

Management Letter Year Ended June 30, 1998

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, 1998, 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, 1998 ". The individual reports in that document are dated October 27, 1998 and December 22, 1998 to coincide with the dates of the auditors' reports on the statutory basis financial statements and the Comprehensive Annual Financial Report.

In addition to the matters discussed in the reports described above, we have developed certain observations and recommendations on other current 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 22, 1998

STATEWIDE OBSERVATIONS

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

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 1998, the Office of the Comptroller (OSC) operating under the requirements of State Finance law and the requirements of the Legislature, as established through the budget and Massachusetts General Laws, was required to use approximately 109 individual funds to account for the operations of the Commonwealth of Massachusetts (Commonwealth).

This use of 109 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 tasks 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.
2. 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 Massachusetts 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 the funds with a Statutory fund deficit:

<u>Fund</u>	<u>Fund Name</u>	<u>Fund Balance</u>
		<u>Deficit</u>
<u>Budgeted</u>		
102	Local Aid	\$1,939,755,000
106	Anti-trust Law Enforcement	1,771,000
110	Victim and Witness Assistance	3,894,000
111	Intercity Bus Capital Assistance	6,388,000
113	Mosquito and Greenhead Fly Control	1,301,000
134	Environmental Challenge	4,594,000
149	Toxics Use Reduction	1,850,000
152	Environmental Permitting and Compliance Assurance	21,700,000

156	Environmental Law Enforcement	1,311,000
157	Public Access	44,000
159	Marine Fisheries	2,739,000
161	Low-Level Radio Active Waste Management	221,000
164	Health Care Access	23,105,000
165	Ponkapoag Recreational	30,000
167	Division of Insurance	217,000
172	Leo J. Martin Recreation	156,000
173	Clean Air Act Compliance	709,000
186	Second Century	3,367,000
187	Safe Drinking Water	13,000
192	Transitional Aid to Needy Families	35,000
193	Social Services Program	<u>480,000</u>
		<u>\$2,013,680,000</u>

Non-Budgeted

107	Government Land Bank	<u>\$34,496,000</u>
		<u>\$34,496,000</u>

Capital

Projects

203	[Boston] Convention [and] Exhibition Center	19,000
210	Highway	559,787,000
230	State Recreation Areas	17,000
240	Metropolitan Parks	3,116,000

271	Community Development Action Grants	36,820,000
273	Suffolk County Jail Facility	18,000
274	County Correctional Facilities	78,000
276	Water Pollution Control	651,000
278	Government Land Bank	11,800
290	Federal Highway Construction Program	<u>34,000</u>
		<u>\$600,551,800</u>
	Total	<u>\$2,648,727,800</u>

While the deficits in the Capital Project Funds will be corrected through future capital bond issuances, the Local Aid Fund deficit, which increased by \$583,926,000, a 43% change, during the past year 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.

Some funds with minimal activity were repealed in the past fiscal year and more are legislated for repeal during fiscal year 1999. While this is a start to addressing the issue of an excessive number of funds, a large number of funds remain and should be evaluated as to their continued need. The following table shows fund balances as of June 30, 1998 for funds with minimal or no activity during the year. This list excludes funds that were created or repealed during fiscal 1998 and funds whose repeal has been legislated for fiscal 1999.

		<u>Revenues</u>	<u>Expenditures</u>
		<u>and</u>	<u>and</u>
		<u>Other</u>	<u>Other</u>
Fund	<u>Fund Name</u>	<u>Financing</u>	<u>Financing</u>
<u>Number</u>		<u>Sources</u>	<u>Uses</u>
106	Antitrust Law Enforcement	\$38,000	\$416,000
107	Government Land Bank	393,000	1,091,000
108	Natural Heritage and Endangered Species	338,000	208,000

110	Victim and Witness Assistance	9,093,000	9,860,000
111	Intercity Bus Capital Assistance	701,000	34,000
113	Mosquito and Greenhead Fly Control	4,711,000	5,270,000
118	Federally-Assisted Housing	135,000	135,000
122	Oil Overcharge	1,562,000	3,703,000
132	Motorcycle Safety	199,000	315,000
134	Environmental Challenge	4,845,000	6,982,000
136	Environmental Trust	1,571,000	878,000
138	Children's Trust	33,000	177,000
140	Labor Shortage Fund	114,000	30,000
144	Drug Analysis	130,000	0
147	County Correction	9,241,000	7,762,000
149	Toxics Use Reduction	5,308,000	5,351,000
152	Environmental Permitting and Compliance Assurance	6,291,000	10,665,000
153	Massachusetts Aids	507,000	693,000
156	Environmental Law Enforcement	5,030,000	5,445,000
157	Public Access	822,000	1,467,000
158	Harbors and Inland Waters Maintenance	2,758,000	4,101,000
159	Marine Fisheries	4,460,000	5,696,000
161	Low Level Radioactive Waste Management	331,000	374,000
162	Trust Fund for the Head Injury Treatment Services	455,000	225,000
165	Ponkapoag Recreational	700,000	737,000
167	Division of Insurance	3,000,000	3,451,000
168	Board of Registration in Medicine	1,639,000	1,639,000
169	Asbestos Cost Recovery	1,546,000	6,256,000

170	Water Pollution Abatement Projects Administration	5,719,000	5,680,000
172	Leo J. Martin Recreation	450,000	474,000
173	Clean Air Act Compliance	2,420,000	2,602,000
176	Motor Vehicle Safety Inspection Trust	5,889,000	8,208,000
179	Reggie Lewis Track and Athletic Center	287,000	240,000
180	Assisted Living Administration	302,000	178,000
186	Second Century Fund	427,000	2,312,000
187	Safe Drinking Water	2,153,000	2,166,000
189	Diversity Awareness Education Trust	1,000	0
196	Caseload Increases Mitigation	10,000	0
230	State Recreation Areas Capital Projects	46,000	20,000
240	Metropolitan Parks Capital Projects	591,000	2,351,000
250	Water Pollution Control Capital Projects	1,121,000	661,000
270	Federally-Assisted Housing Capital Projects	0	48,000
272	Lockup Facilities Improvement Capital Projects	0	0
273	Suffolk County Jail Facility Capital Projects	61,000	79,000
274	County Correctional Facilities Capital Projects	670,000	701,000
278	Government Land Bank Capital Projects	0	0
275	Local Infrastructure	2,350,000	0
280	Intercity Bus Capital Assistance Capital Projects	2,030,000	2,011,000

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 is transferred to the General Fund and the fund or sub-fund is abolished.

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 1998 to 1999 totaled approximately \$260,289,000. The unspent balance in the General Fund for all appropriations at June 30, 1998 is approximately \$78,448,000. Of this amount none 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 1998 even though the balances carried forward from fiscal year 1997 was sufficient to cover 1998 expenditures. This results in an increase in the unspent balances compared to those at June 30, 1997. A similar situation also occurred in fiscal years 1993 through 1997.

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 authorized to be carried forward to fiscal year 1998, of which only \$1,465,000 was expended and the remaining \$1,654,000 was authorized to be carried forward to fiscal 1999.

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. This 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 most recent actuarial valuation showed that the Commonwealth contributed approximately \$447 million to the Retirement System, including the pension contribution and the Cost of Living Adjustment (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 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 Principals.

Actuarial Assumptions Used in the Calculation of the Net Pension Obligations Should be Reevaluated

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, 1997, noted that kick-outs or missing information were substituted for in the following way:

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 are 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

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 can 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, 1998, neither a formal documented review procedure took place nor was an analysis prepared which documented the fluctuations in capital spending. Either the Executive Office for Administration and Finance or the Fiscal Affairs Division should prepare such documentation and/or analysis. 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 \$3,089,493,000 at June 30, 1997 to \$3,215,615,000 at June 30, 1998.

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 Underfunded Workers' Compensation and Group Health Insurance

The Commonwealth should establish a funding program and/or schedule necessary to accumulate assets and satisfy the current underfunded liability related to the internal service funds. As of June 30, 1998, the underfunded liability for the employee's workers compensation and employees' group health insurance was \$271,166,000 and \$44,701,000, respectively. Of these amounts, \$35,500,000 is considered short-term for workers compensation and \$44,014,000 for group insurance. The balance represents accumulated long-term liabilities.

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 operational systems. Many systems in use today may not be able to appropriately interpret dates after December 31, 1999, 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 entity and the integrity of information processing, causing safety, operational, and financial issues.

Our audit of the Commonwealth's financial statements for the year ending June 30, 1998, will not provide any assurances, nor will we express any opinion, that Commonwealth's systems or any other systems, such as those of Commonwealth's vendors, service providers, customers, component units, or joint ventures in which 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 Commonwealth's systems or any other systems are year 2000 compliant or whether the plans and activities of Commonwealth or any third parties 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 other assurances with respect to these matters.

However, during our audit, we made limited inquiries about Commonwealth's activities to address the year 2000 issue. We have not performed any procedures to test the accuracy or completeness of the responses to our inquiries, but we have included our observations resulting from those inquiries in the following paragraphs. Because year 2000 activities are currently in process, we may have had additional observations had we made inquiries after the date of this letter.

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 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.

The client informed us that primary financial software applications, hardware and embedded systems items have been inventoried. A Year 2000 Plan, including a compliance standard definition, has been published and distributed. The 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 the 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.

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.

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 state's infrastructure it may be difficult, if not impossible, to obtain information regarding the state's 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 its 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.

The Need to Improve Accounting for the Assets and Liabilities of Counties Abolished by the Commonwealth

There were 14 counties in Massachusetts, but county government has been abolished in four of them and is

scheduled to terminate in three others. Franklin and Middlesex Counties government were abolished in fiscal year 1998. Hampden and Worcester Counties government were abolished on July 1, 1998. On August 13, 1998, legislation was approved abolishing county government in Hampshire, Essex and Berkshire Counties on January 1, 1999, July 1, 1999 and July 1, 2000, respectively. Virtually all functions, duties and responsibilities of the affected counties are transferred to the Commonwealth. As of the date of abolition of an affected county's government, all valid liabilities and debts of such county which are in force immediately before such date become obligations of the Commonwealth, and all assets and revenues of such county become assets and revenues of the Commonwealth.

The fixed assets of the counties, which consist largely of buildings such as courthouses, jails and houses of correction, should be brought onto the Commonwealth's books at historical cost. However, for Franklin and Middlesex Counties this has been a difficult task as the original purchase or construction documentation has proven difficult to obtain. To assess historical cost, the Capital Accounting Bureau (CAB) used known historical cost when available, or made estimates based upon known historical data, such as acquisition or construction date, current assessment amounts, and type of structure, and real estate inflation assumptions to calculate an assessed value of each respective fixed asset.

While these estimates appear reasonable and the amounts in the fiscal year 1998 financial statements do not appear materially misstated, the assets should be recorded at historical cost and the Commonwealth develop a plan to obtain actual historical cost documentation for the County assets which will be assumed by the Commonwealth subsequent to June 30, 1998. The fixed asset balances of these counties may be material and the Commonwealth will need to obtain historical cost documentation in order to report fixed assets in the financial statements in accordance with generally accepted accounting principles.

OFFICE OF THE COMPTROLLER

Need for Monitoring of Subrecipient 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 that 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, However 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 subrecipients 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.

Indirect Cost Rates

The Accounting Bureau (Bureau) in Office of the Comptroller develops the indirect cost rates to be charged to federal grants and contracts as well as negotiates the final rate with the various federal cognizant agencies for approximately 50 of the Commonwealth's departments. In developing these rates departmental personnel are often consulted to determine the propriety and accuracy of including certain cost elements in the indirect cost pool. Oftentimes, however, the rates are developed by extracting data from MMARS for inclusion in the pool with very little, if any, consultation with departmental personnel. The departments are then notified by the Bureau of their indirect cost rate.

While the personnel in the Bureau are very knowledgeable about MMARS, OMB Circular A-87, Cost Principles for State, Local and Indian Tribal Governments, and the amount of the central service agency allocations to be included in each department's indirect cost rate, they are not as familiar with the operations and functions of the 50 departments as the personnel who work at those departments. Such knowledge is essential in determining what cost elements should be included in or excluded from the indirect cost pool. During the course of the audit, personnel in some of these departments have raised questions as to the rate itself and commented on their lack of involvement or consultation in the development of the rate. We recommend that the Bureau consult with the appropriate personnel at the departments for whom it develops indirect cost rates to ensure that the cost elements included in or excluded from the pool accurately reflect the operations and functions of the department.

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.

Activity Based Costing

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

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

The Commonwealth Should Begin to Consider the Benefits of Popular Reporting

The reporting of the financial results for governmental entities will continue to evolve as the Government Accounting Standards Board (GASB) moves forward with its new reporting model as discussed elsewhere in this letter. While the reporting model will provide some additional information and a different display of a government's operations it will still require an extensive level of detail, footnote information and combining schedules to demonstrate compliance with generally accepted accounting principals. The information is so detailed that few experienced financial experts, much less the average citizen, can understand the information provided.

In recent years there has been discussion of the concept of "popular reporting". This level of reporting is intended to communicate with words, graphs and limited financial tables the important messages concerning a government's operations in a way that the citizens and average readers can begin to understand.

While this level of reporting is not currently on GASB's agenda, it is a natural outgrowth from both the use of the management discussion and analysis that will be required and the transmittal letter which accompanies the comprehensive annual financial report. We suggest that the Commonwealth begin to experiment with popular reporting as plans are developed to implement the reporting model.

Focus on Financial Condition

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

This emphasis on financial condition is similar to the State Comptroller's emphasis on intergovernmental equity. This focus should be on the development of the plans to pay for long-term obligations, both debt related and non-debt related, while also recognizing that financial plans need to exist for the repair or replacement of fixed assets and infrastructure. The focus is not so much on the growth of net assets as it is on the maintaining of a net asset balance that demonstrates a sound and stable financial condition with sufficient resources to offset economic downturns. We suggest that the Commonwealth begin to develop models that include plans for future financing of obligations and assets.

PUBLIC EMPLOYEE RETIREMENT ADMINISTRATION COMMISSION

Pension Assumption and Valuation Changes

The Commonwealth is statutorily responsible for the pension benefits for Commonwealth employees (State Employees' Retirement System) and teachers of the cities towns, regional school districts throughout the Commonwealth and Quincy College (Teachers' Retirement System, except for teachers in the Boston public schools, who are members of the State – Boston Retirement System but whose pensions are the responsibility of the Commonwealth). During fiscal year 1998 changes were made to the underlying assumptions of the actuarial valuation which significantly affected the Unfunded Actuarial Liability (UAL). These changes were not communicated to the Public Employee Retirement Administration Commission (PERAC) or the Office of the Comptroller in a timely manner.

Any time the basis underlying actuarial assumptions are modified or updated there is a chance that the overall change of the net pension obligation and the UAL could be significantly affected. In the most recent valuation, as of January 1, 1998, three of the underlying valuation assumptions were modified from the previous pension valuation. First, the assumed rate of return on investments of present and future assets decreased from 8.50% to 8.25% per year resulting in a \$641,000,000 increase in UAL. Second, the use of an updated mortality table

resulted in a \$1,100,000,000 increase in the UAL. Third, a change from using the market value of assets to an actuarial value of assets increased the UAL by \$643,000,000.

Though all of the new assumptions more accurately reflect the net pension obligation and the UAL, there should be a more thorough and timely evaluation and discussion of the financial reporting and economic impact of the changes in the pension valuation process. This would allow PERAC and the Office of the Comptroller to be better informed and have ample time to thoroughly examine and research the proposed changes. The Comptroller's office needs to have the final valuation issued in an acceptable amount of time prior to the legislatively mandated reporting deadline for the Statutory Basis Financial Statements. Accordingly, any changes in the valuation and the status of the valuation should be communicated during the planning stages of the valuation in order to keep PERAC and the Office of the Comptroller educated and informed of the process to avoid delays in the issuance of the Statutory Basis Financial Statements.

OFFICE OF THE TREASURER

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 audit field work, and daily conversations with Treasury personnel, the requested information was not received until after the end of scheduled field work. We recommend preparation for the audit should be prioritized and a work plan prepared in order to complete the required information on a timely basis.

Float Fund

The Treasury maintains a cash suspense fund in MMARS that 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 activities in the fund is identified through the cash reconciliation process, however, there may be activities in the fund which were recorded prior to the improvement in the cash reconciliation process. The Treasury had provided information showing summary of the components in the float fund at June 30, 1998, however, the information was not adequate in order to determine the age and validity of the activities and whether certain amounts should be written off and transferred to abandoned property. The total amounts of the float fund as of June 30, 1998 and 1997 were \$342 million and \$296 million, respectively. The Treasury should perform a detailed analysis of the float fund to substantiate the balance on a go-forward basis and to identify any old transactions that have not been presented for payment.

Cash Reconciliation

Numerous differences existed in cash balance between Treasury and the MMARS system maintained by the Office of the Comptroller at June 30, 1998 and they were not reconciled on a timely basis. We recommend that cash reconciliations between the Treasury and MMARS are prepared on a monthly basis and any reconciling items be investigated and documented.

STATE LOTTERY COMMISSION

Support for Expenditures

The Lottery was not able to provide documentary support for one expenditure, an electronic fund transfer ("EFT"), selected for testing during the audit. Lottery personnel indicated that documents supporting all EFT transactions are maintained on file for two to six months and then are destroyed. If the information is needed after it is destroyed, it must be recreated from EFT tapes. This exception related to a transaction that took place prior to a system conversion at the Lottery in November 1997. No exceptions were noted under the new computer system.

The Commonwealth's common rule for record retention is a minimum of three years after the close of the related transaction. Since the majority of documents used by the Lottery relates to winnings and payments and their related investments that span over a long period of time, documents supporting these activities should be maintained for a minimum of three years after the close of the life of the winning, payment, and investments. We recommend the Lottery becomes familiar with record retention requirements and maintain its documents accordingly.

Timely Update of EFT Transactions

The Lottery does not provide electronic fund transfer ("EFT") information to the Treasury on a timely basis. Information for certain EFT transactions were not provided to the Treasury for as long as three months after the transactions took place.

EFT letters are necessary to provide the Treasury with a weekly breakdown of revenues and expenditures by game and the amount of cash received by the bank account. EFT's are to be faxed to the Treasury weekly so that MMARS may be updated and wire transfers reconciled.

We recommend the Lottery personnel ensure that all EFT information is provided to the Treasury weekly so that cash and wire transfers can be reconciled on a timely basis.

Recording and Reporting of EFT Rejects

EFT rejects are posted against Instant Game revenue rather than to the specific games affected. The Lottery provides the Treasury the total amount of rejects per the daily bank link statement but does not provide a detail of rejects by the related games. As a result, Instant Game revenue is understated in MMARS and other game revenues are overstated.

The Lottery classifies revenues by game type using an excel spreadsheet for its internal use; the information is not always posted to MMARS. At June 30, 1998, rejects totaling approximately \$22 million were posted against Instant Game. Although revenue in total is not misstated, we recommend the Lottery set up clearing accounts on MMARS and track EFT rejects by game type so that revenue by game type is more accurately reflected.

Need for an Automated General Ledger System

The State Lottery Commission's (the "Lottery") financial statements are developed using Excel spreadsheets. In addition, the Lottery did not perform timely reconciliations of its financial information to MMARS. Failure to perform such reconciliations may lead to errors going unnoticed for prolonged periods of time, making subsequent correction more difficult. These errors may also not be discovered in time to make adjustments to the financial statements that could result in material misstatements. 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 that are used in a system of internal controls, such as requiring balanced journal entries to make changed to financial information.

We recommend that the Lottery 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.

Lottery Commission as an Enterprise Fund

The 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 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 have significant transactions and activities 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 and benefit of its operations while providing additional assurance to the public. Such accounting would require that the Lottery's accounting systems be evaluated and possibly upgraded so that operations could be reported on a full accrual basis.

Support for Accounts Receivable and Accounts Payable Balances

The Lottery personnel were not able to provide information necessary for the audit of the Lottery's accounts receivable and accounts payable at June 30, 1998. The Lottery had experienced significant personnel turnover during fiscal year 1998 and 1997 and new employees are not familiar with MMARS in order to provide auditable information.

At June 30, 1998, gross accounts receivable totaled approximately \$19 million, the related uncollectible amounts totaled approximately \$5 million, and accounts payable totaled \$33 million. These amounts were not auditable as the information was not available.

We recommend that the Lottery ensure that employees are cross-trained so that extended absences or turnover would not cause a break in financial operations. In addition, we recommend that adequate training on MMARS is provided to accounting and financial reporting personnel so that financial information can be reviewed and reconciled on a timely basis and are auditable.

Investment Rating

While testing prizes payable and insurance annuities, we noted one insurance company that maintains certain annuities for the Lottery was in financial difficulty at June 30, 1998. This insurance company holds approximately \$1.5 million which represents 0.10% of total prizes payable balance at year end. This amount is not material to the financial statements of the Commonwealth; however, the Lottery does not record an allowance for defaulted annuities and does not have policies and procedures in place to provide alternative payment sources in the case of defaults. We recommend that the Lottery establish a reserve to reflect annuities at their net estimated realizable value in case of market fluctuation and review the investment ratings for all of its investment custodians at least on an annual basis. In addition, we recommend the Lottery identify alternative investment vehicles as back ups to ensure that it will be able to meet all prizes payments as they become due in case one or more annuity custodians become insolvent.

Understatement of Prizes Payable

Prizes payable was understated at June 30, 1998. From a sample of 34 annuities selected for testing, five accounts were understated. The total amount of the known understatements was approximately \$11 million and an additional likely understatement of approximately \$9 million was projected. Although the total amount of the

known and likely understatement is not material to the financial statements of the Commonwealth, we recommend that the Lottery improve its procedures for reconciling prizes payable and annuity contracts to ensure that the related liabilities are properly stated.

DEPARTMENT OF REVENUE

Accounting for Internally Constructed Fixed Assets Needs to be Improved

We noted during the testing of fixed assets at the Child Support Enforcement Agency that the Commonwealth of Massachusetts Enforcement Tracking (COMET) system was not recorded. Per the Commonwealth's Fixed Assets Subsystem User Guide, assets that are constructed (including software) should be priced at the total costs to build the asset. This includes both direct and indirect costs. The estimated fixed asset value of the COMET system is approximately \$41.4 million, and thus, should be recorded.

The Department of Revenue needs to become more familiar with the Commonwealth's fixed asset policies and procedures for the purchase or development of new assets to ensure that all assets, including assets considered "constructed" or "self-constructed" are recorded within the Fixed Assets Subsystem in a timely manner. Controls should also be established and implemented to ensure compliance with the standard policies and procedures.

DIVISION OF EMPLOYMENT AND TRAINING

Lease Payment Schedule

As part of our audit of the Commonwealth of Massachusetts' (the "Commonwealth") Comprehensive Annual Financial Report prepared in accordance with generally accepted accounting principles, we examined the lease payment schedule prepared by the Division of Employment and Training (the "Division"). From a sample of two leases (one selected from the lease agreement file and agreed to the lease payment schedule, and another selected from the lease payment schedule and agreed to the lease agreement) we noted that the aggregate lease obligation for each selection agreed with the lease agreement; however, the lease terms were not properly recorded on the schedule and annual future lease payments were reported all in the same year rather than classified in the years corresponding to the lease payments.

The MMARS lease payment system is limited in its ability to track leases when lease terms are greater than one year. Therefore, for GAAP reporting purposes, department and agencies of the Commonwealth are to manually correct the lease payment schedule in order to facilitate GAAP reporting and disclosure. However, the Division did not make the manual corrections for the year ended June 30, 1998.

The effect of not disclosing leases based on their annual payments was not material to the Commonwealth's financial statements but it has an effect on future lease payment disclosure in notes to the financial statements.

We recommend that management revisit the lease payment schedule as soon as possible and resubmit the information to the Office of the Comptroller to ensure proper financial statement disclosure.

Department of Public Health

Internal Control Manual Needs Improvement

The Department of Public Health's Internal Control Manual (Manual) did not contain all the sections as recommended by the Office of the Comptroller's Internal Control Guide (Guide). Each department is required to maintain a written internal control plan which contains the component parts required under Chapter 647 of the Acts of 1989. Although the Manual includes a listing of oversight manuals in section 2.3, the various systems and transactions do not make specific reference to the oversight manuals which detail the controls in place. The Manual only contains general controls over the various aspects of the accounting system and no references to specific control procedures or policies. The checklist used during the audit to evaluate the Manual was developed from the Guide.

Although the oversight manuals are summarized within the Manual, the specific transactions discussed do not make reference to the respective oversight manual. The Department should update the Internal Control Manual to make reference to all oversight manuals which detail specific controls in place at the department for each type of transaction outlined in the manual. The Guide should be used as a checklist in this update.

STATE POLICE DEPARTMENT

Absence of Accruals reported on the GAAP Package

The State Police Department (Department) needs to improve its GAAP reporting procedures to recognize all liabilities. The Department did not include approximately \$29 million in accruals on the GAAP package provided to the Comptroller's Office for the year ended June 30, 1998. Ninety-six percent of the amount related to a collective bargaining contract, signed on March 20, 1998, with the State Police Association of Massachusetts (SPAM). The agreement stipulates that retroactive salaries, overtime, bonuses and GIC rebates are to be paid to SPAM members and senior officers. The remaining balance of the unreported accrual related to unpaid overtime. Both amounts were approved by the Legislature in late August 1998. The Department subsequently corrected its GAAP reporting package.

HIGHER EDUCATION

Reporting of the University and College Fund Type Needs Improvement

The Universities 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. Fifteen 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 ten institutions, which include Bunker Hill Community College, Cape Cod Community College, Greenfield Community College, Massachusetts Bay Community College, Massachusetts College of Liberal Arts, Massachusetts Maritime Academy, North Shore Community College, Northern Essex 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).

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 1998 UMASS audited financial statements fixed assets balance was \$779 million greater than the amount reported in MMARS. At Bridgewater State, the equipment balance as reported in the audited financial statements was \$22 million greater than the amount reported in MMARS. Westfield State had a fixed assets balance per the financial statements \$11 million greater than the amount recorded 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 ten institutions which do not issue audited stand-alone financial statements begin and/or complete the process of producing them prior to the November 1, 1999 deadline, necessary for inclusion in the fiscal year 1999 CAFR. The CAFR. 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 also recommend that the University and Colleges monitor and reconcile the variances between the audited financial statement balances and the balances in MMARS.,.

In addition, we recommend that the University and Colleges follow and adopt policies the Office of the Comptroller establish and adopt a uniform set of accounting policies and uniform financial statement disclosures that 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

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. Ten of the twenty-five institutions included in the Fund Type do not produce complete audited stand-alone financial statements. Consequently, many of 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.

There were differences between cash balances reported in MMARS and included in GAAP packages submitted by the colleges to FRAB. The most significant differences were with North Shore Community College in which MMARS amounts exceeded GAAP package amounts by approximately \$2.4 million and at Mass Maritime Academy where GAAP package amounts exceeded MMARS amounts by approximately \$1.2 million.

We recommend that the six institutions which do not issue audited stand-alone financial statements begin and/or complete the process of producing them prior to the November 1, 1999 deadline, necessary for inclusion in the fiscal year 1999 CAFR.

We also recommend that 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 1998, 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-nine 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, 1998 deadline established by the Office of the Comptroller, resulting in several late adjustments and reporting disclosures to the CAFR.

Bunker Hill Community College, Cape Cod Community College, Greenfield Community College, Massachusetts Bay Community College, Massachusetts College of Liberal Arts, Massachusetts Maritime Academy, North Shore Community College, Northern Essex Community College, Roxbury Community College and Salem State College 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, 1999 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.

In addition, we recommend that the component units adopt the uniform set of accounting policies and financial statement disclosures suggested by the Comptrollers office. This will help the OSC organize information for inclusion in the financial statements of the Commonwealth and help ensure that similar accounts across component units are grouped together properly.

Reporting of the Commonwealth and Other Entities

For financial reporting purposes, the Commonwealth includes under the requirements of Government Accounting Standards Board Statement No. 14, "The Financial Reporting Entity", all funds, organizations, account groups, agencies, boards, commissions and institutions which it is accountable. The Commonwealth has also considered all potential component units for which it is financially accountable as well as other organizations for which the nature and significance of their relationship with the Commonwealth are such that exclusion would cause the Commonwealth's financial statements to be misleading or incomplete under the requirements of Statement No. 14. Each of these entities should apply the appropriate basis of accounting under the generally accepted accounting principals (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 not uniformity of accounting is the Regional Transit Authorities (RTAs). Of the 15 RTAs 14 follow proprietary accounting and one, the Lowell Regional Transit Authority, follows governmental accounting. RTA's are generally considered to be entities that should follow proprietary fund 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 Government Accounting and Standards Board (GASB). New standards issued by the GASB should be implemented in accordance with the provisions and guidance provided by the Commonwealth and the GASB.

Symmetry of adopting accounting standards between the primary government, the component units, and institutions of higher education entities will greatly assist in accurate and timely financial reporting.

In Fiscal Year 1998 the Commonwealth of Massachusetts implemented Governmental Accounting Standards Board ("GASB") Statement No 32, *Accounting and Financial Reporting for Internal Revenue Code Section 457 Deferred Compensation Plans*. GASB No 32 required the Commonwealth to amend its deferred compensation plan such that the plan's assets are now held in trust, and reported as an expendable trust fund, for the exclusive benefit of participants and their beneficiaries. In response to this statement all reporting entities with assets held under this plan should not be reporting amounts held in the expendable trust on their own financial statements because the Commonwealth has fiduciary responsibility over the plan. The other participants in the plan should also remove the agency liability from their financial statements in accordance with GASB 32.

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