

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

DISTRICT OF COLUMBIA

**Independent Auditors' Report on
Internal Control and
Compliance Over Financial Reporting
Fiscal Year Ended September 30, 2007**



**CHARLES J. WILLOUGHBY
INSPECTOR GENERAL**

GOVERNMENT OF THE DISTRICT OF COLUMBIA
Office of the Inspector General

Inspector General



April 9, 2008

The Honorable Adrian M. Fenty
Mayor of the District of Columbia
Mayor's Correspondence Unit, Suite 316
1350 Pennsylvania Avenue, N.W.
Washington, D.C. 20004

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

Dear Mayor Fenty and Chairman Gray:

In connection with the audit of the District of Columbia's general purpose financial statements for fiscal year 2007, BDO Seidman, LLP submitted the enclosed final Independent Auditors' Report on Internal Control Over Financial Reporting and on Compliance and Other Matters (OIG No. 08-1-08MA).

This report details identified significant deficiencies. A significant deficiency adversely affects the District's ability to initiate, authorize, record, process, and report financial data. Three of the significant deficiencies identified in the report are considered material weaknesses: (1) Office of Tax and Revenue – Refund Process; (2) Management of the Medicaid Program; and (3) District of Columbia Public Schools.

It is imperative that management address the deficiencies in the report 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.

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While the Office of the Inspector General will continue to assess District agencies in pursuing corrective actions, 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.

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

Sincerely,



Charles J. Willoughby
Inspector General

Enclosure

CJW/ws

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Government of the District of Columbia

**Independent Auditors' Report on Internal Control Over
Financial Reporting and on Compliance and Other Matters
Based on an Audit of Financial Statements Performed in
Accordance with *Government Auditing Standards*
Year Ended September 30, 2007**

Government of the District of Columbia

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**Independent Auditors' Report
on Internal Control Over Financial Reporting and on Compliance
and Other Matters Based on an Audit of Financial Statements
Performed in Accordance with *Government Auditing Standards***

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

We have audited the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the **Government of the District of Columbia** (the District), as of and for the year ended September 30, 2007, which collectively comprise the District's basic financial statements, and have issued our report thereon dated March 31, 2008. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the District's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the District's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the District's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the District's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the District's financial statements that is more than inconsequential will not be prevented or detected by the District's internal control. Significant deficiencies in internal control over financial reporting are identified below and described in greater detail in Appendix A.

- | | |
|---|---|
| I. Office of Tax and Revenue. | VI. Management of Grants. |
| II. Management of the Medicaid Program. | VII. Compensation. |
| III. District of Columbia Public Schools. | VIII. Management of the Disability
Compensation Program. |
| IV. Investment Reconciliations and Activities. | IX. Management of the Unemployment
Compensation Program. |
| V. National Capital Revitalization Corporation
and the Anacostia Waterfront Corporation. | |



A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the District's internal control.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, of the significant deficiencies described above, we consider the following to be material weaknesses.

- I. Office of Tax and Revenue.
- II. Management of the Medicaid Program.
- III. District of Columbia Public Schools.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the District's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are identified below and described in greater detail in Appendix B.

- I. Noncompliance with Procurement Regulations.
- II. Noncompliance with the Quick Payment Act.
- III. Noncompliance with the Financial Institutions Deposit and Investment Amendment Act.

We also noted additional matters which we have reported to management of the District in a separate letter dated March 31, 2008. The status of prior year instances of reportable conditions, material weaknesses, and material noncompliance is presented in Appendix C.

The District's responses to the findings identified in our audit are included in Appendix A and Appendix B. We did not audit the District's responses and, accordingly, we express no opinion on them.

This report is intended solely for the information and use of the Mayor, the Council, the Inspector General of the District, District management, the U.S. Government Accountability Office, the U.S. Congress, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

BDO Seidman, LLP

Washington, D.C.
March 31, 2008



**Material Weaknesses and Significant Deficiencies in Internal Controls
Over Financial Reporting**

I. Office of Tax and Revenue (OTR)

On November 7, 2007, federal investigators announced the arrest of Office of Tax and Revenue (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 noticing financial irregularities in some of the checks that had been deposited by persons charged in the case.

As a result of this fraud, extended audit procedures were required for the issuance of the FY 2007 Comprehensive Annual Financial Report (CAFR). The entire manual refund process at OTR was audited in significant detail. There was a significant increase in the number of transactions examined and types of procedures performed. Personnel with forensic background and skills were involved in the development and implementation of 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 nearly two months. The District of Columbia Home Rule Act requires the completion of the annual CAFR by February 1. As a result, the District is noncompliant with the provisions of the Act.

For the fiscal year ended September 30, 2007, the Office of Integrity and Oversight (OIO) provided us a listing of 17 manual real property tax refunds which it had identified as fraudulent. We reviewed an additional 134 manual tax refunds and we were only able to validate 125 of them as legitimate. The result was 9 additional suspect manual real property tax refunds, totaling \$1 million, of potentially fraudulent transactions which had not been identified by the District. All of these amounts have been expensed and segregated in the FY 2007 CAFR.

Antifraud Policies and Procedures

Antifraud policies and procedures are part of an overall system of internal control. The District is responsible for designing and implementing effective systems and procedures for preventing, deterring, and detecting fraud. The following conditions are generally present when fraud occurs:

1. Incentive/Pressure – Reason to commit fraud.
2. Opportunity.
 - a. Ineffective controls.
 - b. Absence of controls.
 - c. Override of controls.
 - d. Decentralized controls.
3. Attitude/Rationalization – Justification for committing fraud.

An effective antifraud program would have a system of controls to address all three of the fraud conditions identified above.



**Material Weaknesses and Significant Deficiencies in Internal Controls
Over Financial Reporting**

An effective antifraud program would not completely eliminate the possibility of fraud as there is no such thing as a fraud-proof system. For example, collusion among employees can override even a well run antifraud program. However, the District could benefit from a more comprehensive antifraud program. The basic controls of a comprehensive antifraud program include:

1. Prevention controls which are designed to reduce opportunities for fraud to occur.
 - a. One example is updating investigations of individuals as they are promoted to positions of trust.
2. Detering controls which focus on controls that discourage individuals from committing fraud.
 - b. May involve sanctions. Perception of the chance of getting caught generally persuades most individuals to not commit a fraud.
3. Detection controls which are processes that will assist in the quick discovery of fraud.
 - c. One example is a fraud hotline that is available 24/7 and is anonymous.

A comprehensive antifraud program should also include:

4. Creating an ethical culture.
 - a. Includes establishing and communicating the proper "tone at the top" and creating a positive work environment.
5. Implementing antifraud controls.
 - b. Includes the internal development of a fraud risk assessment process.
6. Developing an oversight process.

The District may have elements of an antifraud program, but it does not seem to have as coordinated and comprehensive an antifraud program as it should given its size and complexity. The District needs to reevaluate its antifraud program with an immediate emphasis on its risk assessment. The leadership of the District will need to provide both the resources and the necessary support to assist in the success of this program.

Management's Response:

OTR agrees and will reevaluate its antifraud program. OTR will work in conjunction with the Office of Integrity and Oversight (OIO) as part of the reevaluation. In addition, during the first part of FY 2008, an outside consultant was utilized to review controls at OTR. OTR will also use recommendations from that review as a guide towards reevaluating its antifraud program. Additionally, OIO received from the auditors a list of the 9 additional manual real property tax refunds identified. OIO reviewed these refunds and found all 9 additional refunds were previously identified by OIO as potentially fraudulent.



**Material Weaknesses and Significant Deficiencies in Internal Controls
Over Financial Reporting**

Refund Process – Introduction

The fraud disclosed on page 3 occurred through the manual tax refund process at the Office of Tax and Revenue (OTR). OTR processes the majority of its refunds through an automated system called the Integrated Tax System (ITS). As a result of the aforementioned fraud, significant additional audit processes were performed on the entire refund process at OTR. While we were able to satisfy the validity for a significant amount and number of refunds, we often had to use alternate methods. Following are issues noted in the controls of the entire refund process. This section is divided into 3 parts:

- Manual Tax Refunds.
- Automated (ITS) Tax Refunds.
- Other Issues.

I – A. Manual Tax Refunds

Reason for Processing Manual Tax Refunds

One reason for processing manual tax refunds is due to errors encountered when processing tax refunds through the Integrated Tax System (ITS). A process is not in place to communicate these errors to supervisors and to the department responsible for the maintenance and support of the ITS system. Each department should update the other on the current status of items and changes being made. We recommend that when errors are encountered in the processing of tax refunds, the error message or related information be communicated to supervisors and the department responsible for the maintenance and support of the ITS system to ensure that the reason for the system errors is addressed and corrected. A forum may be necessary for suggestions or concerns and as a means for using a team-approach to addressing these items. In addition, an increased monitoring and review process surrounding these issues should be implemented.

Management's Response:

When a department encounters a problem with processing a tax refund in ITS, it will communicate with the other departments in OTR the nature of the problem being experienced, and notify the Information Systems Administration (ISA). ISA will have the responsibility of researching the ITS issue, and resolving it. ISA will then communicate back to the departments that the issue has been resolved.

Policies and Procedures

If the District plans to continue issuing manual tax refunds, we recommend that policies and procedures for processing manual tax refunds be documented and among other items, include the following:

1. The events which cause a manual tax refund to be initiated.
2. Types of supporting documentation required from the taxpayer:
 - Internal forms required.
 - External support for each type of manual refund.

**Material Weaknesses and Significant Deficiencies in Internal Controls
Over Financial Reporting**

3. The internal staff positions which are designated to:
 - Prepare, collate, and research the supporting documentation required for each type of manual tax refund;
 - Review and approve the adequacy of the supporting documentation attached to the manual tax refund voucher;
 - Input the manual tax refund voucher into the general ledger for payment processing;
 - Authorize and release the manual tax refund voucher for payment; and
 - Reconcile the manual refunds to the general ledger.

The Board of Directors for the Office of Tax and Revenue (OTR) tasked a Business Process Committee (BPC) to make recommendations and implement new procedures to strengthen the internal controls and to reduce the risk of fraudulent manual tax refund transactions. We have reviewed a draft directive of the initial proposal of recommendations made by the BPC. Our recommendations suggested above are in addition to those controls proposed by the BPC.

The draft directive describes the roles and responsibilities of the directors, their subordinate managers, and employees involved in the review and approval process of the manual tax refund vouchers. To ensure a smooth transition between the existing procedures in place for processing manual tax refund vouchers and those procedures that are recommended for implementation, we suggest that all employees involved in the manual tax refund voucher processing be trained on the new policies and procedures. The training should focus on the types of supporting documentation required with a manual tax refund voucher and the review and approval process.

Management's Response:

A Draft Directive was created to be used as the main source for procedural guidance, and speaks to how each administration will process refunds. Revenue Accounting Administration (RAA) staff have been trained on the process. The procedures have been documented to clearly state the step by step processes needed by RAA staff to process refunds and to identify refunds that need additional documentation before approval can be granted. RAA has also provided numerous one-on-one training sessions for those OTR employees who were granted signature approval authority for refunds. This has been a key step towards ensuring the effectiveness of the new signature approval process.

Other administrations within OTR that request refunds have committed to creating written procedures related to the new procedures by September 30, 2008. The other administrations will also complete training for their staff on the new refund directive by April 30, 2008. Finally, RAA will assemble a formal training workshop related to the new process and schedule training sessions by April 30, 2008.

Adequate Supporting Documentation

A detailed listing of required supporting documentation for each type of manual tax refund voucher does not currently exist. The following findings are instances where insufficient documentation was attached to a particular manual tax refund, excluding the 17 real property tax refunds identified by the Office of Integrity and Oversight (OIO).



**Material Weaknesses and Significant Deficiencies in Internal Controls
Over Financial Reporting**

Through a cumbersome and laborious process, we were able to validate most of the refund vouchers by requesting additional information from various other sources within the Office of Tax and Revenue (OTR). However, an additional 9 suspect checks totaling approximately \$1 million of potentially fraudulent transactions was uncovered.

These types of issues increase the chances of human error since the reconciliation processes are highly dependent on the understanding of a significant number of exceptions. We identified these discrepancies from a sample of transactions that were selected for testing. Management should recognize that the potential exists for additional discrepancies.

1. Items marked as Hold for Pick Up: For 10 of the 134 manual tax refund sample selections, the manual tax refund check was marked "Hold for Pick Up". In each of these instances, the supporting documentation for the manual tax refund voucher did not have any correspondence from the taxpayer or vendor or their representative requesting this action and no other support was noted in the file.
2. Insufficient and/or Contradictory Evidence: For 7 of the 134 manual tax refund sample selections, the supporting documentation attached to the SOAR Revenue Refund Voucher (SRRV) was completely unrelated to the refund request. Further, there was 1 sample item where the supporting documentation attached to the SRRV was illegible and unclear.
3. Missing SRRVs and Supporting Documentation: We were unable to find any documentation including a SRRV, a Refund Research Form (RRF), or any other underlying supporting documentation for 3 of the 134 manual refund sample selections.
4. Taxpayer/Vendor Correspondence and/or External Documentation: For 64 of the 134 manual tax refund sample selections, there was no taxpayer/vendor correspondence and/or other external supporting documentation attached to the manual tax refund voucher. As a result, additional information had to be requested from OTR to ensure that the manual tax refund voucher was valid.
5. For 5 manual real property tax refund sample selections, the square and lot numbers to which the refund pertained did not appear to exist.
6. For 1 of the 134 manual tax refund sample selections, the tax refund check was issued to an individual other than the taxpayer and/or taxpayer representative. Further, there was no relevant Power of Attorney or other instructions from the taxpayer attached to the SRRV indicating that the refund check should be issued to this third party.

Supporting documents and detailed reports should be readily available and these records should be maintained. We recommend the following:

1. The District must strengthen controls and improve its segregation of duties if it will continue to allow these returns to be "Hold for Pick Up." At a minimum, supporting documentation such as written communication from the vendor/taxpayer or their designated representative should be attached to the SRRV. In addition, some record of who picked up the check and when that took place needs to be documented.



**Material Weaknesses and Significant Deficiencies in Internal Controls
Over Financial Reporting**

2. Manual tax refund vouchers should be reviewed by the Revenue Accounting and Administration department to ensure that required supporting documentation is attached to the voucher and that appropriate individuals have authorized the refund voucher prior to the voucher being input into the system for payment.
3. For real property manual tax refunds, the square and lot number for which the request is noted for should be verified for existence prior to processing of the tax refund.

Management's Response:

OTR is working on establishing a document which specifies the instances when a Hold for Pick-Up disbursement is to be allowed. OTR will change the process for Hold for Pick Up disbursements to match the guidelines as outlined in the March 4, 2008 memorandum issued by the Office of Finance and Treasury, as well as the Office of Integrity and Oversight (OIO) Internal Audit Alert from January 22, 2008. These recommendations will then be incorporated into the Draft Directive.

Authorization and Approvals

We noted that 4 of the 134 manual tax refund sample selections were entered and released for payment in the system by the same individual in the Revenue Accounting and Administration (RAA). In addition, 6 manual tax refund vouchers did not contain evidence to indicate that the voucher was reviewed and approved by anyone prior to processing for payment. We identified these discrepancies from a sample of transactions that were selected for testing. Management should recognize that the potential exists for additional discrepancies.

Per the draft directive issued by the Business Process Committee (BPC) as of November 2007, refunds greater than \$10,000 are now subject to a tiered review process. Management has represented the RAA performs a review of manual tax refund vouchers prior to processing the refunds for payment. We recommend that the District also consider that:

- The review process should be documented so that it indicates roles and responsibilities in reviewing a manual tax refund voucher.
- The individual responsible for reviewing and approving the manual refund voucher should document his/her review and approval on the SOAR Revenue Refund Voucher (SRRV).

In addition, the same individual who enters the manual tax refund request in the system for payment processing should also not release the voucher for payment. We recommend that management carefully consider the implementation of appropriate measures to ensure proper segregation of duties.



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Management's Response:

RAA implemented draft policies and procedures on February 4, 2008 to address the separation of duties, roles and responsibilities, and signature authority necessary to establish solid internal controls necessary to manage the manual tax refund process. RAA will continue to refine these procedures as necessary until a final version is created.

Internally Generated Standard Forms for Requesting and Processing

Internally generated standard forms used to initiate and process a manual tax refund are not accurately completed. Listed below is a description of the two applicable forms:

SOAR Revenue Refund Voucher (SRRV) – This form summarizes the pertinent aspects of each manual tax refund, the taxpayer name, address, social security number/employer identification number, the tax refund amount, and the nature of the manual tax refund.

Refund Research Form (RRF) – This form is required only for real property manual tax refunds other than those refunds that pertain to court-ordered real property tax refunds. This form is used in instances where a taxpayer has overpaid real property taxes or where the taxpayer has become entitled to a waiver or reduction of real property taxes due to a change in the tax assessment. The purpose of this form is to determine the reasonableness of the refund request by ensuring that the refund request matches the amount of real property taxes paid by the taxpayer less the taxes due.

Our review of 134 manual tax refunds which had been selected for review indicated the following.

1. 127 manual tax refunds had at least three of the following fields outstanding on the SRRV:
 - a. *Batch Number* – number of the batch which the SRRV was a part of when transmitted from the respective administrative department for processing.
 - b. *Document Date* – date the manual tax refund voucher was prepared and authorized by the respective administrative department.
 - c. *Effective Date* – the tax year for the manual tax refund voucher.
 - d. *Due Date* – the date the manual tax refund voucher was required to be paid.
 - e. *Vendor Number* – the reference number of the vendor and/or the taxpayer in the Integrated Tax System (ITS).
 - f. *Taxpayer ID* – the taxpayer's social security number/employer identification number.
2. A signature list of the individuals authorized to review and approve the SRRV is not maintained by the respective departments responsible for releasing the manual tax refund for payment. As a result, it is difficult to identify if the appropriate person(s) authorized the manual tax refund request. Management should consider adding the printed name of the individual(s), who are authorized to approve the manual tax refund request, to the SRRV form.
3. 12 manual tax refund vouchers were not court-ordered, and therefore required a RRF to be completed. We noted that a RRF was prepared for only 11 of these selections and only 1 of the 11 was completed entirely accurately.

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4. The RRF is a research form that is completed to determine the reason why a manual tax refund is issued to the taxpayer and/or vendor. However, this form does not include a field where the individual performing the research can add a comment indicating why a manual tax refund is being issued to the taxpayer and/or vendor.
5. All SRRVs are assigned a sequential document number (similar to an invoice number). For 1 manual tax refund sample, the document number on the SRRV had been manually changed.

To improve controls surrounding the review and approval of the manual tax refund requests, we recommend the following:

SOAR Revenue Refund Voucher (SRRV):

1. All fields in the SRRV form should be completed with the appropriate detail. In addition, where a particular field is not applicable (i.e. where the taxpayer or taxpayer representative does not have a vendor number in the Integrated Tax System), the reason that the field is not applicable should be annotated in the space allocated at the bottom of the form.
2. The SRRV should provide space for the preparer, reviewer, and approver to note their respective names and signatures.
3. The SRRV should be pre-printed with sequential document numbers to eliminate the risk of alteration of these document numbers. In addition, this should assist in tracking and accounting for manual tax refund vouchers.

Refund Research Form (RRF):

Per the draft directive issued by the Business Process Committee (BPC), a SOAR Refund Certification Form was created in November 2007, the objective and purpose of which was similar to the RRF.

The SOAR Refund Certification Form, however, does not list all of the supporting documentation that would be required for processing and ensuring that a particular manual tax refund voucher is valid. Further, the SOAR Refund Certification Forms are unique to each administrative department that may initiate or process a manual tax refund voucher. Different types of manual tax refunds may be processed within a particular administrative department; therefore, a checklist per administrative department cannot be specific in order to incorporate all of these different types of manual tax refunds.

We recommend that the District consider creating a SOAR Refund Certification Form for each tax refund category. Therefore, all manual tax refunds for a particular category will have similar supporting documentation irrespective of the administrative department which initiated and processed the tax refund request. Consistency in the supporting documentation will also simplify and expedite the review process.



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Management's Response:

1. Revenue Accounting and Administration will retrieve print screens from the SOAR system, which will be attached to each SRRV. This will provide all relevant information keyed into the system that was previously missing on the SRRV.
2. The combination of the required signatures on the SRRV, as well as the signature authority page, as required in the Draft Directive, will provide space for all signatures required for each refund.
3. The ability to create pre-printed, system generated and sequentially numbered SRRVs from a centralized data base is one of the system requirement requests for the new general ledger system, which will replace the existing SOAR system. At this time, the timeframe for implementation of the new system is 2009.

I - B. Automated Tax Refunds

Adequate Supporting Documentation

We were unable to verify the validity of 90 out of the 140 (or 64%) real property tax refund sample selections that had been processed through the Integrated Tax System (ITS). The total of these non-verifiable transactions amounted to approximately \$3.6 million. Below are reasons the 90 selections were not able to be validated:

1. Adequate tax refund vouchers and/or documentation supporting the real property tax refunds could not be located for 12 of the 140 real property ITS refund sample selections.
2. Proof of payment to validate the issuance of a real property tax refund was not provided for 29 of the remaining 128 real property sample selections.
3. For 120 of the real property tax refund sample selections, vouchers were only signed by the Real Property Tax Administration & Adjustments Unit (RPTAAU) employee who prepared the voucher. A manager's review and approval was not documented for these real property tax refund vouchers.
4. For 31 of the remaining 128 sample selections, the tax amount paid in by the taxpayer per the refund voucher or the ITS system did not match the proof of tax payment (i.e. cancelled check or wire transfer) submitted by the taxpayer.
5. For 32 of the remaining 128 sample selections, the real property tax refund checks were sent to entities and/or individuals other than the real property owner listed in the real property deed. In several instances, the recipients of these checks were also different than the mortgage company and/or the bank that made the tax payment to the District government. We were unable to determine the relationship of the tax refund check recipient with the taxpayer or owner of the real property.



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6. For 4 of the remaining 128 sample selections, the notation in ITS indicated that the tax refund check was distributed to the taxpayer. However, based on further inquiries and review of the check register, we noted these tax refund checks had in fact been cancelled and/or a stop payment order had been placed on these checks. The ITS system was not updated to reflect the “true” status of the tax refund payment.

All real property tax refunds processed through the ITS system should have the required supporting documentation such as a proof of tax payment made by the taxpayer, tax assessment bill, and correspondence from the taxpayer requesting the refund. In addition, if the tax refund check is issued to an entity or an individual other than the taxpayer, the RPTAAU should require an authorization letter from the taxpayer indicating that the third party is authorized to request and receive a tax refund on their behalf. All real property tax refund requests should be reviewed by a manager prior to being processed in the ITS system for validity and ensuring that the requests are supported by adequate documentation.

Management’s Response:

All real property tax refunds processed through the ITS system should have the required supporting documentation such as a proof of tax payment made by the taxpayer, tax assessment bill, and correspondence from the taxpayer requesting the refund. In addition, if the tax refund check is issued to an entity or an individual other than the taxpayer, the RPTAAU should require an authorization letter from the taxpayer indicating that the third party is authorized to request and receive a tax refund on their behalf. All real property tax refund requests should be reviewed by a manager prior to being processed in the ITS system for validity and ensuring that the requests are supported by adequate documentation. We have reviewed these refunds and no additional fraudulent refunds have been found.

Returned Refund Checks

Some tax refund checks mailed to District taxpayers are sent back to the Office of Tax and Revenue (OTR). A tax refund check is often returned because it could not be delivered to the taxpayer due to a change of name and/or address, or the address on the check was not specific enough (i.e. a taxpayer who lives in an apartment building but does not specify an apartment number). The following steps are taken when a tax refund check is returned to OTR:

- The Customer Service Department re-establishes the tax refund liability to the taxpayer in the Integrated Tax System (ITS).
- The returned tax refund checks are sorted by tax type and sent to the Revenue Accounting and Administration (RAA) along with an excel listing of all returned tax refund checks.
- The returned tax refund checks are then sent from RAA to the Office of Finance and Treasury (OFT), where OFT will cancel the check in their “Checkwrite” system (i.e. remove it from their outstanding check list). The returned tax refund check is then sent back to the RAA, who is responsible for recording the journal entry in the general ledger.

We noted that returned tax refund checks were not always recorded accurately in the general ledger. Specifically, we noted the following:



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- The returned tax refund checks were recorded in the general ledger and not ITS (or vice versa).
- The returned tax refund checks were recorded to the incorrect transaction code (i.e. the wrong tax type-Corporate Franchise instead of Sales & Use).
- The returned tax refund checks were recorded in the wrong fiscal period (i.e. fiscal year 2006 instead of 2007).
- Incorrect tax refund amounts were recorded to the general ledger (i.e. \$7,900 instead of \$9,700).

Refunds processed through ITS were not reconciled to SOAR, the District's accounting system of record, during the year. The reconciliation occurred during the audit. Based on the reconciliation, the net effect of unrecorded returned tax refund checks or errors in recording these items totaled approximately \$690,000 for the fiscal year ended September 30, 2007.

Returned tax refund checks were accounted for only on one system when they should have been recorded on both the general ledger and ITS. Due to the lack of preparing such a reconciliation, management was unable to identify these errors on a timely basis. Management should reconcile ITS refunds, by tax type, to the general ledger on a periodic basis to ensure accurate financial reporting. In addition, the RAA needs to ensure that returned refund checks are accounted for in both ITS and the general ledger and the correct refund amount is recorded into both systems.

Management's Response:

The processing of undelivered checks is a series of steps involving 3 different departments (Revenue Accounting and Administration (RAA), Customer Service Administration (CSA), and the Office of Finance and Treasury (OFT). In order to prevent timing differences from the time an undelivered check is re-established as a liability with the District and the time that journal entries are made to re-credit revenue back to the general ledger, a control must be put in place to identify checks that have been through part of the system, but have not yet been fully processed. As a result, a formal reconciliation between checks that are issued from the SOAR and ITS systems and compared to the General Ledger (SOAR) has been developed, and will be prepared on a monthly basis. This reconciliation will also include undelivered checks that were cancelled in ITS and recorded as revenue back to the general ledger.

Reconciling items that are found at the end of each reporting period will be discussed with the appropriate parties in CSA and OFT, in order to work towards clearing the reconciling items. The formal reconciliations should eliminate the conditions as set forth:

1. A formal reconciliation for each agency object should identify any mis-postings to SOAR. During the past fiscal year, 3 SOAR undelivered check transactions were coded to the incorrect SOAR agency object. Based on the number of undelivered check transactions that are processed by the RAA during the fiscal year, the number of erroneous postings is immaterial. However, the new process will assist to eliminate errors in the future.



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2. A formal reconciliation should identify and eliminate timing differences that can occur between fiscal years. As checks are cancelled in ITS, they will be tracked via the reconciliation for delivery to OFT for cancellation in the Check Write system, as well as subsequent journalizing to the appropriate SOAR revenue agency objects. All activity should occur within the same fiscal year in order to have a balanced reconciliation.
3. OTR's research shows that one entry was journalized for the incorrect amount. The journalizing of tax refund amounts should be reconciled by the agency (Office of Financial Operations and Systems - OFOS) reconciling the disbursement bank accounts. Any differences between the voucher amount and the SOAR entry should be addressed and corrected at the request of OFOS.
4. Should any checks be journalized back to revenue in SOAR without an appropriate ITS adjustment, the reconciliation should identify the difference.

Finally, the \$690,000 understatement in revenue in FY 2007 either corrected an overstatement of revenue from FY 2006, or will be recognized as revenue in FY 2008.

Legible Scanned Copies of the Original Tax Return not Maintained as Supporting Documentation

The following four departments within the Returns Processing Agency (RPA) are involved in ensuring that proper scanned images of tax returns are maintained in the Integrated Tax System (ITS) as supporting documentation for tax refunds processed. In addition, these departments are responsible for ensuring that the information entered in ITS matches the information on the tax returns as submitted by the taxpayers and scanned in the system.

- Document Preparation Unit – This unit is responsible for preparing various tax returns and correspondence to be scanned into the Integrated Data Capture System (IDCS).
- Scanning and Review Operations Unit – The primary function of this unit is to scan tax returns into the IDCS. The IDCS system performs a balancing check, to ensure that the information entered into ITS matches the data in IDCS.
- Data Input and Repair Unit - After items have been scanned into IDCS, an edit check is done to determine if the scanned tax returns have errors. If an error has occurred, generally due to the system inability to read the information on the imaged returns, data operators receive the batches and manually enter the missing information into the Quick Key module of IDCS.
- Output Review Unit – This unit functions as quality control for the scanning and entering of tax information in ITS. The unit randomly selects 12% of all billed and refund returns and ensures that scanned tax return images are proper and the information per the scanned copies of the tax returns matches the information entered in ITS.

During our procedures we noted that proper tax documents were not scanned in for 51 of the 955 (or 5%) sample selections for tax refunds processed through ITS. Specifically, we noted the following:



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- For 29 of the 955 sample selections, the information in ITS such as the taxpayer name, address, and/or social security number or employer identification number did not completely and accurately match the information per the scanned copy of the tax return.
- For 20 of the 955 sample selections, there was no accompanying tax return scanned in ITS to support the tax refund issued to the taxpayer.
- 1 sample selection had missing pages in the scanned tax return.
- An incorrect tax return was scanned into ITS for another sample selection.

The proper scanned tax return should be maintained within ITS without exception. Management should ensure that all tax returns processed through RPA are scanned properly into IDCS, which is then uploaded to ITS. Additionally, management should ensure that the information listed on the tax return matches the information in ITS.

The Output Review Unit currently selects for review approximately 12% of the total tax refunds processed within the ITS system. The Output Review Unit should consider increasing this percentage. In addition, the errors and/or issues noted by this group during its review should be communicated to the other departments within RPA who are responsible for the scanning function to ensure that systematic problems are identified and corrected.

Management's Response:

RPA has implemented a change to business processes to require the staff to initial all batches prior to scanning which will indicate they have verified the batch header against the contents of the batch.

There is already a standing process with respect to returns that were scanned incorrectly, where a notification of the issue is provided to the manager of the scanning unit. If it is determined that a staff member requires additional training, it is provided. If the scanning problem is found with our lockbox contract, a lockbox trouble report is sent to the lockbox analyst within RPA, who in turns notifies the COTR and the contractor.

The 12% review criterion does not apply to refund returns, only those accounts that would generate a bill for the tax due. We have not seen any documentation that would support a need to increase the percentage beyond the current 12%.

I - C. Other Issues

Tax Sale Process

As required by D.C. statute, the Office of Tax and Revenue (OTR) holds a public auction during July of each year to sell real property tax liens. The auction is for both commercial and residential property for which property taxes are unpaid for the previous tax year by the property owner as of the auction date.

We identified the following control issues in the Tax Sale process:



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1. A credit check is not completed on the prospective auction participants to ensure that they will be able to pay the final purchase price of the tax sale to the District.
2. A Tax Sale database is created for each annual tax sale auction. Accordingly, there is no consolidated database where a respective Buyer's information is maintained. In addition, as the Buyers may be issued a different number each tax sale year, there is no unique identifier across the various tax sale databases which can be used to identify the Buyer and obtain the Buyer's information.
3. The total Buyer's liability per the various Tax Sale databases is not regularly reconciled to the total Buyer's liability per the general ledger. Specifically:
 - a. A reconciliation of the Tax Sale cash receipts recorded in the general ledger and Buyers deposits per the Tax Sale database is not performed.
 - b. When the surplus refund is processed through the accounts payable system, the liability account (Buyers deposit) and cash is reduced for the amount of the refund. However, it does not appear that the journal entry to reduce the liability and recognize the revenue for the tax lien amount is recorded timely and accurately. A reconciliation is not performed between the general ledger and the Tax Sale database to ensure that all journal entries relating to the surplus refunds recorded in the database have also been appropriately recorded in the general ledger.
 - c. A reconciliation is not performed between the general ledger and the Tax Sale database to ensure that all redemption refunds paid and recorded in the general ledger have also been recorded in the Tax Sale database.
4. Adequate segregation of duties in initiating and recording the tax sale refund in the Tax Sale database and authorizing the tax sale refund should be further evaluated.
5. Information in the Tax Sale database may not be accurate. For example, some tax sale refunds, although processed and paid, may not have been recorded in the Tax Sale database.

We recommend that management review the complete process of recording and maintaining tax sale information in the Tax Sale database. In addressing these issues, management should ensure:

- Access to record information in the Tax Sale database is restricted to designated individuals within the Tax Sale Unit. These individuals should not have the ability to authorize a tax sale refund.
- A verification process should be implemented to ensure the validity and accuracy of the information maintained in the Tax Sale database. In addition, information in the Tax Sale database (e.g. Buyer's deposits and refunds) should be reconciled timely to the activity recorded in the general ledger.
- A report should be created where the total liability per the general ledger can be tracked by Buyer.



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Management's Response:

Finding #1 – In lieu of doing a credit check, the Real Property Tax Administration & Adjustment Unit (RPTA) will verify that the entity is registered to do business in the District, and has filed an FR500 business registration. In addition, RPTA personnel will forward a listing to the Compliance Administration of buyers who were paid interest in specific years, for use in verifying the filing and payment of any tax on the appropriate D20 or D-30 tax returns.

Findings #'s 2-5 – RPTA and the Revenue Accounting and Administration (RAA) management will implement corrective actions to address the findings regarding the Tax Sale. With regard to the recommendations related to management's review of the Tax Sale database, employees in the Assessment Services Division that do not have the authority to generate refunds (which must be approved by a supervisor) should have "Read Only" rights to the Tax Sale database, and a report will be used by RPTA employees to reconcile liabilities of specific buyers.

Accuracy of System Used to Calculate Interest Owed to Taxpayers

The District government holds tax lien auctions for real properties on which taxes have not been remitted by the owners. When an individual bids and purchases the tax lien, the purchase price of the tax lien is deposited with the District government. For each tax lien purchased, a portion of the purchase price is allocated to the principle of the outstanding tax lien and the balance is regarded as a surplus payment. The original owner of the real property against whom the tax lien is levied has a period of time to redeem the tax lien and retain ownership of his property.

If the tax lien is redeemed by the original property owner, the purchaser of the tax lien is due a refund of the money that was deposited with the District government at the time of the tax lien purchase, as well as any subsequent payments made with respect to that property's tax assessment bill.

Tax lien purchasers are paid interest of 1.5% per month on the purchase price which relates to the principal of the outstanding tax lien if the tax lien is redeemed by the original owner. Per the instructions on the Certificate of Bid Off Sale (COBOS) form, the interest is calculated from the date the purchase price was deposited with the District government to the date that the tax lien is redeemed by the original owner.

The interest is calculated by the Fox Pro database when the date of redemption is keyed into the database. However, we noted that the interest amount calculated can be over-ridden.

- For 59 out of the 76 items selected for our review, the interest paid to the purchaser on the principal amount of the outstanding tax lien appeared to be calculated incorrectly.

Taxpayers are also paid interest for court ordered real property tax refunds. The interest rate for these tax refunds is stipulated in the court order. Furthermore, the interest is calculated on the refund amount from the date of the court order to the date the tax refund check is printed and mailed.

- For all 26 court ordered manual real property tax refunds selected for our review, the interest paid to the taxpayer was not able to be accurately recalculated.



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We recommend that access to override the interest payment calculated by the system should be restricted to authorized individuals. In addition, all tax refunds for which the interest calculated is over-ridden should be reviewed and approved by a supervisory level employee. The reliability of information will be increased if only authorized employees have access to certain records.

Management's Response:

The Real Property Tax Administration & Adjustments Unit (RPTAAU) agrees and will ensure that access to override the interest calculation is limited and subject to review and approval of a manager or managers (depending upon the dollar amount of the specific refund).

The Assessment & Tax Cards (A & T cards)

A square and lot number is associated with all real property addresses. The Landata system is used to store and archive the real property information such as the square and lot numbers associated with real property addresses and related real property deeds indicating the owners of a real property. The square and lot numbers for a real property address can often change due to splits or combinations of the real property tax assessment parcels, based on changes made to the property and/or its usage by the taxpayer. As such, a deed may be associated and filed with a former square and lot number assigned to that property. The A & T cards are used to record the changes to the square and lot numbers and to identify the square and lot number where the real property deed is filed, if this information is not evident in the Landata system.

The A & T card is similar to an index card. Each square and lot number has an A & T card associated with it. All changes to the square and lot number for a real property are hand-written on these A & T cards. One has to reference the A & T card to identify the former square and lot number under which the real property deed for a particular property may be filed. As the information in the A & T cards is not maintained in an electronic database, if the A & T card is misplaced, it may be difficult to locate the deed of a real property and therefore the owners of that real property.

Furthermore, the A&T cards do not identify the individual who added or modified information on the cards. As a result, a risk exists that changes made on these cards may not be valid and/or authorized by an appropriate individual. An electronic database should be created which documents the changes made to the square and lot numbers for a particular real property. The database should include the square and lot number under which the real property deed is filed. Individuals authorized to make changes in this database should be identified and a record of the person making the change should be maintained.

Management's Response:

A square and lot number, parcel, reservation, or RT is associated with all real property located within the District of Columbia. The Landata system is used by the Recorder of Deeds to archive real property and related documents. Examples of related documents include but are not limited to deeds, deeds of trust, court orders, deeds of release, leases, liens, lien releases, and others. The Landata system is not related to and does not interact with the Assessment and Tax (A&T) card files or database. The square and lot number, parcel, reservation, or RT may change due to splits, combinations, or a subdivision plot recorded in the Office of the Surveyor. A deed or other document may be filed at the Recorder of Deeds using a square and lot number, parcel, reservation, or RT that had previously been assigned to the property.



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The A&T cards are used to record the changes to a square and lot number, parcel, reservation, or RT and to identify the lot chronology back to the original creation of the lot.

Each square and lot number, parcel, reservation, or RT in the District of Columbia has an associated A&T card. The card is similar in size to an index card with handwritten changes noted as they occur. The A&T cards list any changes that have occurred in the lot since its' original creation. Deed research references the A&T cards to identify any former square and lot number, parcel, reservation, or RT under which a real property deed may have been filed. If an A&T card is in use by an employee or has been misplaced, a user may have to locate the deed of a real property using the ownership cards and referencing the instrument numbers for documents recorded at the Recorder of Deeds.

Changes to A&T cards are completed by the Cartographer or Conveyance Examiner and checked for accuracy by the Lead Conveyance Examiner or the Unit Manager. Supporting documentation is maintained within the Maps and Titles Unit in a secured file cabinet.

The Office of Tax and Revenue (OTR) is currently engaged in a project to scan the A&T cards and create an applicable database. Persons having access and authorization to make changes within the database have been established and specified. The database will have an audit trail to identify which user made changes and when.

The A&T card project has been underway for approximately one year and is expected to be completed within the next several months. Plans are that in the near future this database, along with the ownership cards, will be available for viewing on the CFO website.

Inadequate Access Controls Exist for Generating Signed Copies of the Certificate of Bid Off Sale (COBOS)

COBOS is a form given to the bidders as "proof of ownership" for purchase of properties at tax sale auctions held by the Office of Tax and Revenue (OTR). The form is printed from the Fox Pro system and includes property details and the amount for which the tax lien on the property was purchased by the bidder. This form is also signed by either the Chief or Director of the Assessment Services Division (ASD) to authenticate and approve the form. Many employees in the ASD had access to print the document from the Fox Pro system as well as imprint the digital signature of the Chief or Director of the ASD. In addition, the COBOS forms that had been previously authorized could be altered when viewed in the system. As a result, a risk exists that unauthorized COBOS forms may be printed from the Fox Pro system.

We recommend the following:

1. Access to imprint the authorizing signature on the COBOS form within the Fox Pro system should be limited to either the Chief or Director of the ASD or their authorized representatives.
2. When the COBOS form has been completed and signed, the form should be secured from further alteration.

The reliability of information will be increased if only authorized employees have access to certain records.



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Management's Response:

The above finding fails to mention that only the original COBOS has the embossed District of Columbia Seal. Any duplicates issued from the Fox Pro based Tax Sale database will not include the Seal and therefore are easily determined not to be the original.

The Real Property Tax Administration & Adjustments Unit (RPTAAU) concurs with the recommendations and has already implemented actions to limit who is authorized to change the automatic signature and to prevent any changes in other information (date, address, SSL, names, and amounts) on a COBOS.



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II. Management of the Medicaid Program

Medicaid Program is Classified as an Area of Risk

In its FY 2007 *Report on the Activities of the Office of the Inspector General (OIG)* dated December 1, 2007, the OIG identified the Medicaid Program as an area of risk for the District. The Medicaid Program had been also been identified as a risk area in previous OIG reports. The current assessment states that the impact of potential losses to the District is significant. The 2008 plan is to continue OIG's vigorous oversight of the Medicaid Program, focusing on areas such as nursing home reimbursements, third party liability, Medicaid recordkeeping and documentation, and other related issues. Following are the summarized results of three recent audits performed by the OIG:

Audit #1 - Audit of the Department of Health's Contracting for Non-Emergency Transportation Services, issued March 13, 2007.

Medical Assistance Administration (MAA) officials attempted to outsource Non-Emergency Transportation (NET) Program services without evaluating the costs to perform the services and providing documentation to support that doing so was in the best interest of the District. Specifically, MAA did not prepare and submit a cost-benefit analysis to the Office of Contracting and Procurement (OCP) prior to requesting that OCP solicit and award a contract for a transportation broker (Broker). The cost estimate is required by District law and would have assisted MAA officials in reaching an informed decision about whether to perform the services in-house or to outsource them.

Also, OIG's review of the solicitation to obtain Broker services disclosed that the bid prices submitted by three offerors to provide NET Program services were based on an excessive amount of annual trips, which was estimated by MAA officials. The three offerors used 540,000 trips yearly as the basis for computing the total program costs (bid price) to manage and administer the NET Program. Prior to the completion of OIG's audit, OIG met with Medical Assistance Administration – Office of Program Operations (MAA-OPO) officials to discuss the number of annual transportation trips. The officials agreed with OIG's determination that the annual trip estimates were inflated and reduced the estimated number of annual trips, revised the solicitation, and requested best and final offers from the prospective bidders. As a result of the reduction in the number of trips, the District could save as much as \$6.8 million in the first year of the contract and an additional \$27 million, should the District opt to contract for all 4 option years.

In addition, the solicitation contained ambiguous language pertaining to the Broker's use of the Medical Necessity form. The solicitation provided that the Broker had the authority to determine the mode of transportation afforded to program participants. However, Department of Health (DOH) procedures require that the medical necessity for transportation be determined by a physician. This vague solicitation language was inconsistent with DOH procedures and may have negatively impacted the services provided to program participants, and could result in unreasonable Broker profits.



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Management's Response:

Management responds with the following correspondence forwarded to the OIG:

Cost/Pricing Analysis Required Under District Law

We provided OCP with a documented cost/pricing analysis comparing the "fully allocated cost," as referenced in the Management Alert Response (MAR), of providing NET program services using District employees versus the transportation broker model. This was completed as soon as we were made aware of this requirement in our prior meetings with OIG staff and by OCP. A copy of that documentation has since been provided to the OIG office as well. The subject documentation was prepared in advance of OCP's award of the contract and in advance of approval by the Office of the Attorney General for the District of Columbia and the District of Columbia City Council. We believe that our decision to operate the NET program with a broker manager is an informed, prudent, and efficient one, particularly since it appears that the District will save millions of dollars and also, there is no possibility of any District government employee being displaced from employment as a result of the NET broker contract. Simply stated the District will save millions of dollars annually using the health care industry best practice, NET broker contract model.

Number of NET Eligible Medicaid Recipients and Volume of Trips

The Solicitation (i.e. RFP) that was issued to the public, in fact, contained both the number of eligible Medicaid recipients who may receive NET program services and the actual number of Medicaid recipients who used NET program services in the preceding fiscal year.

Based on available data we have reviewed and analyzed, MAA estimates that 45,000 Medicaid beneficiaries may be eligible for the NET program services and 10,000 of those beneficiaries will utilize NET services on at least one occasion. The Solicitation does not state that MAA proposed an increase of 540,000 trips annually.

The Medicaid fee-for-service (non-managed care) population ranges from 40,000 to 50,000 recipients. The RFP gave a "mid-point" figure of 45,000 recipients for the vendors to utilize in order to develop their "capitation" rates for their price proposals for the Broker procurement. Only 10,000 unduplicated recipients actually utilize transportation services.

MAA reduced the total number of trips that were stated in the RFP by 20%, for the 3 historical years (2001 thru 2003). The 20% reduction in the number of trips was based on the potential number of MAA estimated NET claims due to fraud, waste, and/or abuse of Medicaid program resources. Each vendor reduced their cost proposal, accordingly, in their best and final offer documents (BAFO) which were submitted to OCP on November 22, 2006.

Transportation Requests and Medical Necessity Certification Forms

MAA has implemented new protocols and procedures to track and monitor Medical Necessity Certification Forms (medical necessity forms).



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These are immediate corrective actions intended to address the need for corrective action and improvement of program integrity pending the longer term solution for a transportation broker. MAA informed the OIG office of this change in a response letter to matters previously raised in MAR No. 06-A-09 for OIG audit No. 05-2-18HC.

Ambiguity Regarding Broker's Use of Medical Necessity Form

Based on the medical necessity determination of the NET medical clinician that supports a specific mode of transportation and level of service, the broker will assign the mode of transportation which cannot vary from the documentation of the medical clinician. To the extent that any ambiguity was perceived, we apologize for the potential discrepancy and appreciate the identification of this issue which we have resolved.

1. Establish sound NET program patient-participation and financial data before attempting to outsource this service to Broker.

Based on national research, MAA selected a national best practice model for transportation reform. Currently used in at least 14 states nationwide, the NET transportation broker model is consistently receiving high marks for customer satisfaction. We need this type of reform and potential results for the NET program.

The final fiscal impact report included assertions related to claims data and financial information accumulated over the time period of three (3) years. The report was certified by Mercer as sound under applicable and prevailing professional accounting industry standards based on the data utilized.

MAA completed a cost/pricing analysis, which compared three (3) options available for administering the non-emergency transportation program in the District. In addition, MAA submitted to the District of Columbia City Council the fiscal impact report/statement, the Solicitation, the Request for Proposal (RFP), and the Medicaid Waiver which were approved by the D.C. City Council. The Medicaid Waiver and State Plan Amendment were subsequently approved by the Federal government (U.S. Department of Health and Human Services, Centers for Medicare and Medicaid (CMS)). This submission included detailed costs, and the actuarial study that was completed by the professional services firm of Mercer Consulting.

2. Prepare a program cost estimate as required by District law to calculate and compare the cost of providing the non-emergency transportation services using District government employees to the cost associated with contracting the service.

Pursuant to the D.C. Privatization Law, MAA prepared and completed a cost/pricing analysis and a report that substantially complies with that law. That report indicates that no District employees will be displaced as a result of the potential award of the Transportation Broker contract.

The current cost to administer the transportation program exceeds \$24 million. All of the bids submitted for the Broker contract were under \$14.5 million. Projected savings from the NET program will exceed several million dollars.



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3. Submit to the Office of Contracting and Procurement and the District of Columbia Council all necessary documents in accordance with the requirements set forth in D.C. Code §2-301.05b) prior to awarding a contract for the NET Program to a Broker.

MAA completed all the necessary documents that were requested and required by OCP since the start of this procurement in 2004. Specifically, MAA completed the requirements associated with the D.C. Privatization Law (D.C. Code Section 2-301-.05b (2001, as amended). As previously discussed, MAA provided this information to the responsible OCP contracting officer.

4. Amend the Solicitation to specify that the Broker provides and arranges NET services based on the medical necessity form prepared by a participating physician, should a decision be made to outsource the services.

We will require that the NET broker utilize MAA's medical necessity forms which may be completed only by the treating or clinical provider.

Audit #2 - Audit of the Department of Health's Oversight of the D.C. Medicaid Managed Care Program, issued July 18, 2007.

This audit disclosed that the Medical Assistance Administration (MAA) fiscally mismanaged the Managed Care Organizations (MCO) program. The strategy for setting annually renewable capitation rates was flawed when MAA officials did not adjust the capitation rates to levels which would have avoided excessive MCO profits and maximized dollar expenditures for patient care. Further, MAA did not have a system to collect and use valid encounter data to best identify and evaluate the extent that MCO members used medical services.

MAA accepted an actuarial methodology that used the total medical costs of three MCOs to develop a single base as the starting point for capitation rate development. This "one size fits all" method of setting capitation rates and the lack of encounter data resulted in Amerigroup receiving \$74 million (or 20.9 percent) more than necessary for patient care over the past 5 years. In addition, D.C. Chartered and Health Right received \$17.5 and \$5.1 million (or 4.2 and 3.8, percent respectively) more than necessary for patient care over the past 5 years. More importantly, Amerigroup spent as little as 64 percent of its capitation payment on patient care, as compared to 77 percent or more spent by the same MCO in Maryland and New Jersey and the 76 to 86 percent spent in the District by D.C. Chartered Health Plan, Inc. and Health Right, Inc. Although Amerigroup's capitation rates have been reduced by MAA over the past two years, the OIG believes that Amerigroup has made excess profits.

Based on the most current premium payment information available, OIG calculated that over the next 5 years, the District could pay D.C. Chartered and Amerigroup \$51.6 million (or 3.9 percent) more than necessary for patient care if quality encounter data is not used and this "one size fits all" practice continues. Further, because the District has not complied with the federal requirement to use valid encounter data in the development of capitation rates, it is in danger of losing its federal approval and funding.



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Management's Response:

OIG RECOMMENDATION 1: Calculate a base starting point for each MCO using individual medical costs to eliminate the "one size fits all" methodology until encounter data can be collected, validated, and used to supplement cost data for rate setting purposes.

Response: MAA believes this recommendation is not in the best interest of the District at this time. Using MCO-specific (or plan-only) data for rate setting has hurt the District in the past. Prior to its current actuary, the District's consultant did set rates in this manner. CMS requested that the District discontinue the practice of using a MCO-specific rate development approach because that type of method resulted in very large unexplainable rate variations from one MCO to another.

The OIG argues the District's rate setting methodology is flawed with a "one size fits all" method. The OIG goes further to advocate a non standard approach that would result in different, potentially disparate, rate ranges for each MCO. The OIG focuses on the methodology as the only driver of MCO profits. This is an incorrect conclusion. This limited viewpoint is not useful in enhancing the District's Medicaid MCO program and in fact may have an opposite harmful effect if implemented.

For the District to follow the OIG recommendation on a rate setting methodology would put the District in the unique position of being one of the only programs in the country using this methodology. The OIG has not provided evidence that this methodology would have prevented any excess profits being earned by the MCOs or explained how it would benefit the District. Conversely, the current methodology used in the District is generally accepted by CMS and the American Academy of Actuaries, which is the governing body of actuaries. The current D.C. rate setting methodology is used in nearly every other state, including Maryland and New Jersey.

OIG RECOMMENDATION 2: Enforce 42 CFR § 438.242 and contract provisions that require MCOs to collect and submit valid encounter data to MAA and have MAA make valid encounter data available to the actuary responsible for calculating capitation rates for each MCO.

Response: The District is in compliance with 42 CFR § 438.242 in collecting encounter data from the MCOs. In the current procurement, the District has also enhanced the contract provisions related to encounter data collection. MAA has provided Mercer encounter data for use in rate setting. Mercer reviewed the data and included encounter data as a direct data source in the CY 2008 rate development.

OIG Statement: MAA did not have a system to collect and use valid encounter data to best identify and evaluate the extent that MCO members used medical services.

Response: MAA does now have a system for gathering accurate, complete, and consistent encounter data. This system has evolved over the last few years through significant technical assistance from MAA and Mercer to the MCOs. The District's encounter data collection system is fully operational; the remaining encounter data challenges are primarily centered on the collection of data from service providers, by the MCOs. This is particularly true where the plans have sub-capitated the providers and may need to consider changing their reporting incentive/disincentive policies and procedures.



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OIG Statement: MAA did not use encounter data in developing the capitation rates. The failure to use encounter data distorts the capitation rate calculation because it excludes the extent to which MCO members used medical services.

Response: The availability of encounter data does not have a direct impact on the medical costs. While the encounter data provides more detail for analysis, it does not change the actual costs to deliver services to the Medicaid population. With encounter data, MAA will be in a better position to explain cost differences among the MCOs and enhance the overall rate setting process; however, this does not change the actual medical costs of the program.

The financial data submitted by the MCOs outlines the amount of money spent on doctors' visits, inpatient hospital stays, outpatient visits, primary care, specialty care, pharmacy, and dental care. This is a reasonable starting point to adequately assess future levels of service costs. The capitation rates are not distorted due to the lack of encounter data. While CMS prefers encounter data as the primary data source, the financial data is sufficient to determine the cost of the medical services utilized by MCO members. CMS has approved the use of financial data as a source for rate setting in the District as well as in Maryland, New Jersey, and numerous other states.

OIG Statement: We [The OIG] found that the District lags far behind Maryland, Virginia, and New Jersey, all of which have been collecting encounter data since calendar year 2000.

Response: While the encounter data collection in the District did begin after Maryland and New Jersey, the District is the only one of these programs to incorporate their encounter data as a direct data source in rate setting. The other two states rely solely on MCO financial data and use encounter data to support risk adjustment calculations. Given these facts, MAA disputes the conclusion that "the District lags far behind Maryland, Virginia, and New Jersey."

OIG Statement: Because the District has not complied with the federal requirement to use valid encounter data in the development of the capitation rates, it is in danger of losing federal approval and funding.

Response: This statement is simply not correct. There is no basis to the statement that the District is at risk of losing federal funding because of its encounter data collection efforts. CMS has approved the District's use of financial data in determining capitation rates. When the requirement became apparent, the District proactively made it a priority to develop an encounter data collection system. The experience throughout the country has been that it takes three to five years before encounter data reported by MCOs is complete and accurate enough to incorporate into rate setting. The District's experience in developing their system is consistent with the experience of other states. Throughout this process the Department has periodically discussed and reported to CMS its plans and progress made on encounter data collection. As mentioned above, the District now has an encounter data system and has made use of the encounter data in the most recent rate development and will continue to incorporate encounter data in future rate setting.

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OIG RECOMMENDATION 3: Coordinate efforts with the actuary to require the use of risk adjustment factors when developing capitation rates based on valid encounter data.

Response: MAA and Mercer have discussed the potential for risk adjustment during our meetings with the OIG audit team. MAA is interested in pursuing a risk adjustment program using the encounter data for this purpose. Given the upcoming procurement, MAA must first determine the MCOs that will serve the Medicaid members before introducing risk adjustment. However, risk adjustment is a goal for the program in the coming years. We would also note that the risk adjustment process reallocates the capitation dollars amongst the winning MCOs; it does not reduce the amount of capitation outlay for the Medicaid program.

OIG RECOMMENDATION 4: Benchmark the Maryland managed care program to identify and implement better methods for setting capitation rates.

Response: This recommendation appears to be inconsistent with the OIG's expressed concern about how the District calculates rate ranges. Maryland's rate setting methodology is based on utilizing total MCO costs. This is the same method used in the District. Maryland and the District have very similar rate setting methodologies. This is known because Mercer is also Maryland's actuary.

In terms of "benchmarking" the Maryland program, MAA would also like to point out that the District's DCHFP capitation rates are 5-10% lower than the rates paid in Baltimore, a metropolitan jurisdiction comparable to the District; and the annual rate increases have been lower in the District than in Maryland.

OIG RECOMMENDATION 5: Establish internal controls designed to measure the performance of the Office of Managed Care in relation to the rate setting process.

Response: The Office of Managed Care has operated in compliance with all District and federal laws while managing the program within the budget allocated by the District City Council. MAA has complied with the contracting rules put forth by the Office of Contracting and Procurement and complied with the federal regulations put forth by CMS. MAA will continue to look for ways to improve program performance. However, we want to stress that the Office of Managed Care has complied with all Department policies and applicable laws and regulations.

Over the last five years, MAA has negotiated rate increases with the MCOs that averaged 2.2% overall. This has allowed MAA to keep the Medicaid managed care program within budget. Nationally, medical costs have increased nearly 7.0% per year.

OIG RECOMMENDATION 6: Pursue with the MCO contractors and the actuary, monetary remuneration, due to the excess profits made over the target rate.

Response: The actuary has satisfied the requirements of their contracts with MAA. MAA does not appear to have recourse to pursue monetary remuneration from them based upon the analysis provided in this report. There are no legal terms and conditions in the current MCO contracts that define minimum loss ratios or excess profits. All current MCO rates have been reviewed by CMS and CMS approval was obtained for each rate cycle over the last five years.



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CMS review of rates and their review of the actuarial sound rate range and rate methodology is a requirement enforced by CMS on all Medicaid managed care programs.

However, because MAA has been concerned about MCO profit levels, independent audits are being completed on the finances of each of the MCO's. Based on the results of these audits, and the facts that will be presented surrounding their profitability, MAA will discuss the audit results with District legal staff and make a determination on what action to take when the audits are complete.

Audit # 3 - Audit of the District of Columbia Department of Mental Health's Program Management and Administration of Provider Reimbursements, issued December 11, 2007.

This audit found that a process for reworking and resubmitting denied Medicaid claims at the Department of Mental Health (DMH) is nonexistent. Denied Medicaid claims have not been reworked and resubmitted since the eCura system was brought to DMH in FY 2001. Based on estimates provided to OIG by DMH personnel, the value of denied claims is approximated at \$30.1 million. This figure represents denied Medicaid claims since November 2002.

The audit also found that DMH's main information system application software for managing its business objectives needs improvement or replacement because of significant weaknesses regarding reliability, integrity of information reported, and the effectiveness of provider claims processing. This includes the claims processing function that interfaces with the Medical Assistance Administration (MAA) fiscal intermediary, Affiliated Computer Services (ACS).

The information system currently in place does not produce timely and reliable monthly reports that summarize program statistics and accountability as to projected performance measures.

The Chief Procurement Officer (CPO) had to ratify additional amounts in unauthorized DMH commitments in FY 2005 and again in FY 2007. The FY 2005 ratifications were the result of Mental Health Rehabilitative Services (MHRS) providers exceeding task order values with DMH, while the FY 2007 ratifications were the result of DMH's failure to have signed and approved provider agreements in place before provider's submitted claims for payment. The unauthorized commitments resulted from DMH's failure to implement information systems application controls necessary to reduce vendors' risk of exceeding DMH task order limits, which may have violated the District's Anti-Deficiency Act. Additionally, DMH management does not have properly trained and assigned Contracting Officers' Technical Representatives (COTRs) to provide oversight for services provided and claims submitted to DMH for payment.

The Memorandum of Understanding (MOU) between DMH and MAA should be renegotiated so that MAA, the state Medicaid agency, assumes the role of payer of first resort for providers of Medicaid claims. In the current process, DMH pays the provider first and then seeks 70 percent reimbursement (federal portion) from MAA. Thus, DMH uses 100 percent of its local dollars to pay providers and then attempts to recover the 70 percent. This approach has not been effective or efficient. Further, internal controls surrounding validation of provider claims need significant improvement. DMH has a documented policy that requires periodic audits of MHRS providers.



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However, DMH was unable to provide documentation supporting any audits performed during FY 2006 or FY 2007.

Lastly, DMH has an excessive number of Human Care Agreements (HCA) with providers which have contributed to DMH's inability to effectively manage MHRS dollars amongst the number of providers seeking business with DMH. DMH's current utilization of 51 service providers appears to be excessive given that 18 providers receive 92 percent of DMH's \$40.8 million budget for MHRS services. The current number of providers places a strain on DMH personnel assigned to work with the providers to insure adequacy of services for consumers, as well as resolve billing, payment, and provider training issues. The OIG noted that for FY 2006, two MHRS providers received as little as \$4,000, while another 5 received less than \$100,000 each.

Management's Response:

Prior to September 2006, DMH acknowledges that it did not have an adequate process in place to actively reprocess Medicaid claims from prior years that MAA had denied and that a sizable "Accounts Receivables" (A/R) had accumulated. Since that time, DMH took several actions to manage this process, which include:

1. Contracting with an outside vendor, ValueOptions, to identify, quantify, prioritize, correct, and resubmit claims denied for Medicaid eligible services provided;
2. Contracting with KPMG, LLP to provide program management consultant services to develop a work plan for staff to use to guide this process and assist in establishing repeatable processes for program administration; and
3. Contracting with a consultant dedicated solely to managing the MHRS program, including working with DMH staff to develop management reports.

These steps have yielded a significant return on the A/R effort and resulted in better management of the MHRS program.

DMH must first correct the OIG's finding about the amount of potential A/R recovery. The OIG report states that DMH had denied Medicaid claims totaling \$22,682,071 and rejected claims totaling \$7.5 million. It appears that the OIG combined the two numbers to reach the \$30.1 million potential recovery amount stated in the report. We believe that this approach results in an inflated amount of recovery. Due to the success of these efforts, DMH has closed out its outstanding receivables balances for FY 2005 and FY 2006. To date, DMH has recovered \$11.6 million in outstanding accounts receivable.

In order to relieve DMH of the responsibility of paying claims to providers first and then forwarding them to MAA for reimbursement, MAA has assumed responsibility for paying MHRS providers for Medicaid eligible services for claims with dates of services November 1, 2007 forward. The transition of this payment function to MAA has moved the responsibility of managing claims denials and resubmissions appropriately to the MHRS.



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The OIG Report concludes that eCura has numerous problems interfacing with MMIS, which indicates some misunderstanding about how the application works. eCura is designed to export claim data files so that they can be imported by a system like an MMIS system. To that extent, the eCura application works as it was designed.

Since the time of the OIG Report, DMH has taken the following steps:

1. DMH will make the system changes to allow providers to adjust authorizations annually effective the first quarter of FY 2008.
2. With the transition of the Medicaid payment process to the MAA, DMH is fully compliant with the HIPAA transaction set.
3. While the OIG concluded that eCura's Provider Connect function cannot support DMH's fee-for-service model, DMH contends that the application performs as it was designed, i.e. to support the delivery model that is currently in place.

DMH chose to suspend claims processing while corrections were made to the system logic problem cited in this report. DMH is not aware of any other instance in which eCura was inoperable over extended periods of time.

The OIG concludes that eCura does not provide detailed monthly reporting to monitor DMH performance measures and goals and attributes this to an eCura "system design flaw." DMH disagrees that there is a "system design flaw." DMH purchased and currently uses the data warehouse to develop reports when requested.

DMH disagreed with the OIG's conclusions about the authorization system control. The authorization process was discontinued in 2003 and reinstated in November 2005. The reintroduction did not create any claims file format problems as reported.

Throughout FY 2006 through the present, DMH has initiated the following corrective actions:

1. Hired a permanent Director of Contracts and Procurement in January, 2007 that is certified as a Public Procurement Officer (CPPO) and Public Purchasing Buyer (CPPB).
2. Engaged an independent consultant to perform a complete assessment of the DMH contracts office and to assist in the preparation of policies and procedures.
3. Required all Contract Officer Technical Representatives (COTRs) who had not been trained to attend training. As of this time, 60 additional staff received this training and now properly appointed as COTRs.
4. In the process of developing a plan to transition all contracting and procurement functions for Saint Elizabeth's Hospital to administrative staff at Saint Elizabeth's Hospital.



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In order to relieve DMH of the responsibility of paying claims to providers first and then forwarding them to MAA for reimbursement, MAA has assumed responsibility for paying MHRS providers for Medicaid eligible services for claims with dates of services November 1, 2007 forward.

With respect to periodic audits of providers, DMH has initiated the following corrective actions:

1. DMH hired a Deputy Director for Accountability in December 2006. The Office of Accountability (OA) re-started the claims audit process by adopting a new, statistically valid methodology and a more precise audit tool.
2. The audits for FY 2005 and FY 2007 have been completed, and providers are beginning to receive notification of their initial audit results.
3. Because there is a current DMH moratorium on new MHRS providers, OA no longer performs audits on "new provider claims." Instead, now that the backlog of claims audits has been made current, OA will be auditing all claims on a quarterly basis.
4. The DMH Deputy Director, Accountability and the MAA Program Integrity Chief have been meeting regularly to develop an MOU regarding repayment of failed claims/false claims to CMS, and recoupment of paid funds from providers.

Regarding a review of the number of MHRS providers, DMH has established a procedure for assessing the performance of providers to determine whether they should receive continued funding. The criteria that will be used to judge provider performance include:

1. A quarterly review of the claims history of all certified providers to determine whether they are billing for services.
2. Development of quality indicators that are tied to fidelity and claims audits.

It should also be noted that there is currently a moratorium on the certification of new providers until such time as DMH determines whether the needs of the network are being adequately met by its current number and array of certified providers.

Findings of the Medicaid Fraud Control Unit

The Medicaid Fraud Control Unit (MFCU) is a unit of the Office of Inspector General (OIG) that has a dual mission. It investigates and prosecutes Medicaid providers who engage in fraudulent billing. The MFCU also investigates and prosecutes the abuse, neglect, and financial exploitation of persons who reside in Medicaid-funded facilities.

As also reported in the District's FY 2006 Office of Management and Budget Circular A-133 Audit Report, the Medical Assistance Administration (MAA) is not referring all potential fraud cases directly to the MFCU. The MAA's Office of Surveillance and Utilization (SUR) is mandated to perform surveillance and utilization reviews that monitor and control improper or illegal utilization of the program by the providers and recipients of medical services and make referrals to the MFCU if they suspect fraud or abuse.



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However, it was noted that the SUR unit is referring potential fraud cases to the Office of Investigation and Compliance (OIC) within the Department of Health (DOH) instead of referring the cases directly to the MFCU. The OIC conducts an investigation into the potential fraud case and then after inquiry and data gathering, refers the case to the MFCU. This is a duplication of effort for OIC and interferes with MFCU investigating potential fraud cases once the case is referred to them.

On May 27, 2003, a Memorandum of Understanding (MOU) was signed between the MFCU and the MAA. The MOU delineates the terms and conditions for both parties. Specifically, it requires that the MAA refer matters when they have suspicion of fraud. Based on discussions with the MFCU, there has been no improvement in the current situation and the number of cases being referred from MAA remains minimal.

We recommend that MAA comply with the terms and conditions of the MOU and make SUR referrals directly to MFCU.

Management's Response:

The following response was provided by Medical Assistance Administration (MAA) personnel:

The Medicaid Fraud Control Unit (MFCU) is a unit of the OIG that has a dual mission. It investigates and prosecutes Medicaid providers who engage in fraudulent billing. The MFCU also investigates and prosecutes the abuse, neglect, and financial exploitation of persons who reside in Medicaid-funded facilities.

In the FY 2007 Report on the Activities of the Office of the Inspector General (OIG) dated December 1, 2007, it was stated that the MFCU initiated 207 investigations and closed 98 matters. Through trial or settlement, the MFCU attained 17 substantive dispositions of outstanding fraud, abuse, neglect, and sexual assault cases, significantly surpassing its target levels. The MFCU obtained 13 criminal convictions through trials and plea agreements. Additionally, the MFCU recovered over \$2.3 million in four civil settlements for the Medicaid program, recouping almost \$4 for every dollar funding the MFCU.

The MAA's Office of Surveillance and Utilization (SUR) is mandated to perform surveillance and utilization reviews that monitor and control improper or illegal utilization of the program by the providers and recipients of medical services and make referrals to the MFCU if they suspect fraud or abuse. The SUR unit is referring potential fraud cases to the Office of Investigation and Compliance (OIC) within the DOH for evaluation before referring the cases to the MFCU. The OIC conducts an investigation into the potential fraud case and then after inquiry and data gathering, it will then refer the case to the MFCU.

On May 27, 2003, a Memorandum of Understanding (MOU) was signed between the MFCU and the MAA. The MOU delineates the terms and conditions for both parties.

The comment above focuses on the following issue:

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Issue: That the District of Columbia, Department of Health, Medical Assistance Administration (MAA) is not referring all potential fraud cases directly to the District of Columbia Medicaid Fraud Control Unit (MFCU) and, as a result, the MFCU is not being fully utilized pursuant to its duties and responsibilities under 42 C.F.R. 1007.11.

MAA strongly disagrees with this comment for several reasons. Foremost, the comment does not reflect an understanding of Federal and district regulations and administrative rules.

Federal regulations at 42 CFR Part 455, require the State Medicaid agency to first investigate potential fraud cases and then after inquiry and data gathering, refer cases of suspected fraud to appropriate officials including the MFCU. Pursuant to this federal law, the District of Columbia's Medicaid State Plan requires that:

"The Medicaid Agency has established and will maintain methods, criteria and procedures that meet all requirements of 42 CFR 455.13 through 455.21 and 42 CFR 455.23 for prevention and control of program fraud and abuse."

The Office of Investigations and Compliance (OIC) located within the MAA, Office of Program Integrity (OPI), is the functional unit within MAA/OPI with whom the SURS unit, also located within MAA/OPI, works to conduct the preliminary investigations as required by 42 CFR 455.14.

If MAA were to refer all variations in Medicaid service utilization detected by the SURS unit without conducting a preliminary investigation, MAA would be in violation of Federal regulations governing Medicaid and the Federally required District of Columbia Medicaid State Plan, and the Deficit Reduction Act of 2006, and potentially, other Federal and local laws, rules, and regulations governing Medicaid program operations and safeguards.

With respect to MAA's relationship with the MFCU, during FY 2007, approximately 16 cases were referred to the MFCU, representing in excess of 1 million dollars in paid claims. MAA also routinely assists the MFCU in its investigations of potential fraud cases by providing detail Medicaid claims payment and related data upon request from the MFCU generally, in a timely manner. When a request is voluminous and requires extensive MAA production, MAA notifies the MFCU in advance and requests an extension of time in which to respond to the MFCU request.

MAA notes that the MOU between MAA and MFCU is five years old and needs to be updated to include additional checks and balances to ensure that MAA continues to make, and potentially increase, its Medicaid fraud referrals to the MFCU and, in turn, for the MFCU to prosecute referrals made by MAA in a timely manner.

The following response was provided by Medicaid Fraud Control Unit (MFCU) personnel:

The Office of the Inspector General, Medicaid Fraud Control Unit agrees with the findings set forth above. MAA's non-compliance with federal statutes and the MFCU/MAA MOU has been discussed on numerous occasions with MAA staff and management since 2001. In fact, the MFCU has shared the federal statutes with the staff at MAA to insure that they are knowledgeable regarding their responsibility under law. MAA continues to violate the statute.



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The MFCU has almost no contact with the SUR unit. As a result, the MFCU is not aware of what fraud detection activities are being undertaken by the SUR unit. The MFCU has no information regarding providers, provider types, or fraud schemes that are being reviewed for signs of fraud. One exception relates to “anonymous” referrals. In these instances, SUR unit staff members called the MFCU directly reporting matters previously referred to the OIC. The SUR unit staff generally indicates that they have referred information to the OIC and OIC has not acted on or responded to that referral. The only reason MFCU is made aware of the incident is because the OIC has not acted or responded at all.

In addition to duplicating the MFCU's efforts to investigate fraud, it is problematic that the activities of the OIC actually delay, interfere, impede, and complicate the MFCU's investigative activities. As part of their preliminary inquiry, the OIC gathers data, interviews witnesses, reviews documents, and visits provider sites. These OIC actions are extremely harmful, as providers are forewarned that they are the subjects of scrutiny, thereby giving providers the opportunity to amend or destroy documents, hire and fire staff, change practices, or otherwise alter evidence that may be critical to the criminal investigation conducted by the MFCU. In addition, the interviews conducted by the OIC create potential evidence problems for the criminal prosecutors, such as duplicative or conflicting statements of witnesses.

In some instances, the OIC refers suspected fraud not only to MFCU, but to multiple law enforcement agencies, including the Federal Bureau of Investigation (FBI) and the Health and Human Services Office of the Inspector General (HHS OIG). Management personnel at MFCU, FBI, and HHS OIG discussed the preliminary inquiry OIC conducts and all agree it creates problems.

Those agencies requested that OIC simply identify potential fraud committed by providers and turn the matters over to law enforcement for investigation. That request was made because MAA is unnecessarily expending efforts, time, and resources conducting inquiries into fraud matters, delaying the referral of information to the MFCU, the law enforcement entity statutorily mandated to conduct the full investigation into suspected fraud (see 42 CFR § 455.13 Methods for identification, investigation, and referral and § 455.15 Full investigation).

MAA's violation of the federal statute and the MOU is problematic. The federal statutory scheme clearly intends that the single state agency SUR unit detect fraud, and conduct a preliminary investigation (see 42 CFR § 455.14 Preliminary investigation), then refer matters of suspected fraud to the MFCU for criminal investigation and prosecution. The MFCU staff of criminal investigators, auditors, and prosecutors should be the professionals who initiate the full investigation into potential fraud committed by providers.

Delay in Issuance of Audited Cost Reports

Various District agencies, including the District of Columbia Public Schools (DCPS), Child and Family Services Agency (CFSA), and the Department of Mental Health (DMH) provide Medicaid services to eligible District residents. The costs incurred by these agencies are summarized in a cost report that is submitted to the Medical Assistance Administration (MAA), part of the District's Department of Health, for approval before those claims are submitted to the Federal government for reimbursement.



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The cost reports are required by the Medicaid State Plan to be audited. We noted that final audited cost reports for these agencies are completed after a significant period of time. Reasons for the delay in the completion of the audit of the cost reports are generally due to: (1) delays in submission of cost reports by District agencies; (2) appeals by the agencies for the disallowances by MAA caused by failure to file Medicaid claims timely, as well as to provide sufficient support for the claims that are incurred; and (3) delays in resubmission of revised cost reports together with the additional documentation to support previously disallowed claims. The difference between costs submitted for reimbursement and the costs actually reimbursed result in the use of local, rather than federal, dollars to fund Medicaid expenditures.

The summary below shows the status of the cost report audits:

<u>Agency</u>	<u>Cost Report Completed</u>	<u>Cost Report Available for Audit</u>	<u>Status of Cost Report Audit</u>
1. DCPS	Up to FY2002	FY2003 to FY2006	Audit has not started.
2. CFSA	Up to FY2004	FY2005	Audit has not started.
3. DMH	Up to FY2004	FY2005	Audit has not started.

It is also noted that the contract to audit the cost reports expired on June 30, 2007, and District personnel have represented that a new contract has not yet been issued. The audit of cost reports will continue once a new contract is in place.

We recommend District agencies improve the claims submission process and submit cost reports to MAA on time and improve communication and better coordinate the submission of claims by agencies in a form that is acceptable to MAA. We also recommend that cost report audits be done on a timely manner. This will allow the District to reduce the time between Medicaid expenditures being incurred and the ultimate reimbursement from the Federal government.

Management's Response:

MAA concurs with this finding. However, it must be noted that the appeal process which contributes to the delay in the audit process is by State rules, a right of the auditee. Similarly, the delay in awarding a contract is sometimes necessary to ensure compliance with laws and regulations of the Office of Contracts and Procurement. Nevertheless, MAA is committed to make a concerted effort to expedite the entire process for the same reasons listed in this finding. By the end of the current FY 2008, MAA plans to complete the audit of DCPS through FY 2006. By the end of FY 2009, MAA will endeavor to work with DCPS to complete the audit of FY 2007 and FY 2008.

MAA understands that CFSA and DMH have plans in place internally to speed up the process. The Office of Contracts and Procurement is near the end of the award of the audit contract which is the vehicle with which cost reports are audited. Once the award is done, MAA plans to vigorously complete the audit of all submitted cost reports by the end of the current fiscal year.



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Overdrawn Medicaid Federal Funds at the Department of Health (DOH)

In FY 2006, DOH's request for Medicaid funds included costs that had not been paid out before the request for Federal reimbursement was made. As a result, DOH had overdrawn \$16,466,386 from the Federal government. The overdrawn amount was not returned to the Federal government during FY 2007. As a result, this amount is currently reflected as deferred revenue on the September 30, 2007 books and records.

Costs must be incurred or paid out before reimbursement is requested from the program's funding. DOH's requests for funds for the program were not based on its immediate cash needs. In addition, interest may be owed to the Federal government since the overdrawn amount was not remitted back to the Federal government in a timely manner.

We recommend DOH comply with policies and procedures to ensure that program obligations have been incurred prior to requesting reimbursement. In addition, DOH needs to ensure that overdrawn Federal funds are remitted back to the Federal government in a timely manner.

Management's Response:

After completion of the revised 2006 Cash Management Improvement Act (CMIA) report in FY 2007, the \$16,466,386 in deferred revenue was certified as an over draw of the letter of credit. However, the completion of the report occurred too late in FY 2007 to correct the Medicaid draws for 2007 to reflect the over draw. DOH corrected the over draw in FY 2008 by reducing two draws, DA8MED07 and DA8MED10, by \$8,000,000 and \$8,466,386, respectively. The revenues for FY 2008 were made whole by transferring the deferred revenue from FY 2006 to FY 2008. DOH will ensure that only funding for cash expenditures is requested in compliance with the CMIA agreement.

Maintenance of Supporting Documents at Income Maintenance Administration (IMA)

The Department of Human Services' Income Maintenance Administration (IMA) is responsible for determining eligibility of the participants in the Medicaid program. IMA uses the Automated Client Determination System (ACEDS) to evaluate the eligibility of the applicant. We noted the following during our review of 132 participant files which had been selected for testing:

1. 2 of the 132 participant files were missing documentation to conclude whether the applicant was Medicaid eligible.
2. 1 of the 132 participant files did not have a signed application.
3. 7 of the 132 participant files did not have evidence that the applicant's income was verified.

The District is required to maintain source documentation to support the eligibility of Medicaid recipients. Further, it is important to produce certain detailed records at specific time periods, and to maintain these records for possible analysis by users such as management, independent auditors, or other governmental bodies. We recommend that IMA review its existing processes for document retention, as not having the required documentation can increase the possibility of disallowance of these expenditures.



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Management's Response:

1. IMA concurs with the finding.
2. IMA agrees with the finding that the application was not signed; however, benefits were authorized and notices of approval were sent to the customers timely.
3. Of the 7 cases cited for income, management disagrees. SSR used net income instead of gross income; however, customers would remain eligible if gross income was used.

Medicaid Assistance Administration Program Operations (MAAPO) – Provider Eligibility

MAAPO reviews provider enrollment applications for completeness, accuracy, and compliance with Department of Health (DOH) requirements and the MAAPO Chief approves, as appropriate, or requests any clarification or corrections needed from the applicant. The MAAPO Chief signs a form to approve each application and the signed forms are sent via courier to Affiliated Computer Services (ACS), Medicaid Management Information System's (MMIS) third party administrator, whereupon the provider is activated as eligible.

45 Medicaid providers who enrolled during FY 2007 and 32 Medicaid providers who enrolled prior to FY 2007 were selected for testing to determine eligibility to receive payments for Medicaid services provided. During our review, there were no exceptions noted with the 45 providers who enrolled during FY 2007; however, 22 of 32 sampled agreements with providers who enrolled prior to FY 2007 were not signed and approved by the MAAPO Chief.

MAAPO acknowledged in a letter dated January 16, 2007, that several provider agreements on file did not contain appropriate signature and approval. The Medical Assistance Administration (MAA) went through a re-enrollment process during 2002 and concentrated on updating provider demographics and issuing new provider numbers rather than obtaining the required signatures on the provider agreements. We noted that the acknowledgment letter was inserted in each provider file but these do not equate to MAAPO's approval.

Management's Response:

The acknowledgment letter inserted into each provider file serves as authorization and approval of the provider agreement. MAA has ensured that all provider agreements processed as of these findings are signed by the Office of Program Operations Chief or a staff member with delegated authority.

Medicaid Management Information System (MMIS)

The MMIS system is the system that processes provider claims. On an annual basis, the Medical Assistance Administration (MAA) engages an independent accounting firm to review the controls placed in operation and tests of operating effectiveness on the MMIS system which is administered by a third party contractor. A review was performed for the year ended September 30, 2007 and it was noted that the following control objectives were not achieved:



**Material Weaknesses and Significant Deficiencies in Internal Controls
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1. Controls provide reasonable assurance that an entity wide security program plan and risk assessment process is in place to identify risk and periodically monitor the effectiveness of the program.
2. Controls provide reasonable assurance that both physical and logical access to computing resources is restricted to authorized individuals.
3. Controls provide reasonable assurance that modifications to application software are authorized, tested, approved, and implemented.
4. Controls provide reasonable assurance that incompatible functions and duties are segregated within the organization.

Considering the significant number of transactions and the significant dollar amounts being processed through the MMIS system, it is very important that all control objectives are met. Not having these controls in place could jeopardize the accuracy and completeness of provider claims processed which could affect the District's financial results. We recommend MAA either conduct follow-up with the third party administrator of MMIS or consider other alternatives to ensure that the above control objectives are achieved in FY 2008.

Management's Response:

MAA has given its third party administrator 90 days to put in place checks and balances to provide MAA assurances that the above controls weakness have been corrected. MAA is confident that such control weaknesses would not be an issue in the next audit.

Potential Medicaid Claims Disallowance

During our audit, we noted that the Centers for Medicare and Medicaid Services (CMS) of the U.S. Department of Health and Human Services issued a letter of deferral of payment in the amount of \$20 million pertaining to cost settlements of Medicaid claims from FY 2000 to FY 2003 provided by the District's Child and Family Services Agency (CFSA). Per the CMS letter, cost settlements included inappropriate indirect costs, transfer costs which were not related to the services provided, and per diem rates which were not properly calculated. A formal letter of disallowance from CMS has not yet been received by the Medical Assistance Administration (MAA).

Even though MAA believes that the Medicaid claims are allowable and fully supported, it has provided for a disallowance of the entire amount in its accounting records. An appeal will be filed immediately by MAA once the formal disallowance letter is received.

MAA and CFSA should continuously improve their claims documentation in order to minimize potential disallowances in future years. In addition, they have to ensure that all claims submitted are allowable and fully supported in accordance with the approved Medicaid State Plan.



**Material Weaknesses and Significant Deficiencies in Internal Controls
Over Financial Reporting**

Management's Response:

MAA received the electronic version of the disallowance letter from CMS on March 3, 2008. An appeal will be filed immediately after discussion with the Office of the City Administrator.

Review of Long Outstanding Receivable Balances

During our audit, we noted long outstanding receivables due from the Federal government amounting to \$8.3 million and relating to the Medicaid program.

These receivables largely pertain to administrative expenses, provider claims, and vendor payments incurred from FY 2004 through FY 2006 that have already been reported to the Centers for Medicare and Medicaid Services (CMS) as valid expenditures but the necessary requests for reimbursement were not filed on time. These balances were left outstanding for a long period of time since there was no regular review.

We recommend that the Department of Health (DOH) comply with policies and procedures to ensure that necessary requests for Medicaid expenditures are filed for reimbursement on a timely basis. In addition, receivable balances should be reviewed regularly to ensure that only valid receivables are reflected on the books. Management should recognize that failure to collect receivables promptly creates hidden expenses in that cash flow is reduced and receivables must be financed.

Management's Response:

61MMMD – the amount represents administrative costs for the Medical Assistance Administration (MAA) that was submitted to the Federal government and is collectable. DOH has been waiting for the increase on the letter of credit in order to draw the funds. The draw was completed on February 14, 2008.

51MMMD – the amount (\$4,358,285) represents a receivable for an accrued expense that was established for contractual services rendered but not paid. These services were subsequently paid, but funding for these payments was not made readily available on the letter of credit. The draw was completed on October 9, 2007.

41MMMD – the amount (\$2,971,773) represents a receivable for provider payments made by MAA. The amount was reported to the Federal government but at the time, funding for these payments was not made readily available on the letter of credit. The draw was completed on February 14, 2008.

The remaining balances represent the amounts owed to the public provider agencies and will be settled after the audits of cost reports. DOH will undertake reviews of all Medicaid receivables to ensure timely draws of funds owed to the program.



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III. District of Columbia Public Schools (DCPS)

DCPS is part of the General Fund of the District. However, certain significant processes and procedures at DCPS are conducted independently of the District. Findings related to those processes are detailed below.

DCPS is Classified as a "High Risk" School District

In a letter dated April 21, 2006, the U.S. Department of Education cited DCPS as "high risk", due to systemic weaknesses. The issues cited included:

1. Submission of untimely audits.
2. Inadequate monitoring of federal funds.
3. Inadequate documentation of salary charges.
4. Insufficient support for charter school funding.

As a result, there is potential for DCPS to lose federal funding and it may be required to have a third party monitor its federal funds. It should also be noted that the U.S. Department of Education indicated that it would consider imposing penalties if no progress was made within a year's time.

We have noted no change in this classification during FY 2007.

Management's Response:

In July 2007 representatives of DCPS and the Office of the Chief Financial Officer (OCFO) met with the U.S. Department of Education (DOE) to discuss its comprehensive corrective action plan which was initiated in March FY 2006. The plan was developed to address the issues associated with the DCPS high-risk designation and to address the FY 2006 material weaknesses cited by BDO Seidman.

DOE was informed of the task force that was created which included the following parties: OCFO-DCPS/CFO, Deputy CFO for Financial Operations, the Executive Director of the Office of Integrity and Oversight, DCPS-Chief Operating Officer, Medicaid Director, Executive Director of Federal Grants, Procurement Officer, and U.S. Department of Education liaison.

The working group met weekly to review the status of the action plans and to discuss any issues that were encountered. Written action plans were provided to the facilitator to document the progress of the plans.

As to the High Risk designation, a detailed corrective action plan was developed to address the identified concerns. A project manager was assigned to work with the U.S. Department of Education liaison to track the progress of the plan.



**Material Weaknesses and Significant Deficiencies in Internal Controls
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There is also a set of actions that were taken by the DCPS-OCFO to improve internal controls to address the High Risk Status designation. As part of the ongoing effort to implement corrective action, the DCPS-OCFO and the Chancellor have added staff to concentrate on compliance as it relates to grants. This was done with the intent of DCPS being removed from its High Risk designation by the U.S. Department of Education.

Human Resource/Payroll System

DCPS' human resources department utilizes the Comprehensive Automated Personnel Payroll System (CAPPS) to process and manage payroll. CAPPS was implemented in 1999 and replaced the Unified Personnel Payroll System (UPPS). Our audit process noted several systemic deficiencies with CAPPS. CAPPS is less automated and requires more manual interface than UPPS which results in unintentional errors and the use of an antiquated system.

Step Increases

CAPPS does not have the capability to track and calculate step increases for employees. Therefore, human resource personnel must determine when an employee is eligible for a step increase and process it manually. We reviewed 45 step increases and noted that in 1 step increase, the pay rate was incorrect. 3 of the 45 step increases tested were not processed timely. Another employee was two step increases behind.

Management's Response:

DCPS will transition from CAPPS to PeopleSoft in late FY 2008 and early FY 2009, utilizing the time and attendance, labor distribution, and human resource components. As a step increase is based primarily on the employee reaching the anniversary date of their employment, PeopleSoft will automatically update the step increase which lessens the chance for human error.

Checks and Balances

Checks and balances for CAPPS is a manual process making it difficult to validate the data in CAPPS. Furthermore, it is difficult to produce reports from CAPPS to help analyze human resource/payroll functions. As a result, the following issue was noted:

The District of Columbia Teachers' Fund (the Fund) holds, in trust, the assets available to pay pension benefits to all teachers employed by DCPS, including certain other educational employees in public day schools and certain eligible educational employees in the public charter schools of the District. The Fund receives information, instruction, and data from other agencies and departments of the District in order to generate financial and non-financial information for the Plan. Following are the entities which provide information to the Fund relating to the Teachers' Plan.

**Material Weaknesses and Significant Deficiencies in Internal Controls
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- The District of Columbia Board of Education makes findings of fact, conclusions of law, and decisions regarding involuntary retirement, survivor benefits, and annual medical and income reviews.
- The Fund's Benefits Department receives the retirement orders for retirement benefit calculations for all active plan members found eligible for retirement by DCPS, and carries out the day-to-day processing of retirement benefits. The Fund also processes employee requests for refunds of contributions.
- The Office of Pay and Retirement Services (OPRS) maintains contribution and participant data relating to active participants. OPRS also maintains historical payroll data for retired or terminated employees for a number of years. The Fund's Benefits Department receives payroll history of retired and terminated employees from OPRS and determines pension and refundable contributions based on such information.
- DCPS enrolls and enters personnel data for all teachers in CAPPs which is used by OPRS to generate payroll and contribution data. DCPS' actuary obtains participant data from OPRS who extracts the data from the CAPPs system.

During FY 2007, we noted a review by the Fund's actuary (EFI Actuaries) which indicated DCPS operational failures dealing with erroneous tracking of employees under various retirement programs. It was noted that during the affected time periods of the operational failures, contributions to the Fund have been affected due to the submission of improper amounts of employee and employer contributions and an inaccurate reflection of the Teachers' Plan population. Specifically, participants contributed too much or too little to the Fund and the appropriate groups of participants were not accounted for as part of the annual actuarial valuations.

OPRS provided the actuary with missing contribution amounts based on historical contribution data available from the District's payroll system. Considering all known corrections as determined from information provided by DCPS and OPRS, the actuary estimated the total actuarial impact to be approximately \$7.5 million as of September 30, 2007. DCPS has accrued a contribution payable to the Fund for this amount for FY 2007.

We recommend that management consider a task force be established with representatives from DCPS, the Fund, OPRS, the Office of Inspector General, and appropriate legal counsel. Among other items, the task force should consider the following:

- Development of corrective action for the data issues affecting the teachers' participant population;
- Agreement on the parameters of the population to be verified; and
- Establishment of a timeline and completion of the review as soon as possible.



**Material Weaknesses and Significant Deficiencies in Internal Controls
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Management's Response:

DCPS met with OPRS and identified the population affected. This information has been forwarded to the outside consultant that DCPS retained to verify the validity and the correctness of the data.

DCPS is currently in discussion with the Fund and is working on a resolution. DCPS is on track to resolve the issue by the end of FY 2008.

Grants Management

We noted the following issues in the testing of grants managed by DCPS:

1. Grant receivables did not agree to internally generated reports from the general ledger. Grant revenue amounts exceeded total expenditures.
2. DCPS' Medicaid Cost Reports are required to be audited by an independent third party. DCPS has filed all required Medicaid Cost Reports to date. However, reports from FY 2003, 2004, 2005, and 2006 have not been audited as of yet. Based on a historical analysis of prior year disallowances or other appropriate methodology, DCPS has not recognized any liability for potential disallowances uncovered during audits of the cost reports for these years.
3. The United States Department of Education establishes an indirect cost rate which defines the maximum amount of indirect costs that can be attributed to Federal programs. DCPS was unable to provide complete support for the total program expenditures that were used to calculate the indirect costs that were applied to each grant. Further, DCPS was unable to provide evidence that total indirect costs were posted to SOAR, the District's accounting system of record. We also noted that in some cases, more indirect costs were applied than were allowed to be applied to that respective grant.

As a result of the conditions noted above, DCPS is not recognizing grant revenue and related grants receivable accurately. We recommend that DCPS develop and adopt policies and procedures around grant drawdowns. DCPS should carefully review each of its grant drawdown requests to ensure that the drawdown is valid for the specific grant. Further, we recommend that DCPS review all grant activity reports on a regular basis to ensure propriety of activity conducted. DCPS should develop a reasonable methodology to estimate the audited Medicaid Cost Report disallowance amounts. DCPS should also improve its recordkeeping to ensure that all indirect costs claimed are valid.

Management's Response:

Total DCPS grant revenues and expenditures for FY 2007 were over \$121 million. However, DCPS grant revenue did exceed FY 2007 DCPS grant expenditures by \$232,251. New policies and procedures will be drafted at DCPS, and staff will be trained, to better manage the calculation and recording of indirect cost allocations, the calculation and timing of grant drawdown, and the recording of grant receivables.

DCPS has recorded over \$4.5 million as potential grant disallowances. \$1.8 million of this liability is for the potential of a disallowance from the audits of Medicaid cost reports for FY 2003, 2004, 2005, and 2006.



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Staff will be trained on improved reporting skills so that internally generated receivable reports prepared as part of the closing process will agree with the actual receivable balances in the general ledger.

Documentation for Transactions

DCPS has experienced significant turnover in the current fiscal year. In addition, DCPS has undergone significant changes in its process and procedures. The loss of institutional knowledge combined with the significant changes caused certain documentary evidence to be difficult to locate throughout the audit process. For example, the following issues were noted with journal entries:

1. 13 out of 65 journal entry vouchers did not contain evidence of review and appropriate approval by supervisory personnel.
2. 11 out of 65 journal entries did not have adequate supporting documentation.
3. 3 out of 65 journal entries did not exactly match the amount posted in SOAR, the District's accounting system of record.

We recommend that DCPS consider instituting a Journal Entry cover sheet which accompanies the supporting details. This cover sheet should have a designated place for both the preparer and reviewer to sign and date after completion of their respective roles. In addition, support for all journal entries should be included with the cover sheet. DCPS should also evaluate its filing process to ensure these documents can be readily accessed. In addition, any changes that are made should have accompanying supporting documentation and not just be entered into SOAR.

In addition, the following issues were noted with disbursements:

1. 8 out of 262 disbursements lacked adequate supporting documentation.
2. 3 out of 262 items were not properly authorized.
3. 9 out of 262 items were not date stamped indicating the date they were received.
4. 5 out of 262 disbursements did not contain a signature indicating that the transaction had been posted into the accounting system.
5. In addition, subsequent disbursements were evaluated and a \$14.3 million adjustment was recorded.

We recommend that DCPS follow its existing policies for documentation related to the disbursement process. We further recommend DCPS focus on the maintenance of the related records, to help ensure that all transactions are proper and appropriately supported. More detailed analysis needs to also be considered in analyzing disbursements to ensure they are reported in the proper period.



**Material Weaknesses and Significant Deficiencies in Internal Controls
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Management's Response:

A new policy is in place for a narrative to be added to the journal entries and for the journal entries to be scanned and saved in a shared drive on the network. Employees have been instructed not to post journal entries that do not have approval signatures.

The disbursements process will be reviewed and modified as needed. Staff has been briefed on these findings and the importance of adhering to the policies of the office. Staff has also been instructed to obtain proper supporting documentation for payments. With respect to the findings on subsequent disbursements, we do not agree as we recorded a majority of this amount on a timely basis.



**Material Weaknesses and Significant Deficiencies in Internal Controls
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IV. Investment Reconciliations and Activities

Investment Account Activity

We selected various investment reconciliations for our test work and noted the following:

1. The District was not able to provide an investment schedule which reconciled from the amounts held with various third parties to the amounts recorded in SOAR, the District's accounting system of record. Multiple attempts to provide such a schedule were made by District personnel; however, significant variances existed.

Through a cumbersome and laborious process, the ultimate amounts were able to finally be reconciled in March 2008 (nearly six months after the end of the fiscal year) with significant adjustments required to SOAR and significant investigation of differences by District personnel.

2. Investment activity is not being recorded into SOAR on a timely basis. Numerous reconciling items on the monthly investment reconciliations are carried over from month to month without being resolved. Many investment transactions, such as sales, purchases, paid downs, and interest are being accumulated for months and then recorded in one lump sum amount into SOAR. For instance, the investment reconciliation listed a \$22 million amount that was with the Bank of New York. Disbursements of \$11.7 million, primarily for athletic field renovations, and dividends of \$63,675 had not been recorded on the books of the District. Therefore, an adjustment was recorded to reflect this activity during the audit process.

In addition, the District receives daily activity e-mails from M&T Bank, its primary advisor. This significant activity is not being evaluated or recorded on a daily or weekly basis. Instead, it is recorded at month-end in large lump sum amounts in an effort to agree into the total sales and purchases per M&T statements and no support is being maintained to tie back into the details.

3. During our process over investment earnings, we noted a journal entry in the amount of \$104,597 and a journal entry in the amount of \$307,985 which did not contain evidence of approval before entry into SOAR. In addition, \$48,802 was recorded as investment earnings without support and \$726,488 needed to be adjusted during the audit.
4. In our discussions with District personnel, it has been noted that investment activity from October 2007 through March 2008 has not been reconciled to SOAR.

Further, there was significant difficulty in agreeing the confirmed investment balances to what was reflected on the respective SOAR accounts which resulted in delays, rework, and extensive time spent by various personnel during the audit process.

Investment reconciliations should be performed more timely by District personnel; in addition, District personnel should reevaluate the existing reconciliation process. The new process should eliminate the significant variances related to a variety of issues including the fact that amounts from component units are ineffectively commingled within the District's general ledger even though these amounts have already been transferred to the general ledger of the individual component units.



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These types of issues not only make the reconciliation process difficult and laborious but increase the chances of human error since the reconciliation process is highly dependent on the understanding of a significant number of exceptions.

Balance sheet reconciliations quickly identify errors and needed corrections and the failure of Office of Finance and Treasury (OFT) to enter daily or weekly activity into SOAR on a timely basis creates a shortage of information for investment reconciliation preparation. Therefore, the reconciliation department, Office of Financial Operations and Systems (OFOS), is solely reliant on the monthly investment statements to analyze outstanding items. We believe that all security and other investment transactions should be properly recorded in detail records and accumulated, classified, and summarized in control accounts. As such, we recommend that OFT take measures to enter investment activity into SOAR on a more regular basis which will allow for effective review and analysis of investment operations. One of the many benefits of timely reconciliations is that errors do not accumulate but can be identified and attributed to a particular period, which makes it easier to perform future reconciliations. Timely reconciliations and adjustments will also ensure meaningful and accurate financial data. We also recommend that interest and earnings, including amortization/accretion of premiums/discounts, be periodically reviewed for accuracy by a responsible person. All supporting documentation should be attached and made part of the reconciliations.

Further, communication between OFT and OFOS should be streamlined to allow for timely resolution of outstanding investment issues. Steps should be taken to ensure that all employees maintain a clear understanding of how duties should be performed and the flow of responsibility. Each agency should update the other on the current status of items and changes being made. A forum may be necessary for suggestions or concerns and as a means for using a team-approach to resolving outstanding items.

Management's Response:

The following response was provided by Office of Financial Operations and Systems (OFOS) personnel:

OFOS attempted to provide investment schedules as requested. As these schedules were being prepared, journal entries continued to be recorded in SOAR, thus, the amounts on our schedules did not agree with SOAR. After all of the journal entries were completed, OFOS was able to provide an investment schedule that agreed to the balances in SOAR.

On a monthly basis, OFOS reconciles all investment accounts that we have been assigned. All reconciling items on these reconciliations are shared with those parties involved in recording the activity. OFOS will work with OFT to review the list of bank and investment accounts and ensure that reconciling responsibilities have been clearly identified

The following response was provided by Office of Finance and Treasury (OFT) personnel:

Investment transactions for our primary investment accounts are recorded in a timely manner, on a daily basis or whenever transactions occur. When the investment is in a money market fund that is not liquidated, but simply maintained from day to day, there is no entry done from day to day, and the interest that accrues on such an investment from day to day is recorded on a monthly basis, in accordance with the monthly posting of such interest to the District's account by the bank that is the custodian for the money market fund investment.



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Accounts for which the investment activity was not recorded timely were agency and/or debt-related accounts, for which an automatic overnight sweep investment mechanism produced numerous transactions, that the Cash & Investments Unit was not aware of and/or had not included in its universe of accounts for which investment activity existed and therefore needed to be recorded.

Better communication/coordination between units/agencies is the solution to this issue going forward. The departure/transition of key staff persons in the Cash & Investments Unit and a technical issue with the automated process that had been developed to record transactions into SOAR through our Treasury Workstation system contributed to the results indicated in this finding. Consistent and timely reconciliations for all such accounts would also help to ensure that no such activity is being excluded from proper recording.

The staffing, technical, communication/coordination, and reconciliation issues have either been addressed or are currently being addressed, and will all be resolved during the current fiscal year, ensuring that the issues indicated in this finding do not exist going forward.

District Contributions and Disbursements to the Other Post Employment Benefits Plan (OPEB)

Under new standards issued by the Governmental Accounting Standards Board, the District had its Postretirement Health and Life Insurance Trust (OPEB Trust) audited for the first time this fiscal year. The District is required by law to ensure that any funds earmarked from the General Fund which are to be contributed to a benefit plan are included in the approved budget and properly reserved.

We noted that over \$37 million of contributions to the OPEB Trust were made since 2003 without proper budgetary authorization. These contributions were made from the accumulated General Fund "budgetary savings" which were a result of the District funding a significant portion of its required contributions to the separate 401(a) Plan from various 401(a) Plan forfeitures.

We also noted that pay-as-you-go employer contributions in the amount \$4,583,433 made since 2002 were paid out of the General Fund. The District's pay-as-you-go contributions should be paid out of the Trust's assets.

The District is in the process of defining its responsibilities over the OPEB Trust. As part of this process, we recommend management ensure adequate controls are in place over the contributions and disbursement process.

Management's Response:

The prior administration of the Office of Finance and Treasure (OFT) established a practice of having 401(a) Plan forfeitures earmarked to fund other post employment benefits (OPEB) and transferring such funds to investments for OPEB, in the interest of seeking to enable the District to meet its OPEB funding requirements. Since these transfers were invested and not expended, they represent funds that were invested in the OPEB fund versus being invested in the general fund.



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Given that it has been determined that transfers to the OPEB fund in excess of amounts that were appropriated should be and can be transferred back to the general fund, the end result is that as of the current fiscal year, the OPEB fund and the general fund will be funded in the appropriate respective amounts. Going forward, all such transfers will be appropriated prior to being invested in the OPEB trust funds.

Regarding the pay-as-you-go employer contributions, as with the amount referred to above, the result is that the indicated amount is to be transferred from invested OPEB funds to the general fund to produce the appropriate balance in each. As of the current fiscal year, this is being done, which resolves this issue. Going forward, employer contributions will be made from the OPEB trust fund.

Given that this is the first year of the OPEB audit requirement, some of these issues were unclear and have now been clarified, and as such, the OPEB fund will maintain its appropriate balance and will be administered appropriately going forward.



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V. National Capital Revitalization Corporation and the Anacostia Waterfront Corporation

Background and Accounting Issues

The National Capital Revitalization Corporation (NCRC) was created in 1998 and has been treated as a related organization by the District. A related organization is defined as one for which the primary government is accountable but not financially accountable. NCRC has maintained its own books and records since its creation. The District's Council enacted the Reorganization Clarification Act of 2007 which effectively dissolved NCRC. This Act transferred the accounting responsibility of NCRC to the District. Additionally, in the spring of 2007, the District enacted legislation to transfer real estate assets from NCRC to the Anacostia Waterfront Corporation (AWC).

The District did not appear to have properly anticipated the impact of the accounting responsibility for NCRC and its subsidiary, the Redevelopment Land Agency Revitalization Corporation (RLARC). Furthermore, the District did not appear to anticipate the related issue of increased resources needed at AWC due to the increased activity this year.

As a result, significant accounting activities had not been performed and numerous transactions for each of these entities were not properly recorded, including activities of the Economic Development Finance Corporation (EDFC) a "sister" organization of NCRC. Following are examples of some of the more significant omissions and errors identified during our audit process:

- Assets of NCRC and its subsidiary RLARC required analysis to reflect the District's position on these assets in accordance with GASB 34. The analysis was not performed until February 2008.
- The NCRC bond financing for D.C. USA in the amount of \$46.9 million and a related note in the amount of \$42 million was not recorded until February 2008.
- A \$110 million bond issuance for AWC was not properly recorded and the associated interest rate swap was not evaluated for disclosure in the financial statements until February 2008.
- Gains on the disposal of properties at RLARC were not calculated and recorded until February 2008.
- Over \$1.9 million of capitalized pre-disposition costs at RLARC were incorrectly expensed and needed to be reclassified.
- A \$3 million cash account held by NCRC for its Gangplank properties was not transferred to AWC. NCRC used the account for purposes unrelated to Gangplank creating a \$1.2 million payable to AWC.
- A Bank of America securities account with a balance of approximately \$124,000 was not reflected on the books of RLARC.
- Over \$21 million of funds collected from a note receivable were incorrectly charged to the land account at RLARC.
- Accurate financial statements for the period ended September 30, 2007 were not able to be provided by the District on any of these entities until March 2008.
- Previously audited stand-alone financial statements were not available for NCRC, RLARC, and EDFC since at least 2004.

We recommend the District evaluate its needs for these entities and provide the appropriate resources to ensure transactions are accurately recorded on a timely basis.



**Material Weaknesses and Significant Deficiencies in Internal Controls
Over Financial Reporting**

Management's Response:

Pursuant to the National Capital Revitalization Corporation and Anacostia Waterfront Corporation Reorganization Clarification Temporary Act of 2007, NCRC, RLARC, and AWC have been dissolved and all functions, duties, powers, records, real and personal property, liabilities, and other rights, authorities, obligations, and assets have been transferred to the control of the Mayor, effective October 1, 2007. The District, however, has engaged in a vigorous due diligence process related to the dissolution of NCRC/RLARC and AWC and the transfer of their assets to the District. During that due diligence process, the District has uncovered and corrected many deficiencies, including those noted in the auditor's findings. In addition, the District's own current level of controls are sufficient to address and protect against the NCRC/RLARC and AWC issues identified by the auditors.

National Capital Revitalization Corporation (NCRC)

Following are additional significant items related to NCRC and its subsidiary revealed during the audit:

Approval of Land Dispositions

Dispositions of property require Board or other appropriate governing body approval. During our audit, we were unable to find evidence of such approval for 5 out of 11 land dispositions. NCRC did not maintain appropriate documentation to support its activities. Lack of required reviews for sales of land is a significant breach of internal controls.

Contracts

NCRC's contract procedures require that procurements be done on a competitive basis and clearly describe the specific and limited situations where sole source procedures may be used. During our review of contracts, there was no evidence of competitive bidding in 22 out of 150 contracts that had been selected for review.

Payroll

NCRC does not use timesheets to record time worked by employees. Since timesheets are the source document supporting NCRC's labor expenses, failure to maintain a timesheet system may result in NCRC paying for time not worked. NCRC may also have insufficient information to address the allocation of costs to programs where such allocation is required.

Purchasing and Disbursements

Proper and approved invoices and other payment information form the basis of payments for goods and services provided by vendors. NCRC's policies require a purchase order for goods and services where price is the primary evaluation criteria and other approval processes. During our review of purchasing and disbursements, we noted the following issues:

1. Supporting documentation for payments made to 79 out of 300 disbursements was not available.



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2. Purchase orders for payments made to 96 out of 300 disbursements tested were not available.
3. Authorized approvals were not completed in compliance with NCRC policies in 78 of 300 disbursements tested.

Without sufficient documentation to support payments, the basis of expenditure cannot be fully justified. There is a risk that NCRC may have paid for goods or services not provided. We recommend the District evaluate the current system and processes in place at NCRC and determine the how to bring these systems and processes in compliance with the District's systems and processes.

Management's Response:

Pursuant to the National Capital Revitalization Corporation and Anacostia Waterfront Corporation Reorganization Clarification Temporary Act of 2007, NCRC has been dissolved and all functions, duties, powers, records, real and personal property, liabilities, and other rights, authorities, obligations, and assets have been transferred to the control of the Mayor, effective October 1, 2007. In addition, the District has adequate controls in place to address and protect against the NCRC issues identified by the auditors.



Material Weaknesses and Significant Deficiencies in Internal Controls Over Financial Reporting

VI. Management of Grants

The District's grant activity is comprised of approximately \$2 billion in annual revenues and expenditures, both from federal and private sources. Administration of grant funds has historically been handled at the agency level, with each agency Deputy CFO taking responsibility for compliance with grant agreements, the accounting treatment related to revenue recognition of grant funds, monitoring of draw downs, and cash management and collectibility of grant funds.

During our procedures, we noted several deficiencies as described below. Many of these deficiencies resulted in significant adjustments being processed during the audit process. Additional oversight controls should be implemented. There are several reporting tools available through the Office of the Chief Financial Officer (OCFO) which can assist with this process. Currently, these tools are not widely used at the agency level and no formal policy exists for monitoring grants at the OCFO level.

Grants Receivable Collection and Monitoring

Each year, the District's balanced budget is based on the plan that within any given year the approved expenditures (outflows) will not exceed the expected revenues (inflows) plus the resources available at the beginning of the year. The D.C. Appropriation Act approves budget authority for a grant award only when it is reasonably certain that the outflow of cash for grant expenditure will be quickly replenished by the inflow of cash via the collection of grant revenue. Since grant revenue cash is received subsequent to the actual outflow of cash for grant expenditures, pooled cash is used to pay for expenses. When pooled cash is used to fund grant expenditures in advance of receiving the grant revenue cash, there is a decrease in the cash available in the General Fund. In effect the grant ends up borrowing cash from the General Fund. It is usually not necessary to record this borrowing because it is only temporary. When the grant cash revenue is received quickly, the temporary borrowing is repaid. However, when the pooled cash is not replenished as expected it is important to recognize and report the gap in funding.

During our review of federal grants receivable balances as of September 30, 2007, we noted significant amounts which needed to be adjusted. This was noted for all of the funds and at numerous District agencies. When submitting the year-end packages, each agency provides a signed certification stating "*The agency has and will take the steps necessary to make the receivable balances "available". This implies that the cash in the receivable balance will be received by the District within the next fiscal year.*"

Most policy makers assume that sufficient cash is available to allow them to direct the spending of the unreserved fund balance in the General Fund. If the Mayor or the District Council decides to spend the unreserved fund balance, they may encounter a cash flow problem to the extent that pooled cash has been used to finance uncollected receivables.

We also noted that some of the uncollectible balances had been written off during the year, and some accounts from Medicaid grants were followed up for collection and subsequently collected. However, additional oversight is needed to accurately reflect the year-end receivable balance as during our procedures and discussions with District personnel, the District identified additional balances that were determined to be uncollectible and were thus written-off in the General and Federal Funds amounting to approximately \$6.8 million and \$8.2 million, respectively.



**Material Weaknesses and Significant Deficiencies in Internal Controls
Over Financial Reporting**

We noted that the District has recently implemented a new policy to address the timely collection of outstanding receivables. We recommend the District strictly adhere to the new policy on the administration and collection of receivables and assign responsibility for monitoring each agency's compliance to the Office of Chief Financial Officer (OCFO). In addition, we recommend that at the agency level, there should be continual monitoring and review of the collectibility of these receivables. Increased effort to collect and stay current on outstanding balances will result in improved cash flow to the District.

Management's Response:

The District is cognizant of this issue based on its past experience, and is determined to establish and maintain a process that will encourage prompt replenishment of the District's funds used to defray grant expenditures. The plan of action was shared with the Auditors during the FY 2007 audit. Most District receivables, however, are collected on a timely basis. Consequently, the cash flow risk for the District as a result of delayed collection is nominal. Furthermore, in order to strengthen the internal controls environment over grant receivables and obviate future unjustifiable delay in collection of District funds used to pay for grants, management has developed additional policies during the FY 2007 year-end close. Agencies are expected to continue their collection efforts on outstanding receivables but are required to charge against their budgets any receivable that is outstanding longer than twelve months.

Grant Revenue Recognition and Deferred Revenue Balances

Based on a review of the deferred revenue balances in the General Capital Fund as of September 30, 2007, we noted funds received for government projects for which the earnings process had been completed. The revenue needed to be recognized for these projects as expenditures had already been incurred. As a result, the District processed a correcting journal entry in the amount of approximately \$27.3 million.

In addition, based on our procedures over the Housing Production Trust Fund's (HPTF) deferred revenues as of September 30, 2007, we noted that amounts had not been properly deferred. As a result, the District processed a correcting journal entry for the net difference of approximately \$48.4 million.

We recommend that the District agencies' financial personnel closely monitor grant related accounts and close out projects when the earnings process is complete and properly defer revenue as applicable. In addition, management should consider an improved monitoring process to provide more oversight and guidance on grant revenue recognition and the related deferred revenue balances.

Management's Response:

We agree with the assessment to have the agencies review and comply with all closing instructions. Furthermore, we also agree that there needs to be an individual from the Office of the Chief Financial Officer (OCFO) to provide oversight and compliance on all accounting issues.

With respect to the Housing Production Trust Fund, the Department of Housing and Community Development (DHCD) recognized and corrected the error when informed. In addition, it must be clear that no grants were issued or involved in the Housing Production Trust Fund. DHCD will ensure that in the future that this error does not occur.



**Material Weaknesses and Significant Deficiencies in Internal Controls
Over Financial Reporting**

Management of Direct Loans

The Office of the State Superintendent of Education (OSSE) makes direct loans to Public Charter Schools throughout the District to help build and upgrade facilities. Direct loans are established where the public charter school is required to make either interest only payments or principal and interest payments.

The principal amount for 9 direct loans made to public charter schools over the past few years amounted to approximately \$13 million. During our review of these 9 loans, we noted that:

1. 3 public charter schools were required to make interest only payments, but have made no payments to OSSE.
2. 1 of the 9 public charter schools was required to make monthly principal and interest payments but has made no payments to OSSE.
3. There was no documentation in the loan agreement files for all 9 loans reviewed which indicated that OSSE had contacted the schools to inquire why repayments had not been made.

Sound management and proper oversight procedures of the direct loan program dictates that OSSE and the Office of the Chief Financial Officer (OCFO) monitor the repayments of public charter schools to ensure adherence to the loan agreements. It is noted that management and oversight of the direct loan program resides with OSSE. OCFO is responsible for receiving payments and posting them to SOAR, the District's accounting system of record. We noted no reports or repayment history being sent from the OCFO to the OSSE Program office to indicate which public schools were making repayments to OSSE. Since there is a separation of responsibilities and OSSE does not always know when a school has made repayments, closer coordination between the two agencies is needed to adequately manage and oversee the direct loan program.

As a result, since repayments were not made for 4 of the 9 loans reviewed, the collectibility of \$5.6 million in direct loans is deemed questionable. We recommend that OSSE follow-up immediately on all outstanding loans and establish policies and procedures to adequately manage and oversee the direct loans. In addition, we recommend that OCFO provide timely repayment documentation to OSSE to facilitate its management and oversight functions.

Management's Response:

OSSE acknowledges the condition identified. The current director responsible for supervision of the Direct Loan program was hired in March 2007. On multiple occasions during FY 2007, written requests were submitted to OCFO for repayment information and reconciliations of interest income recorded in SOAR, but none was provided. As stated in this finding, OCFO is responsible for receiving payments and posting them in SOAR. Without regular payment information it is difficult for the program to monitor repayments. OSSE is developing a performance agreement with OCFO to ensure that OSSE receives information necessary to perform its monitoring role. In the case of one of these loans disbursed in July 2007, the school did contact OSSE requesting where to send the first payment due in September; however, OSSE instructed the school to defer payment, so that a more efficient and transparent loan servicing process can be developed. OSSE does not anticipate any difficulty receiving interest and principal owed from this school.



**Material Weaknesses and Significant Deficiencies in Internal Controls
Over Financial Reporting**

Overdrawn Federal Funds

During FY 2007, the Department of Human Services (DHS) had overdrawn on its reimbursement from the Federal government by approximately \$3 million for the Temporary Assistance for Needy Families (TANF) program. At year-end, it was determined that there were not sufficient local expenditures to meet the program's maintenance of effort (MOE) requirement. As a result, expenditures were reclassified from the grant fund to the local fund, and DHS established a deferred revenue account. The overdrawn amount was not returned to the Federal government during FY 2007. This amount is still currently reflected as deferred revenue on the September 30, 2007 books and records.

DHS' requests for funds for the program were not based on its immediate cash needs. In addition, interest may be owed to the Federal government since the overdrawn amount was not remitted back to the Federal government in a timely manner.

We recommend DHS comply with policies and procedures to ensure that program obligations have been incurred prior to requesting reimbursement. In addition, DHS needs to ensure that overdrawn Federal funds are remitted back to the Federal government in a timely manner or future draws reduced to account for the overage.

Management's Response:

The Office of Chief Financial Officer for DHS will comply with the policies and procedures to ensure that requests for reimbursement of funds is consistent with the Cash Management Improvement Act (CMIA) agreement; also the deferred revenue at 09/30/07 was converted to revenue in FY 2008 and used to reimburse expenditures incurred during the first quarter ended 12/31/07.

Schedule of Expenditures of Federal Awards

A schedule of expenditures of federal awards (SEFA) reports the total expenditures for each federal program. The District presents a system generated report which includes all federal program expenditures and revenues for audit purposes. This district-wide SEFA was not available for review on a timely basis. The complete SEFA was not available until nearly five months after year-end and had not reconciled with the system generated report. An inability to create a complete and accurate SEFA with all required elements, by agency, in a timely manner represents an internal control deficiency.

Management's Response:

Detail and summary schedules of grant expenditures for specific agencies were requested several times and were provided as early as October 2007. We mentioned to the auditors that we were working on updating the CFDA numbers, and we assured them that when they did receive the SEFA schedule for the Single Audit work, it would tie out to the CAFR numbers.



**Material Weaknesses and Significant Deficiencies in Internal Controls
Over Financial Reporting**

VII. Compensation

Overtime Payments

District policy requires that all overtime work be authorized and that time and attendance records be properly supported and documented. We reviewed overtime payments made to 45 employees during the year. Per the payroll register, total overtime hours reviewed was 3,900. Per review of the corresponding documentation, only 3,615 of those hours were supported as approved. Following are the agencies for which we noted discrepancies and the number of differences noted at each agency:

1. 4 differences noted at the Department of Public Works.
2. 2 differences noted at the Metropolitan Police Department.
3. 2 differences noted at the Department of Corrections.
4. 2 differences noted the Department of Mental Health.
5. 1 difference noted at the Department of Property Management.
6. 1 difference noted at the Department of Transportation.

In addition, District regulations prohibit employees who are classified as career service (CS) grade 14 and above and other exempted services employees from receiving overtime pay. The database information that was provided by the District revealed 79 instances totaling approximately \$75,000 where the District paid overtime to ineligible employees.

The District does not appear to have implemented the proper internal controls to ensure that only authorized and approved overtime is paid to employees. Lack of adequate authorization and improper maintenance of documentation increases the risk of unauthorized or incorrect payments being made. The District should strengthen and improve its current policies and procedures surrounding the authorization, approval, and maintenance of documentation supporting overtime pay. Improved policies and procedures needs to be developed at the agency level and improved management oversight needs to be a critical part of the improved policies and procedures.

Management's Response:

The following response was provided by Office of Pay and Retirement Systems (OPRS) personnel:

During the parallel testing phases of the PeopleSoft Payroll System implementation, several District union negotiations and temporary District Personnel Manual (DPM) Issuances were in effect that provided difficulty in defining a technical solution to identifying ineligible employees for overtime.



**Material Weaknesses and Significant Deficiencies in Internal Controls
Over Financial Reporting**

Therefore, in an effort to not delay the system implementation, the D.C. Department of Human Resources agreed to ensure that agency heads understand the overtime rules and take responsibility for complying with District Personnel regulations for overtime. In support of that effort, OPRS added two additional levels of review and approval of time reporting within the agency for the Time and Labor Module. In addition, the Office of the Chief Financial Officer (OCFO) developed overtime reports to provide agency detail information by employee in an effort to assist in identifying overtime to ineligible employees. When detected, overtime payments to ineligible employees were adjusted on future payments or employees were required to repay the funds.

Now that the PeopleSoft Payroll Module is operational and several of the temporary DPM Issuances regarding overtime have expired, the OCFO, the Office of the Chief Technology Officer, and the D.C. Department of Human Resources are revisiting this effort to provide technical controls in order to comply with the DPM Instruction No. 11B, Section 1138.2.

The following response was provided by Department of Public Works personnel:

Discrepancies in overtime will be corrected. Additional training of timekeepers and staff will be undertaken. Reviews of employee timesheets and files will be scheduled to ensure compliance.

Health Benefit Payments Made After Termination

The District pays health benefits to third parties for its employees. We reviewed 45 terminated employees and noted that in 5 cases, the District continued to pay health benefits for employees for up to 2 payroll periods after the employee's separation from the District government. Based on District policies and procedures, employees are not entitled to health benefits after termination.

It appears that employee personnel actions were not always submitted for processing in a timely manner. As a result, benefit payments were made beyond the employee separation date. Insufficient coordination appears to exist between District Agencies, the Office of Personnel, and the Office of Pay and Retirement Systems in the timely processing and monitoring of terminations of employees.

Delays in processing and failure to closely monitor personnel actions for terminated employees may result in unnecessary benefit costs being incurred by the District for terminated employees. We recommend that the District improve its policies and procedures over the timely processing of personnel actions for terminated employees. In addition, the District should consider enhancing its payroll system to prevent benefits payments beyond employees' termination date(s).

Management's Response:

Effective October 2007, the PeopleSoft Human Resources, Benefits Administration, and Payroll Modules were all fully implemented. Unlike our legacy system, these fully integrated modules now allow automatic termination of benefits as soon as a personnel action is processed for termination.



**Material Weaknesses and Significant Deficiencies in Internal Controls
Over Financial Reporting**

Evaluation of Bonus and Retro Controls

During our audit of bonuses, retro payments, and special awards made to District employees, we reviewed payments for 45 employees. Following were the deficiencies noted:

1. The Office of Pay and Retirement Systems (OPRS) was unable to locate documentation supporting 1 retro payment.
2. Supporting documents provided in 7 instances was not sufficient to determine whether the payments made were accurate and properly authorized.
3. We were unable to match the retro payment amount in 1 instance to the documentation provided.

The District does not appear to have implemented proper internal controls to ensure that supporting documentation is maintained and properly authorized. The lack of adequate authorization and improper maintenance of documentation increases the risk of unauthorized or incorrect payments being made. We recommend the District reevaluate its existing policies and implement measures to reinforce the established policies and procedures for document retention and also ensure that payments are properly reviewed and authorized.

Management's Response:

OPRS management will review its policies and procedures with its staff regarding maintaining proper supporting documentation. In support of this effort, management is currently reviewing the procurement of scanning technology which will improve the agency's internal controls.



**Material Weaknesses and Significant Deficiencies in Internal Controls
Over Financial Reporting**

VIII. Management of the Disability Compensation Program

The District through the Office of Risk Management (DCORM) administers a disability compensation program under Title XXIII of the District of Columbia Comprehensive Merit Personnel Act of 1978.

Data Integrity

Generally an actuarial study uses data that includes all of the open and closed claims in any given policy year. The District's actuarial report for FY 2007 referred to the fact that complete claims information, mainly those related to claims closed in earlier years, was not available. This missing historical claims information would have assisted in providing more insight and would be used to provide a better estimate of the resulting loss and loss expense reserve at September 30, 2007.

Since certain historical claims development data was not available for the DCORM program, factors based on industry data were used in the analysis. This method is not the most reliable in providing an estimate of the resulting loss and loss expense reserve. DCORM was unable to supply such historical data due to changing claims administrators over time. Since the claims were not transferred to the present third party administrator (TPA), it was unable to provide the claims data to the actuary for the actuarial review.

We also noted that even the data for open disability compensation claims provided by DCORM did not have certain basic consistency such as agreement with the data provided by DCORM to the actuary. The number of open claims provided by the claims processor was 88 claims less than what was reported on the actuarial report.

As a result, there is a possibility of inaccurate liability information being generated by the actuary, which in turn would have the effect of incorrectly reporting the reserve incurred but not reported (IBNR) amounts. We recommend management create and continue to maintain strong internal controls over new claims while trying to assess the quantity and values of previous claim files during the forthcoming fiscal year. This will aid in formulating a complete database for submission to the actuary in future years.

Management's Response:

The management of the Disability Compensation Program has been shifted between various agencies and entities within the District government. Prior to the creation of the Office of Risk Management, disability compensation claims were managed by the Department of Employment Services (DOES) and then by the Department of Personnel (DCOP), now Department of Human Resources in 2002. Pursuant to the terms of the "Reorganization Plan No. 1 of 2003 for the Office of Risk Management," this responsibility was transferred to the newly established District of Columbia Office of Risk Management.

By way of history, the transition of claim files and financial information from DOES and DCOP to DCORM through a Third Party Administrator (TPA) was not a smooth one and unfortunately both claim files and significant data was lost in the process.

In the newly created Office of Risk Management, the Disability Compensation Program is managed by a TPA who has oversight of the claims administration process for the program which included having full responsibility for the receipt and review of all new and existing claim files



**Material Weaknesses and Significant Deficiencies in Internal Controls
Over Financial Reporting**

DCORM acknowledges that insurance industry data was used as a part of the FY 2007 and prior years' actuarial studies. In fact, the insurance industry data method, when used to produce paid loss and incurred development factors, was the most reliable method of providing estimates for DCORM's September 30, 2007 evaluation because some District historical loss data was not available. If the use of an alternative method is required, besides the insurance industry method (assuming historical data is unavailable), DCORM will certainly use such a method going forward.

Beyond the use of insurance industry data, all District agencies have received training in reporting claims to the TPA's intake center which is open 24 hours a day and 7 days a week. The current distribution for all new claims includes DCORM's Disability Compensation Manager and Claims Analyst. Those new claims are reviewed by the claims analyst on a regular basis. Furthermore, these new losses are reflected on monthly detailed loss reports provided by the TPA. DCORM also conducts quarterly audit reviews per the contract which contains very specific standards as outlined in the Performance Agreement. Furthermore, C.5.22 of the contract specifies all claims data will be available 24 hours a day and 7 days a week. The vehicle for that review is a secured web based site, ViaOne. DCORM has also requested the TPA to provide backup data on a monthly basis.

Completeness of Actuarial Report

The District's actuarial report should be complete so that it can be relied upon for a comprehensive analysis of the loss and loss expense reserve liability related to worker's compensation. DCORM should provide certain analyses and data information to the actuary in order to achieve a completed report.

During our review of the 2007 actuarial report, several conditions were noted as follows:

1. The report does not currently provide data related to policy year cumulative paid and reported losses, and reported, closed, and open claim counts by evaluation date.
2. Currently DCORM does not perform a 6 month run-off test to ascertain actual paid and reported losses compared to the expectations implicit in the selected development factors.
3. During the current year, there was no compilation of an exposure base, such as payroll, to monitor ultimate loss trends, such as frequency and severity, by policy year.
4. There was no analysis available regarding the reasons for the increased case reserve for disability compensation payment claims for the year 1983 and prior and for the 2005-2006 general liability claims.

It is recommended that the actuary performs the above analyses to help compare the trends and other statistics related to the computed liability, and therefore satisfactorily explain changes in the liability related to workman's compensation. DCORM and its claims processing organization will have to provide the necessary data to the actuary, in order to enable the actuary to perform these analyses.

**Material Weaknesses and Significant Deficiencies in Internal Controls
Over Financial Reporting**

Management's Response:

1. The cumulative Disability Compensation, Auto Liability, and General Liability program of adjusted claim reserve data as of 9/30/2005, 9/30/2006, and 9/30/2007 is contained on Exhibits WC-5, AL-5 and GL-5, pages 1, 2, and 3. These pages, whether separate or combined, contain the cumulative paid loss, case loss reserve and incurred loss for all available open and closed claim counts by policy year evaluation date. The comparable data for the Metropolitan Police Department and the District Fire Department was requested but was not available. Per our review of actuarial evaluation report files prior to 9/30/05, cumulative data as of pre-9/30/05 evaluation dates are not available. For each future evaluation date, DCORM actuarial studies will continue to add in future cumulative paid loss, reserves, and incurred losses for open and closed claims for all incurred years. Our strategic goal is to combine the six or more cumulative evaluations of loss data in a "traditional" loss development triangle for inclusion in the report within the next three years. As of now, the construction of such a triangle with incomplete historical claims data and substantial claim adjusting activity over the last two years, does not produce loss development factors that are useful to produce expected experience that compares favorably to actual experience.

2. DCORM agrees that we do not currently produce a 6 month test to compare actual paid and reported losses to expected paid and reported losses. However, through its outside actuary, DCORM does perform an internal 12 month run-off test, using the three years of available cumulative data to determine if District development factors produce credible estimates. DCORM's actuary used insurance company industry paid and incurred loss development factors to produce valuation estimates of expected experience because the current limited District data does not produce credible expected results. Given the limited data, DCORM's actuary compares the District's current selected ultimate loss with the prior year's selected ultimate loss for each policy year to better understand the differences in the estimate of the ultimate loss by policy year. The 12 month run-off test is included within the actuary's internal files with other methodology checks to compare the actual loss development to the expected loss development, but the 12 month run-off test is not represented by an exhibit to the actuarial study because it is not used to produce report valuation estimates. Given the recommendation, DCORM will work to perform a 6 month run-off test in the future. Furthermore, if the recommendation is that DCORM perform the 12 month run-off calculation for inclusion in each year's actuarial report, DCORM will include it in its budget proposal for future year calculations.

If the recommendation is that DCORM obtain exposures for all policy years that associated losses are available, then DCORM will include it in its budget proposal for future year calculations.

3. DCORM concurs that there was no compilation of an exposure base performed in connection with the FY 2007 actuarial study. In the future, DCORM will seek to compile such an exposure base. That said, DCORM's actuaries have stated that the compilation of an exposure base does not in any way affect the financial reports, calculations, or any methods used to determine the District's liability.



**Material Weaknesses and Significant Deficiencies in Internal Controls
Over Financial Reporting**

4. Substantial claim adjustments were made during the 10/1/2006-07 fiscal year primarily due to the review and reevaluation of older claims for ultimate exposure and settlement. Prior to and during FY 2005-2006, reserves were not appropriately set for tort liability claims.

As a result of this, active and paid claims were reviewed and reserves were established. Overall, this increased the established reserves and impacted the outstanding and incurred reserves on general and auto liability claims in subsequent reporting periods. These findings were also highlighted in the last and most recent actuarial studies.

Historical loss information was provided to the actuaries, not the auditors. Upon review of the actuarial data, it was discovered that duplicate claims were reported. During the clean up of the data, associated reserves/payments were removed as well. Once discovered, the associated reserves/payments were reconciled and provided to the actuaries. It should be noted that only the claim numbers were duplicated, not the dollars associated with the claims reported. In light of the reconciliation of data, it was suggested to the auditors that the fiscal year-end numbers be obtained from the actuaries.

Auditors were advised that claims are pursued until closure or confirmation of payment. Thus, it is likely that the figures initially reported changed due to subsequent notices of payment or modification of claim reserves. *EX: a claim pending in FY 2007, but verification of that payment indicates that it was satisfied in FY 2006 or FY 2005; that claim will be closed with a retro date to the paid date. This does have an impact on the District's total incurred liability for any given fiscal year.*

Claims at DCORM

We noted that certain files were either not available or the files had incomplete data. Further, data had not been fully transferred from the EDOCS Imaging system to the new SIR Imaging system. We noted that some of the documentation was incomplete both in the SIR Imaging System as well as in the hard copy formats provided to us. Payments were made based on wage information which did not always agree to the actual wages of the disabled employees.

Open Claims

We noted that during July 2007, there was a system change from the EDOCS Imaging system to the SIR Imaging system. During the transfer, electronic approvals for invoice payments were not properly transferred in certain instances. As a result, we had to view the invoice support electronically in the EDOCS Imaging system, which we were able to do for 8 out of 45 selected items. However for 4 invoices, we could not find the support in the SIR Imaging system.

Whenever a system change is made, there must be adequate controls in place to ensure that all of the information is completely transferred over from the older system to the new system, and DCORM was not able to provide evidence that this was done.



**Material Weaknesses and Significant Deficiencies in Internal Controls
Over Financial Reporting**

Closed Claims

In 1 instance out of 13 selected closed claims, the file provided contained only partial claim information required for testing. Further, the first report of injury related to this claim was not available.

General Liability

We noted that in 1 instance out of 46 general liability claims selected for testing, there was a reserve established against a closed claim. There should be no reserve established against closed claims. This was done incorrectly. Reserves against closed claims will distort the liability accrual at the end of the year.

We recommend management ensure that all claim files have complete information. We also recommend that a strong documentation preparation and review mechanism be put in place to avoid the recurrence of such errors. Approving authority should review all invoices before processing the payments. Further, wage information should be also reviewed prior to payment of claims. Lastly a comprehensive set of controls and reviews must be in place to ensure that data migration errors do not take place.

Management's Response:

Open Claims

Of the selected 45 claims, 33 files were open and included date ranges from 1970 to 2007. 60% of that sampling had injury dates from 1970 to the 1990s. Only 9 of the open claims had injury dates during the dates between 2005 and 2007.

The auditor viewed 8 invoices in EDOCS and the auditor acknowledges they have seen the approved invoices. Due to system migration these approvals had to be reviewed in the prior imaging system (EDOCS) which continues to be available.

Closed Claims

For the record, the remaining 12 files were in a closed status. The date ranges covered 1995 to 2007. 83% of the files were for injuries dated between 2004 and 2007. Only 1 file could not be located. This represents 2.2% of the entire sample population.

This condition refers to a claim where the date of injury was 11/22/2004. The file was closed 11/18/2005. The last payment made was to a medical provider on 8/12/2005 for service rendered 3/7/2005. The Disability Compensation Program transitioned to the new third party administrator (TPA) in May 2005. To date, the actual hardcopy file can not be located.



**Material Weaknesses and Significant Deficiencies in Internal Controls
Over Financial Reporting**

General Liability

As a point of clarification, the general liability claims are not handled by the TPA. The references to the imaged documents found in SIR or EDOCS are specific to the Disability Compensation Program only.

Regarding the recommendations, the TPA's contract for services is very specific regarding the requirements of the Disability Compensation Program. In addition, DCORM has very specific standard operation procedures. The current TPA has incorporated contractual and DCORM requirements in its overall best practices procedures which are required to be followed by the TPA's claims staff.

Furthermore, all the payments in the sample size were properly approved and noted on the actual bills as well as the indemnity payments in this sampling.

The claims management system used by the Tort Liability Program has a reserve control in place to automatically "zero out" reserves on closed claims. Additional testing will be performed monthly to ensure that all closed claims have a zero reserve balance.

Claims at Metropolitan Police Department and Fire and Emergency Medical Services

Complete and accurate data for all claimants must be maintained in order to ensure claimants receive accurate and correct payments and also to ensure that the reserve liability and the incurred but not reported liability amount is properly computed as of year-end and also at any given point in time. The following was noted during our audit process. We identified these discrepancies from a sample of items that had been selected for testing. Management should recognize the possibility that additional discrepancies may exist.

Metropolitan Police Department (MPD)

In 1 instance out of 21 selected samples, the claimant returned to work in October 2007, but the claim was incorrectly classified in the database as being "Closed" as of September 30, 2007. Such errors would result in the liability being inaccurately stated as of year-end. This would have an effect on the computation of the incurred but not reported (IBNR) liability amount.

Fire and Emergency Medical Services (FEMS)

In 13 instances out of a sample of 24 selected items, the claimants' hourly rate used for indemnity payments were less than what was documented in the PeopleSoft payroll report.

This is due to the fact that the rate did not take into effect the pay rate changes during the year and the increases in payroll for length of service. This resulted in payment amounts being lower than the actual amount which should have been paid, to the claimant(s).

In 2 instances out of the 24 selected samples, the number of hours for which FEMS employees were paid for was more than what should have been paid, based on the information in the database.



**Material Weaknesses and Significant Deficiencies in Internal Controls
Over Financial Reporting**

Correct pay rates, hours on disability, and status such as 'open' and 'closed' should be reviewed regularly, taking into account pay rate changes and return to work status. There should be a proper review process in place so that all claimant information is updated properly.

Management's Response:

The following response was provided by MPD personnel:

The claimant in question was injured on 9/4/2007 and in the original report submitted for the audit, it was reported that the claimant was at either a limited or full duty status on or before 9/30/2007, which resulted in the claim being reported as "Closed" in the claims data submitted for the FY 2007 Actuarial Study. During the audit, it was determined that this claimant remained in a sick leave status as of 9/30/2007, and did not return to work on a full duty status until 10/24/2007. By reporting the claim as closed as of 9/30/2007, the report indicated that the claimant had no "Expected Future Hours" for injury and no "Indemnity Compensation Reserve."

The final report submitted for the FY 2007 Actuarial Study should have indicated the "Total Expected Future Hours for Injury" as 6,988 rather than 6,852; and the "Total Indemnity Comp. Reserve for POD Injury/Illness" as \$1,688,500.65 rather than \$1,685,315.53. This error resulted in MPD's liability being stated inaccurately by \$3,185.12. While this is an error, it constitutes less than 1% of the \$961,808 combined IBNR for MPD and FEMS.

Regarding the recommendation that a "proper review process" be put in place, the Medical Services Division will increase the size of its periodic sampling of claims against its automated "Roster" database and hard copy medical records to make sure that claims status dates are more accurate.

The following response was provided by FEMS personnel:

In response to the hourly rate, yes it was different. The figures were submitted by the members' officers. PeopleSoft is a new payroll system which has just come on line in the summer of 2007 for the Fire Department. FEMS will from now on check the PeopleSoft system to confirm a member's hourly rate. Prior to getting the PeopleSoft system it was difficult to get a person's exact hourly rate without having the member's history.

In response to 1 member's total hours of a Performance of Duty Injury, FEMS did not properly transfer the full amount of hours as was documented. With respect to the other person there was a discrepancy of one hour related to the Performance of Duty Injury.



**Material Weaknesses and Significant Deficiencies in Internal Controls
Over Financial Reporting**

IX. Management of the Unemployment Compensation Program

The District's Department of Employment Services (DOES) is responsible for the administration of the Unemployment Compensation Program. While performing our test work, we noted the following:

Tax Receipts

The Tax Division was only able to complete 205 audits, which is 35% of the 580 audits required to be completed for FY 2007. In addition, DOES was unable to provide supporting documentation for 4 of the 40 employer audits selected for review. The Department of Labor Unemployment Insurance Program Letter Number 18-93 requires DOES to perform audits annually of 2% of its active contributor employer accounts. The total number of active contributing employers in the District is approximately 29,000. Therefore, the Tax Division should perform about 580 audits.

According to the Tax Chief, the Tax Division continues to be challenged with performing the required audits due to vacancies in the unit and additional staff training needed to ensure the audits are performed properly. DOES should allocate sufficient resources to ensure the required annual audits are performed and performed properly or consider using a third party contractor to conduct the required audits.

Management's Response:

The UI Tax Division will increase in current number of Auditors from 6 FTEs to 8 FTEs by end of the 3rd quarter of 2008. It is anticipated that an increase of 2 FTEs will increase field audit completion by 25% or approximately 80 additional audits annually. The division has worked with its contractors to design and develop an audit assignment application to eliminate the manual process currently in place. The auto-audit-assignment software will be in production by March 31, 2008.

Additionally, OIT is aware of the problem and researching software for laptop access to enable auditors to process an audit and upload the information to a server from the field. The process will improve efficiency, accuracy, and timeliness.

Inadequate Controls over the Web Enabled Benefit System

The Web Enabled Benefit System (WEBS) does not have adequate access controls to prevent or detect ineligible, unauthorized, or fraudulent claims from being submitted. For instance, a user can select an arbitrary social security number and request WEBS to generate the weekly benefit amount. If WEBS calculates the maximum weekly benefit amount (\$359) for the selected social security number, the claimant can alter the name and address on the account to receive benefits. Additionally, we observed that multiple claims for unemployment were filed using the same mailing address, multiple claims were filed using the same IP address, and the same named claimant was used with different social security numbers.

This issue has been referred to the Office of the Inspector General (OIG) and is currently under investigation. To date, the total number of inadequate claims identified is 16 for a total of approximately \$91,000. Best practices require that the logical access to and use of information technology computing resources should be restricted by the implementation of adequate identification, authentication, and authorization mechanisms, linking users and resources with the access rules.



**Material Weaknesses and Significant Deficiencies in Internal Controls
Over Financial Reporting**

Adequate controls were not in place to properly identify, authenticate, and authorize users and as a result, unemployment compensation benefits were being paid to ineligible claimants. Management should improve the current security architecture of WEBS by ensuring proper identification, authentication, and authorization mechanisms; for instance, a claimant should be required to validate his/her identity through a series of security questions and/or appearing in person.

Management's Response:

Management upon detection through the BARTS (Benefits Auditing and Recovery Tracking Systems) and through the conscientiousness of agency employees, was able to develop a suspicious claims list. The WEBS system flags a claim if the name, SSN, IP address, or password is the same or appears on the list. The claimant is informed the claim cannot be processed at the time and the claimant is referred to DOES for further instructions. Claimants are called in from the suspicious list and must bring proof of identity and SSN. While any theft is not acceptable, the amount of the accumulated theft of approximately \$90,000 for 16 claimants is not massive when consideration is given to the fact that more than \$90,000,000 in benefits were paid to more than 23,000 claimants in the past year.

Processing Employer Refunds

The procedures for processing employer refunds are not adequate to ensure amounts are properly paid, posted, and reported in the correct period. In addition, for 2 of the 40 employer refunds tested, DOES/Shared Service Center could not provide the documentation to support the refund request was paid.

The Tax Examiners prepare requests for employer refunds and forward them to the Shared Service Center for processing. The payments are processed in SOAR, the District's accounting system of record, but are never reconciled to the District Unemployment Tax Assessment System (DUTAS) to ensure all amounts requested were paid.

Further, there is no cut-off period for processing the requests to ensure the amounts are recorded in the correct fiscal year. DOES should reconcile the employer refund account with the Shared Service Center on a periodic basis to ensure amounts requested to be paid were actually paid. An effective date should be included on the request to ensure amounts are posted to the correct period.

Management's Response:

DOES and the Shared Services Center have designed an application, DAFRN, that automates the refund process. The application, in conjunction with the Internal Tax Refund Web Site (DOES Intranet site) will automate the approval process and the release of the refund request to SOAR. Once SOAR processes the refund and a check is issued, feedback in the form of a FTP file will be forwarded to DUTAS alerting DOES of the issuance. An auto alert will be sent to DUTAS from SOAR notifying DOES of the check clearance. The application development is in the final stages and is anticipated to be launched by April 30, 2008.



**Material Weaknesses and Significant Deficiencies in Internal Controls
Over Financial Reporting**

Reconciliation between the District Unemployment Tax Assessment System (DUTAS) and SOAR

DUTAS is the primary tax database for capturing unemployment taxes paid by and due from employers. There was no evidence that monthly reconciliations between DUTAS and SOAR, the District's accounting system of record, were reviewed and approved by supervisory personnel during the fiscal year.

Where multiple systems are used to operate and manage a program, periodic reconciliations should be performed, reviewed, and approved to ensure the systems agree and the reporting of information regarding the program is consistent. DOES should modify its process for reconciling DUTAS to SOAR to include at a minimum, supervisory review and approval.

Management's Response:

The reconciliation between DUTAS and SOAR was done in FY 2007. The Shared Service Center Financial Reporting Manager, reviewed the reconciliation, and emailed it to the DOES Tax Division and did a follow up with another email. The Tax Division reconciled all known variances and discrepancies and the UI tax Officer reviewed, approved, and forwarded the request back to Shared Services Financial Reporting Manager.

While there was no signatory page affixed to the reconciliation document that would authenticate the review and approval, one has since been created and will accompany all reconciliation activities between the UI Tax Division and the Shared Services Center in the future.



Material Noncompliance with Laws and Regulations

I. Noncompliance with Procurement Regulations

The District's procurement transactions are primarily governed by statute, as well as rules and regulations outlined in the District of Columbia Municipal Regulations (DCMR). In addition, the Mayor, Chief Financial Officer, and Director of the Office of Contracting and Procurement can issue directives, orders, and memorandums governing procurement actions.

The District of Columbia established the Office of Contracting and Procurement (OCP) in 1997 to improve acquisition outcomes. OCP functions as the District's lead contracting office on behalf of a significant number of District agencies and departments. The United States Government Accountability Office issued a report in January 2007, which indicated that approximately 2/3 of the District's \$1.8 billion of procurement in fiscal year 2005 was processed through OCP. While District personnel represent the procurement percentages have not changed significantly for FY 2007, District personnel were not able to provide specific percentages for FY 2007.

Several other District entities also perform procurement independently. Some of these include the Office of the Chief Financial Officer (OCFO), Child and Family Services Agency (CFSA), and the Department of Mental Health (DMH). Following are issues noted during our test work performed in conjunction with the audit of the FY 2007 Comprehensive Annual Financial Report.

Database Review

The OCFO, DMH, and CFSA do not have databases which track all contracts. These agencies provided contract information in the form of an Excel spreadsheet for which the agencies could not confirm its completeness. We reviewed the database information provided by OCP and the information provided by the OCFO, DMH, and CFSA. We noted the following errors:

1. There were 20 instances in which the amount and/or the contract number per the listing provided by OCP and the independent agency, CFSA, differed from the actual amount awarded in the contract file. There were 9 instances at OCP and 11 instances at CFSA.
2. There was 1 grant at DMH and 1 small purchase at OCP that was inappropriately included as a contract.

We recommend that the District consider the design and maintenance of a centralized tracking system (database) with information that identifies the amount and status of each contract for all procurement. We further recommend that the District strengthen controls over its current contracting database(s). It is critical that periodic reviews are conducted during the year to ensure the integrity of the database information. Commodity managers should be responsible for the review of the information and a report documenting any errors and their disposition should be communicated to senior management with appropriate corrective action performed in a timely manner.

Management's Response:

OCP currently has several database systems that work independently of the Procurement Automated Support System (PASS). In FY 2008 and 2009, OCP, in conjunction with the Office of the Chief Technology Officer, will enhance the functionality of the PASS system by implementing the contracts and sourcing modules.



Material Noncompliance with Laws and Regulations

These new modules will not only make the stove pipe programs obsolete by performing their functions, but will also increase the accuracy of information and create a centralized tracking system to be used by all contracting agencies.

At one point, CFSA had an Access database in place prior to the tenure of the current and previous Contracts Administrator, but for some reason its use had been suspended in favor of utilizing MS Project to manage contract information. Presently, the CFSA Contracts Administrator is working to build an Access database to track contract and contract compliance data as an interim measure until an assessment can be made whether we would integrate our contract information and/or utilize OCP's systems. We anticipate that this database will be functional by the summer of 2008. CFSA has recently learned that the PASS system will be upgraded to include the contracts and sourcing modules, and these enhancements could prove beneficial to CFSA's operations.

Approval Process

Requisition Approvals

1. There were 4 instances whereby we were unable to verify the Fiscal Officer's approval, the Budget Officer's approval, and the Contracting Officer's approval because the agencies did not provide the requisitions. 1 instance was at OCP and the other 3 were at CFSA.
2. There were 3 requisitions that were not signed by the Fiscal Officer, the Budget Officer, and the Contracting Officer at CFSA.
3. There were 2 instances at OCP where the requisitions were approved by the Fiscal Officer, the Budget Officer, and the Contracting Officer; however the amounts on the requisitions appeared to exceed the award amount.
4. There were 5 instances at CFSA where the requisitions were approved by the Fiscal Officer, the Budget Officer, and the Contracting Officer; however the amounts on the requisitions were different from the award amount.

Office of Attorney General's (OAG) Approval

5. There were 2 instances at OCP where we were not provided with the OAG's required approval.

City Council Approval

6. Evidence of Council approval for contracts over \$1 million was not provided for 2 contracts selected for testing from OCP.
7. There was 1 instance at OCP where the City Council's approval was for less than the amount for which the contract was issued.



Material Noncompliance with Laws and Regulations

Business Clearance Memorandum (BCM) Approvals

8. There were 9 instances at OCP for which the required Business Clearance Memorandums were not provided.
9. There were an additional 10 instances for which there was a lack evidence of review and approval (signatures). We were unable to determine whether these were approved, disapproved, or conditionally approved because the required box was not checked. There were 3 missing approvals from OCP and 7 from CFSA.
10. There was 1 instance at OCP in which the BCM was approved; however, it was not signed by the preparer.

Determination and Findings (D&F) Approvals

11. There were 10 instances where the required approvals were not provided from OCP.
12. There were 2 instances where the required approvals were not provided from DMH.
13. There were 4 instances at OCP where a D&F was not signed by a required signatory.
14. There were 16 instances at CFSA for which either the Contracting Officer and/or the Interim Director of the Agency did not certify the contractor's responsibility D&F prior to the issuance of the contract. The Agency also failed to change amounts, vendor names, and sometimes contract number(s).

Review and Certification of Sole Source Contracts by the Chief Financial Officer

15. There were 7 sole-source contracts that were extended or renewed where review and certification by the Chief Financial Officer of the District was not provided. There were 2 instances at OCP and 5 instances at CFSA.
16. There was 1 instance at OCP where the Chief Financial Officer's certification was approved; however, the certification document was not on letterhead.

Management's Response:

OCP is aware of the need to improve management controls. In December 2007, the Chief Procurement Officer created a new unit within OCP to address many of these issues. The new unit is called the "Office of Procurement Integrity and Compliance" (OPIC). The mission of OPIC is to ensure compliance with basic procurement principles for all District procurements and mandatory policies and procedures, and to identify high risk procurement issues.

The new Director, Contracts and Procurement/Agency Chief Contracting Officer (Director/ACCO) for DMH has addressed this issue by conducting workshops with the Contract Specialist and internal customers to reinforce the importance of compliance with the laws, rules, regulations, policies, and procedures that govern contracts and procurement in the District of Columbia.



Material Noncompliance with Laws and Regulations

CFSA's Contract and Procurement Administration (CPA) concurs with the finding for the need to improve management controls. The CFSA Contracts Compliance Officer came aboard in FY 2007, and has been making diligent progress in file maintenance and quality assurance. CFSA recently implemented internal audit procedures included in its recent policies and procedures to address file content and quality check points to ensure that contract file requirements are met. These new policies are being incorporated into CFSA's Standard Operating Procedures, and include reviews of file content to include compliance with procurement actions performed and documented to include certification of funds, tax compliance data, sole source justifications, determinations and findings, and City Council approvals.

CPA is working with the CFSA Chief Financial Officer and its IT department to establish an automated funding document process for those services which CFSA cannot purchase through the Procurement Automated Support System (PASS). The vast majority of CFSA's purchases are client specific, and CFSA has been utilizing its federally certified SACWIS (child welfare system) as per federal guidance. CFSA is analyzing how to either develop an automated function in the FACES system for contracting and payment; or, whether the agency would be allowed to pursue using PASS for these purchases. Automation in terms of encumbrance of funds and integration with payment systems would improve compliance in this area.

We do not concur with the findings regarding business clearance memorandum requirements. Legal guidance has confirmed that the DCMR 27 does not include requirements for business clearance memorandums.

Ratification Process

1. Ratification for the services provided by 3 out of 16 vendors was disapproved (DDOT; UDC; DPR).
2. The Office of the General Counsel determined that the procurement for 2 out of 16 vendors did not need to be ratified as the vendors had already received full payment from the agency (CFSA).
3. The ratification for 1 out of 16 vendors was initially disapproved and went for a second hearing review. It was finally approved but there was no signature or date on the final approval ratification notice (CFSA).
4. Ratification for the services of 1 out of 16 vendors was conditionally approved by the Committee. The package needed to be resubmitted to the Committee after necessary changes, and once approved by the Committee, it needed to be submitted to the Council for approval, as this was the third instance where this vendor had provided services to the District without a contract in place (UDC).
5. Supporting documentation was not provided for 2 of 16 vendors. Thus, we were unable to perform procedures over the ratification process (DOH and OAH).

Management's Response:

The Chief Procurement Officer (CPO) has notified agency heads and the vendor community that the practice of providing and receiving goods without a valid written contract is unacceptable.



Material Noncompliance with Laws and Regulations

The rate of unauthorized commitments in the District is much higher than the rate for other jurisdictions. The CPO is committed to eliminating unauthorized commitments that result in after-the-fact ratifications.

Purchase Order Splitting

1. There were 10 instances, for which short-term purchase orders were individually less than \$1,000,000 but cumulatively totaled over \$1,000,000, and were issued to the same vendor for similar services within a twelve month period. There were 6 occurrences at OCP, 2 occurrences at CFSA, and 2 occurrences at DMH.
2. There were 8 instances where we did not obtain evidence of approval from City Council for purchase orders which exceeded \$1,000,000 in the aggregate for vendors. There were 6 at OCP and 2 at CFSA.
3. There were 8 instances where we did not obtain evidence of approval from the OAG for purchase orders which exceeded \$1,000,000 in the aggregate for vendors. There were 6 at OCP and 2 at CFSA.

Management's Response:

The issuance of multiple purchase orders to the same vendor is not necessarily indicative of purchase order splitting. However, the value of a central procurement organization, such as the Office of Contracting and Procurement, is that the organization should recognize the need for term contracts and establish those contracts. The result is that the purchases are then made under an existing contract that reflects economies of scale in pricing, and that the need for stand-alone purchase orders to the same vendor no longer exists. The bottom line is that the appearance of purchase order splitting is significantly reduced.

CFSA does not concur with this finding. Purchases in aggregate associated with the test vendor exceed \$1,000,000 because this is a vendor who is listed on the D.C. Supply Schedule and is LSDBE qualified. In the future, CFSA will list the D.C. Supply Schedule Number on the requisition and purchase order for easy reference.

Limited Competition Small Purchases

1. 1 oral quotation was not provided for 55 non-competitive small purchases. We noted 3 at DMH, 2 at CFSA, and 50 at OCP.
2. The three required oral quotations were not provided for 17 competitive small purchases. We noted 1 at OCFO, 1 at CFSA, and 15 at OCP.
3. Insufficient quotations were provided for competitive small purchases for 11 items at OCP.
4. The three required written quotations were not provided for 15 competitive small purchases. In the instance at DMH, three written quotations were received, but one of them was received after the closing date of the request for quotes. The other 14 were noted at OCP.

Material Noncompliance with Laws and Regulations

5. The three required written quotations were not provided for purchases made outside of the Greater Washington Metropolitan Statistical Area/local trading area. This occurred at OCP for 5 purchases.

Management's Response:

The Chief Procurement Officer (CPO), in the third quarter of FY 2007, issued a directive that contracting ensure that they obtain three quotes when they are conducting small purchases. If the contracting officers cannot obtain three quotes, the contracting officers must justify, in writing, their efforts to comply with the directive.

The new Director, Contracts and Procurement/Agency Chief Contracting Officer (Director/ACCO) for the Department of Mental Health has reinforced the necessity of obtaining and documenting receipt of quotations for non competitive small purchases.

CFSA does not concur with this finding. 27 DCMR §1801.1, except as provided in §1801.2, a contracting officer may make a procurement for an amount of ten thousand dollars (\$10,000) or less without obtaining competitive quotations if the contracting officer determines that the purchase is in the best interest of the District government considering the price and other factors (including the administrative cost of the purchase). In one instance, CFSA was able to provide a copy of the Sole Source D&F.

Competitive Small Purchases

1. Contracts for purchases from 20 vendors which cumulatively exceeded the dollar threshold for small purchases [\$500,000 for Office of the Chief Technology Officer (OCTO) and the Metropolitan Police Department (MPD) and \$100,000 for all other agencies] were not provided. There were 16 at OCP, 1 at MPD, and 3 at OCTO.
2. There were 2 requisitions for OCTO (which cumulatively exceeded the \$500,000 threshold for small purchases) where the required approval by the Budget Manager was performed later than other approvals which should have been obtained in the approval chain.

Management's Response:

The issuance of multiple purchase orders to the same vendor is not necessarily indicative of purchase order splitting. However, the value of a central procurement organization, such as the Office of Contracting and Procurement, is that the organization should recognize the need for term contracts and establish those contracts. The result is that the purchases are then made under an existing contract that reflects economies of scale in pricing, and that the need for stand-alone purchase orders to the same vendor no longer exists. The bottom line is that the appearance of purchase order splitting is significantly reduced.

Maintenance of Files

The District of Columbia Municipal Regulation (DCMR) states that files shall be maintained at organizational levels to ensure effective documentation of contracts, ready accessibility to principal users, and conformance with any regulations or procedures for file location and maintenance.



Material Noncompliance with Laws and Regulations

In addition to the time-consuming process noted in the gathering of files which we had requested, the following additional items were noted:

1. There was 1 instance at OCP where no file was provided; hence, we were unable to test the file. The file was transferred to the Department on Disability Services (DDS), which gained contracting independence during FY 2007. DDS was unable to produce the file.
2. There were 2 instances at CFSA where the award amount and the award date did not agree to any documentation in the contract file; hence, we were unable to test the files.

Management's Response:

The Office of Contracting and Procurement (OCP) is aware of the issues which have continued to plague the contract filing and maintenance system for some time. Hence, OCP recently updated its Contract File Preparation Guidelines, which provide the necessary guidance to contracting personnel for contract file contents. Additionally, OCP is planning to enhance the contract file location, identification, and organization process. OCP has already begun to take an inventory of every file and verify its contents.

As OCP improves its contract filing and maintenance system, OCP will share the system with other District procurement agencies.

The findings in this area all relate to quality assurance. As identified in previous sections, CFSA's Contracts and Procurement Administration (CPA) recently implemented a number of control measures to address these issues. Internal audit procedures and quality assurance checks will alleviate discrepancies between award amount and award date. These revised processes will address maintenance of files in accordance with all requirements. CPA will be training its entire staff on these new policies and procedures.

Other District of Columbia Municipal Regulation (DCMR) Issues

We noted the following issues during our audit process:

Review of Significant History of the Procurement

1. OCP was unable to provide a significant history for 1 procurement file.

Review of Documentation of Full and Open Competition

2. CFSA was unable to provide evidence of full and open competition for 1 procurement file.

Review of Support for the Rationale to Limit Competition

3. There was 1 file identified at CFSA for which there was insufficient documentation present in the file to support the rationale to limit competition.

Review of Cost Price Analysis

4. There were 6 instances at OCP where the file reviewed lacked evidence that a cost/price analysis was performed.

Review of Compliance with Tax Requirements

5. There were 3 contracts at CFSA where the Tax Certification Affidavit was not provided for review.



Material Noncompliance with Laws and Regulations

6. There were 4 instances at OCP where the Tax Certification Affidavits were missing from the procurement files.
7. There was 1 instance at OCP, where the Tax Certification Affidavit in the file was not current.
8. There were 2 instances at CFSA where we were not provided with tax verification responses from the Department of Employment Services (DOES) and the Office of Tax and Revenue (OTR).
9. There were 6 instances at OCP, where we were not provided with all of the required tax verification responses from DOES and OTR.
10. At DMH, a Tax Verification Response was not received for 1 contract.
11. There was 1 procurement file for which OCP exercised the 30-day option prior to receiving a Tax Verification Response from DOES and OTR. We further noted that OCP exercised the other eleven (11) months even though by this time they still had not received the Tax Verification.

Review of Debarment, Suspension, and Ineligibility List

12. There were 16 instances at CFSA where the files lacked adequate documentation regarding verification against the Federal Debarred and Suspended List and District's Excluded Parties List.
13. There were 16 instances at DMH where the files lacked documentation regarding verification against the Federal Debarred and Suspended List and District's Excluded Parties List.
14. There were 22 instances at OCP where the files lacked documentation regarding verification against the Federal Debarred and Suspended List and District's Excluded Parties List.
15. There was 1 instance at OCP where a Federal Debarred and Suspended List was provided; however the date within the body of the search did not agree with the date that the search was printed, and accordingly, we could not determine whether the search was performed shortly before the contract was issued.
16. There was 1 instance at CFSA where a Federal Debarred and Suspended List was provided; however the wrong name was used in the search of the Excluded Parties List System.

Review of Contractor Evaluation

17. We noted 7 instances at OCP where contractor evaluations were not provided.
18. We noted 17 instances at CFSA where contractor evaluations were not provided.
19. We noted 9 instances at DMH where contractor evaluations were not provided.
20. There was 1 instance at OCP where the contractor evaluation provided was incomplete.

Review of Contracts for Accrued Expenses

21. 6 transactions were recorded as accrued expenses and were not supported by valid contracts prior to the services being rendered. We were not provided with any evidence that the contracts had been submitted for ratification.



Material Noncompliance with Laws and Regulations

DCMR states that files shall be maintained at organizational levels that ensure effective documentation of contracts, ready accessibility to principal users, and conformance with any regulations or procedures for file location and maintenance.

We recommend that closer oversight and monitoring controls be placed over contracting at the independent agencies. We further recommend that the Child and Family Services Agency (CFSA), Department of Mental Health (DMH), and Office of Contracting and Procurement (OCP) review their current controls over document maintenance and retrieval. Special focus should be placed on ensuring that all agencies conform to the regulations and are accountable at a centralized level. Management at the contracting offices should perform a periodic review and design checklists which must be approved by supervisory personnel prior to being filed.

We recommend that the District perform an assessment of the current training program available to contracting personnel. Focus should be placed on ensuring that these employees are trained in the compliance regulations applicable to contracts. The training program will assist in the employees obtaining the requisite tools needed to carry out their daily assignments. Training needs to be consistent and ongoing and not be considered as a quick fix to a long term problem. The District must also retain personnel with the appropriate competencies to ensure that procurement as a major process is guided properly.

We recommend that OCP and all independent agencies review their current contracting procedures with special focus on the contracting officers or designees and their responsibilities for ensuring compliance with contract dollar limitations and the approval process. The commodity managers should meet with senior procurement personnel to review the status of certain contracts during the year and action should be taken to remedy deficiencies cited.

Management's Response:

The Chief Procurement Officer (CPO) recognizes the responsibility to ensure a transparent procurement process and appropriate management controls at all District agencies conducting contracting activities. The CPO conducts quarterly meetings among the contracting officers of District agencies subject to the Procurement Practices Act to address cross-cutting procurement issues. OCP has already instituted a year-long series of training seminars open to all contracting personnel, regardless of agency, to promote standardization and compliance with applicable statutory and regulatory requirements.

The new Director, Contracts and Procurement/Agency Chief Contracting Officer (Director/ACCO) for the Department of Mental Health has implemented new procedures to specifically address the lack of documentation regarding verification against the Federal Debarred and Suspended List and the District's Excluded Parties List, while emphasizing to the Contracting Staff the importance of obtaining verification documentation as part of their routine in identifying responsive/responsible contractors prior to contract award.

In addition, the Director/ACCO has implemented the issuance of Contracting Officer's Technical Representative (COTR) Appointment Memorandum that includes the requirement to properly evaluate contractors on a quarterly basis based upon performance and compliance.



Material Noncompliance with Laws and Regulations

CFSA accepts the recommendation that more stringent oversight of contracting and procurement practice is needed. In response, CFSA hired a Contract Compliance Officer in April 2007. Since that time, a number of compliance driven policies and procedures have been developed to ensure that compliance with regulatory standards in advance of award is sufficiently performed.

In many of the findings surrounding tax affidavits, CFSA would like to explain that the response included in the file was a result of submission of the affidavits to the appropriate tax office. In other words, these OTR responses would not be documented in the file had not an affidavit been previously sent into OTR requesting the response. CPA has been maintaining the affidavits in a separate filing system, and not in the official contract files. CPA will be revising its practice in order to ensure both are maintained in the official contract file.



Material Noncompliance with Laws and Regulations

II. Noncompliance with the Quick Payment Act

The Quick Payment Act of 1984 states, in part, the following:

In accordance with rules and regulations issued by the Mayor of the District of Columbia ("Mayor"), each agency of the District of Columbia government ("District"), under the direct control of the Mayor, which acquires property or services from a business concern but which does not make payment for each complete delivered item of property or service by the required payment date shall pay an interest penalty to the business concern in accordance with this section on the amount of the payment which is due.

Specifically, the due dates required are as follows:

- The date on which payment is due under the terms of the contract for the provision of the property or service;
- 30 calendar days after receipt of a proper invoice for the amount of payment due;
- In the case of meat or a meat food product, a date not exceeding seven calendar days after the date of delivery of the meat or meat food product; and
- In the case of agricultural commodities, a date not exceeding seven calendar days after the date of delivery of the commodities.

Furthermore, the act addresses various requirements for payment of interest penalties and includes provisions regarding required reports as follows:

- Each District agency shall file with the Mayor a detailed report on any interest penalty payments made.
- The report shall include the numbers, amounts, and frequency of interest penalty payments, and the reasons the payments were not avoided by prompt payment, and shall be delivered to the Mayor within 60 days after the conclusion of each fiscal year.
- The Mayor shall submit to the Council within 120 days after the conclusion of each fiscal year a report on District agency compliance with the requirements.

For the year ended September 30, 2007, we noted 130 instances where the District failed to comply with the Quick Payment Act.

Management's Response:

Prompt payment rests on quick approval of vendors' invoices and submission to an agency's finance division by the program office or the office responsible for the certification of delivery of service or goods. Management will increase efforts to ensure compliance with the Quick Payment Act.

Material Noncompliance with Laws and Regulations

III. Noncompliance with the Financial Institutions Deposit and Investment Amendment Act

For collateral requirements, the Financial Institutions Deposit and Investment Amendment Act, among other requirements, dictates the following:

Except for securities directly purchased without a repurchase agreement and money market funds, an eligible financial institution must at all times provide collateral equal to at least 102% of the District funds held by the eligible financial institution for deposits and investments that are not fully federally insured.

During our procedures, we noted 21 instances of noncompliance with the aforementioned provision, where the collateral held by the District's investment custodians was less than 102% of the value of the particular investment. The noncompliance occurred with respect to the collateral held by the following Federal Reserve Bank Pledge Holdings bank accounts: Adams Bank, Bank of Georgetown, and Cardinal Bank. In addition, the District did not prepare collateral reports on a monthly basis throughout the year.

We recommend that District personnel closely monitor the collateral held by custodians, to ensure that the District remains in compliance with the requirements of this law.

Management's Response:

The 102% requirement was monitored and adhered to for the accounts that hold the vast majority of the District's funds. This should have occurred with all accounts. We concur with the finding and recommendation that regular, systematic monitoring and reporting should occur for all accounts, and we have implemented a process by which this is now done.

All of the 21 cited instances relate to activity for 3 of our relatively small banking relationships. Each of these banks was requested by the Office of Finance and Treasury (OFT) staff to establish and maintain collateral at the required 102% level. Two of the banks established and maintained the collateral at 100% as opposed to 102%, despite having been requested in writing by OFT staff to establish and maintain it at 102%. The third bank had been maintaining collateral at 102%, but did not adjust the collateral as it should when there is an increase in the deposit balance.

OFT staff knew that the banks had posted collateral for these accounts and presumed that such collateral was at the required level as the banks had been instructed to do. When it was discovered that the three banks were under-collateralized, they were notified and the collateral was immediately increased to 102%. As stated above, we have implemented a new monitoring and reporting process to ensure that collateral for all account balances is maintained at the 102% level.



**Status of Prior Year Reportable Conditions, Material Weaknesses, and
Material Noncompliance with Laws and Regulations**

Nature of Comment	Type of Comment in Fiscal Year 2006	Current Year Status*
District of Columbia Public Schools	Material Weakness	Material Weakness
Management of the Medicaid Program	Reportable Condition	Material Weakness
Noncompliance with Procurement Regulations	Material Noncompliance	Material Noncompliance
Noncompliance with the Quick Payment Act	Material Noncompliance	Material Noncompliance

* The terminology and classification of the current year findings is based on Statement on Auditing Standards, No. 112.