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, 2008

CHARLES J. WILLOUGHBY
INSPECTOR GENERAL

OIG No. 09-1-10MA **February 4, 2009**

GOVERNMENT OF THE DISTRICT OF COLUMBIA
Office of the Inspector General

Inspector General

February 4, 2009

The Honorable Adrian M. Fenty
Mayor
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 2008, BDO Seidman, LLP submitted the enclosed final Independent Auditors' Report on Internal Control Over Financial Reporting and on Compliance and Other Matters (OIG No. 09-1-10MA).

This report details identified significant deficiencies. A significant deficiency adversely affects the District's ability to initiate, authorize, record, process, and report financial data. Two of the significant deficiencies identified in the report are considered material weaknesses: (1) Treasury Functions; and (2) Management of the Medicaid Program.

While I am pleased to report progress relative to the financial management of the D.C. Public Schools and the Office of Tax and Revenue, 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.

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 Audit, at (202) 727-2540.

Sincerely,

Charles J. Willoughby
Inspector General

Enclosure

CJW/ws

cc: See Distribution List

DISTRIBUTION:

Mr. Daniel M. Tangherlini, City Administrator and Deputy Mayor, District of Columbia (1 copy)
Mr. Neil O. Albert, Deputy Mayor for Planning and Economic Development (1 copy)
Mr. Victor Reinoso, Deputy Mayor for Education (1 copy)
The Honorable Mary M. Cheh, Chairperson, Committee on Government Operations and the Environment, Council of the District of Columbia (1 copy)
Mr. Andrew T. Richardson, III, General Counsel to the Mayor (1 copy)
Ms. Carrie Kohns, Chief of Staff, Office of the Mayor (1 copy)
Ms. Bridget Davis, Director, Office of Policy and Legislative Affairs (1 copy)
Ms. Mafara Hobson, Director, Office of Communications (1 copy)
Mr. William Singer, Chief of Budget Execution, Office of the City Administrator (1 copy)
Ms. Cynthia Brock-Smith, Secretary to the Council (13 copies)
Mr. Peter Nickles, Attorney General for the District of Columbia (1 copy)
Dr. Natwar M. Gandhi, Chief Financial Officer (4 copies)
Mr. Robert Andary, Executive Director, Office of Integrity and Oversight, Office of the Chief Financial Officer (1 copy)
Ms. Deborah K. Nichols, D.C. Auditor (1 copy)
Ms. Kelly Valentine, Director and Chief Risk Officer, Office of Risk Management (1 copy)
Mr. McCoy Williams, Managing Director, FMA, GAO (1 copy)
Ms. Jeanette M. Franzel, Director, FMA, GAO (1 copy)
The Honorable Eleanor Holmes Norton, D.C. Delegate, House of Representatives, Attention: David Grosso (1 copy)
The Honorable Henry A. Waxman, Chairman, House Committee on Oversight and Government Reform, Attention: Phil Schiliro (1 copy)
The Honorable Darrell Issa, Ranking Member, House Committee on Oversight and Government Reform (1 copy)
The Honorable Danny K. Davis, Chairman, House Subcommittee on the Federal Workforce, Postal Service, and the District of Columbia, Attention: Tania Shand (1 copy)
The Honorable Kenny Marchant, Ranking Member, House Subcommittee on the Federal Workforce, Postal Service, and the District of Columbia (1 copy)
The Honorable Joseph Lieberman, Chairman, Senate Committee on Homeland Security and Governmental Affairs, Attention: Holly Idelson (1 copy)
The Honorable Susan Collins, Ranking Member, Senate Committee on Homeland Security and Governmental Affairs (1 copy)
The Honorable Daniel K. Akaka, Chairman, Senate Subcommittee on Oversight of Government Management, the Federal Workforce, and the District of Columbia (1 copy)
The Honorable George Voinovich, Ranking Member, Senate Subcommittee on Oversight of Government Management, the Federal Workforce, and the District of Columbia (1 copy)
The Honorable David Obey, Chairman, House Committee on Appropriations, Attention: Rob Nabors (1 copy)
The Honorable Jerry Lewis, Ranking Member, House Committee on Appropriations (1 copy)

The Honorable José E. Serrano, Chairman, House Subcommittee on Financial Services and General Government, Attention: Dale Oak (1 copy)
The Honorable Ralph Regula, Ranking Member, House Subcommittee on Financial Services and General Government (1 copy)
The Honorable Robert C. Byrd, Chairman, Senate Committee on Appropriations, Attention: Terrence E. Sauvain (1 copy)
The Honorable Thad Cochran, Ranking Member, Senate Committee on Appropriations (1 copy)
The Honorable Richard Durbin, Chairman, Senate Subcommittee on Financial Services and General Government (1 copy)
The Honorable Sam Brownback, Ranking Member, Senate Subcommittee on Financial Services and General Government (1 copy)

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, 2008

Government of the District of Columbia

Contents

BDO Seidman, LLP
Accountants and Consultants

1250 Connecticut Avenue, NW, Suite 200
Washington, D.C. 20036
Telephone: (202) 261-3565
Fax: (202) 261-3563

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, 2008, which collectively comprise the District's basic financial statements, and have issued our report thereon dated January 30, 2009. 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. Treasury Functions.
II. Management of the Medicaid Program.
III. Compensation.
IV. Office of Tax and Revenue.
V. District of Columbia Public Schools.
VI. Management of the Postretirement Health and Life Insurance Trust.

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. Treasury Functions.
II. Management of the Medicaid Program.

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.
IV. Expenditures in Excess of Budgetary Authority.

We also noted additional matters which we have reported to management of the District in a separate letter dated January 30, 2009. The status of prior year instances of significant deficiencies, 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.
January 30, 2009

Appendix A

Material Weaknesses and Significant Deficiencies in Internal Controls
Over Financial Reporting

I. Treasury Functions

The District's Office of Finance and Treasury (OFT) has the responsibility for maintaining custody of all public funds belonging to or under the control of the District government. As part of that responsibility, OFT oversees the activity of the District's cash and investment accounts. OFT works with the Office of Financial Operations and Systems (OFOS) to ensure proper recording of cash and investment activity. During the audit process it was noted the District experienced issues with this responsibility. The details of these issues are discussed in the remaining section of this finding.

Cash and Investment Account Activity

The District is not accounting for all of its cash and investment activity appropriately in the District's accounting system of record (SOAR) on a timely basis. During the audit process, we noted numerous unidentified and unrecorded transactions listed as reconciling items in a vast majority of the cash and investment accounts selected for testing. These unidentified and unrecorded transactions date back to October 2007.

The District's process of accounting for reconciling items is summarized in this paragraph. Bank statements arrive approximately 10 working days after the close of each month. After all reconciling items have been identified, the corresponding District agency is contacted and reconciling transactions are forwarded to the appropriate personnel for resolution. With the exception of the month of September, the District's policy is that the cash reconciliation process span a 30-45 day period which includes resolution of these unidentified and unrecorded transactions. The District is currently not in compliance with its own internal policies.

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

Timely preparation of complete and accurate reconciliations is key to maintaining adequate control over cash receipts and disbursements. Not reconciling accounts on a periodic basis means that errors or other problems might not be recognized and resolved on a timely basis. It is generally easier and less time-consuming to reconcile accounts timely. Also, an unreconciled difference that appears immaterial can obscure significant but offsetting items.

We recommend the District enforce its policy to ensure unidentified and unrecorded transactions are not listed on the reconciliations but are properly reflected in SOAR on a timely basis to ensure the accuracy of cash and investments each month. We further recommend the District enforce its policies and that OFT take measures to enter investment activity into SOAR on a more regular basis. The District should also consider expanding its review of the cash and investment reconciliation process.

Communication between OFT and OFOS should be streamlined to allow for timely resolution of these outstanding 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. OFT and OFOS should communicate more regularly on the status of outstanding items and changes being made or recommended. A forum may be necessary for suggestions or concerns as a means for using a team-approach to resolving outstanding items.

Material Weaknesses and Significant Deficiencies in Internal Controls Over Financial Reporting

Bank Reconciliation Process (BID 121)

Bank Account ID (BID) 121 is a pooled cash account which is centrally managed by OFT and reconciled by OFOS. During our audit process over the year-end bank reconciliation, we noted the following:

1) A reconciling item entitled "Journal Entry Credit Posting Errors" in the amount of $31,877,497 was on the year-end bank reconciliation. The amount was adjusted during the audit process as follows:
    - 2 journal vouchers represented entries intended to record an accrual for payroll expense related to Medicaid, and thus should have been recorded to a liability account and not to cash. The effect of these correcting entries was to decrease cash and increase liabilities by $27,529,776.
    - 3 journal vouchers represented incorrect postings of wire transfers relating to another BID account. The total amount incorrectly recorded was $3,912,417.

2) The SOAR report provided with the reconciliation reflected a balance which was incorrect by $141,835.

3) Stopped checks in the amount of $3,008,345 had been carried forward on the reconciliation from the prior year. While stop payments had been issued by the District on these amounts, we noted that $257,827 of current year checks were honored by the bank despite their cancellation. Our understanding from the prior year was that management had implemented an electronic process to minimize the occurrence of such errors.

Management's Response:

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

BID 121 is reconciled and reviewed by management on a monthly basis. As reconciling items are identified, they are presented to the agencies to make the correcting entries. To maintain the proper segregation of duties, OFOS' reconciliation staff is not permitted to prepare journal entries for the reconciling items. These reconciling items remain on the reconciliation, from month to month, until the agency has recorded the proper entries to the account.

The SOAR Report mentioned reflects a known variance in the SOAR data from prior years. This report is adjusted for this variance in our reconciliation.

We will provide to OFT, on a monthly basis, a listing of cancelled checks that were cashed by the bank.

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

BID 121 is a controlled disbursement account on which payments are made and recorded by various District agencies. OFT is responsible for funding the presentments against this account, but is not responsible recording or reconciling the payment activity in this account. OFT will work closely with OFOS going forward to ensure that any issues that relate to OFT or for which OFT can be of assistance are properly addressed.

Material Weaknesses and Significant Deficiencies in Internal Controls Over Financial Reporting

Bank Reconciliation Process (BID 200)

BID 200 is a pooled cash account used by various agencies but centrally maintained by OFT and then reconciled by OFOS. During our audit process over the year-end bank reconciliation, we noted the following:

1) The reconciliation included erroneous journal entries as of year-end. We reviewed a sample of the entries and noted issues as follows:
    - 1 journal voucher in the amount of $76,688,960 represented a prepaid asset.
    - Another journal voucher of approximately $43,000,000 was recorded to BID 200 incorrectly and was reclassified to the appropriate cash account during the audit process.
    - 2 journal vouchers of approximately $59,000,000 represented transactions that were incorrectly recorded amongst a variety of cash accounts, which were reclassified during the audit process.
    - 9 journal vouchers totaling $308,000,000 represented transactions that were inadvertently on the reconciliation twice.
    - 1 journal voucher totaling approximately $54,000,000 was a data entry error.

2) The reconciliation included significant unrecorded bank transactions. Of this amount, $5,233,141 were outgoing wire transfers that were improperly recorded as FY 2009 transactions. The remaining amounts were primarily transfers to other cash accounts that were not properly reconciled until January 2009, during the audit process.

Management's Response:

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

> BID 200 is reconciled and reviewed by management on a monthly basis. As reconciling items are identified, they are presented to the agencies to make the correcting entries. To maintain the proper segregation of duties, OFOS' reconciliation staff is not permitted to prepare journal entries for the reconciling items. These reconciling items remain on the reconciliation, from month to month, until the agency has recorded the proper entries to the account.

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

> BID 200 represents the District's central custodial account, and is utilized for transactions initiated by various agencies throughout the government. Certified agency personnel are required to authorize and record disbursements initiated by their respective agencies prior to the movement of the funds. Movement of funds in and out of BID 200 initiated by OFT typically represents the transfer of funds from one District account to another. Appropriate schedules and statements are maintained to document all of the funds movements and balances in each account on a daily basis.
>
> It is important to stress that the finding does not reflect funds being improperly transacted. It reflects issues regarding the posting of journal entries into the accounting system. Safeguards are in place, and were in place throughout FY 2008, to ensure that fund movements are only transacted by authorized and certified officers of the District, with the requirement that multiple persons initiate, authorize, and release such transactions. All transactions were properly executed with the appropriate authorizations.

Having said that, it is important that entries be appropriately posted in the accounting system, and that is occurring on a daily basis. During a period of time in the second half of FY 2007 and the first half of FY 2008, an abnormal confluence of employee turnover and the corresponding temporary vacancies in three positions in the chain of command responsible for this activity in OFT caused a temporary disruption in the execution of the standard journal entry posting process. Management was very focused on ensuring that transactions were properly executed by personnel temporarily assigned to this activity while building a new team to manage and execute these functions. All transactions were properly executed. A new, high-quality team is now in place and functioning well.

Under its new management, the Cash & Investments Management Unit in OFT has implemented enhanced procedures for ensuring that all transactions are journalized appropriately, timely, and accurately on an on-going basis. The Office of Integrity and Oversight has reviewed these procedures and determined that they are appropriate and sound.

Moreover, OFT and OFOS have initiated enhanced coordination to ensure that all issues that involve an intersection between the two offices are appropriately handled and that the appropriate steps are taken to ensure that this finding and other findings of this nature do not recur in FY 2009.

Bank Reconciliation Process (BID 999)

The District maintains this BID for recording transfers of funds between various SOAR accounts, BID accounts, and funds. When all the transfers have been properly made and activity has been properly identified, the net balance of this account should be zero. However, during our audit, we noted exceptions including the following:

1) 4 agency bank accounts were reflected in BID 999 totaling approximately $11,000,000. These amounts were adjusted during the audit process to ensure that agency cash accounts were properly reflected in the September 30, 2008 Comprehensive Annual Financial Report (CAFR).

2) At year-end, approximately $4,800,000 of consumable inventory was included in BID 999 as a result of an incorrect journal entry. The result was that inventory was understated by this amount at year-end.

3) During the audit process, an $11,900,000 credit balance was identified as a result of an incorrect journal entry. The offsetting debit was located in BID 846.

4) No separate BID account had been established for certain Tobacco Settlement bank accounts. Over the years, bank activity relating to these accounts, such as deposits and disbursements, had been recorded to BID 999 and this activity accumulated to approximately $61,800,000. During the audit process, the District established separate BID accounts for these monies and properly reclassified the amounts out of BID 999 to the new BID accounts.

Management does not appear to have procedures in place to review BID 999 to make sure that all entries recorded are properly investigated and transferred out to the correct BIDs.

Appendix A

Material Weaknesses and Significant Deficiencies in Internal Controls
Over Financial Reporting

Management's Response:

The primary purpose of BID 999 is to:

1. Serve as a clearing account for SOAR transactions that require a balancing account when reclassifying transactions form one account to another; and

2. Serve as a Cash Account placeholder for transactions that affect cash, but do not have a BID assigned to them. When the BID is established, the transaction recorded to BID 999 is reversed and the balance is transferred to the new BID.

Occasionally, transactions posted to BID 999 as a placeholder may not clear in the current accounting period, as noted above. OFOS has implemented procedures to monitor pooled cash postings to BID 999. Our procedures identified the activity above, even though, the transactions related to these items were not posted in SOAR until January 2009.

During FY 2009, OFOS will expand it's procedures to review BID 999 transactions posting to accounts other than Pooled Cash.

Bank Reconciliation Process (Sampling of BIDs)

Following are other issues noted in our test work:

Pooled Cash Accounts

1) Although we were advised that all pooled cash bank reconciliations are reviewed and approved by a responsible employee, no indication of such a review was evident on the September 30, 2008 reconciliation for BID 216. We also noted that on the original copy of the July 31, 2008 reconciliation for BID 242, the SOAR balance utilized in the reconciliation was that of another BID account. The reconciliation had been signed off as reviewed and approved.

2) We noted that the October 31, 2007 reconciliation for BID 130 was not prepared and reviewed until early January 2008. We also noted that while the October 31, 2007 bank reconciliation for BID 268 was prepared on a timely basis, the review was not performed within the timeframe set forth by the District's policy.

3) During our review of the outstanding checklist preparation for the September 30, 2008 reconciliation for BID 130, a disbursement account, it was noted that the cash reconciliation unit relies on external reports to determine the total checks paid during the month, as the internal report generated is insufficient.

4) During our review of the July 31, 2008 reconciliations for BID 213, 242, and 268, we noted significant unresolved activity which did not correspond to activity in the Bank. The total of these items amounted to $10,180,869, resulting in an understatement of the cash balance.

Material Weaknesses and Significant Deficiencies in Internal Controls
Over Financial Reporting

5) The District incorrectly recorded a cash receipt of $2,000,000 that arose as a result of a bank error in BID 247. As such, the SOAR balance for this account was overstated.

   Further, in BID 247, it was noted that the outstanding checklist calculation was not properly performed, resulting in an additional overstatement of the account by approximately $960,000. We noted that the outstanding checklist for disbursement accounts includes stale and cancelled checks. As such, each month the cumulative stale and cancelled checks are added back to the total population of outstanding checks to determine the true balance of outstanding checks.

Agency Cash Accounts

Agency cash accounts are maintained and reconciled by various District agencies and managed by the Office of Financial Operations and Systems (OFOS). Agencies are required to perform monthly reconciliations within 30-45 days from the close of the month. The reconciliations are to be reviewed by agency management and then provided in a quarterly reporting package to OFOS. The reconciliations then undergo a second level of review at OFOS. During our audit process, we noted the following:

6) No evidence of OFOS' review of the first quarter reconciliations for BID 269 and the fourth quarter reconciliations for BIDs 713, 483, 260, and 269.

7) No evidence of the agency's review of the first quarter reconciliations for BID 713 and fourth quarter reconciliations for BID 269.

8) The SOAR balance utilized in the bank reconciliation for BID 269 did not agree to the SOAR balance for the month of November 2007. The difference related to accrued interest.

9) During our review of the reconciliations for BID 713, we noted the reconciliations were not prepared within the District's policy of 30-45 days.

10) During our review of the reconciliations for BID 483, we noted that the District prepared the bank reconciliation on an annual basis and not on a monthly basis.

11) In lieu of a bank reconciliation, management provided copies of bank statements for 3 BID accounts selected for testing.

Management's Response:

Pooled Cash Accounts:

All pooled cash accounts assigned to OFOS are reconciled and reviewed by management on a monthly basis. Management will evaluate our current reconciliation review process and ensure that the evidence of our review is complete.

As reconciling items are identified during the reconciliation process, they are presented to the agencies to make the correcting entries. To maintain the proper segregation of duties, OFOS' reconciliation staff is not permitted to prepare journal entries for the reconciling items. These reconciling items remain on the reconciliation, from month to month, until the agency has recorded the proper entries to the account.

Appendix A

Material Weaknesses and Significant Deficiencies in Internal Controls
Over Financial Reporting

Due to the requirements of the Comprehensive Annual Financial Report (CAFR) audit, the preparation of the pooled cash account reconciliations for the months of October to January can be delayed. However, any delays in preparing reconciliations during this period are usually eliminated by the end of February.

Specifically, for BID 242, when pulling together and copying the reconciliation package, the staff, inadvertently, mixed the reconciliation cover page of another BID to the requested reconciliation package.

Agency Cash Accounts:

Agency cash is reviewed during the Interim Closings as of March 31 and June 30. A third and final review of agency cash is performed at September 30. OFOS will enhance the Interim Close FY 2009 review procedures by adding the following two steps:

1. A standardized review sheet will be developed and used by OFOS in the review of the Interim and Year-end/Final Agency Cash closing packages.

2. The communications that occur between the agencies and OFOS during the review process will be documented better in FY 2009.

Schedule of Investment Portfolio

During our audit process, we requested a schedule to support the valuation of the District's portfolio of investments. The initial schedule provided did not reconcile to SOAR by more than the entire value of the District's investments. A significant amount of extra time and effort was required during the late stages of the audit process in reconciling the completeness of the schedule and in determining which bank and investment accounts were missing from the schedule. This process was made more laborious as it was unclear which District personnel and agencies were responsible for various accounts.

Divisions of responsibility should be clearly defined. Communication between agencies should be open to ensure OFT has the information necessary to allow it to perform its duties. OFT must have the information and detail in place to support its investment balances including a master investment schedule that is regularly reconciled.

Management's Response:

The first point of concern with the finding relates specifically to the request that was made by the auditors to the Associate Treasurer. The auditors specifically requested a copy of OFT's Investment Portfolio/Schedule. They did not request a schedule of the entire District's Cash and Investment Schedule. Those are two distinctly different schedules. We could have provided a comprehensive schedule that included all various cash accounts had that been part of the initial request.

The second point that management would like to make is that the variance indicated by the auditors was resolved and explained to the auditors with supporting documentation to resolve the discrepancy within two to three business days. The variance was addressed and the discrepancy was resolved, as management was able to explain and provide statements to support all of the noted variances.

Material Weaknesses and Significant Deficiencies in Internal Controls
Over Financial Reporting

Going forward, we will be prepared to provide the auditors with the type of schedule that they were apparently seeking when they asked for the Investment Schedule. It is now clear what type of schedule they were seeking, which is distinguishable from our Investment Schedule, thus producing the miscommunication and the apparent variances, which were resolved.

Bank Reconciliation Process (BID 300)

Bank Account ID (BID) 300 is the main investment account used by various agencies but centrally maintained by OFT and then reconciled by OFOS.

The initial investment reconciliation provided to us by District personnel on December 4, 2008 contained a significant volume of unrecorded transactions and erroneous journal entries within the account. We requested the District research, record, and correct these reconciling items. A substantially revised reconciliation was provided to us on January 14, 2009.

While the majority of the differences represented mispostings between investment accounts, we also noted other issues including:

1) 2 journal vouchers, for a net balance of $7,721,633, that could not be supported by activity in the bank. The net result was an overstatement of the account balance.

2) 1 journal voucher, for a net balance of $6,000,000, represented a bank transaction that had been recorded twice. The net result of this entry was an overstatement of the account balance.

3) 1 journal voucher in the amount of $14,000,000 was recorded to the incorrect general ledger account, and thus, was included as a reconciling item on the bank reconciliation. While cash and investments overall remained the same, this entry served to overstate investments and understate cash at year-end.

We also looked at the October 31, 2007 reconciliation and the July 31, 2008 reconciliation which were not prepared and reviewed on a timely basis. The District is not in compliance with its own internal policies.

Management's Response:

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

> OFOS personnel reconcile approximately 178 investment accounts on a monthly basis. This equates to over 2,100 reconciliation months performed every fiscal year. Our reconciliation procedures include, thoroughly reviewing the activity of these accounts, as recorded in SOAR by agency staff, in comparison to activity reflected on the Investment Bank statements.
>
> As reconciling items are identified, they are presented to the agencies to make the correcting entries. To maintain the proper segregation of duties, OFOS reconciliation staff is not permitted to prepare journal entries for the reconciling items. These reconciling items remain on the reconciliation, from month to month, until the agency has recorded the proper corrections to the account.

Material Weaknesses and Significant Deficiencies in Internal Controls
Over Financial Reporting

Due to the requirements of the Comprehensive Annual Financial Report (CAFR) audit, the preparation of the pooled cash account reconciliations for the months of October to January can be delayed. However, any delays in preparing reconciliations during this period are usually eliminated by the end of February.

During the FY 2008 year-end closing process, as journal entries continued to be made in SOAR, we continued to update our reconciliations. As a result, the reconciliations provided to the auditors on several occasions, reflected the updated status of BID 300 as of that point in time.

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

It is important to stress that the finding does not reflect funds being improperly transacted. It reflects issues regarding the posting of journal entries into the accounting system. Safeguards are in place, and were in place throughout FY 2008, to ensure that fund movements are only transacted by authorized and certified officers of the District, with the requirement that multiple persons initiate, authorize, and release such transactions. All transactions were properly executed with the appropriate authorizations.

Having said that, it is important that entries be appropriately posted in the accounting system and that is occurring on a daily basis. During a period of time in the second half of FY 2007 and the first half of FY 2008, an abnormal confluence of employee turnover and the corresponding temporary vacancies in the three positions in the chain of command responsible for this activity in OFT caused a temporary disruption in the execution of the standard journal entry posting process. Management was very focused on ensuring that transactions were properly executed by personnel temporarily assigned to this activity while building a new team to manage and execute these functions. All transactions were properly executed. A new, quality team is now in place and functioning well.

Under its new management, the Cash & Investments Management Unit in OFT has implemented enhanced processes for ensuring that all transactions are journalized appropriately, timely, and accurately on an on-going basis. The Office of Integrity and Oversight has reviewed these processes and determined that they are appropriate and sound.

Moreover, OFT and OFOS have initiated enhanced coordination to ensure that all issues that involve an intersection between the two units are appropriately handled, and that the appropriate steps are taken to ensure that this finding and other findings of this nature do not recur in FY 2009.

<u>Investment Reconciliation Process (Sampling of BIDs)</u>

Following are other issues noted in our test work:

1) The October 31, 2007 reconciliations for BID account 814, 304, 371, 695, and 386 were not prepared and reviewed on a timely basis.

Material Weaknesses and Significant Deficiencies in Internal Controls
Over Financial Reporting

2) Significant reconciling items (i.e. unrecorded transactions) were carried forward from month-to-month in several investment accounts. Of the 25 investment account reconciliations reviewed, 17 had significant unrecorded bank transactions.

3) Significant reconciling items of erroneous journal entries were carried forward from month to month in several investment accounts. Of the 25 investment account reconciliations reviewed, 14 had significant unresolved erroneous journal entries.

4) For BID 246, we noted a sweep account of approximately $3,700,000 that had not been reflected on the District's books.

5) We noted an erroneous balance of approximately $12,000,000 that had been carried in Miscellaneous Agency Funds without any money in the bank(s). This resulted in an overstatement of the account balance as of September 30, 2008.

6) We noted approximately $700,000 that had been posted to BID 625 that should have been recorded as a transaction to BID 802.

7) During our review of BID 223, we noted unrecorded bank service charges of $679,418.

Management's Response:

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

OFOS personnel reconcile approximately 178 investment accounts on a monthly basis. This equates to over 2,100 reconciliation months performed every fiscal year. Our reconciliation procedures include, thoroughly reviewing the activity of these accounts, as recorded in SOAR by agency staff, in comparison to activity reflected on the Investment Bank statements. As reconciling items are identified, they are presented to the agencies to make the correcting entries. To maintain the proper segregation of duties, OFOS reconciliation staff is not permitted to prepare journal entries for the reconciling items. These reconciling items remain on the reconciliation, from month to month, until the agency has recorded the proper corrections to the account.

Due to the requirements of the Comprehensive Annual Financial Report (CAFR) audit, the preparation of the pooled cash account reconciliations for the months of October to January can be delayed. However, any delays in preparing reconciliations during this period are usually eliminated by the end of February.

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

It is important to stress that the finding does not reflect funds being improperly transacted. It reflects issues regarding the posting of journal entries into the accounting system. Safeguards are in place, and were in place throughout FY 2008, to ensure that fund movements are only transacted by authorized and certified officers of the District, with the requirement that multiple persons initiate, authorize, and release such transactions. All transactions were properly executed with the appropriate authorizations.

Material Weaknesses and Significant Deficiencies in Internal Controls
Over Financial Reporting

Having said that, it is important that entries be appropriately posted in the accounting system and that is occurring on a daily basis. During a period of time in the second half of FY 2007 and the first half of FY 2008, an abnormal confluence of employee turnover and the corresponding temporary vacancies in the three positions in the chain of command responsible for this activity in OFT caused a temporary disruption in the execution of the standard journal entry posting process.

Management was very focused on ensuring that transactions were properly executed by personnel temporarily assigned to this activity while building a new team to manage and execute these functions. All transactions were properly executed. A new, quality team is now in place and functioning well.

Under its new management, the Cash & Investments Management Unit in OFT has implemented enhanced processes for ensuring that all transactions are journalized appropriately, timely, and accurately on an on-going basis. The Office of Integrity and Oversight has reviewed these processes and determined that they are appropriate and sound.

Moreover, OFT and OFOS have initiated enhanced coordination to ensure that all issues that involve an intersection between the two units are appropriately handled, and that the appropriate steps are taken to ensure that this finding and other findings of this nature do not recur in FY 2009.

Unclaimed Properties

During the audit, we were provided with a schedule of unclaimed properties as of September 30, 2008.

1) In reviewing the detail of the schedule, we noted the balances did not accurately reflect investments on hand at year-end as various balances were based on bank statements from months throughout the fiscal year but had not been updated at year-end.

2) As a part of our confirmation procedures of unclaimed properties, we noted 1 instance where the District had improperly recorded the receipt of funds, due to a bank error, in the amount of $566,836. The bank corrected the error in the following month and escheated the funds; however, the District had not corrected its records. As such, the funds were improperly included on the unclaimed properties schedule at year-end.

3) We noted approximately $8,000,000 that was reflected in SOAR for which no support could be provided. During the audit process, it was determined that it was an overstatement of investments and current year investment income that has since been adjusted.

4) During management's research of the unclaimed properties issues noted above, $13,500,000 of overstated liabilities and understated investment income was identified.

Material Weaknesses and Significant Deficiencies in Internal Controls
Over Financial Reporting

Management's Response:

We agree that the schedule was not sufficient, and we are currently working to resolve issues related to the delay in some of the unclaimed property entities providing us with updated statements within a defined time frame as needed to keep the schedule updated. The Unclaimed Property Unit has contacted and submitted requests to get updated statements from all the counterparties noted on the existing schedule.

In reference to the second issue noted in the finding, this circumstance resulted from a bank posting error, and represents less than 1% of the Unclaimed Property balance. We have since corrected the schedule and will ensure that it is correct on an on-going basis.

In reference to issues three and four, these issues resulted from a transition in the manner in which unclaimed property funds are reflected in SOAR accounts. These issues did not involve having any funds at risk, but did involve the need to clarify and clean up the manner in which they were reflected and adjusted in SOAR. These issues have been clarified in the FY 2008 audit process, and therefore are resolved.

<u>Accounting for Guaranteed Investment Contracts</u>

We noted that the District maintains approximately $126,000,000 in Guaranteed Investment Contracts (GIC). The District is required to comply with a number of specified requirements if it invests in GIC instruments. During our audit process, we noted that the District was not in compliance with the stated requirements as follows:

1) Management is responsible for making value measurements and disclosures. From the information initially provided by the District, we were unable to readily determine whether the balance recorded represented the contract value or fair market value of the GICs.

2) The District was unable to provide the details of the underlying investments within the GICs.

3) Management did not appear to have sufficient information on hand to evaluate and independently challenge the valuation methodologies utilized by the investment manager(s).

Additional research and investigation was required during the audit process to address these issues.

As part of fulfilling its responsibility, management needs have a sufficient understanding in order to be able to establish an accounting and financial reporting process for determining value measurements and disclosures; to select appropriate valuation methods; and to identify and adequately support any significant assumptions used by the fund manager(s) in valuing the underlying investments included in the GICs.

Development and implementation of such procedures will help to ensure the District's investments are accurately recorded and presented.

Management's Response:

As indicated by their name, Guaranteed Investment Contracts (GICs) represent an investment contract guaranteeing a fixed principal investment amount and a fixed interest rate for the life of such contract.

Material Weaknesses and Significant Deficiencies in Internal Controls
Over Financial Reporting

The existence of a guaranteed contract at a stated investment value documented by agreement and by a third-party custodian means that the value of the investment is fixed and is supported by the full credit of the GIC provider. Both of the GICs that comprise the amount stated above are guaranteed by AAA-rated entities, meaning that they are in the highest possible credit quality category. The value of the GICs is fixed, per the contractual obligation of the companies, and is not subject to change based on market conditions.

The District's investments are supported by the fixed values in the contracts and the provisions that allow for the District to terminate the contract at full value if the credit rating of the provider falls below the AA-level. This provides protection for the District's investment at the full value of the contract.

Management provided copies of the guaranteed contracts, verification of the AAA credit ratings, the most recent audited financial statements of the GIC providers, documentation of the guarantees supporting the contracts, and statements documenting and verifying the value of the investment contracts as of 9/30/08. Moreover, in discussions with the GIC providers, who also provide GICs for many other clients, the GIC providers indicated that the common industry practice is for clients and auditors to value the GICs at the stated value of the guaranteed investment contracts.

Given the backing and guarantee of an AAA entity and verification of the balance of the investment contract, these providers indicated that they had not experienced other clients or auditors seeking to assign a different value to these investments than the stated, guaranteed contract value.

Wire Transfers

The District's banking systems require separate individuals to input and release/approve wire transfers. Once the wire transfer information has been entered into the appropriate banking system, the original wire transfer request and transaction report are provided to the Cash and Investment Manager for review and release/approval. This review is documented on each wire transfer request and the End of Day Wire Transfer report.

During our procedures, we noted that for 25 out of 45 wire transfers which had been selected for testing, there was no evidence that the End of Day Wire Transfer report had been reviewed and approved.

Management has represented and it was apparent during our procedures that the recent reduction and turnover of staff is putting a strain on the current staff to complete their responsibilities. However, the District should consider a methodical identification and documentation of its significant operational and accounting processes at OFT and identify back-up positions, so that the necessary reviews and existing internal controls are not comprised.

Management's Response:

The original wire transfer request and transaction report are provided to the Cash and Investment Manager for review and release/approval. Therefore, appropriate approvals are required prior to the release of the wires, which is documented. A signature on the End of Day report was previously not a requirement, but was added as an additional control in the 3rd quarter of the audited fiscal year under the new manager of Treasury's Cash Management unit.

Appendix A

Material Weaknesses and Significant Deficiencies in Internal Controls Over Financial Reporting

Maintenance of the Accounts Database

The District utilizes Bank Account ID numbers to track the activity of each bank account within its accounting system of record (SOAR). With a few exceptions, typically a District bank account is assigned to a Bank Account ID (BID). It is the responsibility of OFT to maintain an accurate inventory of the District's bank accounts.

Management should recognize that retaining unnecessary accounts in the general ledger and chart of accounts, especially accounts that are similar to others, can lead to confusion and inaccuracy in posting transactions or creating journal entries. Also, undue time must be spent reconciling these small accounts. We recommend that the general ledger and chart of accounts be periodically reviewed and that unused or unnecessary accounts be eliminated.

We also recommend that management periodically review the functions of all bank accounts to determine whether they are necessary. Only the minimum number of bank accounts consistent with operating requirements should be established.

Numerous bank accounts result in complexity and inefficient administration. Time needed to record accounting transactions could be reduced if the District considered eliminating or combining bank accounts when possible. This can also result in improved internal controls and simplification of reconciliation procedures.

Cash Bank Accounts

During our audit procedures, we noted numerous inaccuracies, as follows, in the information maintained by OFT regarding each bank account:

1) Incorrect account numbers.

2) Correct account number but incorrect bank.

3) Incomplete and inaccurate list of authorized account signers.

4) Incorrect Bank Account ID (BID) number assigned to the account.

5) No Bank Account ID (BID) number assigned to the account.

6) Accounts that had been closed for several years were reflected as active. Likewise, for 1 Bank ID which had been selected for testing, we noted that a bank account that was still open at the financial institution had been reflected as closed within the District's SOAR system.

7) Accounts that were not registered under the District's Tax ID number.

8) Employees no longer with OFT still had signatory authority to the respective bank accounts for 2 BIDs.

Appendix A

Material Weaknesses and Significant Deficiencies in Internal Controls
Over Financial Reporting

Investment Bank Accounts

During our testing of the bank account database, we noted the following:

9) The database does not clearly distinguish investment accounts (which represent investments within a custodial account) from bank accounts (which are depository, disbursement, and custodial accounts).

10) In numerous instances, investments had since been sold, resulting in needless maintenance and tracking of accounts with zero balances.

11) In other instances, new investments purchased had not been established as investment accounts and reflected in the database.

12) Employees no longer with OFT still had signatory authority to the respective bank accounts for 2 BIDs.

Management's Response:

Cash Bank Accounts:

Management concurs with the finding that various items in the bank account database need to be cleaned up in order to make this database listing perfect, as it should be. This is a dynamic and not static endeavor, as there is are on-going changes and adjustments needed to such a database, and we are committed to making sure this happens on an on-going basis. For the vast majority of the database listings, representing the District's primary accounts, all of the information in the database is as it should be. There was some clean-up work needed regarding some of the smaller, more ancillary items in the listing.

To specifically address the issues listed above:

Incorrect account numbers. Three account numbers in the extensive listing were incorrect due to apparent keypunch errors.

Correct account number but incorrect bank. This resulted from the acquisition of one bank by another, and the name of the bank had not been changed in the listing to accommodate the acquisition.

Incomplete and inaccurate list of authorized account signers. The vast majority of these listings were accurate, but there was a need to update some of them. In recent years, the District has communicated changes in authorized signers to the banks electronically, and gotten confirmation of the bank's acceptance of the changes electronically as well, in order to expedite the process. In some cases, the hard copies of the signature cards were not correspondingly updated for the file. Going forward, we will ensure both electronic and hard copy listings are completely up to date.

Incorrect Bank Account ID (BID) number assigned to the account. We are not aware of this circumstance.

Material Weaknesses and Significant Deficiencies in Internal Controls
Over Financial Reporting

No Bank Account ID number assigned to the account. This finding relates to accounts associated with an economic development project with a developer that have been determined to not be District accounts. The District does a periodic bank account survey with all banks to determine the existence of any accounts under the District's name or tax ID number that had not been previously identified, and with the results of such survey, the District takes appropriate action regarding those accounts.

Accounts that had been closed for several years were reflected as active. The few accounts associated with this finding were updated in the database to reflect their current status. Further, management adheres to the policies and procedures associated with this finding and seeks to ensure that all agencies comply. Management will continue to be proactive to seek to ensure that there are no recurrences of the instance indicated in the finding with respect to an account open at the financial institution but reflected as closed within the District's SOAR system.

Accounts that were not registered under the District's Tax ID number. A couple of ancillary quasi-independent agency accounts were established with a separate tax ID number. When such a circumstance occurs, the matter is reviewed and action is taken to convert such accounts as appropriate.

Employees no longer with OFT still had signatory authority. Given the increase in electronic communication as an immediate and efficient communication tool, signatory changes were communicated to and accepted by the respective financial institutions via email. As such, the departed employees did not have access to the respective bank accounts, even though in the indicated cases, the hard copy of the signature cards did not reflect the change. Going forward, a copy of the updated signature card will be placed in both the respective bank account folder and the employee's folder.

Investment Bank Accounts:

We take these matters seriously and are committed to addressing the deficiencies that were noted and making the database perfect. The primary purpose of the bank account database is to track bank accounts and bank IDs, and that purpose is being accomplished by the database. Investment accounts are tracked, monitored, and documented separately by the Cash & Investment Management Unit, and daily movements of investment funds are managed, documented, and updated by this unit. Management agrees with the recommendation that the inclusion of investment accounts and bank accounts in the same database is not ideal, and that separating them in the database would be better and clearer, and this will be done in FY 2009. As previously mentioned, the investments are already tracked and documented separately.

<u>Elimination of Unnecessary Accounts</u>

We noted that for some accounts, the SOAR balance is made up of outstanding and stale checks and other amounts which should be removed and cleared out. The balance of these accounts amounted to approximately $5,408,000 as of September 30, 2008. While deemed insignificant to the overall operations of the District, this has the effect of understating cash and investments.

For other accounts, we noted that the SOAR balance is made up of current year activity that has been posted to these accounts as a result of erroneous posting journal entries or as a result of inadequate communication to the agencies that the account status is closed.

Management's Response:

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

> The District has a scheduled quarterly process that reviews the BID listing for closed accounts with balances in SOAR. Action has been taken to clear up balances on closed accounts. In FY 2009, the District will continue to use this process to clear up any such balances from the general ledger.
>
> Cash accounts in SOAR are flagged with either with an A (Active) status or an I (Inactive) status. The District has been successful in minimizing any keying errors by ensuring that these flags are properly set. The District will continue to be diligent in its use of this system control.

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

> OFT and OFOS have initiated enhanced coordination to ensure that all issues that involve an intersection between the two offices are appropriately handled and that the appropriate steps are taken to ensure that this finding and other findings of this nature do not recur in FY 2009. Specifically, with regard to this finding, we will ensure that there is complete agreement on every item regarding the maintenance of respective account listings between OFT and OFOS.

<u>Communication of Account Information</u>

During our procedures in reviewing where each bank account in the database is reflected in SOAR, we noted the following:

1) The confirmed bank balances did not agree with the bank balances listed in the schedule of pooled cash, investments, and agency cash as provided by the Office of Financial Operations and Systems (OFOS). Upon further investigation, it was noted that in most instances, the correct bank balance had been utilized by OFOS in preparing the bank reconciliations, but had not been properly input into the schedule provided.

2) Several District accounts were identified for which neither OFOS nor OFT could account for. While deemed insignificant to the District, we also noted bank accounts for which the District was unable to identify whether they had been presented in the CAFR.

3) For a few accounts, OFT and OFOS could not agree on which bank accounts were associated with which SOAR accounts. After significant research, most instances were identified as inaccuracies in the bank account database; however, in one instance, it was noted that a non-District bank account had been utilized in the reconciliation process.

Material Weaknesses and Significant Deficiencies in Internal Controls
Over Financial Reporting

Management's Response:

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

> OFOS shall improve the communication of bank ending balances between OFOS and the agencies. OFOS will use a bank to book variance report to track the variances. A key element of the report is the fiscal month end balances as reported on bank statements. OFOS will be soliciting this information monthly from the agencies during FY 2009.
>
> In all cases, the errors were corrected by OFOS when pointed out during the audit process. OFOS is not aware of the accounts mentioned in issue #2. Issue #3 pertains to the Storm Water Permit Compliance Fund bank account accounted for in agency KG0, fund 654 and BID 269. There are two bank accounts accounted for in KGO 0071 (agency controlled cash). One account is administered by the District Department of Environment and the other is administered by the Water and Sewer Authority (WASA). Although the WASA administered account is in its name, the funds in both accounts belong, to the District and are properly accounted for in agency KG0, fund 0654 and BID 269.

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

> OFT and OFOS have initiated enhanced coordination to ensure that all issues that involve an intersection between the two offices are appropriately handled and that the appropriate steps are taken to ensure that this finding and other findings of this nature do not recur in FY 2009. Specifically, with regard to this finding, we will ensure that there is complete agreement on every item regarding the maintenance of respective account listings between OFT and OFOS.

<u>Activity Recorded to Closed Accounts</u>

We noted journal entries that had been posted to BID accounts where the related bank accounts had been closed in previous years. Since these accounts had been closed, current year activity recorded in these BIDs represented activity intended for other accounts, thus resulting in the opportunity for incomplete and inaccurate bank reconciliations.

Current procedures do not require research and resolution of all SOAR balances for closed bank accounts. This activity was reallocated to the proper BID accounts for accurate presentation on the September 30, 2008 CAFR.

Management's Response:

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

> We will expand our monthly review to include balances reflected in closed accounts.

Appendix A

Material Weaknesses and Significant Deficiencies in Internal Controls
Over Financial Reporting

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

> We recognize that there was activity in SOAR for some bank accounts that were closed. This activity represented efforts to clear and clean up any outstanding reconciling items in these accounts in SOAR in order for the account balance to be stated appropriately in SOAR. Given that the actual bank account was closed, there was no possibility to actually move cash, so this activity was accounting clean-up activity.

* * * * *

Appendix A

Material Weaknesses and Significant Deficiencies in Internal Controls
Over Financial Reporting

II. Management of the Medicaid Program

Medicaid Program is Classified as an Area of Risk

In its FY 2008 *Report on the Activities of the Office of the Inspector General* (OIG) dated December 1, 2008, the OIG identified the Medicaid Program as one of the 6 areas of risk for the District of Columbia. The Medicaid Program had also been identified as a risk area in the previous years' OIG reports. The current assessment says that the impact of potential losses to the District is significant. The 2009 plan is to continue OIG's vigorous oversight of the Medicaid Program, focusing on areas such as third party liability, nursing home reimbursements, Medicaid recordkeeping and documentation, Medicaid funded durable medical equipment, and other related issues. Following are the summarized results of two recent audits performed by the OIG:

Audit #1- Audit of the Department of Mental Health (DMH)'s Program Management and Administration of Provider Reimbursements issued on December 11, 2007.

OIG's audit found that a process for reworking and resubmitting denied Medicaid claims 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 $16.1 million in unauthorized DMH commitments in FY 2005 and again in FY 2007. The FY 2006 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 provider 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. However, during FY 2006, 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 has 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. OIG noted that for FY 2006, two MHRS providers received as little as $4,000, while another five received less than $100,000 each.

Management's Response:

Issue #1: Prior to September 2006, DMH did not have an adequate process in place to actively reprocess Medicaid claims from prior years that the Department of Health Care Finance (DHCF) (formerly the Medical Assistance Administration) had denied and that a sizable "Accounts Receivables" (A/R) had accumulated. Since that time, DMH took several actions to manage this process including:

- Contracting with an outside vendor to identify, quantify, prioritize, correct and resubmit claims denied for Medicaid eligible services provided;
- Contracting with an outside vendor 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,
- Contracting with a consultant dedicated solely to managing the MHRS program, including working with DMH staff to develop management reports.

These steps yielded a significant return on the A/R effort and resulted in better management of the MHRS program. Due to the success of these efforts, DMH closed out its outstanding receivables balances for FY 2005 and FY 2006 and $11,600,000 million was collected. DMH continues to correct and resubmit claims to close out the FY 2007 accounts receivable.

In addition, DMH has enhanced its reporting capacity so that the agency has a series of management reports that track payments for services from both Medicaid and local funds. The edits in the claims payment system are also closely aligned with those in the ACS system, and the DMH claims system has been enhanced to accept and report on the HIPAA compliant 835 remittance advices generated from the ACS system so that denied claims can be reworked.

Issue #2: DMH has initiated the following corrective actions:

- The service authorization process that was discontinued in 2003 was reinstituted in November 2005.

Material Weaknesses and Significant Deficiencies in Internal Controls
Over Financial Reporting

- A permanent Director of Contracts and Procurement was hired in January 2007 that is certified as a Public Procurement Officer (CPPO) and Public Purchasing Buyer (CPPB).
- DMH engaged an independent consultant to perform a complete assessment of the DMH contracts office and to assist in the preparation of policies and procedures.
- Required all Contract Officer Technical Representatives (COTRs) who had not been trained to attend training. As of this time, 95% of staff overseeing contracts have been trained and are now properly appointed as COTRs.
- Implementation of Purchasing Cards for agency small purchases.
- Worked with the District's Office of Contracts and Procurement to close out all ratifications; this process was completed in November 2008.

Issue #3: The transition of the claims payment function to DHCF for Medicaid eligible services became effective for services delivered November 1, 2007 forward. This process has moved the responsibility of managing claims denials and resubmissions appropriately to the MHRS providers. The Memorandum of Understanding with DHCF was amended to reflect the process accordingly. With respect to periodic audits of providers, DMH has initiated the following corrective actions:

- DMH hired a Deputy Director for Accountability in December 2006.
- In the spring of 2007, the Office of Accountability (OA) re-started the claims audit process by adopting a new, statistically valid methodology and a more precise audit tool. Both the statistical methodology and the audit tool reflect Medicaid's clinical documentation and medical necessity requirements for reimbursement.
- DMH is working in conjunction with DHCF to initiate audit recoupment where warranted. Provider audits are currently being performed on claims relating to the 2nd quarter of FY 2008.

Issue #4: While the OIG report recommended that DMH reduce the number of providers, it is the prerogative of the agency to assess the services delivered and whether the number of providers is appropriate. It should also be noted that while a provider can be MHRS certified, the DMH Office of Programs and Policy makes the final decision on what providers are funded under the program. DMH is currently working on the details of a major restructuring of the service delivery system which will include closing the majority of services at the publicly operated DCCSA and move those consumers to the care of the private providers. Therefore, it is important that adequate capacity be available in the system in order accommodate this transition.

<u>Audit #2 - Audit of Non-Emergency Transportation Provider Compliance with License and Certification Requirements issued on February 22, 2008.</u>

DOH Medical Assistance Administration, Office of Program Operations (MAA-OPO) officials did not effectively manage the Non-Emergency Transportation (NET) Program. Specifically, officials did not adequately determine whether all Providers: (1) were authorized to provide motor vehicle carrier services; (2) complied with federal safety regulations; (3) hired reputable, responsible drivers before receiving approval to participate in the NET Program; and (4) clearly marked vehicles with identifying information. As a result, the safety and well-being of NET Program participants was jeopardized, which increases the District's liability.

Material Weaknesses and Significant Deficiencies in Internal Controls Over Financial Reporting

Specifically, the OIG audit uncovered the following deficiencies in the NET Program:

- Improper payments – The District paid $112,000 to 5 of 21 providers (24 percent) that were unauthorized motor vehicle carriers.
- Federal Safety Regulations – It was determined that 5 of 50 providers (10 percent) did not comply with federal safety regulations to perform annual safety inspections.
- Criminal History Checks - Of 50 providers reviewed for compliance with criminal history checks, 29 (58 percent) did not perform criminal history checks on 60 of 91 drivers (66 percent).
- Drug Tests – The review showed that 28 of 50 providers (56 percent) did not perform drug testing for 55 of 91 drivers (60 percent).
- Driver Record Check - Of the 50 providers reviewed for driver record checks, 43 providers (86 percent) did not check drivers' records for 78 of 91 drivers (86 percent), and 18 providers (36 percent) could not provide copies of employees' driver licenses. Also, a review of drivers' records revealed that 5 drivers were operating with license restrictions. 4 of the 5 drivers were restricted from operating vehicles for compensation and were required to be accompanied by an authorized driver. In addition, it was found that none of the 91 drivers had the required commercial driver's licenses.
- CPR Certification – 22 of the 50 providers (44 percent) did not ensure that 42 of 91 drivers (46 percent) obtained the CPR certifications required by the Medicaid Provider Agreement.
- First Aid Certification - Of the 50 providers reviewed for first aid certification, 35 (70 percent) did not ensure that 62 of 91 drivers (68 percent) obtained the first aid certifications required by the Medicaid Provider Agreement.
- Vehicle Markings – It was observed that 10 of 70 vans (14 percent) that did not include each provider's legal name and Certificate of Authority number.

Management's Response:

On July 19, 2007, the Department of Health Care Finance (DHCF) (formerly the Medical Assistance Administration) contracted with a non-emergency transportation (NET) broker (the Broker). The following issues raised by the OIG have been remedied in FY 2008 when the new NET Broker system began transporting recipients on October 19, 2007.

Issue #1: Officials did not adequately determine whether all providers were authorized to provide motor vehicle carrier services.

Since October 2008, every provider vehicle registered with the Broker must pass this inspection and any deficiencies identified upon initial inspection must be corrected before formal acceptance in the transportation network. In addition, all drivers are required to provide proof of a valid commercial driver's license and a copy is placed in the provider's file. The requirement to have a valid commercial driver's license is needed prior to enrollment with the Broker's network. If a transportation provider changes or adds drivers to their company, those drivers are required to have a federal background check and have their license information validated by the Broker before being allowed to operate a vehicle for Medicaid recipients. This information is verified annually.

Appendix A

Material Weaknesses and Significant Deficiencies in Internal Controls Over Financial Reporting

Issue #2: Officials did not adequately determine whether all providers complied with federal safety regulations.

Since October 2008, all providers are subject to an annual inspection to ensure compliance. Since the release of the OIG report, the NET Broker has begun performing inspections bi-annually. In addition, the NET Broker has increased compliance with the American with Disabilities Act by training a staff member to become a certified ADA inspector in June 2008. This provides an additional level of expertise with regards to vehicle inspections and further protects the well being of the Medicaid recipients that utilize NET services.

Issue #3: Officials did not adequately determine whether all providers hired reputable, responsible drivers before receiving approval to participate in the NET Program.

In response to the OIG Report recommendations, the NET Broker system has increased requirements related to provider and driver enrollment. For example:

- Upon initial enrollment into the NET provider network, a complete review of all drivers and vehicles is conducted by the Broker.
- All drivers registered with the Broker's network are required to undergo a FBI background check prior to formal acceptance into the program. A copy of the background check is placed in the provider's file.
- All drivers are subject to an initial drug screening before they are granted permission to transport Medicaid clients. In addition, the Broker conducts quarterly-random drug screenings in order to ensure compliance. If a driver tests positive, he/she is immediately removed from the MTM provider network.
- Any complaints logged against drivers for reasons of bad conduct are documented. Such complaints are discussed with the driver and the driver is required to submit an incident report describing his/her recollection of the incident. If it is determined that the driver acted inappropriately, the driver is placed on corrective action or disciplinary citation. Both the incident and the corrective action plan are maintained in the provider file.
- The Broker conducts a monthly desk audit of 10% of all files to ensure accuracy and completeness. Reports of the outcome of these desk audits are kept and are available to the COTR upon request. In addition, the Broker program will be audited at the end of every contract year.
- The Broker coordinates with WMATC when the operating status of a Provider is suspended, revoked, or terminated. Upon any change in status, WMATC notifies the Broker via email that a certification has expired. The Broker places the provider on suspension and transfers any scheduled trips to other transportation providers. Upon verification that certification is again in good standing, the Broker removes the provider from a suspended status.
- The Broker conducts regular training with drivers to review policies, proper conduct, and ensure current certifications. The Broker's Education, Training, and Outreach (ETO) Manager convenes mandatory training for the drivers and provider staff within the provider network. The mandatory courses include: First Aid, CPR, Defensive Driving, and Wheelchair Safety and Securement.

- Additional training is conducted on the Department of Disability Services (DDS), Developmental Disabilities Administration (DDA) core policies. The core policies include: psychotropic medications, positive behavioral support plan (BSP), individual support plan (ISP), adaptive equipment, basic assurances, most integrated community settings, human rights, and incident management.

Issue #4: Officials did not adequately determine whether all providers clearly marked vehicles with identifying information.

As part of the provider enrollment process, a review of potential transportation providers includes the verification and validation of WMATC certification. A provider must show proof of WMATC certification prior to formal enrollment with the Broker and evidence of certification is placed within the provider's file. Prior to the issuance of the OIG report, the need for a WMATC decal on the vehicle was not part of the Broker's checklist. As a result of the report, the Broker has updated its checklist to include this as a requirement. A copy of this checklist is placed in the provider's file.

Lastly, with the use of the Broker, DHCF can now capture accurate and reliable data surrounding the NET program. Having this data at our disposal allows DHCF to make better decisions and produce more targeted approaches to improving the NET program. DHCF has worked diligently to improve the non-emergency transportation program and continues to do so. The implementation of the Broker is an enormous step towards ensuring the quality and integrity of the NET program. However, DHCF understands that migrating towards the Broker model is not the sole solution but a good first step. DHCF will continue to work with the Broker, consumer advocates, and sister agencies to identify and develop ways to better serve our clients while maintaining a fiscally sound NET program.

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.

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.

Appendix A

Material Weaknesses and Significant Deficiencies in Internal Controls Over Financial Reporting

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

Agency	Cost Report Audit Completed	Cost Report Available for Audit	Status of Cost Report Audit
1. DCPS	Up to FY 2006	None noted	No available cost report for audit.
2. CFSA	Up to FY 2005	FY 2006	Audit has not yet started.
3. DMH	Up to FY 2006	None noted	No available cost report for audit.

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:

The following response was provided by the District of Columbia Public Schools (DCPS):

> Field work for audits of FY 2003-2006 has been completed and notices of program reimbursement were issued January 9, 2009. By September 30, 2009 cost audit reports for FY 2007 will be complete and cost audit reports for FY 2008 will be in process.

The following response was provided by the Child and Family Services Agency (CFSA):

> Field work for audits of FY 2004 and 2005 has been completed and notices of program reimbursement were issued January 5, 2009. By September 30, 2009 cost audit reports for FY 2006 and FY 2007 will be complete and cost audit reports for FY 2008 will be in process.

The following response was provided by the Department of Mental Health (DMH):

> Field work for FY 2005 and 2006 was completed in FY 2008 and final notices of program reimbursement were issued November 19, 2008. Cost audit reports for FY 2007 and FY 2008 will be completed by September 30, 2009. As a September 30th year-end provider, St. Elizabeth's' FY 2008 cost report is due Feb. 27, 2009.

Potential Claims Disallowance and Accounts Receivable Write-offs

In connection with the cost report audits mentioned previously, the audited cost reports pertaining to Child and Family Services Agency (CFSA) for FY 2004 and FY 2005 and pertaining to the District of Columbia Public Schools (DCPS) from FY 2003 to FY 2006 reported that both CFSA and DCPS owe back to the Federal government in the amount of $37,672,880 and $24,529,979, respectively for potential Medicaid claims disallowances. These potential disallowances were recorded as accrued liabilities at year-end.

Material Weaknesses and Significant Deficiencies in Internal Controls
Over Financial Reporting

We noted that CFSA and DCPS had been very aggressive in claiming Medicaid reimbursements from FY 2003 to 2006. Based on the audited cost reports, the potential disallowances were mainly due to claim expenditures that were not adequately supported and claim reimbursements that were not allowable.

As a result of these potential disallowances from the previous years, a portion of the Medicaid claims from FY 2006 to FY 2008 and some remaining Medicaid accounts receivable are also subject to disallowance. As a result, management estimated additional potential disallowances and reflected these as accrued liabilities in the accounting records at year-end in the amount of $45,616,572 and $9,024,762 for CFSA and DCPS, respectively. In addition, Medicaid accounts receivable for CFSA amounting to $42,872,825 were also adjusted during FY 2008.

CFSA and DCPS should improve their claims documentation in order to minimize potential disallowances in future years. In addition, they must ensure that all claims submitted are allowable and fully supported in accordance with the approved Medicaid State Plan. Further, receivable balances should be reviewed regularly to ensure that only valid receivables are reflected on the books.

Management's Response:

After the release of the 2007 Comprehensive Annual Financial Report (CAFR) highlighting inadequate billing practices as a material weakness for the District, the Administration made a commitment to conduct and pursue comprehensive audits from past fiscal years to determine and correct years of billing mismanagement. As a result, the Department of Health Care Finance (DHCF) (formerly the Medical Assistance Administration) conducted an audit of FY 2004 and 2005 for the Child and Family Services Agency (CFSA) and FY 2003 through 2006 for the District of Columbia Public Schools (DCPS). Based upon the audited cost reports, the potential disallowances are primarily the result of:

- Poor or nonexistent documentation of services provided;
- Improper billing to the Medicaid program when other sources of funding were available; and
- Duplication of billing.

CFSA has established a monthly internal audit process to investigate Medicaid claims and has instituted strict requirements for any claims identified as lacking sufficient documentation. DCPS is ensuring better documentation of services provided through utilizing a new electronic data system and archiving key documents, in addition to changing the billing structure associated with the liabilities named above. DHCF is coordinating efforts to reform the District's Medicaid billing practice to significantly reduce the risk of future liabilities related to the Medicaid Program. Led by the Public Provider Liaison Unit, progress at DHCF includes:

- Establishing a more active role in the Medicaid audit contract process;
- Reviewing current claims and developing corrective actions steps for agencies;
- Developing guidance and training sessions for agencies on adhering to Federal and District requirements; and
- Working with DCPS and CFSA on alternative health care delivery system options to minimize potential disallowance risk in the future. For example, DHCF will implement a CMS-approved cost-allocation report for DCPS. In addition, DHCF is working with CFSA to shift the risk to the provider instead of CFSA by having them bill DHCF directly.

Appendix A

Material Weaknesses and Significant Deficiencies in Internal Controls
Over Financial Reporting

DHCF has partnered with The George Washington University Medical Center to produce a comprehensive analysis report on Medicaid claims processes. This effort will guide DHCF in the development of an Administrative Services Organization (ASO) to streamline Medicaid billing. The report was released on November 21, 2008 and has informed the development of a request for proposal for an ASO. This draft Request for Proposal (RFP) has been completed with a projected award in summer of 2009.

DHCF is also actively analyzing options for negotiations with CMS regarding the total audit liability as well as its legal options in response to potentially improper advice regarding Medicaid revenue maximization.

Maintenance of Supporting Documents at Income Maintenance Administration (IMA)

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

1) 3 participant files could not be located and thus were not provided for testing.

2) 6 participant files did not have signed application forms.

3) 4 participant files did not have a verification of the applicant's income.

4) 4 participant files did not have complete and signed citizenship declaration forms.

5) 2 participant files did not show that the social security number (SSN) was furnished or was verified.

6) 2 participant files were not closed in the system when the applicant failed to recertify.

7) 5 participant files did not have evidence of supervisor review and approval for eligibility determination decision.

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.

Management's Response:

The Income Maintenance Administration (IMA) is modernizing its entire business process. IMA has just completed the first phase of that process. In the first phase, the paper files at each of the respective service centers was migrated from a numerical filing system, based on the customer's address, to an alphabetical filing system, based on the head-of-household's name.

The Centers also moved to a case-banking system – away from an individual caseload. The high worker turnover among SSRs meant that cases were often floating between workers, and at times left incomplete. With case banking, a worker only touches the case to update it, and then returns to a controlled central file at each respective center.

These two changes lay the foundation for moving to a fully automated system. IMA is presently preparing the paper case files to be scanned, and stored in an automated filing system and linked to the case record. This will eliminate lost or missing files, and also enable workers to easily identify documents, which may be needed to complete the file or application. The physical scanning of records should begin this spring, and once complete, no paper records will be maintained.

Following the scanning of the case files, IMA is developing an automated application and recertification process. The automated application and recertification process will have system triggers, which will force both workers, as well as customers to compete certain fields (such as applicant signature) before a final determination of benefits is rendered. The system will also have triggers which, insure that administrative functions – such as supervisory approval and the closing of cases, are further automated into the system, thus eliminating the potential for worker error.

Medicaid Management Information System (MMIS)

MMIS is a 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, 2008 and it was noted that the following control objectives were not achieved:

- Controls provide reasonable assurance that both physical and logical access to computing resources is restricted to authorized individuals.
- Controls provide reasonable assurance that modifications to application software are authorized, tested, approved, and implemented.
- Controls provide reasonable assurance that incompatible functions and duties are segregated within the organization.
- Controls provide reasonable assurance that the agency has the ability to recover from a business continuity event.

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 2009.

Management's Response:

Issue #1: Controls provide reasonable assurance that both physical and logical access to computing resources is restricted to authorized individuals.

Material Weaknesses and Significant Deficiencies in Internal Controls
Over Financial Reporting

In FY 2007, it was noted that 11 individuals with card key access did not have business justification for their access. When the original report was run, it included all cards Active and Inactive. So the report showed users whose accounts were inactive and cards were inactive (therefore no access granted by the card); once this was pointed out the IT staff deleted the Inactive accounts removing the cards from the system and re-ran the report showing only active cards.

The new policies include our fiscal agency, ACS, granting physical and logical access to individuals based on the manager's completion of new user forms. These forms grant the logical access to the network as required by the employee to fulfill his/her job. Once the employee starts working onsite, he/she signs a form and receives a physical access badge which grants him/her access to the facility. When an employee is severed from the company, a separation form is completed for that user and all rights are terminated to both the building and the network.

Issue #2: Controls provide reasonable assurance that modifications to application software are authorized, tested, approved, and implemented.

In FY 2007 there were concerns raised about the controls related to modifications to the application software. Internal and external modifications to the software are initiated by a Customer Service Request (CSR). A weekly CSR meeting is held with representatives from the District and ACS to review all CSRs - both internal and external. A SOX (Sarbanes-Oxley) form is provided for District approval and a closure letter is sent after implementation. In FY 2009, the District also implemented a rule that modifications must go through three checks post implementation before the closure letter is sent for sign off. There are five people at ACS authorized to move software modifications into production following previously established procedures.

Issue #3: Controls provide reasonable assurance that incompatible functions and duties are segregated within the organization.

In FY 2008, it was noted that a user's access must be updated if they are working on a special project that would give him/her access to data that should otherwise be segregated. Procedures are in place to ensure that system functions were segregated so that users are not given system access that could allow a user to comprise the District's claims payment. Users are given update or inquiry access to different functions in the MMIS system. A user with update access to claims processing is limited to inquiry only access to provider and recipient data. The reverse applies as well.

Issue #4: Controls provide reasonable assurance that the organization has the ability to recover from a business continuity event.

ACS has a business continuity and disaster recovery plan to ensure that the organization could recover within an acceptable timeframe should there be a business continuity event. The plan is available for the review at the ACS office.

- The ACS corporate recovery service is notified if there is an emergency event for the District Medicaid system. This initiates the launch of the business continuity plan.
- The District Medicaid system is located in our Pittsburgh data center and this data center has its own Data Recovery Plan. This plan is tested annually.

Material Weaknesses and Significant Deficiencies in Internal Controls
Over Financial Reporting

- The systems staff currently maintains the capability to operate the system from their home offices.
- ACS maintains a Disaster Recovery contract with SunGard in Herndon, Virginia should there be a need to house staff outside the district for a local failure.
- The BCCP plan calls for ACS to continue to provide call center and claims processing services by leveraging the sister- Medicaid account in Georgia if and when they would need to establish our call center and other capabilities in Atlanta. This ACS account has connectivity to the Pittsburgh data center and similar call center and claims processing functionality to the District.
- The Prescription Benefit Management (PBM) system operates from the Pittsburgh data center and would remain operational should there be a local failure.
- The pharmacy call centers would leverage the Henderson, North Carolina call center to respond to emergency prescription supplies and prior authorizations and currently has this capability for District Medicaid beneficiaries.

* * * * *

Material Weaknesses and Significant Deficiencies in Internal Controls
Over Financial Reporting

III. Compensation

During FY 2008, the District implemented a new PeopleSoft Payroll System. The PeopleSoft system replaced the previous Unified Personnel Payroll System (UPPS) used by the District. UPPS was less automated and required more manual interfaces and adjustments to record payroll expenditures in SOAR, the District's accounting system of record. The new PeopleSoft system is intended to be a more dynamic and integrated system requiring less manual adjustments.

<u>Lack of Segregation of Duties within PeopleSoft</u>

One of the basic elements of internal control is separation of duties. Separating certain duties improves internal controls and reduces the possibility of errors and irregularities. Without proper controls over payroll transactions, there is an increased risk that unauthorized transactions may be processed. We recommend that management review users with excessive access to determine if their access is appropriately restricted to only those functions that are necessary to perform their duties.

We obtained a data extract from the Production environment at the end of FY 2008 for purposes of evaluating the segregation of duties and user access review as they relate to PeopleSoft HRMS applications (modules).

The following are potential segregation of duties issues noted in our test work. Included within the information below are all PeopleSoft users with either update or inquiry access based on electronic IDs.

Conflicting Roles	Implication	# of Users
Add Non-Employee vs. Global Payroll	Users have the ability to update non-employee and his/her own personal information and define global payroll rules, maintain global payroll data, and manage the global payroll process.	35

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

> The District does not use the Global Payroll Process, although it is a delivered PeopleSoft product. The District uses the North American Payroll, USF. The actual # of users is 3.

Conflicting Roles	Implication	# of Users
Maintain Personal Data vs. Global Payroll	Users have the ability to update non-employee and his/her own personal information and define global payroll rules, maintain global payroll data, and manage the global payroll process.	35

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

> The District does not use the Global Payroll Process, although it is a delivered PeopleSoft product. The District uses the North American Payroll, USF. The actual # of users is 3.

Appendix A

Material Weaknesses and Significant Deficiencies in Internal Controls Over Financial Reporting

Conflicting Roles	Implication	# of Users
Calculate Employee Absences vs. Review Payroll Data	Users have the ability to modify vacation/leave time and update payroll data.	88

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

Only OPRS employees can update payroll data. IT support staff may have this access in order to provide support.

Conflicting Roles	Implication	# of Users
Calculate Payroll Process vs. Banking Process	Users have the ability to review and approve salary calculations and prepare the employee payment details for submission to the bank.	34

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

Various District of Columbia Human Resources (DCHR) departments have the ability to approve salary changes. OPRS and the Office of Finance and Treasury (OFT), with IT support submits pay check information to banking, along with the requisite funding documents to support the District's payroll.

Conflicting Roles	Implication	# of Users
Calculate Payroll Process vs. Update Employee Earnings Deductions	Users have the ability to review and approve salary calculations and also update employee earnings-deductions.	34

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

OPRS has the ability to run the payroll process for payment of time submitted through time and labor. OPRS also can update/change some general deductions, such as Union Dues, Savings Bonds, Parking Fees, etc. Employees can also make changes through Employee Self Service (ESS).

Conflicting Roles	Implication	# of Users
Compensation Administrator vs. Global Payroll Administrator	Users have the ability to define salary plan, define merit increase, maintain budget, change salaries, calculate compensation, etc. and define global payroll rules.	3

The following response was provided by District of Columbia Human Resources (DCHR) personnel:

A limited number of users are responsible for global payroll changes. Only a few high level compensation users in OCTO, DCHR, and OPRS have the ability to define salary plans. There are checks and balances in place in PeopleSoft as all users have specific login identities that will track any actions taken by users including the date the actions were taken, the approval of the action, and the authority to institute the action.

It should be noted that DCHR has not implemented PeopleSoft functionality to define merit increases and to maintain budget.

DCHR will examine the controls in place related to this issue and will take any and all appropriate actions to mitigate risks identified. The global payroll rules are set by OPRS.

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

The District does not use the Global Payroll Process, although it is a delivered PeopleSoft product. The District uses the North American Payroll, USF.

Conflicting Roles	Implication	# of Users
Global Payroll Administrator vs. HR Administrator	Users have the ability to define global payroll rules, maintain global payroll data, manage global payroll process, etc. and create budget, maintain positions, maintain competency data, maintain & update employee personal information, terminate workforce, monitor and update absences, etc.	3

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

The District does not use the Global Payroll Process, although it is a delivered PeopleSoft product. The District uses the North American Payroll, USF.

Conflicting Roles	Implication	# of Users
Recruitment Administrator vs. Global Payroll Administrator	Users have the ability to recruit the workforce and update employee contracts and personal information and to define global payroll rules.	3

The following response was provided by District of Columbia Human Resources (DCHR) personnel:

DCHR staff can initiate, recruit, and hire workforce through the PeopleSoft workflow process. Each action has an approval path that includes initiation of actions by agency staff, approvals by agency fiscal officers, and final approval of action by DCHR agency managers. The PeopleSoft controls prevent DCHR personnel from processing actions unless the actions have been approved by agency fiscal officers in PeopleSoft. Updates to personal information can be accomplished by employees through employee self-service. Employees are given a range of options through drop down boxes and can only choose those options. DCHR will work with the ASMP team to ensure that effective controls govern the workflow process.

The global payroll rules are set by OPRS, and DCHR plays no role in defining global payroll rules.

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

The District does not use the Global Payroll Process, although it is a delivered PeopleSoft product. The District uses the North American Payroll, USF.

Appendix A

Material Weaknesses and Significant Deficiencies in Internal Controls Over Financial Reporting

Conflicting Roles	Implication	# of Users
Confirm Pay Process vs. Employee Bank Transfer	Users have the ability to review and approve salary calculations and also to prepare the employee payment details for submission to the bank.	66

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

Users are OPRS and IT support personnel. Some OPRS staff have two user ids for access to the global payroll system and other duties; therefore the number of users could be double counted.

Conflicting Roles	Implication	# of Users
Create Employee Paysheets vs. Confirm Pay Process	Users have the ability to create an employee (and update his or her personal and salary details) and also to calculate payroll amounts.	66

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

All users do not have the ability to create an employee. Some users have the ability to create employee pay sheets, but not employees; pay sheets cannot be created for employees who do not exist in PeopleSoft. Again OPRS and IT support have this access.

Conflicting Roles	Implication	# of Users
Create Employee Paysheets vs. Unconfirm Pay Process	Users have the ability to calculate employee salary and reverse the approval of salary calculations.	66

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

OPRS users must have this ability along with IT support.

Conflicting Roles	Implication	# of Users
Update Employee Paysheets vs. Confirm Pay Process	Users have the ability to review and approve salary calculations and update paysheets (i.e. process payroll).	66

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

OPRS users must have this ability along with IT support. Only OPRS confirms the pay process to process the pay checks (8 OPRS employees).

Conflicting Roles	Implication	# of Users
Update Employee Paysheets vs. Unconfirm Pay Process	Users have the ability to both unconfirm pay (i.e. to reverse the approval of payment calculations) and update paysheets (i.e. to process payroll).	66

Material Weaknesses and Significant Deficiencies in Internal Controls
Over Financial Reporting

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

OPRS users must have this ability along with IT support. Only OPRS confirms the pay process to process the pay checks.

Conflicting Roles	Implication	# of Users
Confirm Pay Process vs. Payment Check Printing	Users have the ability to review and approve salary calculations and also to print payroll checks.	42

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

OPRS users must have this ability along with IT support. Only OPRS confirms the pay process to process the pay checks.

Conflicting Roles	Implication	# of Users
Create Employee Paysheets vs. Update Employee Pay Data	Users have the ability to update pay and create paysheets.	34

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

OPRS users must have this ability along with IT support.

Conflicting Roles	Implication	# of Users
Create Paysheets vs. Hire Employees	Users have the ability to create an employee (and update his or her personal and salary details) and calculate payroll amounts.	34

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

OPRS does not have the ability to create an employee; but has the ability to create pay sheets. IT support also has ability for support.

Conflicting Roles	Implication	# of Users
Update Employee Pay Data vs. File Export - Payroll Interface	Users have the ability to update pay data and create the payroll export files.	34

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

OPRS users must have the ability to create payroll files along with IT support. OPRS does not update salary, grade, step of employees, but does have ability to update tax withholdings.

Appendix A

Material Weaknesses and Significant Deficiencies in Internal Controls
Over Financial Reporting

Conflicting Roles	Implication	# of Users
Update Employee Paysheets vs. Hire Employees	Users have the ability to hire employees and update paysheets.	34

The following response was provided by District of Columbia Human Resources (DCHR) personnel:

DCHR is responsible for the on-boarding process which entails placing the initial information in PeopleSoft to create the new employee record. Prior to creating the employee record, all information including salary, title, and budget authority have been approved by agency managers and agency fiscal officers. No action can be placed in PeopleSoft without the requisite approval by agency managers and agency fiscal officers. However, DCHR will work with the ASMP team to ensure that the controls in place maintain the integrity of the hiring process, particularly as it relates to the on boarding process.

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

Various Human Resource departments have the ability to hire employees. Only OPRS, along with supporting IT department, can create pay sheets for payment.

Conflicting Roles	Implication	# of Users
Update Employee Paysheets vs. Update Employee Pay Data	Users have the ability to update pay (i.e. to update payroll calculation data) and update paysheets (i.e. to process the payroll and arrive at the net pay amounts).	34

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

OPRS users must have this ability along with IT support.

Conflicting Roles	Implication	# of Users
Create-Update Employee Positions vs. Hire Employee	Users have the ability to create employee positions and hire employees.	400

The following response was provided by District of Columbia Human Resources (DCHR) personnel:

While DCHR is responsible for these functions, there are controls in place that create segregation of duties between employees initiating personnel actions and the actual hiring of employees. The PeopleSoft system is set up such that the authority for position management (i.e., creating positions and assigning position numbers) rests with the compensation and classification administration, while the authority to post positions, create vacancy announcements, and make selection decisions rests in the Administrative Services Administration (ASA).

Employees of ASA have review access to position management data. Once a position is established and assigned a position number, that information cannot be altered by recruitment staff and can only be changed through the position management process.

All aspects of this process are captured in the PeopleSoft approval paths which includes sign-offs by agency managers and agency fiscal officers. Prior to creating the employee record, all information including salary, title, and budget authority have been approved by agency managers and agency fiscal officers. No action can be placed in PeopleSoft without the requisite approval by agency managers and agency fiscal officers.

However, DCHR will work with the ASMP team to ensure that the controls governing the creation of employee positions and the hire of new employees preserve the integrity of the system.

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

There is a customization in place for the position creation process which requires the agency CFO/Financial Staff the role to approve positions. The Human Resource staff can create a new position, but only in a "Proposed Status". Only after the agency CFO/Financial Staff has approved the position, can HR complete the hiring process. OPRS staff cannot create positions nor can they hire employees.

Conflicting Roles	Implication	# of Users
Create-Update Variable Compensation Plan vs. Modify Variable Compensation Allocation to Employee	Users have the ability to set up variable compensation plans and also to allocate them to employees.	34

The following response was provided by District of Columbia Human Resources (DCHR) personnel:

DCHR does not necessarily agree with this finding. This PeopleSoft module has not been implemented and the District does not currently have any variable pay plans. Should this module be implemented, DCHR will work with the ASMP team to implement controls to monitor the actions of users and to create a record of actions taken with respect to plans of this nature.

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

Selected users at the DCHR level are authorized to set up compensation plans after authorized approval.

Conflicting Roles	Implication	# of Users
Data Preparation For Payroll Process vs. File Export - Payroll Interface	Users have the ability to prepare data for payroll processing and create the payroll export file.	34

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

OPRS users must have this ability along with IT support.

Material Weaknesses and Significant Deficiencies in Internal Controls
Over Financial Reporting

Conflicting Roles	Implication	# of Users
Maintain Recruitment Tables vs. Global Payroll	Users have the ability to access the 'Global Payroll' permission list (allows the user to define global payroll rules, maintain global payroll data, and manage the global payroll process) and the 'Maintain Recruitment Tables' permission list.	35

The following response was provided by District of Columbia Human Resources (DCHR) personnel:

DCHR will seek further clarification of the potential risks with the maintenance of recruitment tables. DCHR will take any and all appropriate actions to mitigate the risks identified.

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

The District does not use the Global Payroll Process, although it is a delivered PeopleSoft product. The District uses the North American Payroll, USF.

Conflicting Roles	Implication	# of Users
Setup Compensation Tables vs. Global Payroll	Users have the ability to access the 'Setup Compensation Tables' permission list (allows the user to define salary grades, define salary plan, define merit increase, etc.) and the 'Global Payroll' permission list.	35

The following response was provided by District of Columbia Human Resources (DCHR) personnel:

The ability to setup compensation tables is limited to only a few high level compensation users in OCTO, DCHR, and OPRS. There are checks and balances in place in PeopleSoft, as all users have specific login identities that will track any actions taken, the date the actions were taken, approval of the action, and the authority to institute the action. (It should be noted that DCHR has not implemented PeopleSoft functionality to define merit increases and to maintain budget.) DCHR will work with the ASMP team to examine the controls in place and will take any and all appropriate actions to mitigate risks identified.

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

Selected users at DCHR level are authorized to set up compensation plans after authorized approval. OPRS does not have this authority. The District does not use the Global Payroll Process, although it is a delivered PeopleSoft product. The District uses the North American Payroll, USF.

Appendix A

Material Weaknesses and Significant Deficiencies in Internal Controls Over Financial Reporting

Incomplete Utilization of PeopleSoft

Two significant proposed enhancements of the PeopleSoft Human Resources/Payroll Systems allow employees' payroll costs to be recorded in multiple accounting codes in SOAR (the District's accounting system of record) and employees have the ability to directly charge hours to specific grant programs or local funded projects on time and attendance forms. Both of these capabilities reduce the amount of required manual adjustments and allow for a clear audit trail between specific amounts charged to an account code to the actual employee time and attendance reporting mechanism. Previously, without this functionality, District agencies were required to prepare manual and complex labor redistribution entries to reallocate personnel charges to/from local and federal grant programs.

While agencies are now able to assign a default account code for an employee's personnel charges that will allow payroll costs to be allocated to multiple accounting codes, most District agencies (with the exception of the Department of Public Works and the Department of Transportation) still do not utilize the newly available functionality of having employees charge hours directly to specific grant programs or other local funded projects that require costs to be specifically allocated. As a result, extensive labor redistribution entries are still required and are based on previous allocation methods when the payroll system did not have the capability to allow employees to directly charge payroll costs to multiple and specific federal and local programs/projects.

We understand that it may not be feasible to have employees directly charge time to specific projects and federal grants; however in many cases District agencies are not fully utilizing the capabilities of the current Human Resources/Payroll system. We recommend that each agency develop polices and procedures and train employees to directly charge their time to specific federal grants and local programs.

Management's Response:

The following response was provided by District of Columbia Human Resources (DCHR) personnel:

> DCHR will seek to implement these modules on a District-wide basis.

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

> The PeopleSoft Human Resource and Payroll System purchased by the District is a very comprehensive application with robust functionality. All of the features for this product were reviewed and a Functional Steering Committee discussed these features with agencies and assessed their desire to participate in the implementation of certain features that are new procedures for the District. The agencies selected to pilot the Labor Distribution functionality were those that had experience with the process and understood the benefits of these new features.
>
> The Labor Distribution process is a process that is included in the Time and Labor Module. Modifications were made to legacy payroll system which PeopleSoft replaced (UPPS) to temporarily allow the Time and Labor Module transactions to interface for six months prior to processing these transactions through PeopleSoft. During this period of time, the system was reviewed and the time keepers trained to correctly process a labor distribution payroll entry with the appropriate accounting entries.

The implementation process was smooth but still provides challenges and enforced the implementation approach to select only a few agencies. It has now been a year since the system has been fully implemented and as such, enhancements and program corrections have been made to facilitate a smoother payroll process for the agencies and OPRS. The last District agency who has not implemented the PeopleSoft payroll system is the District of Columbia Public Schools (DCPS) with it many unique requirements. After PeopleSoft implementation at DCPS, the District's intent is to evaluate the PeopleSoft features that are available and not used by agencies.

At that time, the Labor Distribution feature will be addressed with these agencies and they will be shown the time savings and data accuracy of PeopleSoft, which should enhance their implementation to the Labor Distribution Module. While this will have benefit to most agencies, it is felt that this feature will significantly benefit the larger District agencies.

<u>Lack of Adequate Supporting Documentation</u>

Personnel action forms, including employees' completed benefits forms, were not provided during testing. We also noted that there was no consistency in the accountability of the maintenance of Official Personnel Folders (OPFs) and reorganizing/switching of these responsibilities to different agency groups was prevalent. This lack of accountability for records management can cause logistical problems of where to obtain the needed personnel records. In addition, the constant reorganizing/switching of responsibilities for filing OPFs can cause loss of personnel records during transition. We also noted that file room staffing was reduced in FY 2008.

For a sample of new hires, terminations, and transfers, we noted the following:

1) When personnel actions are initiated by an agency through submitting manual documentation, an HR Advisor/specialist enters the information into PeopleSoft based on the package received. However, it appears that there is no control in place for a review and approval of the information entered to ensure completeness and accuracy and to ensure the change has been properly authorized.

2) Personnel files (i.e. SF52s, offer letter, I-9, and Competitive and Non-Competitive forms) were not provided for 12 out of the 50 new hire samples as selected from the independent agencies.

3) For 3 out of 50 employees tested, verification of employee approval of benefits was not provided. Per discussion with the HR personnel, the forms could be missing because effective November 2007, employees were encouraged to enroll into selected benefits via Employee Self Service (ESS) in PeopleSoft. However, when the employee enrolls via ESS, the system does not uniquely indentify whether it was the employee or HR personnel who completed the form. Thus, the system does have a control in place to provide electronic confirmation or an audit trail to confirm who made the online enrollment.

   Of the 3 instances mentioned above, 1 instance was noted at the Department of Mental Health and 2 instances were noted at District of Columbia Human Resources.

Material Weaknesses and Significant Deficiencies in Internal Controls
Over Financial Reporting

4) Personnel files (i.e. employee resignation letter and/or an approved SF52 or related supporting documents) were not provided for 3 out of the 45 resigned/terminated samples. We also noted that in 1 instance, the termination was not performed timely.

5) The date of transfer as listed in the database provided to us to select our sample for testing did not match the effective date of the personnel action(s) in PeopleSoft. We noted that 2 personnel action forms in our sample appeared to have been deleted; however, there was no system audit trail or history of the deleted personnel actions.

6) The District was unable to locate 16 personnel files out of a sample of 50 related to transfers of employees from one agency to another. In addition, 9 of the 50 personnel files for our transfer samples lacked supporting documents (i.e. SF52s, supporting documents authorizing the transfers). While this may not affect payroll overall, the District needs to better track the transfer of its employees.

We further recommend that a quality review be performed to ensure all appropriate documents are maintained and made available for review as required. A follow up should be made to ensure that documents/forms are obtained, processed, and filed into each personnel file in accordance with the District's internal control requirements.

Management's Response:

All Official Personnel Folders for which DCHR is responsible are housed in a central location that is secure and accessed only by authorized personnel. DCHR has established protocols for the use and transfer of official personnel files for agency use. When needed, OPFs are signed out by authorized personnel and tracked by Records Management staff.

With the closing of the Reeves Center in July 2008, DCHR transferred the records management function from the Reeves Center to 441 Fourth Street. Records management personnel remained the same and the procedures for obtaining and maintaining OPFs remained the same. DCHR added staff to ensure proper handling of OPFs and to enhance records management and retention functions.

As part of its internal evaluation process, DCHR will examine the controls in place regarding the filing and maintenance of official personnel files to ensure the integrity of the process. DCHR will take any and all appropriate actions to mitigate risks identified by the auditor.

Issue #1: DCHR concurs with this finding, but also notes that personnel actions are no longer initiated by an agency through manual documentation. All aspects of the hiring process are now handled within PeopleSoft. This includes position management, creating positions, assigning position numbers, posting positions, and placing new hires into the PeopleSoft system. All aspects of this process are captured in the PeopleSoft approval paths which includes sign-offs by agency managers and agency fiscal officers. Prior to creating the employee record, all information including salary, title, and budget authority have been approved by agency managers and agency fiscal officers.

In addition, DCHR has established an audit and compliance function whose sole purpose is to conduct audits of agency human resources activities and to determine compliance with human resources rules and regulations. This team examines agency recruitment and selection practices and works with agencies to identify issues including target areas for training and compliance with agency rules.

DCHR has established a table of infractions that provide for corrective actions in cases where the agencies repeatedly violate personnel rules.

Issue #2: DCHR does not dispute this finding; however, DCHR only maintains the official personnel files for agencies subordinate to the Mayor's personnel authority. By statute, certain District agencies have independent personnel authority. As such, these agencies serve as the custodian of the record for their own official personnel files. Of the 50 new hire samples, only 28 of the samples were in agencies supported by DCHR. DCHR provided the personnel files for all 28 OPFs in cases where DCHR serves as the custodian of the record.

DCHR will work with partner agencies by providing advice and guidance on the proper maintenance of official personnel files and by updating rules, regulations, and issuances that further clarify agency roles with respect to the maintenance of records.

Issue #3: DCHR concurs that documentation verifying benefit enrollment was not available for the employee files referenced. DCHR does not necessarily agree that there are inadequate controls to provide for electronic confirmation or audit trail. PeopleSoft has benefit confirmation sheets that can be printed by DCHR staff. The system uniquely identifies the individual signing on by their login ID, which determines exactly what functions are available. DCHR will examine the controls in ESS and determine whether additional record-keeping is necessary.

Issue #4: DCHR does not dispute this finding. For the reasons outlined in the response to #2 above, DCHR was the custodian of the records for approximately half of the termination test samples and DCHR provided documents to support all its terminations. DCHR will continue to work with partner agencies by providing advice and counsel on the proper maintenance of official personnel files and by updating rules, regulations, and issuances that further clarify agency roles with respect to the maintenance of records.

Issue #5: DCHR will work with the Office of the Chief Technology Officer to determine why this data discrepancy exists so that the issue can be resolved.

Issue #6: DCHR does not dispute this finding.

<u>Overtime Payments</u>

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 78 employees during the year. Following are the agencies for which we noted discrepancies and the number of differences noted at each agency:

1) 1 difference noted at the Metropolitan Police Department.

2) 2 differences noted at the Department of Transportation.

3) 1 difference noted at the Department of Motor Vehicles.

4) 1 difference noted at the Child and Family Services Agency.

5) 2 differences noted at the Department of Mental Health.

In addition, District regulations prohibit employees who are classified as career service (CS) grade 14 and above and exempted service employees from receiving overtime pay. The database information that was provided by the District revealed 155 employees totaling approximately $111,000 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.

We did note that in August 2008, the District addressed a portion of these circumstances and the payroll system was configured to prevent overtime payments to exempt employees.

Management's Response:

The following response was provided by District of Columbia Human Resources (DCHR) personnel:

> DHCR does not review all approvals of timesheets and authorized overtime for each agency. Policies and procedures are in place regarding authorization needed for overtime. Each agency is responsible for ensuring that agency managers follow District policy that requires that all overtime work be authorized and that time and attendance records be properly supported and documented.
>
> However, DCHR will examine the controls in place governing the proper application of the overtime rules and, where necessary, issue clarifying amendments and policies on this issue.
>
> DCHR Classification and Compensation Administration will continue to provide technical assistance to subordinate agencies and will take any and all appropriate actions to mitigate risks identified by the auditor.
>
> The database information that was provided by the District revealed 155 employees where the District paid overtime to ineligible employees. DCHR acknowledges that the HRIS and Payroll system required more time in setting up the system to accommodate the newly issued rules, and in August 2008, the District addressed a portion of these circumstances.

Material Weaknesses and Significant Deficiencies in Internal Controls
Over Financial Reporting

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

Agencies are required to approve and retain paper documentation for overtime payments, at the agency level, according to instructions contained in the District Personnel Manuals (DPM). Within the PeopleSoft payroll system, overtime is entered by the employee and/or a designated timekeeper and is approved online by the appropriate supervisor/manager.

The issuance of the revisions of the DPM and the actual PeopleSoft System changes to accommodate policy changes is an area for close coordination between the District Department of Human Resources (DCHR) and the Office of the Chief Technology Office (OCTO).

There are agencies which have exceptions to the guidance issued by DCHR in the District Personnel Manuals (DPM) and therefore authorize overtime payment for employees, who in another agency at a comparable grade may not be authorized the overtime.

Collection of improper overtime payments from numerous employees was accomplished in FY 2009.

<u>Lack of a Formal Payroll Review Process at the Agency Level</u>

Based upon discussions with various agencies, we noted that not all agencies have formal policies and procedures which address the performance of a review of the agency payroll data submitted to the Payroll Office for processing.

While there are procedures in place for a supervisory review of employee time and attendance records, we recommend that this should be supplemented by an agency level review to ensure the payroll data is reasonable and consistent with prior periods and any discrepancies are investigated and resolved. The lack of a formal review process or designation of a specific oversight responsibility increases the risk that payroll errors and irregularities will not be detected on a timely basis. Evidence of the review should also be documented.

Management's Response:

The following response was provided by District of Columbia Human Resources (DCHR) personnel:

DCHR does not dispute this finding. Internally, DCHR follows general standard operating procedures on Time and Labor Reporting as established by ASMP. In addition, DCHR has its own internal controls to ensure that after time is entered by each DCHR employee into e-Time, the payroll supervisor follows the procedures listed below:

- At regular intervals, collect all sign in/out sheets from each unit in DCHR;
- Collect leave slips and cross-reference them with the sign in/out sheets for the corresponding employees;
- Match the time entered by each employee in e-Time to the employee's sign/out sheet;

- The approver/reviewer of each unit keeps a copy for the unit file of the sign in/out sheets, leave slips, and any other hard copy of approved overtime, comp time, or advance leave of each employee for auditing and quality control purposes;
- In the event that the unit approver is not available, the time and labor supervisor enters, approves, and corrects time for those employees. The unit supervisor is required to submit a request in writing granting permission to the time and labor supervisor to approve time for the employees of their unit;
- If there is an error in time entered or the employee changes his/her time entered after the supervisor has approved time, the time and labor supervisor notifies the unit supervisor of the discrepancy for correction.

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

The PeopleSoft system is a decentralized system which allows the individual employee to input his/her time online which, in turn, must be approved online by a manager/supervisor for processing. Although agency payroll managers conduct reviews for high level discrepancies (no time entered, less than 80 hours entered into the system, non payable status, etc), every single discrepancy which could occur is not reviewed. This recommendation may be appropriate for specific agencies, but it must be coupled with the resources available to perform the duties, the appropriate internal control environment, and able to be accomplished within the short window for payroll processing.

However, management agrees that the overall process should be reviewed and changes made as appropriate.

* * * * *

Appendix A

Material Weaknesses and Significant Deficiencies in Internal Controls
Over Financial Reporting

IV. 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.

While the fraud disclosed above occurred through the manual tax refund process at OTR, the majority of refunds are processed 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. 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.

Following are issues noted in the controls of the entire refund process. This section is divided into 3 parts:

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

IV - A. Automated Tax Refunds

Unidentified Taxpayer Accounts and Converted Remittances in the Integrated Tax System (ITS)

Unidentified taxpayer accounts are used to record tax returns and payments received which contain inadequate identifying information. The use of these accounts was also identified in an Office of Integrity and Oversight (OIO) report dated June 5, 2008. The OIO report noted the following:

- The creation and use of the unidentified taxpayer accounts dates back to 2001.
- OIO identified 8 unidentified taxpayer accounts that were in use when its report was issued. As of January 2009, a total of 10 unidentified taxpayer accounts have been isolated.
- Unidentified taxpayer accounts may have numerous profiles or sub-accounts attached to the one base account.
- Converted remittances (i.e. payments or credits) are posted to unidentified taxpayer accounts.

During our procedures, we noted the following with respect to unidentified taxpayer accounts:

1) Any individual with access and modification rights within ITS can create a taxpayer account, including unidentified taxpayer accounts or an invalid taxpayer account. Further, any individual with access and modification rights to ITS can access unidentified taxpayer accounts, record adjustments, and transfer balances to and from these accounts. Prior to September 30, 2008, there were no polices and procedures regarding management's review of the activities processed through these accounts.

2) A taxpayer account can be created with any nine digit number identified as an Employer Identification Number (EIN) or a Social Security Number (SSN).

Currently, a process does not exist to match the EIN/SSN in ITS to a federal database to ensure that these identification numbers are valid. The EIN/SSN numbers are used as unique identifiers for a taxpayer account.

3) A review has not been completed to detect all potential unidentified taxpayer accounts within ITS. We were able to enter "000-00-0000" as a SSN within ITS and this number was associated with an ITS account and had 158 profiles/sub-accounts. As such, management has been unable to identify the universe of unidentified taxpayer accounts, the total balances of these accounts, and/or quantify the activity that is processed through these accounts.

4) Within ITS, the notes feature is used to attach explanations to specific transactions recorded in an account. However, the notes are linked to the taxpayer account and not the transaction code. As a result, it is difficult to find the explanation for a specific transaction. For instance, a taxpayer account may have numerous notes associated with it; however, the note is not linked to the specific transaction.

We noted that as of October 2008, several manual controls have been developed and are in the process of being implemented over the review of activity in the 10 unidentified taxpayer accounts detected by the OIO and management. Based on a review of these 10 accounts, management has stated that:

- 572 returns and payments are included as part of the balance in these accounts.
- At September 30, 2008, unidentified payments totaling $58,000 and converted remittances totaling $215,000 remain in the accounts.

During our procedures, we noted the following with respect to converted remittances in unidentified taxpayer accounts:

1) Converted remittances are payments or credits in taxpayer accounts that were not properly posted to the correct taxpayer account when OTR underwent the conversion from the old legacy system(s) to the new ITS system.

2) Management has been unable to quantify the balance of converted remittance payments in the ITS system.

3) Adequate controls do not exist over the review and transfer of converted remittance credits to taxpayer accounts to reduce a taxpayer's liability. In a January 5, 2009 report, OIO identified 2 instances where a Returns Processing Administration (RPA) employee used the converted remittance credits in an unidentified taxpayer account to reduce the tax liability of two taxpayers.

   In one of the two occurrences, the taxpayer's tax liability was reduced from $19,000 to $1,000. In the other occurrence, a refund was attempted to be generated for the taxpayer; however, it was not processed further because the taxpayer had additional outstanding tax liabilities.

The use of unidentified taxpayer accounts can result in erroneous tax bills to the taxpayers, incorrect application of taxpayer payments, and create an opportunity for the generation of potentially fraudulent refunds.

Material Weaknesses and Significant Deficiencies in Internal Controls
Over Financial Reporting

In addition, inadequate controls over review and transferring of converted remittance payments can result in generation of fraudulent tax refunds and/or fraudulent reductions in taxpayer liabilities. We recommend the following:

- Management should institute a process to determine the existing universe of the unidentified taxpayer accounts in ITS and quantify the balances and activity in these accounts. In conjunction, management should identify the total amount of converted remittance balances in these unidentified taxpayer accounts.
- Going forward, management should discontinue the use of multiple unidentified taxpayer accounts. Instead, limited number of suspense accounts can be created to record unidentified tax payments and tax returns. Modification rights to these accounts should be restricted to a selected group of individuals. The activity in these accounts should be reviewed by a supervisory level employee who does not have modification rights to these accounts.
- Access to record and transfer converted remittance credits to active taxpayer accounts within ITS should also be restricted to a selected group of individuals. The number of converted remittance credits transferred to legitimate taxpayer accounts should be reviewed by a supervisory level employee who does not have modification rights to these accounts.
- Establish policies and procedures to validate EIN/SSN and taxpayer identification numbers in ITS against Internal Revenue Service (IRS), Social Security Administration, or other Federal databases.
- To enhance the audit trail related to specific transactions, the notes associated with unidentified taxpayer accounts should be linked to the transactions rather than the taxpayer account.

Management's Response:

We have taken or are taking the following actions:

- OTR will discontinue creation of new dummy accounts and will merge together into two accounts all existing accounts that were considered dummy accounts. These accounts will be handled using the "VIP" processing procedures which restricts read and write access to a limited number of OTR staff. Usually VIP access is limited to a need to know basis.

- RPA staff will be instructed to cease posting any transactions to accounts that are unidentified (i.e. dummy accounts). Transactions that do not have sufficient data to allow posting to an account will either be stopped in the Code and Edit function for management direction or if the transactions do get through the Integrated Data Capture System (IDCS) system, it will fall into the Suspense queue at which time, the case will be referred to management for additional direction.

- As referenced above, dummy accounts will be reclassified as VIP accounts and read/write/update rights will be extremely limited to select OTR personnel.

- OTR is currently working with the IRS, Social Security Administration, and other federal agencies to secure identification information that can be used within OTR to validate taxpayer's identification information.

- A SIR has been written to request ISA systemically delete the converted credits currently posted in the dummy accounts. The converted credits are not true credits and are a system error from the conversion from the former legacy system into ITS.

- Management will review all accounts that have "converted credits" to account for any credits that may have been transferred.

- All actions taken on dummy accounts will be documented. It is the intention to scan documentation of dummy account activity into the system and that it be associated with the account or transaction.

Integrated Tax System (ITS) User Rights

An Office of Integrity and Oversight (OIO) report dated January 5, 2009, identified an employee who was able to process unauthorized adjustments to taxpayer accounts because he was granted access rights beyond his job responsibilities.

A coordinator between Returns Processing Administration (RPA) and the Information Service Administration (ISA) is responsible for designing and developing systems and forms for RPA, and communicating such enhancement requirements to ISA. However, as this individual had modification rights within ITS, he was able to transfer the converted remittance credit balance in an unidentified taxpayer account to two different taxpayer accounts and reduce the tax liability of these taxpayers.

As of January 2009, OIO is in the process of reviewing other transactions recorded by this individual. In addition, management has changed the access rights for this individual and restricted modification rights in ITS.

During our review of a sample of users with access to ITS, we noted the following:

1) 5 employees were noted as terminated but still had access to the system.

2) 4 users (2 student trainees, 1 administrative assistant, and 1 clerical assistant) did not have the appropriate access.

To enhance controls over transactions recorded in ITS and to prevent unauthorized entries or adjustments, management should review ITS user profiles of all employees and assign appropriate user rights based on an individual employee's job responsibilities. Management should consider a formal process with adequate audit trails to ensure that all ITS users are authorized, that all access rights are modified accordingly, and that users are removed from the system on a timely basis upon termination.

Management's Response:

A review of ITS user profiles for all RPA employees has been conducted and completed. This review looked at the function of each employee and the access (rights) the employee required for his/her position. Management will ensure that all user profiles are reviewed and rights are assigned appropriately.

Appendix A

Material Weaknesses and Significant Deficiencies in Internal Controls Over Financial Reporting

Transfers and Adjustments to Taxpayer Accounts within the Integrated Tax System (ITS)

Internal controls are designed to safeguard assets and help or detect losses from employee dishonesty or error. A fundamental concept in a good system of internal control is the segregation of duties.

We noted that adequate segregation of duties does not exist over the initiation and posting of transfers and adjustments to taxpayer accounts. The same individual who initiates the transfer and/or adjustment to a taxpayer account can also authorize and post the transaction. In addition, a supervisory level review of the transfers and/or adjustments is not performed. Inadequate controls over this process can result in the generation of fraudulent tax refunds and/or fraudulent reductions in taxpayer liabilities.

OTR should create and enforce policies which are set up to improve existing internal control without impairing efficiency. Management may also consider the creation of a report of transfers and/or adjustments posted to taxpayer accounts, which can be reviewed by a responsible individual.

Management's Response:

User profiles have been reviewed and adjusted to limit employee access (rights) based on their specific job responsibilities. Our Suspense and Review employees will still maintain the capability to transfer and/or adjust taxpayers' accounts which is a requirement to process and settle a return. We will request the capability to generate reports that will enable us to monitor and quality check transfers or adjustments to taxpayer's accounts.

The Collection Division established an Adjustment Unit that is responsible for making adjustments. Potential adjustments must be approved by management prior to transfer for input. Employees within the Adjustment Unit do not have inventory assigned to them and cannot adjust accounts.

Reconciliation between SOAR and the Integrated Tax System (ITS) - Undelivered Tax Refund Checks

Some tax refund checks mailed to District taxpayers are sent back to OTR. A tax refund check can often be 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 did not specify an apartment number). The following steps are taken when a tax refund check is returned to OTR:

- A Returns Processing Administration (RPA) employee picks up the checks from the Post Office. Subsequently, another RPA employee prepares a listing of the undelivered checks. The listing along with the undelivered checks is then sent to the Customer Service Administration (CSA) to be canceled in ITS.
- CSA voids the undelivered check, cancels the check in the ITS system, and re-establishes the tax refund liability to the taxpayer within ITS. In addition, CSA instructs the system not to reissue the tax refund check by "suppressing" the refund check request.
- The voided undelivered tax refund checks are sorted by tax type and sent to the Revenue Accounting Administration (RAA) along with an electronic listing.
- RAA then sends the undelivered tax refund checks to the Office of Finance and Treasury (OFT) where OFT cancels the check in its Checkwrite system (i.e. removes it from the outstanding check list.)

Material Weaknesses and Significant Deficiencies in Internal Controls
Over Financial Reporting

- Once RAA receives confirmation from OFT that the check has been canceled in the Checkwrite system, RAA records a journal entry in SOAR, to reinstate the revenue and cash.

We noted that undelivered tax refund checks were not always recorded accurately in SOAR and ITS. Effective July 2008, RAA began to prepare a monthly reconciliation of undelivered refund checks recorded between ITS and SOAR. However, this reconciliation only compares the cumulative number of undelivered checks recorded in each system as of the reconciliation date.

As a result, management is unable to identify and post correcting entries for the individual undelivered checks that may have been recorded erroneously in either system. Based on this reconciliation of the cumulative undelivered refund checks recorded in the ITS system and SOAR, the net effect of undelivered checks recorded in SOAR but not reversed in ITS amounts to approximately $991,000 for the fiscal year ended September 30, 2008. This amount represents an overstatement in revenue and cash when compared to the ITS system.

We also noted that although a limited number of personnel within CSA have the right to cancel and suppress refund checks in ITS, all CSA personnel below the manager level have the right to release suppression of refund checks.

Management should improve the communication between the Customer Service Department, the RAA within the OTR, and OFT to reduce the number of errors in recording these checks within the ITS system and SOAR. In addition, outstanding reconciling items due to recording and posting of undelivered refund check transactions should be investigated and resolved timely. To enhance controls over issuance of suppressed refund checks, the access to release these checks for re-issuance to the taxpayer should be restricted to a selected group of individuals. A supervisory level employee who does not have access to release these checks should review the released checks to ensure propriety.

Management's Response:

RAA will work with the other administrations to ensure that undelivered and suppressed refund checks are properly accounted for and that reconciliations are prepared on a monthly basis.

<u>Real Property Tax Refunds Processed through the Integrated Tax System (ITS)</u>

The following issues were noted during our review:

1) Tax refund vouchers and/or other documentation supporting real property tax refunds could not be located for 5 of the 64 real property ITS refund samples selected for testing. According to District procedures, supporting documentation for a real property tax refund should include a tax refund voucher, the Real Property Tax Bill (Form FP-177), and correspondence requesting the tax refund from the taxpayer, its agent, or the mortgage company/bank.

2) Of the remaining 59 sample selections, 12 refund vouchers were processed prior to the implementation of the Interim Refund Directive on March 31, 2008. These 12 refund vouchers were only signed by the Real Property Tax Administration and Adjustment Unit (RPTAAU) employee who prepared the voucher. A manager's review and approval was not documented for these real property tax refund vouchers.

All real property tax refunds processed through the ITS system should have the required supporting documentation, such as a tax assessment bill and correspondence from the taxpayer requesting the refund.

Further, all real property tax refund requests should be reviewed by a manager prior to being processed within ITS for validity and ensuring that the requests are supported by adequate documentation.

Management's Response:

All refunds are being processed in accordance with the Interim Refund Directive and include supporting documentation. All refunds greater than $1,000 are being reviewed prior to being approved in ITS.

<u>Legible Scanned Copies of the Original Tax Return not Maintained as Supporting Documentation</u>

The following four departments within the Returns Processing Administration (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 13 of 707 of the sample selections for tax refunds processed through ITS. Specifically, we noted the following:

Material Weaknesses and Significant Deficiencies in Internal Controls
Over Financial Reporting

1) For 11 of the sample selections, the information in ITS such as the taxpayer name, address, and/or social security number or employer identification number did not match the information per the scanned copy of the tax return.

2) For 2 of the sample selections, there was no accompanying tax return scanned into ITS to support the tax refund issued to the taxpayer.

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. Further, if a proper scanned image of the tax return is not maintained within ITS, the information entered into the system cannot be supported by external documentation provided by the taxpayer.

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.

Also, with regards to incorrect names and addresses, it is recommended that the taxpayer be contacted for his/her name and/or new address. Once this has been determined, the current information should be updated into ITS. Management should establish policies and procedures to validate EIN/SSN, taxpayer identification numbers, in ITS against Internal Revenue Service, Social Security Administration, and other Federal databases.

Management's Response:

RPA currently has several different levels of review that were implemented to ensure scanned tax information matches the data in ITS. These reviews are as follows:

- For all returns and payments scanned processed by our lockbox contractor, a sampling (minimum 3%) of each batch is performed to ensure that the document (image) and data agree. If the image and data do not agree, the batch is returned to the lockbox contractor for correction. A report is submitted each day that we receive documents/data from the lockbox contractor. The report provides management with statistical information on the number of documents and data received, number reviewed by batch, and a number of errors by batch.

- For all returns, declarations (estimated payments), extensions, or other documented postings to ITS, if these transaction falls into either the Suspense or Review queue, a 100% review is conducted to ensure the image matches the data. If a mismatch situation is found, the employee is instructed to (1) research all of the documents that were processed in the batch to ensure they were processed with the data and image are correctly associated; (2) document each mismatched image in Notes with sufficient information as to the issue; (3) if the correct image needs to be rescanned and associated, take the necessary action; and (4) complete a report that identifies the mismatch case(s) and the report is sent to management for additional research and statistical purposes.

Material Weaknesses and Significant Deficiencies in Internal Controls
Over Financial Reporting

- The Output Review unit has numerous review criteria, of which the 12% criteria cited is but one. Each of the review criteria has the same requirement to conduct a 100% of image to data.

- Over the past two processing years, OTR has eliminated capturing address information from most non-return documents (i.e. extension requests, declarations (estimated payments), sales returns, etc). OTR is implementing a Taxpayer Address Request system that will collect the latest address information from the IRS and that information will be used to update accounts in ITS.

Withholding Payments Processed through the Integrated Tax System (ITS)

There is no documented match of withholding payments received by the District from taxpayers to the tax payment reported on the taxpayer's tax return. In addition, management does not appear to have an adequate process to match the withholding information received from employers to the tax returns submitted by taxpayers. Therefore, a refund may be issued to taxpayers without determining if taxpayers have in fact made tax payments to the District. To ensure that tax payments reported on tax returns have been received by the District, management should institute a process to match the following:

- Withholding payment received by the District to tax payments reported on tax returns.
- Withholding information received from employers to the withholding amounts indicated on tax returns.

Management's Response:

A system has been created which contains W-2 information. Information in this system will be used to match tax payment information reported by the taxpayer.

"Voided" or "Canceled" Checks Processed through the Integrated Tax System (ITS)

There are not adequate controls to ensure that a tax refund check has not been cashed at the bank prior to "voiding" the check in ITS. Additionally, there does not appear to be a system control to prevent a refund check from being voided or cancelled in ITS multiple times. A change report is not created for manager review when a check is recorded as "VOID" in the system. This report could be used to identify unusual transactions or patterns when checks are recorded as "VOID" or "CANCEL".

We recommend management enhance controls over voided and cancelled checks. Further, a supervisory level employee who does not have access to "VOID" checks in ITS should review the change report for unusual transactions or patterns.

Management's Response:

OTR will lead an effort to produce a document which applies to all administrations that will address controls related to "VOIDED" and "CANCELED" checks.

Material Weaknesses and Significant Deficiencies in Internal Controls Over Financial Reporting

IV – B. Manual Tax Refunds

Policies and Procedures for Processing a Manual Tax Refund

The following administrations have developed or are beginning to develop policies and procedures which address manual tax refunds but these policies were not in place at the beginning of FY 2008.

- Revenue Accounting Administration (RAA) – This administration is responsible for reviewing the manual refund voucher for appropriate authorization and adequacy of the supporting documentation and processing the voucher in SOAR, the District's accounting system of record. The manual refund process has been included in a detailed policies and procedures manual for RAA. This manual was implemented in May 2008.

- Real Property Tax Administration and Adjustment Unit (RPTAAU) – The Interim Refund Directive drafted by the Business Process Committee (BPC) and implemented on March 31, 2008, does not contain a complete and final listing of the documentation required to issue a manual refund generated from RPTAAU. Three divisions within this administration are in various stages of developing and implementing policies and procedures for processing manual refunds. Specifically:

    a. Tax Sale Division – RPTAAU has developed a policies and procedures manual for this division. The document includes policies for processing manual refunds and was implemented in December 2008.
    b. Homestead Unit – RPTAAU has developed a *draft* policies and procedures manual for this unit. This document includes policies for processing manual refunds and has not yet been implemented.
    c. Adjustment Unit – RPTAAU has developed a *draft* policies and procedures manual for this unit. This document includes policies for processing manual refunds and has not yet been implemented.

Policies and procedures for processing manual refunds have not been established or documented by the following three administrations and divisions within OTR:

- Compliance Administration (CA)
- Returns Processing Administration (RPA)
- Problems Resolutions Office (PRO)

We recommend that policies and procedures for processing manual refunds be developed and that these policies should address:

- The trigger events for initiating a manual refund.
- Instructions to indicate how the forms supporting the manual refund voucher request as defined in the Refund Directive should be completed.
- The individuals who are designated to prepare, collate, and research the supporting documentation required for each type of manual refund.

Without defined guidelines on how a manual refund should be processed, reviewed, and approved, a risk exists that unauthorized manual refunds may be processed through the system. Further, the RPTAAU section of the Refund Directive should be finalized to include the supporting documentation required for each type of refund processed through this administration.

Management's Response:

Policies and procedures for processing manual refunds will be documented for CA, RPA, and PRO.

<u>Internally Generated Standard Form for Requesting and Processing</u>

The SOAR Revenue Refund Voucher (SRRV) form used to process manual refunds is not always accurately completed. The SRRV summarizes the pertinent aspects of each manual tax refund: voucher number, taxpayer identification information, agency object, amount of refund, and the nature of the manual refund.

Our review of the 101 manual refunds which had been selected for testing indicated the following:

1) 22 items had one or more of the following fields outstanding (blank) on the SRRV:
    a. *Description* - description of the refund, relevant tax year, and justification for the refund.
    b. *Entered in SOAR by* - Name of the individual who entered the manual refund into SOAR, the District's accounting system of record.
    c. *Approved in SOAR by* - Name of the individual who approved and released the manual refund in SOAR.

2) A signature list of the individuals authorized to review and approve the SRRV is not maintained by the Revenue Accounting Administration (RAA), the administration responsible for releasing the manual refund for payment. As a result, it is difficult to identify if an authorized employee has approved the manual refund request on the SRRV form. Management should consider adding to the SRRV form the printed name of the individual who prepares and approves the manual tax refund request, to avoid confusion if signatures are unidentifiable or illegible.

3) All SRRVs are assigned a sequential document number (similar to an invoice number). For 5 manual refunds tested, the document number on the SRRV had been manually changed. If the document numbers can be changed manually, a risk exists that document numbers may not be assigned sequentially and therefore may not be easily tracked.

4) When manual refund data is input into SOAR, the entry is not reviewed for accuracy. In 3 instances, the vendor name was misspelled when input into SOAR and consequently printed incorrectly on the refund check. In 1 instance, the vendor name was spelled incorrectly on the SRRV and consequently input incorrectly into SOAR and printed incorrectly on the refund check.

5) The SOAR Refund Review Certification form is attached to manual refund vouchers greater than the threshold amounts defined in the Refund Directive. This form is signed by the appropriate authorized approvers of a manual refund voucher within each respective administration.

Material Weaknesses and Significant Deficiencies in Internal Controls
Over Financial Reporting

The form includes language which states several steps that the reviewer is "certifying" they have completed to ensure that the voucher is related to a valid refund request. However, we noted that the form does not contain language that states that the reviewer has ensured all supporting documentation as required by the Interim Refund Directive has been attached to the manual refund voucher. As a result, the reviewer is not asked to certify that they have reviewed the manual refund voucher in detail to ensure that all supporting documentation is attached to the voucher.

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

- All applicable fields on the SRRV form should be completed with the appropriate detail.
- The SRRV should provide space for preparers, reviewers, and approvers to not only sign, but also to print their full name and title.
- The RAA should maintain a listing of employees, by administration, which are authorized to prepare and approve the SRRV packet. This list should be consulted during the review of each manual refund packet.
- 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.
- The SOAR Refund Certification Form should include language "the reviewer has ensured all supporting documentation as required by the Interim Refund Directive has been included with the manual refund voucher." Inclusion of this language in the form will hold reviewers accountable for ensuring that appropriate supporting documentation is attached to the refund voucher requests.

Management's Response:

Management will ensure that the following actions are taken:

- SRRVs are fully completed and properly authorized.

- A list of authorized signatories is currently maintained on the G: / Drive by the Management Program Analyst. This list will be updated so that it remains current.

- In one instance, the sequential numbering system was manually altered due to a one-time system problem. Relevant personnel will be advised to not change the numbering system. Any system problems will be brought to the attention of management so that any out of sequence numbers will be duly noted.

- Releasers and approvers will be instructed to review the data screen for accuracy before final approval is assigned to a voucher.

- The Documentation Check List will be updated to make sure that the supporting documentation covers all tax refund types.

- Revision of the Certification Form requiring the preparer to certify that all supporting documentation has been attached to the manual refund voucher.

Material Weaknesses and Significant Deficiencies in Internal Controls Over Financial Reporting

Lack of Adequate Supporting Documentation

A listing of required supporting documentation for each type of manual refund did not exist until March 31, 2008, when the Interim Refund Directive was implemented. The following findings are instances where insufficient documentation was attached to a particular manual refund voucher.

1) *Missing Manual Refund Voucher Packet* – Management was unable to provide us with 13 of the 101 manual refund vouchers as these vouchers could not be located. Based on additional documentation requested and alternate procedures conducted, we were able to determine that the vast majority of these refunds were valid refunds, even though the refund voucher could not be located.

2) *Insufficient Taxpayer and Vendor Correspondence or External Documentation* – Insufficient documentation was attached to the SRRV to substantiate the manual refund request. As a result, additional information had to be requested from the appropriate administration to ensure that the manual refund voucher was valid. In the majority of these instances, management was able to provide the documentation to support the validity of the refund. Specifically, we noted the following:

   Real Property Tax Manual Refund Sample Selections:

   A. *Real Property Assessment, Roll Correction Report, or Special Billings Report* - This document demonstrates a decrease in the assessed value of the property, therefore resulting in an overpayment of real property taxes. Management provided this support for 14 of the real property tax manual refund sample selections selected for review. Of the 14 samples tested, 3 required a Real Property Assessment, Roll Correction Report, or Special Billings Report. This documentation was not attached to the SRRV in any of these sample selections. However, OTR was able to provide the supporting document when requested.

   Tax Sale Manual Refunds Sample Selections:

   A. *Attorney Release Letter* - The lack of an attorney release represents a risk that the original property owner has not completed redemption on the applicable property, and therefore the tax sale purchaser is not due a refund. For 11 of 54 Tax Sale and Tax Sale Subsequent Payment manual refunds tested, the attorney release was not attached to the SRRV and had to be requested from the Real Property Tax Administration and Adjustment Unit (RPTAAU). OTR was unable to provide this document for 7 of these selections.

   B. *Buyer's Report* - The Buyer's Report details each Square, Suffix, and Lot (SSL) number sold to a particular buyer for a particular tax year, and includes the amount of the outstanding taxes purchased and the amount of the surplus paid. Exclusion of the Buyer's Report from a manual refund package exposes OTR to the risk of disbursing unauthorized manual refunds. For 15 of 54 Tax Sale and Tax Sale Subsequent Payment manual refunds tested, the Buyer's Report was not attached to the SRRV and had to be requested from the RPTAAU. OTR was able to provide the supporting document when requested.

Material Weaknesses and Significant Deficiencies in Internal Controls
Over Financial Reporting

C. *Certificate of Sale (COS) or Certificate of Bid-off Sale (COBOS)* - The COS or COBOS verifies the tax sale purchaser's purchase of a specific SSL. Without this document, the veracity of the tax sale purchase cannot be determined, and consequently a risk exists of disbursing unauthorized manual refunds. For 4 of the 49 Tax Sale manual refund selections, the COS or COBOS was not attached to the SRRV and had to be requested from the RPTAAU. OTR was able to provide the supporting document when requested.

D. Tax Sale Registration Form - This document serves as further verification of the tax sale purchaser's purchase of a particular property at a particular District Tax Sale Auction. Furthermore, it bears evidence in the form of a stamp from the Cashier's Office that the tax sale purchaser deposited money with the District and is owed a refund. For 8 of 54 Tax Sale and Tax Sale Subsequent manual refund selections, the tax sale purchaser's Tax Sale Registration Form was not attached to the SRRV. Supporting forms had to be requested from the RPTAAU. OTR was able to provide the supporting document when requested for all but 1 sample selection.

3) *Erroneous Supporting Documentation:* For 12 of the 101 manual tax refunds selected for testing, the supporting documentation attached to the manual refund request was erroneous. In each of these instances, we were able to obtain the appropriate supporting documentation and validate the tax refund.

Management's Response:

Attached to every SOAR refund request is a Document Checklist that names the supporting documentation required by the type of tax being refunded. Management will update the Document Checklist to include supporting documentation required by the different tax types. Reviewers and approvers will be instructed by management to return all SOAR requests that are not supported by required documentation.

Refund Review Certification Form (Certification Form)

The Signature Approval portion of the Interim Refund Directive states that employees are able to delegate their authority level to their subordinates. We noted that supervisors did generally delegate their approval authority levels to their subordinates (i.e. individuals who are not authorized to review and approve transactions at the predefined level). Although the delegations of authority are usually for a specific time-period, a risk exists that authority levels may not be updated accurately and timely. As a result, individuals may receive their supervisor's authority levels indefinitely.

The delegation of authority to individuals previously not authorized to review and approve refunds can impact the segregation of duties related to review and approval. For instance, an authorized approver may delegate their approval authority to an individual who has the ability to initiate a refund. As a result of the delegation of authority, there will be no longer be a segregation of duties between the individual responsible for initiating the refund and the individual responsible for authorizing the refund.

During our procedures, we noted the following for the vouchers processed after March 31, 2008 when the Interim Refund Directive was implemented:

Appendix A

Material Weaknesses and Significant Deficiencies in Internal Controls
Over Financial Reporting

1) Two Real Property Tax Administration and Adjustment Unit (RPTAAU) employees signed 5 manual refund Certification Forms for tax sale refund vouchers above their approval authority levels. The delegation of authority documentation could not be located for one employee. For the second employee, email documentation stated that the employee's supervisor had granted the employee temporary authority to sign at the supervisor's approval level. However, the email documentation did not clearly state the start date and end date of this delegation of authority.

2) Two RPTAAU employees signed two ITS Certification Forms for a Real Property and a Fiduciary Tax refund above their approval authority levels.

3) The Certification Form does not have a column to indicate the date of review. As a result, the Revenue Accounting Administration (RAA) will be unable to verify if the individual signing and authorizing the refund voucher had the authorization to do so on the date of his or her review.

The Signature Approval Directive should be amended to state that supervisors are not able to delegate their authority level to their subordinates. Instead, if an individual needs to delegate his or her authority level, this authority should be delegated to either a peer or supervisor. The Refund Certification Form should also be modified to include a column for date of review.

Management's Response:

Management will change the Approval Directive to state that refund approval authority for first line supervisors cannot be delegated to their subordinates.

<u>Manual Refunds Posted to the Incorrect Agency Code</u>

The Real Property Tax Administration and Adjustment Unit (RPTAAU) processes several different types of refunds which include but are not limited to: Deed Recordation Fees, Real Property Taxes, Tax Sale Purchases, Tax Sale Subsequent Payments, Real Property/Tax Sale Interest, Individual Income Taxes, Inheritance and Estate Taxes, and Deed Recordation Taxes. Each of these refund types has a corresponding agency object code in SOAR, the District's accounting system of record.

During our testing, we noted that 4 of the 101 manual refunds selected for testing were posted and recorded to the incorrect agency object in SOAR.

We recommend that the review process for the SOAR Revenue Refund Voucher (SRRV) should be enhanced to ensure that the accurate agency object codes are listed on the voucher. Individuals responsible for reviewing and authorizing the vouchers should verify that correct agency code is indicated.

Management's Response:

A line will be added to the Documentation Checklist requiring the reviewer to check off that coding has been reviewed and is correct.

Appendix A

Material Weaknesses and Significant Deficiencies in Internal Controls Over Financial Reporting

IV - C. Other Issues

Reconciliations and Year-End Closing

In the process of performing our audit, we encountered several instances where revenue schedules had to be revised due to the fact that amounts did not reconcile with the supporting details:

1) We noted unreconciled differences between the amounts recorded in SOAR, the District's accounting system of record and the amounts in OTR's individual general ledger.

2) We noted that reconciliations of revenue accounts were incomplete. For instance, we discovered errors in the formula computing accrued revenue with respect to ballpark fees.

3) We also found that the treatment of non-real property pipeline collections was incorrectly calculated at year-end.

Timely reconciliations would have quickly identified these errors and the needed corrections. Reconciling differences should be corrected before the books are closed. We believe that a more timely review and evaluation of transactions would expedite the year-end closing.

Management's Response:

It should be noted while Revenue Accounting Administration (RAA) experienced management and staff turnover in FY 2008, it now has a new but experienced management team which is committed to developing, implementing, and documenting reliable and efficient year-end closing procedures; establishing standards for work paper sufficiency; ensuring supervisory/management reviews and approvals of all RAA work products and processes; setting timetables for recurring SOAR to OTR subsidiary ledger reconciliations; strengthening procedures and reviews in risk areas; and periodically reviewing RAA policies and procedures for continuing effectiveness. The error regarding non-property tax "pipeline" revenues is one-time in nature due to changes in personnel, poorly documented procedures, and insufficient legacy work papers. These conditions will be rectified in FY 2009. RAA will coordinate its activities with the Office of Financial Operations and Systems, providing work papers, analyses, and justifications, as needed.

Reconciliation of the Tax Sale Ledger

An adequate process is not in place to reconcile the Tax Sale Ledger, the D.C. General Ledger, and SOAR, the District's accounting system of record, on an on-going basis. Listed below is a brief description of the three systems:

- *Tax Sale Ledger* – This database contains properties available for sale during the current tax sale year, information of Buyers that are participating in the tax sale, record of initial deposits made by the prospective buyers, the winning bid amount for the property, and the subsequent settlement payment to complete the purchase made by the Buyer. A database is created for each tax sale year. This data base is used to support refunds to individuals that made deposits to participate in the tax sale but did not win any bids. Therefore, the deposit amount has to be refunded to these individuals.

- *D.C. General Ledger* – This is a consolidated database of all properties that have been purchased at the Tax Sale through various years and the corresponding purchase amount for the properties and the Buyer information. This database is used to support the refunds to Buyers due to cancellation of the tax sale, redemption of the tax lien property by the original owner, or successful foreclosure on the tax lien property.
- *SOAR* – This is the general ledger financial accounting system of the District.

Since these systems were not properly reconciled in the past, OTR engaged an outside consulting firm to perform these reconciliations in October 2008. Management should implement a process to reconcile these systems on a more regular basis.

Management's Response:

Real Property Tax Administration (RPTA) has completed a reconciliation of Tax Sale Ledger with the D.C. Ledger for 2008. RPTA has already begun working with Revenue Accounting Administration (RAA) to reconcile with the D.C. Ledger with SOAR and will work with RAA to develop procedures for periodic reconciliations during the fiscal year.

<u>Tax Sale Database</u>

We noted that a separate Tax Sale database is created for each annual tax sale auction. Consequently:

- There is no consolidated database where a Tax Sale buyer's balance (i.e. the amounts deposited at the Cashier's Office less refunds issued) is maintained.
- Since Tax Sale buyers are issued a different buyer number each tax sale year, there is no unique identifier across the various tax sale databases which can be used to identify the Tax Sale buyer and obtain his/her balance.
- Non-bidders and non-winners of the Tax Sale are not uploaded to the D.C. General Ledger. As a result, refunds due to these tax sale participants are maintained in a separate database.

Due to the lack of a consolidated Tax Sale database, it is difficult to analyze the total activity per Tax Sale Buyer. We recommend that each tax sale participant be assigned a unique identifier. This identification number should be used to generate a report that details the buyer's complete tax sale history.

Also, all tax sale participants and their tax sale data should be uploaded to the D.C. General Ledger, not just winning bidders. If the Real Property Tax Administration and Adjustment Unit (RPTAAU) maintained all tax sale participant data in the D.C. General Ledger, only one system would need to be reconciled to SOAR.

Management's Response:

Each Tax Sale participant will be assigned a unique identifier for all subsequent tax sales. A tax sale history will be maintained for each entity on a continual basis. The tax sale history will be searchable and will be able to produce a report for each individual entity as necessary. Management will study the feasibility of uploading the complete tax sale bidder database to the D.C. General Ledger using the current system. Requirements for a new system are currently being developed and this will be proposed as one of the system requirements.

Appendix A

Material Weaknesses and Significant Deficiencies in Internal Controls
Over Financial Reporting

Potential Segregation of Duties Issues

A fundamental concept in a good system of internal control is the segregation of duties. We noted the following during our procedures:

- When processing refunds, the Returns Processing Administration (RPA), the Problem Resolution Office (PRO), and the Recorder of Deeds (ROD) generally mark manual check requests hold-for-pickup (HFP) so that they are sent back to their administration. This is done so that the refund check can be verified for accuracy before distribution to the taxpayer. However, checks can be sent back to the individual who initiated and/or authorized the refund request.

- The Revenue Officers responsible for collecting delinquent taxpayer accounts receive check and money order payments from taxpayers and have access to post credit adjustments to taxpayer accounts. In addition, they are able to change taxpayer balances by recording various adjustments such as abate penalty and/or interest. They are also able to transfer payments from one year to another. Only a periodic manual review of the credit adjustments is performed by the collection managers.

- The same individuals within RPA who receive taxpayer payments and prepare the deposit also record the payments to taxpayer accounts within the Integrated Tax System (ITS). There is no reconciliation of taxpayer payments posted in ITS to the cash deposited in the bank and cash recorded as received in SOAR.

To enhance controls, management should ensure that refund checks are not returned to the same individual who initiated and/or authorized the refund request. Further, revenue officers should not have access to or receive taxpayer payments. An exception report should be created to monitor the adjustments to taxpayer accounts in ITS. Unusual adjustments or pattern of adjustments should be reviewed by the supervisors of the collection department. The individuals responsible for performing this review should not have access to post adjustments to taxpayer accounts in ITS. Individuals who have access to the taxpayer payments (i.e. cash receipts) and/or who are responsible for preparing the deposit should not have access to record payments or adjustments to taxpayer accounts in ITS. Reconciliations should be performed of payments recorded in ITS, cash deposited per the bank, and cash recorded in SOAR.

Management's Response:

Effective May 30, 2008, the DCFO for OTR issued a delegation of authority ensuring that refund checks were not returned to the same individual who authorized the refund request. This hold for pick up process is now delegated to the Director, Customer Service Administration.

Regarding the procedures related to the delinquent taxpayer accounts, the procedures have been changed so that revenue officers may not input adjustments to accounts assigned to them. An Adjustment Unit has been established to perform input of all adjustments for the Collection Division. Employees within the Adjustment Unit do not have cases assigned to them and therefore they cannot perform adjustments to accounts assigned to them. Adjustments must be approved prior to transmission to the Adjustment unit.

Material Weaknesses and Significant Deficiencies in Internal Controls Over Financial Reporting

We also concur with the findings and recommendations regarding segregation of duties for individuals with access to payments (i.e. cash/receipts) and/or are responsible for preparing deposits and not having access to record payments or adjust accounts. A review of ITS profiles was conducted and completed. The result was that employees who work deposit activities will not have access to adjust taxpayers' accounts.

Homestead Tax Credit Program

During the testing of controls over the Homestead and Senior Citizen Tax program, we noted the following:

1) There was no consistent audit trail or evidence of review of the Homestead applications; this is specifically related to applications received prior to 2004 and processed outside of the Homestead Unit within the Real Property Tax Administration (RPTA) department of OTR.

2) Currently, Homestead applications are processed and approved either by the Homestead Unit or Recorder of Deeds Division. There is a lack of a centralized approval process.

3) In 1 out of 45 properties selected for testing, we found that supporting documentation related to the Homestead application could not be located.

4) We noted that because of the inconsistent reviews of the Homestead applications, there were many instances of individuals receiving multiple Homestead credits for multiple properties. The Homestead credit is only allowed for one property which is the property in which the owner resides in during the year. This lack of reviews has also resulted in a cap credit deficiency, which allowed individuals with multiple properties to receive the cap credit on more than one property.

5) In 2 out of 10 properties, selected by us for testing, with duplicate owner's names, we found that both properties were owned by the same individual who received the Homestead credit incorrectly. At our request, OTR then researched its database and determined that the estimated number of incorrect Homestead credits given related to at least 252 properties.

6) Certain category of non-individuals, including LLCs, which are ineligible for the Homestead credit, received this credit, to which they were not entitled. These entities also received the Assessment Cap Credit to which they were not entitled.

The District does not appear to have a proper and comprehensive review process in place, which would have allowed them to identify these errors related to the incorrect application of credits. Failure to properly and comprehensively review and approve applications can result in employees granting improper tax deductions and credits to ineligible entities which can result in lost revenue to the District. We recommend that management consider centralizing the approval process and ensure that only eligible entities are allowed these tax credits. In addition, we recommend that evidence of review be properly documented to provide a better audit trail of the transactions.

Management's Response:

Historically, the role of the Homestead Unit was to audit and remove the homesteads; the applications were approved by the Assessment Division.

Material Weaknesses and Significant Deficiencies in Internal Controls
Over Financial Reporting

The Homestead applications have never been reviewed or approved by Recorder of Deeds (ROD). All functions related to Homestead have now been consolidated in the Homestead Unit for FY 2009.

RPTA has consolidated all functions related to the homestead exemption in the Homestead Unit including the review of all Homestead applications. Each application will receive more rigorous review against information currently in ITS.

OTR is exploring partnerships with the Vital Statistics, the Department of Motor Vehicles, and the Census Bureau to acquire comprehensive data for inclusion in the OTR data warehouse. Audits will be performed annually against data in the expanded data warehouse and questionnaires will be sent to all homeowners who could potentially be receiving a duplicate homestead exemption to request more information.

Management concurs with the recommendations. Please note, these findings do not take into account the recent change in the law which provides that when a property is transferred, the exemption remains for the period in which the transfer occurred. The exemption and cap are removed at the beginning of the next period.

* * * * *

Material Weaknesses and Significant Deficiencies in Internal Controls Over Financial Reporting

V. 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.

Grants Management

DCPS has set guidelines on creating payment/draw down requests. In general, draw down amounts should not exceed the actual expenditure. Based on an analysis prepared for FY 2007, it appeared that there were instances when the cash receipts requested exceeded the federal expenditures for the corresponding period.

As a result, it was noted that subsequent to year-end in October 2008, DCPS and the Office of the State Superintendent of Education calculated the exact amount overdrawn considering cumulative expenditures incurred over all open phases of various grants. District officials represent that they have sent back approximately $11,213,000 in overdrawn funds and accrued interest to the U.S. Department of Education.

We recommend that DCPS request federal funds based on its actual expenditures. We also recommend that DCPS develop written procedures for its draw down process. Those procedures should be consistently performed for each draw down request.

Management's Response:

Our drawdowns systematically included accrued expenses and thus resulted in drawdowns in advance of the cash expenditure. We have revised our drawdown procedures to include drawing down grant funds for cash expenditures only, except for the last drawdown of the fiscal year. To ensure that federal drawdowns are received during the correct grant period we include accrued expenditures in our final drawdown for the fiscal year (September 30).

As indicated above, the District has completed an extensive analysis on grant drawdown activity and has returned overdrawn funds to the U.S. Department of Education.

Medicaid Provider Programs and Claims

It was noted that the Medicaid Cost Reports for FY 2007, for the seven Medicaid provider programs at DCPS, had not been completed as of the end of FY 2008. Medicaid guidelines require that the report be submitted to the Department of Health Care Finance within four months after fiscal year end. Consequently, DCPS is not in compliance with applicable Federal and state guidelines.

In addition, during our review of 77 Medicaid claims, we noted that 1 of the claims lacked supporting documentation. Also see pages 28-29 for Medicaid disallowances related to DCPS in the current fiscal year.

We recommend that timelines for completion of the Medicaid cost reports be developed and implemented with the independent third party utilized by DCPS to complete the applicable Medicaid cost reports. DCPS should also maintain its files on hand in a manner that allows for timely retrieval.

Material Weaknesses and Significant Deficiencies in Internal Controls
Over Financial Reporting

Management's Response:

The time for claiming payments for Title XIX (School-Based Programs) expenditures is two (2) Years. This is in accordance with 45 CFR, Section 95.1(a). During the past eight months, DCPS cleared the back–log of outstanding cost reports by completing cost settlements for FY 2003 through 2006. Due to the on-going settlements, DCPS requested and received an extension from the Medical Assistance Administration (MAA) (now Department of Health Care Finance) for the 2007 Cost Report (for the seven Providers). DCPS will submit the Cost Report for 2007 (seven Providers) by June 30, 2009.

With respect to Medicaid claims lacking supporting documentation, DCPS has implemented an electronic document management system which will enhance our ability to manage and retrieve documents.

<u>Payroll – Timesheets</u>

Sound internal control procedures dictate that time sheets are properly approved, that time sheets are reconciled with the check register hours, and that the master employee file is updated periodically to reflect employee's actual pay rates. We requested timesheets for 50 active employees and noted the following deficiencies:

1) For 8 out of 50 transactions sampled, DCPS did not have properly approved time sheets.

2) For 2 out of 50 transactions sampled, the hours per the actual time sheets did not agree with the hours per the check register.

3) For 15 out of 50 transactions sampled, the actual pay rate did not match the employee master file.

Time cards are the source document supporting the District's labor expenses. A proper review should be conducted to determine that the employees have recorded time only when it had actually been worked and that the allocation of time by category was appropriate and reasonable.

DCPS should also ensure that the payroll calculations are accurate as errors can cause an over or under payment of wages

Management's Response:

DCPS anticipates conversion to the PeopleSoft personnel system in April 2009. This improved system, along with the process redesign work that DCPS is doing in anticipation of the new system will dramatically improve business processes for many functions related to the personnel system.

DCPS payroll personnel review each time sheet for evidence of supervisory approval prior to processing in the Comprehensive Automated Personnel Payroll System (CAPPS). We are continuing to improve our record retention procedures by implementing an electronic filing system. We anticipate the use of the electronic filing system will improve our ability to locate authorized original and revised timesheets.

Appendix A

Material Weaknesses and Significant Deficiencies in Internal Controls
Over Financial Reporting

Disbursements

1) We reviewed 105 disbursements made during FY 2008 and DCPS could not locate the supporting documentation for 1 item.

2) We reviewed 45 direct disbursements and noted DCPS lacked supporting documentation for 2 of the direct disbursements.

3) We reviewed 54 subsequent cash disbursements and noted that 4 items, totaling approximately $7,000,000, were not properly accrued for in FY 2008 by DCPS management. The amounts were related to construction and food service expenditures and were adjusted during the audit process for year-end financial statement presentation.

We recommend DCPS follow its existing policies for maintenance of supporting documentation. More detailed analysis needs to also be considered in analyzing disbursements to ensure they are reported in the proper period.

Management's Response:

We will revise our current internal policies and procedures to further incorporate the integrated features of SOAR, the District's official accounting system of record. Individuals responsible for approving vouchers and journal entries have been counseled to review each transaction for sufficient evidential support. Further, DCPS will work to ensure that all subsequent disbursements are properly accrued in the proper fiscal year.

* * * * *

Appendix A

Material Weaknesses and Significant Deficiencies in Internal Controls
Over Financial Reporting

VI. Management of the Postretirement Health and Life Insurance Trust

Plan Governance

For any retirement and other employee benefit plans, the Plan Document is the legally binding document that defines the benefits, eligibility, and administration of the plan's activity. The Plan Document further defines the responsibilities of the Plan Sponsor and Administrator.

The District, the Plan Sponsor, has not completed a Plan Document for the Postretirement Health and Life Insurance Trust (the Plan). As of April 1, 2008, the Plan has 254 teachers, police officers, and firefighter retirees and 44 regular District retirees. Teachers, police officers, and firefighter retirees are administered by the District of Columbia Retirement Board (DCRB) and others are administered by the District's Department of Human Resources (DCHR).

Due to the lack of Plan Document, the responsibilities of the administration of the Plan are not clearly defined and retirees may not be fully aware of the postretirement benefits that are available to them. The lack of a Plan Document results in unclear processes and administration responsibilities within the District. It can also increase the risk of disputes over benefit entitlements, enrollment eligibility, and participants' responsibilities.

We noted that the District has set up an irrevocable trust for the Plan, effective September 30, 2006. However, the trust does not define the terms of the Plan. We continue to recommend that a comprehensive Plan Document be prepared and implemented as soon as possible.

Management's Response:

A primary reason that a Plan Document has not been completed is that the level of post-employment benefits has been under review and consideration by the City Administrator and the Department of Human Resources (DCHR) for possible revision. This review should be completed during FY 2009, and once the level of benefits is confirmed or revised, a formal Plan Document can and will be developed. However, the D.C. Code outlines eligibility requirements, the level of post-employment health and life insurance benefits, and the respective portions of the cost of these benefits to be covered by the District and the former employee(s).

In addition, employees complete an application to continue or discontinue their benefits into post-retirement at the end of their employment tenure. Those who elect to continue benefits into post-employment receive a letter from DCHR outlining the benefits selected, the cost, and the procedure they should follow to make premium payments.

Administrative and investment responsibilities are divided between the Office of Finance and Treasury (OFT) and DCHR. OFT is responsible for the investment and management of trust fund assets as stated in the written trust agreement. Trust fund assets are invested in accordance with a written Investment Policy and are reviewed on a regular basis with an investment consulting firm and the fund's investment managers. DCHR works with employees transitioning to retirement status and provides them with the counseling and information needed to maintain their benefits.

Appendix A

Material Weaknesses and Significant Deficiencies in Internal Controls Over Financial Reporting

Plan Investments

Currently, the Plan maintains an investment policy which appears insufficient to monitor activities. While it does outline an investment allocation and segregation of duties, it lacks documentation for regular recordkeeping, custodial processes, and management processes. We also noted a variety of other concerns in connection with the administration of the investments. Specifically, we noted the following:

1) The investment policy does not consider accounting treatment requirements and valuation risks associated with various types of financial instruments.

2) The District did not follow its own investment policy parameters. We noted that while the policy only allows for up to 10% in alternative investments, almost 21% of the funds were invested in alternative investments.

3) A team of 2 members at the Office of Finance and Treasury (OFT) made all investment decisions for FY 2008.

4) OFT relies on quarterly investment reviews from a third party, and yearly evaluations from each of the fund managers for assessment of fund performance and valuation. OFT does not review these for reasonableness. In particular, we noted that investment income had not been reviewed for reasonableness, accuracy, or completeness.

5) Despite confirmation that the BlackRock investment is an alternative investment type, OFT did not perform valuation procedures required by the accounting standards to have sufficient information to evaluate and independently challenge the fund's valuation and assess the composition of the underlying assets. Management is responsible for the fair value of alternative investment amounts as presented in the financial statements, and OFT currently outsources this responsibility to a third party. Outsourcing this function does not eliminate management's responsibility.

   As a result, management did not appear to have sufficient information to evaluate and independently challenge the fund's valuation. Management also did not have a documented process for determining the estimated fair value of the investments. Audited financial statements for alternative investments should have been obtained and evaluated by management. The Plan was not able to produce BlackRock's audited financial statements.

6) Management fees are charged for each of the funds in the Trust, but they are not regularly monitored, recorded, or reviewed.

Investment management activities carried out during the year were not sufficient to monitor the different funds in the Trust. We recommend an amendment to the investment policy in order to clearly define controls and processes. This will help ensure that funds are allocated appropriately to achieve the greatest benefit and that investment income is accurate, complete, and reasonable. The investment policy should also include provisions for the preparation of monthly reconciliations, the recording of all management fees and investment income, and appropriate managerial valuation of alternative investments.

The District may consider the establishment of an investment committee which would be entrusted with the task of managing the funds.

Material Weaknesses and Significant Deficiencies in Internal Controls
Over Financial Reporting

Consideration may also be given to external consulting with investment specialists. As the securities markets have become more volatile, the District has to more closely and frequently monitor interest rate and market changes, maturity dates, interest and dividend receipts, economic developments, etc., and make decisions about how to invest new money or maturing instruments.

Management's Response:

The investment policy was not intended to cover administrative issues such as recordkeeping and the custody of assets. We will review the written procedures we developed for the Plan and adjust them to include record keeping and the custody of assets. We are in process of amending our investment policy and we will consider the suggestions made to include provisions regarding the accounting and valuation of our financial assets. Investment decisions were properly reviewed and approved in 2008. The investment of available cash is reviewed with our investment advisor and its recommendations are then reviewed at OFT. Investments are made in accordance with investment policy and our asset allocation guidelines. The Trust Fund's Investment Policy clearly establishes authority and responsibility by assigning duties to senior members of the Office of the Chief Financial Officer (OCFO). In Section 2, it assigns the responsibility for the approval of investment strategies to the Deputy Chief Financial Officer and Treasurer. This Section also assigns responsibility for the review and reporting of the financial condition of the fund to the Associate Treasurer for Asset Management. A new Associate Treasurer with extensive investment experience was hired in September 2008 and he has augmented the investment team.

We disagree with the statement that the District did not follow its investment policy. We assume that this statement refers to the investment in the BlackRock Growth Fund. We do not consider this an alternative investment, and this conclusion is supported by our investment advisor. Sections 7 and 8 of the Investment Policy clearly outline asset allocation procedures, the criteria for determining approved investments and the use of appropriate benchmarks. Investments in assets such as mutual funds and collective investment funds are specifically authorized investments and are considered a potential investment vehicle to implement designated asset classes e.g., equity mutual funds or collective funds are considered equities for the purposes of asset allocation. We will, however, clarify how the asset allocation strategy takes into consideration various investment vehicles and their underlying assets when we amend the investment policy.

The Fund has an independent investment advisor who reviews investment performance on a monthly and quarterly basis. The quarterly review is more comprehensive in nature including an analysis of the performance of individual investment managers including specific analysis of the underlying holdings within the portfolios. It also provides a review of the total fund performance relative to the market and peers by using a custom benchmark and peer universe comparisons, The report will review the current asset allocation of the Fund to be sure it is compliant with the target policy ranges.

BlackRock's custodian independently values the holdings in the fund. During the preparation of the quarterly reports, the consultant independently reviews the valuation of the securities held in the BlackRock Fund, Copies of this review are distributed to senior management. Audited financial statements are available for BlackRock. The fund holds large capitalization, widely traded companies such as Walt Disney Co., Wal-Mart Stores, Exxon Mobil, and Johnson and Johnson. We have a copy of the audited 2007 financial statements and a draft of the 2008 report. The final 2008 audit is expected shortly. The availability of financial audited financial statements and input from our independent consultant provides us with the basis to judge the adequacy of the fund's valuation process.

Material Weaknesses and Significant Deficiencies in Internal Controls
Over Financial Reporting

We meet with the investment managers at least annually. Our investment advisor attends these meetings to provide an independent perspective on the presentations. Our investment advisor holds periodic meetings separate from our collective meetings to monitor the firm and performance and provides formal due diligence write-ups to the OCFO. OFT remains abreast of the current market environment through conference calls and topical research pieces from the investment consultant in addition to discussions at quarterly meetings.

Fund reports are reviewed by management and formal presentations by fund managers are also reviewed by management and a representative from our investment consulting firm. OFT cannot and does not delegate its responsibilities to a third party. We use a consultant to provide an independent perspective on the performance of the investment managers and their funds. The responsibility to make changes based on this input rests with us.

Management fees are calculated separately for only two of our investments. These are the Bernstein Growth and Value Funds. Bernstein provides invoices on a quarterly basis and they are reviewed by OFT. The remaining fees are charged through mutual fund expenses and they are reviewed as part of the annual audit of the trust fund.

During FY 2008, we began reconciling the investment accounts on a monthly basis. These reconciliations are sent to the Associate Treasurer for review. We will consider establishing a formal Investment Committee to review investment policy, fund performance, and conformity to the fund's Investment Policy. However, we feel that our current processes are effective.

Contribution and Premium Payments

Premium Payments

During our procedures over premium payments (employer portion), we noted the following:

1) For the first ten months of the fiscal year, premium payments were not paid from the Trust's account, even though that was one of the purposes of establishing the Trust. The Bureau of Public Debt (BPD) received bills from the insurance carriers and paid them as they were received. The District's Office of Personnel Management (OPM) and Office of Finance and Resource Management (OFRM) reimbursed BPD for the monthly employer premium payments. In some months, the insurance providers billed the District directly, and those payments were also made from OFRM and OPM. In essence, the District was paying for the premiums on behalf of the Plan.

2) Money was contributed to the Trust specifically to make premium payments under the provisions of the Plan. However, the District was paying for these retiree benefits without any requests for repayment. Additionally, these expenditures were not approved or allowed for within the District's budget and the premium payments were made without proper verification of budgetary authority.

3) Payment from the District's General Fund as opposed to payments from the Trust results in a liability from the Plan to the District which had not been established on the books of the Plan.

Material Weaknesses and Significant Deficiencies in Internal Controls
Over Financial Reporting

4) The total amount of payments made by the District on behalf of the Plan is estimated to be approximately $1,800,000.

5) A proper chain of responsibility over insurance billings has not been established, as invoices were sent to and paid by different agencies at different times of the year.

Contribution Payments

Under new standards issued by the Governmental Accounting Standards Board, the District had its Postretirement Health and Life Insurance Trust (the Plan) audited for the first time in FY 2007. 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.

1) We noted that over $37,000,000 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 Plan's assets.

2) In an attempt to correct this, during FY 2008, the Plan offset the aforementioned unapproved contributions, including interest earned for a total amount of $56,000,000 from the $110,000,000 set aside to fund the Plan for FY 2008.

3) However, the $56,000,000 owed to the District remained with the Plan for an additional 9 months through the end of June 2008. The Plan did not calculate and submit any additional interest incurred during this additional holding period.

4) During FY 2008, another unapproved and unreserved for payment was made by the District to the Plan and amounted to $5,400,000. The Plan did refund the money in June 2008, but did not repay the interest accrued on the investment.

The District should verify that budget authority for all proposed payments exists before transfers are made from the General Fund. We recommend management ensure adequate controls are in place over the contributions and disbursement process.

Management's Response:

This issue was corrected in FY 2008. The District was reimbursed for expenses incurred in FY 2008. Requests for reimbursements are sent directly to OFT for processing.

All pay-as you go contributions were paid out of the Plan assets in FY 2008 and we continue to pay these costs from the trust fund. The plan to reimburse the District for unapproved contributions was made as a result of last year's audit. The interest on these contributions was calculated by our investment advisor, EAI. Interest was calculated through September 30, 2007 and once the calculations were completed we processed the transaction as soon as possible.

Appendix A

Material Weaknesses and Significant Deficiencies in Internal Controls
Over Financial Reporting

The comments related to this problem were made at the end of March 2008 and the correction was made in June 2008. The $5,400,000 million investment was made at a price of $11.26 per share and we purchased 476,808.682 shares of the BlackRock fund. The redemption in June was made at $9.88 per share. We sold an additional 66,600 shares to make the District whole on this transaction.

If we sold the original number of shares, we would have incurred a loss of $658,000. Selling additional shares more than offset any interest accrued on the investment. Please note that BlackRock's financial report indicted that the fund earned net investment income of $.04 per share per year while these monies were in the fund.

Transfers are not made from the General Fund unless an appropriation has been authorized.

Participant Data and Retiree Folders

The Postretirement Health and Life Insurance Trust (the Plan) needs to improve its record-keeping over retirees and active personnel. During our procedures, we noted the following:

1) We were not provided with adequate support for 6 of the 72 sample items requested by us for testing for participants and active employees.

2) For all the participant's files reviewed, the hire data listed in the database did not exactly agree to the hire date per the retirees' file.

3) Several of the participant folders reviewed did not have the benefits enrollment form.

4) For some participant files reviewed, date of birth per the files did not agree with the date of birth per the database used by the actuary for valuation purposes.

5) The District of Columbia Retirement Board was unable to locate 2 files and the Metropolitan Police Department was unable to locate 1 file.

6) The database did not include proper employees' ID or Social Security Numbers, which is necessary to uniquely identify each annuitant or survivor.

7) There are no records of whether the general retiree portion of premium payments, which are mailed to the District's Department of Human Resources (DCHR) were received and recorded by the Office of Finance and Treasury (OFT), and forwarded onto insurance carriers. OFT was unable to confirm the amount due from retirees.

8) Completeness of data used for actuarial calculation purposes is problematic since the actuary obtains the data from multiple sources and then modifies it for inclusion in the actuarial valuation.

We recommend a formal oversight process be implemented over the Plan to resolve these issues.

Material Weaknesses and Significant Deficiencies in Internal Controls
Over Financial Reporting

Management's Response:

Management concurs with some of the issues and understands there are some control deficiencies. OFT management will work closely with the District of Columbia Human Resources (DCHR) and the District of Columbia Retirement Board (DCRB) to ensure that personnel data, retiree premium payments, and other information that is included in the actuarial calculations is complete and accurate. We will look to incorporate audit recommendations into policies and procedures for FY 2009.

* * * * *

Appendix B

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 FY 2005 was processed through OCP. While District personnel represent the procurement percentages have not changed significantly for FY 2008, District personnel were not able to provide specific percentages for FY 2008.

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), the District of Columbia Public Schools (DCPS), and the Department of Mental Health (DMH). Following are issues noted during our test work performed in conjunction with the audit of the FY 2008 Comprehensive Annual Financial Report.

<u>Database Review</u>

While the selected agencies provided contract information, these agencies could not confirm the completeness of this information. The absence of a tracking tool or a database inhibits the ability to verify completeness of contracts awarded, the amounts awarded, and status of each contract entered into. Further, the maintenance of a database is critical in the evaluation of controls.

We further noted that the contracts field in the Procurement Automated Support System (PASS) is not a required field. As such, we could not validate the accuracy and completeness of contracts referenced to in purchase orders.

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 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. 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.

Appendix B

Material Noncompliance with Laws and Regulations

Approval Process and Other District of Columbia Municipal Regulation (DCMR) Issues

We noted the following during our audit process:

1) *Failure to Provide Contract Files* – There were 9 instances at OCP where no file was provided; hence, we were unable to test the files.

   We also noted that DCPS could not provide contract files for 3 of the 25 contracts selected for testing. In addition, we noted that although the budget authority for various transactions is the responsibility of DCPS, the procurement process was handled by the Office of Public Education Facilities and Modernization (OPEFM). However, there does not appear to be adequate coordination between the two agencies and DCPS does not maintain any documentation relating to procurement of these goods or services, which are reflected as part of its costs.

2) *Approvals for Legal Sufficiency* – There were 3 instances during which certain agencies selected for testing failed to provide evidence of the Office of Attorney General's review and approval of the contract for legal sufficiency. There were 2 missing approvals at OCP and 1 at CFSA .

3) *Failure to Provide City Council Approval* – Evidence of Council approval for contracts over $1 million was not provided for 1 contract selected for testing at CFSA.

4) *Failure to Provide Business Clearance Memorandum (BCM) Approvals* – There was 1 instance at CFSA during which the required Business Clearance Memorandum was not provided.

   We also noted 3 instances at OCP where the BCMs were provided, but they were not approved.

5) *Failure to Provide All the Required Determination and Findings (D&F)* – There were 11 instances during which not all the required D&Fs were provided from the agencies selected for testing as follows: 4 from OCP; 1 from CFSA; 2 from DMH, and 4 from DCPS.

   We also noted 2 instances at OCP and 1 instance at CFSA where the required D&Fs were provided, but they were not approved.

   We also noted yet another instance at CFSA where the D&F sole source had an inconsistent amount as compared to the contract.

6) *Review and Certification of Sole Source Contracts by the Chief Financial Officer* – We noted that there were 2 sole-source contracts that were extended or renewed where review and certification by the Chief Financial Officer was not provided. There was 1 instance at OCFO and 1 instance at CFSA.

7) *Inadequate Documentation of the Significant History of the Procurement* – We noted 1 instance where CFSA was unable to provide evidence of significant history of the selected procurement.

8) *Lack of Documentation of Full and Open Competition* – We noted 1 instance where CFSA was unable to provide evidence of full and open competition of the selected procurement.

Material Noncompliance with Laws and Regulations

9) *Failure to Provide Cost Price Analysis* – There were 5 instances at OCFO and 2 instances at CFSA where the file reviewed lacked evidence that a cost/price analysis was performed.

10) *Review of Compliance with Tax Requirements* – There was 1 instance at OCP, 1 instance at D.C. Public Library (DCPL), and 1 instance at DCPS where the tax certification affidavits were not notarized. In addition, there were 2 instances at CFSA where we were not provided with tax verification responses from both the Department of Employment Services (DOES) and Office of Tax and Revenue (OTR).

    We also noted 5 instances at CFSA where the tax verification responses were provided but were not timely for the contract period.

11) *Lack of Evidence of Review of the Debarment, Suspension, and Ineligibility List* – There were 2 instances at DMH and 1 instance at DCPS where the files lacked adequate documentation regarding the procedures for checking against the Federal Debarred and Suspended List and the District's Excluded Parties List.

12) *Failure to Provide Evidence of Contractor Evaluation* – We noted 3 instances at CFSA and 7 instances at OCP where contractor evaluations were not provided.

13) *Review of Contracts for Accrued Expenses* – We also noted that transactions were recorded as accrued expenses and were not supported by valid contracts prior to the services being rendered.

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.

Orderly filing should be maintained to insure proper control over all supporting documentation. The result was that employees spent nonproductive time searching for needed documents. This condition could also present problems when documents are needed in support of various reports subject to audit by us or governmental agencies.

We recommend that closer oversight and monitoring controls be placed over document maintenance and retrieval processes throughout the District's procurement process. The District must follow its existing policies for documentation and approval of transactions. 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 also recommend that the District consider performing 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 should 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.

Material Noncompliance with Laws and Regulations

Management's Response:

In FY 2008, OCP reclassified the position description for file manager (versus the old file clerk) to bring the proper attention to the importance of file maintenance.

After a lengthy search, OCP hired a contract file manager and established a new database record file system and a process to collect, inventory, retain and archive all OCP controlled contract files. The database was created to track the files and to record its content. The Contract File Preparation policy has been implemented which provides the necessary guidance to contracting personnel for contract file contents. Additionally, the newly established Office of Procurement Integrity and Compliance will work closely with the contract files manager to routinely conduct random audits of files to ensure compliance with the Contract File Preparation policy.

As OCP improves its contract filing and maintenance system, OCP will share the system with other District procurement agencies including CFSA, DMH, DDS and all other independent agencies. To address training concerns, the agency training section is in the process of developing a training/certification curriculum; we expect to be able to award this contract to a vendor in the second quarter of FY 2009. A course of instruction will be rolled out to all contracting staff and to agencies wishing to have limited contracting authority. Agency contracting staff will be required to maintain a certain level of procurement certification to ensure that we have the appropriate level of competence and consistency within the agency.

<u>Purchase Order Splitting</u>

We noted that there were purchase orders issued to the same vendor for similar services within a twelve month period. There were 19 instances during which we did not receive evidence of approval from the City Council and 17 instances of lack of evidence of approval from the Office of the Attorney General (OAG) for short-term purchase orders which were individually less than $1,000,000 but cumulatively totaled over $1,000,000.

1) There were 15 instances at OCP where there was no evidence of City Council approval.

2) There were 4 instances at OCFO where there was no evidence of City Council approval.

3) There were 15 instances at OCP where there was no evidence of OAG approval.

4) There were 2 instances at OCFO where there was no evidence of OAG approval.

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 OCP, is that the organization recognizes the need for more term contracts by virtue of the fact that we see the separate requisitions of multiple agencies for the same good or service. By reorganizing in the fall of 2008 to have our contracting personnel assigned to specific commodities instead of agencies, we are now in a position to reorganize and reduce multiple purchase orders for the same items.

This procurement method will be implemented to a greater extent in FY 2009. 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. OCP had not found circumstances where there have been instances of purchase order splitting; therefore, with the development of more term contracts, we feel confident that the appearance of purchase-order splitting will be significantly reduced.

Limited Competition Small Purchase Threshold

Contracts for purchases from 22 vendors which cumulatively exceeded the dollar threshold for small purchases for all other agencies were not provided. There were 21 such instances at OCP and 1 instance at DCPL.

Management's Response:

Multiple agencies and specifically multiple divisions within an agency can purchase goods and services from the same vendors. However, these purchases must be viewed individually not in the aggregate. The Chief Procurement Officer (CPO) recognizes his responsibility to ensure a transparent procurement process and appropriate management controls at all District agencies conducting contracting activities.

The CPO will continue to conduct bi-monthly meetings among the contracting officers of District agencies with independent contracting authority to address common procurement issues. Additionally, OCP will continue to conduct training seminars open to all contracting personnel, regardless of agency, to promote standardization and compliance with applicable statutory and regulatory requirements.

Competitive Small Purchases

Lack of Compliance with Competitive Small Purchases Requirement of One (1) Oral Quote

Out of a sample of 77 vendors, the agencies selected for testing failed to provide one (1) oral quotation for 65 purchases from 30 vendors. This deficiency was noted at both the Independent Agencies and OCP and is summarized as follows:

1) There were 3 purchases at DMH from 3 vendors.
2) There were 2 purchases at CFSA from 1 vendor.
3) There were 3 purchases at OCFO from 2 vendors.
4) There were 57 purchases at OCP from 24 vendors.

Lack of Compliance with Competitive Small Purchases Requirement of Three (3) Oral Quotes

Out of a sample of 77 vendors, the agencies failed to provide evidence of three (3) oral quotations for 70 purchases from 39 vendors as follows:

Material Noncompliance with Laws and Regulations

5) There were 8 purchases at DMH from 4 vendors.

6) There was 1 purchase at CFSA from 1 vendor.

7) There were 5 purchases at OCFO from 2 vendors.

8) There were 56 purchases at OCP from 32 vendors.

Lack of Compliance with Competitive Small Purchases Requirement of Three (3) Written Quotes

Out of a sample of 77 vendors, the agencies failed to provide evidence of three (3) written quotations for 58 purchases from 31 vendors as follows:

9) There was 1 purchase at DMH from 1 vendor.

10) There were 2 purchases at OCFO from 3 vendors.

11) There were 55 purchases at OCP from 27 vendors.

Management's Response:

In FY 2009, OCP hired two Assistant Directors to supervise the procurement of goods and services as well as construction services for the District. These new managers are responsible for ensuring that the agency has complete regulatory conformity of all contracts and small purchases. In addition, the Office of Procurement Integrity and Compliance will be responsible for routine audits of all contract files. A small purchase checklist has been established to ensure that copies of the quotations are included in the file.

Ratification Process and Friendly Lawsuits Process

Although the District discontinued the ratification process on March 29, 2008, we noted that agencies continued to obtain services without the existence of a valid contract. To address this issue, OCP implemented a friendly lawsuit process whereby the vendors can sue the District in an attempt to recover amounts owed. We noted however that between March 30, 2008 and August 28, 2008, there was no evidence of a policy in place to address the issue of noncompliance relating to contracts. During the audit, we noted that agencies reported items totaling $3,456,884 which were incurred without a valid contract.

It is recommended that the District reevaluate the policy regarding instances of noncompliance with procurement laws which address securing the services of vendors without a written contract.

Management's Response:

In 2007, the CPO placed both vendors and agencies on notice that it was illegal to enter into an agreement without a valid contract, and that ratifications will no longer be approved routinely by OCP as of March 29, 2008. Performance without a contract places the District at risk for unknown penalties, and cannot be tolerated.

Material Noncompliance with Laws and Regulations

As part of a one-time effort to address these requests without resorting to the ratification process, OCP and the Office of the Attorney General (OAG) have agreed for a limited period of time to a uniform procedure under which the OAG will consent to a court order, on behalf of the District government, to pay a vendor that has provided goods or services without a valid written contract. Specifically, this consent procedure will be available through January 30, 2009. After that point, it is the total responsibility of the agencies to resolve any unlawful commitments that their personnel have entered into.

* * * * *

Appendix B

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, 2008, we noted 280 instances where the District failed to comply with the Quick Payment Act.

Management's Response:

Prompt payment is dependent upon quick approval of valid vendors' invoices by an agency's program office. Certification of delivery of services or goods must be communicated to the agency's finance division before vendor payments can be made. Management will increase efforts to assure compliance with the Quick Payment Act.

* * * * *

Appendix B

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 7 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.

- Noncompliance occurred in October 2007, with respect to the collateral held by the following Federal Reserve Bank Pledge Holdings bank accounts: Adams Bank, Bank of Georgetown, and Cardinal Bank.
- Noncompliance occurred in November 2007, with respect to the collateral held by Adams Bank.
- Noncompliance occurred in February 2008 and July 2008, with respect to the collateral held by Independence Bank.
- Noncompliance occurred in July 2008, with respect to the collateral held by Bank of America.

We also noted that 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 7 instances cited in the finding are explained as follows:

- One of them was resolved the very next day after it occurred and after being identified by the District's daily monitoring.
- Two of them related to an agency account for which there was a dispute between the bank and the agency regarding whether a portion of the funds was due to the bank for services rendered, and the bank would not return the funds or increase the collateral until a settlement to the dispute was reached. The Treasurer directly intervened and worked with the agency and the bank to resolve the dispute. The issue was resolved in July 2008. The District was not able to increase the collateral during the dispute.
- The remaining instances cited occurred in the first quarter of the fiscal year, prior to the conclusion of last fiscal year's audit, and were corrected in the first quarter of the fiscal year, and have not recurred, as enhanced procedures were implemented at that time to ensure that this requirement is continually met with all accounts.

* * * * *

Material Noncompliance with Laws and Regulations

IV. Expenditures in Excess of Budgetary Authority

The Anti-Deficiency Act states, in part, the following:

> A District agency head, deputy agency head, agency chief financial officer, agency budget director, agency controller, manager, or other employee may not: (1) Make or authorize an expenditure or obligation exceeding an amount available in an appropriation or fund.

The Home Rule Act states, in part, the following:

> No amount may be obligated or expended by any officer or employee of the District of Columbia government unless such amount has been approved by Act of Congress, and then only according to such Act.

Section 301 of the D.C. Appropriations Act 2005, enacted October 18, 2004, states, in part, the following:

> Whenever in this Act, an amount is specified within an appropriation for particular purposes or objects of expenditure, such amount, unless otherwise specified, shall be considered as the maximum amount that may be expended for said purpose or object rather than an amount set apart exclusively therefore.

The District's basic financial statements state in note 1, "Appropriated actual expenditures and uses may not legally exceed appropriated budget expenditures and uses at the function level. A negative expenditure variance in the budgetary comparison statement for a particular function is a violation of the Anti-Deficiency Act and the District of Columbia Anti-Deficiency Act. Also, a violation of the Anti-Deficiency Act exists if there is a negative expenditure variance for a particular purpose or object of expenditure within an appropriation."

At September 30, 2008, the Child and Family Services Agency (CFSA) had overspent its local budget by approximately $82,900,000 million and the District of Columbia Public Schools (DCPS) had overspent its local budget by approximately $26,600,000 million, thus violating the Anti-Deficiency and Home Rule Acts. This was a result of potential disallowances from previous years with respect to Medicaid cost report audits, and management has estimated additional potential disallowances and reflected these as accrued liabilities in the accounting records at year-end for CFSA and DCPS, respectively.

Management's Response:

After the release of the 2007 Comprehensive Annual Financial Report (CAFR) highlighting inadequate billing practices as a material weakness for the District, the Administration made a commitment to conduct and pursue comprehensive audits from past fiscal years to determine and correct years of billing mismanagement. As a result, the Department of Health Care Finance (DHCF) (formerly the Medical Assistance Administration) conducted an audit of FY 2004 and 2005 for CFSA and FY 2003 through 2006 for DCPS. Based upon the audited cost reports, the potential disallowances are primarily the result of:

- Poor or nonexistent documentation of services provided;
- Improper billing to the Medicaid program when other sources of funding were available; and
- Duplication of billing.

Appendix B

Material Noncompliance with Laws and Regulations

CFSA has established a monthly internal audit process to investigate Medicaid claims and has instituted strict requirements for any claims identified as lacking sufficient documentation. DCPS is ensuring better documentation of services provided through utilizing a new electronic data system and archiving key documents, in addition to changing the billing structure associated with the liabilities named above.

DHCF is coordinating efforts to reform the District's Medicaid billing practice to significantly reduce the risk of future liabilities related to the Medicaid Program. Led by the Public Provider Liaison Unit, progress at DHCF includes:

- Establishing a more active role in the Medicaid audit contract process;
- Reviewing current claims and developing corrective actions steps for agencies;
- Developing guidance and training sessions for agencies on adhering to Federal and District requirements; and
- Working with DCPS and CFSA on alternative health care delivery system options to minimize potential disallowance risk in the future. For example, DHCF will implement a CMS-approved cost-allocation report for DCPS. In addition, DHCF is working with CFSA to shift the risk to the provider instead of CFSA by having them bill DHCF directly.

DHCF has partnered with The George Washington University Medical Center to produce a comprehensive analysis report on Medicaid claims processes. This effort will guide DHCF in the development of an Administrative Services Organization (ASO) to streamline Medicaid billing. The report was released on November 21, 2008 and has informed the development of a request for proposal for an ASO. This draft Request for Proposal (RFP) has been completed with a projected award in summer of 2009.

DHCF is also actively analyzing options for negotiations with CMS regarding the total audit liability as well as its legal options in response to potentially improper advice regarding Medicaid revenue maximization.

* * * * *

Appendix C

Status of Prior Year Significant Deficiencies, Material Weaknesses, and Material Noncompliance with Laws and Regulations

Nature of Comment	Type of Comment in Fiscal Year 2007	Current Year Status
Office of Tax and Revenue	Material Weakness	Significant Deficiency
Management of the Medicaid Program	Material Weakness	Material Weakness
District of Columbia Public Schools	Material Weakness	Significant Deficiency
Investment Reconciliations and Activities	Significant Deficiency	Material Weakness; included as part Treasury Functions.
National Capital Revitalization Corporation (NCRC) and the Anacostia Waterfront Corporation (AWC)	Significant Deficiency	NCRC and AWC have been dissolved as of October 1, 2007. All activities have been transferred to the District.
Management of Grants	Significant Deficiency	Control Deficiency
Compensation	Significant Deficiency	Significant Deficiency
Management of the Disability Compensation Program	Significant Deficiency	Control Deficiency
Management of the Unemployment Compensation Program	Significant Deficiency	Control Deficiency
Noncompliance with Procurement Regulations	Material Noncompliance	Material Noncompliance
Noncompliance with the Quick Payment Act	Material Noncompliance	Material Noncompliance
Noncompliance with the Financial Institutions Deposit and Investment Amendment Act	Material Noncompliance	Material Noncompliance