



**COMMONWEALTH OF MASSACHUSETTS**

Management Letter

June 30, 2007



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December 24, 2007

The Comptroller's Advisory Board  
Commonwealth of Massachusetts

We have audited the basic financial statements of the Commonwealth of Massachusetts (the Commonwealth), as of and for the year ended June 30, 2007, and have issued our report thereon dated December 24, 2007. In planning and performing our audit of the basic financial statements of the Commonwealth, we considered internal control as a basis for designing our auditing procedures for the purpose of expressing our opinions on the basic financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Commonwealth's internal control.

During our audit we noted certain matters involving internal control and other operational matters that are presented for your consideration. These comments and recommendations, all of which have been discussed with the appropriate members of management, are intended to improve internal control or result in other operating efficiencies and are summarized on the attached schedule of observations.

The Commonwealth's written responses to our comments and recommendations have not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on them.

In addition, we identified certain deficiencies in internal control that we consider to be significant deficiencies, and in accordance with *Government Auditing Standards* communicated them in writing to the Commonwealth in a separate report dated December 24, 2007.

Our audit procedures are designed primarily to enable us to form opinions on the basic financial statements, and therefore, may not bring to light all weaknesses in policies or procedures that may exist. We aim, however, to use our knowledge of the Commonwealth's organization gained during our work to make comments and suggestions that we hope will be useful to you.

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

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

Very truly yours,

**KPMG LLP**

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## Schedule of Observations

### Office of the State Comptroller

#### Standards Supporting the Statutory Basis Financial Reporting Model

##### *Observation*

The Commonwealth, in addition to issuing audited financial statements in accordance with generally accepted accounting principles (GAAP), also issues audited statutory basis financial statements (SBFR). The Commonwealth's statutory framework is governed by Section 12 of Chapter 7A as amended by Section 4 of Chapter 88 of the Acts of 1997 of the Massachusetts General Laws (MGL). These MGL sections also require the SBFR financial statements to be audited in accordance with *Government Auditing Standards*. Both the GAAP and SBFR statements are made publicly available.

We believe the SBFR statements provide invaluable information to the executive and legislative branches as well as other interested parties of the Commonwealth. We also believe that requiring such information be audited and moreover audited in accordance with *Government Auditing Standards* subjects the Comptroller's Office (CTR) to unnecessary costs both in terms of real dollars and in terms of lost productivity for the following reasons:

- Majority of information in the SBFR statements is included in and subject to the same level of audit effort as in the GAAP statements. Additionally, the GAAP statements are required to be audited in accordance with *Government Auditing Standards*.
- Statutory filing deadline of October 31st requires an exceptional effort on the part of the CTR to close its books, reconcile departmental activity and process last minute supplemental budget activity. All the while, responding to auditors' inquiries. The amount of paid overtime necessary to issue the fiscal 2007 SBFR statements was approximately 420 hours.
- The Statutory framework outlined in the MGL's is outdated and inconsistent with many of the current provisions contained in GAAP. The level of effort required to keep MGL's current should be measured against the prolific nature of the GAAP rule setters to issue and amend current standards.

##### *Recommendation*

We recommend that the CTR in coordination with the Secretary of Administration and Finance (ANF) seek an amendment(s) to MGL to permit the preparation of unaudited SBFR statements. The Commonwealth should also consider the users of the SBFR and update the MGL to accommodate current accounting standards and or eliminate information that is repeated in the GAAP statements. This will allow the Commonwealth to focus the SBFR on specific information desired by governmental decision makers. A possible model to consider is limiting the SBFR to a report of operational and fund balances in the governmental funds and the reporting of specific budgetary calculations such as transfers to the stabilization fund.

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***Management's Corrective Action Plan***

We agree that the SBFR presents invaluable information to decision makers and that information must continue to be delivered in some form. We will work with key decision makers in the executive and legislative branches to determine what legislative changes should be made and assess their level of comfort with the information in the SBFR becoming unaudited and then present a cost-benefit analysis for their consideration.

***Responsible Official***

Eric Berman, Deputy Comptroller

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**Office of the State Comptroller**

**Preparation of Financial Statements**

***Observation***

The preparation of the Commonwealth's financial statements, which includes both the statutory basis financial statements and the comprehensive annual financial report, is a significant undertaking. The preparation of the reports requires the coordination and input of many internal and external parties. The preparation of the statements, and to a large extent the gathering of audit support, is highly dependent upon a single individual. This key dependency exposes the Commonwealth to the risk that significant delays in the preparation of complete and inaccurate financial statements could result should this individual be unavailable for an extended period of time.

***Recommendation***

We recommend that the Comptroller evaluate the resources available to prepare complete and accurate financial statements within the applicable due dates. Adequate resources, cross-functional training and succession planning should be incorporated into the Comptroller's overall departmental plan.

***Management's Corrective Action Plan***

The CTR recognizes that like many other functions of an organization, key individuals play large roles in various tasks. During fiscal 2008 the Comptroller reorganized this business area. This reorganization will be used as an opportunity to reduce dependency on one individual. We endeavor in every way possible to cross-train and shift resources where necessary to achieve goals.

***Responsible Official***

Eric Berman, Deputy Comptroller

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### **Office of the State Comptroller**

#### **Timeliness of the Closing Process**

##### ***Observation***

The Commonwealth's fiscal year ends on June 30. The closing process is such that auditable fund trial balances are not available until early to mid-October, mere weeks before the statutory deadline for reporting to the legislature. While the Commonwealth is clearly a very large, complex, and decentralized organization, the timing of the closing process is such that the current timelines do not allow for the ability to deal with unexpected difficulties or delays should these arise in the finalization of supplemental budget adjustments, or the closing, financial reporting or audit processes without significant effort by the Comptroller's staff. This compression of the closing process also may not allow sufficient time to fully consider the effects of non-GAAP policies, the effects of new accounting pronouncements, or changes to the reporting entity.

##### ***Recommendation***

The Comptroller's staff should review the current organizational structure, including roles and responsibilities, to ensure that there is an appropriate balance of responsibilities and an appropriate level of skills in the respective functions of the CTR to expedite the completion of financial reporting. This analysis should also consider whether a hard close of the Commonwealth's financial records take place at interim dates throughout the year such that certain account balances, capital assets for example, are not reconciled on just an annual basis. While it may not be practical to perform a hard close on an entity-wide basis, there are many accounts within the control of the CTR for which an interim hard close would facilitate the closing process at year-end. Further, the Commonwealth should assess the timelines given to departments for completion of GAAP packages and period 13 reporting to determine if those timelines can be accelerated. Similarly, the documentation to support certain account balances, such as statutory receivables, comprises various reports that must be combined to arrive at the balances reported in the Commonwealth's financial statements. These audit trails often are not clear and require a significant commitment of time to tie out and to support explanations during the audit process. As part of the process described above, management should assess opportunities to streamline the documentation of account balances to expedite the closing process.

##### ***Management's Corrective Action Plan***

The CTR is in the process of revamping certain aspects of its financial report gathering process from independent authorities, institutions of higher education and departments. Fiscal 2007 was the first year of electronic gathering of GAAP packages which proved to be highly successful. We look to expand this in fiscal 2008. We are also examining the audit calendar to further streamline processes, for example auditing debt and investments in the summer of 2008 rather than the fall.

One thing that we cannot control is the timing of final legislation that affects the fiscal year. This occurred during fiscal 2007. We did work and will continue to work with the Legislature and the Secretary for Administration and Finance to make these activities more timely.

##### ***Responsible Officials***

BJ Trivedi, Financial Reporting and Analysis Bureau Director, Julia Burns, General Accounting Bureau Director and Kevin Moran, Federal Cost Allocation Bureau Director

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**Component Unit Information**

***Observation***

The Commonwealth has identified a significant number of component units for reporting in its comprehensive annual financial report. The evaluation and documentation of whether to include or exclude an entity from being designated as a component unit is based on qualitative and quantitative factors. These factors were originally evaluated by the Commonwealth several years ago. Many of the qualitative factors as well as the judgment applied in reaching the final determination to include or exclude a particular component unit were not documented.

***Recommendation***

We recommend that the Commonwealth update its current component unit determinations and supplement its predominately checklist documentation with narratives to support its qualitative and judgmental decisions.

***Management's Corrective Action Plan***

During the winter and spring of 2008, CTR will undergo an exercise to update our GASB Statement Nos. 14/39 component unit determinations in coordination with legal staff. We endeavor to have this analysis completed and transmitted to KPMG by the time summer fieldwork commences.

***Responsible Official***

BJ Trivedi, Financial Reporting and Analysis Bureau Director

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**Reconciliation of Cash Accounts**

***Observation***

The Treasurer's Office (TRE) prepares a daily reconciliation between the cash management system and the primary financial institutions. On a monthly basis, a comprehensive bank to the cash management system to MMARS reconciliation is performed by the CTR. This reconciliation is published in a memo from the Comptroller's Director of Accounting to the Comptroller and the Deputy Treasurer for cash management. We noted that the MMARS to cash management reconciliations were not performed timely during 2007. In general, reconciliations are completed more than 30 days following month-end. This presents the risk that unauthorized or erroneous transactions could have been recorded and not detected within a reasonable timeframe.

***Recommendation***

We recommend that the CTR and the Treasurer evaluate the timeliness of the MMARS to cash management reconciliation. Every effort should be made to perform complete and accurate reconciliations within 45 days following the calendar month-end or 30 days following the accounting period month-end. This should include the follow-up and resolution of all reconciling items.

***Management's Corrective Action Plan***

It should be noted that in addition to the monthly cash reconciliations, CTR performed daily and weekly reconciliations which were completed in a timely manner. These reconciliations are designed to detect major problems in reconciliations between TRE records and MMARS. For example, the daily reconciliation matches TRE CMS daily cash sheet to the amounts on the MMARS Batch Events Table by transaction and confirms the upload into MMARS. The weekly reconciliation confirms the documents uploaded into MMARS have been finalized.

The monthly cash reconciliation is performed by accounting period which ends approximately 10 business days after the month-end. CTR will work with the Treasurer to complete the cash reconciliation within the 15 days of the accounting period close in order to have a complete and accurate reconciliation within 30 days following month-end.

Cash reconciliation has been added to the weekly CTR and TRE meeting agenda.

***Responsible Official***

Julia Burns, General Accounting Bureau Director



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## **Office of the State Comptroller**

### **State-Boston Retirement System**

#### ***Observation***

The Commonwealth administers two retirement systems, the State Employees' Retirement System (SERS) and the Teachers' Retirement System (TRS). These are public employee retirement systems for which the Commonwealth is directly responsible and obligated to satisfy the funding required to meet the obligations made to employees and teachers.

In addition to SERS and TRS, the Commonwealth has committed to reimburse the City of Boston for the actual cost of retiree benefits paid to certain participants in the State-Boston Retirement System (SBRS), primarily teachers in the Boston school system. However, the relationship between the Commonwealth and SBRS is far different from its relationship to SERS and TRS.

Currently, the Commonwealth appropriates funds for SERS, TRS, and SBRS in the same manner. Annually, PERAC prepares a funding schedule based upon acceptable actuarial methods and assumptions and applies that science to the participants of each plan. One of the key actuarial assumptions is the targeted date for full funding. As SERS and TRS approach that milestone, the expectation is that the amount required to be appropriated will decline. Such is not the case for SBRS, as the obligation to reimburse the City of Boston for benefits paid by SBRS will continue indefinitely.

The amount appropriated for SBRS under the current Public Employees Retirement Administration Commission (PERAC) model is slightly more than the amount reimbursed to the City (approximately \$4 million more for fiscal 2007) with the additional funds invested along with all other pension assets in PRIT. However, under the current formula, this trend is expected reverse itself over time.

#### ***Recommendation***

We recommend that the Commonwealth convene a working group to also include representatives from PERAC, the City of Boston and SBRS. This working group should clearly articulate the relationship between the Commonwealth, the City of Boston, and SBRS. It should also evaluate the matters noted above and present to the appropriate committee of the Legislature recommendations to ensure there is a fair and equitable allocation of the cost of providing pension benefits to City of Boston teachers.

#### ***Management's Corrective Action Plan***

A working group meeting has been scheduled for January 28th with officials in the Executive Office for Administration and Finance, the Public Employees Retirement Administration Commission and the Office of the State Comptroller to work to articulate the relationship and responsibilities fairly and equitably for the Commonwealth and the City of Boston.

#### ***Responsible Official***

Mary Ann Bradley, Assistant Secretary of Administration and Finance

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**“Memo” Entries Recorded in MMARS**

***Observation***

In prior years, the Commonwealth implemented a procedure to record certain “memo” entries in the trial balance (MMARS). The initial purpose of these entries was to track certain financial activity of the SERS and TRS that was not recorded in MMARS. Over time, the utility of this process was no longer viable, and the practice was discontinued. However, the balances have remained in the trial balance. While these balances result in a net zero impact, they are not needed and could cause confusion in the preparation of the financial statements.

***Recommendation***

We recommend that the Comptroller quantify all such “memo” activity currently in MMARS and direct that appropriate journal entry activity be recorded to eliminate these balances.

***Management Corrective Action Plan***

Rather than removing the balances, the Comptroller believes new procedures to keep the balances accurate will provide current information to decision makers. As part of the closing activity for fiscal 2007, the CTR adjusts the existing balances that are in MMARS to the balances per the financial statement audit. In fiscal 2008, the CTR will record entries reflecting the SERS and TERS activity, similarly to the process in place for recording investment income. Therefore, the trial balance for fiscal 2008 will reflect the balances per those monthly statements from the Pension Reserves Investment Trust.

***Responsible Official***

Julia Burns, General Accounting Bureau Director

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**Evaluation of Service Providers – Group Insurance Commission**

***Observation***

The Commonwealth offers a variety of health and welfare plans to employees and retirees. These are generally administered through the Group Insurance Commission (GIC). GIC contracts with third-party administrators (TPA) to perform routine tasks including benefit payments.

For certain of these TPAs, the Commonwealth receives an evaluation of the internal controls and their effectiveness; these reports are commonly referred to as SAS 70 reports. We noted that one TPA did not have a SAS 70 report prepared. In another instance, the SAS 70 report did not address the effectiveness of the controls at the TPA. This exposes GIC to the risk that ineligible or inaccurate benefit payments could be processed by the TPAs if adequate controls are not in place.

***Recommendation***

We recommend that GIC require its TPAs to have appropriate oversight in place. This can take the form of SAS 70 reports or other monitoring activities. These monitoring activities should be performed on an on-going basis throughout the year.

***Management Corrective Action Plan***

GIC will work with its TPAs to obtain SAS 70 reports and if not available, perform other monitoring throughout the year.

***Responsible Official***

Kathy Glynn, Director of Policy and Planning for GIC