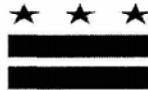


**GOVERNMENT OF THE DISTRICT OF COLUMBIA
OFFICE OF THE INSPECTOR GENERAL**

DISTRICT OF COLUMBIA

**MANAGEMENT LETTER
FISCAL YEAR 2003**



**AUSTIN A. ANDERSEN
INTERIM INSPECTOR GENERAL**

GOVERNMENT OF THE DISTRICT OF COLUMBIA
Office of the Inspector General

Inspector General



April 2, 2004

The Honorable Anthony A. Williams
Mayor
District of Columbia
John A. Wilson Building, Suite 600
1350 Pennsylvania Avenue, N.W.
Washington, D.C. 20004

The Honorable Linda W. Cropp
Chairman
Council of the District of Columbia
John A. Wilson Building, Suite 504
1350 Pennsylvania Avenue, N.W.
Washington, D.C. 20004

Dear Mayor Williams and Chairman Cropp:

In connection with the audit of the District of Columbia's general purpose financial statements for fiscal year (FY) 2003, KPMG LLP submitted the enclosed final Management Letter. This Management Letter details certain matters involving internal control and other operational matters and is presented as follows:

- Appendix A - material weaknesses and reportable conditions, highlighted in the final Independent Auditors' Report on Compliance and on Internal Control Over Financial Reporting (issued February 6, 2004);
- Appendix B – other observations and recommendations to management, along with agency comments;
- Appendix C - single audit management comments, along with agency comments; and
- Appendix D – status of prior year management letter comments.

KPMG set forth recommendations for correcting material weaknesses and other reportable conditions noted. While the Office of the Inspector General will continue to assess the District agencies' implementation of recommendations, it is the responsibility of District government management to ensure that agencies correct the deficiencies noted in audit reports. This Office will work with managers, as appropriate, to help them monitor the implementation of recommendations.

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If you have questions or need additional information, please contact William J. DiVello, Assistant Inspector General for Audits, at (202) 727-2540.

Sincerely,

A handwritten signature in cursive script that reads "Austin A. Andersen". The signature is written in black ink and has a long, sweeping tail that extends to the right.

Austin A. Andersen
Interim Inspector General

Enclosure

AAA/ws

cc: See Distribution List

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The Honorable Susan M. Collins, Chairman, Committee on Governmental Affairs
Attention: Johanna Hardy (1 copy)
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Attention: Patrick J. Hart (1 copy)



KPMG LLP
2001 M Street, NW
Washington, DC 20036

March 31, 2004

To the Mayor and Council of the Government of the District of Columbia
Inspector General of the Government of the District of Columbia:

Ladies and Gentlemen:

We have audited the basic financial statements of the Government of the District of Columbia (District), for the year ended September 30, 2003, and have issued our report thereon dated January 23, 2004. In planning and performing our audit of the basic financial statements of the District, we considered internal control in order to determine our auditing procedures for the purpose of expressing our opinion on the basic financial statements. An audit does not include examining the effectiveness of internal control and does not provide assurance on internal control. We have not considered internal control since the date of our report.

During our audit we noted certain matters involving internal control and other operational matters that are presented in the appendices for your consideration. These comments and recommendations, all of which have been discussed with the appropriate members of management, are intended to improve internal control or result in other operating efficiencies.

Our audit procedures are designed primarily to enable us to form an opinion on the basic financial statements, and therefore may not bring to light all weaknesses in policies or procedures that may exist. We aim, however, to use our knowledge of the District's organization gained during our audit work to make comments and suggestions that we hope will be useful to you. We would be pleased to discuss these comments and recommendations with you at any time.

This report is intended solely for the information and use of the Mayor and Council of the Government of the District of Columbia, the Inspector General of the Government of the District of Columbia, District management, and others within the District government and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP



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GOVERNMENT OF THE DISTRICT OF COLUMBIA

Letter to Management on Internal Control

September 30, 2003

Executive Summary

The timely issuance of the District's September 30, 2003 Comprehensive Annual Financial Report (CAFR) represents another major step forward in the District's external financial reporting process. Through its continued involvement with the certificate of achievement for excellence in financial reporting program (certificate program) sponsored by the Government Finance Officers Association (GFOA), we know that the CAFR meets the high standards for governmental accounting and financial reporting established by the Governmental Accounting Standards Board (GASB) and the GFOA.

Address Material Weaknesses and Reportable Conditions

The next step in continuing to improve the District's financial reporting infrastructure is to address the material weaknesses and other reportable conditions highlighted in our Report on Compliance and on Internal Control over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards* (Yellow Book Report). We have repeated those reportable conditions and our recommendations in Appendix A.

Material weaknesses in internal control discussed in that report indicate areas where the District's basic financial statements are vulnerable to material misstatements that may occur and not be detected within a timely period by District employees in the normal course of performing their assigned duties. Immediate action should be taken by the Office of the Chief Financial Officer (OCFO) to address the following material weaknesses discussed in our report so that the overall financial management of the District is improved:

- Health Care Safety Net Administration Contract Management
- District Medicaid Provider Accounting and Financial Reporting

Other reportable conditions relate to significant deficiencies in the design or operation of internal control over financial reporting that could adversely affect the District's ability to record, process, summarize, and report financial data consistent with the assertions of management. These reportable conditions, while not as serious as material weaknesses, also warrant attention from District management. Matters currently classified as reportable conditions that are not considered to be material weaknesses are as follows:

- Human Resource/Payroll Process Management
- Monitoring of Expenditures Against Open Procurements
- Unemployment Compensation File Maintenance

Our management letter comments, presented in Appendix B, highlight other internal control and financial management observations made during our audit, and what actions we believe the District should take to ensure its financial management infrastructure continues to improve. We also include observations about new accounting and financial reporting standards that we believe the District will need to implement over the next few years.

Continued Focus on Grants Management

During the CAFR audit, we observed that the District continues to struggle with certain aspects of its grants financial management. Because of certain system limitations, especially in the UPPS payroll system, many

GOVERNMENT OF THE DISTRICT OF COLUMBIA

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expenditures that qualify for federal reimbursement are initially recorded against an agency's local budget, and a manual adjustment must be recorded to properly record the expenditure against the agency's federal budget. We observed that this adjusting entry is not posted timely by many District agencies, resulting in an extended upfront investment of local dollars. Although we are unable to quantify it, we believe that the amount of interest that has been lost due to this practice is substantial. We also observed this situation in the District-wide Single Audits of federal expenditures we conducted for the years ended September 30, 2002 and 2001. We issued a management letter specific to our observations during the September 30, 2002 Single Audit and have included those comments as Appendix C to this letter. We further observed that because of a failure to obtain current indirect cost plans the District is not obtaining federal reimbursement at the maximum allowable rate. The District is also foregoing interest revenue because it is failing to draw down federal funds timely. The District should continue to focus on improving its grants management function to maximize federal reimbursement and interest earnings.

Management Responses

Management responses to our observations and recommendations are included in Appendices A, B, and C. We have carefully considered those responses where management indicates that it disagrees with either our observations or recommendations. We continue to believe our comments are valid and that implementation of our recommendations will result in stronger internal controls or operational and financial management improvements.

Summary of Internal Control Observations

- *Improve Information Technology Policies and Procedures* – We observed that each District agency continues to be responsible for developing its own business continuity plan. Improvements in this area are required at all levels, from District-wide to agency level and finally to the data center level. These plans should be coordinated so that a unified response can be developed, tested, and implemented. We further observed that information technology governance standards could be improved by establishment of an Information Technology (IT) steering committee responsible for coordinating IT development efforts at all District agencies.
- *Improve Monitoring of Third-Party Service Organizations* – The District has engaged numerous third-party service organizations to assist in performing critical District operations. These operations include the Medicaid management information system, disability compensation claims management, the Women's Infants and Children's Program, Home Purchase Assistance Program loan disbursement and collection, on-line lottery games, and electronic benefits transfers for the food stamps program. We observed that the District has not established a policy for monitoring service organization activities to ensure that they are being performed properly. We further observed that there is no procedure requiring District agencies utilizing third-party service organizations to obtain a SAS 70 report.
- *Improve Payroll Data Maintenance* – We observed that District policies for payroll file maintenance are not strictly followed. We observed missing payroll files and missing payroll file documentation in several items that we selected for testing. We also observed that certain payroll information at the Metropolitan Police Department was not properly maintained. Finally, we observed that terminated employees were not timely removed from UPPS. Given the significance of payroll costs to the District, it is critical that controls over payroll transactions be properly maintained.

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- *Enhance Controls Over Leasing Transactions* – We observed that several agencies did not maintain adequate supporting documentation for their operating lease closing packages. We further observed that certain agencies were not fully aware of the provisions of operating lease disclosures, thus requiring revisions to the financial statements. Finally, we observed that certain new operating leases with total lease payments greater than \$1 million were not provided to Council for approval in accordance with District regulations.

New Accounting Pronouncements

Although there are no significant new accounting pronouncements that will need to be implemented during fiscal year (FY) 2004, there is a significant accounting pronouncement likely to be issued as a GASB Statement within the next two years that will significantly impact the District's financial position. The objective of this Statement will be to address accounting and financial reporting of post-employment benefits other than pension benefits (OPEB) by employers and plans or other entities that administer them. The principal impact of this Statement on the District relates to post-employment healthcare benefits that the District currently reports on a pay-as-you-go basis. This Statement will require the District to accrue for post-employment benefits to be provided to employees and retirees, thus adding a significant liability not currently recorded in the District's government-wide financial statements.