



# The Commonwealth of Massachusetts

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**INDEPENDENT STATE AUDITOR'S REPORT  
ON AGENCY COMPLIANCE WITH  
THE OFFICE OF THE STATE COMPTROLLER'S  
OFFICIAL YEAR-END CLOSING AND OPENING  
INSTRUCTIONS FOR ENCUMBRANCE AND  
ADVANCE FUND MANAGEMENT  
FISCAL YEAR 2006**

**OFFICIAL AUDIT  
REPORT  
APRIL 10, 2007**

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**INTRODUCTION****1**

Our review evaluated state agency compliance with the Office of the State Comptroller's (OSC's) FY2006 Closing and FY2007 Opening Instructions. The purpose of our audit was to determine (1) agency compliance with the OSC's policy that the June 30, 2006 deadline for encumbrances and the receipt of goods and services be observed, (2) whether management decisions to encumber fiscal year 2006 funds for accounts payable had been based on detailed and meaningful analyses to support or represent exact requirements, and (3) whether fiscal year 2006 advance funds were accounted for before opening fiscal year 2007 advances and accounting was performed through documentation of the expenditure of the advances (EA) or cash repayment of any remaining balance by processing an advance refund (AR), or whether Dynacash advances were accounted for in accordance with OSC's emergency payroll Dynacash account closing procedures.

To determine compliance with the June 30 receipt of goods and services requirement and to evaluate evidence of management's detailed and meaningful analyses of encumbrance needs, we identified 134,992 encumbrances, totaling \$2,734,462,867.49, outstanding as of June 30, 2006. We then examined 250 encumbrance transactions, totaling \$5,124,205.85, from among the 3,164 encumbrances (totaling \$542,084,490.56) that were entered into the Commonwealth's accounting system in the period June 19, 2006 to June 30, 2006, the final two weeks of fiscal year 2006. We also reviewed 25 late encumbrance transactions, totaling \$2,897,065.82 that the OSC entered into the Commonwealth's accounting system after June 30, 2006 on behalf of various state agencies. Furthermore, we reviewed 50 encumbrance transactions, totaling \$2,270,329.93, consisting of open encumbrances as of June 30, 2006.

We performed these tests to evaluate evidence of management's detailed and meaningful analyses of encumbrance needs and agency compliance with the OSC's FY2006 Closing and FY2007 Opening Instructions, Section 6, Contracts, and Section 8, Accounts Payable Management. Our review determined that compliance with these instructions was high: 321 of 325 encumbrance transactions tested, or 99%, were in compliance with the closing instructions for encumbrances as of June 30, 2006.

To determine compliance with Section 8 of the OSC's FY2006 Closing and FY2007 Opening Instructions, we identified 50 agencies with outstanding advances totaling \$80,647,037.74, as of June 30, 2006. From these we selected and examined 46 advances from 31 agencies totaling \$36,777,804.53 to determine whether fiscal year 2006 advance funds were closed before fiscal year 2007 advances were opened, and were documented in compliance with the OSC's closing instructions. Our review determined that all advances tested were in compliance with the OSC's FY2006 Closing and FY2007 Opening Instructions, Section 8, Accounts Payable Management.

The encumbrance issues noted in this report were reported to the OSC during the audit so that timely corrective action could be taken.

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Our prior audit disclosed that three agencies processed three encumbrance transactions totaling \$38,122.30 that were paid for with fiscal year 2005 funds, although goods or services had not been received by the June 30, 2005 deadline. In addition, our prior audit reported that two agencies likely would have used fiscal year 2005 funds for fiscal year 2006 obligations had their encumbrances totaling \$64,702.81 not been selected as part of our review. State Finance Law requires that annual appropriations may be expended only for expenses for the same fiscal year. Consequently, goods and services to be paid for with current fiscal year appropriations must be received and accepted within that same fiscal year (July 1 to June 30). Further, our prior audit disclosed that one agency processed one encumbrance transaction totaling \$165,150.86 that was paid 12 days beyond the 30-day time limit set by the Commonwealth's bill-paying policy, and missed an opportunity to take advantage of a vendor-offered discount that would have saved the Commonwealth an additional \$1,651.51. Additionally, our prior audit disclosed that one agency authorized payment of a vendor invoice totaling \$11,746 prior to receiving all ordered items. The payment for goods not received is contrary to State Finance Law.

Our follow-up review found that appropriate corrective steps had been implemented by the Cape & Islands District Attorney's Office (CIDA), the Massachusetts District Attorneys Association (DAA), the Massachusetts Office of Travel and Tourism (MOTT), and the Soldiers' Home in Holyoke (SHH) to ensure compliance with the OSC FY2006 Closing and FY2007 Opening Instructions pertaining to encumbrance management. Also, because the Berkshire County Sheriff's Office (BCSO) year-end encumbrance transactions did not meet the \$5,000 encumbrance selection criteria in FY 2006, we will follow-up at the BCSO in our FY2007 review. In addition, our follow-up examination disclosed that necessary corrective measures have been implemented by the Department of State Police (DSP) to ensure compliance with the Commonwealth's bill-paying policy and vendor-offered discounts. Further, our follow-up review determined that MOTT, through the Department of Business and Technology, has taken the necessary corrective action by implementing controls to ensure compliance with State Finance Law.

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We tested 325 encumbrance transactions, totaling \$10,291,601.60, and found a significant degree of compliance with the OSC's closing instructions. However, we did find that two state agencies processed three encumbrance transactions totaling \$20,974.37 that were paid for with fiscal year 2006 funds, although goods had not been received by the June 30, 2006 deadline. We also identified one agency that processed one encumbrance totaling \$28,938 that included funds to pay for prior fiscal years 2001 through 2005 obligations totaling \$27,825 with fiscal year 2006 funds. In addition, our review found that one agency modified an encumbrance transaction on June 20, 2006 to \$8,178.86 from \$5,821.14 that later was allowed to lapse at the end of the Commonwealth's accounts payable period ending August 31, 2006. This action is indicative of an agency that did not conduct the OSC-required detailed and meaningful analysis of its year-end

needs. Our examination also disclosed that one agency, contrary to State Finance Law, processed an encumbrance totaling \$18,336 after they had initiated, authorized performance, and accepted ordered goods. Further, we determined that one agency processed two payments for vendor invoices totaling \$5,323.53 and \$3,668.25 that were paid 26 and 29 days, respectively, beyond the Commonwealth's 30-day bill-payment timeframe. Additionally, we determined that one agency processed two encumbrances for capital improvements totaling \$23,849.46 and \$8,980.19, that required additional funding due to responsible personnel not adhering to management-prescribed change order policies and procedures and not ensuring that sufficient funding was available before authorizing scope of work changes for supplemental construction costs totaling \$641.72 and \$5,391.01, respectively.

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## INTRODUCTION

### *Background*

As authorized by Chapter 11, Section 12, of the Massachusetts General Laws, the Office of the State Auditor examined state agency accounting records to review their compliance with the Office of the State Comptroller's (OSC's) FY2006 Closing and FY2007 Opening Instructions, specifically for the June 30, 2006 cut-off for encumbrances and disbursement (advance fund) management. We selected 75 state agencies to test certain encumbrance transactions and 31 state agencies to test certain advance funds. Encumbrances represent a state agency's official notification to the State Comptroller that a certain portion of the funds appropriated to it will be needed to meet known spending obligations. Advances represent spending authority delegated by the OSC and processed by the Office of the State Treasurer (OST) for funds primarily used for department emergency payroll Dynacash accounts and other emergency needs.

Chapter 29, Section 5C, of the General Laws requires the OSC to issue an annual report on state finances to the Commissioner of Administration on or before October 31. That report is essential for subsequent-year budgeting and planning. Included in this year's report are fiscal year 2006 expenditures, which affect the Commonwealth's surplus or deficit and future budgets. To have accurate and timely data for these and other reports, the Commonwealth must close its books accordingly. Therefore, the OSC issues a set of closing instructions to each agency prior to the close of each fiscal year, which ends on June 30.

Included in those instructions are procedures specific to determining the proper encumbrance amounts for accounts payable and the timely disposition and proper accounting for advance funds for the current fiscal year. The procedures ensure accurate accounting for year-end cut-offs for encumbrances and disbursements (advance fund) management, resulting in the use of accurate financial information in the preparation of the Commonwealth's annual financial statements.

Chapter 488 of the Acts and Resolves of 1986, known as the Fiscal Reform Act, requires certain transfers of surplus balances among the funds of the Commonwealth (e.g., from the General Fund to the Program Stabilization Fund and the Tax Reduction Fund). Therefore, it has become imperative for agencies to comply with the closing section instructions and to reserve only the required funds supported by adequate and appropriate documentation. The proper accounting for

encumbrances for the accounts-payable period ensures the completeness and accuracy of the Commonwealth's surplus and deficit balances as reported in the annual financial statements.

***Audit Scope, Objectives, and Methodology***

The scope of our review, which was conducted in accordance with applicable generally accepted government auditing standards, was limited to an evaluation of state agency compliance with the OSC's annual closing and opening instructions. These instructions mandate specific year-end procedures for state agencies in analyzing and finalizing encumbrances and in accounting for advance funds.

To determine compliance with the June 30 receipt of goods and services requirement and evaluate evidence of management's detailed and meaningful analyses of encumbrance needs, we performed two tests of encumbrance management. To determine compliance with the OSC's FY2006 Closing and FY2007 Opening Instructions for encumbrance management, we identified 134,992 fiscal year 2006 encumbrances, totaling \$2,734,462,867.49, outstanding as of June 30, 2006. We selected 325 fiscal year 2006 encumbrance transactions from the Massachusetts Management Accounting and Reporting System (MMARS) Information Warehouse System by utilizing Audit Command Language software. First, we examined 250 fiscal year 2006 encumbrance transactions, totaling \$5,124,205.85 from the 3,164 encumbrance transactions (totaling \$542,084,490.56) that were entered into the Commonwealth's accounting system from June 19 to June 30, 2006, the final two weeks of the fiscal year. Second, we selected 50 encumbrance transactions, totaling \$2,270,329.93, consisting of open encumbrances as of June 30, 2006. In addition, we selected 25 late encumbrance transactions, totaling \$2,897,065.82, submitted by departments to the OSC for entry into the Commonwealth's accounting system during July 2006<sup>1</sup>. We performed these tests to determine whether goods and services purchased by state agencies with fiscal year 2006 funds were received by June 30, 2006 and to evaluate evidence of management's detailed and meaningful analyses of encumbrance needs.

The OSC's advance funds closing instructions require that each department account for fiscal year 2006 advance funds before opening fiscal year 2007 advances by documenting the expenditure of

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<sup>1</sup> The OSC accommodates late encumbrances due to unforeseen circumstances on a limited basis. Late encumbrances may include Contract Transactions, Recurring Payment Orders, and General Accounting Encumbrances. The most common reasons for late encumbrances' being submitted by departments for entry by the OSC include improper coding of (final payment) Commodity Based Payment Requests or General Accounting Expenditures and modifications to accounting line data for existing encumbrances.

advance or cash repayment of any balance remaining or by adhering to specific OSC closing instructions pertaining to departments with emergency payroll Dynacash accounts. To determine compliance with the OSC's advance funds closing instructions, we reviewed a report<sup>2</sup>—provided by the OSC—of the MMARS Warehouse for open advances, of which we identified 50 agencies with advances outstanding as of June 30, 2006, totaling \$80,647,037.74. We then selected 46 advance funds, totaling \$36,777,804.53, from 31 state agencies for review.

During our review of the various state agencies, we (1) contacted key staff to determine whether adequate internal controls existed over encumbrances; (2) obtained and reviewed documentation to support open encumbrance balances; (3) determined whether goods and services were received or provided by June 30, 2006; (4) contacted vendors, when necessary, to obtain independent verification that goods were received and services were rendered by the June 30, 2006 cut-off date; and (5) determined whether fiscal year 2006 advance funds were closed and accounted for in accordance with the OSC's closing instructions. From the two sets of encumbrance transactions tested, we randomly selected 73 for vendor verification of delivery of goods or services by June 30, 2006.

Our review determined that agency compliance with the OSC closing instructions was high: 321 of 325 fiscal year 2006 encumbrance transactions tested, or 99%, were in compliance with the closing instructions for encumbrances as of June 30, 2006. Furthermore, all advances reviewed were accounted for in compliance with disbursement (advance funds) management closing and opening instructions. However, although compliance was high, four agencies selected for this test had not fully complied with requirements of the OSC closing instructions, as reported in the Audit Results section and Schedule A. Further, our review found that one agency had not complied with the Commonwealth's 30-day bill-paying policy, while another agency, contrary to State Finance Law, established an encumbrance after ordering and receiving their goods. In addition, one agency processed two encumbrances for capital improvements that were not effectively monitored, and therefore exposed the Commonwealth to a liability due to increased construction cost obligations totaling \$641.72 and \$5,391.01 without determining whether adequate funding was available.

The encumbrance issues noted in this report were reported to the OSC during the audit so that timely corrective action could be taken. To that end, the OSC processed the necessary adjusting

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<sup>2</sup> Budget fiscal year 2006 Advance Fund Report -open advance table (OPAT) as of 7/3/2006.

entries to properly account for the expenditure of goods received after the June 30, 2006 deadline as fiscal year 2007 obligations and expenses, and credited general revenue as if fiscal year 2006 balances were reverted. Additionally, in an effort to ensure that these shortcomings do not occur again, the OSC requested that each department prepare a Corrective Action Plan (CAP) in response to our results. Furthermore, a copy of each department's CAP will be placed in the OSC Quality Assurance (QA) files and will be part of the next scheduled OSC QA review.

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## AUDIT RESULTS

### 1. PRIOR AUDIT RESULTS

Our prior audit (No. 2005-5001-16S) disclosed that the Cape & Islands District Attorney's Office (CIDA), the Massachusetts District Attorneys Association (DAA), and the Massachusetts Office of Travel and Tourism (MOTT) processed three encumbrance transactions that were not in compliance with the OSC's closing instructions. As a result, \$38,122.30 of fiscal year 2005 funds was used to pay fiscal year 2006 obligations. Only goods and services received by June 30, 2005 should have been paid for with fiscal year 2005 funds. Our follow-up review found that the CIDA, DAA and MOTT have taken the necessary corrective action by implementing the controls needed to ensure compliance with the OSC's FY2006 Closing and FY2007 Opening Instructions pertaining to encumbrance management.

In addition, our prior audit reported that the Berkshire County Sheriff's Office (BCSO) and the Soldiers' Home in Holyoke (SHH) likely would have used fiscal year 2005 funds for fiscal year 2006 obligations had their encumbrances totaling \$64,702.81 not been selected as part of our review. State Finance Law requires that annual appropriations may be expended only for expenses for the same fiscal year. Consequently, goods and services to be paid for with current fiscal year appropriations must be received and accepted within that same fiscal year (July 1 to June 30). Had we not selected these encumbrances as part of our review, these agencies would have inadvertently used fiscal year 2005 funds to pay for goods received after the June 30, 2005 deadline. As a result of our prior review, the BCSO's fiscal year 2006 appropriation was used to pay for goods received after the June 30, 2005 deadline and the SHH allowed its fiscal year 2005 encumbrance to lapse and revert to the Commonwealth on August 31, 2005, the end of the accounts payable period. Our follow-up review determined that the SHH has taken appropriate corrective action by implementing the necessary controls to ensure compliance with the OSC's closing instructions and State Finance Law. However, since the BCSO year-end encumbrance activity did not satisfy encumbrance transaction selection requirements<sup>3</sup>, the BCSO will be included in our FY2007 follow-up review.

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<sup>3</sup> Encumbrance transaction selections required a minimum dollar threshold of \$5,000.

Further, our prior audit disclosed that the Department of State Police (DSP) processed one encumbrance transaction that was not paid within the 30-day timeframe required by the Commonwealth's bill-paying policy and missed an opportunity to take advantage of a vendor-offered discount that would have saved the Commonwealth additional funds. Our follow-up review found that the DSP has taken the needed corrective action by implementing appropriate controls to ensure compliance with the Commonwealth's bill-paying policy.

Additionally, our prior audit disclosed that MOTT authorized and paid a vendor invoice totaling \$11,746 prior to ensuring that all items had been received. MOTT's payment for goods not received constituted noncompliance with State Finance Law. Our follow-up examination determined that MOTT, through the Department of Business and Technology, has taken appropriate corrective action by implementing the necessary controls to ensure compliance with the state finance law.

## 2. ENCUMBRANCE MANAGEMENT

Sections 6 and 8 of the OSC's FY2006 Closing and FY2007 Opening Instructions state, in part:

*State Finance Law requires that funding be in place before goods, services or other obligations can be requested or accepted from contractors, vendors, or employees. Specifically, under M.G.L. c.29, § 26; M.G.L. c.29, § 27; and M.G.L. c.29, § 29, departments may not incur a liability for the Commonwealth in excess of their appropriation or allotments and the Comptroller may not permit the disbursement (payment) or incurring of an obligation (encumbrance) by departments without a sufficient appropriation and allotment.*

*During the final quarter of the fiscal year, departments should perform a timely review to ensure all FY06 encumbrances are in place to support departmental needs. Routine encumbering for all appropriation types should be submitted in MMARS by June 15 so that the remainder of FY06 can be used to handle final adjustments.*

*Departments should review their financial status to ensure that there will be sufficient funding encumbered to cover all commitments incurred during the fiscal year.*

*State Finance Law requires that annual appropriations may be expended only for expenses for the same fiscal year (M.G.L. c.29, §12). Goods and services to be paid for with current fiscal year appropriations must be received and accepted within that same fiscal year (July 1-June 30) (M.G.L. c.4, §7).*

*Under no circumstances should FY2006 funds be used for FY2007 expenditures or vice-versa, unless specifically allowed with appropriate legislative language.*

*Departments should confirm with vendors that all goods and services are to be received or completed by June 30th.*

*FY2006 accounts payable encumbrances are valid only for services rendered or goods delivered on or before June 30, 2006. Completion of services or delivery of goods after this date means that those services or goods are valid FY2007 obligations and should be handled instead through FY2006 prior year deficiency.*

*Completed requests to pay prior year deficiencies out of FY2006 funds must be submitted to the Comptroller's Office, Accounts Payable Bureau, no later than June 15, 2006.*

To evaluate agency compliance with the above requirements, we selected 325 encumbrance<sup>5</sup> transactions, totaling \$10,291,601.60, processed by 75 state agencies. To conduct our review, we performed two tests.

First, we examined 250 encumbrance transactions—totaling \$5,124,205.85, processed by 60 state agencies—from the 3,164 encumbrance transactions (totaling \$542,084,490.56) that were entered into the Commonwealth's accounting system from June 19, 2006 to June 30, 2006, the final two weeks of the fiscal year. Second, we selected (a) 25 late encumbrance transactions for 17 state agencies, totaling \$2,897,065.82, that the OSC entered into MMARS during July 2006 and (b) 50 encumbrance transactions, totaling \$2,270,329.93, processed by 29 state agencies that consisted of open encumbrances as of June 30, 2006. In connection with the 325 encumbrance transactions selected for testing, our review found that two state agencies processed three encumbrance transactions, totaling \$20,974.37, using fiscal year 2006 funds to pay for goods that had not been received by the June 30, 2006 deadline. Further, one state agency—without requesting and obtaining required OSC approval—processed a FY2006 encumbrance that included prior years obligations (FY2001 to FY2005) totaling \$27,825. Another state agency increased an encumbrance by \$2,357.72 to \$8,178.86 in late June that was allowed to lapse on August 31, 2006, the end of the Commonwealth's accounts payable period. This action is indicative of an agency that did not conduct a detailed and meaningful analysis to determine and support its year-end needs. A detailed and meaningful analysis likely would have resulted in an encumbrance adjustment and the fund balance being reverted to the Commonwealth (and available for other obligations) on June 30, 2006, two months earlier .

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<sup>5</sup> An encumbrance is a budgetary document that reserves a portion of authorized funds for a specific purpose. The full amount of purchase orders, contracts, and other commitments of appropriated funds are encumbered and recorded as a deduction from the appropriation prior to an actual expense to ensure that such commitments do not exceed appropriations. The Commonwealth's encumbrance system is a budgetary control feature that allows departments to plan how they will spend their funds and to control the expenditure of committed funds. When used properly, encumbrances can prevent overspending.

Additionally, one state agency, contrary to State Finance Law, processed an encumbrance totaling \$18,336 after they ordered and received their goods; while another state agency processed an encumbrance totaling \$8,991.78 that were not paid within the Commonwealth's 30-day bill-paying policy. Our review also identified another state agency that processed two encumbrance transactions totaling \$23,849.46 and \$8,980.19 for capital improvements made at two correctional facilities that did not include supplemental construction costs totaling \$641.72 and \$5,391.01, and did not ensure that adequate funding was available to support additional construction costs. In one instance, additional funds were allocated from the facility's regional office, while an open construction encumbrance was used to defray additional construction costs incurred for the other shortfall.

**a. Noncompliance with OSC Year-End Encumbrance Closing and Opening Instructions**

Our review found that the Cape Cod Community College (CCC) and the Executive Office of Public Safety (EPS) processed three encumbrance transactions that were not in compliance with the OSC's closing instructions. As a result, \$20,974.37 of fiscal year 2006 funds was used to pay fiscal year 2007 obligations. Only goods and services received by June 30, 2006 should have been paid for with fiscal year 2006 funds. Both the CCC and the EPS used FY 2006 funds to pay for delivered goods after June 30, 2006. The EPS received partial deliveries of rape and sexual assault kits and toxicology kits that ranged from five to seven days beyond the OSC June 30 deadline; while the CCC received its partial delivery of information technology accessories on July 25, 2006 or 25 days beyond the June 30, 2006 deadline. Additionally, the Attorney General's Office (AGO) processed an encumbrance transaction that was not in compliance with the OSC closing instructions when it used fiscal year 2006 funds to pay for prior fiscal years (FY2001 - FY2005) obligations totaling \$27,825 without submitting the required request to the OSC and receiving authorization to pay prior year deficiencies with FY2006 funds. Further, we determined that the Chelsea Soldiers' Home (CHE), by not performing a detailed and meaningful analysis of its year-end encumbrance needs as required by the OSC closing instructions, unnecessarily delayed the Commonwealth use of funds totaling \$8,178.86 until the August 31, 2006 encumbrance period lapsed. Had the CHE performed a detailed and meaningful analysis of encumbrances to determine its needs, these funds would have reverted to the Commonwealth and been available for other obligations two months earlier than the accounts payable closing date of August 31, 2006.

Annually, the OSC provides detailed closing instructions and procedures for departments to follow when finalizing year-end encumbrances and managing accounts payable activity. Although the OSC's FY2006 Closing and FY2007 Opening Instructions emphasized that: 1) goods and services to be paid for with current fiscal year appropriations must be received and accepted within the same fiscal year (July 1 - June 30); 2) a completed request must be submitted to the OSC to pay prior-year deficiencies out of FY2006 funds; and 3) agencies must perform a detailed and meaningful analysis of encumbrances to determine agency needs; our review found that goods were received by the CCC and the EPS the June 30, 2006 deadline; the AGO did not submit a request and receive authorization from the OSC to pay prior-year deficiencies out of FY2006 funds; and the CHE did not perform a detailed and meaningful analysis of encumbrances to determine its needs:

- The CCC created a commodity purchase order (PC) on June 12, 2006 totaling \$54,808.50 for software, software licensing and installation, and technical support services for its campus manager network security system. To determine whether goods and services were received and/or completed by the OSC June 30, 2006 deadline, we performed a vendor verification.<sup>6</sup> The results showed that the CCC received a partial delivery on June 28, 2006 totaling \$48,813.50 and a second delivery on July 25, 2006 (25 days after the June 30 deadline) totaling \$5,995. The college comptroller explained that due to renovations and the lack of available space, the college was unable to take delivery and asked that the vendor hold on to the remaining software items until the college was ready for occupancy and installation. Furthermore, due to the incomplete delivery, the college did not want to pre-pay the vendor invoice and decided to hold on to the invoice until full delivery was completed. The holding of a vendor invoice that is incorrect or cannot for good reason be accepted, e.g., goods not delivered, is not in compliance with the Commonwealth's bill paying policy issued by the OSC. Specifically, departments have fifteen (15) days from the receipt of an invoice to notify a vendor why an invoice has been rejected and to identify requirements to correct the deficiency. Moreover, the invoice should not be held and negotiated, but rather immediately returned to the vendor. Had the CCC returned the original invoice, requested a new invoice for actual FY2006 deliveries totaling \$48,813.50, and asked for another invoice for items delivered after the June 30 deadline totaling \$5,995 and paid for with FY2007 funds, the college would have avoided noncompliance with the OSC closing instructions.
- The EPS recorded two commodity purchase order encumbrances (PC's), one on June 13 and the other on June 14, 2006 (2½ weeks before the June 30 closing), totaling \$59,704 for rape and sexual assault kits and toxicology kits. Through our vendor verification, we determined that kits totaling \$14,979.37, or 25% of the total \$59,704 encumbered, represented vendor deliveries (drop shipments) made to various Commonwealth

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<sup>6</sup> We verified dates of delivery by contacting the vendor and obtaining shipping information and tracking numbers, which are used to trace shipments on the websites of various shipping companies, e.g., the United Parcel Service of America, Inc. and FedEx.

hospitals between July 5 and July 7, 2006, or 5 to 7 days beyond the OSC's June 30, 2006 deadline. The EPS explained that late deliveries were due to the lack of a facility to warehouse kits; consequently, kits needed to be delivered to various hospitals throughout the state by the vendor. Alternatively, the EPS, understanding that it did not have a warehouse facility to house kits, would have benefited from a more-timely review and encumbering of funds to ensure that its FY2006 accounts payable encumbrance was valid and for goods delivered on or before the OSC June 30 deadline. Further, although a notation on the vendor invoice provided by the EPS indicated "confirmed receipt of goods by 6/30/06," our review shows that the EPS needs to do a better job of verifying the receipt of goods, especially at fiscal year-end. It is likely that had the EPS conducted a more timely review and planning of encumbered funds to support its needs and confirmed with its vendor that goods are to be received by June 30<sup>th</sup>, the EPS would have avoided noncompliance with the OSC's closing instructions. As a result of our audit, the EPS stated that they "do not intend to have this occur again in FY 07."

- The AGO entered a contract encumbrance (CT) on June 27, 2006 totaling \$28,938 for information technology (IT) maintenance services and software licenses. Our examination of supporting documentation disclosed, however, that only \$1,113 was for FY2006 software usage expenses, while, \$27,825<sup>7</sup> represented software usage charges relating to the prior fiscal years FY2001 - FY2005. Additional documentation showed that the vendor—in May 2006— notified the AGO of its intent to carry out a license review of its products being used by the AGO. The license review showed that the vendor had under-billed software usage at the AGO over the last six (6) years. The revised information—confirmed by IT staff at the AGO— showed the number of users not billed as follows: fiscal year 2001 (650), fiscal years 2002 through 2004 (450), fiscal year 2005 (150) and fiscal year 2006 (50). The AGO Director of Finance explained that the office was not aware of the under-billed software usage condition until the vendor notification in May 2006 (FY2006). Further, the director commented that: "While the license period was prior to Fiscal Year 2006, the...audit in which this error was found occurred in FY 06. We had not been billed in any of the previous fiscal years for these charges and had, in fact, paid the original bills in the fiscal year in which they were received. For these reasons, we processed this document as a FY 2006 transaction." State Finance Law requires, however, that annual appropriations may be expended only for expenses for the same fiscal year. Furthermore, the OSC year-end closing instructions calls for departments to complete and submit a request to the OSC—no later than June 15, 2006—to pay for prior year deficiencies out of FY2006 funds. Accordingly, the AGO, to avoid noncompliance, should have completed and submitted a request to the OSC and received authorization to pay prior year deficiencies totaling \$27,825 out of FY2006 funds.
- The CHE modified a commodity purchase order (PC) on June 20, 2006 to \$8,178.86 from \$5,821.14 (a 41% increase) for heating fuel. Our review disclosed that although the CHE increased its encumbrance by \$2,357.72, the fuel purchase never took place and the encumbrance was allowed to lapse at the end of the Commonwealth's accounts payable

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<sup>7</sup> Software usage charges totaling \$27,825 not previously billed and relating to prior fiscal years are as follows: \$14,469 (FY2001), \$10,017 (FY's 2002 to 2004), and \$3,339 (FY2005).

period ending August 31, 2006. The OSC's closing instructions require that departments during the final quarter of the fiscal year perform a timely review of their needs to ensure that all fiscal year-end encumbrances are in place to support their needs. In addition, the OSC's instructions established June 15<sup>th</sup> as the date when all routine encumbering for all appropriation types should be submitted in MMARS, and requires that departments use the remainder of the fiscal year—ending on June 30—to handle final adjustments to its encumbrances. The CHE's actions indicate that management's decision to encumber \$8,178.86 in fiscal year 2006 funds was not based on a detailed and meaningful analysis of agency needs. Moreover, because funds encumbered at year-end are not available to the Commonwealth for other obligations, encumbrances that do not represent a valid commitment unnecessarily delay the Commonwealth's access to these funds until the August 31<sup>st</sup> encumbrance lapse date, or two months after the June 30<sup>th</sup> fiscal year closing. The CHE explained that subsequent to its encumbrance increase, its plant engineer—who initiated the heating fuel requisition—ended his employment with the CHE prior to the fiscal year 2006 closing. Since no replacement was made, the heating fuel purchase never took place. Nonetheless, had the CHE year-end control procedures included a reexamination of year-end encumbrances as set forth in the OSC closing instructions, management could have identified the need for a final encumbrance adjustment and timely reverted uncommitted funds to the Commonwealth; thereby avoiding noncompliance with the OSC's closing instructions.

Although unforeseeable circumstances may require some encumbrances to be processed during late June, departments should make every reasonable effort to avoid doing so. Further, the lack of a thorough understanding of and sufficient oversight and monitoring for compliance with the OSC's closing instructions can result in unnecessary delays and issues with the fiscal year closing, and increases the risk that detailed and meaningful analyses of encumbrances may not take place.

### ***Recommendation***

The state agencies cited above should take corrective action to ensure that they adhere to all encumbrance requirements of the OSC's Closing and Opening Instructions and State Finance Law. To that end, expenditures must be charged to the appropriate fiscal year, goods and services must be received by the established June 30 deadline, and a completed request and authorization must be received by the OSC before current year funds can be used to pay prior year deficiencies. Further, state agencies must provide adequate oversight and monitoring over encumbrance activities; perform timely, detailed, and meaningful reviews of their financial status to ensure that encumbrances are in place to support department needs; and confirm with vendors that all goods and services are to be received or completed by June 30<sup>th</sup>. In addition, the OSC should continue to communicate with agencies and conduct additional training to assist

them with understanding the necessity of compliance with its annual closing and opening instructions.

**b. Noncompliance with Commonwealth Bill-Paying Policy and State Finance Law**

Our review identified one agency that did not comply with the Commonwealth's bill-paying policy, the goal of which is to routinely pay bills within 30 days, while another agency did not comply with the State Finance Law that requires that funding be in place before goods, services, or other obligations can be requested or accepted.

The Commonwealth's Bill Paying Policy and General Payment Policies (OSC MMARS Policy: Accounts Payable, issued July 1, 2004 and last revised July 27, 2005) states, in part:

- *The goal of the Commonwealth's Bill Paying Policy is to routinely pay its bills in 30 days via Electronic Funds Transfer (EFT) when no discount is offered, or there are no contractual terms requiring earlier payment. Unless there is financial benefit to the Commonwealth, such as a vendor discount or a contractual payment due date, compliance with the bill payment policy should not be considered successful if payments are issued in less than 30 days. Interest is earned on Commonwealth funds; therefore, if payments are released early with no reciprocal benefit, the Commonwealth loses valuable investment income.*
- *There are four key elements to ensuring Bill Paying Policy compliance:*
  1. **Date Stamp Invoices.** *Date stamp invoices as soon as they arrive on Commonwealth property. Departments are responsible for ensuring that invoices are properly tracked and timely processed in order to avoid late payment penalties. To ensure a proper record for invoices the department must implement sufficient internal controls at all locations receiving invoices to ensure that:*
    - *All invoices are date-stamped as soon as the invoice arrives on Commonwealth property in whatever medium the invoice arrives.*
    - *If a department does central payment processing and receives invoices at regional locations, the invoice must be date-stamped as soon as it arrives at the regional location. Regional locations should also have their own date stamps because an invoice can arrive at regional locations and each location is considered Commonwealth property. Regional locations should be fully aware of this policy and have a plan to handle such documents. The date an invoice is received at a regional location is considered the "date received" and starts the payment clock running even if payments are processed centrally or at another location....*
  2. **Manage the invoices review/approval process.** *(receipt of invoice, review, approval of expense, financial approval, entry of payment into MMARS);*

3. **Return Invoices that are not acceptable.** *(within 15 days, 30 days for Medicaid providers). The department has fifteen (15) days (30 days for Medicaid providers) from the receipt of an invoice to notify the vendor with written reason(s) why an invoice has been rejected and identifying requirements to cure the deficiency. If the invoice is incorrect or cannot for good reason be accepted, it should not be held by the department and negotiated, it should be returned to the vendor immediately. The payment day count will begin again from the beginning when the department receives a corrected invoice.*

4. **Review payment data.** *via the Information Warehouse.*

Our examination found that the Department of Public Health (DPH) processed two vendor invoices for laboratory supplies totaling \$5,323.53 and \$3,668.25 that were paid 26 and 29 days, respectively, beyond the Commonwealth's 30-day bill-paying policy. The DPH attributed the late payments to a new employee in their accounts payable unit that resulted in a significant backlog in unprocessed invoices. Nevertheless, the department's late processing of vendor invoices also points out that necessary supervision and oversight administrative controls were lacking, and that invoice management procedures did not ensure that accounts payable payments (vendor invoices) were being properly tracked, timely processed, and if applicable, vendor-offered discounts would be taken in compliance with the Commonwealth's bill-paying policy. Had the DPH provided closer supervision over its accounts payment unit and properly assessed its payment processing steps, including the tracking of vendor invoices, the late payments and resulting noncompliance with the Commonwealth's bill paying policy likely would have been avoided. Moreover, although the Commonwealth did not incur a vendor-initiated late payment charge, these late payments could have cost the Commonwealth an additional \$41.91 in late-payment and interest expenses.

Additionally, our analysis showed that the George Fingold Library (LIB) was not in compliance with State Finance Law, which requires that funding be in place before goods, services, or other obligations can be requested or accepted from contractors, vendors, or employees, so that an agency cannot authorize performance to begin on a contract or request or accept services or goods in excess of approved available funding. Evidence of sufficient funding is an approved encumbrance in MMARS that fully supports anticipated expenditures. Our review determined that the LIB did not ensure that sufficient funding (commodity purchase order) was in place (approved in MMARS) before they initiated, authorized performance, and accepted computer equipment and accessories costing \$18,336.

Specifically, our review of supporting documentation indicated that on June 9, 2006, the LIB Assistant Director/Head of Systems received a vendor purchase quotation for computer equipment and accessories totaling \$18,336 that was forwarded to the LIB business manager for processing. However, our examination of MMARS records disclosed that the LIB did not enter the necessary commodity purchase order (PC encumbrance) until June 28, 2006, or two days following the Assistant Director/Head of Systems signing of the packing slip—on June 26, 2006—indicating receipt of ordered goods. Requesting, authorizing performance, and accepting goods without committing sufficient funding constitutes noncompliance with State Finance Law and the Commonwealth’s encumbrance budgetary process; as a result, funds may not be available for payments and the Commonwealth incur a liability. The LIB budget manager explained that the late processing of the PC encumbrance document was attributable to the significant number of documents being entered during this critical period. Further, once the deficiency was identified, the PC encumbrance was immediately processed. Effective management oversight and monitoring of encumbrance practices and procurement activities, along with monthly reviews during the last quarter of the fiscal year to ensure that all encumbrances are in place to support department needs, likely would have resulted in the LIB’s compliance with State Finance Law.

***Recommendation***

The DPH should take corrective action to ensure that they adhere to the Commonwealth’s bill-payment policy by paying bills within the required 30-day limit. To that end, the DPH should ensure that appropriate supervision and oversight is given to its accounts payable unit and that payment-processing steps assure that vendor invoices are properly tracked, timely processed and when applicable, vendor-offered discounts are taken.

Likewise, the LIB should take corrective action to ensure that they adhere to State Finance Law and the Commonwealth’s encumbrance budgetary control feature by ensuring that sufficient funding (encumbrance) is in place (approved in MMARS) before goods, services or other obligations are requested and performance authorized or accepted. Additionally, LIB management must provide adequate oversight and monitoring of its encumbrance management practices and procurement activities that include monthly reviews during the last quarter of the fiscal year to ensure that all encumbrances are in place to support its needs.

In addition, the OSC should continue to communicate with the above agencies and conduct additional training to assist them with understanding the necessity of compliance with the Commonwealth's bill-paying policy, State Finance Law, and the Commonwealth's encumbrance budgetary process.

**c. Inadequate Internal Control Over Construction Contracts**

Our review determined that the Department of Correction (DOC) processed two contract encumbrance transactions totaling \$23,849.46 and \$8,980.19 for construction contracts being performed at two of its correctional facilities. Our analysis disclosed that during both construction contracts, responsible DOC personnel authorized scope changes to construction projects without preparing the requisite change order request for approval by the project manager and identifying—through the Administration Division—if sufficient funding was available for supplemental construction costs totaling \$641.72 and \$5,391.01, respectively. In doing so, responsible DOC personnel did not adhere to management-prescribed change order procurement policies and procedures and State Finance Law, which requires that funding be in place before goods, services, or other obligations can be requested or accepted. Moreover, the DOC unnecessarily put the Commonwealth at risk of incurring a liability in excess of appropriated funds to fulfill these unmet obligations.

Each year departments are reminded by the OSC—through their annual fiscal year closing and opening instructions—of State Finance Law requirements that funding be in place before goods, services, or other obligations can be requested or accepted from contractors, vendors, or employees, so that a department cannot authorize performance to begin on a contract or request or accept services or goods in excess of approved available funding.

Further, the DOC Departmental Purchasing Procedures, 103 DOC 340, Section 340.13 (3) Change Orders, states:

*Any deviation from the original scope of work must be noted with a notice of intention and an extra work order must be attached to a change order request. The change order request must be signed by the project manager. With the exception of emergencies, funds need to be identified by the Administration Division before any work is authorized by a change order.*

Detailed below are two instances where correctional facilities did not comply with the above noted provisions.

On February 23, 2006 the Fiscal Services Division of the MCI-Shirley Correctional Facility processed a contract (CT) encumbrance totaling \$8,980.19 based on a proposal and work outline that included the removal of an old fuel inventory monitoring system, the installation of a new fuel inventory monitoring system, replacement of all data cable and testing, and repairs to an underground storage tank. Due to equipment delivery delays, work did not begin until April 6, 2006, at which time an installation review conducted by the contractor revealed that changes to the scope of services were needed due to unforeseen conditions. The facility's Director of Engineering, in consultation with the contractor, approved the new changes prior to the commencement of installation services. Furthermore, according to the Director, the contractor commented, "*any additional costs would be nominal/non-consequential.*" Even so, no change order request and approval was executed, and no determination of adequate funding was made to the Fiscal Services Division before the Director of Engineering approved these services. Supporting documentation also disclosed that the project was completed on April 15, 2006; however, the Fiscal Services Division did not receive an invoice from the contractor until June 23, 2006, nearly 70 days after the completion of construction and seven days before the close of fiscal year 2006. Moreover, the invoice valued at \$14,371.20 exceeded the original \$8,980.19 encumbrance by \$5,391.01, or 60%, and therefore necessitated the allocation of additional funds from its regional office, the DOC Administrative Services-Concord Office.

At the Bridgewater Correctional Complex, its Fiscal Services Division created a contract (CT) encumbrance on June 16, 2006 to encumber funds for the removal and replacement of fencing based on an estimate totaling \$23,849.46 dated June 15, 2006. During construction, the DOC project engineer—due to security concerns—authorized a construction modification with the contractor that called for the installation of a 7' x 7' foot gate instead of the original 5' x 7'. Although the project engineer indicated that he was aware of the DOC procurement procedures, the requisite change order request and project manager approval and identification of sufficient funding with the Fiscal Services Division was not executed before the authorization and acceptance of services. Consequently, the Fiscal Services Division became aware of these procedural deficiencies only after it received the contractor's invoice that disclosed construction costs totaling \$641.72 greater than the original encumbrance. To fulfill this increased obligation, the Fiscal Services Division turned to an open facility repair, installation, and maintenance encumbrance.

Deviation from prescribed operating procedures unnecessarily placed the Commonwealth at risk of incurring a liability due to unexpected increases in construction cost obligations. These deficiencies illustrate that the DOC needs to strengthen internal controls over its procurement practices and affirm the importance of strict adherence to management prescribed policies and procedures. Procurement weaknesses can be eliminated administratively through expending greater attention to assuring that all scope of work modifications include a change order request form approved by the project manager, and that adequate funding is identified by the Administrative Division before any work is authorized by a change order. As a result of our review, the DOC Administrative Services and the Division of Resource Management promptly incorporated measures to address our concerns.

***Recommendation***

Given the deficiencies noted, the DOC should continue to review procurement practices in the context of our observations and address any discernable shortcomings. At a minimum, the DOC should more closely monitor its correctional facility procurement activities and ensure that necessary control measures are in place that assure consistent adherence to prescribed procurement policies and procedures and enable management to effectively track and evaluate procurement practices and costs and ensure that adequate funding is identified before any work is authorized by a change order.

## SCHEDULE A

### Analysis of Selected Encumbrance Transactions for Fiscal Year 2006

Agency	Number of Encumbrances Reviewed	Value of Encumbrances Reviewed	Value of Goods and Services Received before July 1, 2005 (Fiscal Year 2005) Paid with Fiscal Year 2006 Funds	Value of Goods and Services Received after June 30, 2006 (Fiscal Year 2007) Paid with Fiscal Year 2006 Funds
Administrative Office of the Trial Court	22	\$1,069,378.48	-	-
Appeals Court	2	15,713.88	-	-
Attorney General's Office	3	34,883.00	\$27,825.00	-
Berkshire Community College	2	26,422.26	-	-
Bristol County District Attorney's Office	5	138,052.34	-	-
Bureau of State Office Buildings	1	213,952.78	-	-
Cape Cod Community College	5	127,174.50	-	\$5,995.00
Chelsea Soldiers' Home	2	18,178.86	-	-
Chief Medical Examiner	1	26,504.84	-	-
Commission Against Discrimination	1	11,760.00	-	-
Committee for Public Counsel Services	1	6,031.25	-	-
Criminal Justice Training Council	1	6,456.00	-	-
Department of Agricultural Resources	2	21,071.76	-	-
Department of Business and Technology	2	46,726.70	-	-
Department of Conservation and Recreation	24	430,538.22	-	-
Department of Correction	17	284,420.62	-	-
Department of Early Education	2	105,671.54	-	-
Department of Education	2	168,439.00	-	-
Department of Elder Affairs	1	20,000.00	-	-
Department of Environmental Protection	8	1,205,207.91	-	-
Department of Fire Services	4	400,804.56	-	-
Department of Fish and Game	8	174,394.05	-	-
Department of Industrial Accidents	1	15,567.86	-	-
Department of Mental Health	8	79,725.97	-	-
Department of Mental Retardation	16	513,558.52	-	-
Department of Public Health	27	380,360.65	-	-
Department of Revenue	9	332,267.07	-	-
Department of Social Services	1	19,817.77	-	-
Department of the State Police	19	594,100.09	-	-
Department of Transitional Assistance	1	97,475.73	-	-
Department of Veteran Services	2	24,129.59	-	-
Department of Workforce Development	1	49,985.83	-	-
Department of Youth Services	11	127,380.61	-	-
Division of Banks	1	5,461.68	-	-
Division of Health Care Finance	1	6,936.00	-	-
Division of Insurance	1	24,499.60	-	-
Division of Operational Services	1	17,393.49	-	-
Division of Professional Licensure	2	198,006.00	-	-
Division of Standards	2	25,437.00	-	-
Education and Quality Accountability	1	24,663.73	-	-

**SCHEDULE A (CONTINUED)****Analysis of Selected Encumbrance Transactions  
for Fiscal Year 2006**

Agency	Number of Encumbrances Reviewed	Value of Encumbrances Reviewed	Value of Goods and Services Received before July 1, 2005 (Fiscal Year 2005) Paid with Fiscal Year 2006 Funds	Value of Goods and Services Received after June 30, 2006 (Fiscal Year 2007) Paid with Fiscal Year 2006 Funds
Executive Office for Administration and Finance	2	\$ 171,903.06	-	-
Executive Office of Environmental Affairs	3	31,430.00	-	-
Executive Office of Health and Human Services	2	193,700.00	-	-
Executive Office of Public Safety	5	77,289.00	-	\$14,979.37
Executive Office of Transportation	1	281,298.78	-	-
Fitchburg State College	1	57,047.50	-	-
George Fingold Library	1	18,336.00	-	-
Hamden County Sheriff's Department	4	102,401.41	-	-
Hampshire County Sheriff's Department	1	11,403.70	-	-
Holyoke Soldiers' Home	5	54,143.40	-	-
Information Technology Division	4	65,165.48	-	-
Massachusetts Bay Community College	3	61,856.05	-	-
Massachusetts District Attorney Association	1	5,121.00	-	-
Massachusetts Highway Department	1	230,000.00	-	-
Massachusetts Lottery Commission	5	124,184.00	-	-
Massachusetts Rehabilitation Commission	1	47,686.02	-	-
Massasoit Community College	1	6,900.00	-	-
Middlesex County Sheriff's Department	24	520,423.07	-	-
Middlesex District Attorney's Office	1	5,035.00	-	-
Military Division – Massachusetts National Guard	1	11,577.41	-	-
Municipal Police Training Commission	2	10,650.57	-	-
Northwestern District Attorney's Office	1	6,916.00	-	-
Office of the Inspector General	2	38,305.88	-	-
Office of the State Comptroller	5	257,450.18	-	-
Office of the State Treasurer	2	12,447.49	-	-
Parole Board	1	25,334.26	-	-
Registry of Motor Vehicles	7	366,445.86	-	-
Salem State College	2	26,742.37	-	-
Secretary of the Commonwealth	2	51,514.50	-	-
Sex Offender Registry	1	6,874.73	-	-
Supreme Judicial Court	2	23,215.72	-	-
University of Massachusetts	2	193,605.81	-	-
Victim and Witness Assistance Board	3	27,089.52	-	-
Worcester County Sheriff's Department	4	42,550.09	-	-
Worcester District Attorney's Office	1	37,008.00	-	-
Total	<u>325</u>	<u>\$10,291,601.60</u>	<u>\$27,825.00</u>	<u>\$20,974.37</u>

## SCHEDULE B

### Analysis of Selected Advances for Fiscal Year 2006

Agency	Number of Advances Reviewed	Amount of Advances Received FY 2006	Outstanding FY 2006 Advances for 6/30/2006	Amount of Advances for Fiscal Year 2006 Not in Compliance
Administrative Office of the Trial Court	1	\$ 2,677,400.93	\$105,169.37	-
Berkshire County District Attorney's Office	3	40,000.00	1,704.45	-
Bridgewater State College	1	15,000.00	15,000.00	-
Bristol County District Attorney's Office	3	687,000.00	121,840.28	-
Bunker Hill Community College	1	5,000.00	5,000.00	-
Cape and Islands District Attorney's Office	2	981.28	981.28	-
Department of Conservation and Recreation	2	600.00	600.00	-
Department of Correction	1	8,316,641.41	397,873.09	-
Department of Education	1	15,000.00	15,000.00	-
Department of Mental Retardation	2	40,000.00	24,177.82	-
Department of Public Health	1	6,302.00	6,302.00	-
Department of Revenue	2	495,006,000.00	13,389,666.08	-
Department of State Police	1	3,000.00	446.75	-
Department of Workforce Development	3	12,227,474.57	998,331.71	-
Division of Capital Asset Management and Maintenance	1	20,000.00	20,000.00	-
Division of Operational Services	1	2,000.00	2,000.00	-
Executive Office for Administration and Finance	1	15,000.00	15,000.00	-
Greenfield Community College	1	5,000.00	5,000.00	-
Group Insurance Commission	1	16,374,000.00	7,989,143.16	-
Information Technology Division	1	3,000.00	3,000.00	-
Massachusetts College of Art	1	10,000.00	10,000.00	-
Massachusetts Highway Department	2	7,750.00	2,125.00	-
Massachusetts Lottery Commission	2	245,923,459.55	13,228,164.94	-
Massachusetts Rehabilitation Commission	2	15,000.00	15,000.00	-
Norfolk County District Attorney's Office	1	380,000.00	143,366.23	-
North Shore Community College	1	5,000.00	5,000.00	-
Northwestern District Attorney's Office	1	940.00	179.79	-
Office of the State Comptroller	1	220,000.00	220,000.00	-
Salem State College	1	5,000.00	5,000.00	-
Springfield Technical Community College	1	10,000.00	10,000.00	-
Suffolk County District Attorney's Office	3	70,000.00	22,732.58	-
Total	<u>46</u>	<u>\$782,106,549.74</u>	<u>\$36,777,804.53</u>	<u>=</u>