



The Commonwealth of Massachusetts

AUDITOR OF THE COMMONWEALTH

ONE ASHBURTON PLACE, ROOM 1819
BOSTON, MASSACHUSETTS 02108

A. JOSEPH DeNUCCI
AUDITOR

TEL. (617) 727-6200

NO. 2008-0395-3A

INDEPENDENT STATE AUDITOR'S REPORT ON
CERTAIN ACTIVITIES OF THE
CAPE ANN TRANSPORTATION AUTHORITY
JULY 1, 2005 TO SEPTEMBER 30, 2007

OFFICIAL AUDIT
REPORT
APRIL 16, 2008

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In accordance with Chapter 11, Section 12, of the Massachusetts General Laws, we have conducted an audit of certain activities of the Cape Ann Transportation Authority (CATA) for the period July 1, 2005 to September 30, 2007. CATA was established in 1974 pursuant to the provisions of Chapter 161B of the Massachusetts General Laws. CATA provides fixed route bus service and para-transit service to the City of Gloucester and the towns of Rockport, Essex and Ipswich by contracting with vehicle maintenance and operations providers. CATA's activities are managed by an Administrator appointed by an Advisory Board. The Board is comprised of four representatives, each one appointed by the chief political officer of his or her respective member community. The Administrator oversees a staff of five full-time employees and one part-time employee.

The objectives of our audit were to (1) review and analyze CATA's internal controls over receipts and expenditures, including administrative costs and expenses, to determine their adequacy; (2) review CATA's controls over contracts to determine if proper bidding, awarding and oversight procedures are in place; (3) determine CATA's compliance with applicable laws, rules and regulations; and (4) review CATA's recent independent public accountant (IPA) audit reports and management letters to determine whether they were conducted in compliance with generally accepted government auditing standards, and to follow-up on any issues identified.

AUDIT RESULTS

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1. FEDERAL AUDIT AND CATA'S CORRECTIVE ACTION

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As requested by the Federal Transit Administration (FTA), a Financial Management Oversight Review of the Cape Ann Transportation Authority was conducted by Reid Consulting, LLC. Their report outlined two areas of material weaknesses and nine reportable conditions. CATA pledged to address these issues and to take all actions necessary to correct the reported deficiencies. The OSA subsequently reviewed this matter and found that CATA has been attempting to rectify the cited deficiencies primarily through the implementation of a cost accounting system. In response to our report, CATA's Administrator indicated that corrective actions for the remediation of material weaknesses and reportable conditions either have been implemented or will be implemented prior to June 30, 2008.

2. AUTHORITY CREDIT CARD USED FOR NON-BUSINESS PURPOSES

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Our audit noted that the Authority's American Express card was used for non-business purposes such as airfare and hotel costs for spouses and friends. We further noted that some of these personal expenses were not repaid in a timely manner. Authority credit cards should be used solely for expenses that are directly related to the business purposes of the Authority. In response to our report, CATA's Administrator stated he immediately reimbursed the Authority when this oversight was brought to his attention. On October 17, 2007, a credit card use policy was implemented by the Administrator.

INTRODUCTION

Background

In accordance with Chapter 11, Section 12, of the Massachusetts General Laws (MGL), we have conducted an audit of certain activities of the Cape Ann Transportation Authority (CATA) for the period July 1, 2005 to September 30, 2007. CATA was established in 1974 under Chapter 161B of the MGLs as a body politic and a corporate political subdivision of the Commonwealth of Massachusetts. CATA provides fixed route bus service and para-transit service to the City of Gloucester and the towns of Rockport, Essex and Ipswich. In accordance with MGL Chapter 161B, CATA contracts with an operating company, Cape Ann Transportation Operating Company (CATOC), to operate its buses, perform maintenance services and conduct various administrative functions. CATA is authorized to improve, modify or extend existing facilities and enter into agreements for the construction, operation and use of Authority facilities and equipment with government agencies, municipalities, authorities, private transportation companies, railroads, corporations, and other concerns.

An Administrator appointed by an Advisory Board manages CATA's activities. The Board is comprised of four representatives, each one appointed by the chief political officer of his or her respective member community. The Administrator oversees a staff of five full-time employees and one part-time employee.

The chief sources of funding for Authority operations are passenger fares, contractual reimbursements and operation subsidies from the federal and state governments, and member municipalities. In addition, the Authority receives federal and state capital grants to finance the acquisition and improvement of facilities and equipment.

Audit Scope, Objectives, and Methodology

The objectives of our audit were to (1) review and analyze CATA's internal controls over receipts and expenditures, including administrative costs and expenses, to determine their adequacy; (2) review CATA's controls over contracts to determine if proper bidding, awarding and oversight procedures are in place; (3) determine CATA's compliance with applicable laws, rules and regulations; and (4) review CATA's recent independent public accountant (IPA) audit reports and

management letters to determine whether they were conducted in compliance with generally accepted government auditing standards (GAGAS), and to follow-up on any issues identified.

Our audit was conducted in accordance with applicable generally accepted government auditing standards for performance audits, and, accordingly, included such audit tests and procedures as we considered necessary.

To achieve our audit objectives, we reviewed CATA's:

- Most recent IPA audit report to determine if it was prepared in compliance with GAGAS.
- Procedures for advertising, awarding, and monitoring transportation contracts.
- Administrative costs and transportation contract expenditures.
- System of controls over revenues and expenditures.
- Compliance with applicable laws, rules and regulations.

Based on our review, we have concluded that except as noted in the Audit Results section of this report, during the 27-month period ended September 30, 2007, the Authority maintained adequate management controls and complied with applicable laws, rules, and regulations for the areas tested.

AUDIT RESULTS

1. FEDERAL AUDIT AND CATA'S CORRECTIVE ACTION

As requested by the Federal Transit Administration (FTA), Reid Consulting, LLC conducted a Financial Management Oversight (FMO) review of the Cape Ann Transportation Authority (CATA). A report dated October 10, 2007 detailed the results of this review. The FMO outlined two areas with material weaknesses, as follows:

Inadequate Project Management:

- Operating company costs charged to CATA were not adequately monitored and reviewed for reasonableness, allowability and allocability. The Cape Ann Transportation Operating Company (CATOC), which is the operating company hired by CATA, did not maintain a cost accounting system or other acceptable methodology to ensure that costs were equitably allocated to the projects benefited.
- The operating company did not periodically return excess funds to CATA. Outstanding amounts due to CATA because of excess operating funds are currently reflected in CATOC's retained earnings.
- CATA's contract with the operating company did not extend bonding requirements to contracts between CATOC and sub-contractors. Also there is no Buy American or anti-kickback clauses in the operating company contract.
- The operating company did not have formal procurement policies.

Inadequate Budgetary Controls

The FMO found that budgetary controls were inadequate, as demonstrated by the following conditions:

- The FY 2006 monthly budget status reports contained the approved 2005 budget, therefore the variances were misstated and the error was not detected in any of the monthly review meetings.
- The budget line items shown in the monthly budget status reports did not match the line items in the approved 2006 budget.
- No budgeted revenues were included in the monthly budget status report; therefore there was no calculation of the net budget variance.
- There was no written policy for adjustments or changes to the budget.

The FMO review also noted the following nine reportable conditions:

1. Inadequate grant reporting,
2. Inadequate controls over the procurement process,
3. Inadequate cash controls,
4. Adjusting and closing entries not recorded during the year,
5. Inadequate accounting policies and procedures manual,
6. Inadequate accounts payable processing and procedures,
7. Inadequate internal controls related to payroll,
8. Information technology controls need to be improved, and
9. Inadequate controls over fixed assets.

The FMO also made a number of specific recommendations for the remediation of the above noted material weaknesses and reportable conditions. Among the recommendations were:

- CATA regularly review (at least semi-annually) CATOC costs in order to determine whether the costs charged are reasonable, allowable and allocable in relation to federal projects.
- Include a determination of the benefits derived from the costs allocated to the projects as a critical part of the monthly budget review.
- Extend the bonding requirements in the contract with the operating company to contracts between CATOC and subcontractors.
- Ensure that contracts with the operating company contain all required federal clauses and that the operating company adopts formal and documented procurement policies.
- Management should develop and implement written procedures to formally analyze budget variances on a monthly basis.
- CATA should create and implement a written policy for budget changes.
- CATA should maintain complete and accurate minutes of the variances noted in the monthly meetings and indicate the course of action taken to resolve the variances.

Our audit noted that CATA has endeavored to rectify these deficiencies in large part by implementing a cost accounting system for CATOC and developing and implementing new

accounting policies and procedures manual to address the deficiencies found. CATA's Administrator sent a letter dated December 17, 2007 to the Program Director of FTA's Motor Carrier Safety Assessment Division stating it was his intention to follow the recommendations of the FMO to the extent possible within the financial constraints facing CATA. His letter also provided a number of specifics as to how CATA would comply with the recommendations regarding the FMO's reportable conditions. CATA's Administrator indicated that the majority of the reportable conditions would be resolved by providing complete and concise instructions to staff, which would be chiefly accomplished by a thorough revision and implementation of CATA's Accounting Policies and Procedures Manual.

It should be noted that the FMO findings were predominately directed at CATA's operating company (CATOC), and were therefore outside the scope of our audit review. It should also be noted that the final report was received during November 2007, and responses were sent to the FTA in a letter dated December 17, 2007. CATA's efforts to address the FMO recommendations will be made subsequent to the period covered by our audit, since FTA grants a six-month grace period to implement corrective action.

Recommendation

The Authority should adhere to the recommendations contained in the Financial Management Oversight review in order to resolve the material weaknesses and reportable conditions noted.

Auditee's Response

Inadequate Project Management

Excess funds by the operating company (CATOC) were returned to CATA. Bonding requirements have been included in the operating company's procurement procedures, and the Management Contract was amended to include Buy America and anti-kickback clauses. Although CATOC followed CATA's procurement procedures a formal procurement policy was prepared by CATOC and approved by the CATA Administrator. Operating company costs are reviewed for reasonableness and allowability as defined in the FTA A-87 circular; however, there is some question as to what is meant by allocability. We have requested an interpretation from the Federal Transit Administration.

Inadequate Budgetary Controls

All of the inadequate budgetary control conditions have been corrected.

The 2006 monthly budget status report on expenses was correct but mistakenly labeled as 2005 instead of 2006. Budgeted revenues are now included in the monthly budget status report.

The following are CATA procedures in analyzing the operating company budget expenditures.

On a monthly basis, the CATA Administrator and the Operating General Manager shall review the Operating Company consolidated financial statement. Any variance in expenditures exceeding 10% will be investigated by the General Manager and a report submitted to the Administrator with a recommended course of action. Any changes or adjustments to the budget must have the approval of the Administrator with appropriate justifications.

The current monthly income will be reported on a monthly basis and the actual year to date revenues for the current monthly statement.

A written policy for adjustments and changes to the budget is now in effect.

Reportable Conditions

The recommendations for the remediation of material weaknesses and reportable conditions have either been implemented or will be prior to June 30, 2008.

2. AUTHORITY CREDIT CARD USED FOR NON-BUSINESS PURPOSES

Our audit noted that the Authority's American Express card was occasionally used for non-business purposes such as airfare and hotel costs for spouses and friends. These personal non-business expenses should be reimbursed to the Authority in a timely manner. Most Authority cardholders reimbursed the Authority in a timely manner (two instances totaling \$3,669 were reimbursed within the month in which the charges were made); however, we noted that the Administrator still owed the Authority \$1,533 as of December 31, 2007 for non-business expenses dating back to 2005. These expenses are as follows:

\$996 charged on August 11, 2005 for friend's airline ticket and hotel costs

\$437 charged on September 1, 2006 for friend's airline ticket costs

\$100 charged on October 6, 2006 for friend's airline ticket and rental car costs

When we brought this matter to the attention of the Administrator, he reimbursed the Authority for these expenses on January 17, 2008. We further noted that this American Express card used by Authority employees earns points that have never been used. As of December 24, 2007, a total of 24,438 points have been accumulated on the card.

Our review of CATA's credit card policy noted that the use of Authority credit cards for non-business expenses was not addressed until October 17, 2007, at which time the policy was revised to prohibit such use.

Recommendation

The Authority should adhere to its current credit card policy that prohibits the use of the American Express card for personal expenses. The Authority should also use the points earned from its credit card use whenever possible to offset business costs such as travel and accommodations, and thereby reduce its operating costs.

Auditee's Response

The American Express card was used to pay for airline tickets for the Administrator for authorized business purposes which included the ticket cost for his traveling companion rather than using two separate credit cards. The hotel costs were for an extended stay by the Administrator for non-related CATA business. The additional charge of \$100 on October 6, 2006 was for rescheduling a return flight to Gloucester by the Administrator's traveling companion.

The Administrator approves all CATA invoices prior to payment by the Account's Administrator. When the American Express invoices were approved, the Administrator clearly identified on the invoices the amounts that were CATA's responsibility and the amounts that were the Administrator's personal responsibility, and were appropriately noted in the account file. The Administrator immediately reimbursed the authority when this oversight was brought to his attention. On October 17, 2007 a credit card use policy was implemented by the Administrator.

Regarding the accumulation of reward points on the credit card, the Board will discuss disposition at its next meeting. The credit card use policy will also address this issue.