Finance & Audit Committee Meeting

Third Quarter Fiscal Year 2017

January 25, 2017

Audit Update

Risk Management Framework (Prior Meeting Follow-up)

A sustainable risk management framework is a combination of ongoing activities that is built into strategic and operational decision making, embedded into the current governance structure and accountability demostrated through oversight and monitoring.

A sustainable risk management process includes:

- **Risk identification and assessment** to update risk universe, quantify risk impact and likelihood, and prioritize risk.

- **Risk analysis** to understand full risk composition including how and when the risk could present itself to the organization.

- **Mitigation and response** leading to action plans to monitor, mitigate, transfer, or eliminate risk, including understanding cost benefit equation of action plans.

- **Embedded risk management activities** to help ensure consistent risk appetite application and risk prioritization.

- Ongoing **monitoring, reporting, and oversight** by the Board and management.

To refresh existing risk management processes, the Office of Internal Audit and Compliance (IAC) completed an Enterprise Risk Assessment and a Compliance Risk Assessment with the goals of:

- Identifying, evaluating and prioritizing risks;

- Creating a risk-based internal audit plan;

- Enhancing Chicago Public Schools' (CPS) ongoing risk monitoring processes.

Enterprise Risk Assessment – Priority Risks

The priority risks identified by management during the **Enterprise Risk Assessment** are:

Priority Risk	Risk Definition	Impact	Likelihood
Academic Program Excellence	Inability to effectively maintain and expand academic program excellence.	High	Low to Moderate
Federal & State Requirements	Inability of timely and effective maintenance for compliance with federal and state requirements.	Moderate	Low to Moderate
Funding	Inadequate funding to maintain academic gains, provide support services, and meet operational, and capital objectives.	High	High
Infrastructure	Inability to effectively sustain an aging, complex and costly infrastructure footprint.	High	Moderate to High
Information Technology Systems	Inability of IT systems and applications to support current and future CPS needs.	High	Moderate
Internal Control Environment	Lack of effective controls to safeguard assets, provide reliable financial reporting, comply with applicable laws, regulations, and policies, and achieve organization objectives.	Moderate to High	Moderate
Talent	Inability to attract and retain quality talent needed to sustain academic progress and meet organization objectives.	Moderate to High	Moderate

Key Comments

- _The priority risks stated in this document are based on a combination of factors: review of relevant historical information, data analysis, high-level assessment of current organizational strengths and weaknesses, and management judgment._
- _The summary is a current, or point in time, assessment of risk impact and likelihood; priority risks will likely change with conditions._
- _The risk assessment process undertaken is consistent with both audit standards and leading practices._
- _Key next steps include defining the level of management effectiveness (or degree to which each risk is controlled) and confirming ongoing risk mitigation actions – many of which are underway._

Compliance Risk Assessment – Priority Risks

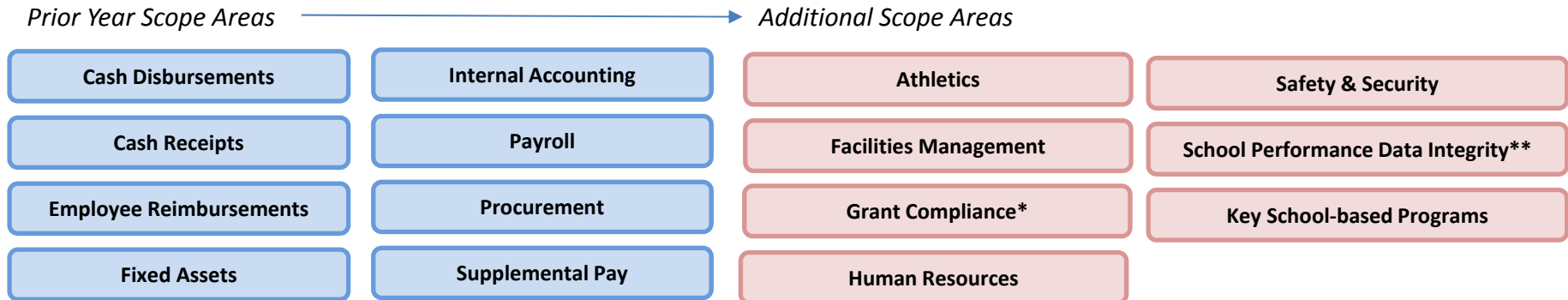The priority risks identified by management during the **Compliance Risk Assessment** are:

Priority Risk	Risk Definition	Impact	Likelihood
Environmental, Health & Safety	Limited capacity to detect or prevent non-compliance with environmental laws and regulations.	High	Moderate
ISBE Reporting Requirements	Inadequate capacity to provide accurate and timely data to demonstrate organizational compliance with ISBE requirements.	High	Moderate
Grant Monitoring (District, Charter, Non-public)	Inadequate monitoring of school and central office management use of grants.	Moderate to High	Moderate
Grant Revenue Management	Inability to monitor the proper and timely usage of grant funds within established guidelines and timeframes.	Moderate to High	Moderate
Privacy & Information Security	Inadequate storing and safeguarding of personally identifiable information, HIPAA-covered information, and academic records.	High	Low to Moderate
Time & Effort Attestation	Inadequate capacity and technical processes to properly monitor time and effort reporting requirements consistent with applicable requirements.	Moderate to High	Low to Moderate

Key Risk Assessment Outcome – Integration

School Audit Program Initiative – Started in Late 2015, Confirmed During Risk Assessment, and Evolving

- **Implemented a school risk assessment based on key performance and risk indicators**, such as the following:

  - ✓ Length of Time Since Last Audit
  - ✓ Last Audit Score
  - ✓ Prior History of Non-Compliance
  - ✓ Internal Accounts Reporting Exceptions
  - ✓ Financial Information (Bank Account, Cash Receipts, Cash Disbursements, Cash On Hand, etc..)
  - ✓ Academic Information (Enrollment, SQRP, Transfers, Grade and Attendance Changes)

- **Combined school-based audit objectives into a single yet comprehensive school audit program to reduce the number of school visits** and time allocated by school and department staff to respond to audit and compliance inquiries.

- **Expanded the school-based audit scope to include grant compliance, school performance data integrity, and other administrative** areas to better gauge the overall strength of internal controls and governance. Incorporated the Grant Compliance Work Program into school audit program.

Prior Year Scope Areas → *Additional Scope Areas*

Cash Disbursements	Internal Accounting	Athletics	Safety & Security
Cash Receipts	Payroll	Facilities Management	School Performance Data Integrity**
Employee Reimbursements	Procurement	Grant Compliance*	Key School-based Programs
Fixed Assets	Supplemental Pay	Human Resources	

- **Created a robust "desk audit" process, utilizing exception reporting and data analytics, to test and evaluate larger transaction populations** and increase audit coverage across CPS at a lower operational cost.

- In early Fall FY18, incorporate the use of a **Control Self Assessment** to expand overall coverage of schools reviewed in programs.

*Includes SGSA; Title I, II, III, IV; IDEA; and Early Childhood Education (Head Start)
**Includes enrollment; attendance and grade changes

Risk Management Framework – Responsibilities

Lines of Defense Model (Representative Model)		
Board of Education		
Executive & Senior Leadership		
1st Line of Defense *Own & Manage Risk*	**2nd Line of Defense** *Monitor & Control Risk*	**3rd Line of Defense** *Validation & Assurance*
Management Controls Internal Control Measures Policies & Procedures	Financial Controller Risk Management Safety & Security Grant Management School Quality Management	Internal Audit & Compliance

Key Ongoing Internal Audit Activities

- **Cybersecurity Diagnostic Assessment** – Evaluate key internal control and management processes related to cybersecurity such as: leadership and governance; information risk management, and incident response; identify strengths and gaps based on IT standards and leading practices; and develop recommendations to remediate gaps.

- **Option Schools Attendance Audit** – Assess accuracy of attendance data provided by management and evaluate alternative funding models based on attendance and enrollment.

- **Payroll Audit** – Evaluate the design and operational effectiveness of key internal controls designed to help ensure integrity in payroll transactions including employee payments, withholdings, and third-party remittances will begin in February 2017 (planning is underway).

- **English Language Learners (EL) Program Compliance** – EL Program Compliance Monitoring Visits based on prior OLCE EL Program Review including district and charter schools will begin in February 2017 (planning is underway).

- **School Audits** – Ongoing as described on prior page.

Closed School Asset Review

Objectives – CPS invested millions of dollars in assets including textbooks; computers, laptops, and tablets; tables, desks, and chairs; and other equipment such as boilers and furnaces. These assets are located primarily within the schools and purchased using a range of funding sources. In mid-to late 2016, IAC conducted a fixed asset assessment to both understand internal controls from acquisition to disposal and to determine location of assets transferred during the 2013 school closings.

Results – IAC was able to gain an understanding of processes employed to tracks assets – both on a general basis and related to the 2013 school closings. IAC, however, was not able to identify with reasonable certainty where all closed school assets ultimately were placed.

The primary reasons for IAC's inability to re-create the exact location of all closed school assets are: 1) the project leadership responsible for tracking the assets are no longer with CPS, 2) lack of available supporting documentation and clear audit trail, and 3) CPS no longer has a relationship the prior vendor.

Based on work performed, IAC is fairly confident that a significant portion of closed school assets were re-purposed to other schools. For example:

- IAC determined there were "open houses" whereby the leadership from non-impacted schools conducted in-person inspections of assets and took immediate possession.

- There were also opportunities for non-impacted school leadership to visit a CPS warehouse to obtain closed school assets for use at their school.

The primary goal appeared to have been focused on quickly reallocating closed school assets to non-impacted schools, particularly welcoming schools. Detailed tracking of asset movement appeared to be a secondary or lower priority.

Key Recommendations – While there are existing polices and internal controls over assets, there is opportunity for improvement. Asset management processes are inherently difficult for any organization due to portability and transaction volume for items such as laptops and textbooks. Management is undertaking a number of actions to improve fixed asset processes including:

- Implementing an integrated system that more effectively tracks assets throughout their life cycle.

- Designating a single individual responsible for oversight of all aspects of the asset lifecycle, policy maintenance and enforcement, and management reporting.

- Performing cycle counts and year-end physical inventory of assets to verify the accuracy and completeness of asset records.

- Updating board rules and management polices as needed.

District-wide Audit Highlights

Options Attendance Audit (Started in 2016 with update underway)

Objectives – CPS provides funding to Option schools, which include Alternative Learning Opportunities Program (ALOP); alternative charter and contract; and Safe* schools. Option schools generally serve students who need a new pathway toward high school graduation. IAC performed an audit of Option schools during FY16 to verify attendance against enrollment and gain insight into attendance recording processes.

Results – IAC noted that for Option schools tested in early to mid 2016, average IMPACT attendance was 52% of enrollment. Additionally, the average actual headcount based on IAC testing was 44% for the same timeframe. As such, Option schools attendance levels are exceptionally low based on IMPACT attendance data and are even lower based on IAC testing. Deficient internal controls have led to low attendance and inaccurate reporting.

The primary reasons for deficient controls over the attendance appear to be: 1) Option Schools are not held fully accountable for low attendance as funding is based on enrollment, not attendance; 2) attendance verification controls are less than ideal; and 3) Option schools oversight could be improved as the program is overseen by only two individuals from Innovation and Incubation (I&I).

Key Recommendations – IAC highly recommends that management address the observed gaps including the following actions:

- Develop a new program model and funding allocation that takes into consideration student attendance.
- Perform a reasonableness check on IMAPCT attendance data by comparing to audited student attendance headcount results on a periodic basis. This includes continued collaboration with IAC to conduct periodic and random attendance headcounts.
- Enhance oversight of the Option schools program to better detect programmatic issues.
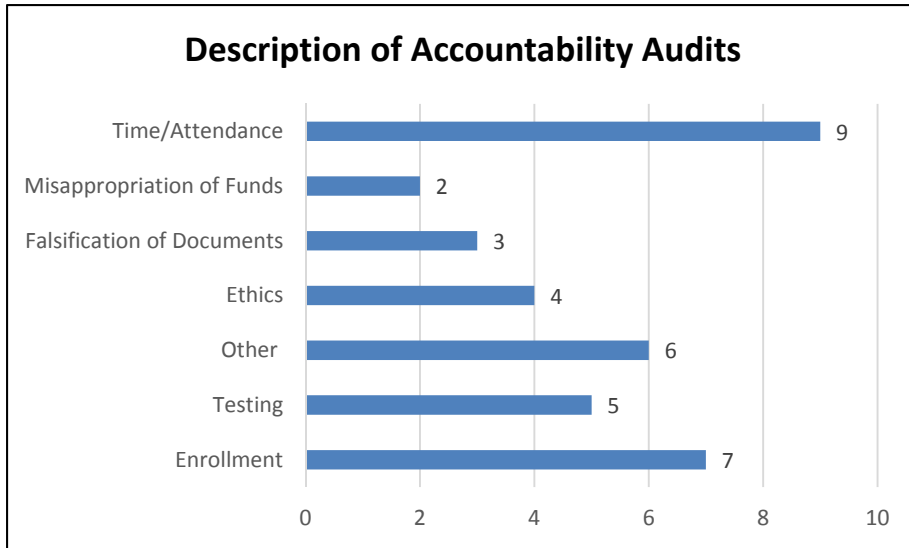
Quantitative Impact – CPS could see significant savings if Option school funding was based on IMPACT attendance data or actual headcount data, instead of enrollment. If funding were based on IMPACT attendance data, IAC estimates CPS could save $12 million annually; and if funding were based on actual headcount obtained from periodic audits, estimated savings could be $15 million annually.

Recent Count Results – *In late 2016, average IMPACT attendance for Option schools improved to 60% of enrollment. While the gap between IMPACT attendance and average actual headcount based on IAC testing narrowed, the over-reporting by Option schools persists. IAC results were 55% of enrollment vs. the 60% reported to IMPACT.*

Safe schools were not included in the initial audit scope, but are included in the follow-up attendance audit.

Accountability Audit Highlights

Description of Accountability Audits

Category	Value
Time/Attendance	9
Misappropriation of Funds	2
Falsification of Documents	3
Ethics	4
Other	6
Testing	5
Enrollment	7

Accountability Audit Outcomes

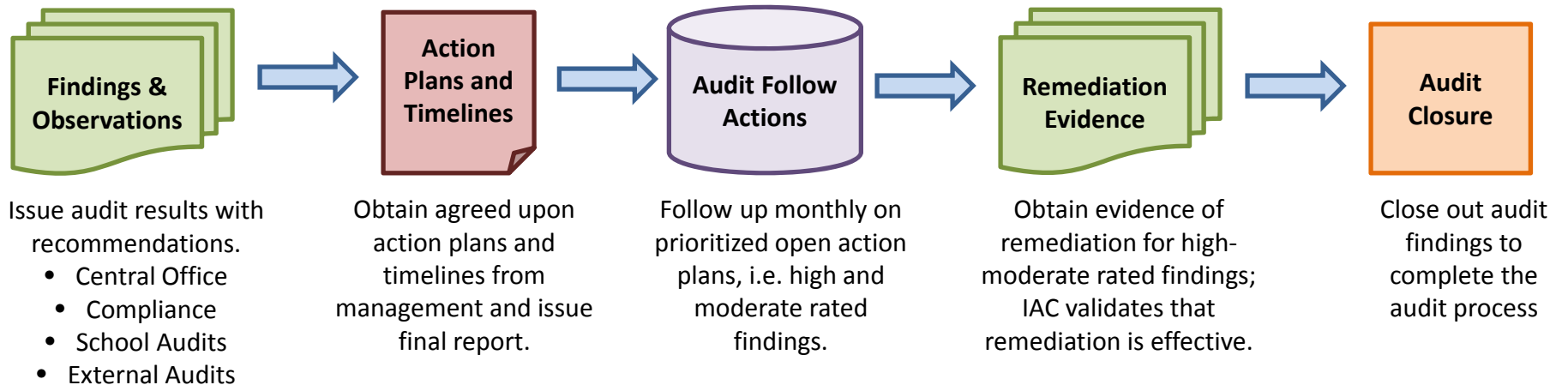| Category	Value
Referred to IG	9
Unsubstantiated	4
Discipline TBD	14
Written Discipline	2
Terminated/DNH	14

Accountability Audit Highlights

- *Time/Attendance* – IAC performed a school audit and determined there were numerous issues involving payroll. Five employees are awaiting discipline due to misuse of benefit time, swiping in for other employees, and extended day payments received for time not worked. Time and sick day abuse results in employee termination.

- *Ineligibility of Sports Players* – IAC received a complaint regarding student athletes at multiple high schools who had recently transferred. IAC reviewed address information and interviewed homeowners to determine students' primary residence. Seven students were denied eligibility due to unverified addresses and residency verification is still pending for four students.

- *Misappropriation of Funds* – IAC received a complaint regarding school facilities rental income. It was determined that an Athletic Director was receiving payments from third parties and not remitting to CPS. Escalated to the OIG for further investigation.

Chief Internal Auditor (CIA) and Inspector General (IG) Interactions

- Since late 2015, the CIA and IG meet regularly to discuss work being performed by IAC and to coordinate efforts as deemed prudent.

- Several other CPS departments and staff continue to refer issues to the IG as deemed prudent.

Internal Audit Follow-up Process

Ongoing Management Reporting and Quarterly Board Updates

Findings & Observations → **Action Plans and Timelines** → **Audit Follow Actions** → **Remediation Evidence** → **Audit Closure**

Findings & Observations	Action Plans and Timelines	Audit Follow Actions	Remediation Evidence	Audit Closure
Issue audit results with recommendations. • Central Office • Compliance • School Audits • External Audits	Obtain agreed upon action plans and timelines from management and issue final report.	Follow up monthly on prioritized open action plans, i.e. high and moderate rated findings.	Obtain evidence of remediation for high-moderate rated findings; IAC validates that remediation is effective.	Close out audit findings to complete the audit process

Board Reporting

- Quarterly Board updates commencing fourth quarter FY2017 (next Finance and Audit Committee Meeting).
- Findings will be tracked from July 1, 2016 to current.

Finance Update

CAFR General Operating Fund Results

000's		2017 Forecast C		2016 Actuals B		2015 Actuals A
Total Revenue	$	5,299,873	$	4,877,767	$	4,909,584
Total Expenses	$	5,299,873	$	5,414,846	$	5,620,366
Revenues in excess (below) Expenditures	$	-	$	(537,079)	$	(710,782)
If CPS would have received its 2016 State Revenue $107,000 on time then the actual 2016			$	107,000		
Adjusted 2016 Total			$	(430,079)		

A. 2015 Operating Revenue was below Operating Expenses - short term borrowing and fund balance were used to complete the year

B. In 2016, CPS improved its financial condition, even though we did not receive over $700M of State and Federal revenue but expenses came in $276M lower

C. CPS is still committed to continuing to improve its financial condition by balancing its budget in spite of the Governor vetoing the $215M pension funding