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INDEPENDENT STATE AUDITOR'S REPORT ON
CERTAIN ACTIVITIES OF THE
MASSACHUSETTS CULTURAL COUNCIL
JULY 1, 2005 TO JUNE 30, 2006

OFFICIAL AUDIT
REPORT
OCTOBER 17, 2008

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INTRODUCTION

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The Massachusetts Cultural Council (MCC) was created within the Office of the State Treasurer by Section 15 of Chapter 653 of the Acts of 1989, which added Sections 52 through 58 to Chapter 10 of the Massachusetts General Laws (MGL). Section 196 of Chapter 653 of the Acts of 1989 transferred to the MCC the duties and obligations of two existing state agencies, the Council on the Arts and Humanities and the Massachusetts Arts Lottery Council. The MCC is governed by a 19-member Board of Directors appointed by the Governor to staggered three-year terms, and an Executive Director appointed by the Board of Directors manages MCC's daily activities. MCC's mission, as outlined in MGL Chapter 10, Section 53, is to:

... promote excellence, access, education, and diversity in the arts, humanities, and interpretive sciences to improve the quality of life for all Massachusetts residents and contribute to the economic vitality of its local communities.

The MCC provides funding and other support services to both public and private eligible entities within Massachusetts that cultivate the arts, humanities, and interpretive sciences. Such entities include various non-profit cultural organizations, schools, libraries, and artists. During fiscal year 2006, the MCC distributed \$8,412,372 in funding to governmental and non-profit grantees.

The purpose of our audit was to review MCC's internal controls over grant administration, including the awarding, disbursing, monitoring, and reporting of grant funds. In addition, we conducted a follow-up review of the conditions noted in our prior audit report (No. 2003-1328-2S) to determine if corrective actions had been taken.

AUDIT RESULTS

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1. PRIOR AUDIT RESULTS RESOLVED

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Our prior audit report (No. 2003-1328-2S) noted that the MCC needed to improve its internal controls relative to a) fixed asset management, b) cash receipts, and c) employee travel expenditures.

a. Fixed Asset Management

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Our prior audit noted that the MCC did not regularly conduct an inventory of its fixed assets and failed to record a Tax-Exempt Lease Purchase (TELP) of office workstations valued at \$153,954 in the Massachusetts Management Accounting and Reporting System (MMARS) Fixed Asset Subsystem. We also found that the MCC did not ensure that its inventory listing was complete, that asset values were included, and that all property items were assigned an asset identification number. Our follow-up review disclosed that MCC has implemented internal control procedures to correct its fixed asset management deficiencies.

b. Cash Receipts **8**

Our prior audit report noted that MCC did not promptly deposit certain cash collections with the Office of the State Treasurer and did not adhere to the State Comptroller's year-end cash cutoff instructions for fiscal year 2002. As a result, cash receipts totaling \$6,180 were not properly recorded as revenue for fiscal year 2002, as they were improperly recorded as revenue for fiscal year 2003. Our current audit disclosed that MCC now promptly deposits donations with the Office of the State Treasurer and records these donations in MMARS within the prescribed timeframe.

c. Travel Expenditures **8**

Our prior audit report noted that certain travel expenses were not accurately classified, recorded, or reported on MMARS by the MCC, and that additional expenses were not adequately substantiated with travel expense documentation. Specifically, an analysis of 57 travel expenditures identified 21 transactions totaling over \$27,000 with improper object code classifications, and an additional \$3,600 in travel costs without adequate supporting documentation. Our current audit disclosed that all of the 110 travel vouchers sampled for fiscal year 2006 were classified in accordance with the Office of the State Comptroller's Expenditure Classification Handbook, and were adequately supported with appropriate documentation.

2. QUESTIONABLE RETENTION OF AT LEAST \$826,103 IN FUNDS **9**

During fiscal year 1995, the State Legislature authorized the MCC to establish a \$1.5 million Massachusetts Facilities Fund (MFF) for the purpose of providing loans and grants to non-profit cultural organizations for facilities projects in Massachusetts. During fiscal year 1996, the MCC entered into an agreement with two non-profit organizations, the Non-Profit Facilities Fund of New York (NFF) and the New England Foundation for the Arts, Inc. (NEFA), to administer the MFF. However, during June 2003, the MCC obtained a release from its agreement with NFF and NEFA to administer the MFF, citing budgetary cutbacks. At that time, rather than remitting the balance of the MFF to the Commonwealth, the MCC entered into an agreement with NEFA to act as its fiscal agent and retain and invest the loan funds that had either been repaid or were in the process of being repaid by the cultural organizations that had received loans from the MFF. As of May 31, 2006, NEFA had retained a total of \$826,103 in funds from the MFF, as well as the rights to collect an additional \$274,770 in outstanding loans made from the MFF. These funds have been used as discretionary monies to fund certain MCC expenses. According to MCC officials, because they were not certain whether these funds should be considered state-appropriated funds subject to statutory requirements such as reversion at the end of the fiscal year, they sought a legal opinion regarding the MFF funds from a private law firm. The MCC officials stated they were advised by legal counsel that "the funds are akin to state trust funds. . . and, therefore, are not subject to reversion or other statutory requirements that govern state appropriated funds." However, since these monies were originally derived from the Commonwealth and placed in the MFF for a specific purpose, in our opinion, once the MCC discontinued administering the MFF, it should have sought advice from the appropriate state agencies, such as the State Treasurer, State Comptroller, and Attorney General, to determine the appropriate disposition of these funds, rather than relying solely on the

opinion of outside legal counsel and subsequently using MFF funds for discretionary expenses.

3. AWARD OF TWO PARTNERSHIP GRANTS WITHOUT COMPETITIVE REQUEST-FOR-PROPOSALS

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Our current audit disclosed that during fiscal year 2006, the MCC provided “partnership grants” totaling \$471,397 to two nonprofit organizations – the New England Foundation for the Arts and the Massachusetts Foundation for the Humanities – without competitive requests-for-proposals. Without establishing an open and competitive process for the granting of funds, the Commonwealth cannot be assured that the funding provided to the MCC is being administered in a fair and equitable manner. Further, awarding funds non-competitively may signify that the MCC is denying funding to other eligible organizations. As disclosed in the previous Audit Result, MCC’s Executive Director is a member of the Board of Directors of one of the two organizations which received this funding in a non-competitive manner. In this regard, the State Legislature has promulgated the state’s Conflict-of-Interest Law (MGL Chapter 268A). The purpose of this statute is to ensure that public employees’ private financial interests and relationships with people or organizations do not conflict with or give the appearance of a conflict with their public obligations. Because the MCC’s Executive Director is on the Board of Directors of one of these grantees and the grantee also functions as MCC’s fiscal agent, we believe that the MCC’s Executive Director should seek an opinion from the State Ethics Commission as to whether this represents a conflict-of-interest situation.

4. IMPROVEMENTS NEEDED IN OVERSIGHT OF LOCAL CULTURAL COUNCILS’ ADMINISTRATION OF MCC GRANT FUNDS

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According to 962 CMR 2.07(6) promulgated by the MCC, all local cultural councils (LCCs) and regional cultural councils (RCCs) must provide the MCC with annual reports, including a year-end financial report. However, we found that although the MCC has instituted an online financial reporting system for LCCs and RCCs to use for this purpose, there are inadequate controls over this activity to ensure that the financial information reported by these entities is accurate. In fact, at the two LCCs we visited, we found significant discrepancies between the financial information relative to MCC grants actually expended by the LCCs and the grant fund expenditures that were reported by these LCCs to the MCC. For example, as of December 31, 2006, the City of Worcester’s MCC grant ledger reflected a balance of \$101,729.41; however, the Worcester LCC reported a balance of zero to MCC. The MCC does not currently perform on-site financial audits or reconcile annual LCC financial reports to the municipal financial records in each community. During our site visits, we identified an instance where a recipient did not comply with the requirements of Section 58 of Chapter 10 of the General Laws, which requires that MCC grant recipients keep grant funds and interest earned on these funds in a separate revolving bank account. As a result of the lack of oversight, the MCC may not be receiving all of the information necessary to properly administer these funds.

5. IMPROVEMENTS NEEDED IN THE MCC’S INTERNAL CONTROL PLAN

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We found that the internal control plan implemented by MCC is not consistent with the guidelines established by the Office of the State Comptroller (OSC). Specifically, MCC’s

internal control plan did not include the policies and procedures recommended by OSC or incorporate the five components established in OSC's guidelines for an efficient internal control system. As a result, MCC's efforts to achieve its mission, safeguard its assets (including annual grant distributions of approximately eight million dollars), and promote operational efficiency may not be optimized.

6. STATE-MANDATED ANNUAL REPORT NOT FILED**26**

MCC did not file an annual report with the Office of the Secretary of State in accordance with its enabling legislation, Chapter 10, Section 53, and Chapter 30, Sections 32 and 33, of the General Laws. Both statutes specify that every state officer, department, board, and commission, excepting those statutorily exempted, must file an annual report with the State Secretary on or before the first Wednesday in December following the close of each fiscal year. As a result of not filing this report, legislators and citizens of the Commonwealth may not have accurate and complete information regarding MCC's programs, accomplishments, and finances.

INTRODUCTION

Background

The Massachusetts Cultural Council (MCC) was created within the Office of the State Treasurer by Section 15 of Chapter 653 of the Acts of 1989, which added Sections 52 through 58 to Chapter 10 of the Massachusetts General Laws (MGL). Section 196 of Chapter 653 of the Acts of 1989 transferred the duties and obligations of two existing state agencies, the Council on the Arts and Humanities and the Massachusetts Arts Lottery Council, to the MCC. According to this statute, a 19-member Board of Directors, consisting of private individuals who have demonstrated scholarship or creativity in, or distinguished service to, the arts, humanities, interpretive sciences, or local arts, governs the MCC. The Governor appoints MCC's Board members to staggered three-year terms. In addition, an Executive Director appointed by the Council's Board manages MCC's daily activities. During the period covered by our audit, the MCC had a staff of 32 employees who performed the daily activities necessary to carry out its mission as outlined in MGL Chapter 10, Section 53, which states that MCC:

... shall promote excellence, access, education, and diversity in the arts, humanities, and interpretive sciences to improve the quality of life for all Massachusetts residents and contribute to the economic vitality of its local communities.

The MCC receives its funding from various sources, including state appropriations, the National Endowment for the Arts (NEA), and other private sources. The table below details the funding received by MCC during fiscal year 2006. Of the \$10,949,767 received by MCC during this fiscal year, \$8,412,372 (approximately 76.8%) was distributed to grant recipients.

State Appropriations

0640-0300 - Operations and Grants	\$7,459,054
0640-0350 - Cultural Resources Act	743,520
0640-0351 - John and Abigail Adams Grants	<u>1,500,000</u>
	<u>\$9,702,574</u>

Federal Funds – National Endowment for the Arts

0640-9716 - Folk and Traditional Arts Initiative	\$ 25,000
0640-9717 - Basic State Grant	379,500
0640-9718 - Arts in Education	66,500
0640-9724 - Youth Reach State and Regional Programs	110,000
0640-9729 - Challenge America	121,000

0640-9730 - Teacher's Institute	416,313
0640-9731 - Healing Arts Initiative	30,000
0640-9732 - Poetry Out Loud	<u>8,000</u>
	<u>\$1,156,313</u>
Private Funds	
0640-9728 - Lila Wallace-Reader's Digest Fund	<u>90,880</u>
	<u>\$10,949,767</u>

The MCC provides grants and other support services to both public and private eligible entities within Massachusetts that cultivate the arts, humanities, and interpretive sciences. Such entities include various non-profit cultural organizations, schools, libraries, and artists. Although requirements for the MCC's different grant programs vary, direct awards to individual artists and cultural organizations typically involve meeting threshold eligibility criteria, followed by a competitive application process with a peer panel or advisory committee review of proposals. Peer panel compositions vary according to discipline, but panelists may include various MCC programmatic and administrative staff, members of other cultural organizations, artists, scholars, interpretive scientists, community leaders, and educators who represent diverse geographic, gender, ethnic, and aesthetic perspectives. The MCC panel or advisory committee assigns an overall quality rating to each grant application, which is used to rank organizations and determine funding recommendations. The panel recommendations are then reviewed by MCC's staff, and the Board of Directors makes the final award decisions.

MCC's Organizational Support Program (OSP) is illustrative of its grant process. The goal of the OSP is to strengthen the cultural infrastructure by providing a continuity of funding to cultural organizations that meet high standards of excellence regarding: (1) quality of programs and services, (2) commitment to community participation, and (3) administrative and financial capability. To be eligible for OSP, non-governmental entities must be incorporated in the Commonwealth as not-for-profit organizations and be governed by a board of directors that meets regularly to set policies. In addition, the organizations must have completed two full years of public programming within the three years prior to the application deadline. Colleges, libraries, and municipal agencies may also apply for OSP if they meet additional criteria. Applications and supporting material that are submitted by entities requesting OSP funding are then scored by the MCC panel according to the following evaluation criteria:

- Quality (60 points): Excellence of programs and quality of the artists, humanists, and scientists involved.
- Community Involvement and Benefit (20 Points): Efforts to broaden community participation, including reaching out to non-traditional audiences (elderly, disabled, low-income).
- Organizational Capacity (20 Points): Demonstrated success in organizational planning. The strength of the governing board, administrative staff, and overall financial health of the organization is also evaluated.
- In addition, as promulgated by Section 56 of Chapter 10 of the General Laws and 962 Code of Massachusetts Regulations (CMR) 2.04, every community in the Commonwealth is eligible to receive funds from the MCC if it establishes a local cultural council (LCC) or joins with other communities to form a regional cultural council (RCC). LCCs are made up of volunteers appointed by the community's chief official and consist of at least five, but no more than 22, citizens who have demonstrated service to the arts, humanities, or interpretive sciences. LCCs are responsible for awarding funds received from the MCC in ways that will serve local cultural needs. Distributions from the MCC to LCCs and RCCs are based on a local aid formula devised by the Commonwealth that takes into consideration a community's population and property values in order to give large distributions to less affluent communities. However, during fiscal year 2006, each participating community was eligible to receive a minimum of \$2,500.

The following is a schedule of MCC's programs and the total funds distributed to recipients during fiscal year 2006:

Funded Grant Programs

Artist Grants (Fellowships to artists in recognition of exceptional work)	\$ 195,000
Traditional Arts (Awards that support the teaching of traditional arts)	15,760
Creative School (Support for schools to promote the arts, humanities, and sciences)	365,700
John and Abigail Adams Arts Program (Economic development grants)	1,360,175*
Organizational Support (Matching grants to non-profit cultural organizations)	3,328,340*
Public Partnerships (Annual awards of financial assistance)	559,397*
Teacher Institute (Program to advance quality in arts' disciplines in schools)	240,000
Youth Reach (Program to provide arts activities for young people "at-risk")	368,000
Healing Arts Initiative (Program that assists patients in developing certain skills)	30,000
Local Cultural Councils (Lottery funds for benefit of public)	<u>1,950,000*</u>
Total Grant Payments	<u>\$8,412,372</u>

* Additional information is provided below for these programs:

- John and Abigail Adams Arts Program: A program funded by a separate annual state appropriation, 25% of which is derived from state lottery funds. The purpose of the program is to distribute cultural and economic development grants that have the capacity to revitalize communities, stimulate income, create jobs, and attract tourism. Eligible applicants can

include both non-profit and for-profit organizations, but must demonstrate project viability. The grant must be matched \$1 for each \$1 granted.

- Organizational Support: A program funded from MCC's annual operating appropriation. Recipients of grants range from large cultural institutions to local community art centers that offer cultural programs in the arts, humanities, and interpretive sciences for the benefit of the public. The funds can be applied to any aspect of the recipient's operation from paying heat and air conditioning to hiring artists and subsidizing school visits. The grants can be multi-year and require the matching of recipient funds; depending on an entity's operating income the ratio of matching funds can range from 1:1 to as much as 4:1.
- Public Partnerships Grants: Public Partnerships grants are made to non-profit organizations with a mission similar to that of MCC; they subsequently re-grant their funds to secondary cultural non-profit entities. In 2006, MCC distributed grants to four public partnerships. Included in the four are two organizations that receive annual partnership funds from MCC. The amount that each receives varies from year to year depending on how much funding MCC has available for distribution. In 2006 MCC awarded \$471,397 in total to these two entities. The partners do not apply for funding, as do other applicants; the grants are awarded based on traditional practice. As well as receiving funding from MCC, these organizations receive funds from various other sources, including the federal government.

Local Cultural Council Program: MCC makes annual distributions of state funds to a network of 329 councils on behalf of the 351 cities and towns in Massachusetts. The councils re-grant the funds using 2 classifications: 1) standard grants, which fund a broad range of cultural projects; and 2) PASS, which subsidizes field trips for school children.

On June 24, 2006, the State Legislature enacted Section 5 of Chapter 123 of the Acts and Resolves of 2006, which amended Chapter 10, Section 35J, of the Massachusetts General Laws (MGL) and created the Massachusetts Cultural Facilities Fund (MCFF). Chapter 167 of the Acts and Resolves of 2006, effective July 13, 2006, stated that the purpose of the MCFF is to enhance cultural activities throughout the Commonwealth by financing the acquisition, construction, expansion, renovation, and repair of non-profit/tax-exempt cultural facilities and certain public and private venues. Chapter 167 calls for the fund to be administered through a collaborative arrangement of the MCC and the Massachusetts Development Finance Agency (Mass Development). The MCC is responsible for managing most aspects of the grant review process of the MCFF, including drafting rules and guidelines, offering technical assistance to applicants, and reviewing grant applications. However, Mass Development has the final authority on all grant decisions and overall fund administration, including the issuance of bonds.

Section 22 of Chapter 123 of the Acts and Resolves of 2006 also calls for the establishment of a new statewide Cultural Facilities Fund Advisory Committee. Currently, this Committee consists of six members appointed by the Governor and the directors or designees of the MCC, Mass Development, and the Office of Travel and Tourism. The function of the Committee is to review applications for grants or loans recommended by the MCC or other designated agency and to issue findings and recommendations to Mass Development as to which applications shall be approved. The Committee may also make recommendations on the overall administration of the fund.

Audit Scope, Objectives, and Methodology

The scope of our audit included a review of certain administrative activities of the MCC during the period July 1, 2005 to June 30, 2006. We conducted our limited scope performance audit in accordance with Generally Accepted Government Auditing Standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence that provides a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

The audit objectives included the following:

- Determining whether MCC adequately addressed the conditions noted in our prior audit report (No. 2003-1328-2S).
- Determining whether MCC has adequate internal controls in place to ensure that grant and contract funds are being disbursed and expended for their intended purposes.
- Determining whether MCC is properly awarding and administering grants and contracts in accordance with applicable legal and regulatory requirements.
- Examining grant and contract files to determine if records are complete, accurate, up-to-date, and maintained in accordance with established criteria.

In order to meet our audit objectives, we first conducted audit testing at the MCC to determine what actions, if any, the Agency had taken to address the issues raised during our prior audit of the MCC . We then reviewed all applicable laws and regulations, as well as the policies and procedures that MCC had developed relative to its administration of the grants and contracts that were in effect during our current audit period. We reviewed various documents, including the minutes of MCC's Board meetings, grant agreements, and the grant files maintained relative to the grants awarded during fiscal year 2006. We held discussions with MCC officials and conducted site reviews in the cities of Brockton and Worcester. During these site visits, we spoke with the city officials who were responsible for the administration of the MCC grant funds, assessed systems that were used by these municipalities to record and report the receipt and expenditure of grant funds, and reviewed all of the documentation these recipients maintained relative to the grant funds they had received from the MCC during fiscal year 2006. We also conducted fieldwork at four non-profit grant recipients.

Based on the results of this audit, we have determined that for the areas tested, except for the issues addressed in the Audit Results section of this report, MCC has adequate systems in place to ensure that grant and contract funds are being expended for their intended purposes and in compliance with applicable laws, rules, and regulations. Additionally, as noted in the Audit Results section, MCC has taken corrective action to address the prior audit deficiencies.

AUDIT RESULTS

1. PRIOR AUDIT RESULTS RESOLVED

Our prior audit report (No. 2003-1328-2S), noted that the MCC needed to improve its internal controls relative to a) fixed asset management, b) cash receipts, and c) employee travel expenditures. The following is a summary of the problems identified in our prior audit and the actions taken by MCC to address these problems.

a. Fixed Asset Management

Our prior audit report noted that the MCC did not regularly conduct an inventory of its fixed assets and failed to record a Tax-Exempt Lease Purchase (TELP) of office workstations valued at \$153,954 in the Massachusetts Management Accounting and Reporting System (MMARS) Fixed Asset Subsystem. We also found that the MCC did not ensure that its inventory listing was complete, that asset values were included, and that all property items were assigned an asset identification number.

Because MCC had not established adequate internal controls over its fixed assets and/or recorded GAAP fixed assets valued worth over \$49,999 in the Commonwealth's MMARS Fixed Asset Subsystem, MCC's fixed assets were at risk for loss, theft, or misuse, and the Commonwealth's financial statements did not accurately reflect GAAP Fixed Asset values.

We recommended that MCC develop and implement the following internal control procedures:

- Perform an annual inventory of fixed assets, including verification of the existence and location of all GAAP and non-GAAP assets as of June 30 of each fiscal year, and reconcile the fixed asset inventory against the Fixed Asset Subsystem and records maintained by the MCC.
- Affix a permanent tag displaying a unique identification number in a readily visible area to all physical property items, other than land, buildings, and infrastructure.
- Ensure that inventory records are complete and include all GAAP and non-GAAP fixed asset costs.
- MCC should immediately enter its TELP-purchased office workstations as GAAP fixed assets onto the MMARS Fixed Asset Subsystem and develop specific reporting procedures for TELP-acquired commodities.

During our current audit, we determined that MCC has implemented the following internal control procedures to correct its fixed asset management deficiencies:

- MCC performs an annual physical inventory of all of its fixed assets as of June 30 of each year, assigns costs to purchases, and affixes identifying tags to all physical property such as equipment, furniture, and fixtures.
- MCC entered its TELP-purchased office workstations as GAAP fixed assets onto the MMARS Fixed Asset Subsystem.
- MCC reconciles its physical inventory counts of GAAP fixed assets to the assets reflected in the MMARS Fixed Asset Subsystem, and also reconciles non-GAAP fixed assets to those recorded in its in-house inventory system.

b. Cash Receipts

Our prior audit report noted that MCC did not promptly deposit certain cash collections with the Office of the State Treasurer and did not adhere to the State Comptroller's year-end cash cutoff instructions for fiscal year 2002. As a result, cash receipts (donations) totaling \$6,180 were not properly recorded as revenue for fiscal year 2002, but were improperly recorded as revenue for fiscal year 2003. We recommended that MCC develop and implement the following corrective actions to properly receive and deposit cash receipts:

- Require that all checks be immediately directed to those individuals with authority to process them.
- Design and implement the internal control policies and procedures needed to ensure that all revenues are recorded, deposited, classified, and reported in a timely fashion in accordance with the State Comptroller's requirements.

During our current audit, we found that MCC has taken the following measures to adequately address this issue:

- Cash received by MCC, although infrequent, typically represents checks for small donations, and is being deposited promptly with the Office of the State Treasurer and recorded on MMARS within the prescribed timeframe. According to the Office of the State Comptroller's revenue report, MCC received a total of \$6,311 in fiscal year 2006 and did not have any cash on hand as of June 30, 2006.

c. Travel Expenditures

Our prior audit report noted that certain travel expenses were not accurately classified, recorded, or reported on MMARS by the MCC and that additional expenses were not

adequately substantiated with travel expense documentation. Specifically, an analysis of 57 travel expenditures identified 21 transactions totaling over \$27,000 with improper object code classifications and an additional \$3,600 in travel costs without adequate supporting documentation.

OSC has published an *Expenditure Classification Handbook* for use by state agencies that provides rules on the appropriate object code classification for all expenditures, including travel. Furthermore, the OSC has established internal control guidelines that state agencies must establish and implement to ensure proper management of transactions, such as the proper recording, classifying, and documenting of expenditures.

Because MCC did not follow the OSC requirements for the proper recording, classifying, and supporting of travel expenditures, neither MCC nor the Commonwealth can ensure that the travel expenses were legitimate or for public purposes in support of MCC's mission.

We recommended that MCC take the necessary corrective action to ensure adherence to OSC's internal control guidelines and the *Expenditure Classification Handbook*. At a minimum, MCC should:

- Ensure that payments for travel obligations are properly classified through MMARS
- Prepare travel reimbursement vouchers based on adequate supporting documentation and proper approvals.

Our current follow-up review showed that MCC implemented the corrective actions recommended in our prior audit, as follows.

A review of travel expense vouchers for fiscal year 2006 revealed that all 110 vouchers sampled were classified in accordance with Office of the State Comptroller's *Expenditure Classification Handbook* and were adequately supported with appropriate documentation, such as expense receipts.

2. QUESTIONABLE RETENTION OF AT LEAST \$826,103 IN FUNDS

During fiscal year 1995, the State Legislature authorized the MCC to establish a \$1.5 million Massachusetts Facilities Fund (MFF) for the purposes of providing loans and grants to non-profit cultural organizations for facilities projects in Massachusetts. During fiscal year 1996, the

MCC entered into an agreement with two non-profit organizations, the Non-Profit Facilities Fund of New York (NFF) and the New England Foundation for the Arts, Inc. (NEFA), to administer the MFF. However, during June 2003, the MCC obtained a release from its agreement with NFF and NEFA to administer the MFF, citing budgetary cutbacks. At that time, rather than remitting the balance of the MFF to the Commonwealth, the MCC entered into an agreement with NEFA to act as its fiscal agent and retain and invest the loan funds that had either been repaid or were in the process of being repaid by the cultural organizations that had received loans from the MFF. As of May 31, 2006, NEFA had retained a total of \$826,103 in funds from the MFF, as well as the rights to collect an additional \$274,770 in outstanding loans made from the MFF. These funds have been used as discretionary monies to fund certain MCC expenses. According to MCC officials, because they were not certain whether these funds should be considered state-appropriated funds subject to statutory requirements such as reversion at the end of the fiscal year, they sought a legal opinion regarding the MFF funds from a private law firm. These officials were advised by outside legal counsel that “the funds are akin to state trust funds. . . and, therefore, are not subject to reversion or other statutory requirements that govern state appropriated funds.” However, since these monies were originally derived from the Commonwealth and placed in the MFF for a specific purpose, in our opinion, once the MCC discontinued administering the MFF, it should have sought advice from the appropriate state agencies, such as the State Treasurer, State Comptroller, and Attorney General, to determine the appropriate disposition of these funds, rather than relying solely on the opinion of outside legal counsel and subsequently using MFF funds for discretionary expenses.

Massachusetts General Law (MGL) Chapter 29, Section 12, places a limit on the amount of time that state-appropriated funds can be used by a state agency, as follows:

... Appropriations by the general court, unless specifically designated as special, shall be for ordinary maintenance of the several departments, offices, commissions and institutions of the commonwealth and shall be made for the fiscal year unless otherwise specifically provided therein.

Further, on July 1, 2004 the Office of the State Comptroller issued a policy regarding unused state grants that states, in part, the following:

For non-continuing accounts or for any funding for which the funding authorization for the grant has expired, overpayments discovered after the close of the accounts payable

period of the fiscal year in which the funds were authorized for payment should be repaid to the department and deposited in the General Fund or the appropriate fund as determined by the Office of the Comptroller and may not be used to offset grant payments in a subsequent fiscal year, or to be used for another grant program unless otherwise authorized.

. . . reimburse to the department at the end of a grant, or as otherwise directed by a department, all un-obligated grant funds or overpayments. Grant funding may not be retained by a grantee at the end of a grant but must be returned to the department and refunded into the account from which funding was originally authorized, or if the account originally authorizing funding has expired, into the General Fund or as otherwise provided by law;

Chapter 60 of the Acts of 1995 (MCC's fiscal year 1995 maintenance appropriation) provided \$1,500,000 for the purpose of creating the MFF, as follows:

. . . that the sum of one million five hundred thousand dollars may be expended for the purposes of a Massachusetts facilities fund, so-called; provided, however, that no funds may be expended for said Massachusetts facilities fund, so-called, until such time as the council has received a matching grant from the cultural facilities fund, so-called;

Accordingly, in June 1995, MCC collaborated with NEFA and designated NEFA as being responsible for administering the MFF, which it did from June 30, 1995 through February 29, 1996. Subsequently, the MCC determined that working with another entity, the Non-Profit Facilities Fund of New York (NFF), would provide the most cost-effective means of coordinating cultural facilities projects (physical facility improvements) and would also generate matching funds from outside New England. Thereafter, NEFA and NFF formed a Massachusetts corporation, the New England Cultural Facilities Fund (NECFF), to administer the disbursement of these cultural project monies, and established within NECFF a separate fund called the Massachusetts Cultural Facilities Project Fund (MCFP) for this purpose. On March 1, 1996, the MCC and NECFF entered into an agreement, which specified the following terms and conditions:

The purpose of the "Project" was to provide technical assistance, grants, planning services, and loan funds to non-profit cultural organizations for cultural facilities projects in the Commonwealth of Massachusetts.

Through NEFA, the MCC invested the \$1,500,000 in the Project and the NFF would provide the required matching grant of \$1,500,000.

The MCC committed an additional \$1,000,000 from its 1996 appropriation to cover administration costs of the program.

During June of 2003, the MCC entered into a termination agreement with NFF and NEFA, under which the MCC stated that it wished to withdraw from active participation in providing loans to cultural organizations, and also requested the return of the \$1.5 million it had granted to this project. According to the termination agreement, MCC and NEFA stated that they would no longer invest, but would continue to support the MCFP by undertaking programs of common interest.

However, rather than returning these funds directly to the MCC, the agency requested that the \$1.5 million be paid to NEFA as a fiscal agent for the MCC. As of June 30, 2003, the amount of MCC funds returned to NEFA on behalf of the MCC equaled \$903,395 in cash and \$537,387 in outstanding loans to be collected. During our audit, we found that as of May 2006, NEFA was retaining \$826,103 in funds that it had received from the MCFP on behalf of the MCC. Loan servicing fees and miscellaneous costs connected with these loans totaled \$59,219.

According to the documentation we reviewed, NEFA manages and invests the transferred funds; however, disbursements are made only at the direction of MCC. On March 3, 2006, MCC and NEFA executed an agreement for fiscal years 2005 and 2006 whereby the fiscal agent (NEFA) planned to charge MCC 50% of the interest earned on the invested cultural facilities funds to pay for its administrative services. During our audit, we asked MCC officials how they chose NEFA to manage these funds, and in response, these officials told us that NEFA's by-laws appoint the Executive Director of the MCC to the Board of NEFA. Consequently, it appears that MCC chose NEFA to act as its fiscal agent because of this affiliation.

Further, during our audit, we asked MCC officials why the agency had not remitted the \$1.5 million it had received upon termination of its participation in the MCFP to the Commonwealth. In response, MCC officials told us that they had sought an opinion from outside legal counsel as to whether these funds were still considered state-appropriated funds subject to reversion and other statutory requirements. On June 15, 2004, MCC's outside legal counsel stated that these funds should be considered trust funds rather than state-appropriated funds because they were expended by MCC when it made the grants to the MCFP, and the funds are now being provided to MCC based on the conditions and parameters set forth in the termination agreement it had drafted with NFF and NEFA. The legal counsel specifically stated:

First, while the funds in question were provided by the MCC in 1995 and 1996 from its state appropriated budget account, those funds were validly expended by the MCC when it made the grant to the Massachusetts Cultural Facilities Project. The funds now being paid to the MCC pursuant to the Agreement and Release are funds of the Massachusetts Cultural Facilities Project and are not state appropriated funds. Second, pursuant to the Agreement and Release, the funds are only being provided to the MCC based on the conditions and parameters set forth in the Agreement and Release. As a result, the funds are akin to state trust funds, which are funds, defined by M.G.L.c.29, §1 as those received by the Commonwealth or state agencies "in a trustee capacity and which must be expended in accordance with the terms of the trust." Trust funds are not state appropriated funds and, therefore, are not subject to reversion or other statutory requirements that govern state appropriated funds. . .

We believe it was prudent for the MCC to seek advice as to the proper disposition of these funds. However, in our opinion, since these funds were originally appropriated to the MCC by the Commonwealth to be used for a specific purpose, the agency should have sought advice from appropriate state agencies such as the Offices of the State Treasurer, State Comptroller and Attorney General to determine the appropriate disposition of these funds, rather than simply accepting an opinion from its outside legal counsel.

In addition to our concerns over the proper disposition of these funds, we are also concerned that the MCC funds being administered by NEFA are not being used for the purposes for which they were appropriated. As previously noted, the state Legislature appropriated these funds to the MCC in 1995 specifically for the purposes of providing financing for cultural facilities projects. However, according to MCC officials, the funds are presently being used for extraordinary non-recurring purchases made by the MCC, and not for the purposes for which they were appropriated. We reviewed the records relative to the funds being administered by NEFA and identified disbursements totaling \$491,101 that were made from this account through December 2006 for 1) software improvements to MCC's website, online office, and grants systems; 2) the creation of an online cultural marketplace, documentary films, and exhibitions; and 3) equipment purchases.

Recommendation

In order to address our concern relative to this matter, we recommend that the MCC consult with the State Comptroller, State Treasurer, and, if appropriate, the State Attorney General to determine the proper disposition of the funds in question. In the future, the MCC should take measures to ensure that it consults with the appropriate state agencies regarding any unused funds of this nature.

Auditee's Response

In response to this audit result, MCC officials provided the following comments:

The MCC will consult with the state comptroller and if necessary the state treasurer to determine the recommended disposition of the funds in question. In the process, we will propose that the funds be transferred to MassDevelopment, to be used for grants under the new Massachusetts Cultural Facilities Fund, which was established by the legislature in 2006. The MCC values the Cultural Facilities Fund program enormously, and we would be delighted to see these funds added to this grant pool. It seems to us that this solution would also be consistent with the language from the original state appropriation that called for the funds to be used for the purposes of cultural facilities.

For the audit record, we would like to clarify several things in this section. The MCC did not "retain" the funds in question. The MCC granted them in 1995 and 1996 to the New England Foundation for the Arts (NEFA); NEFA granted them in turn to the Massachusetts Cultural Facilities Project, a legal partnership between NEFA and the Nonprofit Finance Fund (NFF). The funds were used for the purpose designated by the legislature and by the MCC. The funds provided the match required to successfully launch the Massachusetts Cultural Facilities Project, which offered technical assistance and loans to support the development of nonprofit cultural facilities in Massachusetts.

In 2003, eight years after the launch of this program, NEFA and the MCC together asked for the funds to be returned, when we jointly determined that the funds were no longer being put to adequate use in the facilities loan fund. The funds were then paid back to NEFA through an agreement that effectively dissolved the legal partnership between NEFA and NFF that was established in 1995. That is how the funds came to be returned to NEFA, not because NEFA was chosen by the MCC as a fiscal agent for this purpose, nor because of the MCC director's involvement with the NEFA board.

Auditor's Reply

In its response, the MCC indicates that it will consult with the State Comptroller and Treasurer regarding the disposition of these funds. We believe such measures are necessary and prudent and should serve to determine the appropriate disposition of these funds.

Contrary what the MCC asserts in its response, the funds in question were, for all practical purposes, retained by the MCC. Specifically, although the MCC did not have physical custody of these funds, the agency clearly had sole control over the disposition of these monies. This fact is supported by the agency's actions and also by the legal opinion the MCC obtained from its legal counsel regarding this matter, which characterized the returned funds as state trust funds with MCC as the trustee and requiring "all expenditures to be approved through the board chair and/or the Executive Committee and reported to the full Board." Further, as detailed in our report, the State Legislature appropriated these funds to the MCC in 1995 specifically for the purposes of providing financing for cultural facilities projects. However, according to MCC

officials, during the time of our audit, these funds were being used for extraordinary non-recurring purchases made by the MCC, and not for the purposes for which they were appropriated. Regardless of the reason as to why these funds were returned to the MCC, it is important, as we state in our recommendation, that the MCC consult with the appropriate state agencies to determine the proper disposition of the funds in question, and in the future, take measures to ensure that it consults with the appropriate state agencies regarding any unused funds of this nature.

3. AWARD OF TWO PARTNERSHIP GRANTS WITHOUT COMPETITIVE REQUEST-FOR-PROPOSALS

Our current audit disclosed that during fiscal year 2006, the MCC provided “partnership grants” totaling \$471,397 to two nonprofit organizations – the New England Foundation for the Arts and Massachusetts Foundation for the Humanities – without competitive request-for-proposals. Without establishing an open and competitive process for the granting of these funds, the Commonwealth cannot be assured that the funding provided to the MCC is being administered in a fair, equitable, and cost-effective manner. Further, awarding funds non-competitively may signify that the MCC is denying funding to other eligible organizations. As disclosed in the previous Audit Result, MCC’s Executive Director is a member of the Board of Directors of one of the two organizations that received funding in a non-competitive manner. In this regard, the State Legislature has promulgated the state’s Conflict-of-Interest Law (MGL Chapter 268A). The purpose of this statute is to ensure that public employees’ private financial interests and relationships with people or organizations do not conflict with or give the appearance of a conflict with their public obligations. Because the MCC’s Executive Director is on the Board of Directors of one of these grantees, and the grantee also functions as MCC’s fiscal agent, we believe that the MCC’s Executive Director should seek an opinion from the State Ethics Commission as to whether this represents a conflict-of-interest situation. When we brought this matter to the attention of the MCC’s Executive Director, she stated that because she is not a voting member of the council, she did not believe that this relationship represented a conflict-of-interest situation and therefore did not seek an opinion from the SEC.

The Office of the State Comptroller has promulgated 815 Code of Massachusetts Regulations (CMR) 2.00, which establishes requirements for all state agencies, including MCC, relative to the awarding of grants. In this regard, 815 CMR 2.04(7) states, in part:

Grants of discretionary funds shall be disbursed through an open and public competitive process, as determined appropriate by the department, and in accordance with the department's Legislative Authorization, trust language or a federal grant. This process should include, but is not limited to the following:

- (a) a Grant Application, or other disbursement process, for each Grant or Grant program which complies with all relevant state or federal laws and regulations and federal grant requirements...*
- (b) the Grant Application, or other disbursement process, should identify the purpose, scope, anticipated budget and duration of the Grant or Grant program, the evaluation criteria that will be used for Grantee selection and any information that a Grantee must provide to be considered eligible for a Grant;*
- (c) some form of public notice or notification of the availability of a Grant or Grant Program;*
- (d) notice to all entities responding to the Grant Application, or otherwise reviewed, of their selection or non selection for a Grant;*
- (e) maintenance of a Grant file with complete records of a Grant or Grant Program including Grant Applications, or other disbursement documents, contractual documents and Grant reports....*

As noted in the Background section of this report, the MCC has established a process for awarding grants to eligible organizations and individuals. This process includes establishing special criteria governing the grant-funding process, including conducting eligibility determinations, a panel review and approval process, dollar-match requirements, grant dollar limits, submission of financial and progress reports, and a payment schedule. However, during our review of the grants awarded by the MCC during fiscal year 2006, we found that the MCC awarded grants to two non-profit entities without following its established competitive process. The MCC referred to these grants as "Public Partnerships Grants," funded as follows:

New England Foundation for the Arts, Inc (NEFA):

Dates of Disbursement	Amounts Disbursed
July 1, 2005	\$47,082
June 26, 2006	<u>50,000</u>
	<u>\$97,082</u>

Massachusetts Foundation for the Humanities (MFH):

Dates of Disbursement	Amounts Disbursed
July 1, 2005	\$240,000
July 1, 2005	95,000
June 23, 2006	<u>39,315</u>
	<u>\$374,315</u>

During our review of the documentation relative to these grants, we determined that the MCC did not have separate written policies and procedures specifically addressing the grant process involved for its so-called “Public Partnerships Grant” recipients. For example, MCC does not have written criteria documenting how eligibility is determined for these funds, how much each grantee should receive, and when and how grant funds would be disbursed.

We asked MCC officials what criteria were used to select these entities and how the amounts awarded were determined. In response, these officials told us that it has been an annual practice of the MCC to provide grants to these agencies, and that although there are no legislative or other written criteria, the State Legislature expects MCC to provide annual awards of financial assistance to these two non-profit cultural organizations. These officials further stated that the amounts of the awards provided to the two organizations depends on the total amount of MCC’s appropriations, with the Board establishing and approving the grant amounts. Although the two organizations that received these grants are involved in cultural activities that make them potentially eligible for MCC grants, by not establishing a formal competitive process for the awarding of these grants, the Commonwealth cannot be assured that the funding that it is providing to the MCC is being administered in a fair and equitable manner and that the MCC is not denying funding to other eligible organizations.

Recommendation

In order to address our concerns relative to this matter, we recommend that the MCC take the following actions:

1. Establish and document policies and procedures for the awarding and granting of its Public Partnerships Grants.
2. Seek an opinion from the State Ethics Commission regarding the Executive Director’s involvement with both the MCC and NEFA.

Auditee's Response

In response to this audit result, the MCC provided the following comments:

The MCC will establish and document clearer policies and procedures for the award and granting of public partnership grants. Indeed, we have already done so. In fiscal year 2009, formal requests-for-proposals have been issued for all of the MCC's public partnership grants. We will follow this practice in the future as well.

As the audit suggests, we will also seek an opinion from the State Ethics Commission regarding the executive director's involvement with both the MCC and NEFA. For the audit record we would like to clarify several things in this section. It is true that the MCC awarded partnership grants to the New England Foundation for the Arts and Massachusetts Foundation for the Humanities without a competitive request-for-proposals. ... However, we do not believe the audit fully captures the nature of these two partnerships:

The Massachusetts Foundation for the Humanities is the sole and unique "state-based affiliate" of the National Endowment for the Humanities, established and funded by both the NEH and the MCC to promote the humanities in Massachusetts. By statute, the MCC is also mandated to promote the humanities, and one of the ways we do this is by supporting the sole and unique state-based affiliate of the National Endowment for the Humanities. Over the years, various members of the state legislature have also made clear to us that they expect us to do so – although this is not written down anywhere in our statute.

The New England Foundation for the Arts is the sole and unique "regional arts organization" for New England, established by the National Endowment for the Arts to serve Massachusetts and the five other New England states. All of the state arts agencies in New England provide annual contributions to NEFA; indeed, all 50 state arts agencies in the country provide annual financial contributions to the regional arts organizations in their own respective regions. The system was designed by the National Endowment for the Arts to work exactly this way. We have historically classified our annual awards to NEFA in our own database as grants, but it may be more appropriate to describe them as annual dues payments.

With regard to the MCC director's relationship to the NEFA board, it may be worth noting that all six of the New England state arts agency directors sit on the board of NEFA ex officio, and have done so for many years. The directors serve without compensation, and have no private interest in the funds received by NEFA. We do not see this as a conflict; in fact, we see it as a mechanism to give our director a formal role in protecting our state's interest in the regional consortium.

Auditors Reply

In its response, the MCC states that it will establish and document clearer policies and procedures for the award and granting of public partnership grants. It also states that it will seek an opinion from the State Ethics Commission regarding its Executive Director's involvement with both the MCC and NEFA. We believe that these actions are necessary and appropriate and should serve to address our concerns relative to these matters.

We do acknowledge the working relationships that the MCC has formed with the New England Foundation for the Arts and Massachusetts Foundation for the Humanities. However, this relationship does not mitigate the MCC's responsibility to fully comply with state regulations relative to the administration of grant funds. The disbursements made to these two organizations were processed through the state accounting system as grant expenditures, and the Standard Commonwealth Contract forms for this funding were prepared indicating that these awards were grants. Consequently, the MCC was obligated to follow the applicable state regulations relative to the awarding of grant funds. If the MCC believes that the provision of these funds should not be treated as grants, then it should work with the Budget Bureau and the State legislative liaisons to establish a process whereby funding can be provided to these two agencies outside of a formal grant award process. (e.g., as legislative earmarks obviating the need for a competitive process).

Finally, The "ex officio" status of MCC's Executive Director as a NEFA board member is conferred by NEFA's bylaws, not by the General Laws of the Commonwealth. As such, it does not confer automatic exemption from the state's conflict-of-interest law.

4. IMPROVEMENTS NEEDED IN OVERSIGHT OF LOCAL CULTURAL COUNCILS' ADMINISTRATION OF MCC GRANT FUNDS

According to 962 CMR 2.07(6) promulgated by the MCC, all local cultural councils (LCCs) and regional cultural councils (RCCs) must provide the MCC with annual reports, including a year-end financial report. However, we found that although the MCC has instituted an online financial reporting system for LCCs and RCCs to use for this purpose, there are inadequate controls over this activity to ensure that the financial information reported to the MCC by these entities is accurate. In fact, at the two LCCs we visited, we found significant discrepancies between the financial information relative to MCC grants being expended by the LCCs and what was reported by these LCCs to the MCC. For example, as of December 31, 2006, the City of Worcester's MCC grant balance reflected a total of \$101,729.41; however, a balance of zero was reported to MCC. The MCC does not currently perform on-site financial audits or reconcile annual LCC financial reports to the municipal financial records in each community.

As a result, during our site visits, we identified at least one instance where a recipient did not comply with the requirements of Section 58 of Chapter 10 of the General Laws, which requires

MCC grant recipients to keep grant funds and interest earned on these funds in a separate revolving bank account. As a result, the MCC may not be receiving all of the information necessary to properly administer these funds.

Chapter 10, Sections 56 through 58 of the General Laws authorize the MCC to administer the distribution of the Arts Lottery Fund. Specifically, Section 56 of Chapter 10 states, in part:

The council shall stimulate and encourage the arts, humanities and interpretive sciences within cities and towns by administering the distribution of the Arts Lottery Fund established under the provisions of section fifty-seven to the several cities and towns hereinafter provided and providing guidance, advice, and assistance to local or regional cultural councils established under the provisions of section fifty-eight.

As noted in the Background section of this report, all cities and towns in Massachusetts are eligible to receive funding, provided that the individual city or town establishes an LCC or joins with other communities to form an RCC. The MCC awards grants to various entities, including LCCs and RCCs which subsequently re-grant these funds to eligible cultural organizations supporting the arts, humanities, and interpretive sciences in their communities. LCCs and RCCs re-grant the funds they receive from the MCC through two types of awards: one to local cultural organizations that promote a broad range of cultural activities for the benefit of the general public, and the second through PASS grants, which subsidize cultural field trips for school children. MCC funds are deposited directly with the local municipality and can be disbursed only using the process used by the town treasurer and/or accountant's office.

Relative to the administration of these funds, Section 58 of Chapter 10 requires municipalities to establish a revolving account for the purpose of maintaining the state Arts Lottery Fund and donations. This law stipulates that the account be kept separate and apart from all other funds of the town treasury. The funds, including any interest earned, can be expended at the direction of the local or regional cultural council. Furthermore, the law requires that the municipality's designated officer, such as the city auditor or town accountant, submit an annual report of the revolving fund to all involved officials, such as the mayor, city council members, city manager, board of selectmen, or town manager, as well as to the local cultural council. In addition, 962 CMR 2.07(6), promulgated by the MCC, requires LCCs and RCCs to provide the MCC with various reports as set forth in the MCC's guidelines. According to the MCC's guidelines, LCCs and RCCs are required to provide the MCC with a year-end financial report that details the

status of the local MCC grant account. In order to facilitate this, the MCC has established an online reporting system which is used by MCC to make a determination regarding how much funding will be available from its state appropriation for distribution to LCCs and RCCs.

During our audit, we randomly selected 19 of the 329 grants made by the MCC to LCCs for fiscal year 2006. We reviewed all of the documentation that MCC was maintaining relative to these grants and conducted site visits at two grant recipients, Worcester and Brockton. These LCCs received grants of \$68,060 and \$38,390, respectively, in fiscal year 2006. During these site visits, we (a) performed tests to ensure that each LCC was properly assessing eligibility, (b) reviewed samples of re-grant applications and the re-granting process to determine compliance with MCC requirements, (c) examined bank statements and financial records of State Arts Lottery Funds, and (d) compared actual grant balances with the balances reported to MCC by these two recipients during fiscal year 2006.

Based on our audit work in this area, we determined that although the MCC had established formal online reporting requirements for RCCs and LCCs, it had not developed any controls (e.g., site monitoring or other procedures) to ensure the accuracy of the information being reported by these entities. As a result, there is inadequate assurance that the information reported by RCCs and LCCs is accurate. In fact, we found problems with the administration of the MCC grant funds provided to both of the recipients we visited during our audit, as detailed below:

- The City of Worcester did not keep grant funds and interest earned in a separate revolving bank account as required by Section 58 of Chapter 10 of the General Laws. Rather, the grants were deposited into the City's checking account and re-granted from this account. However, Worcester's fiscal office kept track of the Arts Lottery Fund transactions and available balances, including the posting of interest, on a general ledger account. Regarding this matter, the City's Budget Director told us that he was unaware of the requirement to place funds in a separate bank account, and that he believed that because interest was being properly allocated to the LCC funds, there was no practical reason for doing so.
- Our review of financial records, including bank statements and ledger accounts, revealed that the cash available for re-granting by both of these LCCs as of December 31, 2006 differed from the balances these two LCCs reported to MCC. Specifically, as of December 31, 2006, Worcester's grant balance reflected a total of \$101,729.41; however, a balance of zero was reported to MCC. Similarly, Brockton's reconciled bank statement reflected a balance of \$25,736.34, while Brockton reported that it had a zero balance in these funds to MCC. Furthermore, looking back to the prior year, we noticed that incorrect cash balances were

reported to MCC in that year also. The schedules below show the reporting status for the two LCCs versus the balances reported to MCC as of December 31, 2005 and December 31, 2006:

City of Worcester LCC		
12/31/2005	Balance per City's Arts Lottery Ledger Account	\$100,246.65
	Balance Reported by the City per MCC's Summary Report	0
12/31/2006	Balance per City's Arts Lottery Ledger Account	\$101,729.41
	Balance reported by City per MCC's Summary Report	0
City of Brockton LCC		
12/31/2005	Balance per Reconciled Bank Statement	\$13,430.09
	Balance Reported per MCC's Summary Report	0
12/31/2006	Balance per Bank Statement	\$25,736.34
	Balance reported per MCC's Summary Report	0

We found that the discrepancies that existed between the actual balances in these LCC grant accounts and the amounts reported to the MCC by these entities was due to a lack of communication between city officials and the LCC agencies. Specifically, although 962 CMR 2.05 entitles LCC administrators to receive regular financial reports from their municipalities indicating the actual amount of funds that had been expended from the MCC grant account, neither LCC administrator from the communities we visited claimed to have received such reports or even knew that they were entitled to receive these financial reports. LCC administrators told us that they would routinely report planned expenditures to the MCC, which in both cases were significantly different from what had actually been expended from these accounts.

Although the MCC has an electronic standard reporting process in place that requires LCCs and RCCs to report and summarize the status of their grant activities at the end of each calendar year, there are inadequate controls to guarantee the accuracy of the information being reported by LCCs and RCCs. Specifically, the MCC does not perform any verification of this information. Furthermore, the MCC does not monitor the cash management activities existing at municipalities to ensure that grant funds are kept in separate interest-bearing bank accounts and does not ensure that required financial data is transmitted by the municipal finance administrator to the MCC, at least annually, in compliance with Section 58 of Chapter 10 of the

General Laws. The failure of the municipalities to provide financial reports to their LCC administrators (962 CMR 2.05) and to the MCC (Section 58 of Chapter 10 MGL) made financial reporting more difficult for the LCCs and monitoring more difficult for MCC.

As a result of these internal control problems, these MCC grant funds are vulnerable to loss, theft, or misuse. Also, without accurate reports from the municipalities' finance offices, the LCCs' administrators may not be aware that additional funds are available for re-granting to support cultural projects and events; therefore, local residents and local school children lose opportunities to access the arts, humanities, and interpretive sciences.

Recommendation

In order to address our concerns relative to this matter, we recommend that the MCC take the following actions:

1. Require municipal financial officers and LCC chairs to co-sign annual online submissions to the MCC, in order to promote coordination between financial officers and LCC chairs, and to improve the accuracy of financial information submitted to the MCC.
2. Require municipal financial officers to attest in the annual online submission that LCC funds are kept in a separate interest-bearing account.
3. Provide technical assistance to LCCs and municipal financial officers to promote coordination between them and improve compliance with MCC regulations.
4. Conduct, on a sample basis, periodic site reviews of local cultural councils' financial records.

Auditee's Response

In response to this audit result, the MCC provided the following comments:

The MCC distributes funds to local cultural councils each year under the terms described in the MCC's statute and regulations. Once those funds have been distributed it is the responsibility of each municipality to comply with the statute and regulations that apply to them. The MCC agrees completely that all state funds that have been distributed to LCCs should be properly accounted for by their municipalities, and, where unencumbered balances might exist, these funds should be put to use in each community in accord with the goals of the Local Cultural Council Program. We would also like to see better communications and coordination between financial administrators and chairs of local cultural councils in each city and town...

Auditor's Reply

962 CMR 2.10 promulgated by MCC states in part;

An LCC must comply with its duties as specified in 962 CMR 2.00 and elsewhere in the MCC's Local Cultural Council Program Guidelines.

When the MCC finds a local cultural council has not adequately complied with 962 CMR 2.00, the MCC may suspend all or part of MCC funding for that council. The MCC may also specify corrective actions that the LCC must take before it can begin to receive funds again. If an LCC fails to take corrective actions specified by the MCC, within a time frame specified by the MCC, the MCC may redistribute any funds allocated to that local council.

If an LCC appears unable to comply not only with its duties but also with corrective actions specified by MCC, then the MCC may determine that a partial or complete change in the membership of the local council may be in order to enable the community to begin receiving its funds again. In these extraordinary cases, the MCC may authorize the local appointing authority to remove a member or members from the LCC and appoint a new member or members.

Clearly these regulations empower the MCC to monitor the activities of LCC's and take whatever measures it deems necessary, including removing LCC members, to address any instances of non-compliance. Consequently, we urge the MCC to fully implement our recommendations relative to this matter.

5. IMPROVEMENTS NEEDED IN THE MCC'S INTERNAL CONTROL PLAN

We found that the internal control plan implemented by MCC is not consistent with the guidelines established by the Office of the State Comptroller (OSC). Specifically, MCC's internal control plan did not include the policies and procedures recommended by OSC or incorporate the five components established in OSC's guidelines for an efficient internal control system. As a result, MCC's efforts to achieve its mission, safeguard its assets (including annual grant distributions of approximately eight million dollars), and promote operational efficiency may not be optimized.

Chapter 647 of the Acts of 1989 states that internal control systems shall be developed in accordance with internal control guidelines promulgated by the OSC. Subsequent to the passage of Chapter 647, the OSC issued written guidance in the form of the Internal Control Guide for Managers and the Internal Control Guide for Departments (after the audit period, on September 17, 2007, the OSC replaced these two Guides with one publication called the Internal Control Guide, which updated the older Guides to be more consistent with developments in accounting

and auditing pronouncements), which require that each department's internal control plan be unique and include five components: control environment, risk assessment, information and communication, control activities, and monitoring. In these guidelines, the OSC stresses the importance of internal controls and the need for departments to develop an internal control plan, defined as follows:

... a description of how a department expects to meet its various goals and objectives by using policies and procedures to minimize risk a high-level summary supported by low-level policies and procedures. Each department's internal control plan will be unique; however, it should be based on the same framework-- the organization's mission statement, goals and objectives and components of internal control...

During our audit, we requested a copy of MCC's internal control plan and reviewed this document. Based on our review, we determined that MCC's internal control plan was inadequate in that it did not contain written formally approved policies and procedures incorporating the five components of internal control for the administration of MCC's various grant/contract programs. Also, there were no approved low-level detailed policies and procedures to support the high-level summary. The internal control modifications needed to correct the prior internal control deficiencies (see Audit Result No. 1) were not incorporated into MCC's existing internal control plan.

In discussions with MCC officials regarding the lack of adequate internal controls, they informed us that there are comprehensive policies and procedures on the Agency's website, as well as in separate grant handbooks, relating to grant administration. However, we found that these policies and procedures focus on applicant and grantee requirements for particular grants, rather than elements of internal control for the safeguarding of the MCC's assets. Furthermore, we advised MCC officials that lacking efficient internal controls could result in MCC's assets and resources being vulnerable to loss, theft, or misuse, and could also hinder MCC's ability to achieve its goals and ultimately carry out its mission.

Recommendation

The MCC should modify its internal control plan to comply with Chapter 647 of the Acts of 1989 and the guidelines established by the OSC.

Auditee's Response

The MCC will modify its internal control plan to conform with the latest guidelines that were issued by the Office of the State Comptroller in September 2007.

6. STATE-MANDATED ANNUAL REPORT NOT FILED

MCC did not file an annual report with the Office of the Secretary of State in accordance with its enabling legislation, Chapter 10, Section 53 and Chapter 30, Sections 32 and 33 of the General Laws. Both statutes specify that every state officer, department, board, and commission, excepting those statutorily exempted, file an annual report with the State Secretary on or before the first Wednesday in December following the close of each fiscal year. As a result, legislators and citizens of the Commonwealth may not have sufficient information on MCC's programs, accomplishments, and finances. Chapter 10, Section 53 of the General Laws states:

The council shall annually submit to the budget director the estimates required by sections three and four of chapter twenty-nine, and shall file an annual report as required by sections thirty-two and thirty-three of chapter thirty.

MGL Chapter 30, Section 32 further states that unless particular information is required of an agency, the report can be a brief summary of the fiscal year's work with recommendations for the succeeding fiscal year.

However, our audit disclosed that the MCC did not file an annual report for fiscal year 2006 with the Office of the Secretary of State in accordance with its enabling legislation. Further, MCC officials told us that the Council has never filed annual reports because it believes it is not subject to the aforementioned report-filing requirements. However, MGL Chapters 10 and 30 clearly apply to the MCC; therefore, the Council should have been submitting these annual reports as required by these statutes. By not filing these annual reports, MCC is not in compliance with its legislative requirements, and is not providing the Commonwealth with important information regarding fiscal and programmatic matters and other changes occurring from year to year.

Recommendation

The MCC should file annual reports with the Office of the Secretary of State in accordance with Chapter 10, Section 53, and Chapter 30, Sections 32 and 33, of the General Laws.

Auditee's Response

We were not aware of this requirement. We will file a report with the Office of the Secretary of State on or before the first Wednesday in December every year.