



# Commonwealth of Massachusetts Management Letter Year Ended June 30, 2000

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## **Martin Benison, Comptroller**

### **The Commonwealth of Massachusetts**

In planning and performing the Single Audit of the Commonwealth of Massachusetts for the year ended June 30, 2000<sup>7</sup>, we noted certain matters involving the internal control structure and the compliance of management of the Commonwealth of Massachusetts with laws and regulations which we have reported to the management of the Commonwealth of Massachusetts in a document entitled, ""Reports on Compliance and Internal Control in Accordance with Government Auditing Standards" dated October 24, 2000 to coincide with the date of the auditors' report on the statutory basis financial statements and "The Requirements of OMB Circular A-133 and the Schedule of Expenditures of Federal Awards for the year ended June 30, 2000" dated December 19, 2000 to coincide with the date of the auditors' report on the comprehensive annual financial report.

In addition to the matters discussed in the reports described above, we have developed certain observations and recommendations on other current and future accounting, administrative, operating and financial reporting matters. Our comments, based upon those observations and recommendations, are presented on the attached pages.

This report is intended solely for the information and use of management and federal awarding agencies and should not be used by anyone other than these specified parties.

We will be pleased to discuss these comments and recommendations with you at your convenience.

Deloitte & Touche LLP  
December 19, 2000

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## **STATEWIDE OBSERVATIONS**

## New Reporting Model

The Governmental Accounting Standards Board (GASB) has issued GASB Statement No. 34, "Basic Financial Statements – and Management’s Discussion and Analysis – for State and Local Governments" (GASB 34). This standard dramatically changes the basic financial statements that governments are required to issue. The Commonwealth must adopt this standard for periods beginning after June 15, 2001. Many of the comments on the following pages are a result of the need to evaluate the impact of this standard.

This statement establishes new financial reporting standards for state and local governments, and component units. It is designed to make governments’ general-purpose external financial reports easier to understand and more useful to the citizenry, legislative and oversight bodies, investors and creditors. The statement includes requirements for a management’s discussion and analysis, and dramatically changes the basic format of the financial statements, by requiring governments to provide basic financial statements on both an entity-wide and a fund perspective.

The entity-wide financial statements will provide information about the primary government and its component units without displaying funds or fund types. The financial statements will distinguish between the governmental and business-type activities of the primary government and between the total primary government and its discretely presented component units (the entity-wide perspective will not include fiduciary activities). In addition, capital assets and general long-term liabilities, which are currently reported in account groups, will be reported as assets and liabilities of governmental activities. All information in the entity-wide financial statement is to be reported using the economic resources measurement focus and the accrual basis of accounting, similar to the way that enterprise funds are currently reported in the general purpose financial statements.

Fund perspective financial statements will provide information about the primary government’s fund types, including fiduciary funds and blended component units. Governments will present separate financial statements for each fund category (governmental, proprietary, higher education, and fiduciary) and will no longer present a combined balance sheet. As is currently required, governmental fund financial statements will continue to focus on fiscal accountability and report the flows and balances of current financial resources using the modified accrual basis of accounting. Proprietary and fiduciary fund financial statements will continue to report operating results and financial position using the economic resources measurement focus and the accrual basis of accounting. The fund perspective will

also include component units that are fiduciary in nature.

One of the most significant changes incorporated in this new statement is a requirement for governmental entities to record the cost of infrastructure. Due to the age of some of the Commonwealth's infrastructure, it may be difficult, if not impossible, to obtain information regarding the state's historical cost of infrastructure.

Management has undertaken great efforts to determine the historical cost of infrastructure. Given the significant financial statement impact that will result from the infrastructure reporting requirements of GASB 34, we recommend that management continue to pursue their efforts in this regard. This becomes especially important because of the inherent inequities in certain of the Commonwealth's long-term debt obligations whereby the Commonwealth is bonding to pay for assets that they do not own. When GASB 34 is fully implemented, these inequities will inevitably result in the Commonwealth reporting liabilities in excess of assets. We also recommend that the Commonwealth continue to assess the other potential changes in financial reporting and accounting related to the proposed new reporting model. Finally, we recommend that the Commonwealth continue a comprehensive assessment of component units, affiliated organizations and other Commonwealth "governmental" entities as part of the implementation of GASB Statement 34 and the tentative affiliated organization Statement, to determine whether or not entities should be included or not included as component units of the Commonwealth.

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## **Focus on Financial Condition**

The changes to the governmental reporting model discussed elsewhere in this letter will also begin to focus attention on the overall financial condition of the government. The display of the overall operations of the government into a limited number of columns with debt and long-term assets combined with the other assets and liabilities will begin to place an emphasis on the questions of whether the government as a whole is better or worse off than the previous year. While the concept is commercial in nature, the emphasis will be on the growth or the decline of net assets.

This emphasis on financial condition is similar to the emphasis on the issue of intergenerational equity. This focus should be on the development of plans to pay for long-term obligations, both debt related and non-debt related, while also recognizing that financial plans need to exist for the repair or replacement of fixed assets and infrastructure. The focus is not so much on the growth of net assets as it

is on the maintaining of a net asset balance that demonstrates a sound and stable financial condition with sufficient resources to offset economic downturns.

Over the past year, management has undertaken significant efforts to better understand these and other implications of implementing GASB 34. As guidance continues to be developed by GASB and the American Institute of Certified Public Accountants, management should continue their diligent efforts of not only complying with the basic requirements of GASB 34 but also of understanding the implications it will have on the overall financial management of the Commonwealth. Models should be developed that include plans for future financing of obligations and assets. Management should also begin taking the steps necessary to educate the Commonwealth decision makers along through this process so that decisions that are made at the legislative level are consistent with those deemed prudent by management.

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## **Need to Analyze and Evaluate the Accounting and Reporting of Certain Funds as Individuals Funds**

As discussed in previous years' management letters, the number of funds required by the Legislature and used by the Commonwealth of Massachusetts (Commonwealth) hampers the efficiency of the accounting and financial reporting process. In fiscal year 2000, the Office of the Comptroller (OSC), operating under the requirements of State Finance Law and the requirements of the Legislature, as established through the budget and Massachusetts General Laws, was required to use approximately 124 individual funds to account for the operations of the Commonwealth.

The use of 124 individual funds, an increase of two over the number in fiscal year 1999, makes it difficult for either internal or external users of the Commonwealth's financial information to obtain a clear, concise understanding of the overall operations and financial position of the Commonwealth. Instead of enhancing accountability, the large number of funds makes it difficult for management to perform both the analysis of operations and the detection of errors.

While many of the individual funds designated by the Legislature for a specific purpose have been created to monitor and control resources, this function can effectively be met by using "sub-funds" within the General Fund.

The existing structure has resulted in the following issues:

1. Split appropriations require extensive effort on the part of management to properly account for the fiscal year activity and report final operating results. Split appropriations are not a budgetary practice generally followed by other states.
2. The Legislature regularly budgets expenditures in funds without providing corresponding revenue to support the activity. This effectively overstates the General Fund balance, creates deficits in other funds and raises the question of whether, in fact, a balanced budget at all levels has been passed as required by Massachusetts General Laws.
3. When the Commonwealth is required to implement Governmental Accounting Standards Board Statement No. 34, as discussed in the first observation above, each of the individual 124 funds will have to be analyzed to determine if it should be reported as a major fund.
4. It should also be noted that under generally accepted accounting principles in the United States of America, all fund balance deficits must be reported along with a plan for correcting those deficits. Currently, 27 funds have fund balance deficits.
5. If the proposed statement on footnotes that the Government Accounting Standard Board has issued as an exposure draft goes forward, then the detail of all transfers between the funds would need to be discussed in the Commonwealth's footnotes.

The following table lists the budgeted funds with a statutory fund balance deficit:

<u>Fund Budgeted</u>	<u>Fund Name</u>	<u>Fund Balance/Deficit</u>
106	Antitrust Law Enforcement Fund	\$ 2,519,000
110	Victim and Witness Assistance Fund	7,484,000
111	Intercity Bus Capital Assistance Fund	6,470,000
113	Mosquito and Greenhead Fly Control Fund	1,001,000

134	Environmental Challenge Fund	5,087,000
149	Toxic Use Reduction Fund	5,949,000
152	Environmental Permitting and Compliance Assurance Fund	34,474,000
156	Environmental Law Enforcement Fund	2,914,000
157	Public Access Fund	283,000
158	Harbors and Inland Waters Maintenance Fund	4,537,000
159	Marine Fisheries Fund	4,359,000
161	Low-Level Radioactive Waste Mgt. Fund	501,000
165	Ponkapoag Recreational Fund	100,000
172	Leo J. Martin Recreation Fund	195,000
173	Clean Air Act Compliance Fund	496,000
186	Second Century Fund	4,843,000
194	Local Consumer Inspection Fund	<u>574,000</u>
<b>Total</b>		<b><u>\$81,786,000</u></b>

The current practice, beyond its practical inefficiencies, creates a reporting model that could be misleading to the users of these financial statements. While some funds with minimal activity were repealed during the fiscal year and more are legislated for repeal during fiscal year 2001, a large number of funds remain and should be evaluated as to their continued need. The following table shows fund activity as of June 30, 2000 for those funds with minimal or no activity during the year. This list excludes funds that were created or repealed during fiscal 2000 and funds whose repeal has been legislated for fiscal 2001.

<u>Fund Number</u>	<u>Fund Name</u>	<u>Revenue and Other Financing Sources</u>	<u>Expenditure and Other Financing Uses</u>
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012	Tax Reduction Fund	\$ 385,000	\$ 0
019	Child Support Penalty Fee Fund	563,000	0
022	Brownfields Revitalization Fund	2,332,000	219,000
024	Tax Exemption Escrow Trust Fund	0	0
026	Firearms Records Keeping Fund	1,138,000	639,000
033	Civil Monetary Penalty Fund	97,000	0
106	Antitrust Law Enforcement Fund	116,000	447,000
107	Government Land Bank Fund	980,000	980,000
108	Natural Heritage and Endangered Species Fund	272,000	306,000
111	Intercity Bus Capital Assistance Fund	629,000	15,000
118	Federally-Assisted Housing Fund	136,000	136,000
132	Motorcycle Safety Fund	228,000	177,000
136	Environmental Trust Fund	1,801,000	1,275,000

138	Children's Trust Fund	61,000	44,000
140	Labor Shortage Fund	67,000	0
144	Drug Analysis Fund	124,000	97,000
153	Massachusetts AIDS Fund	196,000	464,000
157	Public Access Fund	860,000	845,000
161	Low-Level Radioactive Waste Mgt. Fund	11,000	205,000
162	Trust Fund Ffor The Head Injury Treatment Services	2,074,000	933,000
165	Ponkapoag Recreational Fund	700,000	723,000
168	Board of Registration in Medicine Fund	1,708,000	1,803,000
169	Asbestos Cost Recovery Fund	412,000	1,493,000
172	Leo J. Martin Recreation Fund	450,000	451,000
179	Reggie Lewis Track and Athletic Center Fund	325,000	245,000
180	Assisted Living Administration Fund	456,000	0

185	Solid Waste Disposal Fund	0	0
186	Second Century Fund	1,549,000	2,268,000
187	Safe Drinking Water Fund	2,201,000	2,123,000
189	Diversity Awareness Education Trust Fund	1,000	0
190	Child Care Quality Fund	207,000	150,000
194	Local Consumer Inspection Fund	0	278,000
198	Voting Equipment Loan Fund	0	0
330	Revolving Loan Fund	1,121,000	4,000

To improve accountability, the OSC, working with the Secretary of Administration and Finance and the Legislature, should seek legislation to:

- Combine or eliminate many of the existing funds noted above. Any remaining funds should be specifically identified in the legislation and any "new activities" subsequent to the legislation should be limited to the establishment of sub-funds unless, after consultation with OSC, a conclusion is reached that individual fund reporting is appropriate.
- If combining or eliminating funds is not accomplished, legislation should be proposed to require funds, other than Capital Project Funds, that have had a deficit in fund balance for three consecutive years be reduced to a zero balance as part of the subsequent year's budget. Nineteen (19) of the 2734 funds listed above have been in a deficit position for three consecutive years.
- "Sunset" provisions should be enacted to require that every fund and sub-

fund, other than the General Fund, be reviewed every five years to determine whether or not it they should be continued. In the absence of a positive action by the Legislature to continue the fund, the Legislature should require that its balance be transferred to the General Fund and the fund or sub-fund abolished.

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## **Overuse of the Practice of Prior Appropriations Continued in the Legislature**

Unexpended appropriations have been carried forward (prior appropriation continued or PAC) for the past eight years. Appropriations continued from fiscal year 2000 to 2001 totaled approximately \$252 million, a \$40 million increase from the prior fiscal year. The unexpended balance in the General Fund for all appropriations at June 30, 2000 is approximately \$179 million, an \$84 million increase from the prior year. Of this amount, nothing was reverted at the end of the fiscal year. A review of the activities within the General Fund indicates that additional funds were appropriated to many accounts in fiscal year 2000, even though balances carried forward from fiscal year 1999 were sufficient to cover all 2000 expenditures. This results in an increase in the unspent balances compared to those at June 30, 1999. This trend has continued since 1993.

An example of a balance carry forward is the Legislature's Telecommunication Appropriation, No. 9744-1000. A balance of \$6.5 million was carried forward from fiscal year 1995. Only \$1.7 million of the appropriation was spent during fiscal year 1996 and the remaining \$4.8 million was carried to fiscal year 1997. Of this amount, only \$1.7 million was expended during the year and \$3.1 million was authorized to be carried forward to fiscal year 1998, of which only \$1.5 million was expended and the remaining \$1.6 million was authorized to be carried forward to fiscal year 1999. In fiscal years 1999 and 2000, an additional \$3.4 million was appropriated and \$3.2 million expended and the remaining \$1.8 million was authorized to be carried forward to fiscal year 2001.

Under Massachusetts General Law, the Commonwealth has the option of either reverting unexpended funds or carrying the balances forward to the next fiscal year. The current trend indicates that more funds are being carried forward from year-to-year than is necessary, thereby diminishing the value of the budgetary controls that should be an element of the annual appropriation process. As an entity with significant impact on controlling budgets and appropriations, the Legislature should be a leader in lapsing unused appropriations.

The Legislature should carefully review and evaluate its use of PACs and its procedures for appropriating and carrying forward funds so that the available funds are more fully utilized to operate the various programs sponsored by the Commonwealth.

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## **Issues Relating to Bond Offerings and Bond Holder Relations**

At this time last year, the management letter reported that the Securities and Exchange Commission (SEC) Office of Municipal Securities had recently held their first annual "Municipal Market Roundtable.". Recently the SEC held their second meeting of this group. While these roundtables were not intended to reach conclusions on the topics covered, they did serve to raise a number of issues that the SEC may focus on as they continue to develop their agenda relating to the \$1.3 trillion municipal bond market and their belief that abuses exist in that market. In addition to these "Roundtables," the SEC has been speaking to a number of governmental groups over the last six months on the topic of municipal disclosures.

A major theme of the programs and speeches is the belief that the market has shifted from one driven by well- informed institutional investors, who readily obtained the information they needed, to a market driven by individual investors who do not have access to similar information. This shift has raised the level of concern on the part of the SEC because they do not believe that the reporting and disclosure practices of municipal issuers have kept pace with the investor shift.

Issues discussed included:

1. The lack of timely ongoing disclosure that is available to the investor community.
2. The need for continued improvements in price and volume information.
3. Who has the responsibility to prepare documents as well as who has the liability when something is not properly disclosed--- the issuer, the underwriter, various counsels or financial advisors
4. Whether the parties, including the underwriters, have sufficient time to review the disclosure documents and perform due diligence.
5. Auditors' involvement in offering statements, their independence and the giving of "consent" to reissue financial statements.

6. Whether continuing disclosure requirements are being met and whether governments are providing information beyond the minimum requirements set forth as the "deadly sins" in 15c2-12.
7. The role of electronic disclosures in fulfilling the responsibilities and the use of websites in aiding the government in meeting these responsibilities.
8. The need for many issuers to have active investor relations programs, whether investors can obtain the information needed to make informed decisions and whether the information they receive is consistent with that available on the government's various websites and from the press.

While the SEC has not yet taken action to directly regulate these activities, they have taken enforcement action in a number of individual cases. It would be prudent for the Commonwealth to take an active role in monitoring the SEC's agenda and speeches and take a lead position in addressing their concerns. The Commonwealth should also evaluate the current status of programs addressing investor relations and the consistency of information provided in the press and "published" on the various Commonwealth websites. This may require an active program to monitor the timeliness of updates to website as events important to investors occur.

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## **Assessment of Internal Controls and Compliance with Chapter 647, the Internal Control Act, Needs Improvement**

Massachusetts General Law, Chapter 647, *State Agencies Internal Control Act of 1989* (Chapter 647), outlines internal control standards, defines the minimum level of internal control systems and establishes the criteria against which internal controls will be evaluated. Chapter 647 also states that internal control systems for the various state departments shall be developed in accordance with guidelines established by the Office of the Comptroller. The Office of the Comptroller issued *The Internal Control Guide for Managers* (Guide) to assist departments in complying with Chapter 647. Departments implement Chapter 647 and the Guide through a document known as the "departments' internal control plan."

Since the passage of Chapter 647, the Office of the Comptroller has been publishing internal control guides; assisting departments, when requested, in developing internal control plans; conducting training sessions on internal controls; and reviewing internal control plans when requested by departments or as part of the statewide Single Audit.

The Office of the State Auditor has also been involved in reviewing these plans. The fiscal year 2000 statewide Single Audit continued the work begun in the 1999 audit – that of educating the departments on the current definition of internal control and emphasizing the need for internal control plans to adopt the new definition. The education process conducted during the fiscal year 2000 Single Audit primarily consisted of visiting departments with major audit involvement, interviewing the department's Internal Control Officer to discuss the department's approach to implementing internal controls and reviewing the internal control plan to obtain an understanding of the plan's organization, scope and composition. The review also assessed if the department had conducted a department-wide risk assessment.

These visits have indicated that the progress seen in 1999 toward complying with Chapter 647 and the Guide continues. More specifically, it was noted that:

1. Although the departments visited all had internal control plans in varying sizes and composition, the departments with internal control units and/or internal audit units tended to have better documented plans;
2. Although the plans generally contain adequate descriptions of fiscal policies and procedures,; a few plans described the controls required to comply with federal and state program laws and regulations or contained documented evidence that a department-wide risk assessment had been conducted; and
3. Some departments understand that the concept of and need for internal controls to involve all departmental operations, not just the financial operations.

To more fully comply with the intent and spirit of Chapter 647 and to develop adequate internal control plans at all departments of the Commonwealth, many departments, groups, and individuals must be involved. Educating departments, increasing their awareness of the importance of internal controls and internal control plans, and assisting them in the development of internal control plans should be continued. The following recommendations may serve to assist in speeding up the full implementation and acceptance of internal controls in the Commonwealth:

- Senior management should pay attention to the subject. The Secretary for Administration and Finance, as well as the Comptroller, should emphasize the importance of internal controls and internal control plans with department heads, senior managers and internal control officers;
- Secretariat and departmental management should consider internal controls to be an integral part of department operations, and should require an

Internal Control Plan as an integral part of the department-wide operations;

- The Office of the Comptroller should continue to educate both department programmatic and fiscal staff about the role and function of the internal control plan;
- The Office of the Comptroller and the Office of the State Auditor should evaluate the need to amend Chapter 647 to re-emphasize and re-energize the internal control focus. Senior Management needs to ensure that internal control officers are always at the senior level required by Chapter 647 in order to affect changes in programmatic controls;
- The Office of the Comptroller needs to continue its development of a model internal control plan, or components of a plan, that could be used as a template to assist departments; and
- The Office of the Comptroller should develop a plan to continue to monitor the progress of departments' compliance with Chapter 647, the Guide and their development of adequate department-wide internal control plans.

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## **Need to Analyze and Evaluate the Vendor Master File**

Currently the Commonwealth has no process in place to remove vendors from its master file. Therefore, records that are inactive are marked for deletion. Once designated, no payments may be processed against that record, yet, the record remains in the system. As a result, the Commonwealth's vendor master file contains approximately 623,000 records. Of that total, approximately 205,000 are marked for deletion. The remaining active files contain current vendors, one-time vendors and old vendors that have not been used but have not as yet been marked for deletion. Due to the sheer volume of vendors, the possibility exists that old vendors could be paid in error.

In addition, the limitations of the accounting system (MMARS) require procedures for entering vendors in the master file that contribute to the problem. Currently, when a vendor is added to the master file it is added twice to record all necessary data fields; once with the remittance address and once with the legal address for tax reporting purposes (W-9 Form). The vendor entered for tax reporting purposes is immediately marked for deletion so that it cannot be used for payment processing. These vendors comprise 137,000 of the 205,000 records marked for deletion. These legal W-9 Forms must remain on the system to be used in the 1099 production process. The Commonwealth's policies require that all new vendors or current vendors that request a modification of remittance information have a form W-9

Form on file.

Currently there are no procedures in place to review the vendor master file to identify vendors that should be marked for deletion. The Commonwealth should periodically run a query on the vendor master file based on the last day of activity. Vendors not used for a determined period of time (i.e. 3 to 5 years) should be marked for deletion and subsequently removed from the system.

The Commonwealth recognizes that a purge of the remaining 68,000 records that have been marked for deletion would benefit the maintenance of this file and has identified this purge process as a requirement for the proposed new MMARS system. In the meantime, the Commonwealth is looking at alternative ways to capture W-9 Form data using web applications to eliminate the duplicate vendor file records stored for tax purposes.

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## **Reporting on the Commonwealth's Retirement Systems**

The various standard setting bodies involved in governmental accounting and financial reporting have begun to evaluate the reporting of retirement systems under GASB Statement 34. While final conclusions have not been reached, there is support for excluding the financial reports of defined benefit plans from the financial statements of the primary government. The reason is that the financial statements, at the fund level, include all assets that are not available to the government in the course of normal operations and are generally held in a trust capacity that is outside of the normal systems of the government.

The Commonwealth is unique among state governments in that it does not have a separately prepared and audited public employee retirement systems. As such, the Commonwealth will not be in a position to take advantage of the reporting exception that may come under GASB Statement 34. The Commonwealth currently has the investments audited but does not prepare a comprehensive annual financial report for the public employee retirement systems. Therefore, many aspects of the program do not have the same level of audit coverage as would be found in other states.

The Commonwealth should consider preparing a separate comprehensive annual report for the pension retirement systems.

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## **Demographic Data Used in the Calculation of the Net Pension Obligations**

While the majority of the demographic data provided by the Teacher's Retirement Board, the State Retirement Board and the Boston/State Retirement Board used in the actuarial assumptions to calculate the pension benefit obligation is factual, stronger controls are needed to reduce the number of assumptions that must be made in compiling this data. In the process of performing the actuarial valuation, the Public Employee Retirement Administration Commission (PERAC) performs a series of edits to reduce the amount of missing or inappropriate data incorporated in the compilation of the underlying data.

**Filtering** – An internally developed program filters individuals with acceptable census data and identifies those with crucial data missing. The individuals with data missing are investigated. Upon investigation, data, based on assumptions, is inserted in place of the missing data and examined for overall reasonableness.

**Assumption Analysis** – For those individuals remaining in the population where no information is available, PERAC has implemented an externally developed assumption application. The assumption file maintenance and generation program will statistically determine the likely value for the missing information. The types of crucial data subject to assumption are job group, salary, sex, age, service and veteran code. The census data from the retirement boards which is available and valid, is entered into the assumption program and, based on the laws of probability, will determine the most likely value for invalid or missing data. PERAC will accept the most likely value for the information and will input results to the PERAC valuation program.

While there has been improvement on behalf of PERAC to obtain the required information, there is still a need for more accurate information on a go-forward basis. While these types of editing procedures to complete the valuation are acceptable alternatives under actuarial standards, we recommend that PERAC continue to audit and clean up this data to reduce the need for assumptions used in the actuarial valuation to be completed during fiscal year 2001. This will also serve to reduce the fluctuations that are present when differing assumptions are used.

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## **Funding Program Necessary for Underfunded Workers' Compensation and Group Health Insurance**

The Commonwealth should establish a funding schedule necessary to accumulate assets to satisfy the current under-funded liability related to the internal service funds. As of June 30, 1999, the under-funded liability for the workers' compensation and group health insurance funds was \$257.9M and \$33M, respectively. Of these amounts, \$36.4M is considered short-term for workers' compensation and \$32.4M for group health insurance. These balances represent accumulated liabilities and will have a material impact on the governmental fund statements when the Commonwealth adopts GASB Statement 34. At that time, these liabilities will be shown as liabilities that directly reduce the "net assets" of the Commonwealth. These and other obligations could result in a negative net asset position.

Available options to furnish the necessary funding include a surcharge to the current statutory chargeback to state agencies, an annual appropriation based upon an actuarially calculated funding schedule, a redirection of investment earnings, and other actions. The Office of the Comptroller and the Legislature should coordinate their efforts to evaluate all options and select the most appropriate one (s) to satisfy the existing liabilities and fund any future liability as it is incurred.

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## **The Commonwealth Should Consider Service Efforts and Accomplishments Reporting**

A major focus in government today is departmental accountability. Service Efforts and Accomplishments Reporting (SEA), as summarized in GASB Concepts Statement No. 2, "Service Efforts and Accomplishments Reporting," measures performance through various indicators and attempts to gauge departmental efficiency.

Because the primary purpose of governmental entities is to maintain or improve the well-being of their citizens, information that will assist users in assessing how efficiently and effectively the Commonwealth is using resources to maintain or improve the well-being of its citizens could play an important role in future financial reporting. The assessment of a governmental entity's performance requires information not only about the acquisition and use of resources, but also about the outputs and outcomes of services provided, and the relationship between the use of resources and their outputs and outcomes.

In prior years, we reported that presently an expanding number of governmental entities are developing and using SEA measures. That trend continues today. In addition, a large number of State Auditor organizations are shifting efforts from compliance and financial audits to audits of these "performance measures." The GASB may ultimately require this reporting as part of the entity's general-purpose financial statements. We suggest that the Commonwealth evaluate the use of SEA reporting as an additional tool to promote accountability and efficiency. Since the services provided by the Commonwealth are diverse and often complex in nature, we further recommend that, in addition to financial management personnel, program and budget personnel, elected officials, internal auditors, professional groups, and citizens become active in developing and using SEA measures.

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## **Activity -Based Costing**

Governments have historically served their citizens regardless of the costs involved. With the continual growth of alternative ways for governments to do business and the pressures to control overall costs, there is a growing focus on the cost of government. The citizens and their representatives in the Legislature have a heightened interest in what programs cost, the cost of delivery under various alternative models and the cost of the individual items or elements required to deliver a service. Activity-based costing is, in effect, government's approach to the cost accounting model used in the private sector to determine the cost to produce a product.

The Commonwealth benefits from having agencies like the Office of the Comptroller employing activity- based costing models as part of the overall management reporting systems. These models allow the Commonwealth to more accurately determine the benefits of electronic benefits transfers, payroll direct deposits or the privatization of an activity. We recommend that the Commonwealth begin additional pilot projects concerning the cost of activities and services that are currently under review for changes in their processes or in the technology used to deliver the services. These pilots should then be used to develop a process for costing the broad range of Commonwealth activities.

The Comptroller has set the example by using ABC studies for the e-Mall, credit cards and Pay-Info pilots. More work needs to be done to communicate these practices statewide.

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## OFFICE OF THE COMPTROLLER

### **Fixed Assets Acquired Need to Be Recorded Within Seven Days of Acceptance**

There is a need for the continued improvement in the recording of various fixed assets. The Massachusetts Management Accounting and Reporting System (MMARS) Fixed Asset Subsystem User Guide requires "assets valued at \$15,000 or more to ...be recorded onto the system within seven (7) days of acquisition... to properly account for and record those items owned by the Commonwealth... and to allow them to be incorporated into the Commonwealth's Annual Comprehensive Financial Report ("CAFR")..." The requirement is designed to ensure that fixed assets are recorded in an appropriate and timely manner. Failure to record such assets understates the value of fixed assets owned and reported by the Commonwealth.

MMARS Memo #290, released on July 9, 1999, reiterated the above facts. The Fixed Asset User Guide as published in May 2000, has a section that reiterated the seven-day policy. All departments have received this guide and it has been posted on the Comptroller's Office website. During the course of the audit, it was noted that three departments (the Administrative Office of the Trial Court, the Metropolitan District Commission and the Department of Correction) and three colleges (Massasoit Community College, Bunker Hill Community College and Bridgewater State College) did not adhere to the policy. In each case fixed assets were acquired in prior years, but not reported until fiscal year 2000. The violations primarily resulted from a lack of knowledge of the "Seven- Day Rule" by the department personnel, and lack of inclusion in the department's internal control plan. The effect of not recording assets timely and correctly is to understate the fixed assets on MMARS and, consequently, the financial statements.

As part of its upcoming fiscal year 2001 Chief Fiscal Officer Conference and open/closing meetings, the Office of the Comptroller should continue to emphasize the need to comply with the "Seven- Day Rule" so that the Commonwealth's financial statements are accurate and reliable. The Office of the Comptroller should also emphasize that this rule should be properly documented in the departmental Internal Control Plans.

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## **All Departments Need to Submit a "GAAP Package" to the Financial Reporting and Analysis Bureau for Proper Reporting of the Comprehensive Annual Financial Report**

The Commonwealth requires all departments to submit a "GAAP Package" to the Financial Accounting and Reporting Bureau (FRAB) at the Office of the Comptroller in order to properly report the Commonwealth's financial condition in accordance with the regulations promulgated by GASB and to allow the Commonwealth to issue accurate GAAP financial statements. OSC distributes instructions to all departments explaining the information that is needed, including accruals for receivables, leases and other balances.

The Comptroller's Office set August 11, 2000 as the deadline for submission of the GAAP Packages. Thirty priority III departments did not submit a GAAP Package for fiscal year 2000. Many of these departments also failed to file GAAP packages in prior years as well. This forces FRAB to make certain estimates and assumptions (concerning payroll, number of employees, etc.). Although these priority III departments are immaterial individually and in the aggregate, the amounts should be reported to give a clear and accurate financial picture.

The Comptroller's Office should continue to communicate with Chief Fiscal Officers in upcoming meetings the need to prepare this package in a timely manner.

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## **INFORMATION TECHNOLOGY DIVISION**

### **System Development Methodology Needs to be Standardized**

A standardized system development methodology has not been developed and consistently applied for network, software, and hardware-related changes. With the conversion of the Commonwealth Automated Payroll System/Payroll-Personnel Management Information System (CAPS/PMIS) to the current Human Resources and Compensation Management System (HR/CMS), the team responsible for the implementation chose to utilize the vendor-specific system development methodology. The Enterprise Applications Bureau (EAB) within the Information Technology Division (ITD) uses a different system development methodology (SDM). Through our review of both system development methodologies within the EAB and HR/CMS, we noted the following areas for potential improvement:

- Although the SDM used by the EAB contains thorough documentation surrounding change control, the procedures have not been updated in approximately 10 years.
- Of a selection of five users tested, all five users within the change control HR/CMS environment had access to the development, test, and production environments. The employees maintained this multi-tiered access due to a variation of job responsibility for each project.
- Large quantities of generic IDs exist within the HR/CMS environment that maintain access to development, test and production environments. The IDs are not reviewed by management on a consistent basis to determine that all are necessary.

Without a standardized systems development methodology there is a potential that system changes can be performed inconsistently. Standardized documentation enables individuals involved in projects to understand the overall scope of projects and determine the current status.

We recommend the formulation and deployment of a single standardized systems development methodology that addresses all projects regardless of the size or environment. The document should address, at a minimum: user requests, authorization, prioritization, project plans, monitoring vendor activities, cost/benefit analysis, testing, documentation, migration procedures and ongoing support.

We also recommend a periodic review of access privileges to ascertain that adequate controls are maintained over the systems environment. In addition, generic IDs should be reviewed to further enhance controls.

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## **Disaster Recovery Plan Needs to be Finalized**

The Commonwealth does not maintain an adequate disaster recovery plan. A comprehensive disaster recovery plan includes provisions for the timely recovery of all mission- critical systems within the environment.

Due to the changing landscape of the Commonwealth Information Technology strategy and systematic architecture, the need for a comprehensive recovery strategy is heightened. Examples of such changing landscapes include the implementation of HR/CMS, the increased use of the data warehouse, on-line functionality such as the RMV registration process, tax filing and the E-Mall. In the future, the Commonwealth has plans to increase the integration of Information Technology in the state business functions.

The intention of a disaster recovery plan is to document actions to be taken in the event the data processing facility is damaged or destroyed. Without an up-to-date tested plan, valuable time can be lost and services may not be able to be provided while options are identified, evaluated, developed, and verified.

We encourage the ITD to continue on their plan of developing an internal mechanism for recovery through developing and hosting their own hot-site. The ITD should utilize their existing recovery strategy as a basis to integrate the changes within the processing environment. A continual update process should be enacted to ensure that all future changes to the computer processing environment are recognized within the plan. As amendments are made to the plan they should be forwarded to all applicable ITD representatives.

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## **Information Systems Security Needs to Be Documented**

The Information Technology Division (ITD) maintains a process for Security Administration. This process is not documented and is not forwarded to departmental security officers to ensure the consistent application of information security practices.

An effective security policy is composed of four elements: Information Protection Strategy, Information Security Architecture, Information Security Policy and Communication and Training. For effective information security, all four aspects need to be addressed.

A strong information protection strategy helps safeguard the Commonwealth against unintentional or malicious acts. Without a comprehensive information security strategy that addresses the current processing environment and changing risks to the Commonwealth, information security becomes less effective.

An effective information security architecture helps to ensure that technology increases business effectiveness while maintaining an appropriate level of integrity and protection. An information security architecture encourages the effective coordination of security controls and their administration. It is used to record and communicate the design, and to coordinate the activities of the system designers and builders.

An effective information security policy identifies information as an asset and defines requirements for protection of that asset. If these requirements are not defined, information may not receive protection commensurate with its value to the

Commonwealth. Without specific guidance relating to information security and mitigation of risk, it is more likely that the integrity, confidentiality and availability of operational and financial information may be compromised.

The final element of an effective information systems security environment is communication and training of users on the policy and procedures.

We strongly urge ITD to document a formal security policy. Once developed, it should be distributed to the agencies and departments throughout the Commonwealth to communicate and explain the need for effective security over computing assets and the methods adopted to maintain security. Decentralized procedures can be developed to address the specific needs of platforms, as long as they support the integrity of the organization-wide control environment. The information security policy should be reviewed on a periodic basis to reflect changes in the business and technical environments. Subjects typically covered in an information security policy include (but are not limited to) the following:

- Policy objectives, scope, and to whom it applies
  - Roles and responsibilities for computer security
  - Platforms and systems covered
  - Dependence of the organization on its computing assets
  - Threats to the computing assets
  - Use of risk assessment and analysis
  - How computing assets are secured
  - Classification of data/information
  - Physical security
  - Logical security
  - Guidelines for user IDs, passwords, and general use of computer systems
  - User access requests and approval processes
  - Review of potential security violations
  - Periodic review of specific access privileges for continued appropriateness
  - Procedures for removing access capabilities of terminated employees and contractors
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## **Modification of the IV Format Needed**

The ITD is responsible for providing mail, computer, and telecommunications services to Commonwealth departments. The rates billed for those services are based on an estimate of what the cost will be for a fiscal year. Since the services are often charged to federal programs, it is necessary for the ITD to determine the actual cost after the end of each year. OMB Circular A-87, Cost Principles for State, Local and Indian Tribal Governments, then requires that a comparison of amounts billed to actual costs be made and any overcharges identified be credited against the federal programs originally charged.

The ITD has been preparing the reconciliation and notifying departments of any credits due federal programs. There is, however, no mechanism in place to clearly and consistently determine whether the offsetting credits have been made to federal programs. The Division ITD has suggested that modifying the format of the interdepartmental voucher (IV) to add a line for adjustments would provide an adequate mechanism and audit trail to ensure credits are properly made.

The ITD is encouraged to renew its efforts to work with the Office of the Comptroller to implement this modification.

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## **OFFICE OF THE STATE TREASURER**

### **Long-Term Debt Documentation**

The preparation of information relating to long-term debt activity during the year continues to be extremely labor intensive and controlled by a single employee in the Office of the State Treasurer (Treasury). As a result of other activities this employee must perform, information necessary to update the Office of the Comptroller's records and prepare support for the financial statements was delayed until after the end of fieldwork.

The Treasury should review the concentration of knowledge with only one employee and determine if additional employees could be used in managing long-term debt as well as preparing the year-end data. This could also involve a form of cross training within the Debt Management Group.

The Treasury should also consider a year-end closing procedures manual, including a checklist to identify for management all the steps that need to be completed for

year -end. The Treasury, in conjunction with the Executive Office for Administration and Finance and the Office of the Comptroller, should coordinate an effort to continually reassess the relationship of all governmental entities in the Commonwealth to the Commonwealth itself. This effort should determine whether or not the entity should be included within the information statements of the Commonwealth as supported or guaranteed debt.

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## **Check Reconciliation**

The reconciliation of the "Float Fund" has, for several years, included a large volume of unreconciled variances. The Office of the State Treasurer's (Treasury) administration has undertaken a process to identify and correct these variances, and checks in excess of \$14 million have been removed from the outstanding check listings. As part of that process in the prior year, certain checks were identified as outstanding in various checking accounts when a corresponding check had already been presented for payment. Although this issue has been resolved, and the variances have been substantially reduced, there continues to be unresolved differences from prior fiscal years.

There are numerous outstanding checks older than one year remaining in the Float Fund balance. Some of these checks date back as far as 1995. Checks are generated from two primary disbursement banks. Aged outstanding checks from the one bank are moved promptly to the unpaid check fund, because the file formats were compatible with new systems developed by the Treasury. Outstanding checks in the second bank have not been transferred to the unpaid check fund because cash management staff noted that the format of the data transmission contributed to the reconciliation problems over the past several years. The Treasury has developed a new software system for the unpaid check fund and developed new file formats to transmit outstanding check data. Test files have been developed with the bank and the software vendor. Treasury management is actively reviewing accounts and has developed procedures to prevent or identify similar transactions should they occur in the future.

We recommend that the Treasury continue its efforts and perform a full analysis of all outstanding checks. We also recommend that it consider the use of outside consultants to facilitate this process. Upon completion of this process, additional corrections should be made to remove these errant checks from the list of those outstanding.

As part of the banking services competitive procurement currently being

undertaken by the Commonwealth, a specification should be added for the redesign of the banking chart of accounts. This would facilitate reconciliation of the float fund.

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## **Collateral held on behalf of the Commonwealth by Fleet Bank**

A collateral agreement exists between Fleet Bank (Fleet) and the Commonwealth. Fleet is required to hold no less than \$ 100 million as collateral on behalf of the Commonwealth in the case of a failure on the part of Fleet. As of June 30, 2000, Fleet was only holding only \$85 million, properly segregated for the Commonwealth. The Office of the State Treasurer (Treasury) had less than \$16 million on deposit in Fleet as of June 30, 2000 and has consistently maintained low balances during the year due to an aggressive cash position management program. As a result, the collateral was sufficient to cover Commonwealth funds. Fleet has also stated in writing that other collateral held by the bank would have been available to meet its obligation to the Treasury. While Fleet's error in reducing the collateral would not have adversely impacted the Commonwealth, it does represent a violation of its agreement with the Commonwealth.

The balance in the collateral account held at Fleet should be periodically reviewed to ensure that Fleet is keeping the required balance in the account in the case of a default. Any balances under \$100 million should be investigated with Fleet in a timely manner in order to discern the reason for the decrease. In addition, the Treasury should remind Fleet that, in accordance with the contractual agreement, Fleet needs to notify the Commonwealth when the balance in the account drops below the \$100 million collateral threshold.

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## **STATE LOTTERY COMMISSION**

## Lottery Commission as an Enterprise Fund

The Lottery is not accounted for or controlled in a manner similar to that followed by many other state lotteries. While the Government Accounting Standards Board has not directly addressed lotteries and refers to the AICPA's audit guide for audit considerations, the relevant accounting can be found in *Governmental Accounting, Auditing and Financial Reporting* (the 1994 edition) published by the Government Finance Officers Association. It states "revenues from lotteries need to be matched with related expenses for prize. Accordingly, lotteries should be accounted for in a fund type that uses full accrual accounting, most commonly an enterprise fund." It also goes on to state that "liabilities should be reported on the balance sheet for games still in progress at the end of the year." This publication qualifies as "other accounting literature" in the hierarchy of generally accepted accounting principles but does raise the important issues for full accrual accounting and the nature of what should be considered expenses of lotteries.

Lotteries are accounted for as enterprise funds so that the full cost of operations is reflected prior to determining the "profits" available for prizes and other uses. In addition, because most lotteries are separately reported as enterprise funds, most states subject them to a separate audit and separate evaluations of the internal control structures on an annual basis. Currently, the Lottery is reported as part of the major special revenue funds in the financial statements of the Commonwealth. Accordingly, the lottery funds are subjected to the audit procedures that are applied to other funds. These are based on levels of materiality which are higher than they would be for a stand- alone audit of the Lottery.

The Commonwealth, as it moves to adopt GASB Statement 34, should consider accounting for the Lottery as an enterprise fund. This would allow the Commonwealth to evaluate the full cost of its operations while providing additional assurance to the public.

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## **Coordination Between Managers of Prizes Payable and Annuities Receivable**

Prize winners in certain games are given the option to receive their prize winnings over an extended number of years. The Lottery purchases annuities, which will yield payments over the extended period of time, in an amount necessary, to satisfy the amount, due to the winner. During testing of the present value of the annuities receivable and prizes payable in the current year, it was noted that the employee responsible for managing the prizes payable and the employee responsible for managing the annuities receivable were not fully apprised of the other person's responsibilities and the interdependency of their functions.

The employees responsible for managing prizes payable and annuities receivable should reconcile their respective accounts on a monthly basis to ensure that annuities purchased do not exceed prizes payable by any significant amount. This would result in more efficient management of assets for the Lottery. Additionally, the two individuals should also be made aware of the interdependency between their functions and the benefit of managing the accounts more closely based on the other's requirements.

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## **OFFICE OF THE ATTORNEY GENERAL**

### **Additional Tracking Required for Settled Yet Unpaid Legal Cases**

The Office of the Attorney General (AGO) is responsible for tracking and reporting on lawsuits pending or threatened against the Commonwealth. The Financial Reporting and Analysis Bureau (FRAB) in the Office of the Comptroller has been working with the AGO, along with the Commonwealth's auditors, to enhance their tracking and reporting system.

A number of lawsuits, arising from the ordinary course of operations, are pending or threatened against the Commonwealth. For those cases in which a probable loss will be incurred and the amount of the potential judgment can be reasonably estimated, the AGO estimates the liability. The current portion of this liability is reported in the appropriate governmental funds and the long-term portion is recorded in the General Long-Term Debt Account Group. This information is communicated to FRAB from the AGO annually during the preparation of the Statutory Basis Financial Report and the Comprehensive Annual Financial Report.

In addition, the AGO confirms the cases that were outstanding in the prior year but which have since been settled. The AGO, however, is unable to confirm whether the amount of settlement or judgment has been paid prior to year -end.

Procedures do not currently exist to either link the AGO information to the accounting records or to track payments and rebates or abatements made by the Department of Revenue in order to determine whether a liability exists at year-end for legal cases settled but not yet paid. In the absence of such tracking procedures, an adjustment equal to \$32 million was required to be recorded for fiscal year 2000.

The AGO should work with the FRAB to develop procedures to improve this system, including the comprehensive roll-forward of all cases. However, this system is still in the development phase. The AGO should continue to work with the FRAB to develop and document additional procedures for tracking such settled cases to avoid any future possible misstatement of the financial records. Those procedures should include processes to contact the attorneys from each department responsible for settling cases, and on a regular and timely basis (once a year, once each quarter, etc.), compiling and updating the information as to the most likely monetary damages which will result from these lawsuits. The FRAB should also develop procedures to determine major payments that have been provided for by legislation to corroborate many of the large-dollar monetary damage suits and continue to track all those all cases until they are actually paid.

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## OFFICE OF THE STATE AUDITOR

### Recruiting and Retaining Audit Staff

Audit organizations in general and governmental entities in particular are facing an increasingly difficult time finding and retaining qualified personnel. With the current strong economy, the increased salaries paid by other employers such as the high technology industry, and the impact of increased educational requirements on CPAs, there is greater competition for the available personnel with accounting or auditing backgrounds. The salary pressures are particularly difficult for governmental agencies to overcome and are a major problem in the geographic areas such as the Northeast, where the technology industry is a major employer. Some governments are even using signing bonuses to attract workers, similar in concept to the Massachusetts program to hire teachers.

As a result, audit organizations are turning to methods other than salary to recruit and retain staff. For example, technology can often be used to offset the need for

some personnel. The Office of the State Auditor (OSA) has recognized this and is currently seeking to obtain audit workpaper and other audit-related hardware and software. However, because of the increasingly complex environment that most auditors face, it is important to hire and retain audit personnel who can deal with the complexities of the new and emerging economy. Many audit organizations have begun specific targeted programs focused on hiring the best, retaining those that are hired and developing all personnel through creative training and development programs. The training and development programs often now go beyond topics relating to audits. Additional best practices include, for example, increased emphasis on encouraging and paying the staff to obtain additional certifications (CPA, CGFM, etc.), providing additional training, providing opportunities to become involved in national organizations for younger staff (National Association of State Auditors, Intergovernmental Audit Forums, etc.).

The OSA is aware of the difficulty it, as well as all audit organizations, are having in recruiting and retaining qualified staff and has already taken steps, as noted above, to deal with these issues. We encourage OSA to continue these efforts and proactively seek out best practices used by other governmental and private audit organizations to recruit, develop and retain staff.

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## **Changes in Government Auditing Standards**

The Comptroller General of the United States is currently evaluating changes to *Government Auditing Standards* including the sections relating to auditor independence. While the exposure draft is still under development, certain aspects of the proposed changes discussed at recent conferences could impact the Office of the State Auditor's (OSA's) operations. For example, situations where the State Auditor is a member of a Board of a Commonwealth entity for which the OSA has audit responsibility could impact auditor independence under the proposed rules.

The OSA has been following the proposed changes to determine what impact they would have on its operations. The OSA should continue its monitoring to determine if any existing laws and regulations may need to be modified to continue to ensure independence.

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**DEPARTMENT OF REVENUE**

## **Tracking and Recording of Fixed Assets**

The Department of Revenue (Department) needs to improve its tracking and recording of fixed assets to fully comply with the Commonwealth's policies and procedures. During fiscal year 1999, the Department moved its offices from the Saltonstall Building, located at 100 Cambridge Street, to a new location, 51 Sleeper Street. Due to space restraints at the Sleeper Street location, various fixed assets remained in the Saltonstall Building. During the 1999 fiscal year audit, one of the four fixed asset selections tested represented an asset located in the Saltonstall Building,, which was no longer in use. This idle asset, a telecommunication-switching device, was recorded at original cost of approximately \$311,000 on the MMARS fixed asset subsystem at the end of fiscal year 2000.

During the fiscal year 2000 audit, two additional idle assets, from a sample of four, also located in the Saltonstall Building, were identified. This idle equipment represented additional costs associated with the telecommunication-switching device (Unix 6000 – Sperry Univac) with original costs of approximately \$94,000 and \$414,000. Upon further review, it appears as though the total value of the seemingly idle telecommunications device is \$2M on the fixed asset subsystem (based on original cost).

The Operational Services Division (OSD) provides guidance that addresses idle assets. Under 802 CMR (Section 3.05) it is the agencies' responsibility to examine their inventories of equipment, supplies, and materials and periodically report property that is no longer needed to the State Surplus Property Officer.

The equipment located in the Saltonstall Building has been idle for approximately 20 months. The Department needs to give further consideration as to the future use of this equipment. It is recommended that the Department should contact the State Surplus Property Officer to discuss sale or disposal treatment of the assets maintained in the Saltonstall Building. Such procedures will ensure that the Commonwealth can identify idle/surplus property and realize the maximum benefit from such property.

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**DEPARTMENT OF REVENUE/DIVISION OF CHILD  
SUPPORT ENFORCEMENT**

## **Personnel Files Need to Be Better Organized**

The Department of Revenue/Division of Child Support Enforcement (Division) needs to improve the organization of its personnel files. While all information necessary to conduct the payroll testing was obtained, it was difficult and often required assistance from Division personnel because the files are voluminous and disorganized.

Organized and chronological personnel files save time and effort for all those individuals who use them. The Division should consider setting up the personnel files in a manner similar to the child support case files and separate the documents into appropriate categories, such as employment application, personnel evaluations, insurance information, and miscellaneous documents.

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## **DIVISION OF MEDICAL ASSISTANCE**

### **GAAP Reporting Needs Improvement**

A review of the initial accounts receivable information submitted to the Office of the Comptroller (OSC) disclosed numerous errors and omissions as follows: The GAAP reporting schedules needed to be revised based upon the audit; some of the information needed from the Department of Transitional Assistance was not obtained until needed for audit; there was no evidence that the reporting package was reviewed by Division of Medical Assistance (Division) management prior to submission to the OSC; and finally, it was unclear as to who had ultimate responsibility for the preparation of the GAAP package due to personnel turnover and transition.

The Division should ensure that the ultimate responsibility for preparation of the GAAP package is assigned to an appropriate individual, and establish a formal review process to eliminate many of the errors/omissions that were noted in the GAAP package information. Often, a reviewer who is removed somewhat from the details of the schedule will be able to identify potential problems, missing data and questions that may be addressed before the commencement of the audit.

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## **MASSACHUSETTS HIGHWAY DEPARTMENT**

## **Need to Strengthen the Process of Handling Construction Materials**

The Massachusetts Highway Department (Department) is responsible for testing materials installed in highway construction projects. If a material fails testing, the results are provided to the resident engineer who makes the ultimate decision whether or not to use the material without any documentation of the decision. Concern was also expressed that samples were not being provided to the laboratory for testing on a timely basis. Some materials were provided for testing after construction was completed.

The Department should establish an independent function to review the decision to use failed materials in construction projects and strengthen procedures to ensure materials are provided to the laboratory for testing on a timely basis

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## **Need to Continue to Update Standard Operating Procedures**

Many of the Department's existing standard operating procedures (SOP) need updating. Some date as far back as the late 1960's, prior to the Department implementing systems such as MMARS, BARS, and PMIS. The SOPs vary in format from one area to another and some areas consider manuals, policy directives and correspondence as part of the SOPs. In addition, there is no central depository or index of SOPs for employee use and the SOPs are disbursed throughout the Department and district offices.

During the year significant efforts were made by various sections of the Department to update their SOPs. In addition, a master index is being developed, which will be put on-line for all employees to access. The use of outdated SOPs in processing information could result in inaccurate project accounting and reporting. Issues are more likely to arise in areas where there is turnover in staff or staff is out on extended leave. The delay in updating existing SOPs was due to the increased volume of activity in federal aid projects and a reduction in staff over the past few years.

The Department should continue to urge all units that have not yet done so to review and revise their SOPs and update their index of current SOPs. SOPs should be integrated and coordinated with the Department's internal control plan, which is required by Massachusetts General Law Chapter 647.

## COMPONENT UNITS

### **Component Units Need to Be More Responsive in Submitting Their Financial Statement Information**

There is a need for continued improvement in the responsiveness of the various component units to financial reporting deadlines. Accurate financial reporting is dependent upon the Office of the Comptroller (OSC) obtaining from these separate entities the information necessary for the preparation of the Commonwealth's financial statements.

During fiscal year 2000, the OSC provided GAAP reporting requirements and guidelines to representatives from each component unit to facilitate the financial reporting process. Currently, the general purpose financial statements of the Commonwealth include 32 component units. Each of these component units is subjected to an audit and is required to report their its financial statements in accordance with GAAP.

Several of the component units included in the CAFR did not submit their final audited financial statements prior to the November 1, 2000 deadline established by the OSC, resulting in several late adjustments and reporting disclosures to the CAFR.

As of fiscal year 2000 the component units adopted a uniform set of accounting policies and financial statement disclosures suggested by the OSC. This helped the OSC organize information for inclusion in the Commonwealth's financial statements and helped ensure that similar accounts across component units are grouped together properly.

The OSC should continue meeting individually and collectively with the various component units prior to June 30, 2001 to instill an "ownership interest" in the financial statements and communicate the role they play in the preparation of the Commonwealth's financial statements. This role will become even more important with the implementation of GASB Statement 34. The discussion should also focus on the disclosures needed in the component units' financial statements in order to meet their responsibility to comply with the standards established by the Government Accounting Standards Board. The component units should participate in establishing the time lines under which they provide the necessary financial statements information within the broader time lines established by the OSC. The component units should also inform their independent auditors of the importance of

the established deadline.

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## **Reporting of the Commonwealth and Other Entities**

For financial reporting purposes, the Commonwealth includes under the requirements of Government Accounting Standards Board (GASB) Statement No.14, "The Financial Reporting Entity," all funds, organizations, account groups, agencies, boards, commissions and institutions for which it is accountable. The Commonwealth has also considered all potential component units for which it is financially accountable, as well as other organizations for which the nature and significance of their relationship with the Commonwealth are such that exclusion would cause the Commonwealth's financial statements to be misleading or incomplete under the requirements of Statement No. 14. Each of these entities should apply the appropriate basis of accounting under the generally accepted accounting principles generally accepted in the United States of America (GAAP). While various options exist under GAAP for the appropriate measurement focus and basis of accounting to be used by certain component units, there should be consistency for similar entities within the Commonwealth, and agreement on the accounting for transactions and other activities that impact both the primary government and the component units.

One area where there is no uniformity of accounting is the Regional Transit Authorities (RTAs). Of the 15 RTAs, 12 follow proprietary accounting and three follow governmental accounting. RTAs are generally considered to be entities that should follow proprietary fund accounting. Upon implementation of GASB Statement 34, it is planned that these RTAs will transfer to Business- Type accounting.

All discretely presented component units that are proprietary should report using a flow of economic resources measurement focus and the accrual basis of accounting. University and College Fund activities should be reported using the accrual basis of accounting. These entities should adopt uniform accounting standards in accordance with GAAP and in accordance with standards established by the Commonwealth and the GASB. New standards issued by the GASB should be implemented in accordance with the provisions and guidance provided by the Commonwealth and the GASB. Symmetry of adopting accounting standards between the primary government, the component units, and institutions of higher education entities will greatly assist in accurate and timely financial reporting.

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