

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

DISTRICT OF COLUMBIA

**Independent Auditors' Report on
Internal Control and
Compliance Over Financial Reporting
Fiscal Year Ended September 30, 2010**



**CHARLES J. WILLOUGHBY
INSPECTOR GENERAL**

GOVERNMENT OF THE DISTRICT OF COLUMBIA
Office of the Inspector General

Inspector General



February 11, 2011

The Honorable Vincent C. Gray
Mayor
District of Columbia
Mayor's Correspondence Unit, Suite 316
1350 Pennsylvania Avenue, N.W.
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 and Chairman Brown:

In connection with the audit of the District of Columbia's general purpose financial statements for fiscal year 2010, KPMG LLP submitted the enclosed final Independent Auditors' Report on Internal Control Over Financial Reporting and on Compliance and Other Matters (OIG No. 11-1-06MA).

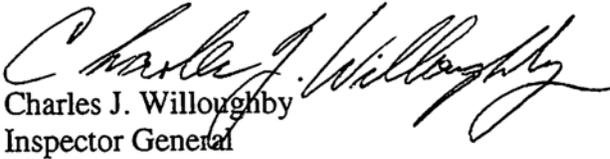
This report identifies five significant deficiencies. A significant deficiency adversely affects the District's ability to initiate, authorize, record, process, and report financial data. The significant deficiencies identified in the report are weaknesses in the following areas: (1) General Information Technology Controls; (2) Procurement and Disbursement Controls; (3) Monitoring Financial Reporting and Non-Routine Transactions in Stand-Alone Reports; (4) Financial Reporting Process at the Office of Tax and Revenue; and (5) Personnel Management and Employee Compensation Process.

I am pleased to report continued progress relative to the financial management of the District of Columbia. For the second consecutive year, the audit of the city's financial statements has revealed no material weaknesses.

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

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

Sincerely,


Charles J. Willoughby
Inspector General

Enclosure

CJW/ws

cc: See Distribution List

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Washington, DC 20036-3389

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

We have audited the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, budgetary comparison statement, each major fund, and the aggregate remaining fund information of the District of Columbia (the District) as of and for the year ended September 30, 2010, which collectively comprise the District's basic financial statements and have issued our report thereon dated January 27, 2011. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. The financial statements of the District of Columbia Water and Sewer Authority, and District of Columbia Housing Financing Agency, both discretely presented component units of the District, were not audited in accordance with *Government Auditing Standards*.

Internal Control over Financial Reporting

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

A deficiency in internal control over financial reporting exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above. However, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies and that are described in Appendix A to this report. A significant deficiency is a deficiency, or combination of deficiencies, in internal control over financial reporting that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.



Compliance and Other Matters

As part of obtaining reasonable assurance about whether the District's basic financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in finding 2010-02 in Appendix A to this report.

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

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

KPMG LLP

January 27, 2011

Appendix A – Significant Deficiencies in Internal Control Over Financial Reporting

Finding 2010-01 – Weaknesses in the District’s General Information Technology Controls

Background:

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 identified pervasive GITC-related findings. Our 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 and/or segregation of duties considerations.
2. Inconsistent performance and/or documentation of user access administration activities, including the approval of new user access and access changes, periodic review of user access rights, and timely removal of user access upon employee termination.
3. Use of generic accounts to perform system administration and/or end user functions within key applications without adequate monitoring controls over such activities.

Program Changes

Conditions:

1. Failure to institute well-designed program change and/or system development life cycle policies that establish procedural and documentation requirements for authorizing, developing, testing, and approving changes to key financial applications and related infrastructure software¹ 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 infeasible, implement independent monitoring controls to help ensure changes applied to the production environment are authorized.

Table 1 below summarizes the key financial applications that were impacted by the findings noted above.

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

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Table 1: Summary of applications impacted by the findings related to the Access to Programs and Data and Program Change control areas

Application	Access to Program and Data	Program Changes
PeopleSoft	X	X
TACIS	X	X
PASS	X	
ACEDS	X	X
DOCS	X	X
DUTAS	X	X
BARTS		X
Meditech	X	
TAS	X	

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 leveraged:
 - a) NIST Special Publications (SP) 800-12, An Introduction to Computer Security
 - 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
 - d) NIST SP 800-14, Generally Accepted Principles and Practices for Securing Information Technology, September 1996
2. The U.S. Government Accountability Office's (GAO's) Evaluating Internal Controls in Computer Based Systems (Black Book)

Cause/Effect:

The findings highlighted above include weaknesses in both the design and consistent operation of policies and procedures considered relevant to the Access to Programs and Data and Program Change areas. We noted a segmented approach in the design and implementation of relevant GITCs, including the lack of a concentrated effort to formalize underlying GITC processes and controls, and the lack of an effective monitoring function. 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:

1. *Related to Access to Programs and Data controls, we recommend that management:*
 1. 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.
 2. 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.
 3. Restrict the use of generic IDs or, if such access is required, implement independent monitoring of the activities performed using generic ID.
 4. Formally communicate policies and procedures per the recommendations above 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.

2. *Related to Program Change controls, we recommend that management:*
 1. Assess and update or, as applicable, develop and document program change control policies and procedures for production applications and underlying infrastructure systems including, but not limited to, requirements for the documentation of: properly detailed change requests, authorization of the change prior to initiation of the work, preparation of test plans and results, and formal approval of the change prior to migration to production.
 2. Formally communicate policies and procedures per the recommendations above 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.
 3. Develop and implement controls that establish organizational and logical segregation between program development roles and change migration roles among different individuals or, independent monitoring of the activities of users provided with conflicting system access.

Management's Response:

The District concurs with the auditor's findings with respect to general information technology controls and will develop and implement the necessary corrective actions to address the deficiencies noted and enhance operational efficiency.

Access to Programs and Data

The District concurs with this finding and will implement the necessary measures to adequately restrict user access to programs and data based on job functions and the need for adequate separation of incompatible duties. In addition, the District will develop (or revise) and implement policies and procedures for: (a) restricting user access; (b) routinely monitoring application access privileges; (c) approving new user access (or access changes); and (d) timely removing user access upon employee separation/termination. Such policies and procedures will also include specific guidance on the use of generic accounts to perform system administration functions (e.g., instances in which such accounts are to be used and how the use of generic accounts is to be monitored).

Program Changes

The District concurs with this finding and will review existing policies regarding authorizing, developing, testing, and approving changes to financial applications and related infrastructure software. To the extent that current policies are not adequate, the District will revise them accordingly. In addition, we will periodically perform internal reviews of program change management practices to ensure that changes made in the financial systems are properly approved, tested, and documented. This will include monitoring whether system developers are being limited to the production environments of financial applications.

Finding 2010-02 – 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 very robust policies and procedures at the Office of Contracts and Procurement, 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.

Condition:

We selected a sample of 25 sole source procurements executed by the District in fiscal year 2010 and noted the following:

Lack of supporting documentation:

- For six (6) contracts, the Determination and Findings (D&F) were not available for review.
- For ten (10) contracts, the screen prints showing that a search was performed to determine whether the vendor was debarred or suspended from doing business with the District were not available for review.
- For three (3) contracts, the use of the sole source method of procurement was not appropriate.

Inadequate approvals:

- For three (3) contracts, the D&F was not approved by the Contracting Officer.
- For two (2) contracts, the Contracting Officer delegation authority was not available for review.
- For one (1) contract, the Contracting Officer was able to approve a purchase requisition above his delegation of authority.
- For one (1) contract, the D&F was not approved by the Agency Director and/or Department Head.
- For four (4) contracts, the Council and Office of the Attorney General (OAG) approval was not available for review.
- For two (2) contracts, the purchase requisition was not approved by the Contracting Officer.
- For one (1) contract, the OAG approval was not available for review.
- In one (1) instance, the contract was misclassified as a sole source contract.

We also selected a sample of 25 emergency procurements executed during fiscal year 2010 and noted the following:

Lack of supporting documentation:

- There was no evidence to support the classification as an emergency procurement for ten (10) procurements.
- There is no evidence of competition or a sole source determination for three (3) emergency procurement contracts.

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- The screen prints to provide evidence that a search to determine whether the vendor was debarred or suspended from doing business with the District was not available for review for seven (7) contracts.
- For one (1) contract, the D&F was not available for review.

Inadequate approvals:

- The delegation of authority for the contracting officer was not available for three (3) procurements.
- The contracting officer approved a requisition above his the delegation of authority for one (1) contract.
- The Council and OAG approval was not available for review for one (1) contract.

Non-compliance with emergency criteria requirement:

- The period of performance exceeded the 120 days requirement for an emergency procurement for three (3) contracts inspected.

We selected seven (7) large construction contracts and determined that the District was unable to provide the supporting documentation for three (3) of the construction contracts as follows:

- The Solicitation and Evaluation documents were not available for review for two (2) contracts.
- The Determination and Finding for price reasonableness and Contractor responsibility, the Council approval and OAG legal review for when the contract was awarded in 2005, were not available for review for one (1) contract.
- The Excluded parties' printouts were not available for review for one contract.

We also selected 37 small purchases over \$5,000 and identified the following exceptions:

- Small purchases quotations were not available for review for four (4) purchases.
- The BPA (Blanket Purchase Agreement) relating to repetitive services was not available for review for five (5) purchases.
- The purchase requisition was not available for review for one (1) purchase.

We also selected 31 large procurements over \$100,000 other than construction contracts and identified the following exceptions:

- Two (2) contracts were not available for review.
- There was no evidence of competition for one (1) procurement.
- There was no evidence that the District performed a search to determine whether the vendor was debarred or suspended from conducting business with the District for two (2) procurements.
- The supporting documents provided for one (1) contract related to a FY2009 contract that had expired and not the active contract.
- The authorization for DC participation in a cooperative agreement with the contractor and the Commonwealth of Virginia was not available for review for one (1) procurement.

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

- One (1) of 92 procurement transactions tested where DCPS was not in compliance with the District of Columbia's Laws regarding sole source procurements. Specifically, one file for a procurement totaling \$4,004 did not contain a copy of the signed contract or proper approval from the contracting officer on the letter of determination and findings.
- Eight (8) transactions, totaling \$259,370, of 68 transactions tested, totaling \$11,503,960, were paid through direct voucher were also related to prior period expenditures that were not properly accrued in the prior year.
- Two (2) transactions, totaling \$12,093, of 68 total transactions tested, totaling \$11,503,960, were paid through direct voucher but were not appropriately listed on the approved direct voucher list.
- Twelve (12) payments, totaling \$343,839, of 160 files tested did not have proper vendor invoices to support the payment made.

In addition, although we were able to substantiate the accuracy and existence of the expenditure, we noted for 8 of the 160 transactions tested, DCPS did not follow its existing internal policies and procedures related to the processing of the transaction. Specifically:

- Eight (8) direct voucher payments totaling \$524,009 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
- Of 160 disbursements tested, we noted 11 transactions totaling \$1,470,290 where the transaction was posted to the incorrect comptroller object code in DCPS' general ledger.

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

- Seventy (70) of 683 non-DCPS payments selected for testing were not paid timely in accordance with the Quick Payment Act; and
- Seven (9) of 169 DPCS payments selected for testing were not paid timely in accordance with the Quick Payment Act. In addition, we noted an additional 27 payments for which ayment was made more than 30 days after the CFO Office received the invoice due to delays in receiving the appropriate documents (i.e., receiving report, etc.) to perform the required three way match.

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."*

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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.”*

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

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.”*

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.

Recommendation:

We recommend that the District conduct mandatory training sessions for all personnel involved in the procurement of and payment for goods and services to reemphasize the critical importance of adhering to the existing procurement and disbursement policies and procedures. Further, we

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recommend that the District conduct an “internal audit” of compliance with the Procurement Practices Act and the Quick Payment Act during fiscal year 2011. This internal audit should be conducted after the internal training sessions are held. During this internal audit, the District should select a sample of fiscal year 2011 sole source and emergency procurements as well as vendor disbursements. By conducting the audit after the training, the District may be able to determine the effectiveness of the training by comparing compliance results from procurements and disbursements before and after the training.

Management’s Response:

The District concurs with the facts of this finding and will implement the necessary control procedures to: (a) ensure that purchases are authorized by the appropriate managers and officials before they are made; and (b) ensure that approvals of purchases are adequately documented and such documentation is retained in the District’s files for quick retrieval, as needed. The District will also periodically review on an on-going basis purchases/disbursements to monitor compliance with applicable laws and regulations (e.g., Procurement Practices Act and the Quick Payment Act).

Finding 2010-03 – Weaknesses in Monitoring Financial Reporting and Non-Routine Transactions in Stand-Alone Reports

Background:

The District's annual financial statement process is complex and highly decentralized. District agencies are required to prepare financial closing packages and submit those packages to the District's Office of Financial Operations and Systems (OFOS) for review and approval. OFOS uses these closing packages to prepare the basic financial statements and the notes thereon. While testing the closing packages and financial statements submitted by various District agencies, we observed the following:

- *Unemployment Compensation Fund* – The District's Unemployment Compensation Trust Fund is a major fund in the District's Comprehensive Annual Financial Report (CAFR), and its management prepares a separate set of financial statements. The original draft of those financial statements submitted to both OFOS and the auditors were substantially incomplete and required significant, material adjustments to both the financial statements and the notes.
- *University of the District of Columbia* - The University of the District of Columbia is presented as a discretely presented component unit in the District's CAFR, and its management prepares a separate set of financial statements. The original draft of those financial statements submitted to both OFOS and the auditors were substantially incomplete and required significant, material adjustments and revisions to Management's Discussion and Analysis, the financial statements and the notes.
- *Convention and Sports Authority* - The District's Convention and Sports Authority is presented as a discretely presented component unit in the District's CAFR, and its management prepares a separate set of financial statements. The original draft of those financial statements submitted to both OFOS and the auditors did not properly account for and disclose the merger of the old Convention Center Authority and the Sports and Entertainment Commission and required significant, material adjustments to both the financial statements and the notes.
- *United Medical Center Intangible Assets* – On July 9, 2010, the District established the Not-for-Profit Hospital Corporation (NFPHC), a discretely presented component unit, to account for and maintain the assets upon which the District foreclosed to satisfy an outstanding debt obligation of the former United Medical Center. Under U.S. generally accepted accounting principles, the NFPHC must record the fair value of both the tangible and intangible assets that existed at July 9, 2010. NFPHC did not originally account for the intangible assets acquired, such as the fair value of its bed licenses, until requested by the auditor.
- *Oversight of Actuarial Advisors* – The District's Office of Risk Management (ORM) engages an actuary to provide a valuation of the liability for disability compensation. Further, the District's Department of Human Resources (DHR) engages an actuary to provide a valuation of the liability for other post employment benefits (OPEB) for

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District retirees. Neither ORM nor DHR adequately documented the rationale behind the actuarial assumptions established between the District and the engaged actuary.

Criteria:

Government Auditing Standards, 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:

District component units do not appear to consider properly the accounting and financial reporting for non-routine transactions in order to develop and maintain documentation to support the amounts and disclosures in the CAFR. Further, these component units and agencies do not have adequate policies and procedures surrounding the year-end financial reporting closing process to develop and support the amounts and disclosures in their stand-alone financial statements.

Recommendation:

We recommend that all District entities that prepare stand alone financial statements should prepare interim financial statements that are submitted to OFOS for review and approval.

Management's Response:

The District concurs with this finding. The Office of the Chief Financial Officer, Office of Financial Operations and Systems (OFOS) will revise its interim closing practices to require more financial analysis and reporting of the component units during the fiscal year (at least quarterly). OFOS will review the interim component unit financial data received from each entity for accuracy and reasonableness and will work with each component unit to resolve reporting issues as they arise during the fiscal year. These measures should reduce the level of effort needed at year-end by the component units to produce accurate, reliable financial statements. In addition, the need for significant audit adjustments should also be minimized as a result of these measures. OFOS will continue the practice of reviewing the annual financial statements of component units for reasonableness and accuracy but will use the interim information received from component units to perform a more meaningful review and analysis.

Finding 2010-04 – Weaknesses in the Financial Reporting Process at the Office of Tax and Revenue

Background:

The District's Office of Tax and Revenue (OTR) had over \$4.95 billion in tax revenues in FY 2010. During our testwork at OTR we observed the following:

- There was insufficient monitoring of internal controls by the Returns Processing Administration (RPA) at its lockbox service provider. The service provider processes approximately \$1.9 billion in lockbox transactions on behalf of the District, yet OTR has not ensured that the service provider has been through an in-depth audit of its control objectives and activities, which include controls over information systems, security of taxpayer data, and other related processes. Specifically, we noted:
 - The service provider received a SAS 70 Type I report (Report on Controls Placed in Operation) in the current year versus a SAS 70 Type II report (Report on controls placed in operation and evaluation of Tests of Operating Effectiveness) in prior years;
 - OTR management did not review the SAS 70 report received, and was not aware of the change of the report type;
 - OTR has not performed a site visit to the lockbox manager or its subservice organizations, since March 2008; and
 - OTR was unable to provide supporting documentation or evidence of review of monthly and weekly performance reports provided by the service provider.
- Multiple auditors who prepare audit assessment change documents within the Compliance 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.
- The District continues to maintain insufficient control procedures over the reconciliation of tax withholdings to taxpayer submitted data. OTR has begun to develop policies and procedures to perform these reconciliations, but these corrective actions were partially implemented during FY 2010. Further corrective actions are needed in order to implement fully the policies and procedures.
- Nine (9) of 25 real property tax exemption applications selected for testing at the Real Property Tax Administration were not properly signed by an assessment specialist as being complete.
- Fifteen (15) of 27 SOAR to ITS monthly reconciliations selected for testing included significant reconciling items which were not corrected or input into ITS.
- Management has not performed adequate verification and validation procedures surrounding the methodologies used for setting the allowance for uncollectible accounts for various types of tax receivables. The current methodology was established in 2004; however, no documentation is maintained that demonstrates management's updated review of the estimates.

Criteria:

Government Auditing Standards, 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:

OTR is not adhering to its existing policies and procedures governing review of lockbox operations, reconciliation of tax withholdings, maintenance of Homestead Tax Credit documentation, and granting of real property tax exemption. Further, OTR has not designed an appropriate policy requiring incompatible duties to be segregated to prevent a single employee from being able to prepare, review and approve SOAR cash receipt vouchers nor has management restricted access appropriately to prevent Compliance Division personnel from having inappropriate access. These deficiencies increase the risk that inappropriate refunds may be issued.

Recommendation:

We recommend that OTR adhere to its existing policies and procedures regarding review of lockbox operations, reconciliation of tax withholdings, and maintenance of Homestead Tax Credit documentation. OTR should also consider specific training in these areas to reinforce those procedures. We also recommend that OTR establish a policy requiring that the incompatible preparation, review and approval duties be segregated when preparing a SOAR cash receipt voucher. Finally, we recommend that OTR establish a policy requiring that management’s review of the estimation methodology for the reserve for uncollectible taxes be documented annually.

We further recommend that the Office of Integrity and Oversight conduct a periodic review of OTR’s implementation of changes as a result of these audit observations.

Management’s Response:

The District’s Office of Tax and Revenue (OTR) continues to place a strong emphasis on its internal controls, including risk and control self-identification and self-assessment. OTR leadership and teammates will continue to work closely with the Chief Risk Officer and the Director of the Office of Integrity and Oversight to design, institutionalize, and monitor effective controls.

Finding 2010-05 – Weaknesses in the Personnel Management and Employee Compensation Process

Background:

The District employs approximately 31 thousand employees and disburses over \$2.6 billion in compensation annually. Various payroll rules and regulations are administered by the District's Department of Human Resources, and the payroll disbursements are administered by the Office of Pay and Retirement Services.

During our testwork over payroll expenditures, we observed the following:

- One (1) of 319 employees tested received overtime pay even though the employee was considered to be exempt under the Fair Labor and Standards Act of 1938 (FLSA) and was not eligible for overtime. This resulted in an overpayment to the employee for 390 hours, totaling \$31,073 for FY 2010.
- Eight (8) of 165 employee personnel files tested did not contain the required supporting documentation (Form SF-52, signed offer letter, and signed I-9 verification form with a copy of the employees' identification) in accordance with District policy. Specifically, we noted 5 files did not contain signed offer letters.
- One (1) of 40 terminated employees tested received pay subsequent to termination from District employment. Specifically, the employee received a car allowance during employment, was terminated in March 2010, but continued to receive a car allowance subsequent to termination, resulting in an overpayment to the employee of approximately \$3,300.
- Fifteen (15) of 63 transactions were tested in which an employee's life insurance and/or retirement payroll deduction did not agree to the approved rate. Specifically, the deduction withheld from the employee's pay was less than the approved rate for the benefit elected. This resulted in total overpayments to employees in the amount of \$252.
- One (1) of 63 transactions was tested in which the employee elected benefit coverage but the appropriate benefit deduction was not withheld from the employee's paycheck.
- Seven (7) of 43 employees tested whose personnel files did not contain the required supporting documentation (Form SF-52, signed offer letter, signed I-9 verification form with a copy of the employees' identification, and transcripts (if applicable)) in accordance with DCPS policy. Specifically, we noted:
 - One (1) file which was missing the signed SF-52, signed offer letter, I-9 and copy of identification and copy of official transcript indicating the employee met the requisite educational requirements;
 - Two (2) files which were missing the signed SF-52 and I-9 and copy of identification;
 - Two (2) files which were missing the signed offer letter; and
 - Two (2) files which were missing the official transcript indicating educational requirements.
- Two (2) of 40 transactions were tested in which the employee received retirement benefits before becoming eligible for the benefit under the District's policy.

Appendix A

- Four (4) of 10 retroactive pay transactions were tested in which the District miscalculated the amount due to the employee which resulted in 3 overpayments to individual employees totaling \$67,572, \$488, and \$696, respectively, and one underpayment totaling \$11,181.
- Twenty two (22) of 165 transactions tested were tested in which the hours paid were reclassified from one fund/index code to another. All 22 reclassifications were approved in PeopleSoft in accordance with DCPS' policies and procedures. However, DCPS was unable to provide supporting documentation for 13 of the reclassifications. Further, for the remaining 9 reclassifications, there was no evidence that the supervisor that approved the original timesheet had reviewed the employees' timesheets prior to approving the reclassification.

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:

District employees are not adhering to existing policies and procedures, which increases the risk that amounts may be incorrectly paid to employees.

Recommendation:

We recommend that the District conduct a comprehensive “refresher” training course or courses for all employees involved in the payroll process. Further, we recommend that the District conduct periodic internal reviews of a sample of transactions to monitor compliance with existing policies and procedures.

Management's Response:

The District concurs with facts of this finding and will take the necessary measures to improve controls over personnel management and compensation. We will review current practices regarding the retention of supporting documentation for personnel actions and other payroll-related transactions. To the extent that current practices are determined to be inadequate, the District will revise existing policies and procedures accordingly. As recommended by the auditors, the District will perform periodic reviews of sampled payroll transactions to monitor compliance with policies and procedures. Moreover, as deemed appropriate, the District will provide additional training to staff that perform payroll-related functions to improve efficiency, and reduce the risk of errors.