

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

**GOVERNMENT OF THE
DISTRICT OF COLUMBIA**

FISCAL YEAR 2013

MANAGEMENT LETTER REPORT



**CHARLES J. WILLOUGHBY
INSPECTOR GENERAL**

GOVERNMENT OF THE DISTRICT OF COLUMBIA
Office of the Inspector General

Inspector General



April 15, 2014

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

Jeffrey DeWitt
Chief Financial Officer
Office of the Chief Financial Officer
1350 Pennsylvania Avenue, N.W., Room 203
Washington, D.C. 20004

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

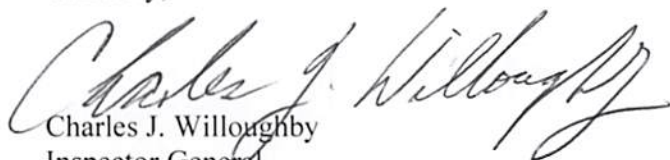
Dear Mayor Gray, Chairman Mendelson, and Mr. DeWitt:

In connection with the audit of the District of Columbia's general purpose financial statements for fiscal year (FY) 2013, KPMG, LLP (KPMG) submitted the enclosed final report, Government of the District of Columbia Fiscal Year 2013 Management Letter (OIG No. 14-1-08MA). 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
Inspector General

CJW/ws

Enclosure

cc: See Distribution List

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The Honorable Richard Shelby, Ranking Member, Senate Committee on Appropriations,
Attention: Dana Wade (via email)

The Honorable Tom Udall, Chairman, Senate Subcommittee on Financial Services and General
Government, Attention: Marianne Upton (via email)

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Mr. Paul Geraty, CPA, Public Sector Audit Division KPMG LLP (1 copy)

Government of the
District of Columbia
Fiscal Year 2013
Management Letter

**GOVERNMENT OF THE DISTRICT OF COLUMBIA
MANAGEMENT LETTER
FOR THE YEAR ENDED SEPTEMBER 30, 2013
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KPMG LLP
Suite 12000
1801 K Street, NW
Washington, DC 20006

March 27, 2014

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

In planning and performing our audit of the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, the budgetary comparison statement, each major fund, and the aggregate remaining fund information of the Government of the District of Columbia (the District), which collectively make up the District's financial statements, as of and for the year ended September 30, 2013, 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, 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 in Appendix A to this report. These comments and recommendations, all of which have been discussed with the appropriate members of management as part of the Notification of Findings and Recommendations (NFR) process, are intended to improve internal control or result in other operating efficiencies. The District's written responses to our comments and recommendations are included in Appendix A. The District's written responses to our comments and recommendations have not been subjected to the auditing procedures applied in the audit of the financial statements and, accordingly we express no opinion on them.

In addition, we identified certain deficiencies in internal control that we consider to be significant deficiencies and communicated them in writing to management and those charged with governance in our *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* dated January 30, 2014.

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.



The purpose of this letter is solely to describe these comments and recommendations intended to improve internal control or result in other operating efficiencies. Accordingly, this letter is not suitable for any other purpose.

Very truly yours,

KPMG LLP

APPENDIX A: CURRENT YEAR FINDINGS AND RECOMMENDATIONS

1. Cash and Investments

- a. Compliance with the Financial Institutions Deposit and Investment Act of 1997

CONDITION

During testwork performed over the District’s compliance with the Financial Institutions Deposit and Investment Act of 1997 and the District’s Cash and Investment Management Policy we noted the following:

- In our sample of 3 months during fiscal year 2013, we identified 2 instances in which a financial institution did not meet the District’s 102% collateral requirement for deposits. The District detected the non-compliance through its monthly review for compliance with collateralization requirements. In all instances, the bank pledged additional collateral within 2-5 days after being contacted by the District.

The following table provides the details associated with the two exceptions:

	Month	Amount of Uninsured Holdings	Amount Undercollateralized
1	October 2012	\$14,750,000	\$37,023
2	June 2013	\$14,750,000	\$33,318

- In our sample of 15 financial institutions (5 from each of 3 months selected above) to test completeness and accuracy of the underlying data used by the District to monitor each financial institution’s compliance with the District’s 102% collateral requirement, we noted the following:

- a) For 5 of 15 financial institutions, the bank balance per the Collateral Monitoring Worksheet did not agree to the balance reported per the corresponding month’s bank statement:

	Month	Bank Balance per Worksheet	Bank Balance per Bank Statement	Difference
1	October 2012	\$7,142,313	\$499	\$7,141,814
2	June 2013	\$2,268,787	\$1,141,812	\$1,126,975
3	June 2013	\$261,806	\$252,893	\$8,913
4	September 2013	\$5,000,000	\$5,005,208	\$(5,208)
5	September 2013	\$980,455	\$839,120	\$141,335

APPENDIX A: CURRENT YEAR FINDINGS AND RECOMMENDATIONS

- b) For one financial institution, we noted the bank balances reflected on the October 2012 and June 2013 Collateral Monitoring Worksheets were the bank balances as of December 31, 2011 and December 31, 2012, respectively, as the District only receives an annual bank statement from this financial institution in December of each year. As a result, the monthly calculations performed by the District to monitor compliance with the District’s 102% collateral requirement were not accurate, and there is increased risk that instances of non-compliance may not be detected on a timely basis for this financial institution.

- End of Day Quick Reports are used by the District to prevent and detect non-compliance with the Financial Institutions Deposits and Investment Act – General Deposit and Investment Requirements and the District’s Cash and Investment Management Policy. The District’s current Policy requires the Associate Treasurer to review the District’s daily investment transactions within 30 days. However, we believe that this control would be more effective in preventing and detecting non-compliance if required to be performed within 3 business days. In our testing of the timeliness of the Associate Treasurer’s review of the District’s daily investment transactions for 29 days throughout fiscal year 2013, we noted that all reviews were completed within the required 30 days and, as reflected in the following table, only 8 instances where the reviews were not performed within 3 business days.

	Daily Report	Approval Date	Number of Business Days
1	10/5/2012	10/15/2012	10
2	10/5/2012	10/15/2012	10
3	1/7/2013	1/14/2013	7
4	2/26/2013	3/4/2013	7
5	5/8/2013	5/15/2013	7
6	7/9/2013	7/15/2013	6
7	7/23/2013	7/31/2013	8
8	9/24/2013	9/29/2013	5

- In order to test the completeness and accuracy of the Total Assets and Total Deposit balances reflected in the District’s daily *Cash Note Report*, which is used by the District to monitor compliance with the Financial Institutions Deposits and Investment Act – General Deposit and Investment Requirements and the District’s Investment Policy, we

APPENDIX A: CURRENT YEAR FINDINGS AND RECOMMENDATIONS

selected a sample of 25 Total Assets and Total Deposit daily balances from throughout fiscal year 2013 and noted the following:

- a) Total assets used to perform the daily calculation of total daily deposits held at the financial institution to the District's total assets are not updated on at least a quarterly basis; and
- b) The District policies/procedures do not specifically address the frequency in which updates to the total deposits balances used to perform the daily calculation of percentage of deposits held at the financial institution of the district's total assets are to be made.

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 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:

- *Effectiveness and Efficiency of Operations*
- *Reliability of Financial Reporting*
- *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 achieve 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.

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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.

Per the Financial Institutions Deposit and Investment Act of 1997, Section 47-351.8, Collateral and reporting requirements, “(a) *Except for securities directly purchased without a repurchase agreement and money market funds, an eligible financial institution must at all times provide collateral equal to at least 102% of the District funds held by the eligible financial institution- for deposits and investments that are not fully federally insured.*”

Per the Financial Institutions Deposit and Investment Act of 1997, Section 47-351.3, General deposit and investment requirements, “(b) *The Mayor, or the CFO pursuant to [Section] 47-351.2(c), shall determine what amount of District funds are needed immediately and maintain deposit funds in amounts great enough to satisfy that need. The Mayor, or the CFO pursuant to [Section] 47-351.2(c), shall invest all other funds.*”

Per the Financial Institutions Deposit and Investment Act of 1997, Section 47-351.3, “(d) *The Mayor, or the CFO pursuant to [Section] 47-351.2(c), shall not allow the amount of District funds deposited or placed for the provision of financial services in a single eligible financial institution to exceed the lesser of either- (1) Twenty-five percent of the total assets of the eligible financial institution, exclusive of District funds; or (2) Twenty-five percent of the total District funds available for deposit or investment as of the date of such deposit or placement and as of the end of each fiscal quarter thereafter.*”

CAUSE

- From October 2012 through August 2013, the control in place to monitor collateral held on deposits was not properly designed whereby non-compliance would be prevented. We note the monthly review was designed to detect instances of non-compliances after they have occurred. We note the District revised its policy, effective October 1, 2013, to require all financial institutions to either 1) pledge collateral of 110% with the Federal Reserve or 2) to enter into a tri-party agreement with the Bank of New York, where pledged collateral can remain at 102%. As of September 30, 2013, we noted all financial institutions were in compliance with the revised policy.

APPENDIX A: CURRENT YEAR FINDINGS AND RECOMMENDATIONS

- The bank balances reported for each financial institution per the monthly Collateral Monitoring Worksheet are not updated consistently on a monthly basis to ensure the amount reported is current, and materially accurate.
- The review deadline of 30 days required per the District policy is not timely enough to prevent or detect non-compliance with requirements to invest excess funds.
- The total assets and total deposits reported for each financial institution per the daily Cash Note reports are not updated consistently on a periodic basis to ensure the amount reported is materially accurate.

EFFECT

- At certain points during the year, the District was not fully compliant with the collateralization provisions in the Financial Institutions Deposit and Investment Act which increases the District's risk of loss in the event that the financial institution is unable to meet its obligations.
- The failure to make timely updates to the bank balances reported per the Collateral Monitoring Worksheet could result in unidentified and uncorrected non-compliance with the Financial Institutions Deposit and Investment Act – Collateral and Reporting Requirements.
- The failure to identify inappropriate/inaccurate investment transactions could result in non-compliance with the District investment policy.
- The failure to make timely updates to the Total Assets reported per the Cash Note reports could result in unidentified and uncorrected non-compliance with the Financial Institutions Deposits and Investment Act – General Deposit and Investment Requirements, and the District's investment policy.

RECOMMENDATION

- We noted the District revised its policy, effective October 1, 2013, to require all financial institutions to either 1) pledge collateral of 110% with the Federal Reserve or 2) to enter into a tri-party agreement with the Bank of New York to monitor the District's compliance and pledge additional collateral, in which case pledged collateral can remain at 102%. As of September 30, 2013, we noted all financial institutions were in compliance with the revised policy, and thus the control

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deficiency existed from October 2012 through August 2013, and was remediated at year-end. As such, we have no further recommendation.

- We understand that the District is in the process of revising its policy, to become effective in FY 2014, to require the bank balances reported per the Collateral Monitoring Worksheet to be updated monthly. We recommend that the District implement such revised policy.
- We recommend that the District revise its policy to require that daily investment transactions be reviewed within 3 business days.
- We recommend that the District revise its policy to update the total assets amounts for each financial institution reported per the Cash Note reports on at least a quarterly basis.

MANAGEMENT'S RESPONSE

- There were two instances cited in which a financial institution did not meet the District's 102% collateral requirement according to the Financial Institutions Deposit and Investment Act of 1997. It was detected through the review of balances and collateral for compliance. In the two instances of shortfalls, the bank pledged additional collateral within 2-5 days after being contacted.

The District has revised its policy to state that financial institutions maintaining collateral at the Federal Reserve will be required to increase holdings from 102% to 110%. A meeting was held with each financial institution to communicate this revised policy. Colombo Bank was one of those financial institutions. Colombo now holds collateral at the Federal Reserve on behalf of the District on average at 115%. The added percentage of collateral holdings is an additional control to assist in preventing non-compliance from occurring and further reduce potential risk of loss.

- Financial institutions were tested to determine if the District's 102% collateral requirement had been met and noted that 6 of 15 financial institutions per the Collateral Monitoring Worksheet did not agree to the balance reported per the corresponding month's bank statement. It is agreed that there was a difference between the bank balances tracked on the collateral report as compared with the bank statements. However, it should be noted that once the FDIC insurance coverage was subtracted from the collateral report balance, there was more than adequate collateral to support the remaining bank balances. The District was in no danger of loss in any of the above cases. The above balances result from certificates of deposit for which banking will, going forward, request a second statement for its records based on availability. Most

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banks only provide statements for time deposits at interest credit periods or maturity.

Further, it was noted that the Bank Balance for one financial institution reported per the October 2012 and June 2013 Collateral Monitoring Worksheet was the bank balance as of September 30, 2011 and September 30, 2012, respectively, as the District only receives an annual Bank Statement from this financial institution in December. The District was unable to provide the Bank Statements as of October 30, 2012 and June 30, 2013. Most banks do not provide monthly activity statements for time deposits. Usually they are provided at interest credit periods or maturity. Going forward, Banking will request a second statement for its records.

Additionally, it was noted that the monthly calculations performed to determine compliance with the collateral requirement per the Financial Institutions Deposit and Investment Act were not accurate, and there is increased risk that instances of non-compliance may not be detected. It is agreed that potentially, but not indicated in the above results, there could be a risk of balance inaccuracy resulting in non-compliance. OFT plans to mitigate this risk by requesting a duplicate statement for its records to ensure accuracy and detection of balance changes expediently.

- Regarding the exceptions noted relating to timely review of the Beginning and End of Day Quick Reports, we agree with the recommendation and the Cash Management Unit will update its policy to have the review process executed within 3 business days. The other major controls in relation to the transfer of funds are done by requiring dual entry of electronic transfer request, establishing transfers via repetitive templates that require dual entry and approval and limiting to three individuals the capability to authorize final execution of transfers.

Regarding the exceptions noted relating to the timely updating of total assets values used to perform percentage of deposits held at the financial institution of the financial institution's total assets, we agree with the recommendation and the Cash Management Unit will update its policy and will on a quarterly basis at quarter end update the total assets at the requisite institution and place all supporting documentation in the daily folder representing the last day of the quarter.

- Further, regarding the exceptions noted relating to the timely updating of the total deposit balances used to perform the daily calculation of percentage of deposits held at the financial institution of the District's total operating assets, we agree with the recommendation and the Cash Management Unit will update its policy to reflect that at month end the

APPENDIX A: CURRENT YEAR FINDINGS AND RECOMMENDATIONS

unit will perform a bank account reconciliation to ensure compliance with the deposit percentage test in the Financial Institutions Deposit Act.

b. Improper Classification and Valuation of Investments

CONDITION

During our testing of cash and investments, we noted the reported balance of a mortgage-backed security was not properly adjusted to fair market value at September 30, 2013, resulting in an overstatement in the Restricted Investments balance of \$3,399,956 in the General Fund.

Additionally, during our testing of cash and investments, we noted the reported balance of a repurchase agreement in the amount of \$11,155,001 was improperly classified as Restricted Cash and Cash Equivalents rather than Restricted Investments in the Payment in Lieu of Taxes (PILOT) Fund. The security had a maturity date of June 25, 2037, and therefore did not meet the District's definition of Cash Equivalents.

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.”*

COSO Internal Control Integrated Framework as previously described on pages A-3 and A-4 of Appendix A.

Governmental Accounting Standards Board (GASB) Codification Section 2450 paragraph 106 states: *“For purposes of this section, cash equivalents are defined as short-term, highly liquid investments that are both: a) Readily convertible to known amounts of cash. b) So near their maturity that they present insignificant risk of changes in value because of changes in interest rates. Generally, only investments with original maturities of three months or less meet this definition”*

Governmental Accounting Standards Board (GASB) Statement 31, paragraph 7 states: *“Except as provided in paragraphs 8, 9, 12 and 16 of this Statement, governmental entities, including governmental external investment pools, should report investments at fair value in the balance sheet (or other statement of financial position). Fair value is the amount at which an investment could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. If a quoted market price is*

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available for an investment, the fair value to be used in applying this Statement is the total of the number of trading units of the instrument times the market price per unit.”

CAUSE

The District’s internal controls over financial reporting of investments were not operating effectively to ensure cash, investments, and investment-related transactions were properly and consistently classified as “cash equivalents” or “investments” and valued appropriately at cost or fair market value based on that classification.

EFFECT

The Restricted Investments balance in the General Fund was overstated by \$3,399,956 at September 30, 2013. Additionally, the Restricted Investments balance was understated, and the Cash balance was overstated by \$11,155,001 in the PILOT Fund at September 30, 2013 in the District’s draft financial statements. Subsequently, management recorded an adjustment to correct these errors in their financial statements.

RECOMMENDATION

We recommend that the District strengthen internal controls to ensure that funds are properly classified as “cash equivalents” or “investments” for financial reporting purposes.

MANAGEMENT’S RESPONSE

Regarding the exceptions noted relating to the valuation of the mortgage backed security, we agree with the recommendation. The write down of the mortgage-backed securities to Fair Market Value (FMV) was properly recorded in SOAR, the District’s general ledger, and properly updated in the notes to the financial statements. The Office of Finance and Treasury (OFT) and the Office of Financial Operations and Systems (OFOS) will institute a check and balance to ensure the FMV in SOAR is agreed to the amount included in the District’s Comprehensive Annual Financial Report (CAFR).

Regarding the improper classification of the repurchase agreement in the PILOT fund, we agree with the recommendation. These bonds were issued by the Anacostia Waterfront Corporation and DC Government inherited the account that holds these bonds. The debt agreement requires that the PILOT payments and the funds in the reserve fund account are invested in this type of instrument which was established during the bond issuance. OFT and OFOS will begin a coordinated effort to verify the proper classification of investments for this account.

APPENDIX A: CURRENT YEAR FINDINGS AND RECOMMENDATIONS

c. Unclaimed Property Management

CONDITION

During testwork performed over unclaimed property, we noted that the District did not take into account all Bank IDs holding unclaimed property when recording the change in the agency fund liability balance as of September 30, 2013. This resulted in an overstatement of \$13.5 million in Restricted Cash and Revenues in the General Fund and an understatement of Cash and Liabilities in the Agency Fund for the same amount as of and for the year ended September 30, 2013.

In addition, for 1 out of 10 securities selected for price testing, we noted a discrepancy between the fair market value recorded in the financial statements and amounts we obtained from external pricing sources resulting in a projected understatement of approximately \$3.7 million in Restricted Cash and Cash Equivalents in the General Fund as of September 30, 2013.

CRITERIA

Government Auditing Standards, issued by the Comptroller General of the United States (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.*”

COSO Internal Control Integrated Framework as previously described on pages A-3 and A-4 of Appendix A.

Per GASB Statement 21, *Accounting for Escheat Property*, paragraphs 5 and 6:

“Escheat revenue should be reduced and a fund liability reported to the extent that it is probable that escheat property will be reclaimed and paid to claimants. Payments to claimants should reduce the liability. The liability should represent the best estimate of the amount ultimately expected to be reclaimed and paid, giving effect to such factors as previous and current trends in amounts reclaimed and paid relative to amounts escheated, and anticipated changes in those trends. (This liability may differ from the amount specified in law to be separately held for payments to claimants.) If escheat property is initially reported in an expendable trust fund, amounts transferred to the ultimate fund should be reported as an operating transfer.”

APPENDIX A: CURRENT YEAR FINDINGS AND RECOMMENDATIONS

CAUSE

The District lacks adequate documented policies, procedures and controls to ensure proper classification of Unclaimed Property in the financial statements.

In addition, the District records unclaimed property for securities based on the quarterly statements received from the account custodian. The September 2013 statement was not received until October 2013, and thus the ending balance per the June 2013 statement was used to record the year-end balance.

EFFECT

The balance of Restricted Cash reported for unclaimed property in the General Fund was overstated, and the balance of Restricted Cash was understated in the Agency Fund, by \$13.5 million as of September 30, 2013.

The balance of Restricted Cash in the General Fund was potentially understated by \$3.7 million.

RECOMMENDATION

We recommend that the District strengthen internal controls to ensure that the reported balances of unclaimed property are valid, complete, and accurate. Further, we recommend that the District record the fair market value of the investments as of the fiscal year-end, or perform an analysis to verify that the difference in fair market value between the interim and year-end values is immaterial.

MANAGEMENT'S RESPONSE

We agree with the unclaimed property condition in the finding. During the fiscal year unclaimed property had a sudden change in staffing, as a result of this action there was not a formal transition period and part of the year-end accounting process was not fully transitioned or executed by the new accounting manager. Unclaimed property is enhancing an accounting policy and procedures manual that will include updated guidance from OFOS on proper recordation of the accounting entries for the unit.

We do not agree with the second condition in the finding related to discrepancy in fair market value. Unclaimed property's mission is to return unclaimed property to the rightful owner or heir. When securities are escheated to unclaimed property, the unclaimed property unit is required by law to hold these assets for 3 years before the securities can be sold for cash. Holders that have escheated this type of property routinely do not provide statement balances after escheatment and when they provide they can be limited to a quarterly or annual basis. As a result the unclaimed property unit

APPENDIX A: CURRENT YEAR FINDINGS AND RECOMMENDATIONS

records these assets on the books at cost and updates its records as statements are received to get the best estimated value of these assets. Also the value of the assets held at our custodian provider includes additions, distributions and asset appreciation/depreciation. We believe this is the most efficient approach to manage the recordation of these assets. We will continue to work with the accountants and auditors to properly value the holdings in unclaimed property.

KPMG'S RESPONSE

We have reviewed management's response and the finding remains as indicated.

2. Disability Compensation

a. Claims Management

CONDITION

During our testwork over a sample of 25 non-uniform disability compensation claims included in the District's actuarial calculation of the September 30, 2013 disability compensation liability, we noted that claims were not properly supported by readily available claims documentation. Specifically, we noted the following:

- 1 instance in which the original claim documentation was not provided for the sample.
- 2 instances in which the Notice of Determination, which is issued by the third-party claims processor to the claimant informing them of the current status of the claim, was not provided for the sample.

CRITERIA

Government Auditing Standards, issued by the Comptroller General of the United States (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."

COSO Internal Control Integrated Framework as previously described on pages A-3 and A-4 of Appendix A.

APPENDIX A: CURRENT YEAR FINDINGS AND RECOMMENDATIONS

CAUSE

The exceptions noted are older claims that originated with other government agencies prior to the establishment of ORM as an agency.

EFFECT

Claims that were included on the non-uniform division claims reports submitted to the actuary that were used in the calculation of the Disability Compensation liability did not have readily available supporting documentation.

RECOMMENDATION

We recommend that the District adhere to current policies over the disability compensation financial reporting process to ensure that supporting documentation for all claims is properly maintained.

MANAGEMENT'S RESPONSE

The Office of Risk Management (ORM) disagrees with the finding that its internal controls are not operating effectively to ensure that the Public Sector Workers Compensation (PSWC) claims, specifically older claims, are properly supported with readily available documents.

Of the twenty-five (25) sampled files, ORM was unable to provide all of the requested documents for two (2) files. Both claims were filed and handled prior to the establishment of ORM as a District of Columbia Government Agency. Claims filed prior to the establishment of ORM incurred multiple inter-agency transfers (i.e. U.S. Department of Labor, Department of Employment Services, Office of City Administrator, D.C. Office of Personnel). As a result, ORM did not receive from the prior agencies, which ORM did not control or have oversight responsibilities, the few documents that are now missing.

It should be noted that the third-party administrator was not responsible for the issuance of the NODs for the samples. Again, those claim files where documentation was found to be missing are older claims that were not investigated by either the current third-party claims administrator or ORM. Accordingly, ORM requests that KMPG withdraw this NFR finding.

KPMG'S RESPONSE

We reviewed management's response and the finding remains as indicated.

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b. Disability Compensation Liability

CONDITION

Annually, the District records a liability related to accrued disability compensation and tort liabilities related to claims incurred. The District engages an actuarial specialist to assist in the calculation of the liability which amounted to \$129.3 million as of September 30, 2013. This amount represents the present value of the direct costs associated with the settlement of open, unpaid claims as of the end of the fiscal year and the unallocated loss adjustment expenses (ULAE), which are the indirect costs associated with the administration of open claims as of September 30, 2013.

During our audit, we noted that the District did not initially include in its recorded disability compensation liability the ULAE calculated by its actuary which amounted to \$10.7 million as of September 30, 2013. The District subsequently recorded an adjustment for the ULAE to properly state the actuarial liability as of September 30, 2013.

CRITERIA

Government Auditing Standards, issued by the Comptroller General of the United States (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.*”

COSO Internal Control Integrated Framework as previously described on pages A-3 and A-4 of Appendix A.

GASB Statement No. 10, *Accounting and Financial Reporting for Risk Financing and Related Insurance Issues*, establishes accounting and financial reporting standards for risk financing and insurance-related activities of state and local governmental entities, including public entity risk pools. The risks of loss that are included within the scope of this Statement include torts; theft of, damage to, or destruction of assets; business interruption; errors or omissions; job-related illnesses or injuries to employees; acts of God; and any other risks of loss assumed under a policy or participation contract issued by a public entity risk pool. Also included are risks of loss resulting when an entity agrees to provide accident and health, dental, and other medical benefits to its employees.

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Paragraph 23 – “Liabilities for claim adjustment expenses should be accrued when the related liability for unpaid claims is accrued. Claim adjustment expenses include all costs expected to be incurred in connection with the settlement of unpaid claims. Allocated claim adjustment expenses are those that can be associated directly with specific claims paid or in the process of settlement, such as legal and adjusters’ fees. Claim adjustment expenses also include unallocated claim adjustment expenses, which are other costs that cannot be associated with specific claims but are related to claims paid or in the process of settlement, such as salaries and other internal costs of the pool’s claims department.”

CAUSE

The District’s controls over the review of the journal entry to record the entry were not operating effectively to detect and correct the omission of ULAE.

EFFECT

The disability compensation liability recorded in the District’s draft governmentwide financial statements was initially understated by \$10.7 million. However, an adjustment was subsequently recorded by the District to include the ULAE in the disability compensation liability as of September 30, 2013.

If the noted deficiency in internal control is not remediated there is an increased risk that the disability compensation liability will be misstated in the future.

RECOMMENDATION

We recommend the District strengthen internal controls over their review of the disability compensation accruals.

MANAGEMENT’S RESPONSE

Management concurs with the finding and will recommend that the actuary provide a separate statement indicating that the ULAE is included in the above computations shown in the final report.

3. Capital Assets

a. Inventory

CONDITION

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We noted that the District lacks sufficient controls to properly account for personal property capital assets through completion of a regularly conducted physical inventory count. The District's policies and procedures require that the Office of the Chief Financial Officer (OCFO) conduct a biannual physical inventory. OFOS last performed a full physical inventory count in fiscal year 2010. The District engaged a contractor to perform a limited-scope physical inventory count in fiscal year 2013; however, the inventory count did not encompass all District agencies.

CRITERIA

Government Auditing Standards, issued by the Comptroller General of the United States (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.*”

COSO Internal Control Integrated Framework as previously described on pages A-3 and A-4 of Appendix A.

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. 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.*”

The Office of the Chief Financial Officer *Financial Policies and Procedures Manual*, section 10302000.60 states:

“OFOS will conduct a physical inventory of personal property capital assets biennially (every 2 years) to ensure that adequate care is used in the control and accountability of District assets. The inventory will be conducted based upon the assets listed in FAS as of a given date.”

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CAUSE

The District did not perform a physical inventory of all District personal property in fiscal year 2013 as there was not sufficient time to engage a third-party contractor to perform a District-wide inventory prior to fiscal year end.

EFFECT

Failure to perform a periodic inventory could result in capital assets that are not properly identified, tracked and recorded in the District's general ledger which could result in a misstatement in the District's financial statements at fiscal year end. Additionally, the District is not in compliance with its existing policies and procedures.

RECOMMENDATION

We recommend the District enhance current Capital Asset policies to ensure procedures are implemented to include, but are not limited to the following:

- Proper identification, tracking and recording of capital 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.
- Each inventory record should include an asset identification number, a location number, asset description, cost, fund information, and acquisition date.
- 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'S RESPONSE

Management concurs with the findings that the District has performed physical inventory only for selected agencies, i.e. Department of Transportation, Department of Public Works, Unified Communications and Department of Motor Vehicles. According to the independent contractor's report, close to 90% of the assets on our books have been found. During fiscal year 2014, management plans to develop and implement a District-wide policy that requires annual inventory on a rotational basis that would cover the entire agencies within two years.

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b. Leases

CONDITION

The controls at the agency level and the District's oversight controls over the review of lease classification are not designed and implemented effectively to ensure that lease classification assumptions are appropriate and properly supported in order to classify leases as capital or operating for financial reporting purposes. Additionally, controls are not fully effective to ensure the lease footnote disclosure is complete and accurate and that executed lease agreements are recorded timely. Specifically, we noted the following:

- The District uses the current year tax assessed values of leased property to evaluate whether the present value of the minimum lease payments at the beginning of the lease term equals or exceeds 90 percent of the fair value of the leased property. We note that the value of the tax assessment may not always be an accurate representation of the fair market value as the District assessed values on commercial property are often adjusted through the real property tax appeals process. However, the District does not perform any additional analysis to verify that the tax assessed value used was a reasonable approximation of the current fair value.
- During our testwork over a sample of 6 new or amended operating leases totaling \$9.6 million of the District's fiscal year 2013 lease payments, we noted the following:
 - a. 3 instances in which the economic useful life used in the calculation was not properly adjusted to reflect the remaining useful life of the asset based on the length of time that the District had already leased the facility.
 - b. 1 instance in which the fair value amount used by the District to compare to the present value of the future minimum lease payments was the proposed value assessed for fiscal year 2014, rather than the actual tax assessed value for fiscal year 2013.
 - c. 1 instance in which the lease was signed in a prior fiscal year, but was not included in the District's lease disclosures until the current fiscal year.
- KPMG noted that the District does not properly record operating lease expenses on a straight-line or fair value basis for leases that contain scheduled rent increases or periods of rent abatement that are not systematic and rational, pursuant to Government Accounting Standards Board Statement (GASBS) 13, *Accounting for Operating Leases with Scheduled Rent Increases*. Rather, the District records operating lease expenses based on actual expenses incurred, regardless of payment terms that include rent abatements or other unsystematic fluctuations in rental costs. The impact of this error was not material to the financial statements.

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CRITERIA

Government Auditing Standards, issued by the Comptroller General of the United States (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.*”

COSO Internal Control Integrated Framework as previously described on pages A-3 and A-4 of Appendix A.

Financial Accounting Standards (FAS) 13, Paragraph 7 states:

“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 executor 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.*

GASB Statement No. 13, *Accounting for Operating Leases with Scheduled Rent Increases*, paragraphs 5 and 6 states:

5. Transactions arising from operating leases with scheduled rent increases should be measured based on the terms of the lease contract when the pattern of the payment requirements, including the increases, is systematic and rational. Following are examples of payment schedules that are considered systematic and rational.

- a. *Lease agreements specify scheduled rent increase over the lease term that are intended to cover (and are reasonably associated with) economic factors relating to the property, such as the anticipated effects of property value appreciation or increases in costs due to factors such as inflation.*
- b. *Lease payments are required to be made on a basis that represents the time pattern in which the leased property is available for the use of the lessee.*

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6. Sometimes an operating lease with scheduled rent increases contains payment requirements in a particular year or years that are artificially low when viewed in the context of earlier or later payment requirements. This situation may take place, for example, when a lessor provides a rent reduction or “rent holiday” that constitutes a financing arrangement between the lessor and the lessee. As another example, a lessor may provide a lessee reduced rents as an inducement to enter into the lease. In these cases, the operating lease transactions should be measured using either of the following methods.

a. The operating lease transactions may be measured on a straight-line basis over the lease term.

b. The operating lease transactions may be measured based on the estimated fair value of the rental. The implicit financing by the lessor of the lessee’s cash flow should be accounted for using the interest method. That is, interest should be calculated for each period so that it results in a constant rate of interest over the lease term on the period’s outstanding accrued lease receivable or payable.

CAUSE

The District’s internal controls over financial reporting for leases were not operating effectively to ensure that lease classification assumptions are appropriately supported and accounting standards for lease reported are appropriately adhered to for all lease agreements.

EFFECT

While the errors identified did not impact the classification of the leases in the District’s financial statements, if the District does not strengthen its internal controls over the reporting of leases, there is an increased risk that leases could be misclassified, leading to misstatements in the District’s assets, liabilities, expenditures, expenses and related note disclosures.

RECOMMENDATION

We recommend that the District strengthen its internal controls over financial reporting for leases including:

- When available, using independent third-party appraisals of the fair market value of leased property for all significant lease transactions instead of District tax assessed values. Our understanding is that for all significant transactions the District is performing analyses to determine whether it would be more advantageous to lease the property or to purchase the property and that such analysis would include obtaining an appraisal of the property by an independent third-party appraiser. Alternatively, we recommend the District perform other analysis of tax

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assessed values of leased properties to ensure that the tax assessed value is a reasonable approximation of fair market value and that it has not been subsequently adjusted or pending adjustment through the District's real property tax appeals process.

- Maintaining proper documentation for all lease transactions, including assumptions used to determine lease classification.
- Performing detailed reviews of agency submitted Closing Package lease information to ensure completeness and accuracy of the data. This includes a thorough review of templates used to ensure accuracy of pre-populated formulas and verification that proper supporting documentation exists for the assumptions.
- Providing additional training to agency personnel who are responsible for completing closing package information.

MANAGEMENT'S RESPONSE

- Regarding the use of the tax assessed value in determining the fair value of leased property for lease classification tests, management has reviewed the auditors' comments and does not concur with the finding as noted. Consistent with D.C. Code § 47-820 (3), "*the assessed value for all real property shall be the **estimated market value** of such property as of the valuation date*" The determination of the estimated fair value of the leased property was made by qualified professionals in the field within the District's Office of Tax and Revenue (OTR). Applicable authoritative guidance issued by the Governmental Accounting Standards Board (GASB) and the Financial Accounting Standards Board (FASB) does not specify how or by whom fair values should be determined. Accountants must rely on valuations made by professionals in the related field who possess the requisite expertise. Therefore, we believe the assessed value of real property as determined by OTR was a reasonable approximation of fair value. An argument can also be made against the D.C. government expending funds on alternative appraisals of the District's leased property, if the alternative appraisals do not definitively prove to be more accurate than the original appraisal. The D.C. government has a fiduciary responsibility to its taxpayers, and spending additional funds on merely an apparent and not actual superior valuation assessment could be deemed a violation of this responsibility.
- Regarding the use of the full economic useful life of leased property for lease classification tests, we have reviewed the auditors' comments and do not concur with the finding as noted. FASB Accounting Standards Codification (ASC) 840-10-35-4 states the following: "*at any time the lessee and lessor agree to change the provisions of the lease, other than*

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by renewing the lease or extending its term, in a manner that would have resulted in a different classification of the lease under the lease classification criteria in paragraphs 840-10-25-1 and 840-10-25-42 had the changed terms been in effect at lease inception, the revised agreement shall be considered as a new agreement over its term, and the lease classification criteria in paragraphs 840-10-25-1 and 840-10-25-42 shall be applied for purposes of classifying the new lease." Likewise, except if a guarantee or penalty is rendered inoperative as described in paragraphs 840-30-35-8 and 840-30-35-23, any action that extends the lease beyond the expiration of the existing lease term, such as the exercise of a lease renewal option other than those already included in the lease term, shall be considered as a new agreement, which shall be classified according to the guidance in Section 840-10-25. "

As such, at the beginning of each lease renewal period we not only consider the lease renewal as a new lease agreement, but we also perform a new assessment of the economic useful life of the asset. In performing this most recent assessment, we determined that the asset had a 50-year economic useful life spanning multiple future users as of the inception of this latest lease renewal.

Additionally, FASB ASC 840-10-20 states the following:

"Estimated economic life - the estimated remaining period during which the property is expected to be economically usable by one or more users, with normal repairs and maintenance, for the purpose for which it was intended at lease inception, without limitation by the lease term. "

This codification further emphasizes the estimated economic life of leased property is not necessarily the same as the property's depreciable life. Depreciable life is the estimated useful life to the existing user of the asset; estimated economic life may involve other users. Therefore, in conducting the analysis over lease terms, we assessed the estimated economic life separately from the depreciable useful life.

Regarding the use of the proposed tax assessed value for 2014 for lease classification tests, we concur with the facts as presented; however, it must be noted that the use of the 2014 assessed value as opposed to 2013 assessed value resulted in an immaterial difference of 0.7% (less than 1 %) and did not affect the classification of the lease. The District 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, the District will revise current policies and procedures and work more closely with agencies to ensure adherence to policies related to the reporting of leases.

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- Regarding the recordation of lease expenditures based on actual expenditures incurred, the District concurs with the facts of the finding as noted because current District practice is to record operating lease expenses based on the actual expenses incurred. As such, we will take the recommendations made by the auditors under advisement and implement changes as deemed to be appropriate and necessary.

KPMG'S RESPONSE

We have reviewed management's response and the finding remains as indicated.

4. Grants Management

a. SSR Segregation of Duties

CONDITION

Personnel at the District Economic Security Administration (ESA) are responsible for determining beneficiary eligibility for the Medicaid, Temporary Assistance for Needy Families (TANF), and the Supplemental Nutrition Assistance Program (SNAP) programs. In order to determine eligibility, the ESA Social Service Representatives (SSRs) record personal information from potential beneficiaries into the Automated Client Eligibility Determination System (ACEDS). Once a beneficiary is determined to be eligible, the SSRs are responsible for recording any further case actions - e.g. updates of personal information, termination of benefits, and renewal of benefits. Case actions including initial determination of eligibility can be recorded into ACEDS by all SSRs, however only SSRs with "authority to act" can record actions without supervisory review and approval.

During our tests of design and implementation of internal controls over the eligibility process we inquired about SSRs with and without the authority to act. We identified a lack of segregation of duties as SSRs with authority to act have the ability to both record and authorize beneficiary case actions in ACEDS.

CRITERIA

Yellow Book, Appendix I, section A 1.08d., 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; "*

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COSO Internal Control Integrated Framework as previously described on pages A-3 and A-4 of Appendix A.

CAUSE

The District's ESA has not implemented adequate segregation of duties for those SSRs with the ability to authorize and record beneficiary cases (i.e. those with "authority to act").

EFFECT

Beneficiary cases recorded and authorized by an SSR with the authority to act could be erroneous and/or inappropriate.

RECOMMENDATION

We recommend that ESA strengthen its current policies and procedures to require the SSR duties of recording and authorizing to be segregated. As an alternative, we recommend that ESA strengthen its current monitoring controls to adequately address that SSRs can record changes into ACEDS without supervisory review and approval.

MANAGEMENT'S RESPONSE

Management does not concur with the Notification of Finding and Recommendation. The recommendation that SSR duties of recording and authorizing be segregated is not feasible at this time. Given the local and federal policies and regulations relative to timeliness in processing actions for customer benefits, the increasing caseloads, and the limited number of supervisory SSRs to authorize actions, implementing this recommendation would negatively impact timely actions.

A requirement of the SSR position includes the expectation that the SSR would exercise appropriate judgment and determine eligibility as necessary for the performance of their duties. The "authority to act" designation is bestowed based on an employee's performance. Consequently, an SSR acquires the "authority to act" upon demonstrating ability to consistently and correctly determine eligibility and process customer benefits. An SSR's ability to continue to exercise good judgment in determining eligibility and processing benefits is constantly monitored and reflected in their annual performance evaluations. If an SSR displays diminished competency in their ability to "act", that responsibility is summarily removed.

Further, with respect to the recommendation that ESA strengthen its current monitoring controls, the agency has adjusted its monthly Supervisory Case Reviews (SCR) process, which has been implemented for the primary purpose

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of ensuring program integrity by assessing SSRs adherence to policies and procedures and identifying and correcting errors. Supervisors alert workers when discrepancies are detected, share the appropriate policy and procedures with the staff person responsible for the case action(s) and share the information with all staff during the next scheduled general staff meeting.

DHS is constantly assessing its quality control measures and will continue to evaluate and monitor the outcomes of the case review process and make improvements to strengthen program integrity where needed.

KPMG'S RESPONSE

We have reviewed management's response and the finding remains as indicated.

b. ACEDS to MMIS Exception Report Review

CONDITION

During our tests of the design and implementation of internal controls over the management review of exception reports from the interface of the Automated Client Eligibility Determination System (ACEDS) and the Medicaid Management Information System (MMIS), we noted that DHS does not retain adequate documentation to support the review of the daily response files. DHS did not maintain documentary evidence that the review was performed between October 2012 and July 2013 due to the relocation of its offices.

DHS policies are not sufficient to identify specific criteria for which exceptions should be reviewed, and which should not.

We also noted one exception in the August 28, 2013 report review where the case that was marked reviewed however, the corresponding change in ACEDS was not made.

CRITERIA

Yellowbook, Appendix I, section A.1.08d., states that management at a State and Local government entity is responsible *"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; "*

COSO Internal Control Integrated Framework as previously described on pages A-3 and A-4 of Appendix A.

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CAUSE

DHS does not have adequate policies and procedures in place to adequately address document retention relating, exception review criteria, and completion of review.

EFFECT

Failure to review and resolve exceptions from ACEDS to MMIS interface could result in errors in Medicaid benefits processing.

RECOMMENDATION

We recommend that DHS formalize existing policies and procedures to address documentation retention, specific review criteria, and secondary review.

MANAGEMENT'S RESPONSE

Management concurs with the Notification of Finding and Recommendation. DHS will develop policies that identify specific criteria for which exceptions are to be reviewed, and will develop retention policy related to the Exception Report.

c. MMIS SSAE16 Review

CONDITION

During our tests of the design and implementation of internal controls over the management review of the Medicaid Management Information System (MMIS) SSAE 16 SOC 1 Report, we noted that DHCF does not perform an analysis of the complementary customer agency controls that should be in place at the District as identified in the SSAE16.

CRITERIA

Yellow Book, Appendix I, section A 1.08d., 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;* "

COSO Internal Control Integrated Framework as previously described on pages A-3 and A-4 of Appendix A.

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CAUSE

DHS does not have adequate policies and procedures in place to ensure an analysis of SSAE 16 report complementary customer agency controls is performed.

EFFECT

Failure to implement controls could lead to unapproved access to MMIS information, or processing of inaccurate benefit information by the service provider.

RECOMMENDATION

We recommend that the District Department of Human Services (DHS) and the Department of Health Care Finance (DHCF) create and implement formal policies and procedures that include an analysis of SSAE 16 report complementary customer agency controls.

MANAGEMENT'S RESPONSE

Management does not concur with the finding which was created based on four criteria in the SSAE 16 report which states that “ certain controls should be in operation at the user organization for achievement of control objectives identified in the report. User auditors should consider whether controls have been placed in operation at user organizations to address the following....” DHCF believes that we have adequate controls in place to address these concerns.

- Access to the user organization’s network and client computers is restricted to authorized users.

Given the process a new employee must go through to get access to the MMIS, DHCF believes we have the appropriate controls in place.

- Claims submissions are properly authorized by providers.

To electronically submit claims, providers are assigned a training partner ID and are required to create their password. It is only through this process that DHCF can ensure that properly authorized providers are submitting claims to DHCF. Were there a case of someone submitting claims on behalf of a provider and the claim submissions were not authorized by the provider, the payments in excess of the anticipated amount would be a trigger for the provider to do their own audit to identify the source of the excess payment.

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- Data transmissions to Xerox are monitored for security, accuracy and completeness.

Data transmissions to Xerox are monitored. After each nightly batch cycle, Xerox produces a batch report showing the number of transactions that were processed in the nightly batch. These reports have been in place since the implementation of Omnicaid and are reviewed each day.

- System output and reports are adequately controlled and safeguarded.

System outputs are reports stored in Reports On Line (ROL) which is a sub-system on the web portal at www.dc-medicaid.com. Access to reports online is controlled through user ID and password and system access tied to a user's ID. Without appropriate access rights, a user does not have access to the system output and reports.

KPMG'S RESPONSE

We have reviewed management's response and the finding remains as indicated.

- d. ACEDS to EBT Exception Report Review

CONDITION

During our tests of the design and implementation of internal controls over the management review of exception reports resulting from the interface of the Automated Client Eligibility Determination System (ACEDS) and the Electronic Benefits Transfer (EBT) system, we noted that DHS does not retain adequate documentation to support the review of the daily response files generated from the interface. DHS could not provide evidence of daily response file review from October 2012 to January 2013.

CRITERIA

Yellow Book, Appendix I, section A 1.08d., 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; "*

COSO Internal Control Integrated Framework as previously described on pages A-3 and A-4 of Appendix A.

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CAUSE

DHS does not have adequate policies and procedures in place to adequately address document retention relating to the review of the ACEDS to EBT interface.

EFFECT

Failure to review the daily response files from the interface increases the risk of errors in benefits processing.

RECOMMENDATION

We recommend that DHS formalize existing policies and procedures to address document retention.

MANAGEMENT'S RESPONSE

Management concurs with the Finding and Recommendation. DHS will develop policies and procedures to address documentation retention related to interface between ACEDS and EBT.

e. Beneficiary Eligibility

CONDITION

During testing over beneficiary eligibility for Medicaid benefits, we noted that for four (4) items in our sample of 108 Medicaid beneficiary cases, the District's ESA was unable to provide any documentation to support eligibility determination during audit fieldwork. In addition, we were unable to locate the most recent recertification for five (5) sampled items during the testing period.

CRITERIA

Yellow Book, Appendix I, section A 1.08d., 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;* "

COSO Internal Control Integrated Framework as previously described on pages A-3 and A-4 of Appendix A.

Medicaid State Plan: Citation 42 CFR 431.17AT-79-29, Section: 4.7 Maintenance of Records The Medicaid agency maintains or supervises the

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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.

ESA 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 by 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 both the applicant/recipient's and the agency's efforts to verify the information. All address changes should be documented.

CAUSE

The District has insufficient internal controls and processes for maintaining case record documentation.

EFFECT

The District is not in full compliance with District and Federal Medicaid program requirements for record keeping and maintenance.

RECOMMENDATION

We recommend that the District consistently adhere to policies and procedures for maintaining case record documentation and improve its controls over monitoring compliance. We observed that the District is in the process of implementing a new, automated eligibility system which will help to address the condition over time.

MANAGEMENT'S RESPONSE

Management concurs with the Finding and Recommendation.

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f. Provider Eligibility

CONDITION

During testing of a sample of 95 provider eligibility files for the Medicaid program, we noted that for one (1) provider, we were unable to obtain the provider file for review.

CRITERIA

Yellow Book, Appendix I, section A 1.08d., 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; "*

COSO Internal Control Integrated Framework as previously described on pages A-3 and A-4 of Appendix A.

Title XIX requires that the District of Columbia enter into written agreements with persons or institutions providing services under the State's plan for Medical Assistance. It also requires that the providers -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 the Title XIX of the Social Security Act.

CAUSE

The District has insufficient internal controls over document retention for Medicaid provider eligibility.

EFFECT

Ineligible Medicaid providers could receive payments for Medicaid services from the District. Failure to maintain sufficient documentation to support the eligibility determination for providers could result in disallowances.

RECOMMENDATION

We recommend that the District, in coordination with its third party service provider, consistently adhere to established policies and procedures for maintaining case file information to support Medicaid provider eligibility determinations.

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MANAGEMENT'S RESPONSE

Management concurs with the Finding and Recommendation. DHCF is working with Xerox on improving the internal controls and process by including a quarterly Quality Assurance (QA) audit to ensure provider files are current and have sufficient documentation.

- g. SNAP Eligibility Insufficient Supporting Documentation

CONDITION

During testing over beneficiary eligibility for Supplemental Nutrition assistance Program (SNAP), we noted that DC Economic Security Administration (ESA) was unable to provide sufficient documentation to support the beneficiary's eligibility determination during audit fieldwork for six (6) out of 25 SNAP beneficiary disbursements. Specifically, we noted the following:

- For five (5) sampled disbursements, we noted that ESA was unable to provide the signed application or most recent recertification.
- For one (1) sampled disbursement, we noted that ESA was unable to provide the Form 495.

CRITERIA

Yellow Book, Appendix I, section A 1.08d., 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; "*

COSO Internal Control Integrated Framework as previously described on pages A-3 and A-4 of Appendix A.

ESA Policy Manual Section: *STANDARDS FOR CASE RECORD DOCUMENTATION* 1.3 states: *"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 by 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 both the applicant/recipient's and the agency's efforts to verify the information. All address changes should be documented."*

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CAUSE

The District has insufficient internal controls and processes for maintaining case record documentation.

EFFECT

The District is not in full compliance with eligibility requirements surrounding records maintenance for SNAP.

RECOMMENDATION

We recommend that the District consistently adhere their policies and procedures for maintaining case record documentation and improve its controls over monitoring compliance. The implementation of a new, automated eligibility system, DCAS, will help to address this issue over time.

MANAGEMENT'S RESPONSE

Management concurs with the Finding and Recommendation.

h. Double Counting of HMO Advantage Lawsuit

CONDITION

During substantive testing of the District's Medicaid accrual as of September 30, 2013, we noted that the District Department of Health Care Finance (DHCF) included in the accrual a certain pending lawsuit in the amount of \$4.7 million in the District's governmental funds and government-wide financial statements. However, since this claim does not meet the criteria to be accrued under generally accepted accounting principles in either the governmental funds which use the modified accrual basis of accounting or the government-wide financial statements which use the full accrual basis of accounting, it should not have been included in the District's Medicaid accrual as of September 30, 2013.

This case is also considered annually in the District's contingent legal liabilities analysis which is performed by the District's Office of the Attorney General who has assessed the likelihood of a loss on this claim as "reasonably possible". Accordingly, the District has appropriately included this claim in its required disclosure of outstanding "reasonably possible" cases in accordance with generally accepted accounting principles.

APPENDIX A: CURRENT YEAR FINDINGS AND RECOMMENDATIONS

CRITERIA

GASBS 62: Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements states the following: "102. An estimated loss from a loss contingency (as defined in paragraph 96) should be accrued if both of the following conditions are met: a. Information available prior to issuance of the financial statements indicates that it is probable that an asset had been impaired or a liability had been incurred at the date of the financial statements. It is implicit in this condition that it should be probable that one or more future events will occur confirming the fact of the loss. b. The amount of the loss can be reasonably estimated."

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."

GASB Codification paragraphs 117 through 119 state: ".117 Paragraph .111 requires that a government accrue a governmental fund liability and expenditure for most expenditures and transfers in the period in which the government incurs the liability. However, paragraphs .103 and .104 require that unmatured long-term indebtedness (the portion of general long-term indebtedness that is not yet due for payment) be reported as general long-term liabilities of the government, rather than as governmental fund liabilities. As discussed in paragraph .103, that requirement applies not only to formal debt issues such as bonds, but also to other forms of general long-term indebtedness, including capital leases, compensated absences, claims and judgments, pensions, termination benefits, landfill closure and postclosure obligations, pollution remediation obligations, and "other commitments that are not current liabilities properly recorded in governmental funds."

.118 Matured liabilities (other than those associated with proprietary or fiduciary funds) should be reported as governmental fund liabilities. Matured liabilities include:

a. Liabilities that normally are due and payable in full when incurred

APPENDIX A: CURRENT YEAR FINDINGS AND RECOMMENDATIONS

b. The matured portion of general long-term indebtedness (the portion that has come due for payment).

.119 In addition to the preceding criteria for classification of liabilities, a series of specific accrual modifications have been established pertaining to the reporting of certain forms of long-term indebtedness. For example:

- Debt service on formal debt issues (such as bonds and capital leases) generally should be recognized as a governmental fund liability and expenditure when due (matured)—with optional additional accrual under certain conditions, as interpreted in paragraph .123.*
- Compensated absences, claims and judgments, termination benefits, landfill closure and postclosure care costs, and receipts of goods and services for pollution remediation should be recognized as governmental fund liabilities and expenditures to the extent the liabilities are "normally expected to be liquidated with expendable available financial resources," as interpreted in Section 1600, paragraph .122."*

CAUSE

DHCF management believes it is probable that the District will have to pay such amount 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 Medicaid agency's books as part of the Medicaid accrual.

EFFECT

The amount due to providers in the Medicaid accrual is overstated by \$1.4 million and receivables from the federal government are overstated by \$3.3 million based on the FY 2013 federal matching percentage of 30% local and 70% federal share.

RECOMMENDATION

We recommend that DHCF continue to include lawsuit in the notes to the financial statements, as the likelihood of a loss has been deemed "reasonably possible." As the liability is not "probable," the DHCF should not include the amount in the Medicaid accrual, in accordance with generally accepted accounting principles.

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MANAGEMENT'S RESPONSE

Management agrees with the facts of the finding as stated in the condition. The Government of the District of Columbia FY 2013 Close Instructions for Topic 11 Commitments and Contingencies (page 183) 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.

DHCF believes it is probable that the District will have to pay such amount 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 Medicaid agency's books as part of the Medicaid accrual.

- i. TANF Beneficiary Eligibility Insufficient Documentation

CONDITION

During testing over beneficiary eligibility for Temporary Assistance for Needy Families (TANF), we noted that for three (3) of the 25 TANF beneficiary cases sampled, the District's ESA was unable to provide sufficient documentation to support eligibility determination during audit fieldwork. In addition, we were unable to locate the required letters of support for two (2) sample items during the testing period.

CRITERIA

Yellow Book, Appendix I, section A 1.08d., 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;*"

COSO Internal Control Integrated Framework as previously described on pages A-3 and A-4 of Appendix A.

45 CFR 92.42: Department of Health and Human Services Retention and Access Requirements for Records. Length of retention period. (1) Except as otherwise provided, records must be retained for three years from [...] the day the grantee or subgrantee submits to the awarding agency its single or last expenditure report for that period.

ESA Policy Manual Section: STANDARDS FOR CASE RECORD DOCUMENTATION 1.3 All eligibility criteria and clarifying information are

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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 by 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 both the applicant/recipient's and the agency's efforts to verify the information. All address changes should be documented.

CAUSE

The District has insufficient internal controls and process for maintaining case record documentation.

EFFECT

The District is not in full compliance with eligibility requirements surrounding records maintenance for TANF.

RECOMMENDATION

We recommend that the District consistently adhere to policies and procedures for maintaining case record documentation and improve its controls over monitoring compliance. We observed that the District is in the process of implementing a new automated eligibility system DCAS, which will help address the condition over time.

MANAGEMENT'S RESPONSE

Management concurs with the Finding and Recommendation.

- j. Grants Disallowance

CONDITION

The District records an estimated liability of \$77 million in the government-wide financial statements to recognize the potential disallowances related to Targeted Case Management and Rehabilitation programs at the District Child and Family Services Agency (CFSA) and District of Columbia Public Schools (DCPS). The estimate is primarily based on an analysis from FY 2009.

During our testing of internal controls over management's review of the disallowance estimate, we noted that the CFSA and DCPS management does not have formal process in place to review and reassess their grants

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disallowance estimate that is forwarded to the Office of Financial Operations and Systems (OFOS) each year.

CRITERIA

Yellow Book, Appendix I, section A1.08d., 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;*”

COSO Internal Control Integrated Framework as previously described on pages A-3 and A-4 of Appendix A.

CAUSE

CFSA and DCPS do not have formal policies and procedures in place to annually review and refine the analysis in coordination with the appropriate agencies.

EFFECT

The estimate of potential disallowances in the government-wide financial statements could be inaccurate due to assumptions that are out-of-date or otherwise invalid.

RECOMMENDATION

We recommend that the CFSA and DCPS enhance their current policies and procedures for recording the estimate by formally reviewing the disallowance each year in coordination with the Department of Healthcare Finance (DHCF), the Office of Integrity and Oversight (OIO), and other agencies as appropriate.

MANAGEMENT’S RESPONSE

Management does not concur with this finding. The DCPS liability was recorded in 2009 based on an audited cost report and Notification of Program reimbursement received from the State Medicaid Agency (DHCF). DHCF has held several discussions with the Center for Medicaid Services (CMS). So far CMS has neither forgiven the claim nor demanded payment and, therefore, the liability still exists. Until such time that CMS and, or DCHF determines that the claim is invalid, the liability will continue to exist.

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KPMG'S RESPONSE

The liability that is being referenced in management's response is a different liability this is being carried in the governmental funds. The liability that KPMG is referencing in this finding relates to an additional liability which is being carried only in the government-wide financial statements. As such, our finding remains as indicated.

5. Loans Receivable

a. Other Long Term Assets Loans Receivable

CONDITION

As noted in fiscal year 2012 the District issues affordable housing loans to borrowers under various local and federally supported programs. Loan principal balances and related allowance for doubtful loan collections are recorded annually based on a reconciliation of the loan balances per Department of Housing and Community Development (DHCD)'s records and the loan balances per the third party loan servicer, AmeriNational Community Services (ACS). The District lacks appropriate policies and procedures to ensure that loans are timely recorded in the financial statements within the Housing Production Trust Fund (HPTF), the General Fund, and the Federal and Private Resources Fund (FPRF). Also, the District does not have sufficient controls in place to ensure proper preparation of the allowance for doubtful accounts.

Specifically, during our testwork over a sample of 25 loans recorded by ACS in fiscal year 2013 totaling \$21,165,331 for the HPTF, we noted that 16 of the loans amounting to \$9,648,659 were disbursed prior to FY 2013 and as such were not recorded in the proper fiscal year. During our testwork over management's calculation of the allowance for doubtful loan collections, we noted the initial calculation provided by management was not properly prepared resulting in the following differences: \$1.62 million in the HPTF, \$1.64 million in the General fund and \$1.03 million in the FPRF.

In addition, based on an analysis performed by the District of all fiscal year 2013 loan expenditures in the HPTF, we noted an additional \$4.4 million of loans that were disbursed in FY 2013 that were not recorded in loans receivable as of September 30, 2013.

Finally, as a result of our prior year recommendation for DHCD to perform the reconciliation between the loans recorded by the DHCD and ACS on a periodic basis rather than at year-end, we noted during fiscal year 2013, DHCD implemented a new process to perform the reconciliations on a quarterly basis. However, during our testwork, we noted DHCD did not fully

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implement this control until the third quarter of fiscal year 2013. As such, the control was not operating effectively throughout fiscal year 2013

CRITERIA

Yellow Book, Appendix I, section A1.08d., 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;*”

COSO Internal Control Integrated Framework as previously described on pages A-3 and A-4 of Appendix A.

CAUSE

The District has not developed sufficient policies and procedures to ensure loans are recorded timely in the Fund financial statements. Also, the District does not have sufficient controls in place to ensure that the calculation for allowance for uncollectible loans is properly prepared.

EFFECT

Without effectively designed and implemented internal controls over the recordation process for loans receivable and the related calculation for the allowance for uncollectible loans, misstatements in the other long term assets and unavailable revenue balances may exist.

RECOMMENDATION

We recommend the District improve current policies and procedures related to the recordation of loans receivable and the related allowance to ensure that loan disbursements and the associated receivables and unavailable revenue balances are properly recorded and reflected in the correct accounting period in the Fund financial statements.

MANAGEMENT’S RESPONSE

Management concurs with the finding and recommendation. In FY 2014, management will continue to improve its loan process to ensure that the receivable for loan expenditures are recorded in the period the expense is incurred. Also, going forward, management will perform a more detailed review to ensure completeness before the allowance is calculated and recorded.

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b. Allowance for Uncollectible Loans

CONDITION

During our testwork over other long term assets and the related estimate for the allowance for doubtful accounts, we noted the District does not perform a retrospective “look-back” analysis to determine whether the assumptions used in determining the estimate are reasonable. Additionally, management does not have a process in place to review the outcome of accounting estimates included in the prior period financial statements or their subsequent re-estimation for the purpose of the current period.

CRITERIA

Yellow Book, Appendix I, section A1.08d., 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;*”

COSO Internal Control Integrated Framework as previously described on pages A-3 and A-4 of Appendix A.

CAUSE

The District does not conduct a retrospective "look-back" analysis in order to evaluate the reasonableness of the estimate for the allowance for doubtful accounts.

EFFECT

Failure to perform a retrospective “look-back” analysis of the estimate for the allowance for doubtful accounts could result in misstatements in the financial statements.

RECOMMENDATION

We also recommend that the District refine its methodology for estimating the allowance for doubtful accounts to include a retrospective "look-back" analysis in order to evaluate the reasonableness of the methodology.

MANAGEMENT’S RESPONSE

Management concurs with the finding and recommendation. We plan to improve the current allowance methodology to include a look back analysis of prior year allowances to determine whether prior year assumptions were reasonable.

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6. Revenue

a. Retrospective Analysis of Estimated Refunds Payable

CONDITION

During our testing of the reasonableness of the District's estimated refunds payable accrual for individual income taxes we noted that management does not have a formal process in place to prepare and review a retrospective analysis of the prior year accrual. In addition, during our testwork over the allowance for the taxes receivable we noted that the management did not perform a retrospective analysis of the prior year reserve.

CRITERIA

According to the Yellow Book, Appendix I, section A1.08.d., management of the audited 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.”*

COSO Internal Control Integrated Framework as previously described on pages A-3 and A-4 of Appendix A.

CAUSE

The District's current policies and procedures for estimating refunds payable do not contain a formal process for reviewing estimated refunds payable against actual refund payments data for accuracy. In addition, the District's policies and procedures for the allowance for taxes receivable do not include the retrospective review of the prior year reserve.

EFFECT

The District lacks formal policies and procedures to retrospectively review the accuracy of the accrual which could result in incorrect assumptions and considerations being used to estimate the liability.

RECOMMENDATION

We recommend that the District develop and implement a process by which it reviews the prior year estimated refunds payable accrual in comparison with actual refunds data in order to evaluate the accuracy of the accrual. OTR estimates refunds payable based on historical information, however a “look-back” analysis could improve the accuracy of the estimate. We also

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recommend that the District implements a process to review the prior year reserve for taxes receivable against the actual collections data.

MANAGEMENT'S RESPONSE

Management concurs with the Finding and Recommendation and will implement procedures in FY 2014 to perform a retrospective analysis on the estimate of refunds payable included in the FY 2013 closing entries.

b. Leases Receivable for Nursing Home

CONDITION

During our testing of leases receivable, we noted that the amortization schedules did not include consideration of rent increases. Specifically, according to the J.B. Johnson lease agreement, a 2% increase in rent takes effect on the second anniversary of the commencement of the lease and on each anniversary thereafter during the lease term. According to the Washington Center for Aging Services (WCAS) lease agreement the 2% increase in rent takes effect on the eighth anniversary of the agreement and on each anniversary thereafter during the lease term.

CRITERIA

Pursuant to GASB Codification Section L20.513, minimum lease payments are defined as:

a. From the standpoint of the lessee: The payments that the lessee is obligated to make or can be required to make in connection with the leased property.⁵⁵ However, a guarantee by the lessee of the lessor's debt and the lessee's obligation to pay (apart from the rental payments) executory costs such as insurance and maintenance in connection with the leased property should be excluded. If the lease contains a bargain purchase option, only the minimum rental payments over the lease term and the payment called for by the bargain purchase option should be included in the minimum lease payments. Otherwise, minimum lease payments include the following:

(1) The minimum rental payments called for by the lease over the lease term.

(2) Any guarantee by the lessee of the residual value at the expiration of the lease term, whether or not payment of the guarantee constitutes a purchase of the leased property. When the lessor has the right to require the lessee to purchase the property at termination of the lease for a certain or determinable amount, that amount should be considered a lessee guarantee. When the lessee agrees to make up any deficiency below a stated amount in the lessor's realization of the residual value, the

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guarantee to be included in the minimum lease payments should be the stated amount, rather than an estimate of the deficiency to be made up.

(3) Any payment that the lessee is required to make or can be required to make upon failure to renew or extend the lease at the expiration of the lease term, whether or not the payment would constitute a purchase of the leased property. In this connection, it should be noted that the definition of lease term includes "all periods, if any, for which failure to renew the lease imposes a penalty on the lessee in an amount such that renewal appears, at the inception of the lease, to be reasonably assured." If the lease term has been extended because of that provision, the related penalty should not be included in minimum lease payments.

b. From the standpoint of the lessor: The payments described in (a) above plus any guarantee of the residual value or of rental payments beyond the lease term by a third party unrelated to either the lessee or the lessor, provided the third party is financially capable of discharging the obligations that may arise from the guarantee.

⁵⁵ L20, Footnote 55 —Contingent rentals as defined in this glossary should be excluded from minimum lease payments. Contingent rentals should be recognized as period costs when incurred (or revenue when receivable). (See paragraphs [.113](#), [.128b](#), and [.130b](#).) [GASBS 62, fn133]"

CAUSE

At the time that the leases were entered into management's interpretation of the standards was that scheduled rent increases were not to be included in the computation of minimum lease payments.

EFFECT

Other long-term assets for the general fund and governmental activities were understated by \$10,034,337. Unavailable revenue was understated by \$10,034,337 for the general fund and by \$9,559,984 for governmental activities. The District subsequently recorded an adjustment to include the scheduled rent increases for the two lease agreements.

RECOMMENDATION

We recommend that the District include scheduled rent increases in future minimum lease payment calculations related to direct financing lease transactions.

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MANAGEMENT'S RESPONSE

Management concurs with the finding and recommendation.

- c. Allowance for Doubtful Accounts

CONDITION

During our testing of allowance for doubtful accounts within taxes receivable we identified discrepancies in the calculation of the reserve rates that were used to estimate the allowance. Specifically, we noted that for the annual allowance for doubtful accounts calculation as of September 30, 2013 management misclassified a personal property taxes receivable balance to the improper year which resulted in the use of an incorrect reserve rate. In another instance the three year weighted average calculation was incorrect, resulting in the improper reserve rate being applied to all the accounts receivables for the individual income tax. The net impact of the errors resulted in an understatement of net taxes receivable by \$552,340 and an understatement of deferred revenue by \$373,360.

CRITERIA

Government Auditing Standards, issued by the Comptroller General of the United States 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;*”

COSO Internal Control Integrated Framework as previously described on pages A-3 and A-4 of Appendix A.

CAUSE

Management's review of the estimate did not operate at a sufficient level of precision to identify the errors.

EFFECT

Insufficient review of the estimate calculations in the allowance for doubtful taxes receivable calculations could result in the misstatement of the net taxes receivables on the financial statements.

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RECOMMENDATION

We recommend that the District adhere to existing policies and procedures to review the allowance for doubtful accounts estimate for the mathematical accuracy and the correct inputs.

MANAGEMENT'S RESPONSE

Management concurs with the Finding and Recommendation. OTR recognizes the risk of potential misstatement of revenues associated with errors in calculations. The Revenue Accounting Administration (RAA) has existing procedures for workpaper review and approval to prevent such errors. In this case, the review process did detect an error that caused the initial workpapers to be revised, but the subsequent revision did not receive adequate quality review. RAA will ensure that all workpapers receive proper review to detect errors, including review of the formulas used in spreadsheets and assumptions used in the calculation methodology.

d. Other Accounts Receivable Accrual

CONDITION

The District records revenues on a cash basis during the year and records adjusting entries at year-end in order to present revenue on a modified accrual basis. Under the modified accrual basis, revenues are recognized when they are both measurable and available. In the current year the District recorded an accrual for traffic ticket, parking, moving and camera violations that were not collected as of September 30, 2013. This accrual was not made in the prior year, resulting in an understatement of the beginning fund balance in the current year.

CRITERIA

Paragraph 17 of GASB Statement 33 requires governmental entities to:

“...recognize assets from imposed non-exchange revenue transactions in the period when an enforceable legal claim to the assets arises or when resources are received, whichever occurs first.”

CAUSE

The District's did not have policies and procedures in place to accrue for accounts receivable related to issued moving violations that were not collected as of the fiscal year end.

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EFFECT

The opening fund balance in the general fund is understated by \$20 million. The beginning net assets balance in the government-wide financial statements is understated by \$62 million.

RECOMMENDATION

We recommend that the District continue to refine the policies and procedures for estimating the amount that should be accrued at fiscal year-end relating to non-tax accounts receivable.

MANAGEMENT'S RESPONSE

The District did not provide a response to this finding.

- e. Real Property Tax Appeals Accruals

CONDITION

The Office of Financial Operations and Systems (OFOS) relies upon the District Office of the Attorney General (OAG) to provide estimates of the amounts to be considered for accrual related to all outstanding claims and judgments in the District's government wide financial statements as part of the annual legal letter process. The AG's review has historically only covered those claims and judgments, including Superior Court Appeals, in excess of \$200,000 (the legal letter threshold). However, individual settlements associated with Superior Court Appeals are usually less than the legal letter threshold of \$200,000. As a result, most of the District's outstanding Superior Court Appeals are not assessed for inclusion in the District's fiscal year end claims and judgments accrual.

In order to address this issue the District recorded an accrual as of September 30, 2013 to estimate settlement payments from pending Real Property Tax Appeals claims. The District based its estimate on the number of pending Real Property Tax Appeals claims and the potential change in the amount of revenue that might result from a settlement.

The District relied upon inaccurate case information to calculate its estimate of settlement payments from Real Property Tax Appeals claims. Specifically KPMG noted the following:

- 7 in a sample of 50 cases that were considered to be "pending" for the purpose of the estimate were "closed" as of September 30, 2013 according to the records of the DC Superior Court. The effect of these cases on the estimate would result in an immaterial reduction to the accrual for \$233,841.

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- The estimate of settlement payments was understated by \$110,512 due to an error in the assessment amounts related to tax year 2008.
- There is no retrospective review performed by the District to ensure that the methodology used to accrue for the contingent liability is reasonable.

CRITERIA

Yellow Book, Appendix I, section A1.08d., 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;*”

COSO Internal Control Integrated Framework as previously described on pages A-3 and A-4 of Appendix A.

Governmental Accounting Standards Board Codification C50.150 states:

*“State and local governments are subject to many types of claims. Subject to the accounting and financial reporting distinctions of governmental funds, the criteria of paragraphs .151–.168, should be the guidelines for recognizing a loss liability resulting from all claims that result from actions not included in the scope of paragraphs .109–.148 of this section. (See paragraphs .101 and .102.) Those claims include contractual actions, such as claims for delays or inadequate specifications on contracts, or for guarantees of the indebtedness of others that are not investment derivative instruments entered into primarily for the purpose of obtaining income or profit, **property tax appeals**, and unemployment compensation claims.”*

CAUSE

The District recorded an accrual entry based on information from the tracking system FoxPro without evaluating the completeness and accuracy of the information. In addition, no retrospective review was performed to ensure that the methodology used in the prior year was reasonable.

EFFECT

The District recorded an adjustment in the amount of \$92 million in the government-wide financial statements to account for Superior Court Appeals as of September 30, 2013. The number of cases considered to be “pending” for the purpose of the estimate was overstated, and as a result the accrual may be overstated.

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RECOMMENDATION

We recommend that the District continue to refine the information used in the estimate by coordinating with the Office of Tax Revenue, the OAG, and the DC Court of Appeals to determine an accurate number of “pending” cases as of the end of the fiscal year. In addition, we recommend that the District perform a retrospective review of the methodology used to ensure that it is appropriate.

MANAGEMENT’S RESPONSE

Management recognizes the risk of potential misstatement in the annual financial report and concurs with the finding and recommendation. Although relatively few Superior Court cases are decided each year outside of those for which the District participates in a settlement agreement, there remains a significant number of cases filed for which the ultimate disposition is unknown.

7. Financial Reporting

a. Confidential Disclosure Reports

CONDITION

During our testing of the confidential financial disclosure reports, we noted that 3 out of 25 individuals had not submitted a report for the calendar year 2012 and therefore were non-compliant with the District’s Code of Conduct. KPMG noted that the required deadline for submission was April 19, 2013.

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.*”

COSO Internal Control Integrated Framework as previously described on pages A-3 and A-4 of Appendix A.

Per the Government of the District of Columbia Office of the Chief Financial Officer Code of Conduct (Revised January 2012):

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OCFO employees, DS 13 or above, or those employees whose official positions have been so designated by management, must annually complete the OCFO Confidential Financial Disclosure Report (Form 450). The OCFO Form 450 is sent electronically to covered employees at the end of the reporting calendar year.

CAUSE

Management does not have controls in place to ensure that required individuals submit the confidential financial disclosure reports for the fiscal year ended by the required deadline.

EFFECT

Without proper controls in place to ensure that District personnel are properly and timely completing and submitting the confidential financial disclosure reports, personnel could be noncompliant with the OCFO Code of Conduct and potentially noncompliant with applicable Federal and District of Columbia conflict of interest laws and regulations.

RECOMMENDATION

We recommend that management implement internal controls to monitor the submission of confidential financial disclosure reports to ensure the requirements are met and personnel are compliant with the Code of Conduct.

MANAGEMENT'S RESPONSE

Management concurs with the finding and recommendation and will implement controls to ensure that relevant employees are properly completing and submitting the CFDR.

b. Emergency Reserve Requirement

CONDITION

During our FY 2013 testwork over the Emergency Reserve Requirement, we noted that the District did not have any written policies and procedures in place surrounding the administration of the Emergency Reserve Fund to comply with requirements of the DC Code including 1) the establishment of separate interest bearing accounts 2) the use of interest 3) criteria for use of the amounts in the funds 4) allocation of reserve funds and required CFO analysis 5) notice to Congress of the use of funds 6) replenishment of the reserves and 7) reporting of the reserve. As a result, we noted that the calculation and related report to the Mayor for the Emergency Reserve was not properly reviewed by management which resulted in the calculation being

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understated by approximately \$2 million. This understatement in the calculation resulted in noncompliance with the minimum reserve balance requirement of 2%. The District subsequently corrected the miscalculation and the related report to the Mayor and brought the reserve requirement to its minimum 2% after we brought it to their attention.

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.*”

COSO Internal Control Integrated Framework as previously described on pages A-3 and A-4 of Appendix A.

Per the 108th Congress – 2d Session House Document Nos. 206-220:

“The District of Columbia shall appropriate sufficient funds each fiscal year in the budget process to replenish any amounts allocated from the emergency reserve fund during the preceding fiscal years so that not less than 50% of any amount allocated in the preceding fiscal year or the amount necessary to restore the emergency reserve fund to the 2% required balance, whichever is less, is replenished by the end of the current fiscal year and 100% of the amount allocated or the amount necessary to restore the emergency reserve fund to the 2% required balance, whichever is less, is replenished by the end of the second fiscal year following each such allocation.”

Per District Required Reserve Policy:

“The District is required by federal law to maintain the Emergency Reserve Fund and the Contingency Reserve Fund, and is required by District law to maintain the Fiscal Stabilization Reserve Account and the Cash Flow Reserve Account. The District deposits 50% of the undesignated end-of-year fund balance into each of the two District reserves, or 100% of the undesignated end-of-year fund balance into the account that has not reached capacity. The balance requirement for the emergency reserve fund is 2% of the actual (adjusted) operating expenditures from local source funds for the Fiscal Year of the most recently issued CAFR (less the amount necessary to replenish draws)”

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In accordance with DC Code 1-204.50a:

(a) Emergency Reserve Fund. --

(1) In general. -- There is established an emergency cash reserve fund ("emergency reserve fund") as an interest-bearing account (separate from other accounts in the General Fund) into which the Mayor shall make a deposit in cash not later than October 1 of each fiscal year of such an amount as may be required to maintain a balance in the fund of at least 2 percent of the operating expenditures as defined in paragraph (2) of this subsection or such amount as may be required for deposit in a fiscal year in which the District is replenishing the emergency reserve fund pursuant to subsection (a)(7) [paragraph (7) of this subsection].

(2) In general. -- For the purpose of this subsection, operating expenditures is defined as the amount reported in the District of Columbia's Comprehensive Annual Financial Report for the fiscal year immediately preceding the current fiscal year as the actual operating expenditure from local funds, less such amounts that are attributed to debt service payments for which a separate reserve fund is already established under this Act.

(3) Interest. -- Interest earned on the emergency reserve fund shall remain in the account and shall only be withdrawn in accordance with paragraph (4) [of this subsection].

(4) Criteria for use of amounts in emergency reserve fund. -- The Chief Financial Officer, in consultation with the Mayor, shall develop a policy to govern the emergency reserve fund which shall include (but which may not be limited to) the following requirements: (A) The emergency reserve fund may be used to provide for unanticipated and nonrecurring extraordinary needs of an emergency nature, including a natural disaster or calamity as defined by section 102 of the Robert T. Stafford Disaster Relief and Emergency Assistance Act (Public Law 100-707) or unexpected obligations by Federal law. (B) The emergency reserve fund may also be used in the event of a State of Emergency as declared by the Mayor pursuant to section 5 of the District of Columbia Public Emergency Act of 1980 (sec. 6-1504, D.C. Code) [D.C. Official Code § 7-2304]. (C) The emergency reserve fund may not be used to fund:

(i) any department, agency, or office of the Government of the District of Columbia which is administered by a receiver or other official appointed by a court;

(ii) shortfalls in any projected reductions which are included in the budget proposed by the District of Columbia for the fiscal year; or

(iii) settlements and judgments made by or against the Government of the District of Columbia.

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(5) Allocation of emergency cash reserve funds. -- Funds may be allocated from the emergency reserve fund only after: (A) an analysis has been prepared by the Chief Financial Officer of the availability of other sources of funding to carry out the purposes of the allocation and the impact of such allocation on the balance and integrity of the emergency reserve fund; and (B) with respect to fiscal years beginning with fiscal year 2005, the contingency reserve fund established by subsection (b) [of this section] has been projected by the Chief Financial Officer to be exhausted at the time of the allocation.

(6) Notice. -- The Mayor, the Council, and (in the case of a fiscal year which is a control year, as defined in section 305(4) of the District of Columbia Financial Responsibility and Management Assistance Act of 1995 [D.C. Official Code § 47-393(4)]) the District of Columbia Financial Responsibility and Management Assistance Authority shall notify the Committees on Appropriations of the Senate and House of Representatives in writing not more than 30 days after the expenditure of funds from the emergency reserve fund.

(7) Replenishment. -- The District of Columbia shall appropriate sufficient funds each fiscal year in the budget process to replenish any amounts allocated from the emergency reserve fund during the preceding fiscal years so that not less than 50 percent of any amount allocated in the preceding fiscal year or the amount necessary to restore the emergency reserve fund to the 2 percent required balance, whichever is less, is replenished by the end of the first fiscal year following each such allocation and 100 percent of the amount allocated or the amount necessary to restore the emergency reserve fund to the 2 percent required balance, whichever is less, is replenished by the end of the second fiscal year following each such allocation.

CAUSE

Management did not have written policies and procedures in place to ensure compliance with the District Code, nor did management perform an adequate review over the calculation and related report to the Mayor to ensure compliance with the minimum amount as required by Congress.

EFFECT

Without adequate controls in place to ensure proper management review and adherence to the District Code, the District's original calculation was incorrect and the error remained undetected.. However, after it was brought to management's attention, the District subsequently revised the calculation and the related report to the Mayor meeting the minimum 2% requirement for the Emergency Reserve Fund balance for FY 2013.

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RECOMMENDATION

We recommend that the District implement written policies and procedures surrounding the administration of the Emergency Reserve Fund to ensure compliance with the requirements of the District's Code. In addition, these policies should include a detail review of the calculation and related report to the Mayor to ensure that the minimum reserve requirement has been met.

MANAGEMENT'S RESPONSE

Management concurs with the finding and recommendation. Management will establish written policies and procedures to ensure compliance with the District Code regarding the calculation and any required deposits to ensure that the minimum reserve requirement is met on a timely basis.

8. District of Columbia Public Schools (DCPS)
 - a. Expenditures Recorded to Incorrect Object Code

CONDITION

During FY 2013, DCPS had a total of \$79,379,543 of non-personnel expenditures. During our testwork over a sample of 40 expenditures totaling \$11,260,195, we noted 3 expenditures totaling \$2,376,996 that were posted to the incorrect object code in the System of Accounting and Reporting (SOAR), the District's general ledger.

CRITERIA

Yellow Book, Appendix I, section A1.08d., 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;*"

COSO Internal Control Integrated Framework as previously described on pages A-3 and A-4 of Appendix A.

CAUSE

DCPS budget personnel were not adequately reviewing the purchase orders to ensure the object codes were coded to the appropriate function in the Procurement Automated Support System (PASS).

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EFFECT

Although these errors had no impact on total expenditures, expenditures are presented on DCPS' 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. Specifically, for FY 2013, the line items for supplies and materials (0020), other contractual services (0041), and equipment and equipment rental (0070) were misstated as a result of these errors.

RECOMMENDATION

We recommend that DCPS provide training to budget personnel to ensure that all expenditures are coded to the proper object code.

MANAGEMENT'S RESPONSE

We concur with the finding. A review will be conducted to ensure that expenditures are consistently recorded to the correct object code.

b. Inaccurate Receiving Reports

CONDITION

In fiscal year 2013, DCPS's non-personnel expenditures totaled approximately \$79 million. During our testwork over a sample of 40 non-personnel expenditures totaling \$11,260,195, we noted that for 1 expenditure amounting to \$66,258, the quantity of goods received per the receiving report exceeded the quantity on the related invoice by 80 items.

CRITERIA

Yellow Book, Appendix I, section A1.08d., 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;*"

COSO Internal Control Integrated Framework as previously described on pages A-3 and A-4 of Appendix A.

CAUSE

A DCPS receiving handler accepted the entire order before actually receiving the entire amount. Therefore, items not yet provided by the vendor were

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marked as 'received' in the procurement system prior to DCPS receiving those goods.

EFFECT

When the receiving report is entered incorrectly, there is an increased risk that DCPS could pay for goods or services that have not actually been received because the receiving handler approved the entire order at once.

RECOMMENDATION

We recommend that DCPS strengthen their controls by requiring receiving handlers to only accept actual quantities received on their receiving report.

MANAGEMENT'S RESPONSE

We concur with this finding. We will ensure that receiving report instructions are reviewed and distributed to the responsible department to ensure that receivers only approve items received at that time.

c. Retroactive Payments

CONDITION

During FY 2013, DCPS had total personnel and benefit expenditures of \$527,323,471. During our testwork over a sample of 275 payroll expenditures totaling \$850,326, we noted that for 5 transactions tested amounting to \$15,322; retroactive payments that were earned by employees during fiscal year 2013 were not processed by the fiscal year-end. Further, DCPS did not record an accrual for the amounts owed but unpaid as of September 30, 2013. This resulted in an understatement of payroll expenditures of \$1,957 for the transactions sampled.

CRITERIA

Yellow Book, Appendix I, section A1.08d., 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;*"

COSO Internal Control Integrated Framework as previously described on pages A-3 and A-4 of Appendix A.

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CAUSE

When a DCPS employee earns a raise, it is subject to authorization by both DCPS Human Resources (HR) and the DCPS Payroll Department prior to payment. For the exceptions noted, the employee had earned a pay increase and was due a retroactive payment; however, the proper authorization had not yet been obtained due to delays in processing by DCPS HR and/or the DCPS payroll department. DCPS did not have a process in place to effectively track outstanding retro payments to ensure they were paid timely.

EFFECT

Without proper internal controls in place to ensure that salary adjustments due to employees are properly and timely processed, payroll expenditures could be misstated. The current year total estimated misstatement related to amounts owed but unpaid was \$119,568.

RECOMMENDATION

We recommend that DCPS develop and implement a process to regularly review outstanding retroactive payments due to employees to ensure they are paid to employees timely and that payroll expenses are accurately stated in the general ledger.

MANAGEMENT'S RESPONSE

We concur with this finding and will develop a formal process to track and record all retro requests to ensure these amounts can be adequately tracked through issuance of payment.

d. Payroll Processing Errors

CONDITION

DCPS's personnel and benefit expenditures totaled \$527,323,471 in fiscal year 2013. During our testwork over a sample of 275 personnel and benefit expenditures totaling \$850,326, we noted that 7 of the transactions tested that were either not properly supported by documentation or were incorrect based on the supporting documentation provided. Specifically, we noted the following:

- For 6 of the 275 transactions tested with variances totaling \$996, we noted differences between the amount recorded in the PeopleSoft payroll system and our recalculated amount.

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- The Additional Income Allowance (AIA) for Master Educators was improperly calculated for 4 of the transactions. This resulted in an overpayment of \$361 in gross pay.
 - 1 of these differences was a duplicate payment made as a result of a timesheet change. This resulted in an overpayment of \$576 in gross pay to the employee.
 - An improper pay rate was applied for 1 of the transactions because an employee improperly received an automatic a pay increase despite being on a step hold. This resulted in an overpayment of \$59 in gross pay to the employee.
- For 1 of the 275 transactions tested, the employee was paid \$292 in AIA that they not eligible to receive.

CRITERIA

Yellow Book, Appendix I, section A1.08d., 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;*”

COSO Internal Control Integrated Framework as previously described on pages A-3 and A-4 of Appendix A.

Government Auditing Standards, Appendix I, section 1.08 d. states:

CAUSE

The AIA amounts were not calculated correctly by the Director of IMPACT because within grade/step increases were not factored into the calculation; resulting in overpayments to the employee. Further, management failed to detect an additional employee who was paid AIA and was not included on the list of employees authorized to receive AIA.

For one employee, hours were adjusted to reflect annual leave taken rather than hours worked. The adjustment was not properly reviewed and as such, the employee was paid twice, once for regular pay and again for leave taken.

In addition, PeopleSoft automatically updates within grade/step increases for employees; however, for the exception noted, the employee was on a step hold that had not yet been entered in PeopleSoft, resulting in an overpayment.

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EFFECT

Without proper internal controls in place to ensure that adjustments due to employees are properly processed, and that pay rates are accurately entered into the payroll system, payroll expenditures could be misstated.

RECOMMENDATION

We recommend that DCPS strengthen their internal controls to ensure that employee salary adjustments are processed accurately whereby employees will receive the correct pay. Such improvements to internal controls should include the following:

- Additional management review over the calculations for AIA to ensure that they are based on current rates and calculated accurately;
- Periodic review of payroll disbursements to detect duplicate payments made as a result of processing errors.

MANAGEMENT'S RESPONSE

We concur with this finding and will review the AIA and step approval process to ensure that sufficient measures are in place to allow amounts to be calculated accurately and appropriately awarded to qualifying individuals.