Finance & Audit Committee Meeting

Fourth Quarter FY17

April 26, 2017

Audit Update

Key Ongoing Internal Audit Activities

- **Procurement Audit** – Assess the effectiveness of internal controls governing key activities such as purchase orders, solicitations, and vendor management.

- **Payroll Audit** – Assess the effectiveness of internal controls governing key activities such as time reporting, employee payments, withholdings, and third-party remittances.

- **Option Schools Attendance Audit (Phase II)** – Assess the accuracy of attendance data and evaluate alternative funding models based on attendance and enrollment.

- **Absenteeism Compliance** – Ongoing review of time off and sick day requests to determine compliance with policy.

- **School Audits** – Ongoing (see later slide for details).

Cyber Diagnostic Assessment

IAC assessed CPS' cyber security capability in comparison to a leading maturity model. The assessment is aligned to the National Institute of Standards and Technology (NIST) cyber security framework. In scope areas were:

- *Leadership & Governance, Human Factors, Information Risk Management, Operations & Technology, Business Continuity, Legal, and Compliance & Audit*

Background

- CPS' Information & Technology Services (ITS) is responsible for managing a technology infrastructure encompassing 36,000 employees, 500+ district schools, nearly 400,000 students, and a variety of electronic devices such as laptops, desktops, tablets, cell phones, etc.

- Prior to the assessment, ITS had a number of ongoing initiatives to improve CPS' cyber security capability such as: an open job position for an information security engineer, an identity access management tool update, a virtual private network upgrade, two factor authentication, and training.

  - An outcome of the assessment was to also validate ITS' mid-term to long-term roadmap for enhancing CPS' cyber security framework.

Results

- For an organization of the size and scale of CPS, it would be expected that the cyber security infrastructure would be more mature. While currently assessed as Repeatable, IAC recommends aspiring to Managed.

  - ITS and senior leadership must define a plan to complete in-flight projects as well as a strategy to adopt practice and policy changes that matures the cyber security infrastructure.

  - Until the aforementioned is in place, CPS will have a diminished ability to proactively detect or quickly react to potential security threats.

Cyber Diagnostic Assessment

Cyber Diagnostic Assessment
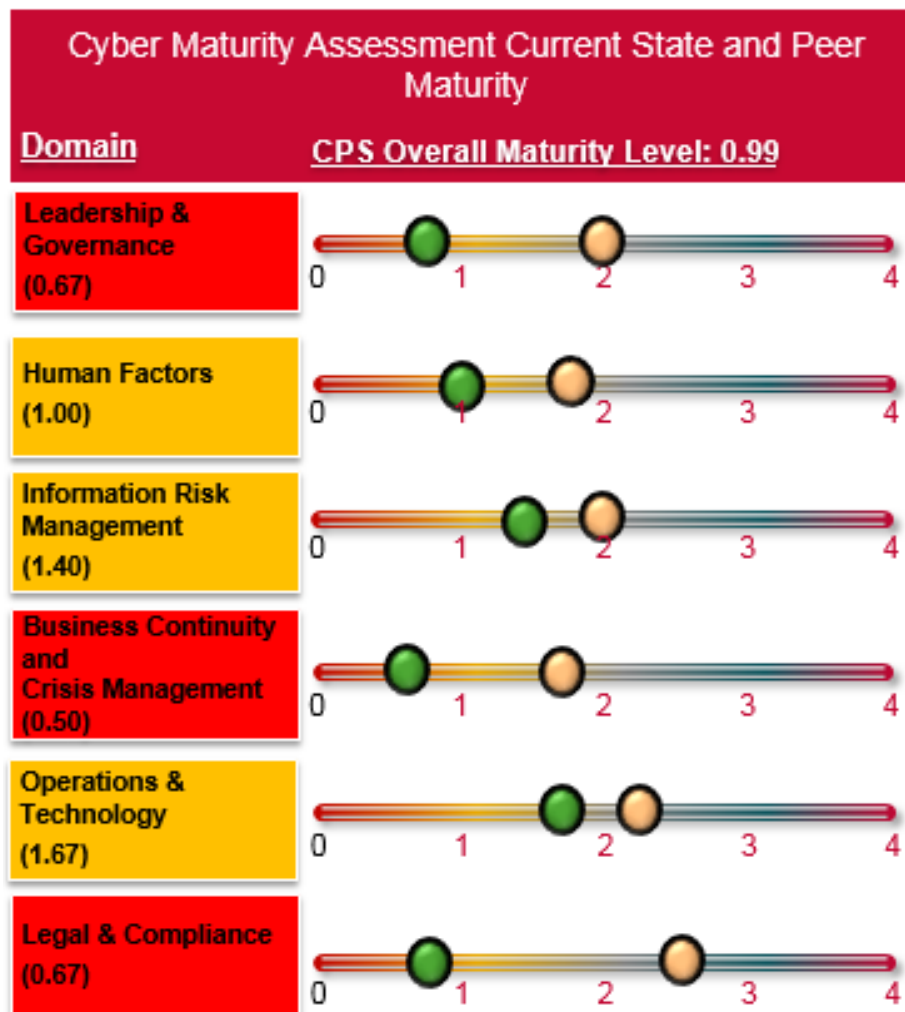
Key Recommendations (as mentioned, some are already in process)

- Hire an information security engineer responsible for managing information and cyber security infrastructure and implementing recommendations.

- Re-establish a formal cyber security governance program with a defined business objective, scope, and purpose that is endorsed by senior management.

- Enhance training program requirements for staff and students (i.e. acceptable use, data classification, data privacy, protection and handling, security policies and procedures, and social engineering).

- Require mandatory cyber security training before employees, contractors, and third parties are granted access to CPS computer systems.

Quantitative and Qualitative Impact

- Diminished ability to proactively detect or quickly react to potential security threats.

Vendor Payments & Employee Reimbursements

IAC performed an analysis of vendor and employee reimbursement data for FY14 through FY16 to identify potential transactional errors, and inform process and policy improvements.

Results

- Less than ideal vendor management processes and controls as indicated by 250 records with different addresses; six vendors with the same tax identification number; 270 vendors records with the same telephone number but different vendor IDs; 100 employees and vendors with the same or similar address; and 90 employees and vendors with the same telephone number.

- Weak procurement expenditure controls to detect transactional errors or abnormalities as illustrated by 200 possible duplicate payments and 140 vendors with purchase orders of $75,000 or more across two or more schools or departments and no strategic source vending relationship or board report – could be indicative of breaking the spirit of procurement rules.

- Less than ideal employee reimbursement processes and controls as indicated by 35 employees with consecutive $500 reimbursements over short periods of time.

Key Recommendations

- Improve procurement processes related to vendor management and expenditures including, but not limited to; 1) enhanced analysis, reporting, and monitoring capabilities to more proactively identify the data abnormalities; 2) enhanced information technology systems to promote data quality, improve management reporting, and strengthen management internal controls; and 3) update policies as needed.

- Perform follow-up procedures on potentially higher risk vendors and transactions identified through analysis.
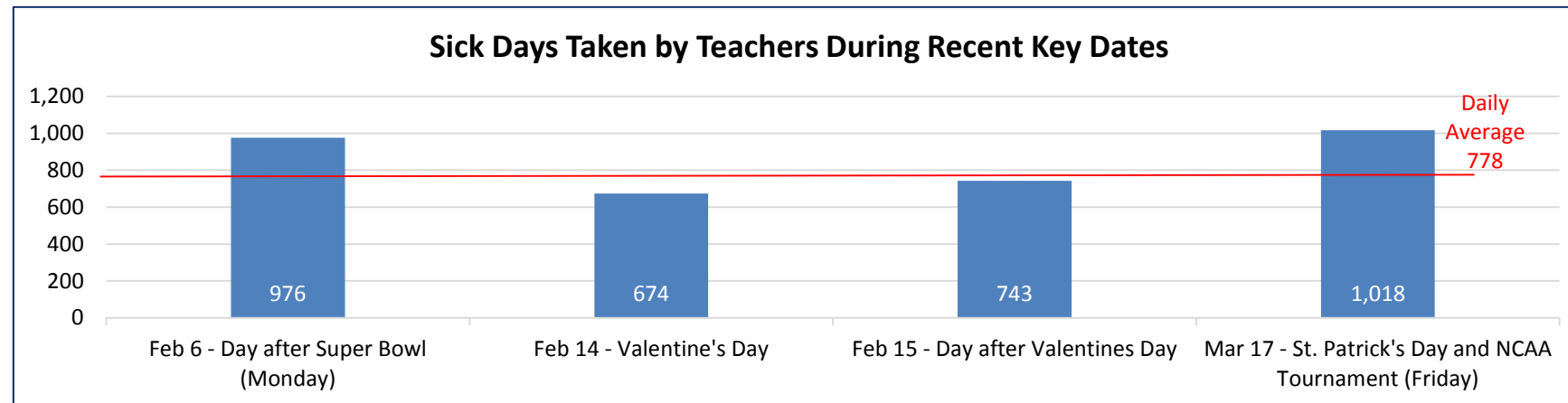
Quantitative and Qualitative Impact

- Diminished ability to proactively identify and reduce transaction errors, manage vendors, and reduce spend.

Absenteeism Compliance

Over the last several weeks, Internal Audit has been performing a review of time off and sick day requests to determine compliance with CPS policy.

- During our analysis, we have noted that CPS employees are more likely to be absent on certain days of the week such as Monday or Friday. Sick day usage also increases during weeks with holidays or special events such as the Super Bowl.

Sick Days Taken by Teachers During Recent Key Dates

| Date	Sick Days
Feb 6 - Day after Super Bowl (Monday)	976
Feb 14 - Valentine's Day	674
Feb 15 - Day after Valentines Day	743
Mar 17 - St. Patrick's Day and NCAA Tournament (Friday)	1,018

Daily Average 778

- The average daily cost of a substitute teacher is $120. Substitute teacher cost for the days stated above is estimated at $410,000. This is in addition to sick pay hours paid to employees who have called in sick.

Absenteeism Compliance

- Due to a high number of _advance scheduled sick day requests_ occurring on 2/6/17, 2/14/17, or 2/15/17, IAC sent letters to approximately 250 employees based on a judgmental sample. The results as of April 12th are below.
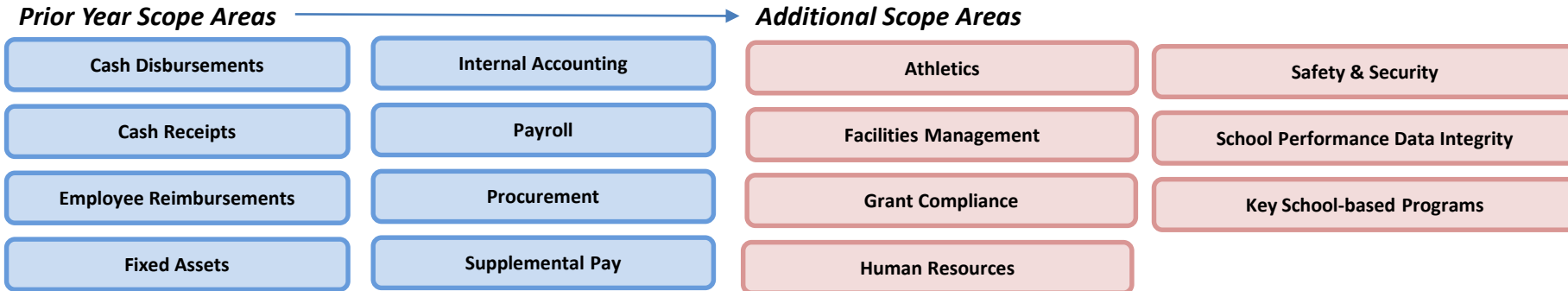
Doctors Note	Employee Statement	No Response	Other
57%	25%	14%	4%
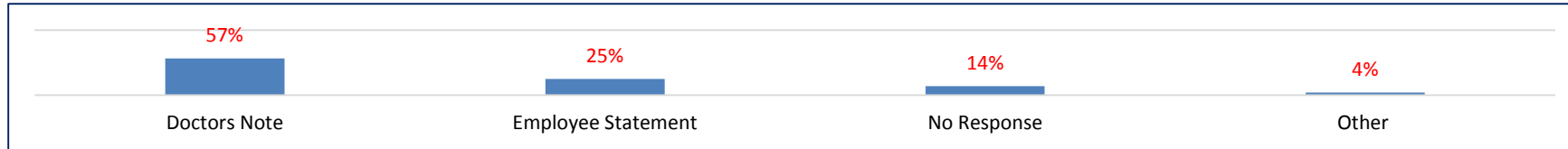
- Due to similar circumstances on March 17th, IAC sent an additional 150 letters based on a judgmental sample. Responses are pending.

- Ongoing _monitoring of reasons stated for sick days_ to determine compliance with policy is occurring as well. Examples of reasons given include:

  - _Wedding in Atlanta_
  - _My son/daughter has an extracurricular event & I am out of personal business days_
  - _Honeymoon_

  - _If I don't use it, I will lose it_
  - _Mental health day_
  - _Getting married in Vegas_
  - _I have to go to Indiana for a 2nd interview_

  - _My son/daughter is receiving class ring and I don't want to miss the event_
  - _I will be out of town_
  - _My dog is sick, she can't keep any food down, I'm taking her to the vet today_

  ✓ Emails are sent to employees requiring a follow-up; approximately 100 letters sent in the last several weeks. Upon receiving the letter, approximately one third of employees have changed their time code from sick day to another code such as personal business day or excused absence without pay.

Next Steps

- Continue compliance monitoring efforts for an indefinite period of time.

- Evaluate the level of discipline (which includes termination) to be applied for actual or attempted sick day policy violations.

School Audits

18 district-run schools have been audited in FY17 to date; volume is lower than the prior year due to few factors: expanded audit scope driving expected decrease in number of audit "visits", desk audits to test large transaction volumes, and later start time due to organizational initiatives.

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	

Need for Structural Change

- The results from school audits and other related audits – and reinforced by recurring audit findings – demonstrate the need to improve the internal control and governance structure across schools.

- Also demonstrates the need to improve process consistency and the level of financial expertise across 500+ schools with varied and diverse financial needs.

- Below is a snapshot of recently recurring audit findings and annual processes that schools manage:

  - ✓ 75% with Payroll-Related Irregularities
  - ✓ 80% with Expense Reimbursement-Related Irregularities
  - ✓ 70% with Monthly Reconciliation-Related Irregularities
  - ✓ 25 Employees with Time Abuse/Falsification Issues
  - ✓ Encompasses findings such as lack of required approval prior to purchase of goods and services, inadequate supporting documentation, and segregation of duties.

  - ✓ 980,000 Manual Payroll Edits
  - ✓ 38,000 Expense Reimbursements, 70,000 Budget Transfers, and 6,000 Bank Reconciliations
  - ✓ $92 million (200,000 transactions) off-contract spending

School Audits

- CPS has an obligation to ensure strong financial controls over the hundreds of millions of dollars that flow through our schools and key to that is process modernization to prevent recurring audit findings.

- CPS is focused on structural changes that will address recurring school audit findings. The School Support Center (SSC) expansion, which will be discussed in the financial portion of this meeting, is a key component of the structural change.

Finance Update

School Support Center Expansion – General

- The revamped SSC has been working with principals this year to remove mundane and repetitive transactions from daily school operations and create better internal controls. Key processes include:

  - Budget transfers
  - Book transfers
  - Monthly reconciliations

  - Employee reimbursements
  - School reimbursements
  - Timekeeping support

- The SSC expansion also includes district-wide rollout of the Kronos Employee Self-Service (ESS), which is the industry standard for timekeeping.

  - *It is important to note that employee responsibility and accountability for managing time has not changed.*

  - *CPS is modernizing the method for employees to report time – like other government entities and major organizations; many central office departments have been using ESS for several years*

- ESS enables employees to make swipe corrections (such as a missed swipe) and time off requests without having to submit paper forms.

- Within schools that have migrated to ESS, 90% of employees are using it to confirm timecard accuracy or to make edits as needed. After the initial changeover, school-based manual edits have decreased by approximately 30%.

- CPS has provided convenient training opportunities for school-based staff and principals through a series of webinars, in-school training sessions, e-learning training modules, and other resources available on-demand at the CPS web portal. Training for ESS is mandatory.

- ESS transactions take just minutes to complete. School-based staff can access ESS through any computer with an internet connection; they do not need to be onsite or on the District's VPN.

- To date, the SSC is providing financial and accounting support for 300 schools with successful results.

- The SSC expansion program will be fully implemented at all district-run schools by the end of this school year.

All-Time Records in 2016:

- 73.5% Graduation

- 87.4% Freshmen on Track to Graduate (+20 Percentage Points from 5 Years Ago)

Dropout Rate Half of Five Years Ago

Students Outpacing Peers Nationally in Reading and Math

Record ACT Scores in 2016

Record $1.1 Billion in College Scholarships in 2016

Financial Crisis Driven by State's Racially Discriminatory Funding

- CPS students are 90% minority
- In FY 17, CPS receives just $0.78 for every $1.00 other Illinois districts receive

State Funding for CPS and All Other Districts ($ in Millions)
Includes Major Sources: General State Aid, CPS Block Grants, Bilingual Education, and Pensions

+31% since FY 12

-2% since FY 12

Legend: All Other Districts — CPS
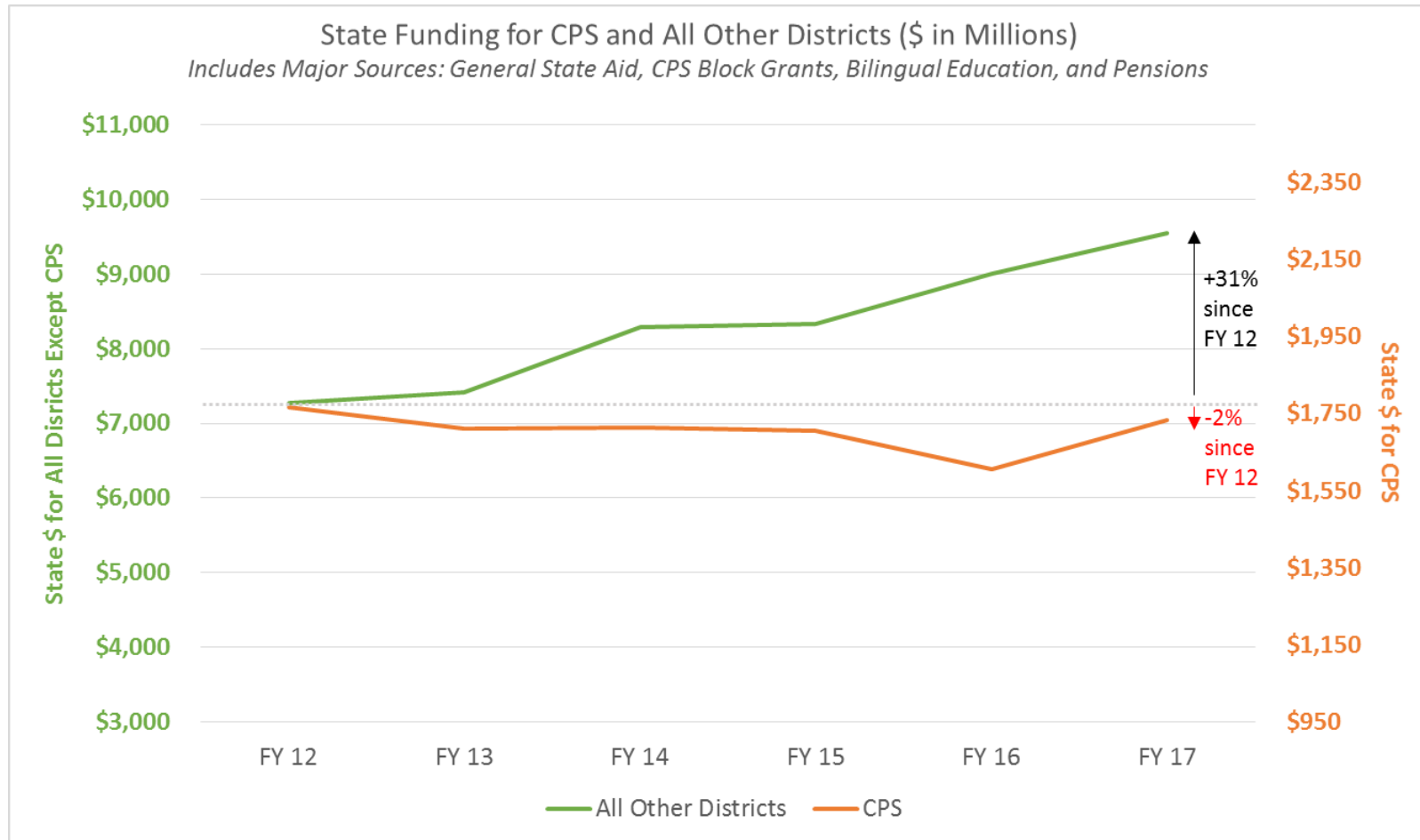
CPS is the Only School District that Funds its Own Pension Payment
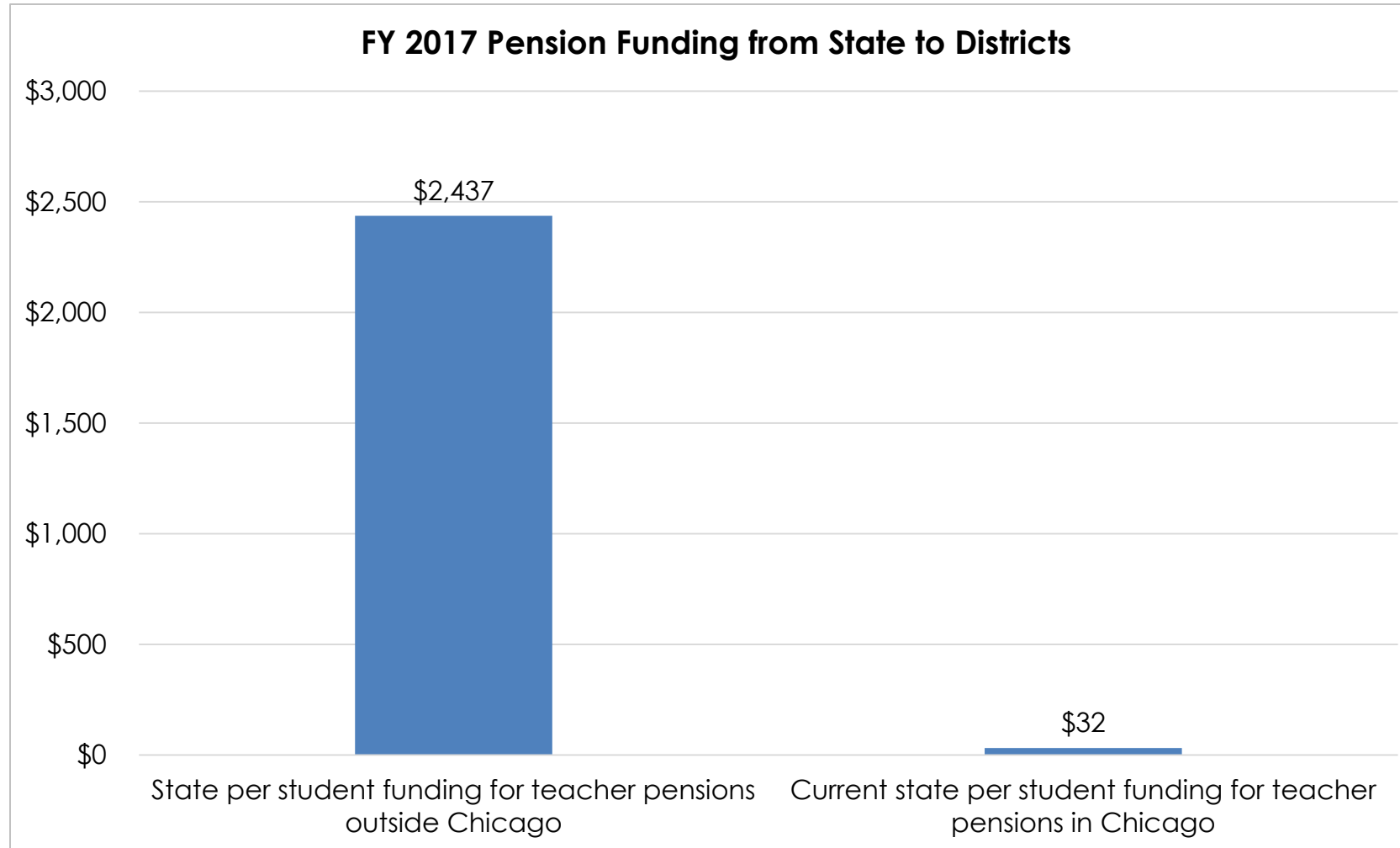
FY 2017 Pension Funding from State to Districts

Bar chart:
- State per student funding for teacher pensions outside Chicago: $2,437
- Current state per student funding for teacher pensions in Chicago: $32

Chicago Public Schools

- In FY 17, CPS receives just **$0.78** for every **$1.00** other Illinois districts receive

- By FY 22, CPS is expected to receive just **$0.67** for every **$1.00** other Illinois districts receive*

- **Disparate impact on African Americans and Latinos becomes *worse* and *worse***

State Funding Per Pupil* FY 2012 to Projected FY 2022
Includes Major Sources: General State Aid, CPS Block Grants, Bilingual Education, and Pensions

Legend:
- CPS
- All Other Districts

X-axis: FY 12, FY 17, FY 22 (Projected)*

* Assumes enrollment flat to FY 16 ISBE Fall Enrollment count; enrollment for FY 17 not yet available. Also assumes current funding levels for categoricals, current equity grant in GSA and GSA hold harmless, and growth in TRS and CTPF pension contributions based on 2016 actuarial valuations

CPS Required Contributions to Teacher Pensions ($ in Millions)

Year	State Contribution	Net CPS Payment
2014	12	601
2015	62	634
2016	12	676
2017	12	721
2018	12	761
2019	12	786
2020	13	811
2021	13	836

■ State Contribution   ■ Net CPS Payment

Sources: 6/30/16 actuarial valuation; FY 17 certified + projections
Assumes CPS nets state contribution from payment
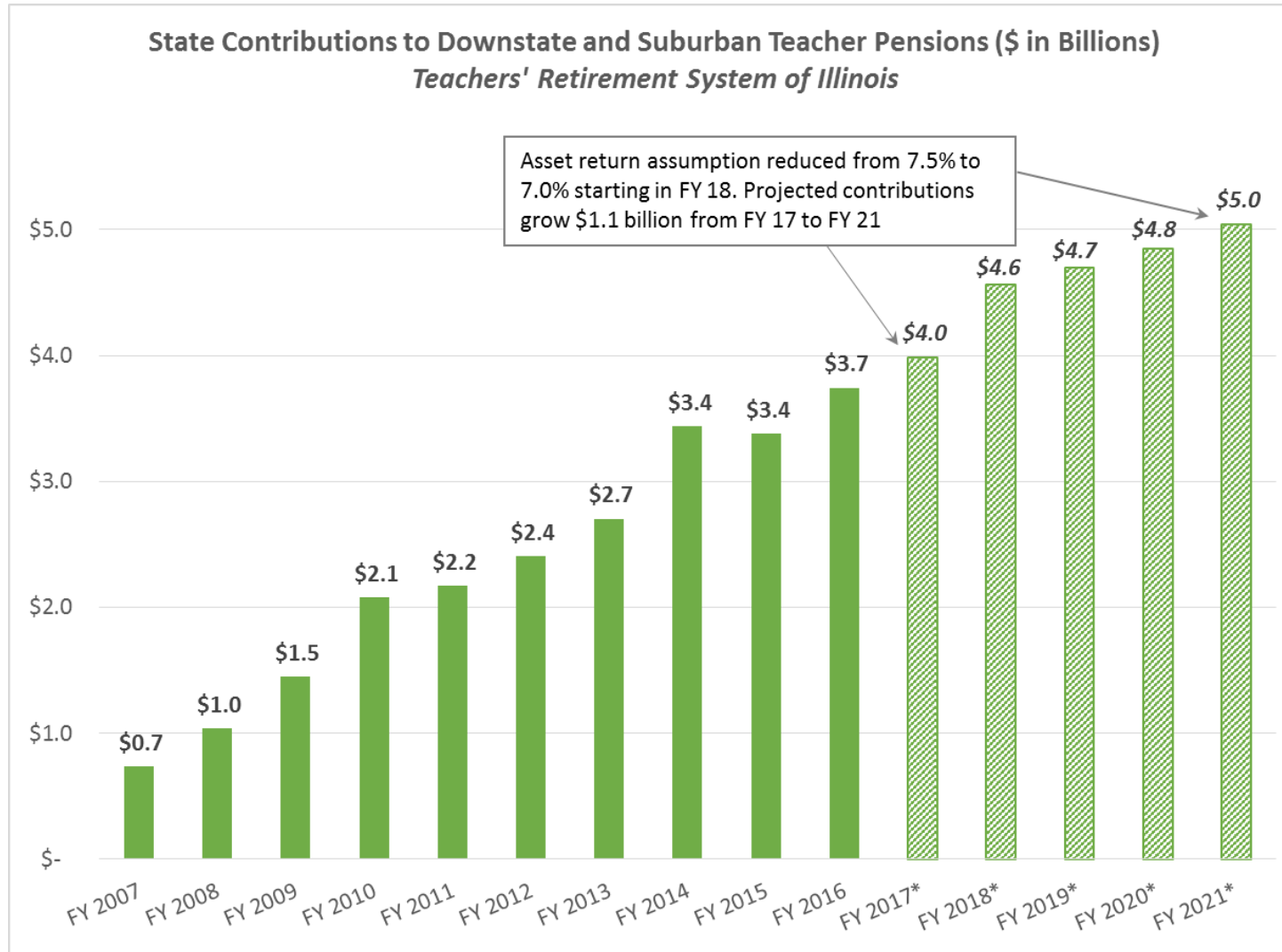
State Contributions to Downstate and Suburban Teacher Pensions ($ in Billions)
Teachers' Retirement System of Illinois

Asset return assumption reduced from 7.5% to 7.0% starting in FY 18. Projected contributions grow $1.1 billion from FY 17 to FY 21

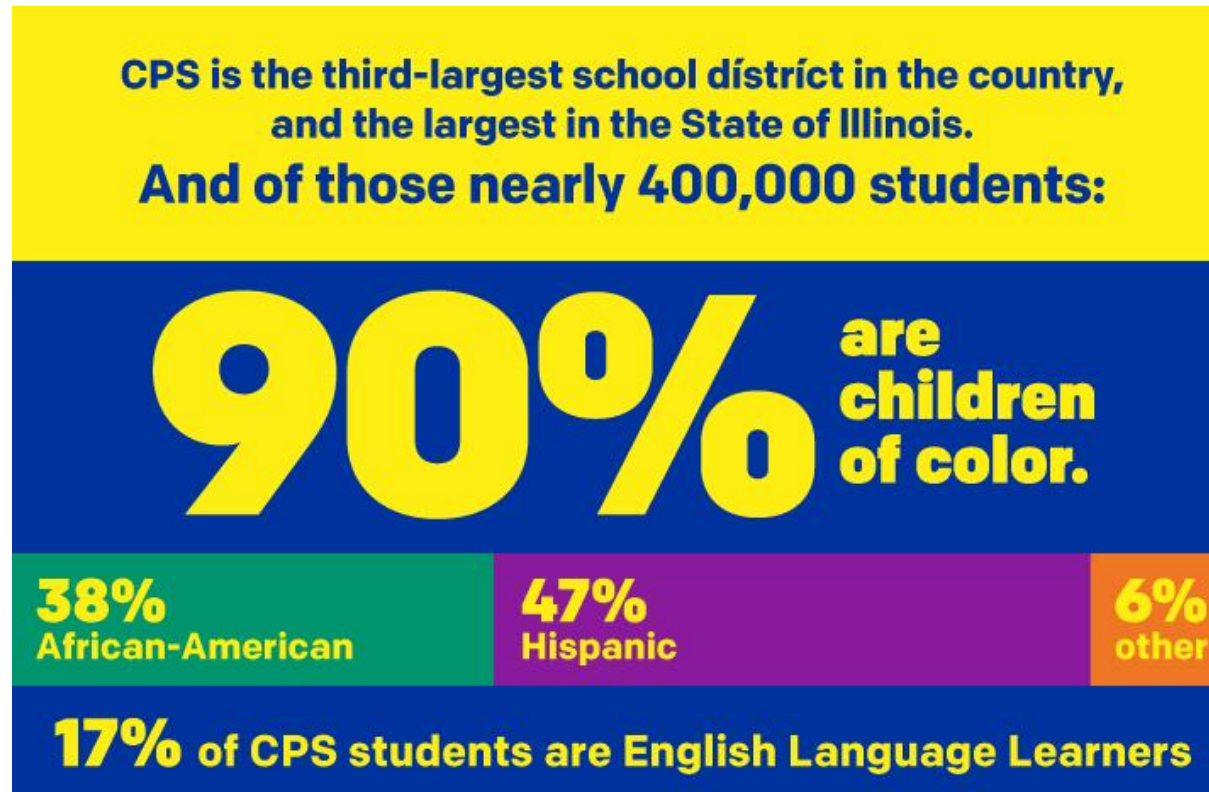| FY	Value
FY 2007	$0.7
FY 2008	$1.0
FY 2009	$1.5
FY 2010	$2.1
FY 2011	$2.2
FY 2012	$2.4
FY 2013	$2.7
FY 2014	$3.4
FY 2015	$3.4
FY 2016	$3.7
FY 2017*	$4.0
FY 2018*	$4.6
FY 2019*	$4.7
FY 2020*	$4.8
FY 2021*	$5.0

*Projected based on 2016 TRS Actuarial Valuation

The original FY17 budget contained $215.2M in revenue associated with partial State pension parity, vetoed on December 1st by Governor Rauner.

	Savings (in Millions)
State Revenue For Pension Payment	$215
4 Furlough Days (Already Announced)	$35
Non-Personnel District-Run School Freeze	31
Centrally Controlled Professional Development Cut	5
Charter Share of Above Reductions	15
Total Expense Reductions	**$86**
Remaining Budget Gap	**$129**

- CPS filed Civil Rights Lawsuit against Governor Rauner and State of Illinois over the inequity in education funding system and its harm to students of color
- 90% of CPS students are children of color

CPS is the third-largest school district in the country, and the largest in the State of Illinois. And of those nearly 400,000 students:

90% are children of color.

38% African-American **47%** Hispanic **6%** other

17% of CPS students are English Language Learners

Visit cps.edu/Equality