COMMONWEALTH OF MASSACHUSETTS
Management Letter
Year Ended June 30, 2005

Commonwealth of Massachusetts
Management Letter
For the Year Ended June 30, 2005

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December 22, 2005

Martin Benison, Comptroller
The Commonwealth of Massachusetts

In planning and performing the Single Audit of the Commonwealth of Massachusetts (the "Commonwealth") for the year ended June 30, 2005, on which we have issued our report dated December 22, 2005, we considered its internal control in order to determine our auditing procedures for the purpose of expressing an opinion on the financial statements and not to provide assurance on the Commonwealth's internal control. However, we noted a certain matter involving the Commonwealth's internal control structure and compliance of management of the Commonwealth with laws and regulations that we consider to be a reportable condition under standards established by the American Institute of Certified Public Accountants. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the Commonwealth's internal control that, in our judgment, could adversely affect the Commonwealth's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. Such matters have been reported to the management of the Commonwealth in the "Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based upon the Audit of the Financial Statements Performed in Accordance with *Government Auditing Standards"* dated December 22, 2005, and "Report on Compliance with Requirements Applicable to Each Major Program and Internal Control over Compliance in Accordance with OMB Circular A-133 and on the Schedule of Expenditures of Federal Awards" dated December 22, 2005.

Our consideration of the Commonwealth's internal control would not necessarily disclose all matters in the Commonwealth's internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are considered to be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by the error or fraud in amounts that would be material in relation to the financial statements or in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. However, based on our procedures and the report of other auditors, the matter identified is not deemed to be a material weakness.

We also submit our comments concerning certain observations and recommendations relating to other accounting, administrative, and operating matters. These recommendations resulted from our observations made in connection with our audit of the Commonwealth for the year ended June 30, 2005. Our comments, arranged by Department, are presented on the following pages.

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

Yours truly,

Deloitte & Touche LLP

STATEWIDE OBSERVATIONS

Departmental Float Funds

A number of departments of the Commonwealth maintain accounts that are referred to as "float funds." A float fund is designed to systemically mirror the balance of outstanding checks. If working effectively, the balance in this control account will agree to the balance of outstanding checks used by the Office of the State Treasurer ("Treasury" or "Treasurer") to reconcile cash. Conceptually, the use of a float fund strengthens the overall control over cash and provides the Treasurer with an independent, systemic tracking of the check clearing process as well as provide the Treasury with assurance that payments it authorized were actually paid. Over a period of years, however, certain departments have been granted the ability to use float funds to essentially manage separate bank accounts outside the control of the Treasury. As a result, a separate reportable condition has been issued because the Treasurer's office is unable to reconcile balances in the float fund. The Treasurer is unable to reconcile these accounts primarily because of the volume of activity that takes place in the float funds that is outside of the Treasurer's control.

The purposes of these departmental funds, outside of the Treasurer's control, are legitimate and necessary to ensure that certain functions of the government can operate effectively on a daily basis. An example of such a situation is the case of witness fees that need to be paid by the Trial Courts. While the purpose of having such accounts is appropriate, the use of float funds to manage them is not. Activity in these accounts should be accounted for through the use of advance accounts. The Commonwealth has specific controls for advance accounts designed to mitigate the exposures inherent in decentralized processing of cash disbursements, the most significant of which is that advance accounts must be zeroed out at year-end.

Departments that have historically used float funds need to work with the Treasury to facilitate the movement of these accounts from float funds to advance accounts. As part of that process, these departments will need to undertake procedures to reconcile their existing float fund accounts. The process will also require these departments to re-assess their current business processes and modify them to accommodate the controls required with the use of advance accounts.

Information Warehouse and Business Process Assessment

During the fiscal year ended June 20, 3005, the Commonwealth implemented a new accounting system. One of the unique features of the new accounting system is that most of the pre-defined, system-generated reports that existed in the old system have been eliminated. In place of those reports, the Commonwealth has developed a much more robust information warehouse than existed with the old accounting system. All information that was previously included in the system-generated reports is available from the warehouse, but the information must be queried by the user. There are certain standard queries that are available to the users, but there is also unlimited flexibility in terms of the type and format of the data that can be mined from the warehouse.

During the audit, we noted that many departments were having difficulty dealing with the lack of information received in its usual format and/or were having difficulty making effective queries from the data warehouse. We also noted that business processes within departments were not assessed and updated in response to the implementation of the new system. The failure to assess and change these business processes to evolve with the change in the form and content of the data received have made the conversion from the old system to the new more difficult.

The management of the departments of the Commonwealth needs to continue to pursue opportunities to provide training to their staff to ensure a proficiency in the use of both the New MMARS system and the information data warehouse. In addition, management of these departments need to reassess internal business processes and ensure that their processes and procedures evolve with the systems to ensure continuity of internal control and efficiency of workflow within the departments. Failure to make dramatic change in the way departments manage their operations in response to the dramatic change inherent in the new system will put departments at an operational disadvantage as well as putting them at risk of not obtaining the information necessary to manage their activities. The Office of the State Comptroller should continue to dedicate resources to assist the departments not only in the use of the new system but also in considering ways in which business processes can be improved to better integrate with the new system.

In addition, the OSC, in conjunction with Information Technology Division, is responsible for managing the information warehouse and in consultation with departments, the end users of those reports, should develop standard queries for financial statement-related information, such as leases and federal expenditures and then create an online standard query book that all departments can access when needed.

Completion of the Central Artery

The Central Artery/ Tunnel Project ("CA/T") is nearing completion. The Massachusetts Legislature passed Chapter 11 of the Acts of 1997(the "Act"). That Act requires the Massachusetts Highway Department ("MHD") to transfer the majority of the CA/T highway facilities to the Massachusetts Turnpike Authority ("MTA") following certain required actions. The final event under the Act that triggers a transfer is agreement between the Chief Engineers of MHD and the MTA that a facility can be safely operated by the MTA or used for its intended purposes, with certain other required actions leading up to that event, including agreement between the parties on terms and conditions of the transfers.

As of June 30, 2005, costs incurred to construct the CA/T facilities designated for transfer to MTA totaled $13.9 billion. Of that amount, only $1.7 billion has been transferred to the MTA. While there has been disagreement over the past several years between MTA and MHD on certain terms and conditions of the remaining transfers, the formal end of construction is scheduled for the spring of 2006. In order for the MHD and the MTA to effectuate the transfers required by the Act, management of these entities needs to come to agreement on the disputed terms and conditions.

The MHD and MTA must comply with the provisions of the Act or work to have those provisions changed. Failure to comply with the Act may result in a reportable finding of noncompliance that is material to the financial statements. We recommend that steps be taken to effectuate the transfers required by the Act before the end of fiscal year 2006.

Reporting on the Commonwealth's Retirement Systems

The Commonwealth is unique among state government in that it does not have separately prepared and audited public employee retirement system financial statements. An independent auditor, as part of a single financial statement, audits the investments of the Commonwealth's three public employee retirement systems. This audit, however, only covers the retirement systems' investments and related investment activity. Accordingly, there is no comprehensive financial statement for the individual plans except that information may be pieced together from the Commonwealth's financial statements. Even then, the presentation combines all three retirement systems, which further limits the ability to assess each plan on an individual basis.

The Commonwealth should consider preparing separate stand-alone financial statements for each of the retirement systems that include all of the assets, liabilities, revenues, and expenses of each system.

Other Postemployment Benefits
The Governmental Accounting Standards Board ("GASB") recently issued GASB Statement No. 45, Accounting and Financial Reporting by Employers for Postretirement Benefits Other than Pensions. This Statement will require the Commonwealth to report its unfunded liability for postretirement benefits other than pensions beginning in fiscal year 2008. While GASB Statement No. 45 will not result in the reporting of a financial statement liability, it will require that the Commonwealth continue funding its other postemployment benefit costs on a current basis and will also require that the Commonwealth begin funding its unfunded liability over a period of years. As was the case when the Commonwealth implemented the provisions of GASB Statement No. 27, Accounting for Pensions by State and Local Governmental Employers, the legislature will need to consider developing a funding plan that will amortize the unfunded liability over a period of years. To the extent that the Commonwealth does not elect to fund this obligation in amounts at least equal to the actuarially determined funding schedule, financial statement liabilities will begin to accrue on the Commonwealth's financial statements.

While no state governments have yet adopted the provisions of GASB Statement No. 45, the State of Maryland has had an actuarial review performed of their unfunded liabilities. The amounts identified in that review were well in excess of the estimates made by management. The impact of failing to fund such obligations with the bond rating agencies has yet to be determined, but it is likely that the failure to fund such obligations is likely to have a negative impact on the Commonwealth's bond ratings in the future. The Commonwealth, like most governmental entities in the northeast, has been very generous in providing such benefits to its employees and the costs of funding these benefits and amortizing the unfunded obligations are likely to be significant.

The legislature should provide funding for and request that an actuarial review of such obligations be performed as soon as possible to determine the magnitude of the required funding. Once determined, the legislature will need to make a determination of the cost/benefit of developing a funding schedule and the impact of such decisions on the budgeting process should be identified as soon as possible to prevent unintended consequences in the Commonwealth's financial reporting.

Statewide Debt Management and Derivatives Policy
The Commonwealth is a sophisticated debt issuer with an excess of $17 billion of debt outstanding. The issuance of debt is regulated by General Laws, federal tax, and securities laws, and is priced according to market factors. Various central service departments of the Commonwealth are involved with debt issuance, including the Treasurer and Receiver – General, the Secretary for Administration and Finance, the Office of the State Comptroller, the Department of Revenue, and various other agencies. Because of the nature of certain aspects of the Commonwealth's debt related to fixed rate refundings and variable rate debt issuance, a degree of administration and coordination is required between departments. In addition, there are a number of component units of the Commonwealth as well as institutions of higher education that may be issuing debt pursuant to their own enabling legislation and through their own processes, separate and distinct from those of the primary government.

We recommend that the Commonwealth develop a debt management policy, which may include the issuance process and general policy considerations relative to the management of a debt portfolio. A debt management policy may include the issuance process and general policy considerations relative to the management of a debt portfolio. It may include the decision making process as to when debt is issued and may demonstrate a commitment to long-term financial planning in light of the Commonwealth's multi-year capital plan, as maintained by the Secretary for Administration and Finance. This policy will also signal to rating agencies and the capital markets that a government is well managed and able to meet its obligations in a timely manner. Finally, the policy may include accounting guidance developed in conjunction with the Office of the State Comptroller for the various structures of debt.

Any policy that is issued should provide specific guidance relative to the use of derivative instruments. Like most sophisticated private and public entities, the Commonwealth uses derivatives to hedge risk. The Commonwealth actively mitigates risks by the use of various swaps and synthetic structures. The Treasurer and Receiver – General is in the midst of promulgating a derivatives policy for derivatives issued in connection with debt issuances, which will encompass the various risks involved and the various tolerances that can be sustained. It is imperative that this policy, when issued, be incorporated within the aforementioned debt policy to ensure that such risks are mitigated on a statewide basis.

Performance Measurement for Decision Making

A key responsibility of state and local governments is to develop and manage programs, services, and their related resources as efficiently and effectively as possible and to communicate the results of these efforts to the stakeholders. Performance measurement when linked to the budget and strategic planning process can assess accomplishments on an organization-wide basis. When used in the long-term planning and goal setting process and linked to the entity's mission, goals, and objectives, meaningful performance measurements assist government officials and citizens in identifying financial and program results, evaluating past resource decisions, and facilitating qualitative improvements in future decisions regarding resource allocation and service delivery.

We recommend that management consider adopting a plan for program and service performance measures to be used as an important component of long-term strategic planning and decision making. These measures should be linked to governmental budgeting as recommended by the Government Finance Officers Association and should:

- Be based on program goals and objectives that tie to a statement of program mission or purpose;
- Measure program outcomes;
- Provide for resource allocation comparisons over time;
- Measure efficiency and effectiveness for continuous improvement;
- Be verifiable, understandable, and timely;
- Be consistent throughout the strategic plan, budget, accounting, and reporting systems and, to the extent practical, be consistent over time;
- Be reported internally and externally;
- Be monitored and used in managerial decision-making processes;
- Be limited to a number and degree of complexity that can provide an efficient and meaningful way to assess the effectiveness and efficiency of key programs; and
- Be designed in such a way to motivate staff at all levels to contribute toward organizational improvement.

The GFOA encourages all governments to utilize performance measures as an integral part of the budget process. Over time, performance measures should be used to report the outputs and outcomes of each program and be related to the mission, goals, and objectives of each department. Governments in the early stages of incorporating performance measures into their budget process should strive to:

- Develop a mission statement for government and its service delivery units by evaluating the needs of the community;
- Develop its service delivery units in terms of programs;
- Identify goals, short- and long-term, that contribute to the attainment of the mission;
- Identify program goals and objectives that are specific in timeframe and measurable to accomplish goals;
- Identify and track performance measures for a manageable number of services within programs;

- Identify program inputs in the budgeting process that address the amount of resources allocated to each program;
- Identify program outputs in the budgeting process that addresses the amount of service units produced;
- Identify program efficiencies in the budgeting process that addresses the cost of providing a unit of service;
- Identify the program outcomes in the budgeting process that addresses the extent to which the goals of the program have been accomplished;
- Take steps to ensure that the entire organization is receptive to evaluation of performance;
- Integrate performance measurements into the budget that, at a minimum, contains by program the goals and input, output, efficiency, and outcome measures; and
- Calculate costs and document changes that occur as a direct result of the performance management program in order to review the effectiveness of the performance management program.
- As governments gain experience, they are encouraged to develop more detailed information and use a variety of performance measures to report on program outcomes.

In the final analysis, GFOA recognizes that the value of any performance measurement program is derived through positive behavioral change. Stakeholders at all levels must embrace the concept of continuous improvement and be willing to be measured against objective expectations. GFOA urges governments to recognize that establishing a receptive climate for performance measurement is as important as the measurements themselves.

Workers' Compensation and Group Health Insurance

The Commonwealth should establish a funding schedule to accumulate assets to satisfy the current under-funded liability related to the internal service funds. As of June 30, 2005, the unfunded liability for the workers' compensation and group health insurance funds was $313 million and $64 million, respectively. Under the new reporting model, these balances represent accumulated liabilities and, as such, are reported as liabilities in the governmental fund statements directly reducing the "net assets" of the Commonwealth. Ultimately, these obligations exacerbate the Commonwealth's negative unrestricted net asset position.

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

Education Program

The recently implemented governmental reporting model requires governments to provide basic financial statements, both at a fund level, similar to what has historically been reported for governmental entities, and at a government-wide level. The government-wide statements are intended to focus attention on the overall financial condition of the government. The display of the overall operations of the government, including all debt and long-term assets, makes it easier to determine whether the government as a whole is better or worse off than the previous year.

This emphasis on government's overall financial condition is similar to the emphasis on the issue of intergenerational equity, which focuses on the development of plans to not only pay for long-term obligations, both debt related and non-debt related, but also on the need for the repair or replacement of fixed assets and infrastructure. The intergenerational equity 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.

These concepts are all tied to the notion of sustainability. Sustainability is the notion that current economic and consumption patterns should not reduce opportunities for future generations by depleting or impairing resources. Many businesses worldwide have demonstrated that they can operate profitably while employing sustainable practices. Similarly, many governments have adopted and implemented sustainable policies and business practices.

To that end, financial statement models should be developed that demonstrate the implications of the Commonwealth's long-term capital, debt related and non-debt related needs, and stress the need for plans to support the future financing of obligations and assets together with the implications of legislative action on financial reporting. This will ensure that decisions made at the legislative level will be consistent with best interests of the taxpayers of the Commonwealth. This is particularly important in the Commonwealth because it has a long history of paying for and financially supporting its authorities as well as local government capital projects. The negative unrestricted net asset balance is, in part, reflective of the fact that the Commonwealth is carrying significant long-term debt obligations for assets that are owned by cities, towns, and independent authorities of the Commonwealth. This is a prime example of the type of legislative decisions that are made that have a significant financial statement impact in the new reporting model.

The concepts defined above are commercial in nature and are not concepts on which governments have historically focused. Part of the rationale for the new reporting model was to begin to change those historical perspectives. Given this change in focus, the OSC should consider developing a training program to educate the administration, the Legislature, and other potential users of the financial statements about these concepts.

Use of Comparative Trend Data for Financial Analysis

The Commonwealth's Comprehensive Annual Financial Report ("CAFR") provides a wealth of data that the Commonwealth and other interested users can use to analyze the Commonwealth's financial position. The Commonwealth enhanced this comparability in FY2004 by implementing certain optional aspects of the GFOA's CAFR award statistical reports as part of the CAFR's statistical section. This was done in anticipation of GASB Statement No. 44 implementation to be finalized in FY2006. Of course, considering financial data in isolation can lead to inappropriate conclusions – appropriate context is essential for sound interpretation. Accordingly, comparative trend data for the Commonwealth itself may not provide the users of the financial statements with sufficient data to make appropriate decisions.

The Commonwealth should consider providing information about other states on its website that would allow users a tool for peer analysis. The decision as to which other states ought to be included should take into consideration population and demographic data, programmatic similarities_ and other factors that would lead to effective comparison. The rationale for the states included could also be provided. Such information can be obtained from the CAFRs published for those states or through industry associations such as the GFOA or the National Association of State Comptrollers.

Compliance with Chapter 647, the Internal Control Act

Massachusetts General Law, Chapter 647, *State Agencies Internal Control Act of 1989* ("Chapter 647"), outlines internal control standards, defines the minimum level of internal control systems and establishes the criteria against which internal controls will be evaluated. Chapter 647 also states "Internal control systems for the various state departments shall be developed in accordance with guidelines established by the OSC." The OSC has issued written guidance in the form of the Internal Control Guide for Managers and, in 2001, the Internal Control Guide for Departments. Departments implement Chapter 647 and these Guides through a document known as the "departments' internal control plan."

Since the passage of Chapter 647, the OSC , in addition to publishing the above-mentioned guides, has assisted departments, when requested, in developing internal control plans; conducted training sessions on internal controls and risk assessments; and in conjunction with the Office of the State Auditor ("OSA"), reviewed departmental internal control plans upon request or as part of the statewide Single Audit. The Single Audits starting in 1999 have been used as a vehicle to promote the OSC's internal control campaign and emphasize compliance with Chapter 647 and OSC Guides.

The OSC campaign to promote compliance with Chapter 647 and its Guides was not promoted as emphatically during the past year primarily because of the implementation of a new accounting and reporting system, New MMARS. Because of the improvements to the effectiveness, efficiency, and economy of operations afforded by full implementation of New MMARS, the internal control structure and processes in departments will need to be reassessed. The OSC is aware that internal control changes will be required in departments and plans to reenergize its internal control campaign. We strongly encourage the OSC to lead an initiative to ensure that all departments are updating their internal control documentation for the changes they implement and that such steps are taken as the changes are being made to ensure the maximum level of efficiency in the process. The OSC initiative should include the following:

1. Require departments to reevaluate their risk assessments in light of the changes;
2. Continue to have departments show that they have internal control policies and procedures in place to mitigate the risks detailed in their risk assessments;
3. Continue to work with those departments that have developed internal control plans that most closely comply with the Guides to be used as a model for other departments to follow;
4. Consider developing a template or model internal control plan or risk assessment component for those departments with common operations, such as the 15 community colleges and the 10 sheriffs' offices.

EOHHS Reorganization

With a goal of improving the effectiveness, efficiency, and economy of Commonwealth human service operations, the Administration undertook the reorganization of the Executive Office of Health and Human Services ("EOHHS") in 2004. EOHHS, in conjunction with the Executive Office for Administration and Finance, is responsible for implementing the reorganization.

EOHHS and the 17 departments or divisions under its umbrella are the largest Executive Branch Secretariat in the Commonwealth. It is estimated that EOHHS administers more than 100 federal programs totaling approximately $7 billion as well as administering an equal amount of state funds. One of the primary objectives of the reorganization that is still in process is the consolidation of some of the administrative functions in these departments. As occurs with all reorganizations and consolidations, some individuals are required to assume new roles and perform new functions.

The effective coordination of the accounting and financial reporting functions with the programmatic function is crucial to the overall operation of all programs administered by EOHHS, particularly now that many of the administrative functions are being physically separated from the programmatic functions. This is most especially the case for federal programs because many of these programs require the Commonwealth to match federal funds or have a cap on administrative spending. It is recommended that EOHHS take all steps necessary to ensure that the policies, procedures, and processes to be followed by individuals in their new roles are adequately documented, so that institutional memory and knowledge is memorialized. Such documentation would improve the overall internal control environment within these departments and help ensure compliance with federal and state laws and regulations.

OFFICE OF THE STATE COMPTROLLER

GAAP Packages

OSC requires each department to submit a "GAAP Package" to its Financial Accounting and Reporting Bureau ("FRAB"). The purpose of the GAAP Package is to properly accumulate the information needed to report the Commonwealth's financial condition under generally accepted accounting principles ("GAAP") in accordance with the standards promulgated by GASB. OSC distributes instructions to all departments detailing the information needed, including accruals for receivables, leases, and other balances. Though GAAP packages are only somewhat effective audit tools, they provide another source of communication of accounting policy to small departments between small departments who may not be audited annually and the OSC.

The OSC set August 15, 2005, as the submission deadline for the GAAP Packages. Thirty nine priority III departments failed to submit a GAAP Package for fiscal year 2005. Many of these departments also failed to file GAAP packages in prior years as well. This forces FRAB to make certain estimates and assumptions (concerning payroll, number of employees, etc.) in order to prepare statements. Although these priority III departments are immaterial, individually and in the aggregate, the amounts should be reported to provide an accurate financial picture.

OSC should continue to communicate with departmental Chief Fiscal Officers in upcoming meetings the importance of that information and the need to prepare this package in a timely manner.

Fixed Assets are not Entered onto MMARS in a Timely Manner

The Commonwealth's fixed assets were not entered into MMARS in a timely manner. As of June 30, 2005, the Commonwealth had not allocated time for the uploading of fixed asset information. As a result, there were no rollforwards or analytical reviews performed during the year, which would allow the OSC to gain confidence in the fixed asset numbers throughout the year. This resulted in extended time needed at year-end to reconcile the fixed asset subsystem with MMARS fixed assets. The OSC should implement policies to ensure that fixed assets be uploaded onto MMARS on a weekly basis. The OSC should also consider performing monthly reconciliations of fixed assets. The upgraded MMARS system now automatically generates a shell for a potential fixed asset transaction with each expenditure that contains certain commodity code information and if the department indicates that this construction or purchase program will result in a fixed asset. These shells are now converted to fixed asset documents upon the run of a program – asset generation batch cycle. The OSC should also consider performing monthly reconciliations of fixed assets, comparing expenditures for fixed asset eligible objects to fixed asset shell generation.

OFFICE OF THE STATE TREASURER AND RECEIVER GENERAL

Reconciliation of Cash – Bank to General Ledger

The reconciliation of cash is a two-tiered process. The first part of that process is the Treasurer's reconciliation of cash from bank to cash as reported in the Treasurer's system ("CMS"). The second part of the process reconciles cash from the CMS system to MMARS, the official books and records of the Commonwealth. The CMS system is a pure Treasury system and accounts for transactions in a manner that is different from the manner in which such transactions are accounted for in the accounting system. As a result, many of the reconciling items in the first part of the reconciliation process ultimately need to be reversed in the second part of the reconciliation process. Combined, the overall process for reconciling cash is complex and labor intensive. It requires joint resources from both the Treasurer and Comptroller's offices. In many cases, these resources have to leverage off of one another in order to complete their respective reconciliations.

The complexity of this process is highlighted in the current year. While reconciliations performed in the Treasurer's office are performed on a daily basis, the second phase of the process was significantly delayed in the current year as resources in the Comptroller's office were re-directed towards the implementation of the new MMARS accounting system. As a result, the Comptroller's reconciliation of cash was not completed until well after year-end. Upon completion, a number of journal entries were required to account for errors and mispostings that were made during the year, but not identified until months after such errors were made.

Treasury management should explore the possibility of leveraging the functionality available in the new MMARS accounting system that would facilitate a single, streamlined reconciliation process. The CMS system is outdated and has a number of functional limitations that impair its effectiveness and clearly hinder the efficiency of Treasury operations.

In the interim period, the Comptroller's office needs to examine the reconciliation processes currently in place and re-prioritize resources as appropriate to ensure a more timely reconciliation of the cash accounts.

Outstanding Fund List Report (OFL)

During our fiscal year 2005 audit of the Treasury, we noticed instances where certain investments were not properly accounted in the Outstanding Fund List ("OFL") report. Two investments that were listed within the OFL report (created by the CMS system) had maturity dates of July 1, 2005. In actuality, the two investments had maturity dates of June 30, 2005. This instance caused an overstatement of investments held, and an understatement of cash within the MMARS system. We also noted that there were investments listed in the OFL report as held by certain banks that, upon examination, were determined to actually be held at another bank. Discussions with Treasury personnel indicated that all investments purchased (Bank Names, Security Type, Amount, and Maturity) are entered into the CMS system manually.

The Treasury should look at the process of recording investment activity. Currently, it appears that much of the investment data is processed manually and there is no formal process to check data once it is entered. Treasury management should assess whether there are technological solutions that are available that would eliminate the need to manually enter data. Management should also implement review procedures to verify the propriety of manually keyed data reported in the investment's system.

CMIA Prioritization

During our fiscal year 2004 and 2005 audits of the Treasury, we noticed instances where federal drawdowns were not being processed in a timely manner, where the interest liability schedule was not being updated in a timely manner and that the volume of rejected transactions in the current year have increased. Federal drawdowns are supposed to be requested weekly on either Tuesday or Thursday. In 9 out of 20 instances selected for testing in the current year, drawdowns were not made on the required dates. Eight of twenty instances selected for testing were rejected for one reason or another. Disruptions caused by the conversion to new MMARS may have occasionally led to an uneven workload causing draws to be late. While management does not anticipate any difficulties with the CMIA workload once the workflow of draw files stabilizes and that the volume of rejects will decrease once the departments become more accustomed to the new accounting system, the matters noted in the current year are consistent with our observations in fiscal year 2004 and indicate that policies and procedures as documented are not being followed.

The Treasury and OSC should monitor compliance with documented policies and procedures relative to CMIA. In the event that the issues identified in 2004 and 2005 appear to be recurring in 2006, management of the respective department should re-assess roles and responsibilities to ensure that adequate staffing is available to drawdown federal cash in a timely manner and effectively comply with all CMIA requirements. OSC has begun to take steps to bring the CMIA draw process into the one consolidated group which should streamline the process of requesting cash draws and reconciling rejected draws.

Process Holder

Roles and responsibilities relative to the CMIA process are performed jointly by the Treasury as well as the Comptroller's Office. The lack of centralized responsibility for CMIA compliance results in disjointed oversight over the process of managing and monitoring federal drawdowns and exacerbates some of the problems that were identified in testing in the current year.

Centralizing responsibility for CMIA oversight should be considered. While effective management of the program may ultimately require resources from both functions, centralized oversight would likely cut down processing time as well as reduce differences in record keeping. To address this, the OSC has embarked on transitioning the CMIA draw function from the Treasurer and Receiver – General to its office. This will further segregate the cash reconciliation function from the physical draw function.

HIGHER EDUCATION

Higher Education Shared Services Center

The Commonwealth should evaluate whether a higher education shared services center would improve the efficiency and accountability of the accounting and student financial aid operations of the community and small state colleges. A secondary goal of a shared services center would be to reduce the operating costs of non-academic functions. Problems encountered in recent years at some of the Commonwealth's colleges combined with the significant turnover experienced by many of these institutions as a result of early retirement incentives offered by the Commonwealth in recent years indicate the need to challenge the current approach to providing the "back room" operations of the state's higher education system.

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

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

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

In considering whether to move to a shared services concept, the Commonwealth and the Board of Higher Education should perform the following steps:

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

Tuition Remission

The Commonwealth should reconsider its tuition remission program. Under the current system, all funds collected by colleges are remitted to the Commonwealth. The Commonwealth then finances the operating activities of the colleges and universities. The Commonwealth should consider making the colleges pay their own expenses through their own collections. This approach would make the colleges and universities accountable for their activities around collections and spending.

Implementing such a policy should be accompanied by further legislative action to eliminate the duplication of efforts that currently exists at the institutions of higher education. Currently, all financial information is entered into the stand alone systems of the institutions of higher education for purposes of ensuring a complete general ledger. Certain financial information is then re-entered into the statewide accounting system for the purpose of ensuring proper recording of certain information required in that system related to non-appropriated funds. The OSC has proposed legislation that would eliminate the reporting of non-appropriated funds by the institutions of higher education. We support that legislation and believe that the guidance proposed in that legislation relative to how the institutions of higher education would report information to the OSC is a more efficient approach that would eliminate the duplication of efforts at those institutions and eliminate the reconciliation procedures that are required at the OSC.