

TESTIMONY OF CHARLES J. WILLOUGHBY, INSPECTOR GENERAL

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

**ISSUANCE OF THE COMPREHENSIVE ANNUAL FINANCIAL REPORT
FOR FISCAL YEAR 2008**

February 6, 2009

GOOD MORNING CHAIRMAN GRAY AND MEMBERS OF THE COMMITTEE. I AM CHARLES J. WILLOUGHBY, AND I AM PLEASED TO SPEAK BEFORE YOU THIS MORNING ON THE ISSUANCE OF THE DISTRICT'S FISCAL YEAR (FY) 2008 COMPREHENSIVE ANNUAL FINANCIAL REPORT (CAFR). ACCOMPANYING ME TODAY ARE WILLIAM J. DIVELLO, ASSISTANT INSPECTOR GENERAL FOR AUDIT AND REPRESENTATIVES FROM BDO SEIDMAN, LLP, OUR INDEPENDENT AUDITORS.

BY LAW, THE INSPECTOR GENERAL MUST ENTER INTO A CONTRACT WITH AN INDEPENDENT AUDITOR TO AUDIT THE CITY'S FINANCIAL STATEMENTS. ON JANUARY 30, 2009, THE DISTRICT OF COLUMBIA RECEIVED AN UNQUALIFIED OPINION ON ITS FINANCIAL STATEMENTS FOR FY 2008 FROM INDEPENDENT AUDITORS BDO SEIDMAN, LLP.

IN A SEPARATE REPORT ON INTERNAL CONTROLS THAT ACCOMPANIES THE FY 2008 FINANCIAL STATEMENT REPORT, THE INDEPENDENT AUDITORS REPORTED ON SIX SIGNIFICANT DEFICIENCIES, TWO OF WHICH WERE CONSIDERED TO BE MATERIAL WEAKNESSES. LAST YEAR'S CAFR REPORT RECORDED NINE SIGNIFICANT DEFICIENCIES, THREE OF WHICH WERE CONSIDERED TO BE MATERIAL WEAKNESSES. WHILE IT IS IMPERATIVE THAT MANAGEMENT CONTINUE TO ADDRESS THE DEFICIENCIES REPORTED THIS YEAR, EFFORTS TO ADDRESS PAST DEFICIENCIES HAVE PROVED FRUITFUL, BEARING IMPROVEMENTS OVER LAST YEAR'S RESULTS IN SOME SIGNIFICANT AREAS.

HOWEVER, BEFORE WE REVIEW SPECIFICS OF THIS YEAR'S CAFR AUDIT, LET ME SHARE SOME PERSPECTIVES ABOUT THE ROLE OF THE OFFICE OF THE INSPECTOR GENERAL (OIG) IN THE CAFR OVERSIGHT PROCESS.

CAFR OVERSIGHT PROCESS

AS YOU KNOW, THE OIG HAS ENTERED INTO A CONTRACT WITH BDO SEIDMAN, LLP (BDO) TO PERFORM THE AUDIT OF THE DISTRICT'S CAFR. THIS YEAR'S CAFR WAS THE 4TH OF A 5-YEAR OPTION CONTRACT. WE MONITOR THIS CONTRACT AND OVERSEE THE AUDIT PROCESS WITH THE ASSISTANCE OF THE CAFR OVERSIGHT COMMITTEE, WHICH THE OIG CHAIRS. THE COMMITTEE MONITORS THE PROGRESS OF THE CAFR EACH YEAR AND ENSURES THAT OBSTACLES THAT MAY HINDER THE COMPLETION OF THE AUDIT, OR MATTERS THAT NEED DISTRICT MANAGEMENT'S ATTENTION, ARE DISCUSSED WITH THE APPROPRIATE

DECISION MAKERS AND PROMPTLY RESOLVED. THE CAFR COMMITTEE, WITH PARTICIPATION FROM MAYORAL AND COUNCIL STAFFS, MEETS REGULARLY THROUGHOUT THE CAFR CYCLE TO ACHIEVE THAT GOAL. IN FY 2008, WE CONTINUED TO HOLD CAFR MEETINGS THROUGHOUT THE SUMMER MONTHS TO MAINTAIN THE MOMENTUM OF THE COMMITTEE'S EFFORTS TO ADDRESS REPORTED MATERIAL WEAKNESSES AND SIGNIFICANT DEFICIENCIES. WE PLAN TO CONTINUE THAT INTENSITY FOR FY 2009, AGAIN HOLDING CAFR COMMITTEE MEETINGS REGULARLY THROUGH THE SUMMER.

THE FY 2008 CAFR CONTRACT TOTALED ABOUT \$4.3 MILLION, A COST INCREASE OF \$765,000 OVER LAST YEAR'S COST OF APPROXIMATELY \$3.5 MILLION. ABOUT 65 PERCENT OF THE COST INCREASE WAS DUE TO ADDITIONAL AUDIT WORK RELATED TO THE PEOPLESFT PAYROLL SYSTEM IMPLEMENTATION. THE BALANCE OF THE COST INCREASE REFLECTED ADDITIONAL WORK REQUIRED IN HIGH RISK AREAS LIKE THE DISTRICT OF COLUMBIA PUBLIC SCHOOLS (DCPS), THE OFFICE OF THE STATE SUPERINTENDANT OF EDUCATION (OSSE), PROCUREMENT, AND SEVERAL TRUST FUNDS.

THE FY 2008 CAFR - WORK REMAINS BUT IMPROVEMENTS NOTED

THE FY 2008 CAFR AUDIT REPRESENTS THE 12TH CONSECUTIVE YEAR IN WHICH THE DISTRICT RECEIVED A "CLEAN" OPINION FROM THE INDEPENDENT AUDITORS. ACCOMPANYING THE FINANCIAL STATEMENT AUDIT AND OPINION IS THE YELLOW BOOK REPORT, OFFICIALLY KNOWN AS THE "AUDITOR'S

REPORT ON INTERNAL CONTROLS OVER FINANCIAL REPORTING AND ON COMPLIANCE”. THE YELLOW BOOK REPORT DISCUSSES THE INTERNAL CONTROLS OVER FINANCIAL REPORTING, PARTICULARLY FOCUSING ON THE SIGNIFICANT DEFICIENCIES, INCLUDING MATERIAL WEAKNESSES, AND COMPLIANCE WITH LAWS AND REGULATIONS. AS MENTIONED IN MY OPENING REMARKS, WE HAVE SEEN IMPROVEMENTS IN THIS YEAR’S CAFR. HOWEVER, OUR RESOLVE MUST NOT WAIVER AS WE STILL NEED TO ADDRESS SOME LONG-STANDING DEFICIENCIES AND MAINTAIN THE PROGRESS IN THOSE IMPROVED AREAS.

AREAS REQUIRING MANAGEMENT’S ATTENTION

IN THE FY 2008 YELLOW BOOK REPORT, BDO IDENTIFIED SIX SIGNIFICANT DEFICIENCIES THAT COULD AFFECT THE DISTRICT’S ABILITY TO INITIATE, AUTHORIZE, RECORD, PROCESS, RECONCILE. AND REPORT FINANCIAL DATA. THE MOST SERIOUS TYPE OF SIGNIFICANT DEFICIENCY IS A MATERIAL WEAKNESS. TWO OF THE DEFICIENCIES IDENTIFIED IN THIS YEAR’S REPORT ARE CONSIDERED MATERIAL WEAKNESSES: (1) TREASURY FUNCTIONS; AND (2) MANAGEMENT OF THE MEDICAID PROGRAM. THE TREASURY FUNCTIONS AT THE DISTRICT’S OFFICE OF FINANCE AND TREASURY WERE CITED AS A MATERIAL WEAKNESS, AN UPGRADED RISK FROM FY 2007, WHEN TREASURY INVESTMENT RECONCILIATION AND ACTIVITY WAS CITED AS A SIGNIFICANT DEFICIENCY. HIGHLIGHTS OF THE PROBLEMS ASSOCIATED WITH TREASURY FUNCTIONS IN FY 2008 INCLUDED:

- THE DISTRICT IS NOT ACCOUNTING FOR ALL OF ITS CASH AND INVESTMENT ACTIVITY;
- THE DISTRICT IS NOT COMPLYING WITH ITS OWN INTERNAL POLICIES FOR RECONCILING CASH, INCLUDING RESOLUTION OF UNIDENTIFIED AND UNRECORDED TRANSACTIONS;
- THE DISTRICT INVESTMENT PORTFOLIO DID NOT RECONCILE TO THE ACCOUNTING SYSTEM OF RECORD (SOAR);
- APPROXIMATELY \$8 MILLION IN UNCLAIMED PROPERTY IN SOAR COULD NOT BE SUPPORTED;
- THE DISTRICT COULD NOT PROVIDE DETAILS TO SUPPORT OR VALUE APPROXIMATELY \$126 MILLION IN GUARANTEED INVESTMENTS CONTRACTS; AND
- THERE WERE NUMEROUS IRREGULARITIES WITH CASH BANK ACCOUNTS, INVESTMENT BANK ACCOUNTS, AND OTHER ACCOUNT IRREGULARITIES.

ONCE AGAIN, MANAGEMENT OF THE DISTRICT'S MEDICAID PROGRAM WAS CITED AS A MATERIAL WEAKNESS. BDO NOTED THAT IN THE FY 2008 REPORT ON THE ACTIVITIES OF THE OFFICE OF THE INSPECTOR GENERAL (OIG), OUR OFFICE IDENTIFIED THE MEDICAID PROGRAM AS ONE OF SIX HIGH RISKS AREAS. BDO ALSO SUMMARIZED THE RESULTS OF TWO OIG MEDICAID-RELATED REPORTS TO SUPPORT THE HIGH RISK DESIGNATION AS WELL AS THE FOLLOWING YELLOW BOOK DEFICIENCIES:

- SIGNIFICANT DELAYS IN OBTAINING AUDITED COST REPORTS THAT RESULTED IN USE OF LOCAL RATHER THAN FEDERAL DOLLARS TO FUND MEDICAID EXPENDITURES;
- THE NEED FOR CFSA AND DCPS TO IMPROVE MEDICAID CLAIMS DOCUMENTATION TO AVOID POTENTIAL DISALLOWANCES AND WRITEOFFS;
- THE NEED TO IMPROVE DOCUMENTATION TO ESTABLISH MEDICAID ELIGIBILITY; AND
- FAILURE TO ACHIEVE CONTROL OBJECTIVES FOR THE MEDICAID MANAGEMENT INFORMATION SYSTEM JEOPARDIZED THE ACCURACY AND COMPLETENESS OF PROVIDER CLAIMS PROCESSED.

IN ADDITION TO THE TWO MATERIAL WEAKNESSES CITED ABOVE, THE INDEPENDENT AUDITORS' YELLOW BOOK REPORT CITED COMPENSATION, THE OFFICE OF TAX AND REVENUE (OTR), DCPS, AND MANAGEMENT OF THE POSTRETIREMENT HEALTH AND LIFE INSURANCE TRUST AS SIGNIFICANT DEFICIENCIES.

OF NOTE, THE OTR AND DCPS, WHICH WERE REPORTED AS MATERIAL WEAKNESSES LAST YEAR, HAVE LESSENED RISKS AND WERE REDUCED TO SIGNIFICANT DEFICIENCIES THIS YEAR. AFTER HAVING BEEN REPORTED IN PAST YEARS AS A MATERIAL WEAKNESS, IT IS NOTEWORTHY THAT DCPS HAS

MADE SUFFICIENT PROGRESS IN MITIGATING FINANCIAL RISKS TO WARRANT A LOWER RISK CLASSIFICATION. HOWEVER, IT IS IMPERATIVE THAT DCPS OFFICIALS MAINTAIN VIGILANCE, ESPECIALLY FOR THE COMING FY 2009 CAFR YEAR, WHICH WILL INCLUDE CONVERSION OF THE CURRENT DCPS PAYROLL SYSTEM TO THE PEOPLESOFT SYSTEM. SIMILARLY, FINANCIAL RISKS WERE MITIGATED AT OTR DUE TO PROCESS IMPROVEMENTS, THE LEVEL OF INCREASED OVERSIGHT, AND MANAGEMENT'S INTENSIFIED EFFORTS IN TAX REFUNDS AND OTHER TAX PROCESSES. CONSEQUENTLY, OTR'S RISK CLASSIFICATION WAS REDUCED TO A SIGNIFICANT DEFICIENCY. WHILE SOME OF THE RISKS AT OTR HAVE BEEN ADDRESSED, WE NEED TO EMPHASIZE THAT CONTINUED EFFORTS ARE NEEDED TO MAINTAIN PROCESS IMPROVEMENTS AND ADDRESS THE OTR RISK AREAS REPORTED IN THIS YEAR'S YELLOW BOOK REPORT.

OVERARCHING MANAGEMENT ACTIONS STILL NEEDED

INTERNAL CONTROLS

MANAGEMENT/INTERNAL CONTROLS PLAY A CRUCIAL ROLE IN FRAUD PREVENTION AND DETECTION. ALTHOUGH WEAK INTERNAL CONTROLS DO NOT MEAN THAT FRAUD EXISTS, WEAK CONTROLS INCREASE THE RISK THAT FRAUD WILL OCCUR. ON THE OTHER HAND, STRONG INTERNAL CONTROLS DO NOT NECESSARILY PRECLUDE FRAUD FROM OCCURRING. IT IS FOR THESE REASONS THAT MANAGEMENT AND EMPLOYERS SHOULD ESTABLISH AND MAINTAIN AN ENVIRONMENT THROUGHOUT THE ORGANIZATION THAT SETS A PROACTIVE

AND SUPPORTIVE ATTITUDE TOWARD INTERNAL CONTROLS. PEOPLE ARE WHAT MAKE INTERNAL CONTROLS WORK.

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

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

HUMAN RESOURCES

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

- IMPROVE THE MANAGEMENT OF HUMAN RESOURCES;
- CONTINUOUSLY FOCUS ON RECRUITING, BUILDING, AND MAINTAINING, A COMPETENT STAFF;

- ENSURE THAT EMPLOYEE PERFORMANCE PLANS ARE IN PLACE, COMMUNICATED, AND TIED TO THE AGENCY MISSION AND GOALS;
- PROVIDE FREQUENT ETHICS TRAINING TO ALL EMPLOYEES;
- ENSURE THAT PERSONNEL ARE PROPERLY EVALUATED AND HELD ACCOUNTABLE; AND
- HIRE PERSONNEL WITH REQUISITE SKILLS AND ENSURE THAT THOSE SKILLS ARE MAINTAINED THROUGH CONTINUING EDUCATION.

FOLLOW-UP

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

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

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

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

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

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