COMMONWEALTH OF MASSACHUSETTS

Management Letter Year Ended June 30, 1997

William Kilmartin, Comptroller

The Commonwealth of Massachusetts

In planning and performing the Single Audit of the Commonwealth of Massachusetts for the year ended June 30, 1997, 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 and the Requirements of OMB Circular A-133 and the Schedule of Expenditures of Federal Awards for the Year Ended June 30, 1997 ". The individual reports in that document are dated October 31, 1997 to coincide with the date of the auditors' report on the statutory basis financial statements .

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

This report is intended solely for the information and use of management and should not be used for any other purpose. This restriction is not intended to limit the distribution of this report, which is a matter of public record.

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

December 11, 1997

STATEWIDE OBSERVATIONS

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

The efficiency of the accounting and financial reporting process is hampered by the number of funds required by the Legislature and used by the Commonwealth. In fiscal year 1997, 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 Mass. General Laws, was required to use approximately 116 individual funds to account for the operations of the Commonwealth of Massachusetts (Commonwealth).

This use of 116 individual funds makes it difficult for either internal or external users of the Commonwealth's financial information to obtain a clear understanding of the overall operations and financial position of the Commonwealth. Instead of enhancing accountability, the large number of funds make it difficult for management to perform both the task of analyzing operations and detecting errors in the funds.

While many of the individual funds were created in the past to meet certain objectives of the Legislature, many of these objectives could be effectively met by using "sub-funds" within the General Fund.

The existing structure has resulted in the following reporting 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 used by other states.

1. The Legislature regularly budgets expenditures in funds without providing the corresponding revenue to support the operations. This effectively overstates the General Fund balance and raises the question of whether, in fact, a balanced budget at all levels has been passed as required by Mass General Laws.

Under generally accepted accounting principles, all fund balance deficits must be reported along with a plan for correcting those deficits.

The following table lists those deficits:

Fund	**Fund Name**	Fund Balance Deficit
Budgeted		
102	Local Aid	$1,355,829,000
106	Anti-trust Law Enforcement	1,393,000
110	Victim and Witness Assistance	3,127,000
111	Intercity Bus Capital Assistance	7,055,000
113	Mosquito and Greenhead Fly Control	742,000
134	Environmental Challenge	2,457,000
149	Toxics Use Reduction	1,807,000
152	Environmental Permitting and Compliance Assurance	17,326,000
156	Environmental Law Enforcement	896,000
159	Marine Fisheries	1,503,000

161	Low-Level Radio Active Waste Management	178,000
164	Health Care Access	10,043,000
172	Leo J. Martin Recreation	132,000
173	Clean Air Act Compliance	527,000
186	Second Century	1,482,000

$1,404,497

Non-Budgeted

107	Government Land Bank	$33,798,000
175	Motor Vehicle Emissions Inspection Compliance	2,654,000
142	Child Support Enforcement	37,000
		$36,489,000

Capital Projects

200	General	$132,680,000
210	Highway	156,562,000
271	Community Development Action Grants	67,472,000
274	County Correctional Facilities	47,000
275	Local Infrastructure	2,350,000
276	Water Pollution Control	1,111,000
230	State Recreation Areas	43,000

240	Metropolitan Parks	1,356,000
280	Intercity Bus Capital Assistance	18,000
$361,639,000		
	Total	$1,802,625,000

While the deficits in the Capital Project Funds will be corrected through future capital bond issuances, **the Local Aid Fund deficit can only be corrected by transferring revenue amounts** or fund balances from the General Fund. These deficits could raise a concern on the part of the financial community as to the Commonwealth's commitment to fully addressing financial issues.

1. A large number of funds have minimal activity and should be evaluated as to their continued need. The following table shows fund balances as of June 30, 1997 for funds with minimal or no activity during the year.

Fund Number	**Fund Name**	**Revenues and Other Financing Sources**	Expenditures and Other Financing Uses
103	Freight Rail	114,000	0
104	Passenger Rail	26,000	0
105	JFK Library and Park	17,000	0
106	Antitrust Law Enforcement	203,000	391,000
107	Government Land Bank	0	2,612,000
108	Natural Heritage and Endangered Species	290,000	237,000

111	Intercity Bus Capital Assistance	464,000	5,000
113	Mosquito and Greenhead Fly Control	4,397,000	5,167,000
118	Federally-Assisted Housing	135,000	243,000
122	Oil Overcharge	1,518,000	3,603,000
132	Motorcycle Safety	184,000	314,000
134	Environmental Challenge	4,373,000	6,734,000
136	Environmental Trust	1,855,000	834,000
138	Children's Trust	31,000	13,000
140	Labor Shortage Fund	205,000	566,000
144	Drug Analysis	136,000	0
146	Re-Employment and Job Placement	0	0
147	County Correction	7,360,000	6,514,000
149	Toxics Use Reduction	4,342,000	5,303,000
152	Environmental Permitting and Compliance Assurance	7,891,000	11,414,000
153	Massachusetts Aids	555,000	477,000

156	Environmental Law Enforcement	4,528,000	5,288,000
157	Public Access	1,046,000	1,137,000
158	Harbors and Inland Waters Maintenance	2,702,000	896,000
159	Marine Fisheries	4,379,000	5,253,000
161	Low Level Radioactive Waste Management	272,000	426,000
162	Trust Fund for the Head Injury Treatment Services	218,000	125,000
165	Ponkapoag Recreational	700,000	695,000
167	Division of Insurance	3,000,000	3,141,000
168	Board of Registration in Medicine	1,814,000	2,250,000
169	Asbestos Cost Recovery	2,113,000	4,587,000
170	Water Pollution Abatement Projects Administration	5,195,000	5,454,000
172	Leo J. Martin Recreation	450,000	486,000
173	Clean Air Act Compliance	1,892,000	2,525,000
175	Motor Vehicle Emissions Inspection Compliance	0	958,000

176	Motor Vehicle Safety Inspection Trust	5,679,000	4,811,000
179	Reggie Lewis Track and Athletic Center	280,000	180,000
180	Assisted Living Administration	227,000	188,000
230	State Recreation Areas Capital Projects	510,000	74,000
240	Metropolitan Parks Capital Projects	2,877,000	3,984,000
250	Water Pollution Control Capital Projects	9,369,000	1,092,000
270	Federally-Assisted Housing Capital Projects	0	0
272	Lockup Facilities Improvement Capital Projects	0	2,000
273	Suffolk County Jail Facility Capital Projects	160,000	10,000
274	County Correctional Facilities Capital Projects	1,591,000	777,000
278	Government Land Bank Capital Projects	0	0
275	Local Infrastructure	0	2,350,000

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    280      Intercity Bus Capital Assistance          16,000
23,000
             Capital
Projects
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To improve accountability , the OSC working with the Secretary for Administration and Finance and the Legislature should seek legislation to:

- Combine or eliminate many of the existing funds with minimal activity noted above. Any remaining funds should be specified in the legislation and any "new activities" subsequent to the legislation should be limited to the establishment of sub-funds.
- If combining or eliminating of funds is not accomplished, legislation should be sought to require funds, other than Capital Project Funds, that have had a deficit in fund balance for three straight years to be reduced to a zero balance as part of the subsequent years budget.
- "Sunset" provisions should be enacted to require that every fund and sub-fund other than the General Fund be evaluated as to whether it should be continued every five years after its creation. 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 be abolished.

Accounting for Leases Needs to be Improved

The lease information obtained from departments in the fiscal year 1997 GAAP Reporting Package represented a significant improvement over the information required in prior years. However, more can still be done. The majority of the departments of the Commonwealth enter into lease contracts to obtain the use of equipment and/or facilities. As of June 30,1997, the Commonwealth accounted for $383,103,000 in outstanding capital and operating lease obligations, and approximately $116,000,000 in expenditures.

The Office of the Comptroller recognized that the process used to gather and report the basic s financial lease information needed improvement. Accordingly, new guidance was issued on how to properly record and classify a lease on MMARS as well as the downloading of MMARS 831A Report (Projected Lease Payments for GAAP) into a form which included all of the leases each department has on MMARS. The fiscal officer of each department has the responsibility to complete the other related information pertaining to the leases at their department.

As indicated above, this process improved the availability of information provided to the Office of the Comptroller, however extensive manual calculations and compilations still had to be made by the Office of the Comptroller at year-end to make financial statement adjustments and disclosures relating to capital and operating leases. There were also several discrepancies noted between the 831A Report and the GAAP information provided by the departments, or the information was incomplete. During the audit, we also noted that several leases recorded as additions in the current fiscal year related to acquisitions in prior fiscal years.

Departments need to make sure they both understand the different types of lease contracts and monitor and update MMARS with new or amended lease information on a timely basis. The Office of the Comptroller should periodically throughout the year, reconcile and verify on a test basis the information provided by the departments.

While the continuous monitoring and the reporting of all material leasing decisions is important to the financial reporting of the Commonwealth, the major benefit in performing these tasks is to assure that the Commonwealth enters into leases that have competitive terms and rates.

Overuse of the Practice of Prior Appropriations Continued in the Legislature

Unspent appropriation balances in the Legislature have been carried forward (prior appropriation continued or PAC) for the past five years. Appropriations continued from fiscal year 1997 to 1998 totaled approximately $180,260,000. The unspent balance in the General Fund for all appropriations at June 30,1997 is approximately $88,580,000. Of this amount, $80,459,200 has been authorized by the Legislature to be carried forward to fiscal year 1998 and only $8,120,800 reverted back to the appropriation pool. A review of the activities within the General Fund indicates that additional funds were appropriated to many accounts in fiscal year 1997 even though the balances carried forward from fiscal year 1996 was sufficient to cover 1997 expenditures. This results in an increase in the unspent balances compared to those at June 30, 1996. A similar situation also occurred in fiscal 1993, 1994, 1995, and 1996.

An example of balance carry forward is the Legislature Telecommunication Appropriation, No. 97441000. A balance of $6,500,000 was carried forward from fiscal year 1995. Only $1,700,000 of the appropriation was spent during 1996 and the remaining $4,800,000 was carried to fiscal year 1997. Of this amount, only $1,699,000 was expended during the year and $3,119,000 was again authorized to be carried forward to fiscal year 1998.

The Commonwealth has the option of either reverting unspent funds back to the appropriation pool or carrying the balances forward to the next fiscal year. The 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 Commonwealth 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 in the Commonwealth.

Financial Information Needed to Cities and Towns for On-Behalf Payments

With the implementation of Government Accounting Standards Board (GASB) Statement No. 24, Accounting and Financial Reporting for Certain Grants and Other Financial Assistance, (Statement), the Commonwealth must provide financial information to cities and towns related to on-behalf payments. On-behalf payments for fringe benefits and salaries are direct payments made by one entity (the paying entity or government) to a third-party recipient for the employees of another, legally separate entity (the employer entity or government). This Statement establishes accounting and financial reporting standards for on-behalf payments for fringe benefits and salaries. On-behalf payments include pension plan contributions, employee health and life insurance premiums, and salary supplements or stipends.

For example, the Commonwealth makes a contribution to the Massachusetts State Teachers' Retirement System (Retirement System) on-behalf of the city and town's teachers included in the Retirement System. The Statement requires the cities and towns to recognize revenue and expenditures or expenses for on-behalf payments for fringe benefits and salaries as well as disclose the amounts recognized for such on-behalf payments. The last actuarial valuation showed that the Commonwealth contributed approximately $392 million to the Teacher's Retirement System, including the pension contribution and the COLA. However, the amount contributed to the Retirement

System on-behalf of each of the cities and towns could not be provided. We recommend that the Commonwealth, in combination with the Massachusetts Public Employee Retirement Administration Commission and the Massachusetts Teachers Retirement Board, coordinate and develop procedures necessary to detail the amounts of payments to the Retirement System on behalf of the cities and towns. **Without Such information, the cities and towns could be subjected to receiving qualified opinions on their audit reports because they cannot comply with Generally Accepted Accounting Principles.**

Actuarial Assumptions Used in the Calculation of the Pension Benefit Obligations Should be Re-evaluated

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. An examination of the edits used in performing the last actuarial valuation as of December 31, 1995, noted that kick-outs or missing information were substituted for in the following two ways:

Filtering - An internally developed program which filters through 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 we acknowledge that there has been continuous improvement on behalf of PERAC to obtain the required information, there is still a need for the divisions to provide more accurate information. While these types of editing procedures to complete the valuation are acceptable alternatives under actuarial standards;. we recommend that procedures be continued to audit and clean-up this data to reduce the need for assumptions used in the actuarial valuation to be completed during fiscal year 1998.

Capital Spending Policies and Analysis Could Benefit from Further Documentation

Since 1992, the Commonwealth has adopted a rolling Five Year Spending Plan (Plan) which sets forth amounts of planned capital project expenditures in various program areas (Transportation, Environment, Housing, etc.) for the next five fiscal years. The objective of the Plan is to limit the debt burden of the Commonwealth by controlling the relationship between current capital spending and the issuance of bonds by the Commonwealth. The Plan allocates spending authority among several program areas in a way which restricts growth in direct outstanding debt of the Commonwealth to less than 2% annually. In 1991, the year prior to adoption of the Plan, annual growth in direct outstanding debt grew by 29%. In 1992, growth fell to 8%, and has subsequently remained under the Plan's 2% objective. Allocations of spending authority among the several program areas may be revised at the discretion of the Governor.

Existing controls over capital project expenditures could be improved by adopting more formal documentation. Analysis of current fiscal year expenditures would benefit greatly from the implementation of periodic reviews and regular documentation of variances from projected spending. For the year ended June 30, 1997, neither a formal documented review procedure took place nor was an analysis prepared which documented the fluctuations in capital spending. Such documentation and/or analysis should be prepared by either the Executive Office for Administration and Finance or the Budget Bureau. Analysis of current year budget and expenditures against the Plan would also assist in identifying future needs in respective program areas. Improved controls are especially important in the current year as the Central Artery/Third Harbor Tunnel Project is entering its main phase of construction. The Commonwealth's commitments for various construction projects have increased from $1,508,602,000 at June 30, 1996 to $3,089,493,000 at June 30, 1997.

A formal policy establishing documentation requirements for allocations of spending authority among respective program areas is recommended. Additional documentation surrounding the allocation of spending authority will increase accountability of supervisors charged with managing expenditures in accordance with limits imposed under the Plan. Further documentation will also facilitate prompt identification of sources of under-and over spending.

Funding Program Necessary for Workers' Compensation and Group Health Insurance

The Commonwealth should establish a funding program and/or schedule to accumulate assets and satisfy the current underfunded liability related to the internal service funds. As of June 30, 1997, the underfunded liability for the employees workers' compensation and employees group health insurance was $251,200,000 and $31,143,000, respectively.

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. We recommend the Office of the Comptroller and the State Legislature coordinate their efforts to evaluate all options and select the most appropriate one(s) to satisfy the existing debt and fund any future liability as it is incurred.

Update of the Computer System for the Year 2000

The year 2000 has gained increasing visibility and is projected by some experts to become a senior management level issue as the scramble for dollars, staffing, avoidance of ever increasing costs and legal protection proliferate. The Year 2000 is about: making some hard business and operating decisions; determining and assessing comprehensive hardware and software inventories; dealing with internal organizations, vendors and the suppliers chain, retiring systems; determining that the hardware and software which the organization is dependent on for all operating and administrative systems and functions (not just core systems and functions); managing possibly the single largest upgrade project in the history of information technology; obtaining state level funding; and, most importantly, executing it on time within the time remaining. Addressing the Year 2000 demands extensive thought, planning and the right people and tools.

The approach of the Year 2000 presents significant issues for many financial, information, and operations systems. Many systems in use today may not be able to interpret dates after December 31, 1999 appropriately, because such systems allow only two digits to indicate the year in a date. As a result, such systems are unable to distinguish January 1, 2000, from January 1, 1900, which could have adverse consequences on the operations of the

Commonwealth and the integrity of information processing, causing safety, operational, and financial issues.

We held a meeting with select key State Information Systems management and State Year 2000 Program Office management and we reviewed select documentation. The nature of the inquiries and review provided a high level understanding of the Commonwealth's activities associated with the Year 2000 issues.

Our inquiries associated with the Year 2000 were regarding the following: written high level plans, Year 2000 compliance standards, identification of sufficient personnel and processing resources to staff a Year 2000 project, timetables, inventory compilation, identification of critical systems and non-compliant critical systems, plans to fix non-compliant critical systems, testing procedures, procedures to address key vendors and service providers and customers, procedures for litigation mitigation, contingency plans, oversight and accountability, senior management awareness and support, Year 2000 related impacts which may have already occurred, and other issues of concern to management.

We were informed that a formal Year 2000 Program Office and Project Plan initiative with relevant timelines has been established. Outside staffing resources have been procured to assist with the project. Further, we were informed by State Information Systems management of the awareness that addressing the Year 2000 was more than just an information systems initiative. A role of the Program Office is to provide guidance and assistance throughout state organizations, as well as, program management oversight and reporting for State Information Systems management.

We were informed by the client that primary financial software applications, hardware and embedded systems items and been inventoried or were in the process of being inventoried. A Year 2000 Plan, including a compliance standard definition, has been published and distributed. Year 2000 plans include steps for the following: identification of critical and non-compliant systems, and strategies to fix them; testing procedures; plans to contact vendors and compliance terms and conditions for procurement of goods and services; incorporation of contingency plans; and other items.

We observed Year 2000 Project Plan planning documentation and related data on the Commonwealth internet site. Information Systems management provided us high level documentation summarizing projected appropriation funding and expense needs, by agency. Further, we were provided a selection of legislative testimony associated with Year 2000 activities throughout the Commonwealth.

Our review did not involve in-depth detailed review of the voluminous documentation developed through the Year 2000 Program Office efforts, nor inquiries outside of State Information Systems Information Systems management of Year 2000 Program Office management. Our audit of the Commonwealth's financial statements for the year ending June 30, 1997, will not provide any assurances, nor will we express any opinion, that the Commonwealth's systems or any other systems, such as those of the Commonwealth's vendors, service providers, customers, component units or joint ventures in which the Commonwealth has an investment, or other third parties, are Year 2000 compliant. In addition, we are not engaged to perform, nor will we perform as part of our audit engagement, any procedures to test whether the plans and activities of the Commonwealth are sufficient to address and correct system or any other problems that might arise because of the Year 2000, nor will we express any opinion or provide any assurances with respect to these matters.

The Year 2000 Project management should continue to carry out and strengthen the project plan in an effort to ensure that all appropriate agencies and other organizations maintain momentum and progress toward timely completion of the project. Year 2000 target dates are important as timelines to adequately address the Year 2000 issues are ever diminishing.

Given the activities required to ensure success in completing the Year 2000 Project, and the aggressive timeline targets identified for initial project steps, internal resources may have to be supplemented or certain other projects delayed. In addition, the project plan must ensure that resources are available to address the Year 2000 without conflicting with normal processing and business requirements. All efforts to ensure compliance should be completed by the December 1998 target date.

GASB Pronouncements

The Governmental Accounting Standards Board (GASB) has issued two accounting pronouncements which will have an impact on the accounting and financial reporting of the Commonwealth. The Office of the Comptroller's Financial Reporting and Analysis Bureau (FRAB) has been assigned the responsibility of studying and analyzing the impact of implementing new GASB pronouncements on an as-needed basis. The two GASB Statements which the Commonwealth has not yet adopted and which require adoption are as follows:

No. 31 "Accounting and Financial Reporting for Certain Investments and External Investment Pools", is effective for periods beginning after June 15, 1997. This statement deals with all investments held in external investment pools and certain investments in other governmental entities. GASB 31 establishes the fair value standards for investments and other reporting changes related to external investment pools.

No. 32 "Accounting and Financial Reporting for Internal Revenue Code Section 457 Deferred Compensation Plans" is effective for periods beginning after December 31, 1997. Under the new IRC 457, the government no longer owns the amount deferred to employees and related income on those amounts. The statement requires that eligible deferred compensation plans hold its assets and income in a trust. The Commonwealth has not yet created a trust for the 457 plan.

We recommend that the FRAB evaluate the implication of these statements to the Commonwealth's fiscal practices and financial reports. We also recommend that legislation statutorily creates a trust for the 457 plan.

New Reporting Model

The Governmental Accounting Standards Board is expected to issue a statement that will make drastic changes to the basic financial statements that governments are required to issue. It is anticipated that this statement will be effective for periods beginning after June 15, 2000.

This proposed statement would establish financial reporting standards for state and local governments, and component units. The standards are designed to make governments' general purpose external financial reports easier to understand and more useful to the citizenry, legislative and oversight bodies, and investors and creditors. The proposed statement includes requirements for a management's discussion and analysis, and changes to the basic financial statements. Governments generally would provide basic financial statements from both an entity-wide perspective and a fund perspective.

Entity-wide financial statements would provide information about the primary government and its component units without displaying funds or fund types. The financial statements would 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 would not include fiduciary activities.) All information would be reported using the economic resources measurement focus and the accrual basis of accounting, as enterprise funds do today.

Fund perspective financial statements would provide information about the primary government's fund types, including fiduciary funds and blended component units. Governments would present separate financial statements for each fund category-governmental, proprietary, higher education, and fiduciary-and would no longer present a combined balance sheet. (General capital assets and general long-term liabilities currently reported in account groups would be reported only at the entity-wide perspective, as assets and liabilities of governmental activities.) As is currently required, governmental fund financial statements would focus on fiscal accountability and would report the flows and balances of current financial resources using the modified accrual basis of accounting. Proprietary and fiduciary fund

financial statements would report operating results and financial position using the economic resources measurement focus and the accrual basis of accounting. The fund perspective also would 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 cities infrastructure it may be difficult, if not impossible, to obtain information regarding the cities historical cost of infrastructure.

In order to avoid delays in issuing financial statements under the new reporting model, we recommend the State begin the process of assessing it's records regarding the historical cost of infrastructure. If such information is not available, a process to estimate the historical value of infrastructure should be established as quickly as possible. We also recommend that the State assess the other potential changes in financial reporting and accounting related to the proposed new reporting model.

OFFICE OF THE COMPTROLLER

Additional Tracking Required for Settled Yet Unpaid Legal Cases

The Financial Reporting and Analysis Bureau (FRAB) does not have tracking procedures to determine which legal cases have been settled but not yet paid. A number of lawsuits are pending or threatened against the Commonwealth arising from the ordinary course of operations. These include claims for property damage and personal injury, breaches of contract, condemnation proceedings and other alleged violations of law. For those cases in which it is probable that a loss will be incurred and the amount of the potential judgment can be reasonably estimated, the Office of the Attorney General (AGO) estimates the liability, the current and long-term portions are thus recorded in the governmental funds and the General Long-Term Obligations Account Group, respectively. Such information is summarized in a legal letter from the AGO to the FRAB. In addition, the AGO confirms the cases that were outstanding in the prior year that have been settled, however, the AGO 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 additional $22 million and $5 million liability was recorded in fiscal year 1996 and 1997, respectively. We recommend that the FRAB develop and document procedures for tracking such settled cases to avoid any future misstatement of the financial records.

Annual Review of Fiscal Year Departmental/Organizational Changes:

Each year the Commonwealth experiences some level of reorganization between departments and secretariats. In fiscal year 1997, the Commonwealth underwent a significant reorganization. Administrators, elected officials, Secretariats and departments heads were advised of the likely structural changes and how they would effect the transition from fiscal year 1996 to fiscal year 1997. Although changes related to the reorganization were communicated to the appropriate personnel, there is a need for greater interaction between and within the departments, and for a more extensive analysis of the impact of these departmental and organizational changes.

Transactions entered into MMARS reference a Department Table that lists all existing secretariats and the departments. The Operations Department is responsible for updating the Department Table for any changes that occur during the year. Updating the Department Table for the fiscal year 1997 reorganization led to a problem in processing payroll. Consequently, some of the information in the Department Table was returned to its fiscal year 1996 status until the payroll problem was resolved. The situation was resolved in the fall of 1997 (fiscal year 1998). However, transactions related to some departments were not reflected under the proper secretariat and expenditure line items were incorrectly classified in MMARS causing several late reclassifications to the financial statements. Additionally, due to a lack of communication between departments, a secretariat which had been legislatively granted level one status was erroneously classified in the Department Table.

The Office of the Comptroller's Financial Reporting and Analysis Bureau (FRAB) should be responsible for studying and analyzing how the annual reorganizations will impact the individual funds and the financial reports. The impact of the fiscal year 1997 changes should have been evaluated prior to the final stages of financial statement preparation. Although the degree of change may vary, departmental and secretariat changes occur almost every fiscal year, the appropriate personnel in Operations, Accounting and FRAB should meet during the year to discuss any reorganizations and the implications on accounting and financial reporting.

Accounting Policies

There is currently a proposed Statement of the Governmental Accounting Standards Board for Accounting and Financial Reporting for Nonexchange Transactions. This proposed Statement would establish accounting and financial reporting standards for nonexchange transactions. It would provide guidance for transactions taking into account shared characteristics.

The provisions of this proposed Statement would be effective for financial statements for periods beginning after June 15, 2000. Earlier application would be encouraged.

The Office of the Comptroller needs to evaluate the impact of the following transactions which took place subsequent to June 30, 1997 in light of the proposed Statement:

In a memorandum of understanding signed September 11, 1997, the Massachusetts Turnpike Authority (MTA) agreed to pay to the Commonwealth $700 million, of which $100 million is due in June 1998 and $600 million is due by December 1998. Transfer of title to the tunnel took place in December 1995. The $100 million to be received in June 1998 is intended to defray costs incurred by the Commonwealth on the project in fiscal 1997. The Executive Office for Administration and Finance has begun discussions with the MTA in an attempt to possibly accelerate the payment schedule of the remaining $600 million to require up to an additional $100 million payment in fiscal year 1998. The remaining $500 million to be received in December 1998 is intended to defray costs to be incurred by the commonwealth in future fiscal years. Future amounts may be required to be paid by MTA for costs to be incurred subsequent to fiscal 1999 as outlined in the memorandum, but not until another memorandum of understanding is signed.

Additionally, there is an exchange transaction that the Office of the Comptroller needs to reevaluate: In a memorandum of understanding signed July 24, 1997, the Massachusetts Port Authority (Massport) agreed to pay to the Commonwealth $200 million in exchange for assets with commensurate value built as part of the Central Artery Project. The payments are due as follows: $12 million in fiscal 1998; $31 million in fiscal 1999; $52 million in fiscal 2000; and $105 million in fiscal 2003. The assets to be transferred have informally been identified, but such identification has not been finalized. The title to the assets will not be transferred until at least fiscal 2001. All of the assets to be identified will exclusively serve the airport and will be located in East Boston.

Although this transaction is an exchange transaction, GAAP is not clear on how a transaction such as this should be accounted for in governmental entities (i.e. whether construction-type accounting applies).

The Office of the Comptroller should establish a formalized accounting policy to account for transactions of this nature with component units or other related entities to ensure that the accounting treatment is consistently applied.

Need for Monitoring of Subrecepient Activity

On July 5, 1996 the President signed into law the Single Audit Act Amendments of 1996. These amendments make several important changes to the Act including, among other provisions, an increase in the threshold for entities requiring a Single Audit to $300,000 in expenditures from $25,000 in receipt of federal funding. This change was aimed at improving accountability and allowing organizations which receive less than $300,000 in federal funds to use the funds to provide services rather incur costs for audits .

This change has a significant impact on departments of the Commonwealth which distribute funds to other entities to carry out program objectives. While these entities are considered subrecipients of the departments' programs,. the departments retain the responsibility to ensure that such subrecipient's funds are used for program objectives and are in compliance with all applicable federal laws and regulations. Due to the increase in the audit threshold, many subrecipients will no longer be required to undergo a Single Audit, one of the primary fiscal monitoring tools used by departments. The funding departments, however, retain the responsibility and accountability for compliance with federal requirements. Noncompliance with such requirements could result in a reduction or loss of federal funding.

Currently, the Operational Services Division (Division), is largely relied upon to furnish the total amount of federal dollars provided to subrecpients thereby allowing the subrecipient to determine whether a Single Audit is required. However, individual funding departments do not know the total amount of federal funds provided and whether or not a Single Audit is required.

We recommend that the Executive Office for Administration and Finance in conjunction with the Comptroller's Office re-examine the Division's and departments' roles related to the information provided to subrecipients and the review of subrecipient activity. Consideration should be given to developing uniform guidelines related to the monitoring of subrecipient activity should be developed and requiring documented departmental review of Subrecipient compliance with regulations related to federal funding.

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.

An expanding number of governmental entities presently are developing and using SEA measures. The Government Accounting Boards may require this reporting as part of the entities general purpose financial statements. We suggest the Commonwealth evaluate the use of SEA reporting as an additional tool to promote accountability and efficiency. As the services provided by the Commonwealth are diverse and often complex in nature, we further recommend that program and budget personnel, elected officials, internal auditors, professional groups, and citizens in addition to financial management become active in developing and using SEA measures.

OFFICE OF THE STATE TREASURER

Cash Reconciliations

Certain items on the Treasury cash reconciliations have been outstanding for several months. There are $2.8 million in reconciling items greater than six months old. There are no reconciling items greater than one year old. In some cases, the reconciling items are for charges and credits relating to departmental transactions, which require explanations from the departments before the reconciling items can be resolved. Since the reconciliation process represents an important internal control over cash, we recommend that old reconciling items be resolved on a timely basis.

Float Fund

The Treasury maintains a cash suspense fund in MMARS which represents a management tool to identify all amounts for which warrants have been issued but the amounts have not cleared the bank. The amounts in this suspense fund ("float fund") are invested in short-term investments until the amounts clear. This fund has been maintained for years, and current activity going through the fund is identified through the cash reconciliation process, however, there may be activity in the fund which was recorded prior to the improvement in the cash reconciliation process. There is no supporting detail to substantiate the balance in the float fund at year-end. The total amount of the float fund as of June 30, 1997 was $296 million. The total amount of warrants paid within the last week of the fiscal year was $345 million. The Treasury should perform a detailed analysis of the float fund at least annually to substantiate the balance on a go-forward basis and to identify any old transactions which have not been presented for payment, such as coupon bonds which matured in prior years.

Client Delays - Long-Term Debt

Significant delays were experienced in obtaining the necessary schedules pertaining to Long-Term Debt. Despite repeated requests for information, including a detailed listing of required schedules provided to the Treasury prior to the start of field work, and daily conversations with Treasury personnel, the requested information was not received until after the end of scheduled field work. Preparation for the audit should be prioritized and a work plan prepared in order to complete the required information on a timely basis.

STATE LOTTERY COMMISSION

Lottery Commission as an Enterprise Fund

The Massachusetts Lottery Commission (Lottery) is not accounted for or controlled in the same manner as other state lotteries. Current accounting literature recommends that lotteries be accounted for as enterprise funds so that the full cost of operations are reflected prior to determining the "profits" available for prizes and other uses. Most states follow this accounting model. In addition, because the lotteries are separately reported as enterprise funds, most states subject them to a separate audit of operations and separate evaluations of the internal control structures.

The Lottery is one of the few departments that has significant transactions and activity occurring on a daily 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 in order to determine that the financial statements are fairly presented in all material respects. Because of the volume of its activity, as well as the significant dollar prizes being awarded, the Lottery is constantly under scrutiny by the public and may require a more detailed audit.

The Commonwealth should consider accounting for the Lottery as an enterprise fund. This would allow the Commonwealth to evaluate the true cost/benefit of the operation while providing additional assurance to the public. Such accounting would require that the Lottery's accounting systems be evaluated and possibly upgraded too so that operations could be reported on a full accrual basis.

Need for an Automated General Ledger System

The State Lottery Commission (Lottery) failed to close their books on a timely basis. Currently, the Lottery's financial statements are developed using Excel spreadsheets. In addition, the Lottery did not perform timely reconciliations of their financial information to MMARS. Failure to perform such reconciliations may lead to errors going unnoticed for prolonged periods of time, making correcting them more difficult. These errors may also not be discovered in time to make adjustments to the financial statements which could result in material misstatement. It also may result in a potential failure to identify manual errors in spreadsheet entries and calculations. Excel spreadsheets do not normally have imbedded controls which are used in a system of internal controls, such as requiring balanced journal entries to make changed to financial information.

We recommend that the Commission adopt a general ledger system. This system could either be based on MMARS downloads or could be an off-the-shelf system which should have requisite imbedded controls. The general ledger system would then aid in the development of monthly financial statements that could be easily reconciled to MMARS. Such reconciliations to MMARS should then be performed monthly.

Need For an Improved Filing System

The Lottery lacks an effective filing system for financial information. Currently, some financial information is kept in the personal filing systems of the individuals responsible for the information. Such systems are not adequate, as was evidenced in the current year when turnover occurred and certain information could not be easily located. A centralized filing system is a necessity for an entity with such a high volume of transactions. In addition, the lack of a central filing system could lead to problems in assessing the completeness and validity of financial information.

The Lottery should consider developing a central filing system which should include the documentation of day-to-day financial information, but also documentation relating to annuity purchases, year end GAAP data, and other routine transactions.

Organizational Structure

The level of accounting and financial reporting experience of Lottery management needs improvement. Due to turnover in the current year, the Lottery shifted the responsibilities of certain individuals. Since some turnover was abrupt, there was not enough transition time or resources available to train the individuals responsible for the accounting function. However, a standard level of accounting knowledge is necessary for such individuals. Additionally, the Lottery does not have sufficient documentation of the responsibilities of management and other accounting personnel, not does enough cross-training occur to prevent a break in the financial operations should further turnover occur. We noted also that lottery personnel have a general lack of understanding of MMARS and how it processes lottery information.

The Lottery should reassess its financial organizational structure: first, to satisfy itself that individuals with the appropriate accounting and financial reporting experience are placed in the appropriate position; second, to ensure that extended absences or turnover would not cause a break in financial operations; and third, to ensure that adequate training on MMARS is provided.

MASSACHUSETTS EMERGENCY MANAGEMENT AGENCY

Disaster Assistance Administrative Fees Not Drawn

The Massachusetts Emergency Management Agency (MEMA) has not drawn or recorded as receivable approximately $143,000 in administrative fees earned in managing the Disaster Assistance Program in 1996 and 1997. Section 406 (f)(1) of the Stafford Act permits the Commonwealth to receive an allowance for requesting, obtaining and administering the Disaster Assistance Program. The fee, which is based on a percentage of federal funds disbursed to subrecipients and some department costs, is above and beyond the indirect cost rate MEMA is entitled to bill. It could not be readily determined whether MEMA was currently entitled to receive other administrative fees for disasters prior to 1996. MEMA should draw Federal funds when earned or record a receivable thereby recognizing revenue in the proper period.

DIVISION OF MEDICAL ASSISTANCE

Accounting and Reporting for Nursing Home Claims Offset Process Needs Improvement

Nursing home recovery receivables, payables and the process by which these transactions are offset should be accounted for more precisely. At year end, the Division may owe a nursing home for outstanding claims or the nursing home may owe the Division for an overpayment or a rate adjustment. In arriving at the net amount of claims outstanding as of June 30, 1997, the Division offsets the payables due to the nursing homes against the receivables due from the nursing homes. All of the receivables in question predate 1993 when nursing homes and rest homes were paid on a retrospective basis ("C" accounts in MMIS). While there appears to be documentation on an individual nursing home basis, the Division needs to do a better job at aggregating and reporting the total claims outstanding. Currently, three departments, Claims Operations, Accounting and Budget, are involved in this process. The Claims Operations Unit processes rate adjustments, the Accounting Unit currently sets up manual recoupment accounts and tracks both manual and system established recoupment accounts. The Accounting Unit also maintains recoupment reports which contain claims history by provider number and summary of account's total. The Budget Unit prepares the Medicaid Accrual receivable adjustments at year-end. A consolidation of these functions would make aggregating and reporting of the outstanding claims in the MMIS at year-end much easier. We recommend that the Division appoint one department with the responsibility of maintaining and reporting the financial activity of this account in order to ensure that all assets and liabilities are properly and fairly stated. In addition, we recommend that all of the GAAP reporting requirements be consolidated under one department.

The GAAP Reporting Package Should Be Prepared in Accordance with Office of the Comptroller's Instructions.

As a result of the desk review performed by the Office of the Comptroller, it was determined that the Division's fiscal year 1997 GAAP Package, with respect to receivables and leases, was not prepared in accordance with Office of the Comptroller's instructions. The Division reported the adjusted net receivables rather than reporting in the required GAAP format the gross accounts receivable, the amount estimated to be uncollectible and the net receivables. Also, the Division did not produce a correct reconciliation to the BARS system as required by the instructions. It reported its BARS receivable rather than the amount of receivables shown on the MMARS RPT 286F. This reporting error occurred due to miscommunication between the Division's Accounting staff and the Comptroller's Office. The adjustment for the variance has been made.

In the future, the GAAP Package should be prepared in accordance with the Comptroller's instructions in order to allow the Comptroller's Office to more accurately analyze and report departmental financial results. Improved communications has already begun as evidenced by the September 24, 1997 meeting between personnel from the Division, its auditors and the Comptroller's Office.

Proper Archival of Original Journal Entries

The Division should maintain journal entries in a centralized file in order to ensure that all transactions affecting the receivables are easily located. In order to ensure a proper segregation of duties, the journal entries are prepared and approved by different individuals. However, the entries are not maintained in a central location making analysis difficult and time consuming. The Division should maintain journal entries in a centralized file in order to ensure that all transactions affecting the receivable are easily located. We recommend that all receivable-related journal entries be stored together after proper approval and recording so that a complete set of information can be quickly referenced.

DEPARTMENT OF EDUCATION

Compensated Absences

The payroll department at the Department of Education (DOE) did not make final adjustments to the PMIS66 report until after the final posting date per the Office of State Comptroller's GAAP instructions. The PMIS66 report details the total sick and vacation time accrued at a given point in time, by employee. The Commonwealth uses the final adjusted PMIS66 report to calculate the necessary GAAP adjustment related to the compensated absence accrual.

Per the GAAP instructions, each department is required to adjust each employee's accrual on the PMIS66 report to reflect the total allowable carryover. Most employees at the DOE are able to carryforward no more than what has been earned and not used in the past two years. Therefore, if an employee has not taken a vacation in the past two years, he/she is able to carryforward no more than the vacation earned in those two years. The amount an employee is able to earn in a year is dictated by various collective bargaining agreements. Per review of the final PMIS66 report for the DOE, we noted no adjustments were made to reduce the excess carryover of accrued vacation prior to the final posting date per the Office of State Comptroller's GAAP instructions. Therefore, the accrued vacation for the DOE is overstated at June 30, 1997, since the PMIS66 report does not reflect the adjusted reduction of the accrued vacation as of June 30, 1997. The total misstatement was not material to the financial statements.

We recommend that the Office of the State Comptroller review the final departmental adjustments and the final PMIS 66 to ensure the payroll departments are performing their adjustments in accordance with the GAAP instructions and vacation policies.

HIGHER EDUCATION

Reporting of the University and College Fund Type Needs Improvement

The Financial Reporting and Analysis Bureau and the University and Colleges, included in the University and College Fund Type (Fund Type), need to continue to improve the procedures relating to financial reporting for the Fund Type. Fourteen of the twenty-five institutions included in the Fund Type currently produce complete audited stand-alone financial statements, which have varying accounting policies and report disclosures. For the remaining 11 institutions, which include Berkshire Community College, Bristol Community College, Bunker Hill Community College, Cape Cod Community College, Greenfield Community College, Massachusetts Maritime Academy, North Adams State College, North Shore Community College, Quinsigamond Community College, Roxbury Community College, and Salem State College, the FRAB must complete a series of complex procedures to prepare accounting information for presentation in the Comprehensive Annual Financial Statement (CAFR). In addition, the Massachusetts Bay Community College did not submit final audited financial statements prior to the completion of the audit for the Commonwealth.

There were several variances between amounts reported in MMARS and amounts reported by the institutions in their audited financial statements and the GAAP Packages submitted to FRAB by the colleges not audited. For example, the fiscal year 1997 UMASS audited financial statements fixed assets balance was $800 million greater than the amount reported in MMARS. At Bridgewater State, the equipment balance as reported in the audited financial statements was $18 million greater than the amount reported in MMARS. Variances from MMARS balances existed in nearly all of the audited Higher Education Component Units. Balances in the CAFR were adjusted to reflect the audited amounts, but they were not adjusted in MMARS or reconciled at any time during the year and therefore cannot be relied upon.

The variances between MMARS and the audited financial statements indicate that there are other likely misstatements that exist at non-audited schools whose presentation in the financial statements of the Commonwealth are based primarily on MMARS.

We recommend that the 11 institutions which do not issue audited stand-alone financial statements begin and/or complete the process of producing them prior to the November 1, 1998 deadline, necessary for inclusion in the fiscal year 1998 CAFR. The Office of the Comptroller and the Board of Higher Education have requested the Governor to file legislation to extend the statutory requirement for stand-alone financial statement audits in conformity with GAAP to all institutions of higher education. We recommend that the legislature adopt such reporting requirements.

We further recommend that the Office of the Comptroller, in conjunction with the University and Colleges, monitor and reconcile the variances between the audited financial statements balances and the balances in MMARS.

In addition, we recommend that the Office of the Comptroller establish a uniform set of accounting policies and uniform financial statements disclosures to be presented to the University and Colleges which are included as component units of the Commonwealth. Each of the entities should be strongly encouraged to adopt these policies and accounting disclosures to ensure that the Commonwealth is able to produce accurate and complete financial statements on a timely basis.

Reconciliations for the University and College Cash Needs Improvement

The Financial Reporting and Analysis Bureau and some of the Colleges, included in the University and College Fund Type (Fund Type), need to improve the procedures relating to the reconciliations, financial reporting and disclosures for cash and investments recorded by the colleges. Eleven of the twenty-five institutions included in the Fund Type do not produce complete audited stand-alone financial. Consequently, many the cash balances reported by these Colleges, in their GAAP Packages to FRAB, do not always agree to the balances recorded on MMARS or in the records of the Massachusetts Municipal Depository Trust (MMDT), an investment pool maintained by the Commonwealth.

The most significant variance noted was at Salem State College. There was a $16 million variance between the balance recorded at MMDT for Salem State and the balance recorded on MMARS. This variance, in conjunction with other less significant variances at other Colleges, could result in a misstatement in the financial statements for the Commonwealth.

We recommend that the 11 institutions which do not issue audited stand-alone financial statements begin and/or complete the process of producing them prior to the November 1, 1998 deadline, necessary for inclusion in the fiscal year 1998 CAFR.

We also recommend that the Office of the Comptroller, in conjunction with the University and Colleges, monitor and reconcile the variances between the unaudited balances included in the Colleges GAAP Packages, MMDT and MMARS.

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 1997, 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 thirty-seven component units. Each of these component units is subjected to an audit and is required to report their 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, 1997 deadline established by the Office of the Comptroller, resulting in several late adjustments and reporting disclosures to the CAFR.

The Corporation for Business, Work, and Learning (CBWL) did not submit final audited financial statements to the Office of the Comptroller (OSC) prior to the completion of the audit for the CAFR.

The OSC, the department legally responsible for the preparation of the general purpose financial statements, must coordinate the efforts of the component units. In that role, the OSC has already taken many steps to obtain timely and accurate data for inclusion in the Commonwealth's financial statements. If a material component unit did not issue audited financial statements prior to the established deadlines, it could result in a qualification to the Commonwealth's financial statements or denial of the Certificate of Achievement for Excellence in Financial Reporting presented by the Government Finance Officers Association.

The OSC should continue meeting individually with the various component units prior to June 30, 1998 to instill an "ownership interest" in the financial statements and communicate the role they play in preparation of the Commonwealth's financial statements. 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 Comptroller. The component units should also inform their independent auditors of the importance of the established deadline.
