

GOVERNMENT OF THE DISTRICT OF COLUMBIA
Office of the Chief Financial Officer



Office of Integrity and Oversight

February 10, 2020

Hanseul Kang, Superintendent of Education
Office of the State Superintendent of Education
1050 First Street, NE,
Washington, DC 20002

Deloras Shepherd, Education Cluster Associate Chief Financial Officer
1200 First Street, NE, Eleventh Floor
Washington, DC 20002

Dear Ms. Kang and Ms. Shepherd,

On October 2, 2019, our office issued the Independent Auditor's report of the Audit of the Office of the State Superintendent of Education (OSSE)'s, Office of Public Charter School Financing and Support (OPCSFS) Direct Loan and Credit Enhancement Fund (DLCEF) Revenue and Expenditure Report for the fiscal year ended September 30, 2018. During our audit, we observed internal control deficiencies in financial data maintenance, preparation and reporting that require management attention.

OIO provided four (4) observations and six (6) recommendations to improve the Office of Public Charter School Financing and Support (OPCSFS) Direct Loan and Credit Enhancement Fund (DLCEF) internal controls and operating efficiencies. Accordingly, this communication is not intended to be and should not be used for any other purpose.

In their November 4, 2019 response, OSSE/OPCSFS and OSSE/OCFO concurred with five of the recommendations and partially concurred with one recommendation. The planned corrective actions for Recommendations 1, 2, and 5 were responsive and met the intent of the recommendation. For Recommendations 3, 4, and 6; we will determine if the deficiencies identified were resolved in our FY 2019 audit. The full text of OSSE/OPCSFS and OCFO management's responses are included as Appendix 1 to this report.

Should you have any questions, please call me at (202) 442-6433, or Tisha Edwards, Director, Internal Audit at (202) 442-6446.

Sincerely,

A handwritten signature in black ink, reading "Timothy Barry". The signature is fluid and cursive, with the first name "Timothy" and last name "Barry" clearly legible.

Timothy Barry, Executive Director
Office of Integrity and Oversight

Attachment

cc: Jeff DeWitt, Chief Financial Officer, D.C. Government
Angell Jacobs, Deputy Chief Financial Officer and Chief of Staff, OCFO
Marshelle Richardson, Chief Risk Officer, OCFO
Ronda Kardash, Director, Office of Public Charter School Financing and Support, OSSE
Paris Saunders, Agency Fiscal Officer, OCFO/OSSE



Office of Integrity & Oversight

**Government of the District
of Columbia, Office of the
Chief Financial Officer**

February 10, 2020

**MANAGEMENT OBSERVATIONS FOR
THE OFFICE OF PUBLIC CHARTER
SCHOOL FINANCING AND SUPPORT
(OPCSFS) DIRECT LOAN AND CREDIT
ENHANCEMENT FUND (DLCEF)
REVENUE AND EXPENDITURE
REPORT FOR THE FISCAL YEAR
ENDED SEPTEMBER 30, 2018**

Internal Controls Over Financial Data Maintenance, Preparation and Reporting Needs Improvement

As part of our audit, we obtained an understanding of the Direct Loan and Credit Enhancement Fund (DLCEF) financial reporting framework, and revised accounting policies and procedures. We reviewed the Direct Loans and Credit Enhancements issued during FY 2018. We reviewed the journal entries input into the System of Accounting and Reporting (SOAR) by OSSE to record the direct loan and credit enhancement activities throughout the fiscal year. We also obtained and reviewed the FY 2018 DLCEF's detailed Trial Balance, Revenue and Expenditure Report and related notes, and supporting documentation for the Direct Loan and Credit Enhancement Fund. In addition, we obtained and reviewed PORTFOL (Direct Loan and Credit Enhancement Sub-Ledger) reports and schedules as well as Board Committee Meeting Minutes for the Direct Loans and Credit Enhancements issued in FY 2018. During our audit, we noted inconsistencies in the recordation of loan payments in the DLCEF subsidiary ledger, internal control deficiencies in the recordation of general ledger journal entries, preparation of Trial Balance and reporting for the DLCEF FY 2018 Statement of Revenue and Expenditure that requires management attention. Specifically, we noted the following:

Observation 1: Improper Revenue Recognition

During our audit we found the following unadjusted revenue over/under misstatements:

Table 1: FY 2018 Unadjusted Revenue Misstatements

Description of the Journal Entries	Amount
Revenue Overstatement - Overpayment of principal from a charter school that was refunded in FY 2019. The original loan was paid-off in FY2017.	\$22,500.00
Revenue Overstatement - A quarterly loan principal and interest payment were paid in advance but recognized as a FY 2018 revenue.	\$23,312.90
Revenue Understatement - Loan principal and interest due from an educational institution due on FY 2018 but not recognized as revenue. Revenue was recognized in FY 2019 when payments were received.	<u>(\$78,846.42)</u>
Net FY 2018 Revenue Understatement	<u>(\$33,033.52)</u>

Created by OIO

Management Observation Report for the OPCSFS DLCEF
Statement of Revenue and Expenditure for the year ended September 30, 2018
Final Report
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Because the DLCEF net FY 2018 revenue misstatement is approximately 2.0% of the FY 2018 net deficit, it was deemed immaterial; therefore, it did not change our audit opinion that the FY 2018 DLCEF Statement of Revenue and Expenditure is fairly stated.

Compliance with the revenue recognition principle was also brought to OSSE/OCFO's management attention in FY 2017. Therefore, it is imperative for OSSE/OCFO management to ensure that improper revenue recognition does not occur in FY 2019 as non-compliance could have an adverse impact.

Recommendation:

We recommend that the Associate Chief Financial Officer (ACFO), OSSE:

1. Apply proper Generally Accepted Accounting Principles (GAAP) accounting practices of revenue recognition to ensure revenues are recognized in the proper period.

MANAGEMENT'S RESPONSE AND OIO COMMENTS**Management's Response (Recommendation 1):**

OCFO management concurred with the recommendation and will continue to apply Generally Accepted Accounting Principles (GAAP) accounting practices to ensure revenue is recognized in the proper period.

OIO Comments:

OCFO management's planned corrective action is responsive and meets the intent of the recommendation.

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Observation 2:**Internal Control Deficiencies in the Recordation of General Ledger Journal Entries:**

During our review of the 37 approved revenues journal entries for direct loans and credit enhancement transactions (100% of the FY 2018 population), we noted inconsistencies in the supporting documentation attached to these entries.

The OCFO policies and procedures state that supporting documentation should be attached to the journal entry by the Accountant (preparer) and reviewed by the Accounting Officer (approver); however, it does not list the specific documentation that must be consistently provided. Based on our review of the journal entries, we noted inconsistencies in the documentation attached. The detail of inconsistencies are as follows:

Table 2: Results from the Review of Revenue Journal Entries

Exceptions	Number of Exceptions	Error Rate Percentage
Missing the Confirmation Form for Delivery of Checks	7	19%
Confirmation Form for Delivery of Checks was not signed by the Receiving Staff from OCFO	4	11%
Missing SOAR printouts of recorded transactions	2	5%

Created by OIO

We also noted that the journal entries were approved despite the above inconsistencies.

Recommendation:

We recommend that the Associate Chief Financial Officer (ACFO), OSSE:

2. Update the DLCEF accounting policy and procedures to specifically outline the documentation that must be attached to journal entries and develop a journal entry supporting documentation checklist to ensure that journal entries are recorded, reviewed and approved for proper supporting documentation before they are finalized.

MANAGEMENT'S RESPONSE AND OIO COMMENTS**Management's Response (Recommendation 2):**

OCFO management concurred with the recommendation. Management will update DLCEF accounting policies and procedures to include a checklist of required supporting documentation

Management Observation Report for the OPCSFS DLCEF
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for revenue journal entries.

OIO Comments:

OCFO management's planned corrective action is responsive and meets the intent of the recommendation.

Management Observation Report for the OPCSFS DLCEF
Statement of Revenue and Expenditure for the year ended September 30, 2018
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Observation 3:**Inconsistent Recording of New Loans Issues in the
Subsidiary Ledger (PORTFOL)**

During FY 2018, DLCEF issued five (5) loans to charter schools in the District. For these new issuances, the Fund charged a one-time loan origination fee of one percent of the face value of the loan. Per PORTFOL's (a third-party loan accounting software) Operating Procedures Manual – the origination fee should be reflected on the settlement fee section of the ledger (as a memorandum, and not as a payment) when the new loan is established.

During the audit, we noted that the origination fees for four (4) of the five (5) new loans were properly recorded as a memorandum in PORTFOL. However, in one instance, a charter school that received a \$2,000,000 loan, requested the loan origination fee of \$20,000 be deducted from the face value of the loan when the funds were wired. The Program Analyst incorrectly recorded this loan origination fee as a reduction of the face value of the loan instead of as a memorandum. As a result, the subsidiary ledger was understated by \$20,000 which ultimately caused a \$20,000 difference between the subsidiary ledger and the general ledger at year end.

Recommendations:

We recommend that the Superintendent of the Office of the State of Superintendent of Education (OSSE) direct the OPCSFS program staff to:

3. Record in the DLCEF subsidiary ledger (PORTFOL) the new loan face value and loan origination fee on a consistent basis as outlined in the PORTFOL Operating Procedures Manual.
4. Establish and maintain a monthly procedure to reconcile (i.e., changes in long-term receivables) the sub-ledger account (PORTFOL) with the general ledger to ensure direct loan and credit enhancement receivables are accounted for accurately.

MANAGEMENT'S RESPONSE AND OIO COMMENTS**Management's Response (Recommendation 3):**

Management concurred with the recommendation as a best practice. Management stated appropriate policies are in place and they will continue to record the new loan face value and

Management Observation Report for the OPCSFS DLCEF
Statement of Revenue and Expenditure for the year ended September 30, 2018
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loan origination fee on a consistent basis as outlined in the PORTFOL Operating Procedures Manual.

OIO Comments:

OSSE management acknowledges the recommendation is a best practice and will continue recording as outlined in the PORTFOL Operating Procedures. We will verify compliance with the PORTFOL Operating Procedures in our FY 2019 audit.

Management's Response (Recommendation 4):

OSSE/OPCSFS management partially concurred with the recommendation. OSSE has an established procedure in which OSSE/OPCSFS staff submits documentation to OCFO from PORTFOL. OCFO reconciles the documentation with SOAR and calls a meeting if any inconsistencies are found. Proper adjustments are then made to ensure direct loan and credit enhancement receivables are accounted accurately. OCFO staff will also use read-only access to PORTFOL to review and verify all loan activity and information that is entered into PORTFOL and will review this information on a monthly basis and make the appropriate adjustments in SOAR.

OIO Comments:

OSSE/OPCSFS believes the reconciliation process is already established. OIO will verify reconciliations are completed in our FY 2019 audit.

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Management's Response (Recommendation 6):

OSSE/OPCSFS management concurred with the recommendation and acknowledged that the anomalies found exist. Management stated they have appropriate policies in place and will continue to record the payment information correctly in PORTFOL.

OIO Comments:

OSSE/OPCSFS believes the policies are already in place. OIO will verify compliance with the procedures for payment recordation in our FY 2019 audit.

GOVERNMENT OF THE DISTRICT OF COLUMBIA
OFFICE OF THE CHIEF FINANCIAL OFFICER *supporting the*
OFFICE OF THE STATE SUPERINTENDENT OF EDUCATION



MEMORANDUM

TO: Timothy Barry
Executive Director
Office of Integrity and Oversight

FROM: Hanseul Kang *HK/kay*
State Superintendent
Office of the State Superintendent of Education

Deloras Shepherd *Del She/RS*
Associate Chief Financial Officer
Education Cluster

DATE: November 4, 2019

SUBJECT: Responses to the Management Observations for The Office of Public Charter
School Financing and Support's Direct Loan and Credit Enhancement Fund
(DLCEF)

OSSE and OCFO has reviewed the observations and recommendations presented in the Management Observations for The Office of Public Charter School Financing and Support's Direct Loan and Credit Enhancement Fund issued on October 9, 2019 related to the Direct Loan and Credit Enhancement Audit conducted by OIO for FY2018.

As noted in the responses, OSSE and OCFO recognizes the importance of the observations and recommendations which require the attention of management related to the review, recordation and reconciliation of the DLCEF transactions.

Attached are the detailed responses to the observations and recommendations presented in the Management Observations for The Office of Public Charter School Financing and Support's Direct Loan and Credit Enhancement Fund issued on October 7, 2019.

[OCFO OPCFS DL/CE FUND AUDIT MANAGEMENT RESPONSES]

November 4, 2019

Improper Revenue Recognition

OIO Observation 1:

During our audit, we found the following unadjusted revenue over/under misstatements:

Table 1: FY2018 Unadjusted Revenue Misstatements

Description of the Journal Entries	Amount
Revenue Overstatement -Overpayment of principal from a charter school that was refunded in FY 2019. The original loan was paid off in 2017	\$ 22,500.00
Revenue Overstatement -A quarterly loan principal and interest payment were paid in advance but recognized as a FY 2018 revenue.	\$ 23,312.90
Revenue Understatement -Loan principal and interest due from an educational institution due on FY 2018 but not recognized as revenue. Revenue was recognized in FY 2019 when payments were received.	<u>\$ (78,846.42)</u>
Net FY 2018 Revenue Understatement	<u>\$ (33,033.52)</u>

Because the DLCEF net FY2018 revenue misstatement is approximately 2.0% of the FY2018 net deficit, it was determined immaterial; therefore it did not change our audit opinion that the FY2018 DLCEF Statement of Revenues and Expenditures is fairly stated.

Compliance with the revenue recognition principle was brought to OSSE/OCFO's management attention in FY2017. Therefore, it is imperative for OSSE/OCFO management to ensure that improper revenue recognition does not occur in FY2019 as non-compliance could have an adverse impact.

Recommendation:

1. Apply proper Generally Accepted Accounting Principles (GAAP) accounting practices of revenue recognition to ensure revenues are recognized in the proper period.

Management Response:

Management thanks OIO for conducting this FY2018 audit review.

- Management agrees with the misstatement of the revenue overstatement of \$22,500. The loan was satisfied. The payment should not have been accepted, voided and returned to the school.
- Management also acknowledges the \$23,312.90 revenue overstatement for a payment that was made prior to the loan amortization scheduled due date.
- Management also acknowledges the \$78,846.42 revenue understatement for payment received after amortization schedule due date and when the revenue was recognized.

[OCFO OPCFS DL/CE FUND AUDIT MANAGEMENT RESPONSES]**November 4, 2019**

- Management will continue to apply Generally Accepted Accounting Principles (GAAP) accounting practices to ensure revenue is recognized in the proper period.

Internal Control Deficiencies in the Recordation of General Ledger Journal Entries**OIO Observation 2:**

During our review of the 37 approved revenue journal entries for direct loans and credit enhancement transactions (100% of the FY2018 population), we noted inconsistencies in the supporting documentation attached to these entries.

The OCFO policies and procedures state that supporting documentation should be attached to the journal entry by the Accountant (preparer) and reviewed by the Accounting Officer (approver); however, it does not list the specific documentation that must be consistently provided. Based on our review of the journal entries, we noted inconsistencies in the documentation attached. The detail of inconsistencies are as follows:

Exceptions	Number of Exceptions	Error Rate Percentage
Missing the Confirmation Form for Delivery of Checks	7	19%
Confirmation Form for Delivery of Checks was not signed by the Receiving Staff from OCFO	4	11%
Missing SOAR printouts of recorded transactions	2	5%

Recommendation

We recommend that the Associate Chief Financial Officer (ACFO) OSSE:

Update the DLCEF accounting policy and procedures to specifically outline the documentation that must be attached to journal entries and develop a journal entry supporting documentation checklist to ensure that journal entries are recorded, reviewed and approved for proper supporting documentation before they are finalized.

Management Response:

Management concurs with OIO's observation regarding consistent documentation. Management will update DLCEF accounting policies and procedures to include a checklist of required supporting documentation for revenue journal entries.

Inconsistent Recording of New Loans Issues in the Subsidiary Ledger (PORTFOL)**OIO Observation 3:**

During FY2018, DLCEF issued five (5) loans to charter schools in the District. For these new issuances, the Fund charged a one-time loan origination fee of one percent of the face value of the loan. Per PORTFOL's (a third-party loan accounting software) Operating Procedures Manual – the origination fee should be reflected on the settlement fee section of the ledger (as a memorandum, and not as a payment) when the new loan is established. During the audit, we noted that the origination fees for four (4) of the five (5)

[OCFO OPCSFS DL/CE FUND AUDIT MANAGEMENT RESPONSES]

November 4, 2019

new loans were properly recorded as a memorandum in PORTFOL. However, in one instance, a charter school that received a \$2,000,000 loan, requested the loan origination fee of \$20,000 be deducted from the face value of the loan when the funds were wired. The Program Analyst incorrectly recorded this loan origination fee as a reduction of the face value of the loan instead of as a memorandum. As a result, the subsidiary ledger was understated by \$20,000 which ultimately caused a \$20,000 difference between the subsidiary ledger and the general ledger at year end.

Management Response:

Management disagrees with the OIO observation.

1. On or about September 11, 2018, OPCSFS closed on a direct loan to ECA in the amount of \$2,000,000.
2. The 1% origination fee of \$20,000 was netted out of the total direct loan proceeds for a total disbursement to ECA of \$1,980,000, consistent with how all of the other lenders in the transaction netted out loan origination and other lenders' fees. *See attached Flow of Funds and see attached financial projections and accountant's report.* The financial assumptions and projections in this New Markets Tax Credit Transaction had the OPCSFS funds go into ECA's disbursement account and in turn ECA wired \$1,538,363 to the ECA Support Corporation and \$441,637 to ECA as part of ECA's equity contribution required under the NMTC financing structure.
3. Additionally, the fees and other contributions to the project were netted consistent with the Donation Transfer Agreement between ECA and the ECA Support Corporation to ensure all funds met the federal Treasury definition of a qualified active low income business. *See Donation Transfer Agreement attached.*
4. The OPCSFS direct loan disbursement of \$1,980,000 is evidenced by the attached OCFO wire transfer authorization, reflecting the authorization for netting of the loan origination fee.

Given the complexity of NMTC and to ensure the entity (here a Charter School) meets the federal qualifications, the netting of loan and other fees is part and parcel of closing on this type of financing. Additionally, while it is OPCSFS and OCFO's preferred practice (and one that we follow with diligence in most transactions) to disburse the authorized loan amounts and collect fees on the backend, District law does not prohibit the netting of fees prior to disbursement. The loan was recorded in both the general ledger and PORTFOL as a \$2,000,000 loan. Within PORTFOL, the fee was attached as a memo, as required, in the section entitled "Settlement Fee." Additional evidence is attached.

Incorrect and/or Inconsistent OPCSFS Submission of Direct Loan and Credit Enhancement Payments**OIO Observation 4:**

During our review of the 37 approved revenue journal entries, we noted for seven (7) of the 37 journal entries or 19%, the OPCSFS submitted incorrect payment information to OSSE/OCFO. As a result, interest and service fees were recorded incorrectly in PORTFOL. We also noted one confirmation form for the check delivery was not signed as required by the receiving staff from OPCSFS.

[OCFO OPCSFS DL/CE FUND AUDIT MANAGEMENT RESPONSES]**November 4, 2019**

Although the PORTFOL ending balance was properly stated, the incorrect classification of interest and service fees in PORTFOL, could potentially cause the incorrect recordation of interest and service fee revenue in SOAR.

Management Response:

Management disagrees with the first part of the OIO observation. Charter Schools are able to make additional payments and/or pay off the loan early with no penalty. In the event that an additional payment is made to the principle of the loan, PORTFOL software updates the amortization schedule, changing the percent of interest and principle for each payment, but not the amount of the payment owed. The new amortization schedule is shared with OCFO for reconciliation purposes. The seven (7) journal entries noted were based on the updated amortization schedule.

Management agrees that the check delivery form was not signed, and that a lack of a documented checklist and procedure would be beneficial. OSSE intends to review documents currently required for the packet, and consolidate/eliminate duplicate forms. A supporting documentation checklist will be created in conjunction with OCFO to ensure all required and supporting documentation are included in the complete packet.

RECOMMENDATIONS:

3. Record in the DLSEF subsidiary ledger (PORTFOL) the new loan face value and loan origination fee on a consistent basis as outlined in the PORTFOL Operating Procedures Manual.

Management concurs with that this recommendation is a best practice, and acknowledges that the individual anomaly found exists. We have appropriate policies in place and will continue to record the new loan face value and loan origination fee on a consistent basis as outlined in the PORTFOL Operating Procedures Manual.

Timeline: Immediately

4. Establish and maintain a monthly procedure to reconcile (i.e., changes in long-term receivables) the sub-ledger account (PORTFOL) with the general ledger to ensure direct loan and credit enhancement receivables are accounted for accurately.

Management partially concurs with this recommendation. OSSE has an established procedure in which OSSE staff submits documentation to OCFO from PORTFOL. OCFO reconciles the documentation with SOAR and calls a meeting if any inconsistencies are found. Proper adjustments are then made to ensure direct loan and credit enhancement receivables are accounted accurately. OCFO staff will also use read-only access to PORTFOL to review and verify all loan activity and information that is entered into PORTFOL and will review this information on a monthly basis and make the appropriate adjustments in SOAR.

[OCFO OPCSFS DL/CE FUND AUDIT MANAGEMENT RESPONSES]**November 4, 2019****5. Document DLCEF payment information correctly according to the nature of the transaction before submission to the OSSE/OCFO.**

Management concurs with this recommendation. OCFO will review transaction packets to consolidate and eliminate duplication. A checklist will be created for OSSE to ensure that packets are complete and consistent.

6. Record the payment information correctly in the DLCEF subsidiary ledger (PORTFOL).

Management concurs that this recommendation is a best practice, and acknowledges that the anomalies found exist. We have appropriate policies in place and will continue to record the payment information correctly in PORTFOL.

Timeline: Immediately