

**TESTIMONY OF CHARLES J. WILLOUGHBY, INSPECTOR GENERAL**

**BEFORE THE  
COUNCIL OF THE DISTRICT OF COLUMBIA  
COMMITTEE OF THE WHOLE**

**ISSUANCE OF THE COMPREHENSIVE ANNUAL FINANCIAL REPORT  
FOR FISCAL YEAR 2007**

**April 14, 2008**

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GOOD AFTERNOON CHAIRMAN GRAY AND MEMBERS OF THE COMMITTEE. I AM CHARLES J. WILLOUGHBY, AND I AM PLEASED TO SPEAK BEFORE YOU THIS AFTERNOON ON THE ISSUANCE OF THE DISTRICT'S FISCAL YEAR (FY) 2007 COMPREHENSIVE ANNUAL FINANCIAL REPORT (CAFR). ACCOMPANYING ME TODAY ARE WILLIAM J. DIVELLO, ASSISTANT INSPECTOR GENERAL FOR AUDITS (AIGA) AND REPRESENTATIVES FROM BDO SEIDMAN, LLP, OUR INDEPENDENT AUDITORS.

WHILE I AM PLEASED TO BE PART OF THE SIGNIFICANT ACCOMPLISHMENT OF ATTAINING AN UNQUALIFIED OPINION ON THE DISTRICT'S FY 2007 FINANCIAL STATEMENTS, MUCH WORK REMAINS. SPECIFICALLY, IT IS IMPERATIVE THAT MANAGEMENT ADDRESS THE DEFICIENCIES REPORTED BY THE INDEPENDENT AUDITORS IN ORDER TO MAINTAIN THE FINANCIAL INTEGRITY OF THE CITY. CORRECTIVE ACTIONS, AS APPLICABLE, SHOULD BE BOTH IMMEDIATE AND SUSTAINABLE RELATIVE TO THOSE PERSISTENT AND RECURRING DEFICIENCIES.

ACCORDINGLY, MY TESTIMONY TODAY WILL FOCUS ON THE CAFR OVERSIGHT PROCESS, SIGNIFICANT EVENTS AFFECTING THE FY 2007 CAFR, AREAS REQUIRING MANAGEMENT'S ATTENTION, AND OVERARCHING MANAGEMENT ACTIONS NEEDED.

### **CAFR OVERSIGHT PROCESS**

AS YOU ARE AWARE, THE OFFICE OF THE INSPECTOR GENERAL (OIG) HAS ENTERED INTO A CONTRACT WITH BDO SEIDMAN, LLP (BDO) TO PERFORM THE AUDIT OF THE DISTRICT'S CAFR. WE MONITOR THIS CONTRACT AND OVERSEE THE AUDIT PROCESS THROUGH THE AUSPICES OF THE CAFR OVERSIGHT COMMITTEE, WHICH THE OIG CHAIRS. THE COMMITTEE MONITORS THE PROGRESS OF THE CAFR EACH YEAR AND ENSURES THAT OBSTACLES THAT MAY HINDER THE COMPLETION OF THE AUDIT, OR MATTERS WHICH NEED DISTRICT MANAGEMENT'S ATTENTION, ARE DISCUSSED WITH THE APPROPRIATE DECISION MAKERS AND PROMPTLY RESOLVED. THE CAFR COMMITTEE, WITH PARTICIPATION OF MAYORAL AND COUNCIL STAFFS, MEETS REGULARLY THROUGHOUT THE CAFR CYCLE TO ACHIEVE THAT GOAL.

UNDER THE CURRENT CONTRACT, BDO IS REQUIRED TO PERFORM THE AUDIT OF THE DISTRICT'S FINANCIAL STATEMENTS. AS PART OF THE AUDIT, BDO MUST PROVIDE: (1) AN AUDITOR'S OPINION AS TO THE FAIR PRESENTATION OF THE DISTRICT'S FINANCIAL STATEMENTS; (2) A REPORT ON THE INTERNAL CONTROLS OVER FINANCIAL REPORTING AND ON COMPLIANCE WITH LAWS AND

REGULATIONS (COMMONLY REFERRED TO AS THE YELLOWBOOK); AND (3) A MANAGEMENT LETTER, AS APPROPRIATE.

THE AUDIT COSTS FOR THE FY 2007 CAFR WERE APPROXIMATELY \$3.5 MILLION, INCLUDING MODIFICATIONS. THE CONTRACT WAS MODIFIED PRIMARILY FOR ADDITIONAL WORK RELATED TO THE OFFICE OF TAX AND REVENUE (OTR) SCANDAL, AND INCLUSION OF THE NATIONAL CAPITAL REVITALIZATION CORPORATION AND THE ANACOSTIA WATERFRONT CORPORATION IN THIS YEAR'S FINANCIAL STATEMENTS.

#### **SIGNIFICANT EVENTS AFFECTING THE FY 2007 CAFR**

ON NOVEMBER 7, 2007, FEDERAL INVESTIGATORS ANNOUNCED THE ARREST OF OTR EMPLOYEES IN CONNECTION WITH AN ALLEGED MISAPPROPRIATION OF DISTRICT FUNDS BY EMPLOYEES WHO WERE ISSUING AND EMBEZZLING FRAUDULENT MANUAL REAL PROPERTY TAX REFUND CHECKS. THE INVESTIGATION INTO THE SIZE, SCOPE, AND DURATION OF THE OTR FRAUD IS CONTINUING. THE ARRESTS WERE THE RESULT OF AN FBI INVESTIGATION, TRIGGERED BY A BANK EMPLOYEE WHO NOTICED FINANCIAL IRREGULARITIES WITH A CHECK THAT HAD BEEN DEPOSITED BY A PERSON CHARGED IN THE CASE.

AS A RESULT OF THIS FRAUD, EXTENDED AUDIT PROCEDURES WERE REQUIRED FOR THE ISSUANCE OF THE FY 2007 CAFR. THE ENTIRE MANUAL REFUND

PROCESS AT OTR WAS AUDITED IN SIGNIFICANT DETAIL. IN ADDITION, WORK WAS EXPANDED IN OTHER TAX AREAS. THERE WAS A SIGNIFICANT INCREASE IN THE NUMBER OF TRANSACTIONS EXAMINED AND TYPES OF PROCEDURES PERFORMED. BDO CALLED IN PERSONNEL WITH FORENSIC SKILLS TO PERFORM THE ADDITIONAL AUDIT WORK. APPROXIMATELY 2,500 HOURS OF ADDITIONAL TIME WAS DEDICATED TO THE REFUND PROCESS AT OTR. THESE ADDITIONAL AUDIT STEPS DELAYED THE ISSUANCE OF THE 2007 CAFR BY ABOUT TWO MONTHS.

#### **AREAS REQUIRING MANAGEMENT'S ATTENTION**

IN THE FY 2007 REPORT ON THE INTERNAL CONTROLS OVER FINANCIAL REPORTING AND COMPLIANCE WITH LAWS AND REGULATIONS, BDO IDENTIFIED DEFICIENCIES, SOME OF WHICH WERE REPORTED LAST YEAR, THAT COULD AFFECT THE DISTRICT'S ABILITY TO INITIATE, AUTHORIZE, RECORD, PROCESS, AND REPORT FINANCIAL DATA. THREE OF THE DEFICIENCIES IDENTIFIED IN THIS YEAR'S REPORT ARE CONSIDERED MATERIAL WEAKNESSES: (1) THE OFFICE OF TAX AND REVENUE – REFUND PROCESS; (2) MANAGEMENT OF THE MEDICAID PROGRAM; AND (3) THE DISTRICT OF COLUMBIA PUBLIC SCHOOLS. IT IS IMPERATIVE THAT DISTRICT OFFICIALS CORRECT THESE DEFICIENCIES AND KEEP VIGILANCE OVER THESE AREAS - TO INCLUDE AGGRESSIVE FOLLOW-UP - ESPECIALLY IN LIGHT OF NEW, MORE STRINGENT ACCOUNTING STANDARDS.

DURING THE PAST SEVERAL YEARS, A STREAM OF CORPORATE SCANDALS OCCURRED IN THE PRIVATE SECTOR THAT LED TO SUBSTANTIAL CHANGES IN ACCOUNTING METHODS, FINANCIAL STATEMENT PREPARATION, AND INTERNAL AUDIT REPORTS. ONE SUCH CHANGE WAS THE SARBANES-OXLEY ACT OF 2002, (PUB. L. NO. 107-204). THIS ACT PLACED GREAT EMPHASIS ON THE REQUIREMENT FOR AN EFFECTIVE INTERNAL CONTROL ENVIRONMENT AND LED, IN PART, TO A MAJOR REVISION OF THE GENERALLY ACCEPTED GOVERNMENT AUDITING STANDARDS (GAGAS). REVISIONS TO THE GAGAS EXPANDED THE DEFINITION OF INTERNAL CONTROL STANDARDS AND STRENGTHENED THE REPORTING REQUIREMENT GOVERNING DISCLOSURE OF INTERNAL CONTROL WEAKNESSES. MOST IMPORTANTLY, AUDITORS ARE NOW REQUIRED TO ELEVATE REPEAT FINDINGS (PREVIOUSLY REPORTED MANAGEMENT LETTER COMMENTS AND REPORTABLE CONDITIONS) TO SIGNIFICANT DEFICIENCIES OR EVEN MATERIAL WEAKNESSES IN ACCORDANCE WITH STATEMENT OF ACCOUNTING STANDARDS 112 (SAS 112). (EMPHASIS ADDED).

## **OVERARCHING MANAGEMENT ACTIONS NEEDED**

### **INTERNAL CONTROLS**

MANAGEMENT/INTERNAL CONTROLS PLAY A CRUCIAL ROLE IN FRAUD PREVENTION AND DETECTION. ALTHOUGH WEAK INTERNAL CONTROLS DO NOT MEAN THAT FRAUD EXISTS, WEAK CONTROLS INCREASE THE RISK THAT FRAUD WILL OCCUR. ON THE OTHER HAND, STRONG INTERNAL CONTROLS DO NOT

NECESSARILY PRECLUDE FRAUD FROM OCCURRING. IT IS FOR THESE REASONS THAT MANAGEMENT AND EMPLOYERS SHOULD ESTABLISH AND MAINTAIN AN ENVIRONMENT THROUGHOUT THE ORGANIZATION THAT SETS A PROACTIVE AND SUPPORTIVE ATTITUDE TOWARD INTERNAL CONTROLS. PEOPLE ARE WHAT MAKE INTERNAL CONTROLS WORK.

IN THIS REGARD, MANAGERS NEED TO EMPLOY MANAGEMENT CONTROLS TO INCLUDE:

- TOP LEVEL REVIEWS OF ACTUAL PERFORMANCE;
- REVIEWS BY MANAGEMENT AT THE FUNCTIONAL OR ACTIVITY LEVEL;
- CONTROLS OVER INFORMATION PROCESSING;
- PHYSICAL CONTROL OVER VULNERABLE ASSETS;
- SEGREGATION OF DUTIES; AND
- ACCESS RESTRICTIONS TO, AND ACCOUNTABILITY FOR, RESOURCES AND RECORDS.

GIVEN THE IMPORTANCE THAT SOUND INTERNAL CONTROLS PLAY, OUR RECENTLY ISSUED DRAFT REPORT ON THE DEPARTMENT OF PARKS AND RECREATION RECOMMENDED THAT THE DISTRICT ISSUE A CITY-WIDE DIRECTIVE REQUIRING MANAGERS TO ESTABLISH, ASSESS, CORRECT, AND REPORT ON INTERNAL CONTROLS.

## **HUMAN RESOURCES**

GIVEN THAT DISTRICT EMPLOYEES ARE PIVOTAL TO ENSURING THE IMPLEMENTATION OF SOUND INTERNAL CONTROLS AND ARE THE FRONT-LINE DEFENSE IN DETECTING AND PREVENTING FRAUD, WASTE, AND ABUSE, AGENCY LEADERS NEED TO:

- IMPROVE THE MANAGEMENT OF HUMAN RESOURCES;
- CONTINUOUSLY FOCUS ON RECRUITING, BUILDING, AND MAINTAINING, A COMPETENT STAFF;
- ENSURE THAT EMPLOYEES PERFORMANCE PLANS ARE IN PLACE, COMMUNICATED, AND TIED TO THE AGENCY MISSION AND GOALS;
- PROVIDE FREQUENT ETHICS TRAINING TO ALL EMPLOYEES;
- ENSURE THAT PERSONNEL ARE PROPERLY EVALUATED AND HELD ACCOUNTABLE; AND
- HIRE PERSONNEL WITH REQUISITE SKILLS AND ENSURE THAT THOSE SKILLS ARE MAINTAINED THROUGH CONTINUING EDUCATION.

## **FOLLOW-UP**

WE STRONGLY BELIEVE THAT AUDIT RECOMMENDATIONS DO NOT PRODUCE THE DESIRED OUTCOMES UNLESS THEY ARE IMPLEMENTED. ACCORDINGLY, AGENCY OFFICIALS MUST ENSURE THAT RECOMMENDED CORRECTIVE ACTIONS ARE TAKEN AND INSTITUTIONALIZED TO OBTAIN LASTING IMPROVEMENTS.

THIS OFFICE WILL WORK WITH MANAGERS, AS APPROPRIATE, TO HELP THEM MONITOR THE IMPLEMENTATION OF RECOMMENDATIONS, AND WE WILL CONDUCT PERIODIC FOLLOW-UP AUDITS TO ASSESS AGENCY PROGRESS IN CORRECTING REPORTED DEFICIENCIES.

IN REGARD TO HOW THE OIG CAN BEST SERVE THE DISTRICT IN ASSESSING AND MITIGATING RISKS ASSOCIATED WITH THIS YEAR'S CAFR, WE WILL:

- DEDICATE AUDIT RESOURCES TO HELP MITIGATE RISKS RELATIVE TO THIS YEAR'S CAFR;
- PROVIDE INSTITUTIONAL KNOWLEDGE REGARDING DEFICIENCIES REPORTED IN PAST AUDITS;
- IDENTIFY AND SOLVE (WORKING WITH MANAGEMENT) CONSISTENT AND PERVASIVE PROBLEMS IDENTIFIED IN DISTRICT OPERATIONS; AND
- CONTINUE TO SERVE AS A CHANGE AGENT AND INTERNAL CONTROL MECHANISM.

LASTLY, I HAVE DIRECTED THAT ASSISTANT INSPECTOR GENERAL FOR AUDITS BILL DIVELLO CONVENE THE CAFR OVERSIGHT COMMITTEE ON A REGULAR

BASIS THROUGHOUT THE YEAR TO MAINTAIN CONTINUOUS OVERSIGHT OF ISSUES REQUIRING MANAGEMENT ATTENTION.

IN CLOSING, I WOULD LIKE TO TAKE THIS OPPORTUNITY TO THANK THE CAFR COMMITTEE MEMBERS FOR THEIR LEADERSHIP AND EXPERTISE IN MONITORING THE CAFR OVER THE LAST SEVERAL MONTHS, KEEPING MANAGEMENT AND OTHERS ABREAST OF THE ADDITIONAL REQUIRED WORK, AND ASSISTING THE AUDITORS IN FACILITATING THE COMPLETION OF THE AUDIT. IN THAT REGARD, I WANT TO SINGLE OUT FOR SPECIAL RECOGNITION BILL DIVELLO, OF MY STAFF; ERIC GOULET AND JEFF COUDREIT, FROM THE CITY COUNCIL; WILLIAM SINGER, OF THE EXECUTIVE OFFICE OF THE MAYOR; TONY POMPA OF THE CHIEF FINANCIAL OFFICER'S OFFICE; AND THE REPRESENTATIVES OF BDO SEIDMAN, LLP FOR THEIR PROFESSIONALISM, HARD WORK, AND COMMITMENT TO GETTING THE JOB DONE.

THIS CONCLUDES MY TESTIMONY AND I WILL BE HAPPY TO ANSWER ANY QUESTIONS YOU MAY HAVE.