GOVERNMENT OF THE DISTRICT OF COLUMBIA
OFFICE OF THE INSPECTOR GENERAL

DISTRICT OF COLUMBIA

MEMORANDUM OF RECOMMENDATIONS

For Fiscal Year
Ended September 30, 2011

CHARLES J. WILLOUGHBY
INSPECTOR GENERAL

OIG No. 12-1-12MA **May 10, 2012**

GOVERNMENT OF THE DISTRICT OF COLUMBIA
Office of the Inspector General

Inspector General

May 10, 2012

The Honorable Vincent C. Gray
Mayor
District of Columbia
Mayor's Correspondence Unit, Suite 316
1350 Pennsylvania Avenue, N.W.
Washington, D.C. 20004

Natwar M. Gandhi, Ph.D.
Chief Financial Officer
Office of the Chief Financial Officer
1350 Pennsylvania Avenue, N.W., Room 203
Washington, D.C. 20004

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

Dear Mayor Gray, Chairman Brown, and Dr. Gandhi:

In connection with the audit of the District of Columbia's general purpose financial statements for fiscal year (FY) 2011, KPMG, LLP (KPMG) submitted the enclosed final Memorandum of Recommendations, known in previous years as the Management Letter. This report sets forth KPMG's comments and recommendations to improve internal control and other operating efficiencies.

While the Office of the Inspector General will continue to assess the District's implementation of recommendations, it is the responsibility of District government management to ensure that agencies correct the deficiencies noted in audit reports. This Office will work with managers, as appropriate, to help them monitor the implementation of recommendations.

If you have questions or need additional information, please contact me or Ronald W. King, Assistant Inspector General for Audits, at (202) 727-2540.

Sincerely,

Charles J. Willoughby
Charles J. Willoughby
Inspector General

Enclosure

CJW/ws

cc: See Distribution List

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KPMG LLP
Suite 12000
1801 K Street, NW
Washington, DC 20006

March 31, 2012

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 District of Columbia (the District), as of and for the year ended September 30, 2011, and have issued our report thereon dated January 25, 2012. In planning and performing our audit of the financial statements of the District, in accordance with auditing standards generally accepted in the United States of America, we considered the District's internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements but not for the purpose of expressing an opinion on the effectiveness of the District's internal control. Accordingly, we do not express an opinion on the effectiveness of the District's internal control.

During our audit, we noted certain matters involving internal control and other operational matters that are presented for your consideration. These comments and recommendations, all of which have been discussed with the appropriate members of management, are intended to improve internal control or result in other operating efficiencies and are summarized in Appendix A. Also included in Appendix B is a current year status of the prior year report findings.

The District's written response to our comments and recommendations has not been subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

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

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

Very truly yours,

KPMG LLP

Section I – EDP Comments

The following EDP comments were presented in the District's "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*" (i.e. Yellowbook Report) as *Finding 2011-01 – Weaknesses in the District's General Information Technology Controls:*

General Information Technology Controls (GITCs) provide the foundation for a well-controlled technology environment that supports the consistent processing and reporting of operational and financial data in accordance with management's directives. Our audit included an assessment of selected GITCs in four (4) key control areas: Access to Programs and Data, Program Changes, Program Development, and Computer Operations. During our assessment, we noted that, while the District made progress and remediated certain GITC findings identified during our prior year audit, pervasive GITC-related issues continue to exist.

The GITC environment is undergoing significant transition during fiscal year 2011. The District is currently in the process of modernizing its District-wide System of Accounting and Reporting. As a result, certain deficiencies previously identified will continue to exist, as they will not be remediated until the new system is implemented. Additionally, the District has already remediated other GITC deficiencies during fiscal year 2011. However, as these remediation efforts did not take place until fiscal year 2011 was well under way, the conditions continued to exist during part of the fiscal year and thus are included in this year's report.

Our fiscal year 2011 findings included the following:

Access to Programs and Data
Conditions:

1. Failure to consistently restrict privileged and general user access to key financial applications in accordance with employee job responsibilities or segregation of duties considerations.

2. Inconsistent performance and documentation of both physical and logical user access administration activities, including the approval of new user access and access changes, periodic review of user access rights, including whether user access is commensurate with job responsibilities, and timely removal of user access upon employee termination.

3. Use of generic accounts to perform system administration or end user functions within key applications without adequate monitoring controls over such activities.

4. Failure to update the policy that defines the minimum password configuration requirements for the District's Information Technology (IT) systems in approximately seven years. Further, inquiry and inspection procedures performed indicate that the

policy was not effectively communicated to responsible personnel. Specifically, we determined:

a. The Office of the Chief Technology Officer (OCTO) Password Management Policy, last revised in November 2004, does not require that systems be configured to automatically lock out user accounts after a predefined number of invalid log-on attempts.
b. There were various inconsistencies between the requirements outlined in the OCTO Password Management Policy and configurations set within certain applications and their supporting databases and operating systems.
c. There is potentially confusing language around the scope of the policy, which indicates it is to include "all District Government agencies and all users of DC Government computing equipment" when, in fact, the Office of the Chief Financial Officer (OCFO) is not under the direction of this policy.

Program Changes
Conditions:

1. Failure to institute well-designed program change policies that establish procedural and documentation requirements for authorizing, developing, testing, and approving changes to key financial applications and related infrastructure software[1] in the production environment.

2. Inconsistent adherence to established program change management procedures, including instances in which changes made to the system were not approved, tested or documented appropriately per the established procedures.

3. Failure to consistently restrict developer access to the production environments of key financial applications in accordance with segregation of duties considerations or, if not feasible, implement independent monitoring controls to help ensure changes applied to the production environment are authorized.

Program Development
Conditions[2]:

1. Failure to consistently follow and provide documentation for system development life cycle policies for authorizing, developing, testing, and approving system developments to key financial systems.

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[1] Infrastructure changes refer to software changes and updates applied to underlying operating systems and databases supporting the key financial applications.

[2] Systems Development findings are specific to the Banner application at the University of the District of Columbia in FY 2011.

2. Failure to consistently restrict developer access to the production environments of key financial applications in accordance with segregation of duties considerations or, if not feasible, implement independent monitoring controls to help ensure changes applied to the production environment are authorized.

3. Usage of generic accounts during the implementation to apply changes to the application, operating system, and underlying database with no evidence of monitoring of these generic accounts.

Computer Operations
Conditions:

1. Failure to establish a monitoring process for identifying and addressing production job failures in several systems.

2. Failure to retain system-generated documentation from the scheduling and processing utility to evidence the completion status of system jobs scheduled through the applications' utilities.

The table below summarizes the key financial applications that were impacted by the findings noted above.

Table 1: Summary of Applications Impacted by the Findings

Application	Access to Program and Data	Program Changes	Program Development	Computer Operations
PeopleSoft		N	N/A	
TACIS			N/A	
PASS			N/A	
ACEDS			N/A	
DOCS	N			N
DUTAS	N		N/A	N
BARTS			N/A	
MEDITECH Health Care Information System (HCIS)	N		N/A	
TAS	N	N	N/A	
SOAR	N	N	N/A	
iNovah	N	N	N/A	
Banner	T	T	T	

Legend
No prior year findings remediated in FY 2011.
Prior year findings partially remediated in FY 2011.

	Prior year findings fully remediated in FY 2011.
	Prior year findings not tested in FY 2011 due to other control objective failures.
N	New findings noted in FY 2011.
T	Findings noted in FY 2011; system not tested in prior year.
N/A	Not applicable; no systems development work was done within FY 2011.

Criteria:

1. The Federal Information Security Management Act (FISMA), passed as part of the Electronic Government Act of 2002, mandates that Federal entities maintain IT security programs in accordance with National Institute of Standards and Technology (NIST). The following NIST criteria were considered:
   a. NIST SP 800-12, An Introduction to Computer Security: The NIST Handbook, October 1995;
   b. NIST SP 800-53, Revision 3, Recommended Security Controls for Federal Information Systems and Organizations, August 2009;
   c. NIST SP 800-64, Security Considerations in the System Development Life Cycle, October 2008; and
   d. NIST SP 800-14, Generally Accepted Principles and Practices for Securing Information Technology, September 1996.
2. The Information Systems Audit Control Association (ISACA) Control Objectives for Information and related Technology (COBIT®) 4.1, 2007.

Cause/Effect:

The findings highlighted above include weaknesses in both the design and operating effectiveness of controls considered relevant to the access to programs and data, program changes, program development, and computer operations areas. Although management has made progress remediating previous findings, additional improvements in formalizing key GITC processes and creating an effective monitoring function are needed. The existence of these findings increases the risk that unauthorized changes applied to key financial applications and the data they process adversely affect application processing and data integrity and, as a result, may materially impact the financial statements. Additionally, the existence of these findings impacts the reliability of key application reports and the ability to rely upon automated, configurable controls embedded within key financial applications.

Recommendations:

We noted that management did remediate several control deficiencies from the prior year across both access to programs and data and program changes. We recommend that management continue to perform the remediated control activities put in place. Further, we recommend that management monitor the effectiveness of these controls on a regular and periodic basis going-forward.

Appendix A

To the extent the following findings are not remediated, we recommend the following:

1. Related to Access to Programs and Data controls, we recommend that management:

   a. Assess and update or, as applicable, develop and document access management policies and procedures for production applications and underlying infrastructure systems. These policies and procedures should address requirements for clearly documenting user access requests and supervisory authorizations, periodic reviews of the appropriateness of user access by agency business management, timely communication of employee separations/transfers, and disablement/removal of the related user access. Management should formally communicate policies and procedures to control owners and performers. Further, management should institute a formalized process to monitor adherence to policies and procedures related to key controls and, as performance deviations are identified, follow up as appropriate.

   b. Develop and implement controls that establish organizational and logical segregation between program development roles, production administration roles, and business end user roles among different individuals or, independently performed monitoring of the activities of users provided with conflicting system access over the activities of the developers (and other individuals) with administrative access that require the documentation of monitoring activities as well as follow up on any suspicious behavior within the system.

   c. Restrict the use of generic IDs or, if such access is required, implement independent monitoring of the activities performed using generic IDs.

   d. Develop and implement a process to review, update, and communicate a District-wide password management policy to responsible individuals on a periodic basis to help ensure it remains current and does not conflict in scope or content with other similar policies enacted across the District. We further recommend that this policy include, at a minimum, requirements for the following password configuration settings:

      i. Minimum password length;
      ii. Password aging and update requirements;
      iii. Password complexity (e.g., at least one number, letter, and special character);
      iv. User account lockout after a predefined number invalid logon attempts; and
      v. Password history/reset restrictions.

   In support of the recommended remediation, management should reconfigure existing password configuration settings at the application, operating system and database level, where applicable, in accordance with the District-wide password management policy. Finally, we recommend that management monitor adherence to the policy.

e. Develop and formally document the physical access management policy and procedures for all server rooms. We recommend that these include, at a minimum, procedural and documentary requirements for:

    i. Requesting and approving physical access;
    ii. Timely disablement/removal of physical access rights during instances of employee separations; and
    iii. Performing periodic reviews of access in consideration of users' ongoing need to retain physical access, and the modification of any updates required as a result of inappropriate access identified during the review process.

2. Related to Program Change controls, we recommend that management:

    a. Develop and implement change management processes and controls that establish one or more of the following:

        i. Organizational and logical segregation of program development roles from production system and database administration roles among different individuals; and
        ii. Implementation of one or more independently operated monitoring controls over the activities of the developers (and other individuals) with administrative access that require the documentation of monitoring activities as well as follow up on any suspicious behavior within the system.
        iii. Additionally, management should continue to document the performance of User Acceptance Testing (UAT).

3. Related to Program Development Controls, we recommend that management:

    a. Develop and implement program development processes and controls that establish one or more of the following:

        i. An evaluation of the generic accounts that exist and documentation of the purpose of each generic account required to remain active, if any. Furthermore, for generic accounts that are required to remain active, we recommend management implement a formal process to approve and document each access request to generic accounts and perform a documented periodic review of generic account activity.
        ii. The implementation of procedural and documentary requirements for:
            - Recording the nature of each change being applied;
            - Evaluating the impact and risk of each change relative to objective rating criteria;

- Approving (and documenting such approvals of) changes; and
- Validating the functionality/system impact of each change via pre-production testing in a model environment.

These policies/procedures should be provided to and discussed with control performers. Further, management should monitor control performer adherence to policies/procedures periodically.

4. Related to Computer Operations controls, we recommend that management:

   a. Implement any required changes to support an extended retention of job processing logs in support of audit requirements. Additionally, we recommend that management continue to save daily Excel reports produced by systems to limit the impact of any future archival issues.
   b. Document the completion of the new process put in place to monitor open application incidents reported to the OCFO Help Desk that are forwarded to the TSG, and also to ensure that they are remediated within a defined time period that is acceptable to application owners.

   These procedures should be provided to and discussed with the personnel responsible for enforcing the control activity. Further, management should monitor the personnel responsible for enforcing the control activity periodically.

Management Response:

The District agrees that there are weaknesses in its general information technology controls and has taken measures to address many of the issues raised by the auditors. For some of the issues, however, there simply are no "quick fixes." Consequently, full remediation of the problems identified will require a longer period of time to develop and implement the appropriate actions.

Some of the measures implemented between 2010 and 2011 include the following:

Tax Administration System (TAS)

To address issues pertaining to access to programs and data, the District has completed the following with respect to the referenced systems:

- Implemented a new security report and signoff workflow application;
- Documented the policies and procedures related to the specific time requirements for completing user access reviews, modifying application privileges to remove any inappropriate access levels identified during reviews, and assigning accountability for the performance of these reviews;
- Incorporated the new policies and procedures into the workflow application;
- Modified the current policy and process to add a supervisory authorization requirement for user access request;

- Implemented a formalized, periodic review process to ensure individuals are not provided the ability to both approve quality assurance (QA) testing and approve migration to production for TAS application changes;
- Updated existing change management policies and procedures to require that documentation of testing results is completed prior to migrating TAS application changes into production;
- Implemented a formalized, periodic review process to determine whether users who have the ability to migrate TAS application changes into production require this access to perform their job responsibilities; and
- OCIO management instituted a formalized reporting mechanism to bring critical help desk ticket open issues to the bi-weekly prioritization meeting for discussion and prioritization and address the non-critical issues through the help desk incident management process.

BARTS/DOCS/DUTAS

- Developed an electronic routing system for access approval flow;
- Reviewed and updated the access control framework and documentation;
- Began performing regular reviews and created reports documenting user and generic access by level and system;
- Established an Access Control Board, consisting of DOES management, to semi-annually review existing access grants (including generic grants) and evaluate their appropriateness (the Board also reviews the access reports for suspect behavior and takes the actions as deemed to be appropriate and necessary);
- Reviewed, updated, finalized and published all OIT policy documents to the OIT policy document library and required all pertinent personnel to review them;
- Held training seminars on the OIT document library; and
- Consolidated the existing ticketing systems into a single OIT issue tracking system.

PASS

- Copies of OCFO Security Policy and Procedures were distributed to each Agency Security Officer (ASO);
- ASOs are required to maintain a working copy and an updated copy of security access reports to show before and after processing;
- Deletion of financial system logon IDs was included as a separate item on the Separation Clearance Form to be signed off by the ASO upon an employee's separation from an agency; and
- Created a standardized worksheet that is to be used as a reporting tool for modifications and deletions needed as a result of the security review.

PeopleSoft

- Identified the applicable IT governance policies to manage the network security;

- Began development of a PeopleSoft System Security Plan which details the functional and technical procedures and mechanisms for PeopleSoft security;
- Communicated with the PeopleSoft Governance Committee to obtain approval for the Security Plan;
- Updated/reviewed current configuration management changes with technical staff; and
- Eliminated/reduced the usage of the “aribasystem” generic user account.

Meditech

- UMC IT staff perform routine reviews of user access to assess compliance with established policies; and
- On a quarterly basis, UMC IT staff selects at least two users groups from the functional areas such as: Radiology, Emergency Room, Patient Billing, for access review.

To address issues pertaining to program changes, the District has completed the following with respect to the referenced systems:

PeopleSoft

- Began work to create a Technical Operations Runbook and Configuration Management Guide for PeopleSoft;
- Implemented the Agile software development methodology; and
- Discussed the development of the Runbook and Configuration Management Guide and implementation of the Agile methodology with the PeopleSoft Governance Committee.

Banner

Deficiencies were also noted with respect to Banner, a system recently implemented by the University of the District of Columbia (the University). The University concurs with the findings as presented by the auditors and has taken measures to address many of the issues noted. For example, the University has:

- Established a Banner Users Group to start reviewing user access in accordance with the established security classes and roles;
- Made plans to continue working with individual business units and departments to assign university functions to specific Banner roles;
- Implemented policies and procedures to minimize the number of generic accounts;
- Begun working with the University’s Human Resources Department to develop and implement a communication process to notify Banner Project Management of personnel changes that affect the roles of individuals using Banner;
- Removed Banner Project consultants’ access to generic accounts; one consultant can make data changes in production using a “personal” account and this consultant’s system use is closely monitored;
- Initiated a review of Banner ERP Security Access;

- Developed and implemented a new Change Control Policy that requires a Change Control Form in order to request, track, and approve system and application changes;
- Began the process for procuring Change Management Software; and
- Instituted a policy requiring all Banner System users to sign a confidentiality agreement prior to being provided database access to the Banner System.

The actions delineated above represent only a portion of the steps taken to address issues in the area of General Information Technology Controls. The District fully recognizes that although much has been accomplished in improving IT controls, there is much yet to be done. The District will continue to be diligent in its efforts to strengthen IT controls and maximize overall operational efficiency.

Section II – Non-EDP Comments

During our audit of the fiscal year 2011 basic financial statements, we have noted deficiencies within various accounting and financial reporting processes. We have broken down these deficiencies by process below along with both our recommendation for remediating the deficiency as well management's response.

1. Procurement and Disbursements

The following Procurement and Disbursement Controls Non-EDP comments were presented in the District's "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*" (i.e. Yellowbook Report) as *Finding 2011-02 – Weaknesses in the District's Procurement and Disbursement Controls:*

Background:
The District expends over $8 billion per year in non-personnel related expenditures. In order to be as efficient and effective as possible, the District has established policies and procedures at the Office of Contracts and Procurement (OCP), as well as at those agencies that have independent procurement authority, to procure goods and services and to make payments for those goods and services. Further, these policies and procedures serve to ensure the District's compliance with various laws and regulations governing procurement and payment, such as the Procurement Practices Act and the Quick Payment Act.

OCP has implemented a comprehensive, multi-year remediation plan to address previously identified deficiencies and has completed the steps scheduled for FY 2011 implementation. A key aspect of the remediation plan is addressing the governance framework and the risk assessment capabilities of OCP. Some of the key aspects of the remediation plan implemented in FY 2011 are as follows:

- **May 14, 2011 –** For the first time, delivered an agency-wide CAFR debrief (FY 2010) to all staff and shared lessons learned and remediation action steps with both OCP-dependent and independent agencies with stand-alone procurement operations;

- **June 9, 2011 –** Distributed an official memo to contracting officers reiterating their responsibilities for maintaining complete and accurate contract files, and the consequences (penalties) for any failures to comply, identified through audits and other means, which includes loss of delegated authority, suspension and/or termination;

- **June 14, 2011 –** Delivered presentation to the Audit Division of the Office of the Inspector General as part of the FY 2012 Audit Symposium and Planning Conference. Provided an overview of the plans for OCP and OPIC, all of which have been or are in the process of being implemented. Also, highlighted opportunities for collaboration.

- **August 22 - August 26, 2011 –** Peer review of OCP's Office of Procurement Integrity and Compliance (OPIC) conducted by the Association of Local Government Auditors (ALGA). OPIC (internal audit group) deemed to be satisfactorily complying with Yellow Book standards.

- **September 1 - September 30, 2011 –** OCP realignment plan implemented/executed. OPIC reorganized to include expansion of scope and frequency of audit and compliance activities. Risk Controls Framework developed containing over 200 risk statements for 5 procurement-specific lines of business and 3 support lines of business. FY 2012 goal is to mainstream the use/understanding of this tool throughout the organization.

Subsequent to the 2011 fiscal year end, the District also implemented the following:

- **November 8, 2011 -** Directive issued to all contracting officers mandating the upload of all newly awarded and active contracts (as of October 1, 2011) into OCP's Contracts Compliance Module by December 31, 2011.

- **November 14, 2011; December 21, 2011 (Follow-Up) –** Directive issued to all agency directors (including those independent of CPO authority), contract administrators and contracting officers alerting them of the need to complete refresher training; beginning December 5th, the commencement of 'penalty free' contract administration audits performed by OPIC; changes to vendor evaluation procedures; and the commencement of official contract administration audits beginning February 27, 2012. For the first time, the official audit reports will be submitted to the City Administrator as well as affected agency directors and responsible staff.

However, as these remediation efforts did not take place until FY 2011 was well under way, the deficiency conditions continued to exist during part of the fiscal year and have been repeated.

Conditions:

A. We selected a sample of ninety-five (95) sole-source procurements executed by the District in FY 2011 and noted the following:

   <u>Lack of supporting documentation</u>:

   1. For two (2) of ninety-five (95) sole-source procurements, adequate substantiating evidence was not maintained in the file documenting why, in the case of that respective procurement, a Determination and Findings (D&F) form was not required.
   2. For three (3) of ninety-five (95) sole-source procurements, the D&F form was not available for review.
   3. For five (5) of ninety-five (95) sole-source procurements, evidence showing that a search was performed to determine whether the vendor was debarred or suspended from doing business with the District was not available for review.
   4. For three (3) of ninety-five (95) sole-source procurements, the use of the sole-source method of procurement was not appropriate or adequately justified.

5. For two (2) of ninety-five (95) sole-source procurements, the contract was not contained in the contract file.
6. One (1) of ninety-five (95) files requested could not be located and made available for our inspection.

Inadequate approvals:

7. For five (5) of ninety-five (95) sole-source procurements, the D&F was not approved by the respective Agency Director or Department Head.
8. For five (5) of ninety-five (95) sole-source procurements, the D&F was not approved by the Contracting Officer.
9. For one (1) of fifty-five (55) contracts, the Contracting Officer's maximum approval authority was less than the amount of the procurement on the purchase requisition.
10. For three (3) of ninety-five (95) contracts, evidence of the Contracting Officer's approval authority was not available for review.
11. For one (1) of ninety-five (95) sole-source procurements, there was no evidence as to whether the contractor was in compliance with the District tax filings requirement.

B. We also selected a sample of seventy (70) emergency procurements executed during FY 2011 and noted the following:

Lack of supporting documentation:

1. For four (4) of thirty-seven (37) 'small' (≥$5,000 but <$100,000) emergency procurements tested, the applicable quotes were not made available for review.
2. For one (1) of thirty-seven (37) 'small' emergency procurements, there was insufficient documentation substantiating that the appropriate number of quotations were received.
3. For six (6) of twenty-four (24) 'large' (≥$100,000) emergency procurements, evidence showing that a search was performed to determine whether the vendor was debarred or suspended from doing business with the District was not available for review.
4. For eight (8) of twenty-four (24) 'large' procurements tested, there was no evidence as to whether the contractor was in compliance with the District tax filings requirement.
5. One (1) of twenty-four (24) 'large' procurements, the contract requested could not be located and made available for our inspection.
6. For one (1) emergency procurement in excess of $1 million, evidence of City Council approval and evidence of legal review by the Office of the Attorney General was not contained in the contract file.
7. For eight (8) emergency procurements, the length of the procurement was not documented in the contract file.
8. For three (3) emergency procurements, the D&F was not made available for review.
9. For eleven (11) procurements, there was no evidence that the procurement was on a sole source basis or that there was competition.

<u>Inadequate approvals</u>:

10. For one (1) emergency procurement, the D&F was not approved by the respective Agency Director or Department Head.
11. For three (3) emergency procurements, the D&F was not approved by the Contracting Officer.
12. For one (1) contract, the Contracting Officer's maximum approval authority was less than the amount of the procurement on the purchase requisition.
13. For twenty-three (23) contracts, evidence of the Contracting Officer's approval authority was not available for review.

<u>Non-compliance with emergency criteria requirement</u>:

14. For six (6) contracts inspected, the period of performance exceeded the 120 day maximum duration requirement for an emergency procurement.

C. We selected ninety-five (95) competitive procurements executed during FY 2011 for review and noted the following:

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

1. For nine (9) of forty-six (46) 'small' (≥$5,000 but <$100,000) competitive procurements tested, the applicable quotes were not made available for review.
2. For four (4) of forty-six (46) 'small' competitive procurements, there was insufficient documentation substantiating that the appropriate number of quotations were received.
3. For fourteen (14) of forty-five (45) 'large' (≥$100,000) competitive procurements over $100,000, there was insufficient documentation substantiating that the appropriate number of quotations were received.
4. For fifteen (15) of forty-five (45) 'large' procurements tested, evidence showing that a search was performed to determine whether the vendor was debarred or suspended from doing business with the District was not available for review.
5. For ten (10) of forty-five (45) 'large' procurements tested, there was no evidence as to whether the contractor was in compliance with the District tax filings requirement.
6. For two (2) of forty-five (45) 'large' procurements tested, the contract was not contained in the contract file.
7. For one (1) of eight (8) procurements in excess of $1 million, evidence of City Council approval was not contained in the contract file.

<u>Inadequate approvals</u>:

8. For one (1) of forty-nine (49) competitive procurements, the contract was not signed by the Contracting Officer.
9. For two (2) of forty-nine (49) competitive procurements, the Contracting Officer's maximum approval authority was less than the amount of the procurement on the purchase requisition.
10. For one (1) of forty-nine (49) competitive procurements, the contract amount was less than the PO amount and the legal sufficiency review from the OAG expired. When the

contract was executed in August 2009, the contract was for $3,628,719; however, the amount has since increased to $11,371,705 with no additional modification to the contract, legal review, or Council approval able to be provided.

11. For five (5) of forty-nine (49) competitive procurements, evidence of the Contracting Officer's approval authority was not available for review.

D. We also selected ninety-five (95) direct vouchers for testing and noted eight (8) transactions were missing the required approval from the District's Office of Financial Operations and Systems (OFOS).

E. During testing over purchase card (P-Card) transactions and monthly P-Card statement reconciliations, we noted the following deficiencies:

1. For two (2) of 25 P-Card transactions for amounts over $2,500, amounting to $7,640 of $171,793 tested, documentation to support the purchases was not available for review.
2. For three (3) of 20 foreign transactions taking place outside of the U.S. (i.e. foreign transactions), documentation supporting the purchases was not made available for review.
3. For six (6) of 25 monthly P-Card statement reconciliations selected, the monthly reconciliation was not performed timely.
4. For three (3) of 25 monthly P-Card statement reconciliations selected, there was no evidence that the reconciliation was performed as the supporting documents were not made available for review.

F. With regard to our testing of compliance with the District of Columbia Quick Payment Act, we determined that:

1. Eighty-one (81) of seven hundred thirty-two (732) District payments (i.e. non-DCPS) selected for testing were not paid timely in accordance with the Quick Payment Act.

Criteria:
The Procurement Practices Act indicates the following:

27 DCMR chapter 17, states that: **"***In each instance where the sole source procurement procedures are used, the contracting officer shall prepare a written determination and findings ("D&F") justifying the procurement which specifically demonstrates that procurement by competitive sealed bids or competitive sealed proposals is not required."*

27 DCMR chapter 17, states that: **"***Each sole source D&F for a procurement in an amount greater than twenty-five thousand dollars ($25,000) shall be reviewed by the Director before solicitation and shall be approved by the Director before contract execution."*

DC Code 1-204.51, states that: *"prior to the award of a multiyear contract or a contract in excess of $1,000,000 during a 12-month period, the Mayor or executive independent agency or instrumentality shall submit the proposed contract to the Council for review and approval.*"

Appendix A

DCMR chapter 17 states that "*An "emergency condition" is a situation (such as a flood, epidemic, riot, equipment failure, or other reason set forth in a proclamation issued by the Mayor) which creates an immediate threat to the public health, welfare, or safety. The emergency procurement of services shall be limited to a period of not more than one hundred twenty (120) days. If a long-term requirement for the supplies, services, or construction is anticipated, the contracting officer shall initiate a separate non-emergency procurement action at the same time that the emergency procurement is made. The contracting officer shall attempt to solicit offers or proposals from as many potential contractors as possible under the emergency condition. An emergency procurement shall not be made on a sole source basis unless the emergency D&F includes justification for the sole source procurement. When an emergency procurement is proposed, the contracting officer shall prepare a written determination and findings (D&F) that sets forth the justification for the emergency procurement.*"

Financial Management and Control Order 07-004A states that "*Direct Voucher payment requests that are not explicitly identified in Financial Management and Control Order 07-004A, shall be submitted to the Deputy Chief Financial Officer for the Office of Financial Operations and Systems (OFOS) for consideration and approval in accordance with policy and procedures set forth for direct voucher payment review and consideration by OFOS.*"

According to the District Purchase Card program policies and procedures:

- **Purchase limit:** An individual who is issued a P-Card under the DC Purchase Card Program shall use the purchase card to buy commercially available goods and services, for *Official Government Business only*, with a value that does not exceed $2,500 per single transaction and a total amount of $2,500 per card per day and $10,000 per card account per monthly cycle, unless otherwise specified by the Chief Procurement Officer in the delegation of contracting authority.

- **Reconciliation:** Each approving official will have a queue of all P-card statements waiting for them in the PaymentNet system. By the 27th of each month, the Approving Official should obtain original receipts from cardholders under their jurisdiction and ensures that the cardholders have reviewed all transactions in PaymentNet. The Approving Official should review each transaction to verify that the good or service were received, that the nature of the purchase was within programmatic guidelines, and that the receipts match the amount listed in PaymentNet. The Approving Official should mark each transaction as Approved in PaymentNet by the 3rd day of the subsequent month.

According to **DC Code 1-204.51**, "*prior to the award of a multiyear contract or a contract in excess of $1,000,000 during a 12-month period, the Mayor or executive independent agency or instrumentality shall submit the proposed contract to the Council for review and approval*"

Also, **DC Code 2-301.05(G)** states that "*All contracts over a million dollars must go to the Office of the Attorney General (OAG) for a legal sufficiency review*."

27 DCMR chapter 15
1511.3 Prospective bidders that have been debarred or suspended from District contracts or otherwise determined to be ineligible to receive awards shall be removed from solicitation mailing lists to the extent required by the debarment, suspension, or other determination of ineligibility

The requirements for allowable costs/cost principles are contained in the A-102 Common Rule (§___.22), OMB Circular A-110 (2 CFR section 215.27), OMB Circular A-87, "Cost Principles for State, Local, and Indian Tribal Governments" (2 CFR part 225), program legislation, Federal awarding agency regulations, and the terms and conditions of the grant award. Management is required to maintain adequate internal controls to prevent and detect instances of noncompliance.

The District's Quick Payment Act indicates the following: *If a contract specifies the date on which payment is due, the required payment date is the date specified in the contract. If a contract does not specify a payment date, the required payment date will be one of the following:*

> *(a) Meat and meat food products - the seventh (7th) day after the date of delivery of the meat or meat product;*
> *(b) Perishable agricultural commodities - the tenth (10th) day after the date of delivery of the perishable agricultural commodity; or*
> *(c) All other goods and services - the thirtieth (30th) day after the receipt of a proper invoice by the designated payment officer.*

Cause/Effect:
District agencies are not adhering to the established policies and procedures governing creation and maintenance of procurement documentation and the payment of vendor obligations, which may cause noncompliance with the Procurement Practices Act and the Quick Payment Act. Further, comprehensive monitoring controls were not established by OCP until FY2011.

Recommendation:
We recommend that the District continue to implement its deficiency remediation plan. These implementation efforts should continue to be led by the OCP Procurement Integrity and Compliance Office (PICO), and sufficient resources should be provided to this office to ensure it can successfully implement the remediation plan. The performance measurement statistics monitored by PICO should be provided to both the Mayor and the Chief Financial Officer at least semi-annually so that senior District management is apprised of progress on the remediation plan.

Management Response:

<u>Office of Contracting and Procurement (OCP)</u>

Unlike past years, results from the FY 2011 CAFR show deficiencies widely distributed across the District's decentralized procurement operations. In FY2010, OCP operations, presently servicing 52 District agencies, accounted for sixty-eight percent (68%) of the approximately one hundred twenty four (124) deficiencies cited, with the balance attributed to procurement offices independent of the Chief Procurement Officer's (CPO's) authority. This year, OCP accounted for forty-one percent (41%) of the approximately 177 deficiencies cited, while independent agencies accounted for the balance, an increase from the preceding year. Given these results, the District acknowledges the need to closely coordinate oversight, monitoring and remediation activities to uniformly and systematically reduce instances of non-compliance.

In response to the FY2010 CAFR findings, the Office of Contracting and Procurement (OCP) noted in part that, "…*While tangible results might not be immediate, we expect that periodic training/refreshers and regular compliance reviews will strengthen the control environment and ultimately improve compliance outcomes in subsequent fiscal years.*"

Consistent with this representation, OCP crafted and implemented a comprehensive multi-year remediation action plan, which, among other risk areas, addressed concerns relative to the award of sole source, emergency, small and large competitive procurements. As of September 30, 2011, ninety-seven percent (97%) of planned actions had been ratified as fully implemented by the District's responsible oversight body.

Further, OCP's Office of Procurement Integrity and Compliance (OPIC) has increased the coverage and frequency of its audits and compliance reviews. Results are now reported in a 'Bellwether' Report to management detailing:

- The phases in the procurement lifecycle where audit concerns or violations have been identified;
- The total number of such concerns/violations by each phase;
- The prevailing themes;
- The accountable procurement staff; and
- Pertinent transaction details and actionable recommendations.

For the first time, quantifiable performance information is readily available to management, providing a near real-time snapshot of OCP issues. OCP will be using this data to correct unsatisfactory actions.

Also noteworthy is that close coordination between the External Auditor and OCP-OPIC is underway, to the extent practicable; to eliminate duplication of effort and to gain 'real-time' visibility into the conditions in the control environment before, during and after an audit engagement.

The District agrees that Purchase Card (P-Card) policies and procedures are not being followed consistently by all District agencies. However, and as communicated in the FY 2010 audit cycle, these findings refer to program oversight and surveillance reporting under the purview of each Agency Review Team (ART). The Office of Contracting and Procurement (OCP) has followed through on its prior year commitment to increase oversight activities. In FY 2012, following an agency-wide realignment, OCP's Office of Procurement Integrity and Compliance (OPIC) began random audits of select District agencies to augment training, administration and guidance provided by the District's P-Card Program Management Office (PMO).

Office of Financial Operations and Systems

Management concurs with the finding as written regarding noncompliance with the Quick Payment Act. In August 2011, a joint memorandum issued by the Office of the Chief Financial Officer (OCFO) and the City Administrator was distributed to all agencies in order to communicate the prevalent causes for late vendor payments and to create a partnership between the District's program staff and the OCFO. The Office of Financial Operations and Systems (OFOS) will continue to bring awareness to the Quick Payment Act in FY2012 by developing training material on the requirements of the "Act." OFOS will also meet with each cluster Controller and their respective Accounts Payable teams, to discuss this finding, to provide an understanding of the specific requirements of the Quick Payment Act, and to assist with identifying solutions to cluster issues that may prevent prompt payment.

2. Procurement Policies

We identified the following deficiencies in the design of internal control surrounding the procurement process:

Conditions:

A. Numerous transactions were identified where OCP policies were not followed due to certain types of 'exceptions' to existing OCP Procurement policy. For instance, during our testing, we tested several procurement transactions which were made as a result of the Blackman-Jones consent decree. Based upon discussion with management, such procurements must be made pursuant to the court order, and, as such, certain documentation substantiating competition, suspension/debarment, etc. would not be found in the files. OCP management indicated that such transactions were exceptions to OCP policy; however, we found no policy governing such exceptions and what file documentation requirements have been established for such exceptions.

B. Numerous transactions were identified where District agencies used government funds to purchase gift cards. During our testing, we found the purchases were appropriate justified and approved by District personnel.

   Through analysis of the raw data extract of District-wide procurements and inquiry with management, we identified the following:

1. 42 transactions totaling approximately $1.02 million for FY 2011 for the purchase of gift-cards from retailers (e.g. Safeway, Giant Food, Target, Office Depot, Dave and Buster's, Apple Computer, etc). Most were 'small purchases' of bulk gift-cards and were in denominations ranging from $10 to some over $500.
2. 217 transactions amounting to approximately $1.71 million were for bulk purchase of WMATA Metro transit fare cards / tokens. More than half of the purchases appear to have been for transportation of DCPS / Special Education students. Additionally, many District agencies appear to provide such fare cards for intra-District travel for official business.

However, we requested that the District provide us with policies and procedures over how District employees were to determine and document the eligibility of a District resident to receive such cards. Further, we requested a reconciliation of the card activity (the dollar value of the cards purchased should equal the value of the cards distributed plus the cards still in the District's possession). Finally, we requested the District to provide us with policies and procedures over how frequently such cards were to be inventoried. We determined that no such procedures over documentation of eligibility of recipients, reconciliation of activity, and inventorying of cards have been developed.

Criteria:
Per the COSO Internal Control Integrated Framework:
Internal Control is broadly defined as a process, affected by an entity's board of directors, management, or other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories:
1. Effectiveness and Efficiency of Operations;
2. Reliability of Financial Reporting;
3. Compliance with Applicable Laws and Regulations; and
4. Safeguarding Assets.

The COSO Internal Control Framework also identifies the five components of internal control, which include Control Environment, Risk Assessment, Control Activities, Information and Communication, and Monitoring. With regard to Control Activities and Monitoring, the COSO Internal Control Framework states:

Control Activities - Control activities are the policies and procedures that help ensure management directives are carried out. They help ensure that necessary actions are taken to address risks to achievement of the entity's objectives. Control activities occur throughout the organization, at all levels and in all functions. They include a range of activities as diverse as approvals, authorizations, verifications, reconciliations, reviews of operating performance, security of assets and segregation of duties.

Monitoring - Internal control systems need to be monitored--a process that assesses the quality of the system's performance over time. This is accomplished through ongoing monitoring activities, separate evaluations or a combination of the two. Ongoing monitoring occurs in the course of operations. It includes regular management and supervisory activities, and other actions personnel take in performing their duties. The scope and frequency of separate *evaluations will depend primarily on an assessment of risks and the effectiveness of ongoing monitoring procedures. Internal control deficiencies should be reported upstream, with serious matters reported to top management and the board.*

Cause/Effect:

A. Failure of the District to implement adequate internal controls which support timely and continuous updates to its policies and procedures to reflect current practice and governing exceptions to file documentation requirements. Inadequate policies and procedures surrounding all types of OCP procurements leads to inconsistent application of internal controls, thereby undermining the controls themselves and subjecting the District to further risk of noncompliance with procurement laws.

B. Failure of District financial management to institute effective internal controls governing the purchase, use, and monitoring of gift-card / fare cards. Lack of strong internal controls surrounding the access and monitoring of use of the gift-cards / fare cards exposes the District to the risk fraud / theft / loss.

Recommendation:

A. We recommend that the OCP establish and maintain effective policies surrounding all types of procurements, explicitly stating what documentation requirements apply in certain 'exception' procurements. Adequate efforts to revise existing policy to encompass all procurement types would help ensure effective internal control procedures are in place.

B. We recommend that the District:

   1. Establish and maintain effective policies and procedures surrounding the purchase, use, and monitoring of gift card or fare card purchases by District agencies;
   2. Document the eligibility criteria and the eligibility determination of each recipient of the gift cards or fare cards, and maintain documentation demonstrating to whom each card was issued;
   3. Require monthly reconciliation of the cards issued and maintained; and
   4. Require quarterly inventory of the cards maintained.

Management Response:

A. Management will document and communicate exceptions to the policies and procedures as discussed with the External Auditor. Further, the process for evaluating and updating policies and procedures will be enhanced to facilitate timely updates and notifications.

B. The Office of Finance and Treasury (OFT) concurs with the above findings and recommendations. In December 2011, OFT began meeting with agencies' ACFOs, Controllers, and AFOs to understand the need, use, distribution, and security surrounding gift/fare cards. OFT conducted, and is still conducting, reviews to ensure that the necessary actions are being taken to address risks associated with gift/fare cards, without disrupting the affected agency's program objectives. Based on KPMG's listing of additional agencies with gift/fare cards, OFT will continue these reviews, which have included inventory audits, collection of excess inventory, and the preparation of a draft policy, procedures and internal controls document.

OFT developed the draft policy and procedural document to begin implementing needed internal controls as well as design and institute a process for card oversight. The scope of OFT's draft policy and procedural document is limited to the financial aspects of card purchasing, security, monthly reporting, reconciliation, and distribution to the agencies. OFT's policy maintains segregation of duties, separating its financial oversight functions from the agencies' distribution of cards to the ultimate recipients. Therefore, each agency's responsible financial officer will be charged with developing internal policies and desk procedures to address inventory controls, accounting, reconciliation, security, and the distribution of the cards.

OFOS's Policy and Procedure Division will assist OFT in ensuring that agencies' policies and procedures for gift/fare cards are completed. Such policies and procedures must include guidance on properly securing/safeguarding the cards from theft, loss, or misuse. In addition, to strengthen internal controls, an audit process will be established to monitor compliance with the established policies and procedures.

Agencies use various types of payment cards to fulfill a variety of functional needs. Securing and overseeing a large number of varying types of cards is and will continue to be a challenge for OFT. For that reason, OFT is consulting with MasterCard, VISA, and WMATA to develop longer term solutions that bring more efficiency and accountability to the process. One alternative that is being pursued by OFT is having the ability to consolidate the various cards that serve a number of different purposes into a multi-functioning card that restricts certain purchases and withdrawals, etc.

3. Revenue

We identified the following deficiencies in the operations at the District's Office of Tax & Revenue (OTR):

Conditions:

A. During our testwork performed at the OTR Real Property Tax Administration (RPTA), we determined that one of the 25 appealed assessments selected for testing was not properly approved by the Chief Assessor in accordance with the Appeal Divisions established procedures.

B. During our walkthroughs performed at the OTR - Compliance Administration, we determined that multiple auditors, who prepare audit assessment change documents within the audit division, have access rights to make audit assessment adjustments within the Integrated Tax System (ITS). Procedurally, these auditors are not allowed to enter assessment adjustments that they have prepared; however, they have the system access to do so.

C. During our follow-up on prior year findings, we determined that OTR has not performed a comprehensive review of all recipients of the Homestead tax credit for which applications were submitted in prior years.

D. During our follow-up on prior year findings, we determined that OTR continued to have insufficient internal control procedures over tax withholding reconciliations. OTR did not have procedures in place to reconcile the tax withholdings reported by taxpayers on their individual income tax returns to the withholding data received from employers. Similarly, OTR did not have a process in place to reconcile taxpayer withholding amounts received to the reported tax withholdings on individual income tax returns.

Criteria:
The Assessment Division within the Real Property Tax Administration (RPTA) has established requirements as follows:

1. For all changes from the current to proposed (new) Estimated Market Values (EMV) on property between 10% and 39% or between $1 million and $4 million, manual approval of the Hearing Officer is required in addition to approval by the Appraiser and Unit Supervisor.
2. For changes from the current to proposed (new) EMV on property for amounts that exceed 40% and $4 million, manual approval of the Chief Assessor is required in addition to approval by the Appraiser, Unit Supervisor, and Hearing Officer.

In addition, Yellow Book, Appendix I, section A1.08 d., states that management at a State and Local government entity is responsible for "*establishing and maintaining effective internal control to help ensure that appropriate goals and objectives are met; following laws and regulations; and ensuring that management and financial information is reliable and properly reported*."

Cause/Effect:
A. Personnel within the RPTA are not following established policies and procedures regarding the review and acceptance of changes to real property assessments.

B. The Compliance Administration's established policies and procedures regarding audit assessment changes do not properly address segregation of duties between the individual who prepares an audit assessment change and the individual who inputs it into the system. As a result, audit assessment changes may be erroneously input into the ITS system without proper review and approval.

C. OTR does not have a comprehensive review process in place over those Homestead tax credits already issued. Inadequate controls over Homestead tax credits increases the likelihood of ineligible recipients and deprives the District of real property tax receipts to which it is entitled.

D. OTR does not have sufficiently established policies and procedures regarding the reconciling of tax withholding amounts. Failure by OTR to implement effective internal control over tax withholdings could lead erroneous refunds being issued.

Recommendations:
We recommend that:

A. RPTA management follow established policies and procedures regarding the review, approval, and reassessment of real property.

B. Compliance Administration remove access rights for auditors to ensure the segregation of duties related to audit assessment changes.

C. OTR perform a thorough and comprehensive review of its existing Homestead tax credits granted to ensure the recipient is eligible and maintain adequate supporting documentation to ensure an audit trail exists to substantiate Homestead tax credit eligibility.

D. OTR institute an internal control procedure to reconcile the taxpayer withholdings received to the taxpayer withholdings which are reported on individual taxpayer returns, and OTR should implement internal controls in order to reconcile the taxpayer withholdings reported with the withholding data submitted by employers.

Management Response:

A. OTR recognizes risks associated with improper and erroneous changes made to real property assessments and thus real property tax billings. We concur with the facts of the condition, cause and effect.

   The Real Property Tax, Assessment Division will modify/program the 1st Level Appeals Tracking System to validate the sign-offs based upon the pre-established review levels as part of the printing of the decision notice process. If the proper sign-offs are not present, the system will not print a decision notice and prompt the user to obtain the required sign-offs.

   In addition, the Chief Appraiser has met with all supervisors involved in the process and given them a copy of the Action/Document-Supervisory Approval level sheets which has the requirements for every action that needs approval.

B. Management agrees that the Compliance Administration should remove access rights for Auditors to ensure the segregation of duties between audit assessments and system adjustments to taxpayer accounts.

   OTR recognized the risks of potential fraud associated with improper adjustments to taxpayer accounts and took several steps to remediate them. Specific employees within each division had been designated as adjustment personnel, and policies and procedures were implemented to ensure that only personnel identified as Adjustment Staff were entering adjustments into the Integrated Tax System (ITS). Creation of specific user classes related to adjustment activity was also completed; however, these system profile changes did not completely address the Separation of Duties issues identified in prior findings. The remaining Audit and Collection staff responsible for making audit assessments in ITS still had the ability to enter adjustments into the system because their need for access to certain windows contained within the "adjust taxpayer accounts" function. Compliance had requested a systematic control for fraud risk was not available and a user class structure was not viable, additional processes to support segregation of duties were required.

The aforementioned systematic deficiency has been addressed by the establishment of a new Compliance Administration Adjustment Unit, which began entering all assessments and adjustments for Compliance in October 2011. This process of establishing a centralized adjustment group, which is comprised of technically competent employees from the Audit and Collection divisions, has further increased internal controls and adjustment accuracy, removed the adjustment process from the business units, and eliminated the risks associated with ITS employee profile security by reducing all other employee access to "Read Only." Written policies and procedures have been developed in order to document the adjustment process to ensure transparency, consistency, and uniformity. This was completed on 5/29/2009. Additionally, new desk guides for the centralized Adjustment Unit were completed on 6/1/2011. User Class changes and ITS Profile Changes have been completed, and only those employees within the Adjustment Unit have the systematic ability to adjust taxpayer accounts.

The review process has been modified to account for changes in work flow. Those persons who have been assigned to the new unit have received group training and will continue to receive training as necessary. The Management Analyst assigned to the group performs control testing related to adjustment activities, developed statistical reporting, and provides requested results to the Unit Manager, Division Chief, and Director for review.

C. The Assessment Division (ASD) has been actively working to ensure risks associated with ineligible grantees are effectively mitigated. The mitigation strategy includes both a portfolio approach as well as an approach for mitigating risks among current applicants. ASD has coordinated with its IT partners to use technology to perform targeted analysis to identify potential grantees for additional review.

To support ensuring current homestead applicants are eligible, ASD's Homestead Unit (HU) has implemented several activities. The HU adopted a strategy that utilizes information that has been provided to the District in order to determine domicile, the requirement for the Homestead exemption. Applications are matched against DMV records, Board of Elections records, and DC tax records to prove domicile. Applicants are given the benefit, but end-dated for six months. This gives an applicant six months to secure the required information and also meets the OCFO's customer service goals, which includes not requiring a taxpayer to provide the same information multiple times. If the HU cannot find this specific evidence to support granting the benefit, the application is queued for audit. Once in audit, additional information is sought directly from the taxpayer requesting the benefit. To ensure that the temporary grant is not extended beyond six months, a Tracking Log is used.

For the portfolio, grantees are matched against DMV records, Board of Elections records, and DC tax records to prove domicile. Grantees for which information cannot be found are similarly sent to the audit queue. As in the current application approach, once a taxpayer has been identified for audit, information is sought directly from the taxpayer. It is estimated that the entire Homestead portfolio will be reviewed within 2 years. The reporting mechanism used for this targeted analysis also identifies duplicates. Once a duplicate is identified, the benefit is removed for duplicates allowing only one benefit per homeowner.

D. The data necessary to perform the reconciliation of withholding reported by taxpayers to the withholding data received from employers has been identified, and the business system design document that defines how this reconciliation is to be performed has been created. OTR first ran this post-audit program in 2009, yielding a relatively small number of cases. When contract staff transitioned at the end of FY2010, the programming used to build the matching file was lost. Re-establishment of the program is underway, with work scheduled to be completed in April 2012 and reports available to Compliance by July 2012. The reports generated as a result of the reconciliation process will be analyzed by Compliance, with the objective of identifying potential audit cases. The procedures that will be used by the Audit Division have already been developed. OTR is, of course, required to give employees credit for taxes withheld from their wages even if the employer failed to remit them.

4. Treasury

During our testwork performed at the District's Office of Finance & Treasury (OFT), we identified the following:

Conditions:

A. <u>SOAR vouchers related to the recordation of cash receipts</u>:
   1. Nine (9) of 153 SOAR vouchers did not demonstrate appropriate segregation of duties or authorization. Specifically, these vouchers were not authorized by a supervisor or were prepared and authorized by the same personnel.
   2. Five (5) of 153 transactions reviewed were not completed timely. Specifically, we noted that these entries were completed more than three months after the date of the transaction.
   3. Lastly, we noted that 98 of 153 transactions reviewed did not support the specific revenue type being recorded. Specifically, entries were supported by deposit tickets or bank statements that only evidenced the total amount being recorded but not the detail of the classification of revenue, or no supporting documentation was provided.

B. Untimely Clearing of Suspense Account Balances:

1. We obtained the District's Category 10 (Cash) Report by Bank IDs (BIDs), which is generated from the District's 9/30/2011 trial balance, as of 1/5/2012. We identified the following suspense accounts that still had outstanding balances at year-end as of 12/15/2011:

Bank ID	Balance	Account Description
999	($84,152,825.81)	Suspense account
Blank	331,132,877.07	Suspense account
Total	$246,980,051.26	

We included the balance without Bank IDs as they were recorded via the iNovah cashiering system and not classified to a specific BID yet. During our testwork, we received and reviewed the journal entry posted by the District on 1/13/2012, which reclassified the balances from the blank Bank ID suspense account to the appropriate Bank IDs.

Furthermore, we determined that the 9/30/2011 balances in the above suspense accounts still had outstanding balances as of 1/5/2012, which is 95 days past the fiscal year end.

Criteria:
Yellow Book, Appendix I, section A1.08 d., states that management at a State and Local government entity is responsible for *"establishing and maintaining effective internal control to help ensure that appropriate goals and objectives are met; following laws and regulations; and ensuring that management and financial information is reliable and properly reported;"*

Per the Committee of Sponsoring Organizations (COSO) *Volume II Guidance on Monitoring Internal Control Systems*, internal controls "ensure that necessary actions are taken to address risks to achieving objectives. Control activities occur throughout the organization, at all levels, and in all functions. They include a range of activities as diverse as approvals, authorizations, verifications, reconciliations, reviews of operating performance, security of assets, and *segregation of duties*."

Per the COSO Internal Control Integrated Framework:
Internal Control is broadly defined as a process, affected by an entity's board of directors, management, or other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories:

1. *Effectiveness and Efficiency of Operations*
2. *Reliability of Financial Reporting*
3. *Compliance with Applicable Laws and Regulations*

The COSO Internal Control Framework also identifies the five components of internal control, which include Control Environment, Risk Assessment, Control Activities, Information and

Communication, and Monitoring. With regard to Control Activities and Monitoring, the COSO Internal Control Framework states:

Control Activities - Control activities are the policies and procedures that help ensure management directives are carried out. They help ensure that necessary actions are taken to address risks to achievement of the entity's objectives. Control activities occur throughout the organization, at all levels and in all functions. They include a range of activities as diverse as approvals, authorizations, verifications, reconciliations, reviews of operating performance, security of assets and segregation of duties.

Monitoring - Internal control systems need to be monitored--a process that assesses the quality of the system's performance over time. This is accomplished through ongoing monitoring activities, separate evaluations or a combination of the two. Ongoing monitoring occurs in the course of operations. It includes regular management and supervisory activities, and other actions personnel take in performing their duties. The scope and frequency of separate evaluations will depend primarily on an assessment of risks and the effectiveness of ongoing monitoring procedures. Internal control deficiencies should be reported upstream, with serious matters reported to top management and the board.

Cause/Effect:

A. OFT does not have detailed and uniform policies and procedures regarding the recording and monitoring of SOAR vouchers related for cash receipts at the various agencies throughout the District. Additionally, OFT does not monitor currently established policies and procedures regarding the authorization, documentation, and maintenance of supporting documentation for cash revenue transactions and manual journal vouchers. As a result, SOAR Vouchers used to record cash receipts and the related revenue classifications could be erroneous or inappropriate.

B. Management did not reconcile the balances in the suspense accounts timely due to the complexity of the District's general ledger system and accounting structure. The failure to resolve suspended transactions timely could lead to improper classification of financial data and result in misstatements to the District's financial reporting.

Recommendations:

A. We recommend that OFT update policies and procedures in place over revenue recognition to explicitly require the duties of the preparation and authorization of SOAR data entry forms to be segregated. In addition, we recommend that the roles of preparers and authorizers to be expressly given to specific employees based on their position and responsibility within their unit.

   In addition, we recommend that the OFT update policies and procedures in place over revenue recognition to ensure other-type cash revenue transactions are recorded in a timely manner.

Lastly, we recommend that the OFT establish and educate staff on policies and procedures over record retention and maintenance of cash revenue transaction documentation.

B. We recommend that the District implement enhanced monitoring procedures to ensure that transactions posted in suspense accounts are cleared out no later than 60 days from the posting date and have a $0 balance at year-end.

Management Response:

A. Management disagrees with the finding noted in the third item in the Condition Section, above, indicating insufficient supporting documentation for revenue recording. Because the District's revenues are recorded by a number of different agencies, and because District revenue deposits often include more than one revenue type, the supporting documentation for revenue deposits is often housed in the respective agencies responsible for their particular portion of the revenue recording. Management indicated to the audit team that supporting documentation could be found for the various revenue deposits by inquiring or making site visits to the various agencies involved. Management was informed that the audit team decided not to make such inquiries or site visits, indicating that time and priority constraints were factors in this decision. However, in consideration of this audit finding, in the future, management will endeavor to make the supporting documentation for revenue deposits more readily accessible to auditors.

B. BID 999, the District's Clearing Account, is monitored daily. Each day, OFOS communicates out of balance transactions to the responsible parties with instructions to post correcting entries by the end of the next business day. We will continue to monitor BID 999 daily and work to ensure that agencies post correcting entries no later than 60 days from the posting date.

   We will develop a new policy regarding the blank BID transactions that are the result of the iNovah cash receipt process that began in FY2011. The policy and accompanying procedures will include, but is not limited to, a provision that transactions should be cleared from the blank BID no later than 60 days from the posting date.

5. Grants Management

During our testwork performed over the District's Grants Management process, we noted the following exceptions:

Conditions:

A. <u>Beneficiary Eligibility:</u>

   1. *Medicaid*

   During testwork over Medicaid beneficiary eligibility, we identified incomplete documentation in 3 of 110 files. We determined that for the three beneficiary eligibility files, the Department of Human Services (DHS) – Economic Security Administration (ESA) was unable to provide documentation of a written application.

2. *Child Health Insurance Program (CHIP)*

During testwork over CHIP beneficiary eligibility, we identified the following:

a. For thirty-seven (37) out of 100 beneficiaries, ESA was unable to provide sufficient documentation to support the eligibility determination during fieldwork.
b. For one beneficiary, ESA determined the beneficiary to be ineligible for benefits prior to FY2011, but the beneficiary received CHIP services rendered in FY2011, which were paid by the District.

3. *Temporary Assistance for Needy Families (TANF)*

During testwork over TANF beneficiary eligibility, we determined that for 13 out of 95 beneficiary files, ESA was unable to provide sufficient documentation to support the eligibility determination during fieldwork.

4. *Supplementary Nutrition Assistance Program (SNAP)*

During testwork over SNAP (formerly Food Stamps) beneficiary eligibility, we determined that for 8 beneficiary files, ESA was unable to provide sufficient documentation to support the eligibility determination during fieldwork.

B. Provider Eligibility:

1. *Medicaid*

During testwork over the Medicaid eligibility, we identified exceptions in 6 of 95 Medicaid provider files selected for testing:

a. For two providers, the provider files were received but the contract was not signed by a representative of the Department of Healthcare and Finance (DHCF). We determined that the signed contracts are not maintained with DHCF. We further determined that providers who operate as plan providers are required to have a signed contract instead of a signed provider agreement. Therefore, a provider agreement and license information are not required, while a signed plan contract is required.
b. For three providers, we were unable to obtain a copy the signed provider agreement.
c. For one provider, the provider's license expired in February 2011, but the provider received payment for services rendered on March 1, 2011. We determined that the provider's licensure information was updated in Omnicaid - also known as the Medicaid Management Information System (MMIS) - on 2/17/2011; however, a physical copy of the license was not able to be reviewed.

C. Delay in Issuance of Medicaid Audited Cost Reports

Public provider entities and private providers who submit costs through accrual cost reports are required by the Medicaid State Plan to subject the cost reports to an audit. During testwork over the Medicaid, we observed delays in the issuance of audited cost reports The District is still awaiting the audited cost report for 2008 for DCPS and CFSA. The audit for 2009 has not been completed for any cost reporting entities.

We also determined that the 2005 and 2006 audited cost reports are still pending resolution for the cost based hospital Specialty Hospital of Washington (SHW) - Hadley. Hadley's 2007 audited cost report is currently under appeal.

SHW Capitol Hill audited reports for 2005, 2006, 2007, and 2008 are currently under appeal. The Psychiatric Institute of Washington audited cost reports for 2006 and 2007 also have not been resolved.

Facility	**Year of Last Audited Cost Report**
DCPS	2007
CFSA	2007
Department of Mental Health	2009
SHW – Hadley	2007
SHW – Capitol Hill	2008
Psychiatric Institute of Washington	2008
National Rehabilitation Hospital	2008
Hospital for Sick Children	2008
SHW LTAC – at United Medical Center	2008

D. <u>Inadequate Review of the Medicaid Cost Accrual:</u>
During testwork over the Medicaid Accrual, we determined that the Department of Health Care and Finance (DHCF) double-counted the HMO Advantage lawsuit for $4.7 million. DHCF recorded the lawsuit as a liability amount in the accrual and disclosed it in the contingent liabilities footnote as a "reasonably possible" case.

E. <u>Inadequate audit documentation for SNAP revenue and expenditure balances:</u>
The District is required by GASB Statement No.24 to record revenues and expenditures in the financial statements related to the value of distributions of the Supplemental Nutrition Assistance Program (SNAP). During our testwork over the SNAP revenue and expenditures entry, we noted that the District does not retain detailed documentation from its service provider, JP Morgan Chase, to support amounts in the entry.

Criteria:

A. Medicaid State Plan: Citation 42 CFR 431.17AT-79-29. Section 4.7 *Maintenance of Records.* The Medicaid agency maintains or supervises the maintenance of records necessary for the proper and efficient operation of the plan, including records regarding applications, determination of eligibility, the provision of medical assistance, and administrative costs and statistical, fiscal and other records necessary for reporting and accountability, and retains these records in accordance with Federal requirements. All requirements of 42 CFR 431.17 are met.

IMA Policy Manual Section. STANDARDS FOR CASE RECORD DOCUMENTATION 1.3. All eligibility criteria and clarifying information are documented on the Record of Case Action, form 1052. The case record should speak for itself. An outside reviewer shall be able to follow the chronology of events in the case be reading the narrative. All application documents including verification and correspondence must be date-stamped. For working recipients, the record should include the dates pay is received and how often the recipient is paid. When the recipient's statement is the best available source, the record should include the application / recipient's and agency efforts to verify the information. All address changes should be documented.

B. Title XIX requires the District of Columbia to enter into written agreement with every person or institutions providing services under the State's plan for Medical Assistance. It also requires that the provider – when applicable – must (1) be licensed in the jurisdiction where located and/or the District of Columbia; (2) be currently in compliance with standards for licensure; (3) services be administered by a licensed or certified practitioner; and (4) comply with applicable federal and district standards for participation in Title XIX of the Social Security Act.

C. <u>Title XIX Section 1902 – State Plans for Medical Assistance</u> requires the establishment of a state agency to administer the program and to outline the administrative guidelines through the state plan.

DHCF as the Medicaid state agency for Washington D.C is responsible for the administration of the Medicaid program. The administrative guidance is outlined by DHCF in the Medicaid state plan. Public providers (e.g.: DCPS and CFSA) and cost based providers are subject to audits of cost information under the administrative guidance from DHCF. The audits result in amounts which are disallowed from reimbursement under Medicaid and amounts which are subject to reimbursement under Medicaid but were not captured initially by the provider.

D. Statement of Federal Financial Accounting Standards (SFFAS) No. 5, *Accounting for Liabilities of the Federal Government*, states "contingencies should be recognized as a liability when a past transaction or event has occurred, a future outflow or other sacrifice of resources is probable, and the related future outflow or sacrifice of resources is measurable. A contingent liability should be disclosed if any of the conditions for liability recognition are not met and there is a reasonable possibility that a loss or an additional loss may have been incurred. Disclosure should include the nature of the contingency and an estimate of the possible liability, an estimate of the range of the possible liability, or a statement that such an estimate cannot be made."

E. <u>GASB F60.101</u> - in the fund financial statements, state governments should recognize distributions of food stamp benefits as revenue and expenditures in the general fund or a special revenue fund, whether the state government distributes the benefits directly or through agents and whether the benefits are in paper or electronic form. Expenditures should be recognized when the benefits are distributed to the individual recipients by the state government or its agents; revenue should be recognized at the same time. State governments should report food stamp balances held by them or by their agents at the balance sheet date as an asset offset by deferred revenue. Revenue, expenditures, and balances of food stamps should be measured based on face value. [GASBS 24. Par.6].

It is management's responsibility to maintain sufficient supporting documentation for amounts in the financial statements as a part of its system of internal controls over financial reporting.

Cause/Effect:

A. ESA does not maintain documentation in a manner such that documentation was readily reviewable. Some beneficiary records do not contain the sufficient supporting documentation required to determine eligibility for Medicaid, CHIP, TANF, and SNAP in FY2011.
B. DHCF does not maintain sufficient, up-to-date, documentation in the provider files, including updated licensure information, signed provider agreements, and signed contracts. The MMIS did not prevent ineligible providers from receiving payment from the DHCF. The DHCF may remit payments to ineligible Medicaid providers.
C. Reasons for the delay in issuance of the cost reports can be attributed to (1) delays in issuance of revised cost reports, and (2) appeals by providers for costs which were disallowed under the audit. As a result, these delays in the audit of cost reports can cause an increase in the use of local funds if costs are found to be disallowed through the audit.
D. The liability amount was reported in the Medicaid accrual and in the litigation accrual. The amount due to providers in the Medicaid accrual was overstated by $1.4 million and receivables from the federal government were overstated by $3.3 million.
E. The OFT receives a monthly issuance reports from JP Morgan's Electronic Benefits Transfer (EBT) system, but OFT only receives a one page summary of the Monthly State Issuer Totals Report. The report is used to support the balances which are recorded as revenues and expenditures for SNAP program at year-end. As a result, District management was not able to provide external reports as support for SNAP revenue and expenditure entry during the FY2011 CAFR audit.

Recommendations:
We recommend that:

A. The District implement policies and procedures to improve the beneficiary case file management. We observed that the District is in the process of scanning all beneficiary files into the Digital Information Management System (DIMS) an attempt to make the files management system electronic. However, this should be accomplished in a systematic and rational manner that will allow for comprehensive file indexing to facilitate file location and review.

B. DHCF improve it process for maintaining complete and up-to-date information for Medicaid providers.

C. The District improve coordination and communication between agencies and with its cost report auditors in order to reduce the lag between the submission of cost reports and the audits of those reports.

D. DHCF should ensure that the Medicaid accrual is reviewed thoroughly to ensure items are not “double counted.”

E. The District maintain the detail related to the monthly distribution reports as a part of its records for the SNAP program.

Management Response:

A. During FY2010 and FY2011, DHS undertook the Document Imaging Management System (DIMS) initiative, which is expected to improve the accuracy of eligibility determination and efficiency of locating documents within ESA. Scanning of records started January 1, 2011. DHS began scanning all new documents upon receipt from customers as of January 31, 2011.

   The DIMS process entailed several phases and tasks including strategically and incrementally conducting scanning of records at each ESA Service Center and transferring records of clients who visited other ESA Service Centers back to the appropriate Center, so that the records would be prepared for the DIMS scanning process.

   The challenge of locating records and documents in time for review by the auditors was a result of several factors, including the fact that space limitations prevented all files and records from being transferred to the appropriate Center for scanning. Additionally, many of the recertification documents were not available for review because they had not been scanned into DIMS due to poor image quality.

   Case records from all Service Centers have been scanned, except for records at the H Street Service Center (the largest Center), wherein cases are currently being scanned. Additionally, case records in Closed Files have yet to be scanned.

   The agency purchased special commercial scanners to address the poor image quality and a contract is pending before the Office of Contracting and Procurement (OCP) to agree to a contract modification to allow for the importing of images. Moreover, all existing documents and records should be scanned within the next year.

   Management does not concur with the finding re: Child Health Insurance Program (CHIP), wherein it was stated: “KPMG noted that ESA determined the beneficiary to be ineligible for benefits prior to FY2011 but the beneficiary received CHIP services rendered in FY2011 and the District paid out for the services provided.”

   It appears that this finding is relative to CHIP sample IH-40, wherein contrary to the audit statement, both DHS and DHCF find the customer eligible for CHIP benefits, therefore making the paid claim legitimate.

B. Management concurs with this finding.

C. Management concurs with this finding.

D. DHCF agrees with the facts of the finding as stated in the Condition.

The Government of the District of Columbia FY 2011 Close Instructions for Topic 11 Commitments and Contingencies (page 169) requires agencies to, in part, "…report each contingent liability with a maximum (worst case) potential loss of $50,000." The Department of Health Care Finance (DHCF) complied with that instruction by reporting the $4.7 million claim before the Contract Appeals Board from HMO Advantage.

DHCF believes it is probable that the District will have to pay HMO Advantage when this action is finally resolved. Since it is a requirement that agencies pay their liabilities, the District has consistently accrued for this $4.7 million claim on the Medicaid agency's books as part of the Medicaid accrual.

E. Management concurs with this findings and recommendation outlined in NFR 2011-25. Though the findings and recommendations related to the lack of adherence to the requirements of GASB No. 24, failure to maintain detailed records, it was not a management oversight but a provision within the service provider contract with JP Morgan that did not provide data warehousing. Access to data warehousing would enable data retention and access to detailed reports that could have been used by the Department of Human Services (DHS) to support its journal entries. At contract procurement, data warehousing had not been developed.

As of February 2012, OFT completed implementation with a new SNAP program service provider, FIS Government Solutions. Data warehousing is incorporated into the new FIS contract. OFT will retain the required report(s) and grant appropriate access to the vendor's report system to DHS staff to retrieve any required information.

OFT does not prepare the journal entries and therefore would not know the appropriate supporting documentation or reports. OFT believes that it is ultimately DHS' responsibility to work with OFT to identify the specific support documentation needed. OFT will cooperate fully to obtain the detail related to the monthly distribution reports from its vendor and maintain them as part of OFT's records for the SNAP program.

OFT projects having the draft report(s) for review by KPMG by March 30, 2012. OFT is arranging a meeting between FIS and DHS next week to begin facilitating discussions around the report requirements.

6. Fixed Assets / Leases

During our testwork performed over the District's fixed assets and leases, we identified the following:

Conditions:

A. <u>Inadequate Lease Presentation</u>

The District policies and procedures are not sufficient to document that operating and capital leases are properly classified to ensure the presentation of the lease footnote is complete and accurate. Further, the District does not record its lease expense evenly over the entire lease term if it is provided with certain lease inducements (such as free rent or other rent concessions) as required in accordance with generally accepted accounting principles (GAAP).

During performance substantive testwork, we also identified the following:

1. *Lease Classification:* One (1) of 8 Municipal Facilities leases was incorrectly classified as an operating lease. This lease is a future lease commitment and should not be classified as an operating or capital lease in FY2011. As the initial classification by management as an operating lease was inappropriate, we determined that this instance as a failure of internal control.

2. *Future Minimum Lease Payments – Capital:* We determined that a future capital lease was not originally disclosed in the footnotes (under footnote 14, *Leases,* or footnote 15, *Commitments*). We further determined that the total of the future minimum lease payments, over the next 20 years from the rent commencement date upon completion of the building that should have been disclosed was $162,315,720. After communication with management, the District appropriately revised footnote 15, *Commitments*, in the FY2011 CAFR to disclose the future lease commitment.

3. *Future Minimum Lease Payments – Operating:* We identified a known difference of operating lease future payments from the Municipal Facilities agency totaling $10,928,984. These differences were communicated to agency management and corrected prior to the issuance of the FY2011 CAFR.

   a. In one (1) instance, future lease payments were not included in the agency's original closing package submission. These differences were communicated to agency management and the agency resubmitted the closing package requirement to include the future payments for this lease.

   b. In three (3) instances, the information used to calculate future lease payment amounts did not agree to the lease agreements. These differences were communicated to agency management and the agency resubmitted the closing package requirement to include the recalculated future payments for these leases.

4. *Straight-line Lease Payments:* We determined that the District does not straight-line lease expense. We recalculated the difference in current year rent expense (between the District's current methodology and using a straight line approach) and noted the variance was inconsequential.

B. Fixed Assets:

The District lacks policies and procedures to ensure Construction in Progress (CIP) is tracked on a project level. In addition, the policies and procedures are not sufficient to ensure supporting documentation exists supporting the District's estimate that the average capital projects duration is approximately 24 months. Furthermore, the District lacks sufficient policies and procedures over fixed assets to ensure that additions and disposals of real property are complete and recorded timely.

1. *Accounting for Transfers from CIP to Fixed Assets:*

   a. Transfers from CIP balances are not available by project at Office of Financial Operations and Systems (OFOS) although the District agencies capitalize CIP based on the completion of the project.

   b. The District was unable to provide documentation to support the transfer of costs from CIP to fixed assets for 2 of the projects selected for testwork. Specifically, the following projects in which transfers were unsupported: Department of Real Estate Services (AM0) was unable to support costs transferred to fixed assets in the amount of the following:

      i. $17,139,177 related to project N1403C; and
      ii. $403,960 related to project PL104C.

   c. The District does not transfer costs from CIP to fixed assets timely. We identified the following errors as a result of costs not being transferred from CIP upon the project's completion in a prior year.

      i. Office of Public Facilities Modernization (GM0):
         - The Certificate of Occupancy for Stoddard Elementary School was dated 8/5/2010; as such, $15,399,690 of costs related to prior fiscal years should have been transferred as of 9/30/2010.

         - The Certificate of Occupancy for the Wheatley School was dated 8/13/2009; as such, $17,582,001 of costs related to prior fiscal years should have been transferred as of 9/30/2009 and 9/30/2010.

      ii. District of Columbia Public Schools (GA0):

- $16,907,251 related to Wheatley School held under this agency was not properly transferred to fixed assets in a prior year. These costs should have been transferred to Fixed Assets during FY2009 as the Certificate of Occupancy for this portion of the school was dated 8/13/2009. This error was communicated to management and corrected prior to issuance of the CAFR.

- The Certificate of Occupancy, for projects NB237C-03 and NB237C-01, was dated 2/17/2006, as such; the costs, $43,130,519 and $28,734,589 respectively, should have been transferred as of 9/30/2006.

- The Certificate of Occupancy, for project NR837C-04, was dated 8/13/2004, as such; the costs, $23,118,434, should have been transferred as of 9/30/2004.

iii. Department of Real Estate Services-City Administrator/Department of the Mayor (AM0-AE0):

- The Certificate of Occupancy for project CAC38C was dated 1/28/2010, as such; the costs, $5,680,895 should have been transferred as of 9/30/2010.

iv. Equipment Financing Program (Master Lease) – ELC:

- Supporting documentation for completion (i.e. receipt of the asset) for projects 20630C and PEQ20C related to FY2010 (8/2/10 and 7/15/10, respectively). As such, the costs, $59,989 and $14,779, respectively, for these projects should have been transferred to fixed assets in the prior year.

d. We determined the following error as a result of expenditures of a non-capital project being incorrectly classified in FAS as capital:

i. Office of the Chief Technology Officer (TO0):

- $1,006,952 related to project 1DCIT5 were categorized incorrectly as a capital project and transferred to Fixed Assets.

2. *Capital Expenditures (Outlays):*

a. The District incorrectly classified certain costs in our sample. Specifically we identified the following:

i. Office of Public Facilities Modernization (GM0):

- In three (3) out 9 samples tested, we determined that $211,383 of costs out of $16,783,343 tested was related to hazmat abatement/allowance and was improperly classified as capital costs.

ii. Office of the Deputy Mayor for Economic Development (EB0):

- In one (1) out of 5 samples tested, we determined that $683,795 of costs out of $5,215,233 tested was related to a property tax abatement that were improperly classified as capitalized and should have been expensed.

iii. Office of the Chief Medical Examiner (FX0-AM0):

- In one (1) out of 3 samples tested, we identified that $4,500 of costs out of $18,321,101 tested was related to asbestos abatement were improperly classified as capitalized and should have been expensed

b. The District did not record prior year capital expenditures (outlays) timely. Specifically, we identified the following:

i. Department of the Environment (KG0):

- In one (1) out of 3 samples tested, we identified $51,893 of costs out of $414,793 tested was related to costs incurred in FY10 that were not accrued in the prior year and were recorded as a capital expenditure in FY2011.

3. *Additions and Disposals:*

a. Real Property:

i. There is no District-wide real property information technology system that agencies can use to account for detailed fixed asset activity. Rather, each agency may use various other record keeping systems, such as spreadsheets, to track real property additions and dispositions. These other record keeping systems are only reconciled to the general ledger once a year. As such, the District is may not be able to verify completeness and accuracy of real property transactions throughout the year.

C. Inadequate Inventory of Fixed Assets:

We determined that no inventory count was conducted in FY2011. This condition is scheduled to be remediated in FY2012 prior to the next scheduled bi-annual inventory being completed. The deficiencies noted during the FY2010 audit are included below:

1. During our observation of the inventory count, we noted the following:

a. The District employed a service organization for completing the FY2010 inventory count. However, the District did not adequately monitor the performance of the service provider to ensure the physical count was performed appropriately.

b. Physical count procedures were not adequately planned prior to the performance of the physical count. The District was unable to provide a copy of the inventory instructions, nor was a physical observation schedule provided to the service organization or District agencies that outlined the planned inventory observation locations and dates.

2. During Metropolitan Police Department (MPD) inventory count observation, we determined the following:

   a. Ten (10) of 10 items selected from the Fixed Asset System (FAS) Inventory listing could not be located at MPD.

   b. Items that were originally located at the MPD as noted on the FAS Inventory Listing had been moved to a different location; however, the accounting department was not notified when these items were moved.

   c. For eight (8) out of 10 items selected at MPD to trace from the inventory floor back to the FAS Inventory Listing, could not be agreed to the FAS report. We also determined that property numbers attached to the inventory items selected could not be matched to the FAS report.

Criteria:
GASB Statement No. 1, *Objectives of Financial Reporting*, recognizes the basic characteristics of financial reporting objectives as understandability, reliability, relevance, timeliness, consistency, and comparability. While GASB does not identify specific control standards, state and local governments follow internal control guidance to meet those objectives. Two of the major sources of guidance for state and local governmental units on auditing and reporting on internal control are the Single Audit Act and Government Auditing Standards (GAS), also known as generally accepted government auditing standards (GAGAS), and popularly known as the Yellow Book. These standards are produced by the Government Accountability Office. GAO's Standards for Internal Control states that for an entity to run and control its operations, it must have relevant, reliable, and timely communications relating to internal as well as external events. Information is needed throughout an agency to achieve all of its objectives. These standard control activities help to ensure that all transactions are completely and accurately recorded.

GASB Statement No. 34 - *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments:* According to Governmental Accounting Standards Board (GASB) Statement No. 34, paragraph 19, capital assets include land, improvements to land, easements, buildings, building improvements, vehicles, machinery, equipment, works of art and historical treasures, infrastructure, and all other tangible or intangible assets that are used in operations and that have initial useful lives extending beyond a single reporting period. In compliance with GASB No. 34, Governments should report all capital assets, including infrastructure assets, in the government-wide statement of net assets and generally should report depreciation expense in the statement of activities.

FAS 13 Paragraph 7 provides the following guidance on classifying leases:

“If at its inception a lease meets one or more of the following four criteria, the lease shall be classified as a capital lease by the lessee.

> a. The lease transfers ownership of the property to the lessee by the end of the lease term.
>
> b. The lease contains a bargain purchase option.
>
> c. The lease term is equal to 75 percent or more of the estimated economic life of the leased property. However, if the beginning of the lease term falls within the last 25 percent of the total estimated economic life of the leased property, including earlier years of use, this criterion shall not be used for purposes of classifying the lease.
>
> d. The present value at the beginning of the lease term of the minimum lease payments excluding that portion of the payments representing executory costs such as insurance, maintenance, and taxes to be paid by the lessor, including any profit thereon, equals or exceeds 90 percent of the excess of the fair value of the leased property.”

In addition, FAS 13 Paragraph 15 states the following for recognizing operating lease expenses:

“If rental payments are not made on a straight-line basis, rental expense nevertheless shall be recognized on a straight-line basis unless another systematic and rational basis is more representative of the time pattern in which use benefit is derived from the leased property, in which case that basis shall be used”

Paragraph 16. “The following information with respect to leases shall be disclosed in the lessee's financial statements or the footnotes thereto (see Appendix D for illustrations).

a. For capital leases:

   i. The gross amount of assets recorded under capital leases as of the date of each balance sheet presented by major classes according to nature or function. This information may be combined with the comparable information for owned assets.

   ii. Future minimum lease payments as of the date of the latest balance sheet presented, in the aggregate and for each of the five succeeding fiscal years, with separate deductions from the total for the amount representing executory costs, including any profit thereon, included in the minimum lease payments and for the amount of the imputed interest necessary to reduce the net minimum lease payments to present value.

Cause/Effect:

A. The District lacks sufficient policies and procedures to ensure the classification of leases as capital and operating is complete and accurate. Further, there is a lack of policies and procedures to ensure that future minimum lease payments are accurate and properly presented in the footnotes. As a result, leases are potentially misclassified and could result in a misstatement of the District financial statements or incorrect presentation in the footnotes.

B. The District lacks sufficient policies and procedures to ensure costs transferred from CIP are tracked and supported on a project level. Furthermore, the District lacks a complete and formalized fixed assets policy and control environment which includes requirements for proper identification, tracking and recording of fixed asset additions and disposals, to ensure complete and accurate recording of fixed assets. As such, the fixed asset balance is not complete and accurate which may result in a misstatement in the District's financial statements.

C. The District lacks a complete and effective fixed asset inventory count process to ensure complete and accurate recording of fixed assets inventory. A lack of a complete and formal fixed asset inventory policies and procedures may result in assets that are not properly identified, tracked and recorded to the general ledger which may result in a misstatement in the District's financial statements.

Recommendations:

A. We recommend that the OFOS enhance its current financial reporting processes to ensure that all agencies are providing complete and accurate financial data in a timely manner to ensure completeness and accuracy of the District's financial statements. These policies should include but are not limited to the following:

   1. Proper documentation is maintained for each lease transaction to ensure proper recording and classification of current lease expenditures and future lease payment amounts in the general ledger and lease footnote.
   2. Monitoring of agency submissions of closing package information to ensure completeness and accuracy of financial data.
   3. Thorough review of templates used to ensure accuracy of pre-populated formulas and data.
   4. Increased instruction and detailed guidance for agency personnel who are responsible for completing closing package information.
   5. OFOS should provide training on these enhanced processes to all District agencies and monitor to ensure adherence to OFOS's financial reporting policies.

B. We recommend that the OFOS enhance its current financial reporting processes to ensure that all fixed asset activity is recorded in a timely matter to ensure completeness and accuracy of the District's financial statements. These policies should include but are not limited to the following:

1. Proper documentation maintained for each fixed asset addition and disposal.
2. Transaction and project level detail maintained in the accounting system for each reported fixed asset balance so that reported balances can be reconciled to actual fixed asset activity.
3. Documentation maintained to support the transfer of costs to fixed assets for projects delivered in phases (i.e. the percentage of completion for the entire project is less than substantial when costs are transferred during the year, however, phases of the project are ongoing and transferred as each phase is complete).
4. Monitoring of agency activity and submissions of closing package information to ensure completeness and accuracy of financial data.
5. The District should provide training on these enhanced processes to all District agencies and monitor to ensure consistent adherence to OFOS's financial reporting policies.

C. We recommend the District enhance current fixed asset policies to ensure procedures are implemented to include, but are not limited to the following:

1. Proper identification, tracking and recording of fixed assets to ensure that each inventory item should be tagged with the corresponding identification number and held at the location number on record. Any changes such as relocation or disposal should be updated in the record.
2. Each inventory record should include an asset identification number, a location number, asset description, cost, fund information, and acquisition date.
3. A physical count should be performed at least annually to ensure the inventory records and the financial statement balances are complete and accurate.

District personnel responsible for performance of these procedures should be trained on the enhanced policies. In addition, the District should implement a monitoring process to ensure adherence to these policies.

Management Response:

A. The Office of Financial Operations and Systems (OFOS) routinely seeks ways to enhance financial reporting processes and maximize overall operational efficiency; therefore, OFOS will take the auditors' recommendations under advisement. TO the extent deemed to be necessary, OFOS will revise current policies and procedures and work more closely with agencies to ensure adherence to policies related to the reporting of leases.

In addition, to address the issues cited by the auditors, the Office of Finance and Resource Management (OFRM) will review its current business practices and revise its policies and procedures as determined to be necessary. OFRM will also work more closely with the Asset Portfolio team at the Department of General Services to ensure accurate reporting of the District's future minimum lease payments.

B. Management concurs with this finding. The District acknowledges that a more detailed process needs to be undertaken by the agencies when analyzing costs associated with capital projects. The lack of such a process is partly the result of shortcomings of SOAR – the District's accounting system, which will be resolved with the implementation of the Oracle financial system. Oracle has a projects module that the District will implement that will track all costs by project and will capitalize into the asset module. Any procedural change initiated in FY2012 addressing this finding will be a short-term fix taking into account the changeover from SOAR to Oracle in FY2013.

C. The District concurs with the recommendation with an exception. The District does not believe that the inventory needs to be performed annually. Due to current budget constraints, the cost-benefit does not justify the expense of an annual inventory. The District does agree that a policy that governs the performance of the inventory needs to be drafted and adopted; such a policy will be created and used for the inventory in FY2012.

7. Disability Compensation and Tort Liability

During our testwork performed over underlying data to the District's disability compensation and tort liabilities, we determined the following:

Conditions:

A. *General:*
   1. The District does not have a uniform or formal policy in place for developing and measuring estimates used for claim future reserve amounts for disability compensation.
   2. The Office of Risk Management (ORM) did not engage an Actuarial Specialist in a timely fashion.

B. *Tort Liabilities (General & Auto)*:
   1. For ten (10) of the 27 General claims and 13 of the 26 Auto claims selected for testing, we were not provided sufficient support for the claims. We determined that five of the General and nine of the Auto claims were paid and not in a pending status. As such, support should have been readily available for these items.
   2. For six (6) of the 17 General claims and 1 of the 13 Auto claims provided for testing, we were not provided support for the future reserve amount.
   3. For one (1) of the 13 Auto claims provided for testing, we noted that the claim had an incorrect claim status. Specifically, we determined that the claim was improperly designated as 'OPEN' although ORM sent the claimant a settlement notice on 10/17/2008 denying the claim. As such, this claim should be designated as 'CLOSED.'

C. *Uniformed (FEMS and MPD) Worker's Compensation*:
   1. For four (4) of the 26 Metro Police Department (MPD) claims and three of the 26 Fire Emergency Medical Services (FEMS) claims selected for testing, we determined that members were earning disability compensation in excess of both the MPD's 1,376 maximum allowable hour cap and FEMS' maximum allowable 512-hour cap.
   2. For ten (10) of the 26 FEMS claims selected for testing, we determined that no support was provided for the estimated future Performance on Duty (POD) hours reported.

3. For two (2) of the 26 MPD claims selected for testing, we determined that the injury date did not agree to the documented claims form (PD Form 42).

Criteria:
GASB Statement No. 1, *Objectives of Financial Reporting*, recognizes the basic characteristics of financial reporting objectives as understandability, reliability, relevance, timeliness, consistency, and comparability. While GASB does not identify specific control standards, state and local governments follow internal control guidance to meet those objectives. Two of the major sources of guidance for state and local governmental units on auditing and reporting on internal control are the Single Audit Act and Government Auditing Standards (GAS), popularly known as the *Yellow Book*. These standards are produced by the Government Accountability Office. and they states that and entity's Internal Control must have relevant, reliable, and timely communications relating to internal as well as external events. Information is needed throughout an agency to achieve all of its objectives. These standard control activities help to ensure that all transactions are completely and accurately recorded.

District of Columbia Official Code 2001 Edition Currentness
Division I. Government of District.
Title 5. Police, Firefighters, and Chief Medical Examiner. (Refs & Annos)
Chapter 6A. Police and Firefighters Limited Duty.

§5-633. Medical leave for performance of duty injuries and illnesses; referral for disability retirement.

c) Except as provided in subsections (e) and (f) of this section, and regardless of whether the prognosis is that the member will be able to perform the full range of duties after achieving maximum medical improvement, the Director shall process for retirement pursuant to § 5-710, those members of the Metropolitan Police Department who spend all or part of 172 cumulative work days in a less-than-full-duty status over any 2-year period as a result of any one performance-of-duty injury or illness, including any complications relating to the injury or illness.

d) Except as provided in subsections (e), (f) and (g) of this section, and regardless of whether the prognosis is that the member will be able to perform the full range of duties after achieving maximum medical improvement, the Director shall process for retirement pursuant to § 5-710, those Fire and Emergency Medical Services members who spend 64 cumulative work days in a less-than-full-duty status over any 2-year period as a result of any one performance-of-duty injury or illness, including any complications relating to the injury or illness.

Cause/Effect:
The District has not developed or implemented policies and procedures over the disability compensation annual valuation processes to ensure accurate and timely recording and monitoring of disability compensation claims data used in the annual actuarial valuation process.

As a result, the District's disability compensation liability may be misstated in the District of Columbia CAFR.

Recommendations:
We recommend that District MPD, FEMS, and ORM management implement formalized policies over the disability compensation processes to ensure:

1. Documentation to support claims is properly maintained.
2. Claims data is reviewed and reconciled by management prior to submission for the annual actuarial valuation process.
3. Management level reviews are implemented to ensure disability compensation maximum allowable hours are not exceeded.
4. The Actuary responsible for the disability compensation study is engaged in a timely fashion to allow for proper management review and auditing of disability compensation information prior to inclusion in the District of Columbia CAFR.
5. A uniform and measurable policy for developing estimates of reserve amounts used in the claims data reports.
6. Lastly, management should provide training on these policies to personnel responsible for performing these processes and also perform monitoring procedures to ensure adherence with these policies.

Management Responses:

A. and B. - Office of Risk Management:

First, while the audit area designated in the finding is for the District's Disability Compensation program, it appears that the audit assessed data from a program (Tort Liability) that is unrelated to "Disability Compensation." Please note that the Tort Liability Program and the Workers' Compensation Program for Uniformed Officers of FEMSD/MPD are not related in any way, and it is error to designate the tort liability program, and any of the data associated with the tort liability program, as being a part of the District's Disability/Workers' Compensation process and/or program.

Second, Management cannot concur with the findings and/or conclusions stated in the "Effect" section of the NFR because, as set forth above, it appears that data from the tort liability program, which has nothing to do with any of the District's disability program, may have been erroneously considered and relied on to reach audit findings and conclusions that the "Disability Compensation Liability may be unreasonable and misstated…" In other words, it is unclear whether the conclusions in this section of the report relied on findings from the Tort and MPD/FEMS disability programs jointly, or if data from a program unrelated to disability (i.e. the Tort Liability) may have overwhelmingly driven the conclusions in the "Effect" section of the NFR. Because it appears that the audit used data from the District's Tort program to reach a conclusion about the District's Disability Compensation program, the District requests withdrawal of this conclusion.[3]

Third, ORM started the process of engaging an Actuarial Specialist in early 2011. However, the Actuary was not engaged until the late Fall 2011 because of the slow encumbering contract approval process of another agency. ORM does not have the authority to enter into a contract with an actuary. However, ORM provided the necessary support to enter into a contract to the agency that has contracting authority and responsibility.

Fourth, some files were unavailable for this audit because prior to Fall 2008, original tort claim files were sent to the Office of Attorney General (OAG) for purposes of litigation. Consequently, some of the audit files appear to have been sent to OAG. Since 2008, copies of files are not given to the OAG and are retained by ORM. Nonetheless, the American Technical Services (ATS) diary system captures some of the data in these files, including reserves. Some paper files were available.

Fifth, the claim notes in the ATS diary system often set forth the rationale and basis for reserves. This information is available to the District for purposes of budget as well as for purposes of the government's actuarial study.

C. Medical Services Branch of the Metropolitan Police Department:
For four of the 26 Metro Police Department (MPD) claims and three of the 26 Fire Emergency Medical Services (FEMS) claims selected for testing, in accordance with DC ST §5-631[4] and DC ST §5-633 (e)[5], the members were provided with additional non-chargeable medical leave

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[3] While it is true that data from both the Tort Program and the Disability Program of MPD/FEMSD can be considered together when discussing the overall liability of the District, it is incorrect to designate the liabilities of the Tort program as disability when in fact it is not. Moreover, the 2011 Actuary Study performed at the request of ORM provides extensive background information about ORM's various programs and addresses the Tort program's liabilities (General and Auto claims) separate and apart from the liabilities incurred from the disability programs. ORM recommends that the audit area be designated as "self-insured workers' compensation, and general and automobile liability programs" as set forth in ORM's 2011 Actuarial Study.

[4] **DC ST §5-631 Definitions –** For purposes of this chapter, the term:
…(2) "Chief" means either the Chief of the Metropolitan Police Department or the Chief of the Fire and Emergency Medical Services Department.
…(4) "Director" means either the director of medical services for the Metropolitan Police Department, or the medical services officer for the Fire and Emergency Medical Services Department.
…(7) "Member" means a sworn employee of the Metropolitan Police Department or the Fire and Emergency Medical Services Department.

[5] **DC ST §5-633** – Medical leave for performance of duty injuries and illnesses; referral for disability retirement. (e) If a member has sustained a serious or life-threatening injury or illness in the performance of duty that may require more than 2 years of medical treatment for the member to achieve maximum medical improvement, and the prognosis is that the member eventually will be able to perform the full

and disability compensation pay until the member achieves maximum medical improvement or completed the disability retirement process through the DC Police and Firefighters Retirement and Relief Board (PFRRB) (DC ST §5-722[6]) for one or more of the following reasons:

1. In accordance with DC ST §5-633 (e), the Director, MPD or MSO, FEMS, sought and gained approval from the Chief of Police or Chief of Fire and EMS to provide the member with additional non-chargeable medical leave and disability compensation pay until the member achieves maximum medical improvement. This approval was sought by the Director or MSO when MPD members spent 172 cumulative work days (1,376 hours) in a less-than-full-duty status or the FEMS members spent 64 cumulative work days (1,536 hours) in a less-than-full-duty status within or over any 2-year period as a result of any one performance-of-duty injury or illness.

   During the KPMG audit, both MPD and FEMS provided the auditor with properly maintained documents to show that either the Director or MSO sought and gained approval from the Chief, in accordance with DC ST §5-633 (e), to provide additional non-chargeable medical leave and disability compensation pay to those member until they achieved maximum medical improvement, or

2. In accordance with DC ST §5-633 (c) and (d), the Director or MSO, in consultation with the Police and Fire Clinic (PFC) Physicians, some of the MPD and FEMS claims were referred to by the Director or MSO to PFRRB for those members to be considered for disability retirement. The cases are pending adjudication by the PFRRB. Once the Director or MSO referred the claims to the PFRRB, neither the Director nor the MSO are responsible for ensuring the members are provided with disability compensation and medical treatment for compensable (POD) claims until the PFRRB completes its disability retirement process and renders a written legal opinion for those cases.

3. The FEMS MSO computed the estimated future hours (disability compensation pay) based on his first hand knowledge about those cases, which was gained through weekly case management meetings with the PFC Physicians and case managers. During those weekly meetings, the PFC medical staff discusses and provides health protected information about the cases, which included but was not limited to: members' medical treatment plans; members' estimated recovery time to return to full duty; case referrals to PFRRB; and recommendations to petition the Chief to provide additional non-chargeable medical leave and disability compensation pay.

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range of duties, the Director, in consultation with Police and Fire Clinic physicians, may recommend to the Chief that the member be provided with additional non-chargeable medical leave and disability compensation pay until the member achieves maximum medical improvement.

[6] **DC ST §5-722 Police and Firemen's Retirement and Relief Board** – (a)(1) In order to carry out his responsibilities under this subchapter with respect to retirement and disability determinations, and related functions, the Mayor of the District of Columbia shall establish a Police and Firemen's Retirement and Relief Board (hereinafter in this section referred to as the "Board").

In the matter of the two (2) of the 26 MPD claims selected for testing, noted as that the injury date not agreeing with the documented claims form (PD Form 42), it appears that when the MSB administrative staff entered those claims into the MSB PD 42 database, there was a data entry error made. The MSB PD 42 database is a Microsoft Office Access database, created in 2000, which is used as one internal division mechanism to track PD 42 Reports. This database is not integrated with any other MPD or PFC system. The data entry errors in no way impacted the appropriate or timely adjudication of the claim reports nor interfered with the PFC Physicians ability to provide the member with proper medical treatment for his or her injury or return to work.

8. Payroll and Human Resources:

During performance of our testwork over the payroll and human resources functions of the District, we determined the following:

Conditions:

A. Inadequate/Insufficient Supporting Documentation of New Hire and Terminations:

1. Five of the 40 new hire sample items tested did not show evidence of review in the form of a signature on the SF-50 to ensure the information from the offer letter agreed to the SF-50.
2. Three of the 40 new hire sample items tested had offer letters and SF-50s with information that did not agree, but the documents with incorrect information were signed by an HR representative.
3. One of the 40 termination sample item tested did not have an SF-50 or any other documentation supporting the employee's separation in the personnel file.
4. One of the 40 termination sample items tested did not have a reviewer's signature on the SF-50.
5. One of the 40 termination sample items tested had a resignation letter in the file dated after the effective termination date on the reviewed SF-50.

B. Retirement Contributions to Ineligible Employees:

1. One out of 95 retirement contribution transactions tested resulted in an employee receiving retirement benefits before they were eligible for the benefit, per the District's policy. Specifically, the employee erroneously received retirement contributions of $107.96 per pay check (5% of base pay) for the period 10/1/10 through 5/31/11 totaling $1,943.28 in erroneous contributions. These erroneous contributions were also paid to the employee during FY2010 since pay period 14 (1 month after the employee was hired).

Criteria:

The *Yellow Book, Appendix I, section A1.08 d.* states that management at a State and Local government entity is responsible for "establishing and maintaining effective internal control to help ensure that appropriate goals and objectives are met; following laws and regulations; and ensuring that management and financial information is reliable and properly reported."

In addition, according to the DC Personnel Regulations Chapter 26C section 2602.1, "Any employee serving in covered employment shall be eligible to become a participant in the Plan (Defined Contribution Pension Plan) upon the completion of one year of credible service." According to section 2602.6, "the Administrator shall terminate the participation in the Plan of each participant who is separated from service in excess of one year."

Cause/Effect:

A. Appropriate HR personnel are not adequately reviewing and investigating differences noted on the SF-50s and other supporting documentation for new hire and terminated employees before signing off on the SF-50. Lack of a proper review by the appropriate HR personnel could lead to improper recording of employee payroll data in PeopleSoft which could lead to misstatements in the payroll expense.

B. Employees become automatically eligible for benefits upon one year of credible service. The District has not established a control to ensure eligibility criteria are met before issuing retirement benefits. Without proper internal controls in place to review an employee's calculation for years of credible service, employees can receive benefits for which they are not eligible.

Recommendations:

A. We recommend that controls are strengthened at both the agency and DCHR level. DCHR should emphasize to HR designees at independent agencies that all offer letters need to be reviewed for accuracy before being signed and sent to an individual and that terminations need to be reviewed timely to ensure the information is accurate and appropriately documented in PeopleSoft as well as the personnel file. Similarly, the review process to ensure that the name, effective date, position, pay plan, occupation code, grade/level, step/rate, and total salary agree with the offer letter should be formalized and emphasized during trainings for HR personnel that are authorized to perform this review at both the agency and DCHR levels.

B. We recommend that the District implement policies and procedures to perform periodic reviews over the eligibility of all employees receiving benefits funded by the District.

Management Response:

A. While we agree in principal with the recommendations provided, we've identified a remediation action plan that will: (1) communicate the findings to the District's HR Professionals and Practitioners; (2) provide Education and Awareness Training; (3) update our operating processes and procedures; (4) implement a monitoring and oversight program to conduct periodic compliance verification testing of transactions; and (5) review existing delegation of authority procedures to ensure proper documentation and compliance.

B. Management concurs with this finding.

Section III – District of Columbia Public Schools

During our audit of the basic financial statements, we determined deficiencies at the District of Columbia Public Schools related to controls over payroll and human resources functions, and procurement and disbursement controls. We have broken down these deficiencies by area below along with both our recommendation for remediating the deficiency noted as well management's response to the noted deficiency.

1. Payroll and Human Resources:

We noted the following deficiencies related to controls over payroll and human resources functions:

Conditions:

A. During our interim testing of controls over new hire employees, we determined that for 2 of 40 new hires sampled, the offer letters given to new hire employees contained salary amounts that did not agree to the salary amount recorded in PeopleSoft. Specifically, the amounts per the offer letters were $53,933 and $60,582, and the amounts per PeopleSoft were $53,993 and $62,931. The salaries per the EPSI form agreed to the incorrect offer letter amount in the first case, and agreed to the correct PeopleSoft amount in the second case. The amounts per PeopleSoft represented the correct amounts, as these amounts agreed to the salary amount per the employee's grade and step per the approved pay scales for their positions.

B. During our testwork over benefits, we determined that 59 out of 446 transactions tested where the employee's payroll deduction did not agree to the rate per the benefit handbook. The deduction being withheld from the employee's pay was less than the specified rate per the benefit handbook for the benefit elected resulting in a total overpayment to employees totaling $503. Specifically, we determined the following:

   1. Five (5) life insurance deductions resulted in an overpayment to employees of $7.69.
   2. Four (4) retirement deductions tested resulted in an overpayment to employees of $61.35.
   3. Forty-four (44) Option A life insurance deductions tested resulted in an overpayment to employees of $405.28.
   4. Six (6) Option B life insurance deductions tested resulted in an overpayment to employees of $28.12.

C. During FY2011, DCPS had a total of $569,294,008 of personnel and benefit disbursements. During our testwork over a sample of 548 payroll disbursements totaling $1,258,964, we identified instances where the employee's pay was not properly supported by appropriate documentation or the employee received the incorrect pay based on the supporting documentation provided. Specifically, we determined the following:

   1. For five (5) of the 548 employee pay rates tested, our recalculated amount did not agree to the proper pay scale and the rate per PeopleSoft and the employee's pay check. Four (4) of these differences were related to retro-active payments that were identified to be

paid to the employees; however, these payments were not properly processed during FY 2011. This resulted in an underpayment to employees of a total of $652.67 in gross pay for the employees sampled. One (1) of these differences was related to an improper pay rate being used. This resulted in an overpayment to the employee of $111.54 in gross pay.

2. For one (1) of 548 transactions tested, DCPS could not provide support for the employee's longevity, and therefore we could not verify that the employee was being paid at the appropriate grade and step. This resulted in a total unsupported overpayment of $330.76.

Criteria:
According to the Yellow Book, Appendix I, section A1.08 d., management at a State and Local government entity is responsible for "*establishing and maintaining effective internal control to help ensure that appropriate goals and objectives are met; following laws and regulations; and ensuring that management and financial information is reliable and properly reported*."

Cause/Effect:

A. Although DCPS has a process in place requiring a review of the step, grade and salary amount generated in PeopleSoft to determine that there is a match between PeopleSoft, the offer letter, and the Electronic PeopleSoft Intake (EPSI) form, this review was not adequately performed for the two items noted above. As a result, failure to perform this review or correct inconsistencies can result in improper salary information being communicated to the employee, as well as inaccurate salary records being kept in the OPF. Failure to perform this control did not have a direct effect on the financial statements since the salary amounts in PeopleSoft are pay scale driven, and amounts paid to the employee are generated from the salary amount stored in PeopleSoft, not the offer letter. However, the absence of this control could allow for incorrectly entered information in the EPSI form or PeopleSoft to go undetected, which could cause an incorrect amount to be paid to an employee.

B. DCPS employees elect benefits and enter the related amounts into PeopleSoft. DCPS HR does not perform any review to ensure the amount which the employee entered in the system is the correct amount per the monthly/bi-weekly premium for the benefit elected, nor do they do any review to ensure that deductions are properly and timely being withheld from employee's paychecks.

   We also determined that for the Option A life insurance, the overpayment was due to the employee's age bi-weekly premium rate factor, for example $0.352 for those under age 35, being deducted instead of the total deduction calculation. We also noted that for the majority of variances in the Option B life insurance, the employee was not switched to the new age timely and therefore the bi-weekly premium rate factor used in the calculation was incorrect. According to the Federal Employees' Group Life Insurance (FEGLI) policy, this switch should occur the pay period following the employee's birthday that results in a shift in their bi-weekly premium rate. We noted that these calculations are system-driven and performed at the District of Columbia (DC) Human Resource (HR) level, not at DCPS.

Without proper controls in place to verify that the deduction being withheld is accurate and timely, an incorrect amount could be withheld from the employee's pay. In addition, this practice could lead to errors in the employee's benefit elections as well as DCPS paying premiums for employees who have not elected coverage.

C. Throughout the year an employee may gain a promotion or obtain a new certification (Master's Degree, Ph.D, etc.) that will affect their yearly salary. These changes may be reflected in PeopleSoft immediately; however, the change is not reflected on the employee's paycheck until a subsequent pay period since the actual payment process, generally due to paperwork, takes longer. In addition, for a portion of these instances, a new principal's pay scale that was used to assign employee pay rates in PeopleSoft was not properly reflected in the employee's paycheck. Therefore, employees received either Additional Income Assistance (AIA) to fill the gap between the salaries per the new pay scale until it was adjusted, and/or were to receive retroactive payments when approved and funding was available. However, this process was not performed timely and resulted in the employees receiving incorrect pay amounts. Without proper internal controls in place to ensure that retro payments and adjustments due to employees are properly and timely being processed, payroll expense can be misstated.

Recommendations:
We recommend that:

A. DCPS follow its established policies and procedures and strengthen their internal controls in place over the review of the salary amount per the offer letter to ensure that the salary amounts documented in the offer letters are in agreement with the amounts per EPSI form and salary amount generated in PeopleSoft. Should the salary amount change subsequent to the offer letter being sent to the employee and the information being entered in the system, some sort of documentation should be kept in the employee's personnel file to indicate this change.
B. Employees are assisted during the election of benefits by a DCPS HR representative. In addition, we recommend that DCPS HR perform a review of all information entered into PeopleSoft to ensure the amount being withheld from the employee's paycheck agrees to the premium per the benefit handbook for the benefit elected by the employee and is being withheld in a timely manner from the employee's paycheck. In addition, we recommend that DCPS and DC HR perform reviews of their benefit tables within PeopleSoft to ensure accurate calculations are being maintained.
C. DCPS strengthen their internal controls to ensure that employee retroactive payments are more accurately and timely monitored to ensure employees receive such payments and adjustments timely. We also recommend that DCPS regularly review retroactive payments due, especially those that have been outstanding for the majority of the fiscal year, and ensure proper staffing to clear any delays in the process, both to pay employees the accurate amount and record an accurate overall payroll expense.

Management Response:

A. The errors identified above represent human errors due to the manual nature of the current process. DC Public Schools has purchased a new talent selection, hiring, and on-boarding software system that will automate most of the manual steps in the hiring process. The planned automation will generate offer letters based on established salary schedules and ensure a match between the salary table, the offer letter, and PeopleSoft.

B. Employees do not have the ability to independently enter an amount for benefits deduction. The amounts are driven by a rate table loaded in PeopleSoft.

   The rate table provided in the Benefits User Guide was provided to DCPS by the DC Office of Human Resources (DCHR). The life insurance rates are loaded into PeopleSoft by DCHR and OCTO. DCPS has no visibility over the final calculation of the deductions.

C. DCPS concurs with the facts. A review of the retro process will be undertaken to ensure improved monitoring and tracking of submissions to identify opportunities to shorten the processing and submission times for each request.

2. Procurement and Disbursements:

In our testing of procurement and disbursement transactions at the District of Columbia Public Schools (DCPS), we observed the following:

Conditions:

A. Inadequate/Insufficient Supporting Documentation of Procurements/Disbursements:

   1. For three (3) contract files supporting payments totaling $19,588, there was insufficient substantiating evidence for a subsequent modification of the respective purchase order; further, DCPS was not able to provide such support after it was not found in the contract files.
   2. For seven (7) purchase order files for payments totaling $988,206, the files did not include a completed Determination of Reasonable Price and Award when the file was first provided by DCPS, specifically:
      a. For three (3) purchase order files for payment totaling $2,068, the Contract Specialist had not indicated how the price for the procurement was deemed reasonable.
      b. For four (4) purchase order files for payments totaling $986,138, the Determination of Reasonable Price Award was not signed by the Contracting Officer.
   3. For one (1) contract file for payment totaling $51,422, the file did not include the appropriate D&F form.
   4. For two (2) contract files for payments totaling $259,905, the file did not contain evidence of appropriate competitive vendor selection.
   5. For thirteen (13) transactions totaling $704,708, the respective purchase order and/or contract file was not provided by DCPS.

6. Three (3) disbursements totaling $2,327 were incurred in the prior year, but were charged to current year expenditures and not properly accrued at the end of the prior year.
7. For one (1) purchase order in the amount of $7,485, the Contracting Officer did not timely perform the 'Determination of Reasonable Price and Award' and 'Determination for Sole Source Procurement.' Both determinations were signed on 1/23/2012, the day the file was provided as support.

B. In addition, although we were able to substantiate the accuracy and existence of the expenditure, we identified certain transactions tested where DCPS did not follow its existing internal policies and procedures related to the processing of the transaction. Specifically:

   1. Out of 425 disbursements tested, we identified 1 direct voucher transaction totaling $5,626 where there was insufficient detail documentation to support DCPS' commitment to various services provided by the vendor, or the support provided was not consistent with the documentation provided; and
   2. Out of 425 disbursements tested, we identified 2 transactions totaling $571 where the transactions were posted to the incorrect comptroller object code in DCPS' general ledger.

C. With regard to our testing of compliance with the District of Columbia Quick Payment Act, we determined that:

   1. One hundred twenty-five (125) of four hundred twenty-five (425) DCPS payments selected for testing were not paid timely in accordance with the Quick Payment Act. All transactions were paid more than 30 days after the Office of the CFO received the invoice.

Criteria:
According to 27 DCMR (Chapter 12):

27-1203.1 The head of each office performing contracting or contract administration functions shall establish files containing the records of all contractual actions pertinent to that office's responsibility.

27-1203.4 The contracting office file shall document the basis for the procurement and the award, the assignment of contract administration (including payment responsibilities), and any subsequent action taken by the contracting office.

GASB 33, *Accounting and Financial Reporting for Non-exchange Transactions,* states that expenses are recognized when incurred.

Additionally, according to the Yellow Book, Appendix I, section A1.08 d., management at a State and Local government entity is responsible for "*establishing and maintaining effective internal control to help ensure that appropriate goals and objectives are met; following* *laws and regulations; and ensuring that management and financial information is reliable and properly reported."*

The District's Quick Payment Act indicates the following: *If a contract specifies the date on which payment is due, the required payment date is the date specified in the contract. If a contract does not specify a payment date, the required payment date will be one of the following:*

> *(a) Meat and meat food products - the seventh (7th) day after the date of delivery of the meat or meat product;*
> *(b) Perishable agricultural commodities - the tenth (10th) day after the date of delivery of the perishable agricultural commodity; or*
> *(c) All other goods and services - the thirtieth (30th) day after the receipt of a proper invoice by the designated payment officer.*

Cause/Effect:

A. DCPS failed to maintain contract files in accordance with procurement rules established by the DC law. Non-compliance with procurement laws and regulations of the District of Columbia can lead to DCPS conducting business with unauthorized vendors or for purchases that have not been approved.

B. DCPS did not provide documentation to support that the expenditure was a required service to the student. Without evidence showing the authorization of services, DCPS could pay vendors for services that were not authorized for purchase. Additionally, DCPS personnel are not adequately reviewing vouchers to ensure object coding is correct prior to recording in SOAR. Although this has no impact on expenditures as a whole, expenditures are presented on the Budgetary Comparison Schedule by function, which is compiled and summarized by the expenditure's object code in SOAR. Without correctly recording transactions to the correct object code, expenditures could be presented under the incorrect function on the Schedule.

C. Payment for these invoices was issued more than 30 days after the invoices were received by the DCPS Accounts Payable Department. As a result, DCPS could be in non-compliance with the District of Columbia's Quick Payment Act.

Recommendation:

We recommend that:

A. DCPS strengthen their internal controls to ensure compliance with applicable procurement laws and regulations.

B. DCPS follow existing control procedures surrounding the retention of supporting documentation showing authorization of services provided to students, to allow all invoices to be traced and agreed to the approved court order, IEP, or authorization letter, if applicable. Additionally, we recommend that DCPS strengthen their controls over the proper review of vouchers prior to recording in SOAR to ensure that all expenditures are coded to the proper object code.

C. DCPS implement measures to improve the timeliness of receiving reports being completed by receivers of the goods and services in PASS to ensure that the 3 way system match can occur and payments be processed within 30 days of the receipt of the invoice In the event that an invoice is not paid within 30 days due to vendor errors, evidence supporting the fact that payment was withheld until issues with the goods or services received or amounts invoiced were resolved should be appropriately documented.

Management Response:
Management concurs with the finding. To strengthen controls with respect to contracting and procurement, DCPS-Office of Contracts and Acquisitions (OCA) will provide training on Procurement Regulations, applicable D.C. Code, and other guidance pertaining to the retention of contract files.

To improve controls with respect to direct voucher payments, DCPS has amended its year-end accrual process instructions to include a checklist of items to review when requesting the accrual or processing of direct voucher payments at year-end. In addition, for direct voucher payments, a summary of key items requiring review will be disseminated to DCPS program and accounts payable staff.

To minimize the use of incorrect comptroller object codes, DCPS will re-emphasize the importance of approvers reviewing such codes for accuracy during the requisition and purchase order approval process. This will be communicated to staff in the form of a memorandum as well as through face-to-face discussion during staff meetings.

Section IV – Other Matters to be Communicated

1. Proposed Statement on Accounting and Financial Reporting for Pensions

The primary objective of this proposed Statement is to improve accounting and financial reporting by state and local governments whose employees are provided with pensions. It also aims to improve information provided by state and local governments about financial support for pensions that is provided on their behalf by other entities. It is the result of a comprehensive review of the effectiveness of existing standards of accounting and financial reporting for pensions with regard to providing decision-useful information, supporting assessments of accountability and inter-period equity, and creating additional transparency.

Some of the major provisions include the following:

- The net pension liability would equal the employer's total pension liability less the amount of plan net position restricted for pensions (plan net position), as of the end of the employer's reporting period. The total pension liability would be the portion of the present value of projected benefit payments that is attributed to employees' past periods of service. Actuarial valuations of the total pension liability would be required to be conducted at least every two years under the proposed Statement, with more frequent valuation encouraged.
- Projected benefit payments would be discounted to their present value using the single rate that would reflect (1) a long term expected rate of return on plan investments to the extent that plan net position is projected to be sufficient to pay pensions and the net position projected to remain after each benefit payment can be invested long-term, and (2) a tax exempt, high-quality municipal bond index rate to the extent that the conditions in (1) are not met.
- A cost-sharing employer whose employees are provided with pensions through a qualified trust would report a net pension liability, deferred outflows of resources and deferred inflows of resources related to pensions, and pension expense based on its proportionate share of the collective net pension liability of all employers in the plan.

The net impact of this proposed Statement will be far reaching and may include:

- Additional assets (or liabilities dependent on the funded status of the plan) presented in the government wide Statement of Net Assets; and/or
- Lower calculated discount rate, resulting in a higher actuarial accrued liabilities for benefits.

The District should continue work with its actuaries to evaluate the impact of this proposed standard on the future financial position of the District.

Appendix B

Status of Prior Year Report Findings

PY Finding Number	Severity	Finding Description	Current Status
Yellowbook 2010-01	SD	*Weaknesses in the District's General Information Technology Controls*	Repeated, Yellowbook 2011-01
Yellowbook 2010-02	SD	*Weaknesses in the District's Procurement and Disbursement Controls*	Repeated, Yellowbook 2011-02
Yellowbook 2010-03	SD	*Weaknesses in Monitoring Financial Reporting and Non-Routine Transactions in Stand-Alone Reports*	Remediated
Yellowbook 2010-04	SD	*Weaknesses in the Financial Reporting Process at the Office of Tax and Revenue*	Downgraded to MLC, 2011 MLC - II.3
Yellowbook 2010-05	SD	*Weaknesses in the Personnel Management and Employee Compensation Process*	Downgraded to MLC, 2011 MLC - II.9
2010 MLC - II.1	MLC	*Fixed Assets, including Leases*	Repeated, 2011 MLC - II.6
2010 MLC - II.2	MLC	*Debt*	Remediated
2010 MLC - II.3	MLC	*Human Resources*	Repeated, 2011 MLC - II.8
2010 MLC - II.4	MLC	*Procurement*	Repeated, 2011 MLC - II.1 & II.2
2010 MLC - II.5	MLC	*Medicaid and Grants Management*	Repeated, 2011 MLC - II.5
2010 MLC - II.6	MLC	*Revenue*	Repeated, 2011 MLC - II.3
2010 MLC - II.7	MLC	*Financial Reporting*	Remediated
2010 MLC - III.1	MLC	*UDC - Third Party Servicers*	**See Status of PY UDC MLCs in the separate UDC Management Letter*
2010 MLC - III.2	MLC	*UDC - Compliance with Investment Policy*	
2010 MLC - III.3	MLC	*UDC - Financial Reporting*	
2010 MLC - III.4	MLC	*UDC - Payroll Process*	

Legend:
SD – Significant Deficiency in internal control
MLC – Management Letter Comment