

Commonwealth of Massachusetts

Management Letter

Year Ended June 30, 2001

COMMONWEALTH OF MASSACHUSETTS

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December 18, 2001

Mr. Martin Benison
Comptroller
The Commonwealth of Massachusetts

In planning and performing the single audit of the Commonwealth of Massachusetts (the "Commonwealth") for the year ended June 30, 2001, on which we have issued our report dated December 18, 2001, we considered its internal control in order to determine our auditing procedures for the purpose of expressing an opinion on the financial statements and not to provide assurance on the Commonwealth's internal control. We noted certain matters involving the Commonwealth's internal control structure and compliance of management of the Commonwealth with laws and regulations that we consider to be reportable conditions under standards established by the American Institute of Certified Public Accountants. Those matters are identified in the "Report on Compliance with Requirements Applicable to Each Major Program and Internal Control Over Compliance in Accordance with OMB Circular A-133," dated December 18, 2001. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the Commonwealth's internal control that, in our judgment, could adversely affect the Commonwealth's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements.

Our consideration of the Commonwealth's internal control would not necessarily disclose all matters in the Commonwealth's internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are considered material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Of the reportable conditions noted above, the matter regarding Roxbury Community College, reported to management of the Commonwealth in the "Report on Compliance with Requirements Applicable to Each Major Program and Internal Control Over Compliance in Accordance with OMB Circular A-133," dated December 18, 2001, is, in our judgment, a material weakness.

We also submit our comments concerning certain observations and recommendations relating to other accounting, administrative, and operating matters. These recommendations resulted from our observations made in connection with our audit of the Commonwealth for the year ended June 30, 2001. Our comments, arranged by department, are presented on the following pages.

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

Yours truly,

Deloitte & Touche,LLP

STATEWIDE OBSERVATIONS

Business Continuity Management

September 11, 2001 confirmed, for many entities, the virtues of effective business continuity management. However, the lessons learned from these events highlight the need to challenge some previously accepted assumptions, strategies, and processes and refocus efforts in areas beyond the traditional information technology recovery plans to areas such as the safety and welfare of people, as well as facilities and communications strategies.

The Commonwealth's business continuity program is focused primarily on information technology ("IT") and does not extend to other critical business functions, nor does it encompass other elements of effective business continuity management such as employee safety.

Furthermore, the Commonwealth's IT disaster recovery plan does not cover all of the information systems at every agency. In 2000, a disaster recovery plan focused on the data center and the systems housed in the data center was developed by the Information Technology Department ("ITD") for the MITC data center in Chelsea. However, several agencies do not host their systems in this data center and the ITD is not responsible for monitoring or administering such systems. These agencies are responsible for developing, maintaining and managing their own disaster recovery plans.

The Commonwealth should consider a centralized business continuity management program. Such a program would encompass the Commonwealth's existing IT-focused recovery activities as well as other key continuity components such as:

- Physical Security – The extraordinary scale of the recent violence made it clear that physical security must receive the utmost attention in continuity planning.
- Communications Strategies and Returning to Productivity – After physical security, verifying employee status and returning employees to work are key priorities for resuming business functions. Comprehensive communications plans must be put in place to reassure, to give instructions, and to share information.
- Facilities Strategies – The geographic alignment of resources and operations must be part of any effective management strategy. Recent trends towards operational concentration must be revisited.
- Extended Enterprise – Communications and business processes with suppliers and service providers must remain viable in the event of a crisis such that transactions and services can continue.
- Continuous Availability – Continuous systems availability should be the key goal of effective, comprehensive business continuity management. It can ensure returning to normal operations in minutes, rather than hours or days. Investment in data center and server consolidation, deployment of fault tolerance systems, and data storage strategies is key to achieving continuous availability.
- Ongoing Testing and Maintenance – An essential element of a robust business continuity management program is regular testing and maintenance. Organizations that make investments in testing experience strong returns on their efforts.

Organizations should thoroughly reassess the recovery plans and the associated business risks and mitigation strategies given the events of September 11th.

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”). Implementation of these standards is required during the coming fiscal year.

This statement establishes new financial reporting standards for state and local governments and component units. They are designed to make governmental financial reports easier to understand and more useful to the citizenry, legislature, oversight bodies, investors and creditors. These statements include requirements for management’s discussion and analysis and dramatically change the basic format of the financial statements by requiring governments to provide basic financial statements on both government-wide and fund perspectives.

The government-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 government-wide perspective will not include fiduciary activities). In addition, capital assets (including, for the first time, all infrastructure assets – i.e., roads, bridges and dams) 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 government-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 in this new statement is a requirement for governmental entities to record the cost of infrastructure. Since this information has not been reported in the Commonwealth’s financial statements, one of the most significant hurdles to the implementation of this standard is the accumulation of the historical cost of infrastructure. A complete and accurate accounting of these assets will be of great importance to the Commonwealth because of the inherent inequities in certain of the Commonwealth’s long-term debt obligations with which the Commonwealth is bonding to pay for assets that it does not own. When GASB 34 is implemented, these inequities will inevitably result in the Commonwealth reporting liabilities in excess of assets. Ensuring that all infrastructure assets are properly recorded will help to minimize the impact of these inherent inequities.

Over the past 18 months, management has undertaken a series of projects geared towards preparing for the implementation date of this standard. These projects include:

- A task force assigned to infrastructure assets
- Developing implementation manuals for the higher education institutions and component units
- Assessment of the proposed changes in financial reporting that will result from the implementation of this standard.

As the Commonwealth moves into the year of implementation, management should create an implementation task force to control and monitor the process. That taskforce should be responsible for developing a formal plan for implementation. The items that will need to be considered include:

- A program to support the higher education institutions and the component units to ensure that these entities are able to implement these standards consistent with the Commonwealth's timelines;
- A plan for monthly contact with these entities to assess their progress towards implementation and a program to support these entities if they fall behind schedule;
- The development of a formal timeline for the conversion of the Commonwealth's financial statements;
- The establishment of deadlines for the completion of the infrastructure assets project;
- A project to draft a management discussion and analysis that complies with the provisions of the statements;
- A plan to re-assess the treatment of affiliated organizations and other Commonwealth "governmental" entities to ensure that such treatment remains appropriate; and
- Educational programs to ensure that current guidance being provided by the GASB and the American Institute of Certified Public Accountants is properly disseminated.

Education Program

The changes to the governmental reporting model will 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 question of whether the government's financial condition, as a whole, is better or worse than in the previous year. While the concept is commercial in nature, the emphasis will be on the change in 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 nondebt-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.

To date, management's efforts have focused on educating the preparers of the financial statements with regard to the implications of adopting these standards. Given the focus on the overall financial condition of the Commonwealth and the issues of intergovernmental equity that are inherent to the new financial reporting model, management should also consider developing a training program that is focused on educating the administration, the Massachusetts Legislature (the "Legislature"), and other potential users of the financial statements to the changes. Models should be developed that stress the need for plans to support the future financing of obligations and assets. Management should ensure that legislators understand the impact that GASB 34 will have on the financial statements and the implications of legislative action on financial reporting. This will ensure that decisions made at the legislative level will be consistent with those deemed prudent by management.

Individual Funds

As discussed in previous years' management letters, the number of funds required by the Legislature and used by the Commonwealth hampers the efficiency of the accounting and financial reporting process. In fiscal year 2001, 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, used approximately 111 individual funds to account for the operations of the Commonwealth.

The use of 111 individual funds 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 have been created to monitor and control resources for a specific purpose, this function can effectively be met by using "sub-funds" within the General Fund.

The existing fund structure and number of funds have 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 a budgetary practice that is unique to Massachusetts.
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 GASB 34, each of the individual 111 funds will have to be analyzed to determine if it should be reported as a major fund. In addition, the activities of the funds will need to be reviewed to determine the "individual" adjustments necessary to bring the accounts to full accrual.
4. Accounting principles generally accepted in the United States of America require all fund balance deficits to be reported in the financial statements along with a plan for correcting those deficits. Currently, 27 funds have fund balance deficits.
5. GASB Statement No. 38, "Certain Financial Statement Note Disclosures," will require the Commonwealth to provide the detail of all transfers between the funds, and such transfers will need to be discussed in the Commonwealth's footnotes.

The following table lists the budgeted funds with statutory fund balance deficits (amounts in thousands) at June 30, 2001:

| Budgeted Fund No. | Fund Name | Deficit |
|------------------------------|--|-------------------|
| 101 | Highway Fund | \$ 278,514 |
| 108 | Natural Heritage Fund | 9 |
| 113 | Mosquito and Greenhead Fly Control Fund | 2,305 |
| 134 | Environmental Challenge Fund | 2,794 |
| 149 | Toxic Use Reduction Fund | 7,686 |
| 152 | Environmental Permitting and Compliance Assurance Fund | 43,155 |
| 154 | Underground Storage Fund | 13,920 |
| 156 | Environmental Law Enforcement Fund | 3,875 |
| 157 | Public Access Fund | 296 |
| 158 | Harbors and Inland Waters Maintenance Fund | 7,599 |
| 159 | Marine Fisheries Fund | 5,330 |
| 160 | Watershed Management Fund | 4,331 |
| 161 | Low-Level Radioactive Waste Management Fund | 505 |
| 173 | Clean Air Act Compliance Fund | 1,048 |
| 019 | Child Support Penalty Fee Fund | 87 |
| 186 | Second Century Fund | 3,594 |
| 106 | Antitrust Law Enforcement Fund | 2,765 |
| 110 | Victim and Witness Assistance Fund | 10,335 |
| 111 | Intercity Bus Capital Assistance Fund | 6,070 |
| 165 | Pondapoag Recreational Fund | 5 |
| 172 | Leo J. Martin Recreation Fund | 179 |
| 188 | Children and Senior Health Fund | 13,197 |
| 192 | Trans. Aid to Needy Families Fund | 11,197 |
| 194 | Local Consumer Inspection Fund | <u>574</u> |
| | Total | <u>\$ 419,370</u> |

While some funds with minimal activity were repealed during the fiscal year and more are legislated for repeal during fiscal year 2002, a large number of funds remain and should be evaluated as to their continued need. The following table (amounts in thousands) shows fund activity as of June 30, 2001 for those funds with minimal or no activity during the year. This list excludes funds that were created or repealed during fiscal 2001 and funds whose repeal has been legislated for fiscal 2002.

| Fund Number | Fund Name | Revenues and Other Financing Sources | Expenditures and Other Financing Uses |
|-------------|---|--------------------------------------|---------------------------------------|
| 019 | Child Support Penalty Fee Fund | \$ 661 | \$ 1,817 |
| 020 | Department of Telecommunication and Energy Trust Fund | 2,337 | 2,766 |
| 026 | Firearms Recordkeeping Fund | 534 | - |
| 031 | Oil Overcharge Fund | 1,416 | 1,374 |
| 033 | Civil Monetary Penalty Fund | 245 | - |
| 106 | Antitrust Law Enforcement Fund | 274 | 520 |
| 107 | Government Land Bank Fund | 1,492 | 1,492 |
| 108 | Natural Heritage and Endangered Species Fund | 313 | 324 |
| 111 | Intercity Bus Capital Assistance Fund | 582 | 182 |
| 118 | Federally Assisted Housing Fund | 135 | 135 |
| 132 | Motorcycle Safety Fund | 251 | 188 |
| 136 | Environmental Trust Fund | 2,362 | 1,911 |
| 138 | Children's Trust Fund | 13 | 62 |
| 140 | Labor Shortage Fund | 241 | - |
| 144 | Drug Analysis Fund | 92 | 101 |
| 153 | Massachusetts AIDS Fund | 184 | 407 |
| 157 | Public Access Fund | 879 | 892 |
| 161 | Low-Level Radioactive Waste Management Fund | 252 | 256 |
| 165 | Ponkapoag Recreational Fund | 898 | 803 |
| 168 | Board of Registration in Medicine Fund | 1,916 | 1,916 |
| 172 | Leo J. Martin Recreation Fund | 683 | 667 |
| 179 | Reggie Lewis Track and Athletic Center Fund | 381 | 271 |
| 180 | Assisted Living Administration Fund | 411 | 353 |
| 185 | Solid Waste Disposal Fund | 1 | - |
| 187 | Safe Drinking Water Fund | 2,138 | 2,217 |
| 189 | Diversity Awareness Education Trust Fund | 3 | - |
| 190 | Child Care Quality Fund | 271 | 126 |
| 194 | Local Consumer Inspection Fund | - | - |
| 198 | Voting Equipment Loan Fund | - | - |
| 330 | Revolving Loan Fund | <u>475</u> | <u>1,803</u> |
| | Total | <u>\$19,440</u> | <u>\$20,583</u> |

Such funds represent less than 1% of the activity of the governmental funds of the Commonwealth.

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 subfunds 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 to be reduced to a zero balance as part of the subsequent year's budget.
- "Sunset" provisions should be enacted to require that each fund and subfund, other than the General Fund, be reviewed every five years to determine whether it 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 subfund abolished.

Prior Appropriations Continued in the Legislature

Massachusetts makes extensive use of the carryforward of unexpended appropriations (prior appropriation continued or "PAC"), therefore reducing the effectiveness of the current budget process. Appropriations continued from fiscal year 2001 to 2002 totaled approximately \$290 million, a \$38 million increase from the prior fiscal year. The unexpended balance in the General Fund for all appropriations at June 30, 2001 is approximately \$183 million, a \$4 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 2001, although balances carried forward from fiscal year 2000 were sufficient to cover all 2001 expenditures. This results in an increase in the unspent balances compared to those at June 30, 2000. This trend has continued since 1993.

An example of a balance carryforward is the Legislature's Telecommunication Appropriation, No. 97441000. 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 Laws, 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.

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.

Workers' Compensation and Group Health Insurance

The Commonwealth should establish a funding schedule to accumulate assets to satisfy the current underfunded, liability related to the internal service funds. As of June 30, 2001, the unfunded liability for the workers' compensation and group health insurance funds was \$262.3M and \$31.9M, respectively. These balances represent accumulated liabilities and will have a material impact on the governmental fund statements when the Commonwealth adopts GASB 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 OSC and the Legislature should coordinate their efforts to evaluate all options and select the most appropriate steps to satisfy the existing liabilities and fund future liabilities as incurred.

Activity-Based Costing

Management, 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 an approach used by many governmental entities to determine the true cost to deliver a service.

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

Employee Recognition Programs

As the Commonwealth enters the uncertain economic period of 2001/2002 with the reduced tax collections, it is important to look at programs that produce cost savings while at the same time rewarding and retaining the resource capital needed to run the business of government.

Rewarding and retaining governmental employees has always been a challenge for governmental entities. It is always more of a challenge to reward employees in tight economic times. In looking at models from other states, several programs are worth noting.

One idea is a "Shared Savings Program" modeled after similar private sector models. This program encourages employees to submit ideas for managing, building or buying something more efficiently. Any actual savings go into a special account, and after a year, half of the savings recognized in the department go to the department employees.

A second idea is a quality service award which allows individual employees to earn financial recognition for accomplishments. The program awards up to \$10,000 to one person or to a number of people.

While other types of programs exist, the goal for Massachusetts should be to reward talented employees while reducing overall costs and improving operational efficiency.

Investor Relations Programs and Related Disclosures

The Commonwealth should review its investor relations program.

The United States Securities and Exchange Commission (“SEC”) has continued to focus on municipal securities and investor information. The reason for this focus, as stated by Stephen J. Weinstein of the Office of Municipal Securities of the SEC in his speech at the August 2001 annual conference of the National Association of State Auditors, Comptrollers and Treasurers, is the emerging dominance of individual investors in the municipal market. In his speech Mr. Weinstein indicated that more than 70 percent of the outstanding obligations are held by or for individuals, either directly or through bond funds, and that nearly 40 percent of the total is held by individuals themselves or in their personal trust accounts.

Because many investors purchased their bond holdings in the secondary market, the disclosures to that segment of the marketplace are beginning to receive a growing level of attention. The SEC has begun to focus on information on governmental websites and whether the information has the potential to mislead investors. Properly used, the website is an important element of an investor relations program and an aid in complying with the SEC rules applicable to governmental securities.

In 1996, the Government Finance Officers Association (“GFOA”) issued a recommended practice on “Maintaining an Investor Relations Program.” The centerpiece of the GFOA’s recommended investor relations program is a commitment to provide annual financial, operating, and other significant information in a timely manner consistent with federal and state laws and SEC rules. Issuers were encouraged to consider addressing the following concerns:

1. Identify individuals responsible for speaking on behalf of the issuer.
2. Develop procedures for identifying and selecting information, both positive and negative, to be made available to investors.
3. Develop procedures for disseminating information so that it gets to all parts of the market simultaneously and not only selected investors.
4. Develop procedures to ensure potential investors receive copies of the preliminary official statement at least one week in advance of a bond sale.
5. Identify ways to stay abreast of issues that are likely to be of concern to investors.
6. Develop and maintain good relationships with the rating agencies.
7. Establish procedures to ensure that financial statements or other information needed for disclosure purposes are completed on a consistent schedule from year to year and prior to the dates established in any contractual commitments.
8. Delineate clearly the roles and disclosure responsibilities in conduit borrowings.
9. Engage in marketing activities to alert investors of a pending bond sale.
10. Identify investors who hold the issuer’s bonds to improve communications.
11. Be aware that legal issues may exist with respect to securities information provided by electronic means.

An article in the June 2001 *Government Finance Review* described a governmental entity's investor relations program. That article discussed the fact that most investors do not accept the minimal disclosures required by SEC Rule 15c2-12 as sufficient. That entity specifically performed the following steps in establishing an investor relations program.

1. Conducted research into the legal requirements.
2. Looked at the information needs of the bond rating agencies, bond insurers and underwriters regarding their requirements to comply with SEC and Municipal Securities Rulemaking Board rules.
3. Developed a cover sheet for all filings with the Nationally Recognized Municipal Securities Information Repositories ("NRMSIRs") that contained all CUSIP numbers. Such a cover sheet is to accompany all filings and is necessary for the NRMSIRs to be able to tie disclosure documents to specific bond issues.
4. Added an "investor relations site" to the government's webpage.
5. Developed a quarterly investor newsletter that is posted on the website.

This government believed that by providing information directly to the investor community it could improve investor relations, increase investor interest in the debt with a corresponding lower interest rate as a result of demand, and obtain more favorable bond ratings.

Compliance with Chapter 647, the Internal Control Act

Massachusetts General Laws, 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 OSC. The OSC has issued written guidance in the form of the *Internal Control Guide for Managers* and, in 2001, the *Internal Control Guide for Departments*. Departments implement Chapter 647 and these guides through a document known as the "departments' internal control plan."

Since the passage of Chapter 647, the OSC, in addition to publishing the above-mentioned guides, has assisted departments, when requested, in developing internal control plans; conducted training sessions on internal controls and risk assessments; and, in conjunction with the Office of the State Auditor, reviewed internal control plans for departments upon request or as part of the statewide single audit.

To support departments in their efforts to improve internal controls and internal control plans, the OSC has expanded its ongoing internal control campaign. The focus for 2001 was to ensure that all departments had prepared department-wide risk assessments. It prepared and conducted two instructional seminars on Developing a Department-Wide Risk Assessment, published existing departmental models for developing internal control plans and risk assessments on the Internet, and held a Chief Fiscal Officers Conference at which internal controls were a key part of the agenda.

In 2001, the OSC and the Office of the State Auditor conducted follow-up site visits of the departments in which internal control plans were reviewed, as part of the 2000 single audit to review their progress on implementing the internal control plan recommendations. The OSC and Office of the State Auditor staffs found that all departments had made incremental progress towards implementing the recommendations and that some departments regularly incorporate operational changes into their internal control plans.

Although most of these plans generally contain adequate descriptions of fiscal policies and procedures, only a few plans described the controls required to thoroughly comply with federal and state program laws and regulations or contained adequate documented evidence that a department-wide risk assessment had been conducted. Most of these departments indicate that they now understand that the concept of and need for internal controls must involve all departmental operations, not only 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. The education process, including departmental awareness of the importance of internal controls and internal control plans, and the development of internal control plans should be continued. The following recommendations may serve to assist in furthering the full implementation and acceptance of internal controls in the Commonwealth:

Senior management must continue to 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 and include discussions on internal controls in any new statewide initiatives as was done with the Managing for Results Initiative (“MRI”);

Secretariat and departmental management must consider internal controls to be an integral part of department operations and require the internal control plan as a key component of department-wide operations;

The OSC should continue to educate both department programmatic and fiscal staff about the role and function of the internal control plan, as was done most recently at the Risk Assessment Seminar; and

The OSC 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 effect changes in programmatic controls.

Higher Education Shared Services Center

The Commonwealth should evaluate whether a higher education shared services center would improve the efficiency and accountability of the accounting and student financial aid operations of the community and small state colleges. A secondary goal would be to use the shared services center to reduce the operating costs of nonacademic functions. The recent problems encountered at Roxbury Community College, combined with the turnover experienced by other institutions, indicate the need to challenge the current approach to providing the “back room” operations of the state’s higher education system.

The use of a shared services center is one approach to improving the accounting and student financial aid operations of many of the smaller institutions of higher education. A shared services center, whether run by a governmental entity or outsourced to a private entity, could provide the following benefits:

1. The ability to keep pace with ever-changing technology
2. Flexibility and scalability
3. The foundation for Internet-based e-business/e-government
4. The ability to enhance responsiveness and customer satisfaction
5. Best business processes and practices
6. The ability to attract and retain good people
7. Optimizing the allocation of existing resources
8. Cost savings and cost control
9. Better information for management decision making
10. Continuous improvement with new ideas and service offerings

Various governmental entities have begun to use shared services centers or similar concepts (see June 2001 issue of *Government Finance Review*). In addition, the Apollo Group (University of Phoenix) has used outsourced providers to service both its accounting and student financial assistance functions.

In considering whether to move to a shared services concept, the Commonwealth should perform the following steps:

- Complete a business process diagnostic evaluation at a number of institutions
- Prepare a requirements definition of core financial functions
- Obtain buy-in from upper management and user institutions
- Develop documentation deliverables
- Perform a best practices review of current operations and new technology
- Research the cost of communication links to the shared services center

OFFICE OF THE COMPTROLLER

Fixed Assets

There is a need for the continued improvement in the recording of 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.

MMARS Memo #290, released on July 9, 1999, reiterated the above facts. The *Fixed Asset Subsystem User Guide*, published in May 2000, has a section that reiterated the 7-day policy. All departments have received this guide, and it has been posted on the OSC website. During the course of the audit, it was noted that two departments (Department of Public Health and Department of Elder Affairs) and one college (Massasoit Community College) did not adhere to the policy. In each case, fixed assets acquired in prior years were not reported until fiscal year 2001. The violations primarily resulted from a lack of knowledge of the “Seven Day Rule” by the department and the college’s personnel. The effect of not recording assets timely and correctly is to understate the fixed assets on MMARS and, consequently, in the Commonwealth’s financial statements.

As part of its upcoming fiscal year 2002 Chief Fiscal Officer Conference, the OSC 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 OSC should also emphasize that this requirement be included in the departmental internal control plans.

“GAAP Packages”

All departments are required by the Commonwealth to submit a “GAAP Package” to the Financial Accounting and Reporting Bureau (“FRAB”) of the OSC. The purpose is to properly accumulate the information needed to report the Commonwealth’s financial condition under accounting principles generally accepted in the United States of America (“GAAP”) in accordance with the standards promulgated by the Government Accounting Standards Board. The OSC distributes instructions to all departments detailing the information needed including accruals for receivables, leases and other balances.

The OSC set August 10, 2001 as the submission deadline for the GAAP Packages. Forty-six priority III departments failed to submit a GAAP Package for fiscal year 2001. Many of these departments also failed to file GAAP packages in prior years as well. This forces the FRAB to make certain estimates and assumptions (concerning payroll, number of employees, etc.) in order to prepare statements. Although these priority III departments are immaterial, individually and in the aggregate, the amounts should be reported to provide an accurate financial picture.

The OSC should continue to communicate the need to prepare this package in a timely manner with chief fiscal officers in upcoming meetings.

INFORMATION TECHNOLOGY DIVISION

Documentation of Backup and Data Retention Guidelines Needs Improvement

The Massachusetts Information Technology Center (“MITC”) needs to document data retention guidance for the agencies it supports. The MITC data center houses and supports the information resources for several agencies. The backup policies regarding those resources are dictated by the individual agencies. Although there exists a standardized backup process, it has not been documented. In addition, there exists no documentation on data retention guidance. Agreed-upon procedures have not been developed and acknowledged by the Information Technology Division (“ITD”) or the agencies it supports.

The procedures and actions followed by computer operators, which include processing production applications and their backups, have an impact on information integrity. It is essential that all such actions are planned and clear instructions are developed and followed for their implementation. Without such formal documentation, management’s intentions regarding backup procedures and data retention may not be clearly understood throughout the organization. If backups and retention policies, procedures, standards, and guidance are not followed, the agencies, and the organization at large, risk the unavailability of data and storage media, non-compliance with the legal requirements, and inefficient use of resources.

We recommend the Commonwealth formulate a single set of guidelines that addresses all aspects of backups and retention of data and resources. These guidelines should be issued and enforced at all agencies that rely on the MITC for their data and resource administration. This process will also help ensure maintainability and education for all other users of the system. Backup and retention guidelines may include documentation regarding the following:

- Definition of systems criticality, downtime tolerance, etc.
- Process to define the relevant data for which the retention is required by law
- Data category definitions and associated required retention periods
- Process to create and label backups
- Inventory of retained records in any centralized media library
- Process to research changes in laws and regulations which affect retention periods
- Procedures for implementing/updating relevant parameters for an automated data retention tool to guarantee that all defined data are stored
- Process to delete expired data
- Communication of the backup and retention policy to all users

Timely Deletion of Terminated Employees

The ITD does not receive a regular listing of terminated employees from the various agencies that have access to RACF. The ITD performs a monthly sweep of the user database and matches RACF to HR/CMS. Profiles existing in RACF, to which no match is found in HR/CMS, are deleted. However, this process is more reactive than proactive. A terminated employee’s access may potentially remain live until the next monthly sweep occurs.

Lack of standard procedures to administer user access related to adds, changes and terminations increases the risk of unauthorized system access. Active administration of information systems security is important to ensure that security policies and procedures are consistently applied across the organization, especially over time and during instances of employee turnover. The lack of standard procedures may contribute to higher levels of administration and overhead costs, inefficiencies and potential security exposures. Access privileges should be established effectively in order to ensure data integrity and confidentiality, and that availability is not compromised through intentional or unintentional errors.

Access paths are the logical routes of access to systems and data. In a multi-systems environment, such as the Commonwealth, there are multiple access paths to data (for example, through operating system utilities, database facilities, and application software). It is essential to evaluate systems' access privileges granted to employees on a regular basis.

We recommend the development of a more effective process to ensure that terminated employee access is disabled in a timely manner (i.e., immediately upon termination). A process should be put in place to obtain daily reports of terminated employees from the Human Resources Division (HRD) as well as HR departments at other agencies. HR departments at all agencies not only need to be aware of all terminations before they happen, but need to report these deletions to the ITD group immediately, so these users can be removed from the system in a timely manner. Additionally, ITD may consider increasing the frequency of reviewing system access privileges, through a match of HR/CMS and RACF.

Incident Response Procedures for Security Violations Should be Clearly Defined

The ITD does not have a clearly defined set of procedures to handle security violations. The ITD performs regular security monitoring by reviewing the daily Internet Security Systems Real Secure intrusion detection logs. Also, alarms have been set up to notify security personnel of high security violations. However, the ITD does not have a formalized methodology for handling such violations at this point. Although certain informal procedures have evolved over time, a standardized set of incident response procedures or comprehensive checklists have not been developed to determine the steps that should be taken in the event of a security violation.

Incident response procedures ensure that all security breaches are handled properly before serious damage can be done to systems. Without a clearly defined set of procedures to handle security violation incidents, there is a risk that security breaches may not be handled properly and serious damage may be caused to critical systems.

We recommend the formulation and deployment of a standardized set of incident response procedures that addresses all aspects of security violations from initial detection to resolution of the incident. A standardized set of incident procedures will ensure that regardless of when the breach occurs or who is available to address the incident, it will be handled quickly and correctly before any damage can occur. At a minimum, incident response procedures should consist of four steps:

- Identification and categorization
- Escalation and notification
- Containment, eradication and recovery
- Post-incident follow-up
- Development of these procedures should be coupled with periodic training to ensure that all security personnel are prepared to handle an actual security violation and that they know who to contact, how to resolve, etc.

Data Transmitted Across External Networks Should be Protected

The ITD is considering using encryption mechanisms from a data classification perspective. However, currently there is no encryption on data transmitted across external networks. The Commonwealth of Massachusetts needs to revisit its existing systems infrastructure. Based on the infrastructure requirements, it may need to evaluate various means of protecting sensitive data.

In the electronic age, information confidentiality and privacy often require that extensive security measures be put into place. When transmitting data across external networks such as the Internet, all sensitive data, such as information about an individual's health or human service needs, should be protected. Encryption is a fundamental security mechanism for protecting data. If sensitive data is not encrypted, an individual with malicious intent or other interest, who has access to the Internet, can capture information exchanged on the Internet as readable text, which leaves an organization susceptible. Encryption adds an additional layer of security that makes it more difficult for unauthorized individuals to capture information transmitted over external networks and helps ensure the privacy of confidential information. This issue is gaining importance because of new regulations over security and privacy, such as the Health Industry Portability and Accountability Act.

With the proliferation of digital communications, it is essential to implement increased security and privacy measures. Given the complexity of the Commonwealth's information systems, many of which reside on different platforms and don't easily lend themselves to encryption or other data protection mechanisms, we recommend that the Commonwealth of Massachusetts revisit its systems infrastructure and review existing industry standards and the costs involved to ensure that all sensitive data that is transmitted across its external networks is protected. We understand that it is currently evaluating various means of performing data security, such as digital signatures, PKI, etc., and we encourage the Commonwealth to continue to make this a priority.

Testing Procedures for Systems Software Changes are not Documented

The objective of testing any change is to ascertain the effectiveness of internal controls designed to help to ensure that new or modified systems software is reliable, accurate, and meets functional requirements. Selection of inappropriate systems software may result in increased system downtime and/or difficulty in integrating the various systems software packages and computerized application systems. At this time, ITD does not maintain documented testing procedures for systems-software-related changes. Although every product would require a different kind for testing, management may consider developing a basic outline of procedures to be followed. Also, testing of any new product or changes to existing systems software products should be documented.

Without procedures to test new products or changes to existing products, inappropriate or ineffective changes could be moved to production and affect multiple users. Any change to the systems software, data architecture or network configuration will impact the organization and can cause disruptions in normal operations.

In order to minimize disruption in normal operations, detailed testing procedures need to be documented to help ensure maintainability and education for all other users of the system. At a minimum, testing procedures should include information about the following:

- What types of testing will be performed (e.g., system and unit testing; interface, parallel and capacity testing; user acceptance testing)?
- When will the test be performed?
- How will the test be generated?
- Who will perform the different types of tests, and who will approve the results and adequacy of such tests?

OFFICE OF THE STATE TREASURER

Cash Management System

Treasury staff and consultants developed the current cash management system in 1991. While it has been modified since 1991, the system has been lacking in meeting the needs of the Treasurer's Office. Treasury management has employed consultants to review the overall functionality of the current system and make a determination as to whether modifications to the existing system or the purchase of a new system represents the most effective long-term solution to eliminate the current system limitations. Based on those recommendations, the Treasury has installed a new investment software system and is in the process of completing the set-up of the interface to the MMARS system. The existing business practices should be examined to satisfy the accounting requirements, daily cash management and cash flow projections. Implementation of the new system, along with the requisite business practice revisions and associated training, will result in less reconciling of items, improved control over the process, and better cash management.

Cash Management Staffing

The duties of the Cash Management Department within the Office of the State Treasurer have been redefined under the current administration. For instance, internal control oversight is now the responsibility of an internal control auditor who reports directly to the First Deputy and the Treasurer. The unpaid check fund, claims validation, claims processing and payment have been segregated and integrated with the state accounting system. The Account Reconciliation Division is now staffed by four individuals. These changes within the Cash Management Department have been accomplished through the addition of new staff. The relative newness of the staff, however, could become a concern without the maintenance of strong supervisory roles to guide this development in the event that there is a change in senior management.

The daily operations of the Cash Management Department are highly dependent on the expertise of one individual. The loss of this individual's experience and expertise could potentially have an adverse effect on the Treasurer's cash management operations.

The creation of an additional supervisory position should be considered. This position should be staffed with a qualified individual with a background in accounting and adequate management experience. This individual would be responsible for managing and supervising the staff function as second-in-command to the Deputy Treasurer.

Long-Term Debt Information

The preparation of long-term debt information is labor intensive and controlled by a single employee in the Treasurer's Office. As a result of other activities that this employee must perform, information necessary to update the Comptroller's records and prepare financial statements is often delayed until after the end of the fiscal year.

Though improvements have been made in this process, delays were still experienced in the preparation of debt-related information. Management should review the procedures used to prepare the long-term debt information. Consideration should be given to development of a transaction-closing checklist to identify all the steps that need to be completed before a bond sale is considered final. The checklist should include information necessary for the preparation of financial statements. When third parties provide information, procedures should be put in place to accumulate the data within a specified time limit after the close of the transaction.

Management should also consider developing a training program to expand the depth of understanding within the department to ensure continuity in the event that the individual currently assigned to perform certain tasks retires or transfers to another function.

Tangible Property Office

Abandoned property turned over to the Commonwealth of Massachusetts includes physical assets submitted by “holders” such as hospitals, prisons, mutual fund companies, insurance companies and banks. Under Massachusetts General Laws Chapter 200A, abandoned property is required to be submitted to the Office of the State Treasurer, after a statutorily determined period of time, along with the names and addresses of the rightful owners. For example, in the case of abandoned bank assets (such as personal safe deposit boxes), these assets are required to be submitted when the property has not been claimed for seven years. Once submitted, the assets are stored and secured by the Tangible Property Office within the Abandoned Property Division. Assets remain in the Tangible Property Office until they are either claimed by the rightful owners or liquidated through an auction conducted by the Abandoned Property Division.

Two individuals run the Tangible Property Office, and they have responsibility and control over the assets submitted. These are the only individuals allowed to take possession of the assets and who know the alarm code to gain access to the assets. They are also responsible for recording the assets into the system database, for advertising the receipt of the goods in order to return them to their rightful owners, and for having property appraised in order to auction.

In addition, inventory counts are not conducted or observed by anyone outside of the Tangible Property Office. Overall, these factors combine to create a risk that physical assets submitted to the office, in accordance with the Abandoned Property Laws of the Commonwealth, may not be handled properly and that such actions have the potential of not being identified by management in the normal course of operations. Otherwise there is no way of reconciling what was sent with what was received by the Tangible Property Office.

Additionally, abandoned property mailed by holders is often mailed to the Abandoned Property Division, rather than the Tangible Property Office. The Abandoned Property Division clerk opens the packages and transfers the assets to the Tangible Property Office. This increases the risk that assets would not be appropriately handled prior to being delivered to the Tangible Property Office.

Holders should be instructed to send all physical assets directly to the Tangible Property Office, and no other employee or department should be authorized to open or accept the package. The holders should also be required to include a master list of the number of bags sent and the names of the rightful owners of the abandoned property so that a reconciliation can be performed between what the bank sent and what the office received. After the contents have been reviewed, the Tangible Property Office should send a written confirmation back to the holder confirming receipt of the property.

We recommend that Treasury management review the separation of duties and segregate the custody and the recording of the assets. Someone independent of the individual who records and receives the assets should retain the master and detailed inventory lists. This independent person should reconcile the list with the items recorded into the database by the Tangible Property Office employees.

Management should also periodically conduct random inventory test counts. Management should select items from the independent list submitted by the holders and trace the selected item to the physical asset secured in the room to ensure that it has been given an identification number and that it has been properly recorded in the database with an accurate description.

Internal Audit Function

In 1999, the internal audit function was created for the purpose of documenting a formal internal control plan in compliance with Chapter 647 of the Acts of 1989. Prior to 1999, the Treasury had no internal audit function and had not submitted an internal control plan. An internal auditor was hired in June of 1999. In fiscal year 2000, the new Treasurer submitted and received approval on its first comprehensive internal control plan. The internal control plan is an evolving document and is updated whenever there are any changes in business operations at the Treasury. When these changes do occur, internal audit is responsible for documenting the new process, identifying the new controls, and conducting a risk assessment. Throughout the year, when new operating procedures and policies need to be established, the internal auditor is involved from the beginning of the process to its completion, acting in a coordinated effort with departments to improve the control environment. Presently, the Internal Audit Department consists of one individual. While this individual has extensive knowledge of the operations of every department within the Treasury, along with a well-documented, detailed internal control plan, it may be time for a transition in the focus of the internal audit function.

The internal control plan describes the operations of each department and details the controls that exist. The internal audit function should consider shifting its focus to testing the controls that are in place and determining the effectiveness of the controls. While ongoing monitoring controls are in place and risks assessments are conducted, it may now be appropriate to adjust the focus of the Internal Audit Department's efforts and conduct more formalized testing of existing controls. Expansion within the internal audit function should be considered so that an appropriate level of staffing exists to implement testing procedures sufficient to obtain assurance that each department is functioning at its maximum potential.

Now that a plan exists and controls are in place, an annual schedule should be developed that includes a plan to test the documented controls to ensure that they are working effectively and are being applied consistent with the intentions of management. The results of the tests should be reported to management, and any deficiencies should be brought to their attention with a suggestion for corrective action. In addition to testing control procedures, the internal audit function should serve as a vehicle for examining the current operations of a department and searching for areas where improvements can be identified. The internal audit function should work with each department and strive to improve daily operations and achieve the departments' missions and goals.

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 OSC has been working with the AGO, along with the Commonwealth’s auditors, to enhance its 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 the FRAB 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, adjustments to the General Fund and the General Long-Term Debt Account Group in amounts equal to \$27 million and \$113 million, respectively, were required for fiscal year 2001.

The AGO and the FRAB should work together to develop procedures and controls to correct this system. This system should include the preparation of a comprehensive rollforward of all cases on a quarterly or semiannual basis. 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 in the financial statements. 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 cases until they are actually paid.

Check Reconciliation

The Public Charity Division (“PC”) of the AGO is responsible for collecting and processing informational returns and the related filing fees from nonprofit organizations.

When the returns and checks are received at the PC, the checks are batched based on the AGO’s sliding fee scale, e.g., the \$50 checks are batched, the \$30 checks are batched, etc. The total number of checks in each batch is entered into an Excel spreadsheet, and the total dollar value of each batch is calculated. A tape with the total value of all the batches is sent to the AGO’s Finance Department. Personnel in the Finance Department recount the checks and separate them into smaller batches for ease of deposit and then compare the deposit slips to the tape sent by the PC. If a discrepancy between the slips and the tape is found, the PC is notified so that it can amend its records. No reconciliation is performed.

Ten transactions were selected for examination and comparison – 5 from the Finance Department’s records and 5 from the PC’s records. Eight of the ten did not reconcile without further investigation because neither party kept copies of the checks or a log.

We recommend that the PC maintain a log of checks received or make copies of the checks. The log or the copies, along with a copy of the Excel spreadsheet, should be maintained in the PC. The original checks and the Excel spreadsheet should be forwarded to the Finance Department. Any discrepancies between the PC data and the Finance Department’s deposit slips should be reconciled and resolved immediately.

MASSACHUSETTS HIGHWAY DEPARTMENT

Need to Monitor Payments to Construction Contractors

During the test of expenditures, it was noted that the Construction Division (“Division”) held one payment voucher of \$103,221 for goods and services rendered between December 18, 1999 and February 26, 2000 until fiscal year 2001. The Division dated the payment voucher (“PV”) March 13, 2000 and changed the beginning and ending date of service to July 1, 2000. The PV was not received and entered by the Fiscal Division until November 17, 2000.

The department should ensure that the Division processes all payment vouchers in a timely manner to ensure compliance with the Commonwealth’s prompt payment act and the costs are recorded in the current year.

Significant Increase in the Backlog of Complete Contract Audits

Over the past five years, the backlog of completed contracts awaiting final audit has steadily increased. When last reported in 1996, Audit Operations had a backlog of 245 completed projects which were greater than three years old. Currently, there are 873 completed contracts, totaling \$657 million, greater than three years old. Although additional effort was obtained through the use of independent CPA firms, it does not appear that there are adequate resources to complete all audits before the end of the seven-year, record-retention requirement for consultants.

The department should consider increasing Audit Operations staff and further supplementing its resources by retaining additional independent CPAs until the backlog is reduced.

DEPARTMENT OF REVENUE/DIVISION OF CHILD SUPPORT ENFORCEMENT

Preparation of Federal Cash Transactions Report Needs to be Consolidated

The Department of Revenue/Division of Child Support (“Division”) needs to consolidate into one department the preparation of the Status of Federal Cash, PMS-272 Report. The involvement of two departments is inefficient and, in instances where there is a lack of communication, may result in errors.

The PMS-272 is a quarterly report that provides total accountability of all federal cash received by the Division. It is partially prepared by the Division of Payment Management (“DPM”) within the Department of Health and Human Services, based on data reported to DPM, and is completed and certified by the Division. Presently, the report is prepared by both the Finance Unit at the division level and the Budget Unit at the department level. All other federal reports are prepared solely by the Finance Department without involvement from the Budget Department.

The 1st quarterly report for the large grant was prepared and submitted by the Finance Unit. The Budget Department, believing it was correcting a previous error, proceeded to submit a revised version of this quarterly report. The Finance Unit had already submitted a report correcting the error, so it then had to adjust another PMS 272 Report so that the reports are now correct. The Division’s internal controls did uncover these errors; however, the error would not have occurred had one department been responsible for the production of the report.

In addition, a review of the 3rd quarter’s small grant report disclosed that the manual version was originally submitted unsigned. Division officials explained that the Commissioner was out the day the report needed to be submitted, it was late, and the DPM informed the Budget Director that the federal government was going to shut down the draws if the report was not filed that evening. The Budget Director signed the report to submit it as quickly as possible. The Deputy Commissioner eventually properly reviewed and signed the report. However, the report was then dated July 10, 2001, after the submittal date of the report.

The Division should assign responsibility for preparing and submitting the PMS 272 Report to the Finance Unit – the Unit which prepares and submits all other federal reports which, when reviewed, were accurate and timely. Such action will help ensure that the PMS 272 Report is completed and submitted in a timely manner. In addition, the report should be submitted for review only to the authorized division reviewer prior to submittal to the federal government.

Vacant Positions Need to be Filled

There are a large number of vacant positions within the Division. The Division lost, through attrition, a total of 45 positions, or 6% of its staff, in fiscal year 2001. Legal and caseworker staffing levels have been most significantly affected by the attrition; however, key management positions have been lost as well. A few examples of vacant management positions are within the Finance Unit and include: the Director, Deputy Director, and Manager of the Financial Processing Unit. Significant and prolonged understaffing in legal and caseworker positions affects the Division’s ability to meet federal performance standards for establishing and enforcing child support obligations and claiming additional federal incentive payments. In addition, lack of consistent management in the Finance Unit places internal control protocols at risk and impairs the Division’s ability to adequately reconcile its accounts and ensure that the work is being done properly.

The Commonwealth’s recent hiring freeze may impact filling these vacancies. Nonetheless, the Division should focus on hiring for legal and caseworker positions as well as a strong team to manage its Finance Unit. Cross training of individuals would also help alleviate the current staffing shortage.

COMPONENT UNITS

Component Units Need to be More Responsive in Submitting Financial Statement Information

While there has been a significant improvement in the responsiveness of various component units in submitting financial statements to the Financial Reporting and Analysis Bureau by the financial reporting deadline, several of the component units again failed to submit their final audited financial statements prior to the November 1, 2001 deadline established by the OSC. This resulted in several late adjustments and the need to adjust disclosures in the CAFR. Continued improvement is necessary for accurate financial reporting.

The OSC provides GAAP reporting requirements and guidelines to representatives from each component unit to ease the financial reporting process. For 2001, the OSC suggested a uniform set of accounting policies and financial statement disclosures for the component units. This helps the OSC organize information for inclusion in the Commonwealth's financial statements and helps ensure that similar accounts across component units are grouped together properly.

Currently, the general purpose financial statements of the Commonwealth include thirty-three component units. Each of these component units is subjected to an audit and is required to report its financial statements in accordance with GAAP.

The OSC should continue to hold group and individual meetings with the various component units to encourage 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 Statements 34 and 37 in fiscal year 2002, which will dramatically change the format of the financial statements. Since next year's financial statements will be more complex than in past years, it is important to stress timely compliance. Discussions 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 statement 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 deadlines.

Reporting of the Commonwealth and Other Entities

For financial reporting purposes, the Commonwealth GAAP financial statements include all funds, organizations, account groups, agencies, boards, commissions and institutions for which it is accountable as required by GASB Statement No. 14, "The Financial Reporting Entity." 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 relationships with the Commonwealth are such that exclusion would cause the Commonwealth's financial statements to be misleading or incomplete under the requirements of GASB Statement No. 14. Each of these entities should apply the appropriate basis of accounting under 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 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 among the primary government, the component units, and institutions of higher education entities will greatly assist in accurate and timely financial reporting.

THE MASSACHUSETTS TEACHERS' RETIREMENT BOARD

Need for Increased Controls Over Submission of Teachers' Retirement Data as Reported to the Teachers' Retirement Board ("TRB")

In order to accurately track teachers' retirements, the Teachers' Retirement Board ("TRB") collects data from every school district in the Commonwealth. Chapter 32 of the Massachusetts General Laws requires that the data must be submitted to the TRB within 10 days after the end of the month. This data includes demographic information (name, address, date of birth, etc.), information regarding the individual teachers' retirements (contribution rate, contribution amounts, date of hire, years of service, etc.), teachers' contribution information (percentage of salary withheld, total dollars withheld for the pay period, etc.), and the actual amount collected from employee contributions.

In the past, this information was difficult to obtain because there was no common system for receiving this data. However, in 1997, the TRB developed a uniform reporting format which is compatible with major commercial payroll-reporting software packages (such as ADP, Munis, etc.). The TRB also developed and provided a reporting software package currently used by over eighty districts and charter schools. Every year, the TRB holds several regional employer training seminars for school payroll and business officials. The TRB staff also provide onsite training for newly hired school payroll officials and districts having reporting difficulties. Despite the efforts of the TRB, certain school districts within the Commonwealth do not submit the data on a timely basis and the TRB is required to pursue the data that is not provided by the school districts. When teachers within these districts are ready to retire, the TRB is unable to process the retirement paperwork because the records are incomplete. This results in retired teachers not being able to receive their retirement benefits in a timely manner. In addition, when the districts do not submit retirement contributions on time, the teachers' overall benefits will suffer since the TRB is unable to earn investment income on contributions that they have not yet received.

Under Chapter 32, Section 18, Paragraph 1A, "If the Board...determines...that there has been an unreasonable delay in filing of any...required information, the Board,...shall so notify in writing such treasurer or other disbursing officer. If, within thirty days thereafter, the Board...has not received such required information, the Board...may petition the superior court to compel compliance with this section and enforce the penalty there under."

In order to remedy the current situation, the Board should continue to notify the members responsible for reporting the districts' information and remitting the appropriate contributions. If the latter fails, the TRB should use the option of petitioning the superior court to enforce compliance.

The Board has submitted legislation that would require local school districts to submit monthly data and contributions on a more timely basis or be subject to an interest penalty.

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