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

# DISTRICT OF COLUMBIA

# MEMORANDUM OF RECOMMENDATIONS

**For Fiscal Year**
**Ended September 30, 2012**

**CHARLES J. WILLOUGHBY**
**INSPECTOR GENERAL**

**OIG No. 13-1-18MA** **April 9, 2013**

# GOVERNMENT OF THE DISTRICT OF COLUMBIA
**Office of the Inspector General**

Inspector General

April 9, 2013

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

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

The Honorable 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 Dr. Gandhi:

In connection with the audit of the District of Columbia's general purpose financial statements for fiscal year (FY) 2012, KPMG, LLP (KPMG) submitted the enclosed final report, District of Columbia Memorandum of Recommendations for Fiscal Year ended September 30, 2012, also known as the Management Letter (OIG No. 13-1-18MA). 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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Mr. Paul Geraty, CPA, Public Sector Audit Division KPMG LLP (1 copy)

# Government of the District of Columbia Fiscal Year 2012 Management Letter

# GOVERNMENT OF THE DISTRICT OF COLUMBIA
# MANAGEMENT LETTER
# FOR THE YEAR ENDED SEPTEMBER 30, 2012
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**KPMG LLP**
Suite 12000
1801 K Street, NW
Washington, DC 20006

March 28, 2013

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

We have audited the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, the budgetary comparison statement, each major fund, and the aggregate remaining fund information of the Government of the District of Columbia (the District), as of and for the year ended September 30, 2012, which collectively comprise the District's basic financial statements and have issued our report thereon dated January 28, 2013. In planning and performing our audit of the basic financial statements of the District, in accordance with auditing standards generally accepted in the United States of America, we considered the District's internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinion on the basic financial statements but not for the purpose of expressing an opinion on the effectiveness of the District's internal control. Accordingly, we do not express an opinion on the effectiveness of the District's internal control.

During our audit we noted certain matters involving internal control and other operational matters that are presented for your consideration. These comments and recommendations, all of which have been discussed with the appropriate members of management as part of the Notification of Findings and Recommendations (NFR) process, are intended to improve internal control or result in other operating efficiencies and are summarized in Appendix A to this report. The current status of prior years' comments and recommendations are summarized in Appendix B.

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 28, 2013, along with our recommendations and management's responses. Such deficiencies have not been repeated in this report.

Our audit procedures are designed primarily to enable us to form an opinion on the basic 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 District's written response to our comments and recommendations has not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on them.

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

Very truly yours,

KPMG LLP

1. Cash and Investments

   a. Compliance with Collateral Requirements

**CONDITION:**
During testwork performed over compliance with Financial Institutions Deposit and Investment Act-Collateral Requirements and the District's Cash and Investment Management Policy, we identified seven (7) instances throughout fiscal year 2012 where the financial institution did not meet the 102% collateral requirement for deposits. The District identified the exceptions 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.

**CRITERIA:**
According to the Financial Institutions deposit and Investment Act of 1997, Section "47-351.8. Collateral and reporting requirements (a) *"Excerpt 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."*

According to the District's Cash and Investment Management Investment Policy, *"The District requires that all cash and other deposits maintained in any financial institution to be collateralized, including bank deposits and certificates of deposits. All deposits of District monies in excess of the amount protected by federal deposit insurance will be collateralized with any combination of U.S. Treasury and federal agency obligations. In order to accommodate market changes and provide a level of security for all monies, the collateralization level shall be at least 102% of the market value of principal, plus accrued interest, or as required by the terms of bond issues, municipal bond insurance policies, and/or other financing agreements which may pertain to the District's monies."*

**CAUSE/EFFECT***:*
The non-compliance was identified through the District's monthly review; however the review is detective in nature and allows for institutions to be non-compliant during any given month. At certain points during the year, the District was not fully compliant with the collateralization provisions in the "Financial Institutions Deposit and Investment Act of 1997" which increases the District's risk of loss in the event that the financial institution were to fail to exist as a going concern.

**RECOMMENDATION:**
We recommend that the District more closely monitor institutions in order to maintain full compliance with collateralization requirements.

**MANAGEMENT RESPONSE:**
Management concurs with the Finding and Recommendation. As noted by KPMG, the District identified the exceptions through our monthly review for compliance with collateralization requirements. However, due to unexpected deposits or market value changes in collateral, there are going to be collateral coverage shortfalls. As also noted by KPMG, in all instances, the bank pledged additional collateral within 2-5 days after being contacted by OFT staff requesting additional collateral. We believe the Banks have complied within a reasonable time frame.

In an effort to reduce the exposure to the District, OFT added to its monitoring controls a daily review of a customized Bloomberg report, listing the specific Federal Reserve-held collateral to monitor market value between monthly Fed reports. As part of OFT's daily compliance monitoring, a Bloomberg report is reviewed to determine the market value of the pledged securities. The Federal Reserve does not provide a daily market value report. The Federal Reserve provides a month-end report with book values by CUSIP and financial institution. The OFT Banking Relations Manager, reviewed the calculation of Bloomberg value to the Federal Reserve Value of collateral to confirm compliance with KPMG.

Of the seven non-compliant occurrences identified by KPMG, three did maintain a minimum of dollar-for-dollar coverage although it was not the required 102%; however the risk of deposit loss was minimized. An additional three occurrences were from one small financial institution that purchases and settles its securities through a third party vendor which delays their ability to quickly comply. However, the financial institution has, to date, increased its collateral position within a reasonable time frame from the request (3 days).

A further enhancement to monitoring controls that is currently being considered by the District is to obtain portfolio maintenance services from a reputable financial institution. The financial institution would provide real time, daily market value positions of all of the District's collateral. In addition, the financial institution would contact the banks directly when shortfalls occur to request additional collateral or move collateral directly from the bank's reserve pools on deposit. This would give the District real time collateral valuation and expedite collateral compliance.

b. Untimely Resolution of Reconciling Items

**CONDITION:**

During our FY 2012 testwork over cash and investments, we noted that although the District is performing monthly reconciliations timely and identifying reconciling items, the reconciling items identified are not being timely resolved by the Agency and accounted for within the general ledger. In addition, we noted that the District needs to strengthen its internal controls over the maintenance and reporting of their bank accounts within their general ledger. Specifically we noted the following:

- For 3 of 25 bank accounts tested, the bank account had been appropriately approved for closure during the fiscal year by Office of Finance and Treasury (OFT) management; however, the general ledger subsidiary accounts for each of the Bank Identification Numbers (ID) had remaining balances in the general ledger as of September 30, 2012.

- For 26 of 765 bank accounts tested, the financial institution confirmed that the bank account was closed as of September 30, 2012; however, a balance still existed in the District's general ledger for these Bank ID's as of September 30, 2012. The 26 bank accounts had a net value of $39,119,401.73. It should be noted that these general ledger balances were being considered as part of the reconciliation of the new bank account. Therefore, the $39 million was not an error in the District's reported cash balances but a misclassification of cash balances between Bank IDs in the general ledger as a result of the old account note being properly closed in the general ledger and the residual balance being transferred to the new general ledger account.

- For 50 of the 765 bank accounts tested, we noted that these bank accounts continue to be carried in the District's master list of bank accounts even though they are owned and operated by the District's component units and are not included as part of the District's cash balances in the Financial Statements. We validated that the bank accounts were properly reported on the component units' general ledger as of September 30, 2012.

- For 19 of 35 September pooled cash reconciliations tested, there were reconciling items amounting to $7,669,658 that have been outstanding more than 60 days.

- A surety bond with a value of $6,204,230, held in Bank ID 998-No Related Bank Account, in the Fund 600-Miscellaneous Agency Funds, was incorrectly recorded as an investment and a liability of the District's general fund as of September 30, 2012. This bond should not have been held on the District's books because it is not an asset or a liability of the District.

**CRITERIA:**

According to the standards applicable to financial audits contained in *Government Auditing Standards,* (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."*

Per the Committee of Sponsoring Organizations of the Treadway Commission (COSO) Internal Control Integrated Framework:

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

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

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

Control Activities – Control activities are the policies and procedures that help ensure management directives are carried out. They help ensure that necessary actions are taken to address risks to 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.

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

**CAUSE/EFFECT:**

The District Office of Financial Operations and Systems (OFOS) is timely reconciling cash accounts and identifying reconciling items, however, District Agencies and other responsible parties are not timely investigating and resolving or adjusting for the reconciling items as requested by OFOS. As a result, necessary adjustments to the general ledger to properly state cash are not being made and identified reconciling items continue to be carried as outstanding reconciling items on District monthly bank reconciliations for more than 60 days. In addition, the District does not have internal controls in place to ensure that old general ledger accounts are appropriately zeroed out and closed within a reasonable period of time. Inadequate or untimely resolution of reconciling items between the bank and the general ledger could lead to misstatements to the financial statements and could increase the risk that improprieties or other errors could go undetected for extended periods of time. Without closing out cash accounts and zeroing out balances on the general ledger, errors can be made during financial reporting to misstate cash.

**RECOMMENDATION:**
We recommend that the District implement procedures to ensure District Agencies and other responsible parties are investigating and resolving reconciling items within a 60 day time period. In addition, we recommend the District continue to perform monthly reconciliations on closed cash accounts until the general ledger account balance is zero and the account is closed in the general ledger. We also recommend that all closed bank accounts be removed from the general ledger within a reasonable time period to keep personnel from mistakenly posting transactions to old accounts. OFT should also ensure that they are accurately identifying which bank accounts are owned and operated by the District and which are component owned and operated accounts.

**MANAGEMENT RESPONSE:**
Management concurs that reconciling items identified are not being timely resolved by the Agency; and that balances still exist in the general ledger for closed accounts. We will explore the implementation of procedures to ensure that agencies and other responsible parties are investigating and resolving reconciling items within a 60 day time period. We will also work to develop a policy to require all closed bank accounts be removed from the general ledger within a reasonable time period.

c. Untimely Clean up of Suspense Accounts

**CONDITION:**
During our testing of cash and investments, we obtained the District's Category 10 Report by Bank ID (BID) and noted that the District's suspense accounts (Bank ID 999) reflected outstanding balances of $1,934,850.92 as of September 30, 2012 that were not cleared by January 10, 2013, (100 days past the fiscal year end).

**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/EFFECT:**
The District does not have policies and procedures in place to ensure reconciling items are cleared timely. Management did not reconcile the balances in the suspense accounts timely due to the complexity of the District's general ledger system and accounting structure. Failure to resolve suspense account balances in a timely manner could result in improper classification of balances in the financial statements.

**RECOMMENDATION:**

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

**MANAGEMENT RESPONSE:**

Management concurs with the facts as reported by the auditors. Measures will be taken to ensure that transactions posted in accounts that are being closed are timely cleared with the accounts showing $0 balances by year-end.

d. Improper Valuation of Mortgaged Back Security

**CONDITION:**

During our investment valuation testwork, we noted that the District held an investment in a Mortgaged Backed Security (MBS) in the amount of $17,852,622 that was reported in the District's draft financial statements as of September 30, 2012 at cost instead of at its fair value of $10,738,568 as required under U.S. generally accepted accounting principles (GAAP). As a result, an adjustment was recorded by the District to reduce the carrying value of the security down to its fair value as of September 30, 2012.

**CRITERIA:**

According to GASB 31, Certain Investments and External Investment Pools, "*Governmental entities…should report investments at fair value in the balance sheet (or other statement of financial position). Fair value is the amount at which a financial instrument could be exchanged in a current transaction between willing parties other than in a forced or liquidation sale. However, governmental entities other than external investment pools are permitted to report certain money market investments at amortized cost, provided that the investment has a remaining maturity of one year or less at time of purchase…Asset-backed securities, derivatives, and structured notes are not (money market investments).*"

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/EFFECT:**

Management does not have adequate controls in place to ensure that all investments that are required to be reported at fair value in the financial statements are revalued at fiscal year end. Failure to maintain the MBS at the appropriate value, could lead to improper classification of financial data and result in misstatements to the District's financial statements.

**RECOMMENDATION:**

We recommend that the District implement policies and procedures to ensure that investment types are reported at the correct value, either fair value or cost. Additionally, we recommend a process be implemented that identifies investments that need to be held at fair value and that any adjustments that need to be made to maintain those investments at appropriate values be made periodically.

**MANAGEMENT RESPONSE:**

Management concurs with the finding.

2. Contingent Liabilities

**CONDITION:**
During our testwork over the District's reported contingent legal liabilities as of September 30, 2012, we noted 3 of 50 cases tested where the case was improperly accounted for in the District's draft government-wide financial statements as of September 30, 2012. Specifically we noted:

- The District incorrectly recorded a liability in the amount of $8,321,500 for a payment that was made in FY 2010, overstating the liability. As the full amount of the settled case was accrued in FY 2009 and payments were made in 2010 and 2011 the liability should be reduced each year by the payments made and only the unpaid value should remain as a liability on the District's books.

- One instance where the probable amount for a case per the legal letter from the Office of the Attorney General (OAG) was not accrued in the amount of $140,000, understating the liability.

- One instance in which the District accrued an additional $1,000,000 for a probable case that was already accrued in the prior year, overstating the liability.

KPMG noted that the District corrected the first two errors noted above by recording audit adjustments that resulted in a net decrease of $ 8,181,500 to the accrued liability for contingent legal liabilities reported in the District's government-wide financial statements as of September 30, 2012.

**CRITERIA**
Yellow Book, Appendix I, section A1.08 d., states that 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/EFFECT:**
Management records the legal liability based on the legal letter prepared by the OAG in response to the auditor's request as part of the audit. Management does not perform their own analysis throughout the year or prior to the auditor's request. In addition, the accrual is prepared and reviewed by the same person. Without conducting their own internal review or ensuring that there is proper segregation of duties surrounding the review, the legal accrual can be misstated in the District's government-wide financial statements.

**RECOMMENDATION:**
We recommend that the District implement policies and procedures to ensure that legal liabilities are recorded on a timely basis and a proper review is performed before the accrual is recorded. We further recommend that OFOS communicates with the OAG on a more frequent basis to ensure that all liabilities are recorded accurately and timely.

**MANAGEMENT RESPONSE:**

Management concurs with the facts as presented by the auditors. The District will take the necessary steps to enhance the accuracy and timeliness associated with the recording of contingent liabilities in the financial system.

3. Disability Compensation
   a. Inadequate support for claims

**CONDITION:**

During our testwork over non-uniform disability compensation and tort liabilities (general and auto), we noted that claims were not properly supported by readily available claims documentation.

*Non-Uniform Worker's Compensation:*

For 1 out of 25 non-uniform workers compensations claims tested, we noted that the status per the JURIS claims system, maintained by the third-party service provider, Sedgwick, did not agree to the Notice of Claim Determination supporting documentation provided.

*Tort Liabilities (General & Auto):*

- For 14 of 25 general tort liability claims and 13 of 25 auto tort liability claims tested, we were not provided sufficient supporting documentation for the claims. Therefore, we could not validate that the claim should have been included on the tort claims report provided to the District's consulting actuary in order to estimate the liability as of September 30,2012.

- For 4 of the 25 auto tort liability claims tested, the District was the party filing the claim. As such, no liability exists and the claims should not have been included in the tort claims report provided to the District's consulting actuary.

- For 1 of 25 general tort liability claims tested, we noted the status of the claim as "Open Litigated", indicating that litigation has been filed and has been transferred to the Office of the Attorney General for further processing and tracking. Therefore, the claim was inappropriately included in the general tort claims report provided to the District's consulting actuary.

**CRITERIA:**

Yellow Book, Appendix I, section A1.08 d., also states that 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/EFFECT:**

The District lacks sufficient internal controls to ensure that all claims, specifically older claims, included on the Torts and non-uniform division claims reports are properly supported and that the status of the claims is accurate. Without effectively designed and implemented internal controls over the financial reporting process for disability compensation and tort liabilities, the reports submitted to the actuary for calculation of the liability may not be detected and corrected in a timely manner.

**RECOMMENDATION:**

We recommend the District implement formalized policies over the disability compensation and tort liabilities financial reporting process to ensure:

- Documentation to support claims is properly maintained;
- Claims data is reviewed and reconciled by management prior to submission for the annual actuarial valuation process; and
- A uniform and measurable policy for developing estimates of reserve amounts is used in the claims data reports.

We also recommend that the District provide training on these policies to personnel responsible for performing these processes and also perform monitoring procedures to ensure adherence with these policies.

**MANAGEMENT RESPONSE:**

The District Office of Risk Management (ORM) does not dispute the findings regarding the tort claim data, however, we would note that for those claims where supporting documentation was not provided, the claims were largely older claims whose statute of limitations has expired, or that are in litigation. In the future, ORM will ensure that such claims are not included in the liability data. We would also note that after we became aware that subrogation claims were included in the tort data provided to the actuary, ORM resubmitted the data, excluding the subrogation claims, to the actuary and the actuary "re-ran" its calculations. Therefore, the inclusion of the subrogation claims did not impact the actuarial valuation.

ORM will continue to enforce its policies that documentation to support both tort and Public Sector Workers' Compensation Programs (PSWCP) claims is properly maintained. Any lack of documentation is due to past practices and/or deficiencies in the programs.

Regarding the review and reconciliation of claims data for the actuarial valuation process, ORM will ensure that in the future, management will reconcile its data files to ensure that the correct information is provided to the actuary. It will also institute a policy requiring a quarterly review of all tort claims to ensure that claims are closed as a result of the expiration of statutes of limitations and other factors. This will ensure that such claims are not included in the data submitted to the actuary. The new policy will also prescribe the procedures to be used when responding to tort and PSWCP data requests from the actuary and the CAFR auditors.

b. Understatement of Disability Compensation Liability

**CONDITION:**

Annually, the District records a liability related to accrued disability compensation and tort liabilities related to incurred claims, which was approximately $135 million as of September 30, 2012. 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. The District engages an actuarial specialist to assist in the calculation of these amounts. However, we noted that the District did not record a liability for the unallocated loss adjustment expenses (ULAE), which are the indirect costs associated with administration of open claims, as of September 30, 2012. As a result, the Disability Compensation liability reflected in the District's government-wide financial statements was understated by approximately $13.5 million as of September 30, 2012.

**CRITERIA:**

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.

Paragraph 23 of GASB Statement No. 10 states that – "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."

Yellow Book, Appendix I, section A1.08 d., also states that 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/EFFECT:**
The District's policies for recording the year-end Disability Compensation liability are not appropriate to ensure that all costs associated with the settlement of open claims are considered. Without proper consideration of ULAE within the disability compensation accrual, the District's disability compensation liability will be understated in the District's government-wide financial statements as of fiscal year end.

**RECOMMENDATION:**
We recommend that the District adjust their current policies over the disability compensation and tort liabilities financial reporting process to ensure that the disability compensation liability appropriately reflects the indirect costs associated with administering open claims, in addition to the direct costs of the claims.

**MANAGEMENT RESPONSE:**
Management concurs with the finding and recommendation. The recommendation provided to the District of Columbia by KPMG will be implemented in the contracted actuarial study for Fiscal Year 2013. This change will add another task to be completed by the actuary and provide the District, in one document, with both the direct and indirect cost associated with the District's self insurance programs.

4. Capital Assets
   a. Inventory

**CONDITION:**
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 last performed a physical inventory in FY 2010 and was scheduled to conduct one in FY 2012; however, the inventory was not completed.

We noted that the District was unable to provide a complete listing of personal property from their capital asset sub-ledger, Fixed Asset System (FAS) that reconciled to the balance of personal property reflected in the general ledger as of September 30, 2012. Further, during testwork over a sample of 25 assets selected from the personal property listing to determine the physical existence of personal property, we noted the following:

- For 6 of 25 sample items selected, the asset was not available for inspection. For 2 of the 25 sample items selected, the asset was not able to be located by the agency based on the data recorded in FAS related to the asset. For 3 of 25 sample items selected, we noted the asset was de-commissioned and had been disposed of prior to FY 2012. For 1 of 25 sample items selected, we noted the asset had been auctioned off and disposed off in FY 2008.

- For 7 of 25 sampled items selected, the property number on the asset did not agree to the property record per FAS.

- For 2 of 25 sampled items selected, the serial number on the asset did not agree to the property record per FAS and the asset was not properly tagged with a property number.

- For 1 of 25 sampled items selected, we noted that the FAS property record was inaccurate and the sample actually represented two separate assets.

- For 1 of 25 sampled items selected, we noted the asset record per FAS is not related to a physical asset but is a transaction of expenditures associated with multiple assets.

During our testwork over a sample of 18 assets that we observed in the performance of the above procedure to determine the completeness of the District's personal property records, we noted the following:

- For 7 of 18 sample items selected for completeness testwork, the asset was not able to be traced to the asset listing per FAS.

- For 8 of 18 sample items selected for completeness testwork, either the asset serial number or property number did not agree to the asset listing per FAS.

**CRITERIA:**

Yellow Book, Appendix I, section A1.08 d., also states that 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.

According to GASB Statement No. 34 - *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, 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 personal property, in the government-wide statement of net assets and generally should report depreciation expense in the statement of activities.

**CAUSE/EFFECT:**

The District did not perform a physical inventory count of personal property in accordance with its own historical practice of performing such a count every two years. Further, the District is not properly tracking personal property activity to ensure personal property records are complete and accurate. A lack of a complete and formal fixed asset inventory policies and procedures may result in assets that are not properly identified, tracked and recorded to the general ledger which could result in a misstatement in the District's capital asset balances reflected in the District's government-wide financial statements.

**RECOMMENDATION:**

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

- Proper identification, tracking and recording of fixed assets to ensure that each inventory item should be tagged with the corresponding identification number and held at the location number on record in FAS. Any changes such as relocation or disposal should be updated in the FAS.
- Each inventory record in FAS 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 bi-annually to ensure the inventory records and the financial statement balances are complete and accurate.

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

**MANAGEMENT RESPONSE:**

Management concurs with this finding. The District will revisit its current policies and practices regarding the physical inventory of capital assets and appropriate measures will be taken to ensure the timely completion of physical inventories on a routine and periodic basis. The District recognizes that a centralized procedure needs to be drafted that specifies how the tagging of assets should occur and the manner in which information needed to identify assets is to be captured.

b. Leases

**CONDITION:**

The District's controls over the review of lease classification are not designed and implemented effectively to ensure that leases are accurately recorded in the District's government-wide financial statements. We noted that District agencies report lease information to the Office of Financial Operations and Systems (OFOS) through an annual Closing Package submission. Further, we noted that OFOS has policies and procedures to review the Closing Packages to ensure that future minimum lease payment calculations are accurate and that the criteria used to classify leases as operating or capital are properly supported. However, we noted that this review is not documented; as such, we were not able to evidence the performance of this control. Additionally, we noted the following errors in financial reporting during our testwork over leases:

1. During our test of design and implementation of the District's financial reporting process for 1 capital lease tested totaling approximately $146 million in future minimum lease payments, we determined that the District inappropriately concluded that the lease contained a bargain purchase option. We noted that the District did not appropriately consider all relevant terms of the lease in determining whether the lease contained a

bargain purchase option, and therefore came to an inappropriate conclusion regarding the bargain purchase option criterion for this capital lease. However, we

2. noted that the lease met other criteria for a capital lease; therefore, the District's conclusion regarding the bargain purchase option had no effect on the classification of the lease as operating or capital in the District's government-wide financial statements.

3. During our testwork over a sample of 4 new operating leases totaling approximately $3.3 million in current year lease payments and 1 new capital lease totaling approximately $3.2 million in future minimum lease payments, we noted all assumptions used in determining the proper classification of the leases in accordance with U.S. GAAP were not appropriately supported. Specifically, we noted that for all 5 of the leases tested, the interest rate used in the lease capitalization template to determine the value of the future minimum lease payments at the beginning of lease were not appropriately supported. However, we noted that the error had no effect on the classification of the leases in the District's government-wide financial statements.

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 that are not systematic and rational as required under U.S. GAAP Rather, the District records operating lease expenses in the government-wide financial statements based on actual expenses incurred, regardless of payment terms that include rent abatements or other unsystematic fluctuations in rental costs. For 2 of 64 operating leases tested, KPMG recalculated the difference between the District's current methodology and using the straight-line approach required under U.S. GAAP and noted an understatement in current year expenses and accounts payable of $2,888,913 in the District's government-wide financial statements.

**CRITERIA:**

Per Financial Accounting Standards (FAS) 13, Paragraph 7*:*

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

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

Per GASBS 13, *Accounting for Operating Leases with Scheduled Rent Increases,* paragraphs 5 and 6:

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 increases 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 4 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.

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.

Yellow Book, Appendix I, section A1.08 d., states that management 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/EFFECT:**

The District lacks sufficient policies and procedures to ensure that a review of the future minimum lease payment calculations and lease classifications submitted by Agencies is consistently performed and documented. Without procedures to ensure proper review and approval of lease information recorded in the District's financial statements and presented in the footnotes, there is a risk that capital lease assets, liabilities, and expenses are incorrectly recorded in the District's government-wide financial statements and incorrectly presented in the related footnotes.

**RECOMMENDATION:**

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

- Maintaining proper documentation for all lease transactions, including assumptions used to determine lease classification.

- Performing and documenting reviews over 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.

- Increased instruction and detailed guidance for Agency personnel who are responsible for completing Closing Package information.

**MANAGEMENT RESPONSE:**

Management concurs with the Finding and Recommendation. We routinely seek ways to enhance financial reporting processes and maximize efficiencies, hence, we will take the auditors' recommendations under advisement. To the extent deemed to be necessary, OFOS will revise current policies and procedures as appropriate, and work more closely with the Agencies to ensure adherence to reporting policies.

c. Real and Personal Property

**CONDITION:**

During our testwork over the District's financial reporting process for real and personal property, we noted deficiencies in the design, implementation and operating effectiveness of internal controls.

1. *Accounting for Real Property*

   The District does not a have a consistent process in place for identifying real property additions and deletions. Real property activity information is obtained informally from internal communication sources, such as the District's news clips and the Office of General Counsel.

2. *Reconciliation of Personal Property*

   Controls related to the review and reconciliation of personal property were not implemented effectively. We note per the District's policies over personal property reconciliations, any differences between the FAS system balance and the agency reported balance must be properly explained and supported. During our test of design and implementation over the District's controls over personal property, we noted one instance in which there was an unreconciled difference of approximately $2.7 million between the capital asset subledger maintained in the District's fixed asset system (FAS) and the general ledger related to the beginning balance of accumulated depreciation for one Agency.

**CRITERIA:**

According to 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 real and personal property, in the government-wide statement of net assets and generally should report depreciation expense in the statement of activities.

District Policies: *Closing Package Topic 8 – Requirement,* states the following:

Every agency in possession of personal property capital assets, either at the end of the previous fiscal year, during the course of the current reporting period, or at the end of the current reporting period, must update Topic 8 – 4 Form at the end of each accounting period. This form must be available for submission to OFOS upon request and when this topic/requirement is due as part of the Interim close activity and/or the Annual Close process.

An Official Certification (signed by the Associate CFO, Agency Fiscal Officer, or Controller, as appropriate) reporting the completion of Capital Assets Requirement 4 must accompany the Topic 8 - 4 forms when submitted to OFOS. The Official Certification should be in the form of a memorandum on the agency's letterhead. The documents for this requirement should not be submitted to OFOS via email. The subject line must be: FY 2011 Capital Assets Requirement 4. The body of the memorandum MUST contain the following statements:

> "(Insert name, telephone number, and email address) is responsible for this close requirement for Agency (insert SOAR financial agency code and the name of agency). Agency (insert SOAR financial agency code and the name of agency) has analyzed the changes in personal property accumulated depreciation and completed Topic 8 – 4 Forms". I certify the following for Agency (insert SOAR financial agency code and the name of agency):
>
> 1. The balance of the Comptroller GL personal property capital asset accumulated depreciation accounts in R*Stars reconciles to the value of personal property capital asset accumulated depreciation records in FAS.
>
> 2. The value of personal property accumulated depreciation is computed in accordance with District policy."

Yellow Book, Appendix I, section A1.08 d., states that 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.

**<u>CAUSE/EFFECT:</u>**

The District has not developed sufficient policies and procedures to ensure real property activity is recorded timely and properly supported. Furthermore, the District lacks financial reporting policies regarding personal property entered into FAS to ensure capitalized costs for personal property assets are properly and timely recorded. Without effectively designed and implemented internal controls over the financial reporting process for capital assets, misstatements in capital asset balances may not be prevented or detected in a timely manner.

**<u>RECOMMENDATION:</u>**

We recommend that the District strengthen their internal controls over the financial reporting process for real and personal property ensure that capital asset balances are complete and accurate as of the period-end. This should include, but is not limited to the following:

- Implementing a project accounting system that is fully integrated with the general ledger that allows capital asset transactions to be tracked at an invoice and project level.

- Developing District-wide policies and procedures for identifying real property transactions to ensure timely recording.

- Adherence to existing internal control procedures for the review and approval of agency-reported closing package information to ensure that the closing packages are submitted timely and that the reported capital asset data is complete and accurate.

- Maintenance of appropriate supporting documentation for all capital expenditures, transfers from CIP to capital assets, and real and personal property additions and disposals.

**MANAGEMENT RESPONSE:**
The District concurs with this finding. Currently, there is a requirement in place for agencies to record disposals of real property; this requirement will be strengthened with a policy that requires the legal staffs of the Department of General Services and the Office of the Attorney General to certify in writing the disposal of real property and forward the appropriate contract of sale along with any other supporting documentation to OFOS for review and recording. Other measures will be taken as deemed most appropriate to strengthen internal controls over real and personal property, such as: revising current policies and procedures: reinforcing with the agencies the importance of adhering to policies and procedures; and reviewing current records retention practices and revising them, as needed..

5. Grants Management

   a. Inadequate 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 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, renewal of benefits. Case actions including initial determination of eligibility can be recorded in 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 noted 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 A1.08 d., states that 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/EFFECT:**
The District's Economic Security Administration does not have adequate segregation of duties in place for those SSRs with the ability to authorize and record beneficiary cases (i.e. those with "authority to act"). As a result, beneficiary cases recorded and authorized by an SSR with authority to act could be erroneous 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 RESPONSE:**

Management agrees that SSRs with the authority to act have the ability to authorize and record benefit case actions in ACEDS. 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, acting upon the recommendation that SSR duties of recording and authorizing be segregated is not feasible at this time and would negatively impact the timely completion of actions. However, measures will be taken to enhance the monitoring of the activities of SSRs with the authority to act to maximize ESA's ability to timely detect errors and improprieties.

b. Double Counting for HMO Lawsuit

**CONDITION:**

During substantive testing of the Medicaid accrual, we noted that the District Department of Health Care and Finance (DHCF) included an accrual for the HMO Advantage lawsuit in the amount of $4.7 million in the District's government-wide financial statements as of September 30, 2012. This case is also considered annually in the District's contingent legal liabilities analysis and disclosed in the notes to the financial statements as a "reasonably possible" case in accordance with U.S. generally accepted accounting principles.

**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 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."

Yellow Book, Appendix I, section A1.08 d., states that 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/EFFECT:**

This was caused by a lack of controls to ensure that this contingent liability is evaluated once in accordance with GAAP.

The amount due to providers in the Medicaid accrual is overstated by $4.7 million in the government-wide financial statements, $1.4 million in the general fund (local match of 30%), and

$3.3 million (federal match of 70%) in the Federal and Private Resources special revenue fund. In addition, receivables from the federal government are overstated by $3.3 million in the government-wide financial statements and in the Federal and Private Resources special revenue fund.

**RECOMMENDATION:**

It is recommended that the District improve its internal controls to ensure that such contingent liabilities are only evaluated once for reporting in the District's financial statements in accordance with GAAP. We also recommend that DHCF disclose the HMO Advantage lawsuit in the notes to the financial statements, as the likelihood of a loss has been deemed "reasonably possible" by the Office of the Attorney General (OAG) as of September 30, 2012. As the liability is not considered "probable" by the OAG, DHCF should not include the amount in the Medicaid accrual, in accordance with U.S. generally accepted accounting principles.

**MANAGEMENT RESPONSE:**

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

The Government of the District of Columbia FY 2012 Close Instructions for Topic 11 Commitments and Contingencies (page 173) requires agencies to, in part, "…report each contingent liability with a maximum (worst case) potential loss of $50,000." The Department of Health Care Finance (DHCF) complied with that instruction by reporting the $4.7 million claim before the Contract Appeals Board from HMO Advantage.

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

c. Delays in Issuance of Cost Audit Reports

**CONDITION:**

Public and private providers who submit costs for reimbursement through cost reports are required by the Medicaid State Plan to subject the cost reports to an audit. The audits are conducted by auditors who are contracted by DHCF. During testing over Medicaid, we noted significant delays in the issuance of audited cost reports.

For example, we noted that the 2009 audited cost report is still pending resolution for one cost based hospital.

We also noted for two public providers, the most recent audit reports issued are 2009 for one and 2010 for another.

KPMG also noted that for certain nursing facilities, the 2007 audited cost reports were still under appeal as of September 30, 2012.

**CRITERIA:**

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

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

**CAUSE/EFFECT:**
Costs reports are issued either late by DHCF or there are ongoing appeals by providers.

Delays in the audits of cost reports and resolutions to appeals can cause an increase in the use of local funds if costs are found to be disallowed through the audit.

**RECOMMENDATION:**
We recommend that the District improve coordination and communication between providers, agencies, and with external auditors in order to reduce the lag between the submission of cost reports and the audit of those reports.

**MANAGEMENT RESPONSE;**
DHCF concurs with the auditor’s comments as presented and agrees with the recommendation.

DHCF has worked proactively with the affected hospitals to resolve issues and issue final settlements.

Regarding public providers, DHCF has accelerated its audit schedule and both 2010 and 2011 are currently being audited for one provider.

The 2009 DSH cost report audit was filed timely with CMS on December 31, 2012. These audits are scheduled in accordance with CMS timelines.

DHCF believes it has made significant progress in resolving outstanding prior year audit issues over the past year and continues to make efforts to advance the remaining issues to conclusion. DHCF concurs that coordination and communication between agencies and with external auditors is desirable to enable timely completion of audits and will continue to work with all parties to make the process more efficient.

d. Inadequate Review and Documentation of Interface Between ACEDS and EBT

**CONDITION:**
During our tests of the design and implementation of internal controls over the interface between the Automated Client Eligibility Determination System (ACEDS) and the Electronic Benefits Transfer (EBT) system, we noted that the Department of Human Services DHS does not retain adequate documentation to support the review of the daily response files generated from the interface. DHS retains only the most recent 6 months of response files. Further, the reviewer does not evidence his/her review of the files.

**CRITERIA:**
Yellow Book, Appendix I, section A1.08 d., states that 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/EFFECT:**

DHS does not have policies and procedures in place to adequately monitor the ACEDS/EBT interface. Failure to review and resolve exceptions from the interface in a timely manner could result in errors in benefits processing.

**RECOMMENDATION:**

We recommend that the District design and implement policies and procedures to support the timely review of the exception report. The policies and procedures should include specific document retention requirements and a requirement that the reviewer evidence his/her review.

**MANAGEMENT RESPONSE:**

Management concurs with the comments as presented by the auditors. We will review and revise current practices with respect to reviewing exception reports and retaining supporting documents. Furthermore, we will develop and/or revise policies and procedures as warranted.

e. Medicaid Accrual Retrospective Analysis

**CONDITION:**

During our testing over the Medicaid accrual we inquired of management as to the accuracy of the prior year accrual. We noted that management did not have a process in place to prepare and review a retrospective analysis of the prior year Medicaid accrual. We requested an analysis from management and were able to obtain one for fiscal years 2010 and 2011, and noted that the retrospective analysis indicated that the nursing home portion of the accrual may be overstated by approximately $10 million at September 30, 2012 and 2011, respectively.

Additionally, we noted that through consultation with a KPMG actuarial specialist, the liability recorded for Diagnosis Related Group (DRG) Hospital claims and non-cost reporting claims may be understated as of September 30, 2012 by approximately $3.8 million for the Federal share. For DRG Hospitals and non-cost providers, DHCF records an estimate for incurred but not received claims based on historical payment data for the 12 month period extending beyond September 30th. The 12 month window is based on the Medicaid State Plan requirement that District providers submit claims within 6 months in order to be reimbursed, and out-of-District providers submit within one year. The audit difference presented by the KPMG actuary represents the portion of Medicaid claims that may be received from these providers and paid subsequent to the 12 month window. While unusual it is possible for claims from DRG Hospitals and non-cost providers to be received and paid subsequent to the 12 month window.

**CRITERIA:**

Yellow Book, Appendix I, section A1.08d., states that 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/EFFECT:**

The District does not have a process/monitoring control in place to perform a retrospective analysis of the prior year Medicaid accrual.

Lack of documented policies and procedures to review the prior year Medicaid accrual could result in incorrect assumptions and considerations used to estimate the liability. According to the retrospective analysis performed by the District for FY 2011 and 2010, the nursing homes portion of the accrual may be overstated by approximately $10 million. Additionally, the Federal share of the Medicaid accrual could be understated by approximately $3.8 million according to the KPMG actuarial analysis.

**RECOMMENDATION:**

We recommend that the District develop and implement a process by which they formally review the prior year Medicaid accrual in order to evaluate how the assumptions and considerations impact the accrual and the accuracy of the liability on an annual basis.

**MANAGEMENT RESPONSE:**

Although DHCF agrees with the facts as described in the Condition, we note that the net effect of finding that the nursing home accrual may be overstated and the non-cost reporting accrual may be understated is a possible overstatement of $5 million, or less than 2%, of the approximately $240 million Medicaid accrual.

That being said, DHCF will conduct a retrospective analysis of the Medicaid accrual in the future, and use the result to adjust the assumptions used for the accrual, if necessary.

f. Insufficient Review of System Interface Between ACEDS and MMIS

**CONDITION:**

During our tests of operating effectiveness of internal controls over the interface between the Automated Client Eligibility Determination System (ACEDS) and the Medicaid Management Information System (MMIS), we noted that the following two (2) out of forty (40) interface issues were not corrected in a timely manner:

| # | Case Number | Action/Change Needed | Correction Memo Date | Date Corrected |
|---|---|---|---|---|
| 1 | 293368 | 21yr old child is too old for AR Medicaid | 1/13/2012 | 12/6/2012 |
| 20 | 170205 | Child's eligibility code is 720 and needs to be changed. | 3/19/2012 | 8/30/2012 |

Additionally, we noted that was not able to provide physical copies for two (2) out of three (3) monthly Medicaid Program Error Memos to evidence review.

**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/EFFECT:**

Management does not have adequate policies and procedures in place to support the timely review and resolution of exceptions identified in the ACEDS to MMIS interface. Additionally, management did not follow up on whether the exceptions were corrected by program analysts in timely manner. Additionally, DHS management does not retain the documentation to support its review of the Medicaid Program Error Memos.

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

**RECOMMENDATION:**
We recommend that DHS implement formal policies and procedures that include processes for tracking and resolving exceptions identified through the interface. We also recommend that the District improve its monitoring controls to ensure that such policies and procedures are being consistently executed.

**MANAGEMENT RESPONSE:**
Management agrees that two (2) out of 40 case actions were not completed timely. Although all of the hard copies of memorandums were not located, evidence that controls were in place was supported by the confirmation of ACEDS action history (ACHI). In addition, printouts of the ACHI for each of the 40 cases were provided to the auditors.

Management will adjust the controls to include a central location for all memorandums and include monitoring to ensure timely actions.

g. Insufficient Review of Grants Disallowances Estimates

**CONDITION:**
During our testing of internal controls over management's review of the District's estimate of the grants disallowance liability at September 30, 2012, we noted that the Office of Financial Operations and Systems (OFOS) management has a formal process in place to review and revise the estimate each year in coordination with the Department of Healthcare Finance (DHCF), the Office of Integrity and Oversight (OIO), and other agencies. However, management does not formally document the completion of their annual analysis.

**CRITERIA:**
Yellow Book, Appendix I, section A1.08d., states that 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/EFFECT:**
OFOS does not have formal policies and procedures in place related to the formal documentation of the completion of its annual review of the adequacy of the grants disallowance estimate to.

There is not a sufficient audit trail to support management's annual review of the estimate of potential grant disallowances.

**RECOMMENDATION:**
We recommend that the District enhance its current policies and procedures for formally documenting management's annual review of the grant disallowance estimate.

**MANAGEMENT RESPONSE:**
The District currently has policies and procedures requiring agencies to estimate and communicate potential grant disallowances or questioned cost to OFOS as part of the year-end closing requirements. Accordingly, agency personnel must review and analyze the grant disallowance liabilities each fiscal year and estimate potential questioned cost and/or disallowed

cost for the federal grant programs. Although OFOS requests and receives the agencies' grant disallowance closing packages, this information is provided to the Office of Integrity and Oversight (OIO) for review because the expertise that OIO possesses about the Single Audit adds significant value to the review process. OIO reviews the closing packages submitted by agencies, provides OFOS with the estimated grant disallowance amount, and collaborates with OFOS in determining the required adjustments to be made in the general ledger.

OFOS will enhance its current practices by documenting the completion of its review of OIO's assessment and other related analyses.

h. Insufficient Documentation for Provider Eligibility Files

**CONDITION:**

During our testing over provider eligibility for the Medicaid program, we noted the following 11 exceptions in 11 out of 95 provider files tested. Specifically, we noted the following:

- For three (3) providers, the provider agreements were not signed by the Department of Health Care Finance (DHCF).
- For two (2) providers, the provider's application and agreements were received but not signed.
- For four (4) providers, the file contained expired licensure documentation and evidence of a current license was not available for review.
- For one (1) provider, we were unable to obtain the provider's file.
- For one (1) provider, the original application was denied and returned to the provider. The provider file did not include a signed and approved application.

**CRITERIA:**

Yellow Book, Appendix I, section A1.08 d., states that 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.

Title XIX of the Social Security Act requires that the District 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/EFFECT:**

Deficiencies in DCHF's internal control over compliance and in its process for maintaining current information to support Medicaid provider eligibility.

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

**RECOMMENDATION:**

We recommend that DCHF, in coordination with its service provider, improve the internal controls and process for maintaining current information to support Medicaid provider eligibility.

**MANAGEMENT RESPONSE:**

DHCF concurs with the finding and will work to improve the internal controls and process including a quarterly Quality Assurance audit to ensure provider files are current and have sufficient documentation.

i. Insufficient Documentation for Beneficiary Files

**CONDITION:**

During testing over beneficiary eligibility for the Medicaid and Supplemental Nutrition Assistance Program (SNAP), we noted the following:

- For nine (9) out of 106 Medicaid beneficiary cases, ESA was unable to provide sufficient documentation to support the eligibility determination during audit fieldwork.
- For five (5) out of 95 SNAP beneficiary cases, ESA was unable to provide sufficient documentation to support the eligibility determination during audit fieldwork.

**CRITERIA:**

Yellow Book, Appendix I, section A1.08 d., states that 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.

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

ESA Policy Manual Section: *STANDARDS FOR CASE RECORD DOCUMENTATION 1.3* states the following; "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/EFFECT:**

The condition is due to deficiencies in the District's internal controls and process for maintaining case record documentation.

The District is not in full compliance with District and Federal program compliance requirements surrounding records maintenance.

**RECOMMENDATION:**

We recommend that the District follow their 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 scanning all beneficiary files into the Document Imaging Management System (DIMS) to allow for the files to be available electronically.

**MANAGEMENT RESPONSE:**
Management concurs with finding and the associated recommendation.

6. Revenue
   a. Inadequate Segregation of Duties in Recording Cash Receipts

**CONDITION:**
During our testing of cash receipts at the District of Columbia Office of Finance and Treasury (OFT), we noted that two (2) out of 130 System of Accounting and Reporting (SOAR) vouchers tested were recorded and authorized by the same person

**CRITERIA:**
Yellow Book, Appendix 1, section A 1.08 d., states that 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.

Per the District Office of Chief Financial Officer (OCFO) Policies and Procedures Manual, a strong system of internal control is required due to the "relatively high risk associated with transactions involving cash." Further, "segregation of duties must be the first priority of an agency when handling cash receipts and disbursements and record-keeping functions."

**CAUSE/EFFECT:**
OFT did not enforce its established policies and procedures for the separation of the recording and authorization functions. If segregation of duties is not enforced, the SOAR Vouchers used to record cash receipts and the related revenue classifications could be erroneous and/or fraudulent.

**RECOMMENDATION:**
We recommend that OFT improve its controls to ensure that there is appropriate segregation of duties in the processing of cash receipts. We also recommend that OFT re-emphasize its established policies and procedures over record retention and maintenance of cash receipts supporting documentation.

**MANAGEMENT RESPONSE:**
Management concurs with the finding and recommendation.

   b. Failure to Accrue for Real Property Tax Appeals Cases Settled But Not Paid and Inaccurate Case Data Used in Estimate of Real Property Tax Appeals Estimates

**CONDITION:**
The Office of Tax Revenue has identified real property tax appeal cases with settlement amounts of approximately $2 million that have been settled in District Superior Court as of September 30, 2012 but for which the District has not yet remitted payment. These claims represent liabilities of the District, but were not considered for accrual in the government-wide or general fund financial statements at fiscal year end until brought to the District's attention.

Additionally, we noted 18 out of 50 “pending” cases sampled that were initially included in the District’s analysis of settlement payments from Real Property Tax Appeals claims were “closed” as of September 30, 2012, according to the records of the District Superior Court.

**CRITERIA:**

Yellow Book, Appendix I, section A1.08 d., states that 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.

Governmental Accounting Standards Board Codification 1500.107 states:
“This concept of current liabilities should include estimated or accrued amounts that are expected to be required to cover disbursements within the year for known obligations […]”

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/EFFECT:**

The District’s current practice is to recognize the settlement of real property tax appeal cases in the period when paid instead of when the appeal has been settled. The District’s accrual for real property tax appeals in the draft government-wide and general fund financial statements was initially understated by approximately $2 million as of September 30, 2012. The District subsequently recorded a correcting journal entry for this amount as of September 30, 2012.

The District recorded an accrual entry in the government-wide financial statements based on information from the OAG case management system without thoroughly evaluating the completeness and accuracy of the information. The District recorded an adjustment in the amount of $58 million to account for outstanding Superior Court Appeals as of September 30, 2012. While we do not believe the District’s accrual at September 30, 2012 is materially misstated in the government-wide financial statements, we do believe that continuing to use the OAG case management system without performing additional procedures to ensure the completeness and accuracy of such data increases the risk that future estimates could be materially misstated.

**RECOMMENDATION:**

We recommend that the District consider real property cases that have been settled but not yet paid at fiscal year-end in its process for recording accruals for real property tax revenues in the general fund as well as the government-wide financial statements as of fiscal year end.

We also recommend that the District implement a process to ensure the completeness and accuracy of case information as a part of its policies and procedures for recording an estimate of the ultimate settlement payments related to outstanding Superior Court Real Property Tax Appeals.

**MANAGEMENT RESPONSE:**

Management concurs with the auditor's comments and recommendation. The Real Property Tax and Revenue Accounting Administrations will adjust year end procedures and work papers to identify and accrue the real property cases that have been settled (by Court Order), but not yet paid, at fiscal year end.

Management concurs that the data received from the OAG was out of date, and the resulting impact to the estimated accrual was calculated and found to be approximately $4 million. Although this is slightly less than 7% of the original estimate, OTR does not believe this is a material misstatement given the many unknowable factors that will eventually lead to settlements or judgments in these cases. OTR will implement policies and procedures to ensure its case status information is accurate and complete by working with the OAG to develop and maintain a database that includes information directly from the Superior Court of the District of Columbia.

c. Inadequate Review of Applicants Eligible for Homestead Deduction

**CONDITION:**

During our testing of real property tax revenue, we identified four (4) properties out of a sample of forty-one (41) that received the Homestead deduction in FY2012 but were ineligible for the benefit.

**CRITERIA:**

DC ST § 47-850 *Residential property tax relief--Homestead deduction for houses and condominium units* states the following:

(a) For purposes of levying the real property tax during a tax year, the Mayor shall deduct $67,500, increased annually, beginning October 1, 2012, by the cost-of-living adjustment (if the adjustment does not result in a multiple of $50, rounded to the next lowest multiple of $50), from the assessed value of real property which qualifies as a homestead. The deduction shall be apportioned equally between each installment during a tax year and shall not be carried forward or carried back.

(b) To qualify the homestead and receive the deduction, the individual shall complete and file with the Mayor an application in a form prescribed by the Mayor. The individual shall certify, under penalty of perjury, the information provided on the application form and the application form shall be filed in the manner prescribed by the Mayor. The Mayor may require the individual to provide any information which the Mayor considers necessary, including all taxpayer identification numbers of the individual, any other owner, any person with legal or equitable title, and any person in the household of the individual. The Mayor may also require the individual, any other owner, any person with legal or equitable title, and any person in the household of the individual to supply information after the homestead has been granted to determine whether the real property remains a homestead and entitled to the deduction.

(c) If a properly completed and approved application is filed during the period October 1 through March 31 of the tax year, the real property shall receive the deduction for the entire tax year. Notwithstanding subsection (a) of this section, if a properly completed and approved application is filed during the period April 1 through September 30, the real property shall receive 1/2 of the deduction for the second installment only.

(d) An individual may only claim one lot as a homestead. If a homestead comprises more than one lot, the deduction may only be applied against the estimated market value of one lot and the other lots shall not receive the deduction. Only one person in a household shall be entitled to claim a homestead in the District.

(e) The real property tax bill shall indicate whether the real property is receiving the deduction.

Yellow Book, Appendix I, section A1.08 d., states that 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/EFFECT:**

Although changes in ownership or other events may trigger the discontinuance of a Homestead deduction, the Real Property Tax Administration (RPTA) within OTR does not conduct comprehensive audits or re-confirmations with taxpayers annually to determine the taxpayers continued eligibility to receive the Homestead deduction.

Ten percent of our sample of 41 was ineligible to be receiving the Homestead deduction. Upon notice, RPTA removed the invalid deduction from the taxpayers' accounts, which resulted in an increase in taxpayer liabilities in the amount of $3,794. Inadequate internal controls over taxpayers continuing eligibility to receive the Homestead deduction increases the likelihood of ineligible recipients and may result in an understatement of real property tax revenue and related receivables. In addition, the District is at increased risk of non-compliance with applicable laws and regulations.

**RECOMMENDATION:**

We recommend that OTR strengthen its policies and procedures regarding the review of existing Homestead deductions. While RPTA sends out reconfirmation notices (audit letters) regularly to property owners whose deductions are identified as potential errors through the portfolio audit or audits on new applicants, additional audits or procedures could decrease the number of ineligible residents receiving the Homestead deduction.

**MANAGEMENT RESPONSE:**

OTR concurs with the finding and recommendation.

RPTA subjects the Homestead portfolio and those receiving the deductions to audits that are conducted throughout the year. Reconfirmation notices (audit letters) are regularly sent out to property owners whose properties and deductions are identified as potential errors through the portfolio audit or audits on new applicants.

OTR has long recognized the risk associated with insufficient monitoring of Homestead tax credits and has established a robust audit process for the review of existing Homestead deductions.

There are currently 93,174 parcels receiving the Homestead and/or senior benefit (75,022 Homestead and 18,152 Senior Citizen). In order to address the complex audit requirements for this large volume of properties, RPTA conducts a series of comprehensive audits throughout the year which are designed to reduce the number of potentially invalid deductions that are identified by different audit processes, both the portfolio audit and new applicant audit.

RPTA has implemented the following analytical reports/data sources to target the homestead population for the portfolio audit process:

Portfolio Audit:

- Comparative analysis against existing data to support domiciliary requirements, such as DMV, BOEE and tax records.
- Multiples Report: This report is used to identify real property owners with more than one property that may be receiving the homestead and/or senior credit. Such properties are sent a reconfirmation letter.
- Sales Report: This report identifies changes in ownership that can potentially affect the invalid rolling over of the homestead and/or senior credit. The properties identified on this report are reviewed and audited.
- Senior /D40 Report: RPTA is developing a comparison of individuals currently granted senior credits against income tax returns. This report will provide critical income related data from the income tax returns data base, which is key in determining the eligibility for the senior credit (i.e. household income cannot exceed $100,000.
- BBL (Business License) Report: This report identifies licenses issued to real property owners that may be renting their home and receiving the homestead and/or senior credit.
- On-going audit of all properties on a five-year cycle.

New Applicants Audit:

- 6 month Audit Report: This report lists all parcels that were granted the homestead and/or senior credit six months within the previous six months. Properties that are identified as not having clear domicile indicators are subject to an audit. RPTA allows applicants six months for taxpayers to establish proper domiciliary requirements (i.e. driver's license, voter registration, etc.).

RPTA is committed to assuring that every property receiving the homestead and/or senior credit meets the necessary criteria set forth by DC Code. RPTA audited 35,835 parcels between 2010–2012, nearly a third of the entire population of properties receiving the homestead and/or senior credit. The above referenced audit effort demonstrates a strong and continuing commitment to audit every property every five years.

d. Inadequate Policies and Procedures to Fully Reconcile Income Tax Withholdings

**CONDITION:**

During our audit we noted that OTR does not have procedures in place to fully reconcile the tax withholdings reported by taxpayers to the withholding data received from employers. Similarly, OTR does not have a process in place to reconcile cash received for withholdings to the withholdings reported on an individual's income tax return.

**CRITERIA:**

Yellow Book, Appendix I, section A1.08 d., states that 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/EFFECT:**
OTR does not have sufficient policies and procedures in place to the reconcile tax withholding amounts.

OTR continues to strengthen its monitoring efforts over tax withholdings; however failure to fully reconcile withholdings amounts could lead to misstatements in revenue and an increased risk of fraud.

**RECOMMENDATION:**
OTR should strengthen its processes and controls to reconcile the taxpayer withholdings received to the taxpayer withholdings which are reported on individual taxpayer returns.

OTR should also implement processes and controls to reconcile the taxpayer withholdings reported with the withholding data submitted by employers.

**MANAGEMENT RESPONSE:**
OTR recognizes risks associated with reliance on taxpayer-provided information, including W-2 withholdings. A withholding match program which is a post-filing audit program will be pursued when the necessary automation and resources are in place. Due to resource constraints, no programming was completed on this project in FY 2012. However, OTR continues to recognize the risks associated with potential W2 fraud, and has in place compensating controls that provide significant mitigation for the risk of issuing fraudulent refunds.

Among these are:

- The Automated Fraud Prevention (AFP) program, which provides a real time data match between filed returns and the OTR data warehouse in order to verify identity, the presence of Unemployment Insurance filings or other wage information in the form of withholding or estimated tax payments, and previous tax filings. The W-2 matching program suggested would not stop fraudulent returns from being issued, but would detect items that would then become part of the audit division caseload. The AFP program provides more robust assurance that refunds are proper.
- Refund review based on dollar thresholds and other criteria, in which all return data for selected refunds is scrutinized in order to ensure that the refunds are correct.
- The Modernized eFile implementation, which will be implemented by January 30th, will support the electronic capture of W-2 data to support improved matching for the post-audit program when it is reinitiated. Real time data matching cannot be accomplished because of the variance between the time that taxpayers begin filing and the date when employer withholding must be reported. Additionally, some large employers (like the Federal government) and many small employers do not file withholding electronically, so there will always be some taxpayers for whom no automated matching can be accomplished. For this reason, OTR continues to believe that W-2 matching is a lower priority compliance project.

OTR also recognizes other risks associated with elongating the refund review cycle, including customer service/reputational risks, revenue risks associated with interest that is accrued when refunds are not issued within a 90-day timeframe, and fiduciary risks associated with the District holding monies due. OTR is confident that it has effectively managed all of the risks cited here and does not agree that additional W-2 to W-4 reconciliation work is warranted at this time.

e. Implement 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 process in place to prepare and review a retrospective analysis of the prior year accrual. Management subsequently provided an analysis for September 30, 2012 and 2011, respectively.

**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/EFFECT:**

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.

Lack of formalized policies and procedures to review the accuracy of the accrual 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 against actual refunds data in order to evaluate the accuracy of the accrual. While OTR estimates refunds payable based on historical information, a "look-back" analysis could improve the accuracy of the estimate.

**MANAGEMENT RESPONSE:**

Management recognizes the risk of potential misstatements in the District's annual financial report, but does not concur that the absence of this additional procedure increases the risk of an inaccurate estimation of outstanding income tax refund liability.

The current estimation process, which is clearly spelled out in procedures for the development of the revenue lead sheet, requires using actual data on refunds issued over the last five years. This averaging process effectively smoothes the peaks and valleys that may occur from year to year, and is therefore less susceptible to economic trends and other factors that might cause volatility and "mis-estimation" of the refund liability from year to year. Management does not believe that the suggested analysis would improve the accuracy of the estimation or add value to the existing procedures.

f. Inadequate policies and Procedures to review Financial Information from the Ambulance Service Provider

**CONDITION:**

During our testing of accounts receivable for related to Emergency Medical Services (EMS) transport we noted that the District does not have policies and procedures in place to review the Statement on Standards for Attestation Engagements (SSAE) No. 16 *Reporting on Controls at a Service Organization* report from the service organization. In addition, we noted that controls were not in place at the District Fire and EMS (FEMS) department to review the monthly Management Summary Reports that are available from the service organization that reflect financial activity. Further, we also noted that the allowance for doubtful accounts recorded by the

District is calculated based on estimated collection rates at the time the receivables are recorded, but the estimate is not updated annually to consider additional uncollected amounts in the allowance.

**CRITERIA:**
Yellow Book, Appendix **I,** section A 1.08 d., states that 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/EFFECT:**
FEMS does not have policies and procedures in place to review the Service Organization's SSAE 16 report and to adequately review the monthly Management Summary Reports from the service provider for reasonableness before recording amounts into the general ledger. Additionally, FEMS does not conduct a retrospective "look-back" analysis in order to evaluate the accuracy of the allowance for doubtful accounts.

FEMS may not be aware of material findings or changes in the control environment at the service organization if it does not review the SSAE 16 report. Also, failure to obtain and review the monthly reports that are available from the service provider for reasonableness before recording general ledger journal entries could result in misstatements in the financial statements.

**RECOMMENDATION:**
We recommend that FEMS design and implement a process to formally review the SSAE 16 report in order to evaluate any deficiencies and user control considerations in the report. 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 accuracy of the methodology. Additionally, we also recommend that the FEMS implement a process to obtain and review the monthly reports from the service provider for reasonableness before recording the journal entry to reflect revenues and accounts receivable in the general ledger.

**MANAGEMENT RESPONSE:**
We disagree with the finding as it relates to the monthly collections provided by the service provider and concur with the lack of policies and procedures to review the SSAE 16 report.
The monthly report referenced in this finding, the Management Summary Report (MSR), was not provided to the OCFO by the service provider. However, the service provider has routinely submitted to the OCFO a separate report with its invoice and monthly revenue documents, which are reconciled with the deposits from the bank.

With respect to the review and adjustment of the annual receivable and allowance for doubtful accounts, we will refine the procedures to include a “look-back” based on the MSR provided by the service provider. We will develop policies and procedures that require the review of the service provider's SSAE 16 report.

g. Inadequate Policies and Procedures to Review Receivables and Deferred Revenue for Housing Loans

**CONDITION:**

During our testing of accounts receivable for the Department of Housing and Community Development and the Deputy Mayor for Economic Development we noted:

- A difference between net loans receivable and deferred revenue for the Housing Assistance Programs of approximately $8.2 million, and;

- A long-term note receivable with an outstanding principal balance of approximately $13.6 million and accrued interest of approximately $5.2 million that continues to be reflected as an asset in the General Fund as of September 30, 2012 even though the terms of the agreement do not require repayment to until 2017.

**CRITERIA:**

Yellow Book, Appendix **I,** section A 1.08 d., states that 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.

According to GASBS No. 33, *Accounting and Financial Reporting for Non-Exchange Transactions*, for revenue recognition to occur on the modified accrual basis, the revenues should be available. "Available" means that the government has collected the revenues in the current period or expects to collect them soon enough after the end of the period to use them to pay liabilities of the current period.

**CAUSE/EFFECT:**

The District's year-end closing process does not address discrepancies between loans receivable and deferred revenue for the Housing Assistance Programs. For the note receivable, the District contemplated the long term nature of the asset, but elected not to record an adjustment in FY2012 as the adjustment was considered immaterial.

Deferred revenue is understated by approximately $8.2 million and fund balance is overstated by$8.2 million in the general fund as of September 30, 2012. Other long-term assets are overstated by approximately $13.6 million, accounts receivable are overstated by approximately $5.5 million, and fund balance is overstated by approximately $19.1 million f in the general fund as of September 30, 2012.

**RECOMMENDATION:**

We recommend that the District implement policies and procedures at fiscal year-end to address discrepancies in the relationship between loans receivable and deferred revenue. We also recommend that the District assess whether or not it is appropriate to be carrying the long-term note receivable and related accrued interest in the general fund now that the due date has been extended to 2017.

**MANAGEMENT RESPONSE:**

Management concurs with the finding and recommendation.

h. Inadequate Review of Components of the Allowance for Doubtful Accounts

**CONDITION:**
During our testing of accounts receivable and the related allowance for doubtful accounts in the general fund we noted a credit balance of approximately $19.6 million that should have been recorded in the Due from the Federal Government.

**CRITERIA:**
Yellow Book, Appendix **I,** section A 1.08 d., states that 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/EFFECT:**
The District's current policies and procedures related to the review of the components of the allowance for doubtful accounts were not sufficient to detect the misclassification.

Accounts Receivable was understated by approximately $19.6 million and Due from the Federal Government was overstated by approximately $19.6 million as of September 30, 2012, prior to management correcting this misclassification.

**RECOMMENDATION:**
We recommend that the District implement policies and procedures to review all components of the allowance for doubtful accounts at fiscal year end.

**MANAGEMENT RESPONSE:**
Management concurs with the finding and recommendation.

7. Loans Receivable
   a. Inadequate Controls over Loans Receivable

**CONDITION:**
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). In addition, the annual reconciliation between the loans recorded by the DHCD and ACS is not properly designed and implemented to ensure the ending balance of loans receivable is properly reconciled for recording in the financial statements. We also noted that DHCD does not have policies and procedures in place for a documented review and approval of the final reconciliation. Further, based on our review and re-performance of the reconciliation and calculation of the related allowance, we noted the following errors as a result of unsupported adjustments and reconciling items between the data maintained by both the District and ACS:

- A $3 million overstatement of the loans receivable in the HPTF.
- A $3.3 million understatement of accounts receivable in the FPRF.
- A $3 million overstatement of loans receivable in the General Fund.

Additionally, the process for recording loans receivable and the related allowance for doubtful loan collections is not sufficient to ensure the amount recorded is accurate at fiscal year end. Specifically, during our testwork over a sample of 12 loans recorded by ACS in FY 2012 totaling $42.1 million for HPTF, we noted the following related to the accuracy of the loans receivable balance as a result of not recording loans timely:

- 10 of 11 loans recorded in FY 2012 in the amount of $41.5 million, were disbursed prior to FY 2012 and as such were not recorded in the appropriate fiscal year.

During our testwork over a sample of 4 new loans in FY 2012 totaling $7.2 million in the FPRF, we noted the following related to the accuracy of the loans receivable balance as a result of not recording loans timely:

- 2 of 4 loans recorded in FY 2012 in the amount of $5.7 million, were disbursed prior to FY 2012 and as such were not recorded in the appropriate fiscal year.

During our testwork over a sample of 3 new loans in FY 2012 totaling $287,500 in the General Fund, we noted the following related to the accuracy of the loans receivable balance as a result of not recording loans timely:

- 1 of 3 loans recorded in FY 2012, per the ACS loan portfolio, in the amount of $275,500, were inappropriately included in the FY 2012 receivable balance since the loan had been paid off in a previous fiscal year.

In addition, during our testwork over a sample of 5 new loans in the first quarter of FY 2013 totaling $12 million, we noted the following related to the accuracy of the loans receivable balance as a result of not recording loans timely:

- 2 of 5 loans recorded in FY 2013, related to the FPRF, had disbursements in FY 2012 totaling $4.4 million, and as such should have been recorded in the financial statements as of September 30, 2012.
- 2 of 5 loans recorded in FY 2013, related to the HPTF, had disbursements in FY 2012 totaling $2.4 million, and as such should have been recorded in the financial statements as of September 30, 2012.

Finally, based on an analysis performed by the District of all FY 2012 loan expenditures in the HPTF, an additional $7 million of loans were disbursed in FY 2012 that were not recorded in loans receivable as of September 30, 2012.

**CRITERIA:**

Yellow Book, Appendix **I,** section A 1.08 d., states that 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/EFFECT:**

The District has not developed sufficient policies and procedures to ensure loans are recorded timely in the Fund financial statements following loan execution and funds disbursement.

Furthermore, the District lacks a complete and formalized reconciliation and financial reporting process to adequately explain and support reconciling items between the District's records and the records of the third-party service provider. We noted that in prior years, a single individual within DHCD was responsible for performing the loans receivable reconciliation. In FY 2012, this individual retired and a transition plan was not fully implemented prior to issuance of the financial statements. Without effectively designed and implemented internal controls over the financial reporting process for loans receivable, misstatements in other long term assets and accounts receivable balances may not be prevented or detected in a timely manner.

**RECOMMENDATION:**
We recommend the District enhance current policies to record the loans receivable and related allowance to ensure procedures are implemented to include, but are not limited to the following:

- Update policies and procedures to ensure that loans disbursed in the current fiscal year are appropriately and timely recorded to reflect the associated receivable versus all receivables being recorded at year-end.

- Reconciling new loans recorded by DHCD and the third-party service provider on a periodic basis, rather than only at year-end.

- Recording loan disbursements in the general ledger with a unique expenditure attribute in order to facilitate reconciliation with recorded receivables.

**MANAGEMENT RESPONSE:**
Management concurs with the finding and recommendation.

8. Inadequate Documentation of New Hires and Terminated Employees

**CONDITION:**
During our controls testwork over new employee hires and terminations, in which we tested 40 new hires and 40 terminations, we noted the following:

- One of the 40 termination files was unable to be provided;
- In addition, seven of the 40 termination samples and one of the 40 new hire samples did not have a reviewer's signature on the Standard Form-50, *Notice of Personnel Action* (SF-50). Of the eight total samples, six were under the authority of the Mayor and two were related to Independent Agencies, the Board of Elections and the Office of the Attorney General, and were not under the authority of the Mayor. KPMG notes that six of the seven SF-50s were reviewed and signed subsequent to our review of the SF-50s; however, the exceptions remain as the SF-50s were not signed at the time of our testwork.
- Two of the 40 new hire samples, which were both from the Board of Elections, did not have an offer letter supporting the information on the employee's SF-50; specifically the employees' grade, step, salary, title, effective date, and other identifying information was missing.

**CRITERIA:**
The *Government Auditing Standards* or *Yellow Book, Appendix I, section A1.08 d.* states that 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/EFFECT:**
Appropriate Human Resource (HR) designees/reviewers are not adequately evidencing their timely, accurate, and complete reconciliation (review and investigation of noted discrepancies) for new hires and termination transactions by signing the SF-50s. The failure to perform timely, accurate, and complete reviews could allow incorrect payroll data to be recorded in PeopleSoft, the District's integrated Human Resources management system, resulting in a misstatement in the District's payroll records.

**RECOMMENDATION:**
We recommend that controls are strengthened at both the Independent Agency and the District of Columbia's Human Resource (DCHR) level. Personnel authorities should emphasize to the respective HR designees at the District's Independent Agencies that all new hire and termination documents, specifically SF-50s, need to be reviewed in a timely manner to ensure the information is accurate and appropriately documented in PeopleSoft as well as in the employee's personnel file. Similarly, the review process should be emphasized during trainings for all HR personnel to ensure that the name, effective date, and other identifying information agrees with the new hire and termination letters as well as other appropriate documentation.

**MANAGEMENT RESPONSE:**
Management does not concur with the finding in its entirety. Specifically, management notes that:

- One of the 40 termination files could not be provided because it was a worker's compensation case that is handled by a third party. DCHR obtained and provided supporting documentation to the auditors which demonstrated that the official personnel file for the sampled employee had been requested by the third party.
- The auditors found that seven of the terminations and one of the new hire official personnel folders did not have the signed SF-50s. One of the termination OPFs cited was for the same employee referred to in the response above. We subsequently provided the auditors with signed SF-50s not as evidence to be included for testing purposes, but rather, as mitigating evidence to show that the SF-50s were reviewed.
- One of the new hire samples was a Wages As Earned (WAE) temporary employee for an independent agency. It is not in the agency's practice to provide offer letters for temporary staff.

DCHR continues to strengthen its processes and has incorporated into the FY 2013 Agency Performance Plan, key initiatives and performance measures aimed at tightening controls and monitoring adherence to the processes and procedures related to the official personnel folders. As part of this plan DCHR has taken an aggressive undertaking to assess and reengineer its Records Management Program.

9. Inadequate Management Review of Statements on Standards for Attestation Engagement (SSAE) 16 Reports

**CONDITION:**
During our testing of internal controls over management's review of the FY 2012 SSAE 16 Reports, for several service organizations, including Medicaid Management Information Systems from Xerox, Inc., Wells Fargo, Fidelity National Information Services, Sedgwick and JP Morgan Chase, we noted that management does not perform a formal review over the reports in order to address the potential control risks associated with control deficiencies identified in the report, and to adequately consider end user controls.

**CRITERIA:**
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/EFFECT:**
The District does not have formal policies and procedures in place that address how management's review and consideration of the SSAE 16 Reports should be performed and documented. Without documented procedures in place to review SSAE 16 reports to ensure that any deficiencies noted do not impact the information being processed by these service organizations on the District's behalf, the District would not be aware of any material findings which may result in compromising the integrity of the data received by these service organizations and relied upon by the District to make financial decisions and calculations.

**RECOMMENDATION:**
We recommend that the District design and implement a process by which it formally obtains and reviews all SSAE 16 reports to evaluate the deficiencies and end user entity considerations noted in the individual reports, and how any identified deficiencies may impact the District to ensure the appropriate controls are in place at the District to mitigate those deficiencies.

**MANAGEMENT RESPONSE:**
Management concurs with the finding and recommendation.

10. District of Columbia Public Schools
    a. Inadequate Documentation for Some New Hires

**CONDITION:**
During our testing of new hire employees, we noted that there were exceptions found for 8 of 45 new hires sampled. Specifically, we noted:

- One sampled item for which the offer letter contained two separate salary amounts ($15.00 per hour and $34.00 per hour). As such, we were unable to determine which rate was being offered to the employee.
- One sampled item for which the offer letter could not be provided.
- Four sampled items for which support, including an EPSI Form and Offer Letter could not be provided for our review.
- Two sampled items for which the Official Personnel File (OPF) could not be provided.

We noted that the amounts reflected in PeopleSoft represented the correct amounts, as these amounts agreed to the salary amount for the employee's grade and step for the approved pay scales for their positions.

**CRITERIA:**
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/EFFECT:**

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

**RECOMMENDATION:**

We recommend that DCPS follow its established policies and procedures and strengthen their internal controls in place over the review of the salary amount per the offer letter to ensure that the salary amounts documented in the offer letters are in agreement with the amounts per EPSI form and salary amount generated in PeopleSoft. Should the salary amount change subsequent to the offer letter being sent to the employee and the information being entered in the system, some sort of documentation should be kept in the employee's personnel file to indicate this change.

**MANAGEMENT RESPONSE:**

Management concurs with the finding and recommendation that DCPS should follow its established policies and procedures to the letter. DCPS is in the process of implementing an automated system for processing new hires. Upon full implementation, offer letters and acceptances will be retained in the system, which will "push" the information into the employee's PeopleSoft record. The system is currently in use for most school-based positions, but has not yet been implemented for Central Office hires and such programs as After School and Substitutes. Changes currently being created in the system are designed to increase its functionality, efficiency, and accuracy. These changes will help maximize internal controls over new hire records.

b. Inaccurate Benefit Deductions

**CONDITION:**

During FY 2012, DCPS had a total of $ 663,834,449.55 of personnel and benefit disbursements. During our testwork over a sample of 594 payroll disbursements totaling $2,427,794.79, we noted that for 10 transactions tested amounting to $41,097.62, the employee's payroll deduction did not agree to the rate per the benefit handbook. Specifically, we noted:

- For seven employees, the deduction withheld from the employee's pay was less than the specified rate per the benefit handbook for the related benefit elected resulting in a total overpayment to employees totaling $45.89.
- For three employees, the deduction withheld from the employee's pay was greater than the specified rate per the benefit handbook for the related benefit elected resulting in a total underpayment to employees totaling $115.65.

**CRITERIA:**

Yellow Book, Appendix I, section A1.08 d., management of an 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/EFFECT:**
DCPS employees elect benefits in PeopleSoft and the related amounts are deducted from their paycheck through a system-driven calculation. DCPS Human Resources (HR) does not perform a review to ensure the benefit amounts being deducted are the correct amounts per the monthly/bi-weekly premium for the benefit elected, nor do they do any review to ensure that deductions are properly and timely being withheld from employee's paychecks. Without proper controls in place to verify that the deduction being withheld is accurate and timely, an incorrect amount could be withheld from the employee's pay. In addition, this practice could lead to errors in the employee's benefit elections as well as DCPS paying premiums for employees who have not elected coverage.

**RECOMMENDATION:**
We recommend that DCPS HR perform a review of all information entered into PeopleSoft to ensure the amount being withheld from the employee's paycheck agrees to the premium pursuant to the benefit handbook for the benefit elected by the employee and is being withheld in a timely manner from the employee's paycheck. In addition, we recommend that DCPS and DC HR perform reviews of the benefit tables within PeopleSoft to ensure accurate calculations are being maintained.

**MANAGEMENT RESPONSE:**
Management concurs with the auditor's finding and recommendation.

The rate table provided in the Benefits User Guide was provided to DCPS by the DC Office of Human Resources (DCHR). The insurance rates are loaded into PeopleSoft by DCHR and the Office of the Chief Technology Officer (OCTO). The DCPS Office of Human Resources (DCPS-OHR) will work with OCTO to create a report which notifies DCPS-OHR of all benefits loaded, deductions assigned and calculations made during a specific period of time. DCPS-OHR will manage quality control of the benefits deduction process, by reviewing and assessing this report periodically to ensure that deductions are consistent with the rate table and final calculations are accurate based upon type of coverage. When errors are uncovered, DCPS-OHR will work with DCHR, OCTO and the Office of the Chief Financial Officer (OCFO) to ensure that corrections are made in PeopleSoft and deductions are accurately reflected in the employees' paychecks. In the event of an inaccurate deduction, the DCPS HR will notify the employee and make the correction.

c. Inadequate Review of Employee's Salary and Rate of Pay

**CONDITION:**
During our testwork over a sample of 594 payroll disbursements, we noted that for 6 transactions tested amounting to $12,492.53 the employee's pay was not properly supported by appropriate documentation or the employee received the incorrect pay based on the supporting documentation provided.

Specifically, we noted the following:

- For six (6) of the 594 employee pay rates tested, our recalculated amount did not agree to the proper pay scale and the rate per PeopleSoft and the employee's pay check.

- Five (5) of these differences were related to retro-active payments that were identified to be paid to employees; however these payments were not processed during FY 2012. This resulted in an underpayment to employees of a total of $498.08 in gross pay for the employees sampled. Although the employee was ultimately paid through the retro-active pay process, these underpayments created timing differences at year-end.
- One (1) of these differences was related to an improper pay rate being used. This resulted in an overpayment to the employee of $162.19 in gross pay.

**CRITERIA:**

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/EFFECT:**

Throughout the year an employee may gain a promotion or obtain a new certification (Master's Degree, Ph.D, etc.) that will affect their yearly salary. These changes may be reflected in PeopleSoft immediately; however, the change is not reflected on the employee's paycheck until a subsequent pay period since the actual payment process, generally due to paperwork, takes longer. This results in retro-active payments being made to the employee, which if not timely identified prior to year-end, can result in understatement of payroll expenditures.

In addition, for a portion of the discrepancies in pay rates, a new principal's pay scale that was used to assign employee pay rates in PeopleSoft were not properly reflected in the employee's paycheck. Therefore, employees received either Additional Income Assistance (AIA) to fill the gap between the salaries per the new pay scale until it was adjusted, and/or were to receive retroactive payments when approved and funding was available. However, this process was not performed timely and resulted in the employees not receiving the correct pay until after the fiscal year end.

Without proper internal controls in place to ensure that adjustments due to employees are properly and timely processed, and that pay rates are accurately entered into the payroll system, payroll expenditures could be misstated. Additionally any retroactive payment related to these adjustments need to be requested and processed in the correct fiscal year.

**RECOMMENDATION:**

We recommend that DCPS strengthen their internal controls to ensure that employee salary adjustments are processed timely and accurately to ensure employees receive the correct pay timely. We also recommend that DCPS regularly review outstanding retroactive payments due to employees, especially those that have been outstanding for the majority of the fiscal year, to ensure that any delays are cleared quickly so that employees are paid accurate amounts and to ensure that overall payroll expenses are recorded accurately.

**MANAGEMENT RESPONSE:**

Management concurs with the finding and recommendation.

In November 2012, DCPS instituted an internal audit process to identify pay rate errors and correct them more quickly. The intended result is clean PeopleSoft compensation data. The audit will verify pay plan, pay grade, step, step progressions and other pay-related data fields for all current employees. Each fall, we will review each new hire record for the same information so that we may more quickly identify discrepancies. If discrepancies are identified, they will be immediately corrected and requests for retroactive pay will be immediately submitted to the payroll division. Once the records have been scrubbed, the need for future retroactive payments will decrease and more timely processing of remaining payments can be made.

d. Lack of Controls Over Termination Dates in PeopleSoft

**CONDITION:**
The termination process can be initiated from various sources. A letter from Labor Management and Employee Relation (LMER) can be sent as a termination request. If the termination is a resignation, a resignation or separation letter will be received by District of Columbia Public Schools (DCPS) Human Resources (HR) for the request to be processed. If the termination is due to the ending of temporary employment, the final date of employment is noted in the offer letter. All termination request information is documented in the employee services tab in PeopleSoft. Then HR processes the request by entering in the employee ID #, role, termination reason code, and effective date.

During our testing of controls over terminated employees, we noted that for 2 of 45 terminations sampled, the termination date reflected in the termination request did not agree to the termination date recorded in PeopleSoft. Further, during FY 2012, we were not able to evidence review of the termination information by DCPS HR. As such, we were unable to verify whether the termination data entered into PeopleSoft had been appropriately reviewed. Additionally, the HR department could not provide the requested documents for 2 of the 45 terminations sampled and therefore testing over these samples could not be completed.

**CRITERIA:**
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/EFFECT:**
Although DCPS has a process in place requiring a review of the termination date entered in PeopleSoft to determine that there is a match between PeopleSoft and the Termination Letter, this review was not adequately performed for the 2 items noted above. Additionally, DCPS did not maintain adequate documentation for employees terminated during fiscal year 2012. Failure to perform a review of termination data entered into PeopleSoft to detect and correct inconsistencies can result in improper payments being made to the employee following termination, as well as inaccurate salary records being kept in the Official Personnel File (OPF).

**RECOMMENDATION:**
We recommend that DCPS follow its established policies and procedures and strengthen their internal controls in place over the review of the termination date per the termination request to ensure that the termination date documented in the requests are in agreement with the dates contained in PeopleSoft.

**MANAGEMENT RESPONSE:**
Management concurs with the finding and recommendation. Due to the manual nature of the process, the errors identified above represent human mistakes. As of December 1, 2012, changes were made to the procedures to include tasks such as peer reviews and data audits that will

mitigate future inaccuracies. Peer reviews will consist of HR Data Integrity employees reviewing the work of their colleagues each pay period before payroll processes. Data audits by the HR Data Analytics team will cross reference system generated reports and termination request documents as an additional measure to identify and correct errors before payroll processes.

e. Discrepancies Between Receiving Reports and Invoice Amounts

**CONDITION:**
In FY 2012, the District of Columbia Public Schools (DCPS) had a total of $212,574,854.51 in non-personnel disbursements. We noted that DCPS has procurement controls in place that require a three-way match be performed between the purchase order, invoice, and receiving report prior to payment to the vendor. During our testwork over a sample of 426 non-personnel disbursements totaling $37,065,265.71, we noted that for 20 disbursements amounting to $165,320.73, the amount and/or quantity of goods received per the receiving report differed from the amount and/or the quantity on the invoice.

**CRITERIA:**
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/EFFECT:**
In some cases, DCPS receiving handlers accept an entire order before actually receiving the entire amount. Therefore, items on backorder or services not yet provided by the vendor are marked as 'received' in the procurement system prior to the vendor invoicing DCPS and DCPS receiving those goods and services. DCPS' three-way match control is weakened if receiving handlers claim they received goods and services prior to actually receiving them. DCPS could be paying for goods and services they did not actually receive because the receiving handler approved the entire order at once.

**RECOMMENDATION:**
We recommend that DCPS strengthen their procurement controls to require receiving handlers to only accept actual quantities received on their receiving report. This will confirm that DCPS pays only for those goods and services that they actually receive.

**MANAGEMENT RESPONSE:**
Management concurs with the auditor's finding and recommendation. In order to ensure the consistent adherence to current DCPS policies, we will re-distribute the receiving report policy to the appropriate staff within DCPS and stress the importance of following the required procedures.

f. Inaccurate Coding to Object Codes

**CONDITION:**
During our testwork over a sample of 426 non-personnel disbursements, we noted five (5) disbursements totaling $569.82 where the transaction was posted to the incorrect object code in SOAR (DCPS general ledger). Per review of the invoice, we noted that the object code recorded in SOAR was not consistent with the type of goods and services provided.

**CRITERIA:**
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/EFFECT:**
DCPS personnel are not adequately reviewing vouchers to ensure object coding is correct prior to recording in SOAR. Although this has no impact on expenditures as a whole, expenditures are presented on the Budgetary Comparison Schedule by function, which is compiled and summarized by the expenditure's object code in SOAR. Without correctly recording transactions to the correct object code, expenditures could be presented under the incorrect function on the Schedule.

**RECOMMENDATION:**
We recommend that DCPS strengthen their controls over the proper review of vouchers prior to recording in SOAR to ensure that all expenditures are coded to the proper object code.

**MANAGEMENT RESPONSE:**
Management concurs with the finding and recommendation. We agree that all transactions should be coded to the appropriate object code. We will ensure that procedures related to the review of object codes prior to the submission and approval of requisitions and payment of vouchers are distributed to staff for improved adherence to stated requirements to enhance nternal controls.

g. Inadequate Controls Over Timesheet Approvals

**CONDITION:**
During our testwork over a sample of 594 payroll disbursements, we noted that for 3 transactions tested amounting to $4,951.36; the employee's time sheet was not approved by an authorized approver for that specific employee. Specifically, KPMG noted that the employee's time was approved by a PeopleSoft super user who had the ability to approve any employee throughout the District of Columbia Public Schools. Based on the results of the General Information Technology Controls, PeopleSoft was out of the scope for the FY 2012 audit based on control failures. As such, its application controls could not be relied upon. In order to determine if we could rely on electronic approvals, KPMG requested additional documentation to verify the reason for the electronic approval by the PeopleSoft super user. DCPS could not provide such documentation and as such we noted these exceptions.

**CRITERIA:**
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/EFFECT:**
DCPS employees must have their time approved within the system before the payroll department can process a check for that employee. If there is any reason that an approver is unable to approve

time within the system, super users within PeopleSoft can approve for any employee working for DCPS. The payroll department receives a paper timesheet which serves as documentation that the time was recorded and approved at the school. The payroll department employee reviews this and then approves the employee's time within the PeopleSoft system. DCPS Payroll department does not keep records of this documentation received. Without proper controls in place to verify that there is a legitimate reason for the super user employee to approve time, a super user could approve time that has not properly approved first by a supervisor. This could cause payment to the employee in an incorrect amount.

**RECOMMENDATION:**

We recommend that DCPS Payroll Department keeps sufficient documentation on file showing the reason for the super user approval of time within PeopleSoft.

**MANAGEMENT RESPONSE:**

We concur with the finding. Given that timekeepers and approvers only have the ability to enter and approve time for two pay periods (current and last) any time outside of this window is entered and approved by the QALs from copies of timesheets submitted and signed off by the employees' supervisor. We will revise our filing requirements to ensure that all documents are readily available for future audits to support proper centralized approval of all employee time.

Status of Prior Years' Findings and Recommendations

| PY Finding Number | Finding Description | FY 2012 Status |
|---|---|---|
| **Management Letter Comment (MLC) #1** | **Procurement and Disbursements** | |
| #1 A | Sole-source procurements:<br>• Lack of supporting documentation<br>• Lack of approvals | Repeated in Yellow Book Report as Material Non-Compliance |
| #1 B | Emergency procurements:<br>• Lack of supporting documentation<br>• Lack of approvals<br>• Noncompliance with Emergency Criteria | Repeated in Yellow Book Report as Material Non-Compliance |
| #1 C | Competitive procurements:<br>• Lack of supporting documentation<br>• Lack of approvals | Repeated in Yellow Book Report as Material Non-Compliance. |
| #1 D | Direct vouchers | Closed. |
| #1 E | Non-adherence to P-card policies and procedures | Repeated in Yellow Book Report as Material Non-Compliance |
| #1 F | Non compliance with District of Columbia Quick Payment Act | Repeated in Yellow Book Report as Material Non-Compliance |
| **MLC #2** | **Procurement Policies** | |
| #2 A | Lack of documentation over transactions that were “exceptions” to the OCP Procurement policy | Closed. |
| #2 B | Inadequate use of government funds | Closed |
| **MLC #3** | **Revenue** | |
| #3 A | In adequate policies and procedures over Office of Tax & Revenue (OTR) property tax appeals | Repeated in Yellow Book Report as a Significant Deficiency. |
| #3 B | In appropriate access rights for auditors in Compliance Administration within Integrated Tax System | Repeated in Yellow Book Report as a Significant Deficiency. |
| #3 C | Inadequate review of applicants eligible for Homestead Credit Tax | Repeated in MLC #6c. |
| #3 D | Insufficient internal control over tax withholding reconciliations. | Repeated in Yellow Book Report as a Significant Deficiency. |
| **MLC #4** | **Treasury** | |
| #4 A | In adequate documentation for SOAR vouchers related to the recordation of cash receipts | Repeated in MLC #6a. |
| #4 B | Untimely clearing of suspense account balances | Repeated in MLC #1c. |
| **MLC # 5** | **Grants Management** | |
| #5 A 1 | Insufficient documentation to determine beneficiary eligibility for Medicaid | Repeated in MLC #5b. |

| | | |
|---|---|---|
| #5 A 2 | Insufficient documentation to determine beneficiary eligibility for Child Health Insurance Program | Closed |
| #5 A 3 | Insufficient documentation to determine beneficiary eligibility for Temporary Assistance for Needy Families | Closed |
| #5 A 4 | Insufficient documentation to determine beneficiary eligibility for Supplementary Nutrition Assistance Program (SNAP) | Repeated in MLC #5i |
| #5 B 1 | Insufficient documentation to determine or support provider eligibility for Medicaid | Repeated in MLC #5h. |
| #5 C | Delay in issuance of Medicaid Audited Cost Reports | Repeated in MLC #5c. |
| #5 D | Inadequate review of Medicaid cost accrual | Repeated in MLC #5e. |
| #5 E | Inadequate audit documentation for SNAP revenue and expenditure balance | Closed. |
| **MLC # 6** | **Fixed Assets/Leases** | |
| #6 A | Inadequate lease presentation | Closed. |
| #6 B 1 | Insufficient policies and procedures to ensure Construction in Progress (CIP) is tracked on a project level | Repeated in the Yellow Book Report as a Significant Deficiency. |
| #6 B 2 | Insufficient policies and procedures to ensure supporting documentation exists to support the District's estimate that the average capital projects duration is 24 months. | Closed. |
| #6 B 3 | Insufficient policies and procedures in place to ensure fixed asset additions and disposals of real property are complete and recorded timely. | Repeated in MLC #4.c |
| #6 C | Inadequate inventory of fixed assets | Repeated in MLC #4a. |
| **MLC #7** | **Disability Compensation and Tort Liability** | |
| #7 A | Insufficient policies and procedures for developing and measuring estimates used for claim future reserve amounts for disability compensation | Repeated in MLC #3b. |
| #7 B | Insufficient support provided for Tort Liabilities (General & Auto) | Repeated in MLC #3a. |
| #7 C | Insufficient policies and procedures to monitor and review calculations for Uniformed (FEMS and MPD) Worker's Compensation. | Repeated in MLC #3a. |
| **MLC # 8** | **Payroll and Human Resources** | |
| #8 A | Insufficient supporting documentation for new hire and terminations | Repeated in MLC #8. |
| #8 B | Retirement contributions to ineligible employees | Closed. |
| #8 C | Insufficient documentation to support employee's pay for DCPS employees | Repeated in MLC #10c. |