to PWD. The Uncollectible Receivables Report and methodology change were subsequently sent to PWD. In the future, PWD will provide copies of the financial statement to WRB so that they may review them prior to final submission and will participate in Accounts Review Panel meetings when invited.

Late Receipt of Component Unit Financial Reports

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

**Response:** We agree that the timely submission of all component unit reports is critical to the timely issuance and accuracy of the City's CAFR. Accounting communicates the required timelines to the component units and emphasizes the importance of timely submissions. During the last year, Accounting met early in the process with management and auditors of various component units concerning the timely audit submission, but still experienced difficulty expediting the receipt of final audits. Accounting, with the assistance of the Finance Director and other City administrators as needed, will continue to communicate the need for timely reporting.

Certain City Agencies Inaccurately Reported Year End Custodial Account Balances

**Finding & Recommendation:** Your report finds that Accounting did not receive accurate and complete custodial bank account information from several city agencies, causing financial reporting errors, and that Accounting did not perform an effective review of the information received. You recommend that Accounting continue to instruct City agencies on the requirement to prepare and submit monthly custodial bank reconciliations, conduct a concerted follow-up effort to obtain the required reconciliations, instruct city agencies to follow proper procedures for establishing new bank accounts, including Finance Director approval, and perform the necessary supervisory review to ensure that all custodial accounts are properly accounted for in the CAFR.

**Response:** We agree that the preparation and submission of custodial bank account reconciliations from all City agencies is critical to the timely issuance and accuracy of the City's CAFR. Accounting will work with the City Treasurer's Office (CTO) to develop and maintain a universe of known custody accounts maintained by departments. We will augment this list with custody accounts maintained by the Sheriff's Office and First Judicial District. Accounting will reissue SAP 4.1.1.g to require departments and the CTO to obtain Finance Office approval prior to opening any new bank accounts and reissue SAP 7.1.3.b to have departments submit monthly reconciliations to Finance for review and inclusion in the financial statements

Unauthorized Individuals are Approving Bi-weekly Payrolls

**Finding & Recommendation:** Your audit noted discrepancies between the Finance Office official signature files and the approval privileges assigned within the on-line payroll system. You recommend the Finance Office

management review the executive-level approvers in the online payroll system to ensure that all individuals are properly authorized and have appropriate access to the system.

**Response:** The Payroll Unit will work with OIT to explore a programmatic approach to remove authorized signors that have terminated or transferred to other departments. In the meantime, the Payroll unit will issue an email requesting that departments review employees currently on signature cards for accuracy and updating, where necessary. The email will remind departments of their responsibility to notify the Payroll Unit of any changes to the existing signatures.

Lack of a Comprehensive Capital Asset System Hampers Reporting Process

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

**Response:** We agree that it would be beneficial for the City to have a capital asset system to accurately maintain cost history records and depreciation history and provide a detailed inventory of the major systems in all of the buildings that the City owns. However, the current system will provide financial information that is accurate and auditable, even though it does not provide the level of detail that a capital asset system might provide.

Real Property Assets Not Subject to Physical Inventory

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

**Response:** We agree that there is no formal written process to document that a physical inventory is occurring and no one system/report where all of the data on property conditions is stored. However, as stated in your report, we believe that a physical inventory of assets is being conducted as a matter of course by the department and that information is the basis for their capital and maintenance budget needs. Accounting will review the report of the Mayor's Task Force on City-owned Facilities and determine if it can be helpful with maintaining the current inventory.

Segregation of Duties Not Enforced for Automated Payroll Time Records

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

**Response:** The security in the payroll systems lets a user with higher level do the work at their level, as well as the levels below them. We do agree that segregation of duties is an important internal control feature, and Accounting will remind the departments about the importance of good internal controls. Currently, the City's OnePhilly initiative is underway with consultants on site to begin the process of modernizing the City's administrative systems, including HR and Payroll. These types of control features will be reviewed for implementation as part of that project.



Water Customer Account Balances Could Be Inappropriately Reduced

**Finding & Recommendation:** Your report indicates that BASIS2, the City's water billing system, lacks an electronic authorization path for supervisory approval of adjustments and may allow for a user to make inappropriate credit adjustments without detection. You further commented that, although credit adjustments reports have been created, they are not reviewed on a timely basis. You recommended that WRB generate and review user reports on a periodic basis as well as have supervisors initial and date reviews to identify any questionable patterns of adjustment.

**Response:** WRB has worked diligently to identify and correct weaknesses in the BASIS2 system. The System maintains an audit trail of all credit adjustments and can identify the exact user name and credentials associated with each adjustment. Accountants conduct daily adjustment reviews to monitor and verify adjustments to ensure that all transactions conducted are proper and reasonable. We acknowledge there has been some delay in reviewing the reports, but WRB's review of the quarterly reports has not revealed any errors or irregularities to date. Going forward, reviews will be conducted in a timelier manner.

Standard Accounting Procedures Need to Be Updated

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

**Response:** Accounting is committed to continual review and updating of its SAPs. We agree that a comprehensive review and update of the procedures should be conducted on a regular basis. On a limited basis, and to ensure that we are in compliance with any changes in accounting regulations, these procedures are updated as regulations change. Additionally, Accounting is beginning a process to update the SAPs on an ongoing basis. We are currently working on updating the SAP concerning Unclaimed Money and aim to update SAP's related to petty cash and custody accounts. Going forward, Accounting will continue their efforts to update the SAPs as much as time and resources permit.

Written Procedures Do Not Exist for the Water and Sewer Fund Capital System

**Finding & Recommendation:** Your report finds that the PWD does not have written policies and procedures for the operation and review of its \$2 billion capital asset inventory system. Real property items are not uniquely identified in the system, and inconsistent with Finance's capitalization policy, assets less than \$5,000 were being depreciated. You recommend the PWD establish written procedures for system use and ensure that the capital asset system uniquely identifies real property by providing complete descriptions of assets.

**Response:** We agree with the Controller that it is optimal to have written procedures for PWD's capital asset system. PWD is in the process of procuring a new Capital Program Management System for replacing the existing Capital Project monitoring and tracking system (CAPIT), and staff is currently researching requirements for a suitable fixed asset system.

Collateralization of City Funds Are Not Adequately Monitored

**Finding & Recommendation:** The audit found that the City Treasurer's Office (CTO) did not adequately monitor its banks to ensure these institutions were in compliance with Philadelphia Code requirements regarding required collateral amounts. Additionally, there are no written procedures in place to instruct staff on how and when to perform monitoring procedures. You recommend that the Treasurer's Office prepare timely monthly collateralization reports and submit reports to the Finance Office for prompt review to identify any collateral shortages.

**Response:** We agree that it is important to review and monitor bank collateral reports on a timely basis. Additionally, the Treasurer's Office is working to develop policies and procedures for collateral management to reflect best practices. The City Treasurer's Office believes the discrepancies cited in your report were related to timing issues. Collateral levels change daily based on the account balances. Collateral reports are compared to deposits at the end of each month. Balances on the last day of the month may not be properly collateralized, but that is corrected immediately on the next business day. The CTO will make all efforts to review bank collateral reports on a more timely basis.

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

Sincerely,

A handwritten signature in dark ink, appearing to read 'Rob Dubow', with a stylized, flowing script.

Rob Dubow

Director of Finance