

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



**TESTIMONY OF CHARLES J. WILLOUGHBY
INSPECTOR GENERAL, DISTRICT OF COLUMBIA**

BEFORE

**THE SENATE SUBCOMMITTEE ON
OVERSIGHT OF GOVERNMENT MANAGEMENT,
THE FEDERAL WORKFORCE,
AND THE DISTRICT OF COLUMBIA**

MARCH 31, 2009

10:00 A.M.

**ROOM 342
DIRKSEN SENATE OFFICE BUILDING**

FULL VERSION

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INSPECTOR GENERAL, DISTRICT OF COLUMBIA**

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GOOD MORNING CHAIRMAN AKAKA, SENATOR VOINOVICH, AND MEMBERS OF THE SUBCOMMITTEE. I AM CHARLES J. WILLOUGHBY, AND I AM PLEASED TO SPEAK BEFORE YOU THIS MORNING AT YOUR HEARING ENTITLED, "STABILITY THROUGH SCANDAL: A REVIEW OF THE OFFICE OF THE CHIEF FINANCIAL OFFICER" (OCFO).

YOU ASKED ME TO ADDRESS SPECIFICALLY (1) THE INDEPENDENT AUDITOR'S REPORT RELATIVE TO MATERIAL WEAKNESSES IDENTIFIED IN THE COMPREHENSIVE ANNUAL FINANCIAL REPORT (CAFR), (2) PROGRESS THAT THE CHIEF FINANCIAL OFFICER (CFO) HAS MADE IN RESPONDING TO RECOMMENDATIONS FROM THE OFFICE OF THE INSPECTOR GENERAL (OIG), (3) COOPERATION BETWEEN THE OIG AND OCFO TO ACHIEVE EFFICIENCY AND IMPROVE ACCOUNTABILITY, AND (4) WAYS THAT THE OCFO CAN IMPROVE ITS FINANCIAL MANAGEMENT.

WILLIAM J. DIVELLO, THE D.C. OIG ASSISTANT INSPECTOR GENERAL FOR AUDIT, IS ACCOMPANYING ME TODAY. AFTER MY REMARKS, WE WOULD BE HAPPY TO ADDRESS ANY QUESTIONS YOU MAY HAVE.

BY LAW, THE INSPECTOR GENERAL MUST ENTER INTO A CONTRACT WITH AN INDEPENDENT AUDITING FIRM TO AUDIT THE CITY'S FINANCIAL STATEMENTS. ON JANUARY 30, 2009, THE DISTRICT OF COLUMBIA RECEIVED AN UNQUALIFIED OPINION ON ITS FINANCIAL STATEMENTS FOR FISCAL YEAR (FY) 2008 FROM ITS INDEPENDENT AUDITORS, BDO SEIDMAN, LLP. IT IS NOTEWORTHY TO MENTION THAT THIS IS THE 12TH CONSECUTIVE YEAR IN WHICH THE DISTRICT HAS RECEIVED A "CLEAN" OPINION ON ITS FINANCIAL STATEMENTS FROM THE INDEPENDENT AUDITORS. WHILE AN UNQUALIFIED OPINION PROVIDES THAT THE FINANCIAL STATEMENTS WERE PRESENTED FAIRLY IN ALL MATERIAL ASPECTS, THE INDEPENDENT AUDITORS ALSO ISSUED A REPORT ON INTERNAL CONTROL AND COMPLIANCE OVER FINANCIAL REPORTING, COMMONLY REFERRED TO AS THE "YELLOW BOOK" REPORT. THE YELLOW BOOK REPORT NOTED A CONTINUING NEED TO ADDRESS SIGNIFICANT INTERNAL CONTROL DEFICIENCIES AND MATERIAL WEAKNESSES. THE GOOD NEWS FOR FY 2008 WAS THAT THERE WERE FEWER SIGNIFICANT DEFICIENCIES AND MATERIAL WEAKNESSES REPORTED THAN IN THE PRIOR YEAR (3 IN FY 2007 VERSUS 2 IN FY 2008). HOWEVER, THE AUDITOR'S REPORT SHOWS THAT PROBLEMS REMAIN IN SOME AREAS THAT REQUIRE MANAGEMENT'S ATTENTION AND ACTION.

FISCAL YEAR 2008 MATERIAL WEAKNESSES AND THE CFO'S RESPONSE

THE FY 2008 YELLOW BOOK REPORT CITED TWO MATERIAL WEAKNESSES: THE FIRST WAS THE OFFICE OF THE CHIEF FINANCIAL OFFICER'S TREASURY FUNCTIONS PERFORMED BY THE DISTRICT'S OFFICE OF FINANCE AND TREASURY; THE SECOND WAS THE MANAGEMENT OF THE MEDICAID PROGRAM, A MULTI-AGENCY PROGRAM PREVIOUSLY MANAGED BY THE DISTRICT'S DEPARTMENT OF HEALTH, AND NOW BY THE DEPARTMENT OF HEALTH CARE FINANCE.

FOR FY 2008, THE TREASURY FUNCTIONS CONTRIBUTING TO THE MATERIAL WEAKNESS INVOLVED THE FAILURE TO RECONCILE CASH AND INVESTMENT ACCOUNT ACTIVITIES. THE INDEPENDENT AUDITORS FOUND THAT THE DISTRICT WAS NOT ACCOUNTING FOR ALL OF ITS CASH AND INVESTMENT ACTIVITY APPROPRIATELY IN THE DISTRICT'S ACCOUNTING SYSTEM OF RECORD (SOAR) ON A TIMELY BASIS. THE AUDITORS ALSO IDENTIFIED NUMEROUS UNIDENTIFIED AND UNRECORDED TRANSACTIONS AND FOUND THAT BANK RECONCILIATIONS OF CASH ACCOUNTS WERE UNTIMELY OR INACCURATE. THE AUDITORS ALSO HAD DIFFICULTY CONFIRMING CERTAIN INVESTMENT BALANCES.

THE OFFICE OF THE CHIEF FINANCIAL OFFICER GENERALLY RESPONDED POSITIVELY TO THESE FINDINGS, PROVIDING DETAILED ACTIONS TO RECONCILE

ALL ACCOUNTS ON A MONTHLY BASIS AND PROVIDING TIMELY INPUT OF SOAR DATA TO ACCOUNTS. GIVEN THE SERIOUSNESS OF THESE MATTERS, THE DISTRICT OF COLUMBIA CITY COUNCIL COMMITTEE ON FINANCE AND REVENUE, CHAIRED BY COUNCILMEMBER JACK EVANS, IS MONITORING THE OCFO'S PROGRESS TO BRING ALL BANK ACCOUNT RECONCILIATIONS UP TO DATE AND TO TAKE ACTION TO ADDRESS ALL CASH AND INVESTMENT ACCOUNT IRREGULARITIES. WE HAVE BEEN INFORMED THAT ALL ACCOUNTS HAVE BEEN RECONCILED THROUGH DECEMBER 31, 2008 (FY 2009) AND THAT EFFORTS WILL CONTINUE TO KEEP CURRENT ALL CASH ACCOUNT RECONCILIATIONS AND CASH AND INVESTMENT ACCOUNT ACTIVITY. THE INDEPENDENT AUDITORS, UNDER THE AUSPICES OF MY OFFICE, WILL ALSO BE PERFORMING A REVIEW OF CASH ACCOUNT RECONCILIATIONS TO ASSURE DISTRICT OFFICIALS THAT THE OCFO IS PROPERLY RECONCILING AND RECORDING ALL CASH AND INVESTMENT ACCOUNT ACTIVITY.

THE SECOND MATERIAL WEAKNESS INVOLVED MANAGEMENT OF THE MEDICAID PROGRAM, WHICH HAS BEEN A LONG-STANDING PROBLEM FOR THE DISTRICT, HAVING BEEN REPORTED AS A REPORTABLE CONDITION IN PRIOR CAFR YEARS AND A MATERIAL WEAKNESS FOR FYS 2007 AND 2008. IN CATEGORIZING THE MEDICAID PROGRAM AS A MATERIAL WEAKNESS, THE INDEPENDENT AUDITORS RELIED HEAVILY ON RECENT OIG MEDICAID AUDITS AT THE DEPARTMENT OF MENTAL HEALTH AND THE MEDICAID ASSISTANCE ADMINISTRATION, AND ON TESTS OF CLAIMS DISALLOWANCES AND ACCOUNTS

RECEIVABLE WRITE-OFFS. THE OIG HAS LONG RECOGNIZED THAT THE DISTRICT'S MEDICAID PROGRAM, APPROXIMATING \$1.5 BILLION IN EXPENDITURES ANNUALLY, HAS HIGH FINANCIAL RISKS. RECOGNITION OF THESE RISKS HAS BEEN JUSTIFIED BY THE FACT THAT THE DISTRICT HAS HAD TO "WRITE-OFF" OR ABSORB HUNDREDS OF MILLIONS OF DOLLARS IN OTHERWISE FEDERALLY FUNDED MEDICAID COSTS OVER THE PAST SEVERAL YEARS. RECOGNIZING THAT MANY OF THE CITY'S MEDICAID PROBLEMS RESIDE IN BILLING AND ACCOUNTABILITY, THE DISTRICT CREATED THE DEPARTMENT OF HEALTH CARE FINANCE WHICH, AMONG ITS NUMEROUS RESPONSIBILITIES, NOW REQUIRES HEALTHCARE PROVIDERS TO THOROUGHLY DOCUMENT MEDICAID DELIVERABLE SERVICES PRIOR TO AUTHORIZING PAYMENT. WE ANTICIPATE THAT WELL SUPPORTED AND DOCUMENTED MEDICAID SERVICES LIKELY WILL SIGNIFICANTLY REDUCE UNSUPPORTED MEDICAID COSTS AND THE RESULTANT MEDICAID COST DISALLOWANCES THAT HAVE CONTRIBUTED TO PAST ACCOUNTS RECEIVABLE WRITE-OFFS. THESE ACTIONS SHOULD HELP MITIGATE SOME OF THE RISKS ASSOCIATED WITH THE DISTRICT'S MEDICAID PROGRAM.

FISCAL YEAR 2007 MATERIAL WEAKNESSES AND THE CFO'S RESPONSE

IN THE FY 2007 CAFR YELLOW BOOK REPORT, THE INDEPENDENT AUDITORS CITED CONDITIONS AT THE DISTRICT'S OFFICE OF TAX AND REVENUE (OTR) AS A MATERIAL WEAKNESS THAT CONTRIBUTED TO A \$50 MILLION FRAUD

PERPETRATED BY AN OTR MANAGER WORKING COLLUSIVELY WITH SEVERAL OTHER INDIVIDUALS. IN RESPONSE TO THIS FRAUD, THE INDEPENDENT AUDITORS CONDUCTED A SIGNIFICANT AMOUNT OF TESTING AND FORENSIC AUDITING TO ASSURE THAT THE CONDITIONS THAT LED TO THE FRAUD WERE LIMITED TO THE PROPERTY TAX REFUND AREA AND NOT SYSTEMIC TO OTHER OTR BUSINESS PROCESSES. CONSEQUENTLY, THE CITY DID GET A CLEAN OPINION FOR ITS FY 2007 FINANCIAL STATEMENTS, BUT THE CFO'S TAX AND REVENUE OPERATIONS WERE CONSIDERED A MATERIAL WEAKNESS. GIVEN THE SEVERITY OF THE FRAUD AND CONCERNS EXPRESSED BY THE INDEPENDENT AUDITORS, MANY INITIATIVES WERE UNDERTAKEN (1) TO EXPLAIN WHY AND HOW SUCH A FRAUD WAS PERPETRATED, AND (2) TO IDENTIFY THE ACTIONS NECESSARY TO PREVENT ANY FUTURE OCCURRENCE. ONE SUCH INITIATIVE OCCURRED WHEN THE DISTRICT'S CITY COUNCIL ESTABLISHED A TAX AND REVENUE INVESTIGATION SPECIAL COMMITTEE (SPECIAL COMMITTEE) TO REVIEW THE OTR FRAUD.

THE SPECIAL COMMITTEE RETAINED WILMER CUTLER PICKERING HALE AND DORR, LLP (WILMER HALE), WORKING WITH THE CPA FIRM OF PRICE WATERHOUSE COOPERS, LLP TO EXAMINE THE FACTS AND CIRCUMSTANCES SURROUNDING THE FRAUD SCHEME AND TO MAKE RECOMMENDATIONS TO PREVENT A RECURRENCE. THE RESULTING REPORT PUBLISHED BY WILMER HALE EXTENSIVELY REVIEWED OTR BUSINESS PROCESSES AND THE CONTROL CONDITIONS THAT CONTRIBUTED TO THE FRAUD. APPROXIMATELY 38

RECOMMENDATIONS WERE DIRECTED TO THE OCFO THAT ADDRESSED THE FAILURE OF INTERNAL CONTROLS, A CULTURE OF APATHY AND SILENCE, WHICH WAS PERVASIVE AMONG MANY OTR EMPLOYEES, AND THE LACK OF EFFECTIVE OVERSIGHT. AS A FOLLOW-UP TO THIS EFFORT, CITY COUNCIL CHAIRMAN VINCENT GRAY REQUESTED THAT THE OIG REVIEW OCFO ACTIONS TAKEN IN RESPONSE TO THE WILMER HALE FINDINGS AND RECOMMENDATIONS. WE RECENTLY INITIATED THAT FOLLOW-UP REVIEW IN RESPONSE TO THE CHAIRMAN'S REQUEST. MANY OF THE RECOMMENDATIONS MADE BY THE INDEPENDENT AUDITORS, THE OIG, AND WILMER HALE SHOULD IMPROVE OR HAVE ALREADY IMPROVED THE CONTROL ENVIRONMENT AT OTR. HOWEVER, ONE CASUALTY OF THE OTR SCANDAL THAT EXTENDS TO BROADER AREAS OF THE OCFO IS THE IMPACT ON PERSONNEL. MANY PEOPLE IN MID-LEVEL POSITIONS HAVE LEFT OCFO. THE OCFO NEEDS TO RECRUIT AND RETAIN MID-LEVEL PERSONNEL TO SUSTAIN AND CARRY OUT MANY OF THE CONTROL ENVIRONMENT IMPROVEMENTS THAT THE OCFO IS COMMITTED TO IMPLEMENT.

OIG AUDITS AND THE CFO'S RESPONSE

IN THE PAST SEVERAL YEARS, THE OIG HAS ISSUED NUMEROUS REPORTS THAT ADDRESSED IMPROVEMENTS IN VARIOUS OCFO AREAS. ONE IMPORTANT REPORT WAS A MANAGEMENT IMPLICATION REPORT (MIR) THAT WE ISSUED IN OCTOBER OF 2007, PRIOR TO THE DISCLOSURE OF THE FRAUD AT OTR, CONCERNING SYSTEMIC INTERNAL CONTROL DEFICIENCIES. A MIR IS A REPORT

THAT NOTIFIES AGENCY HEADS OF MATTERS THAT POSSIBLY HAVE CITYWIDE RAMIFICATIONS, REQUIRING IMMEDIATE OR PRIORITY ATTENTION. WHILE NOT SOLELY DIRECTED AT THE OCFO, THE MIR DID NOTE THAT PERFORMANCE AUDITS WE ISSUED TO THE OCFO FROM FYS 2005-2007 CONTAINED 13 INTERNAL CONTROL DEFICIENCIES. THESE DEFICIENCIES ADDRESSED SUCH ISSUES AS INEFFECTIVE POLICIES AND PROCEDURES, INEFFECTIVE CONTROLS TO PREVENT OR DETECT FRAUD, LACK OF DOCUMENTATION, AND INEFFECTIVE MANAGEMENT OVERSIGHT; ALL OF WHICH ARE ISSUES OR AREAS DIRECTLY RELATED TO THE OTR FRAUD MATTER. WE ALSO EVALUATED INTERNAL CONTROL WEAKNESSES FOUND IN FINANCIAL REPORTS, FINDING THAT FOR FYS 2004-2006 THERE WERE 6 INTERNAL CONTROL DEFICIENCIES AT THE OCFO AND 1 INTERNAL CONTROL DEFICIENCY INVOLVING INEFFECTIVE MANAGEMENT OVERSIGHT AT OTR. THE PURPOSE OF THE MIR WAS TO ENCOURAGE AGENCY MANAGEMENT TO LOOK AT THEIR OWN CONTROL ENVIRONMENT WITH A VIEW TOWARD IMPLEMENTING MANAGEMENT CONTROLS TO PREVENT, DETECT, AND CORRECT CONDITIONS REPORTED IN OIG AUDIT REPORTS.

IN ANOTHER MIR ISSUED IN JANUARY 2009, THE OIG FOCUSED ON INTERNAL CONTROL WEAKNESSES IN THE DISTRICT'S PAYMENT PROCESS. WHILE AGAIN NOT DIRECTED SOLELY AT THE OCFO, THE MIR DID ADDRESS CONTROL DEFICIENCIES IN THE DISTRICT'S PAYMENT PROCESS, OF WHICH THE OCFO IS AN INTEGRAL COMPONENT, WITH RESPECT TO THE VARIOUS PAYMENTS MADE FOR ACQUIRED GOODS AND SERVICES, PAYROLL PAYMENTS, THIRD-PARTY

PAYMENTS, TAX REFUNDS, AND OTHER AUTHORIZED PAYMENTS. SOME OF THE SAME PROBLEMS PREVIOUSLY CITED INCLUDED INSUFFICIENT MANAGEMENT OVERSIGHT, INEFFECTIVE SUPERVISION, LACK OF ADEQUATE POLICIES AND PROCEDURES, MISSING DOCUMENTATION, INADEQUATE SEGREGATION OF DUTIES, AND UNFAMILIARITY WITH STANDARDS OF CONDUCT AND WORKPLACE ETHICS.

OVERALL, THE FINDINGS AND RECOMMENDATIONS THE OIG HAS DIRECTED TO THE OCFO HAVE BEEN MET WITH APPROVAL, ACCEPTANCE, AND IMPLEMENTATION OF CORRECTIVE ACTIONS. OCFO'S MANAGEMENT HAS TAKEN PROACTIVE ACTIONS ON MANY OF THE OIG FINDINGS AND RECOMMENDATIONS.

INTERAGENCY COOPERATION BETWEEN THE OIG AND OCFO

BECAUSE THE OCFO PLAYS AN ESSENTIAL ROLE IN MAINTAINING THE INTEGRITY OF THE CITY'S FINANCES AND SERVING AS THE PRIMARY ACCOUNTANT FOR ALL FISCAL MATTERS ON A LOCAL BUDGET OF ABOUT \$8 BILLION, WE HAVE ENGAGED THE OCFO ON SEVERAL LEVELS TO IMPROVE INTERAGENCY COOPERATION AND OVERSIGHT EFFORTS. THE OCFO, WHILE NOT A VOTING MEMBER OF THE CAFR OVERSIGHT COMMITTEE CHAIRED BY THE OIG, ENJOYS A TENURED ROLE AS AN ACTIVE PARTICIPANT IN REGULARLY SCHEDULED CAFR MEETINGS. CAFR COMMITTEE MEETINGS SERVE AN

EXTREMELY IMPORTANT FUNCTION IN GETTING MANAGEMENT OF DISTRICT AGENCIES AND INDEPENDENT COMPONENTS, ALONG WITH THE OCFO, TO COOPERATE AND TO COORDINATE EFFORTS TO PERMIT TIMELY COMPLETION OF THE INDEPENDENT AUDITORS' FINANCIAL STATEMENT AUDIT. THROUGHOUT THE YEAR, THE OIG, WORKING WITH THE OCFO, CITY COUNCIL, AND THE MAYOR'S OFFICE, INVITES AGENCIES TO CAFR COMMITTEE MEETINGS TO ADDRESS SIGNIFICANT DEFICIENCIES AND MATERIAL WEAKNESSES, AND CHALLENGING AGENCIES TO PROVIDE SOLUTIONS TO THOSE REPORTED PROBLEMS. FOLLOW-UP CAFR MEETINGS ARE HELD TO TRACK PROGRESS ON CORRECTIVE ACTIONS. WE BELIEVE THESE PROACTIVE EFFORTS MAY HAVE CONTRIBUTED, IN PART, TO THE REDUCTION IN THE NUMBER OF SIGNIFICANT DEFICIENCIES REPORTED IN FY 2008.

WAYS THE OCFO CAN IMPROVE ITS FINANCIAL MANAGEMENT

WHILE THE OCFO HAS TAKEN MANY CORRECTIVE ACTIONS RELATIVE TO ITS OPERATIONS, WE BELIEVE THERE ARE SEVERAL AREAS WHERE ADDITIONAL MANAGEMENT ACTIONS SHOULD BE TAKEN TO IMPROVE OCFO OPERATIONS:

- GIVEN THE IMPACT THAT SOUND INTERNAL CONTROL HAS ON ACCOUNTABILITY AND EFFECTIVE AND EFFICIENT GOVERNMENT OPERATIONS, THE OCFO SHOULD ISSUE A CITYWIDE DIRECTIVE REQUIRING MANAGERS TO ESTABLISH, ASSESS, CORRECT, AND REPORT

ON INTERNAL CONTROLS. THE GUIDANCE COULD BE PATTERNED, FOR EXAMPLE, AFTER THE FEDERAL MANAGERS' FINANCIAL INTEGRITY ACT (FMFIA) OF 1982 AND THE OFFICE OF MANAGEMENT AND BUDGET (OMB) CIRCULAR A-123, MANAGEMENT'S RESPONSIBILITY FOR INTERNAL CONTROL. IN OUR VIEW, DISTRICT MANAGEMENT NEEDS TO CREATE A CLIMATE WHERE INTERNAL CONTROLS CAN DEVELOP AND FLOURISH TO PROTECT THE PUBLIC TRUST.

- REGARDING THE PAYMENT PROCESS, THE OCFO NEEDS TO ASSIGN ACCOUNTS PAYABLE OFFICIALS MORE ACCOUNTABILITY BY DEVELOPING WRITTEN POLICIES AND PROCEDURES THAT REQUIRE DUE DILIGENCE PRIOR TO THE PAYMENT OF INVOICES. FOR EXAMPLE, STEPS MUST BE TAKEN TO ENSURE THAT THE PAYMENT OF CONTRACTORS' INVOICES IS MADE ONLY PURSUANT TO THE APPROVAL OF AUTHORIZED AGENCY PERSONNEL.
- RECENT FRAUDS PERPETRATED AGAINST THE DISTRICT DISCLOSED A NEED FOR AN INTENSIFIED ANTI-FRAUD PROGRAM. BY INTENSIFYING ITS ANTI-FRAUD PREVENTIVE AND DETECTIVE CONTROLS, THE OCFO CAN BETTER CREATE A CULTURE OF ETHICAL BEHAVIOR IN THE WORKPLACE.
- THE OCFO NEEDS TO RECRUIT AND RETAIN QUALIFIED PERSONNEL, THEN PROPERLY SUPERVISE ITS STAFF, TO INCLUDE MANAGEMENT REVIEW OF TRANSACTIONS AND PROCESSES, AND TIMELY AND ACCURATE EMPLOYEE EVALUATIONS.

CONCLUSION

IN SUMMARY, MY OFFICE WILL CONTINUE TO PROVIDE AN INDEPENDENT ASSESSMENT OF THE OCFO TO HELP MAINTAIN THE HIGHEST STANDARD OF CONDUCT, INTEGRITY, AND EFFICIENT AND EFFECTIVE GOVERNMENT OPERATIONS.

MR. CHAIRMAN, MY STAFF AND I WILL BE HAPPY TO ANSWER ANY QUESTIONS THAT YOU MAY HAVE.