

Report on City of Philadelphia Internal Control FY2017

OFFICE OF THE CITY CONTROLLER

Each year, the Office of the City Controller audits the City of Philadelphia's basic financial statements. As part of that audit, the Controller's Office reviews the City's internal controls over financial reporting. Once the review is complete, the Controller's Office compiles its findings into a report on internal control and on compliance and other matters, identifying material weaknesses, significant deficiencies, issues of non-compliance and other conditions and making recommendations to address the findings.

WHAT ARE MATERIAL WEAKNESSES AND SIGNIFICANT DEFICIENCIES?

A **material weakness** is a deficiency, or 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.

A **significant deficiency** is less severe than a material weakness, yet important enough to merit attention.

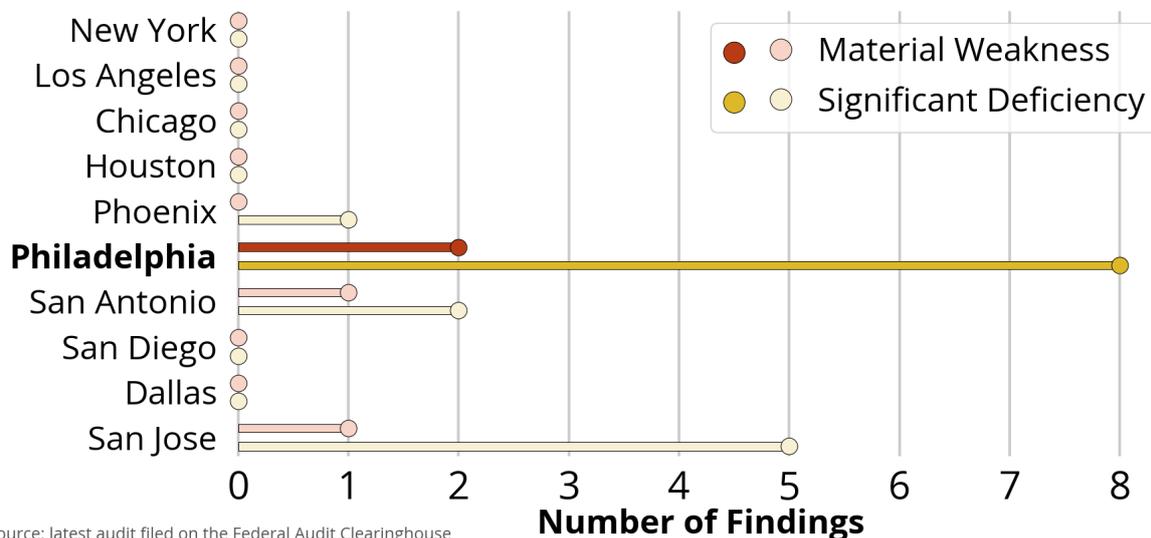
WHY IS THIS IMPORTANT?

If a material misstatement occurred on the City's financial statements, the statements would be considered an ineffective tool for assessing the City's financial health and may have far reaching consequences. Weaknesses in internal controls also create an environment ripe for fraud, abuse and waste. According to study published in Auditing: A Journal of Practice and Theory in August 2017, private companies with a material weakness in internal control were approximately 80-90% more likely to have fraud disclosures than other companies on average.

Philly's Internal Control Findings Compared to the Other Top Ten Largest Cities 2017

When comparing Philadelphia's internal control findings to the other top ten largest cities, you see that Philadelphia has the most reportable findings, by far.

Internal Control Findings: Top Ten Largest Cities



Source: latest audit filed on the Federal Audit Clearinghouse

The Office of the City Controller's mission is to promote the effective and efficient operation of Philadelphia government by identifying cost savings, recommending best practices and modernization, and exposing fraud and mismanagement.



FY2017 Findings

In the internal control report Fiscal Year 2017 (FY2017), the Controller's Office identified two material weaknesses and eight significant deficiencies. The material weaknesses resulted in \$33.3 million being unaccounted for in the City's largest cash account and \$924 million in undetected material misstatements that occurred in the preparation of the City's financial reports.

MATERIAL WEAKNESSES

- Weaknesses in the Treasurer's Office bank reconciliation process created the potential for significant errors and irregularities. (1a, 1b)
- Inadequate staffing levels, lack of technological investment, and insufficient oversight have led to undetected material misstatements. (2a, 2b, 2c, 2d)

SIGNIFICANT DEFICIENCIES

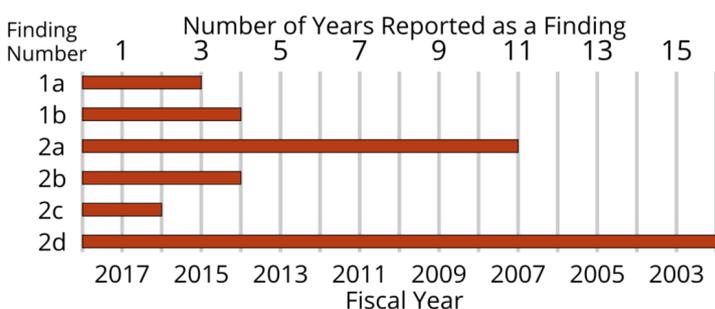
- Lax monitoring of adjustments to tax accounts may lead to undetected errors or irregularities. (1)
- Failure to timely transfer funds between city bank accounts could result in significant reporting errors. (2)
- Standard Accounting Procedures (SAPs) require updating to ensure accurate and consistent application of accounting rules and regulations. (3)
- Capital asset control deficiencies increase risk of reporting errors. (4a, 4b)
- Payment vouchers approved without required management authorization. (5)
- Allowing unauthorized individuals to approve bi-weekly payrolls increases risk for improprieties. (6)
- Failure to segregate payroll duties could allow fraud to occur. (7)
- General information technology controls require strengthening. (8a, 8b, 8c)

"The material weaknesses and significant deficiencies in internal control over financial reporting are not isolated incidents; they are indicative of a much larger problem. Philadelphia has serious issues with its financial management. I call on Mayor Kenney to treat these issues with serious urgency and to develop a comprehensive plan with a detailed timeline to address each finding over the next year."
- City Controller Rebecca Rhynhart

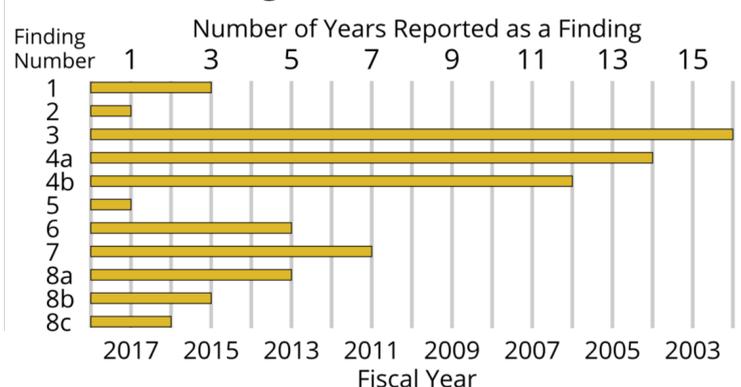
Findings Over Time

Many of the City's internal control findings have been reported year after year without remedy. Each of this year's findings in the list above is labeled to match the chart below, which shows the length of time each finding has been reported.

Material Weaknesses



Significant Deficiencies



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