



# The Commonwealth of Massachusetts

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**INDEPENDENT STATE AUDITOR'S REPORT ON  
FINANCIAL AND MANAGEMENT CONTROLS  
OVER OPERATIONS OF THE UNIVERSITY OF  
MASSACHUSETTS TREASURER'S OFFICE**

**OFFICIAL AUDIT  
REPORT  
AUGUST 31, 2005**

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The University of Massachusetts (UMass) is organized pursuant to Chapter 15A of the Massachusetts General Laws, with the purpose of providing, fostering, and supporting public higher education of the highest quality throughout the Commonwealth. Chapter 75, Section 1, of the General Laws established UMass, consisting of campuses to be maintained in Amherst, Boston, Dartmouth, Lowell, and Worcester. UMass has a Board of Trustees (BOT), consisting of 22 appointed members, including five students.

The Board of Trustees establishes University administrative policies, and the University officers and Chancellors are responsible for implementing the policies set by the Board. One such policy affirms that the UMass Treasurer, under the general oversight of the President, be the general contracting officer of UMass; have custody of and fiduciary responsibility for UMass's endowment funds; ensure the investment of UMass cash in accordance with the BOT-approved Investment Policy; be the official signatory for UMass checks; be a contract and grant signatory; and manage UMass banking relationships, including control of opening, closing, and reconciling bank accounts.

The UMass Office of the Treasurer (OT) is solely responsible for all traditional treasury functions of UMass. One of its primary functions is the investment and reconciliation of funds held by UMass. Under the general direction of the UMass Treasurer, the Associate Treasurer is responsible for keeping abreast of the investment market on a day-to-day basis in order to evaluate the investment options available to UMass. The Associate Treasurer is also responsible for the day-to-day operational activity of the UMass OT.

The purpose of our audit was to review the UMass OT's internal controls and compliance with applicable laws and regulations regarding administrative and operational activities, including cash management and investments, endowments, the Unpaid Check Fund, and contracts, for the period July 1, 2002 to September 30, 2003.

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Our audit found that the UMass OT generally had adequate policies and procedures in place for controlling UMass transactions, which exceed \$1.4 billion annually. We determined that the UMass OT reconciled the activity in UMass's credit card bank accounts and its investment account to the transactions posted in its accounting records on a regular basis; however, our review of UMass's other bank reconciliations for which the UMass OT is responsible found that it was not in compliance with UMass requirements and proper internal controls. Specifically, fiscal year 2003 reconciliations of other monthly bank statement activities to entries in the UMass accounting records were performed late, OT officials did not prepare overall (summary) reconciliations that balanced bank and investment account balances to the recorded cash balance in the accounting records on a monthly basis, and the UMass OT did not adequately monitor or provide sufficient oversight of banking activity involving UMass's imprest bank

accounts. Without a timely, adequate, and effective reconciliation process, there is no assurance that UMass's bank balances agree with its recorded cash balance. Furthermore, delayed reconciliation of cash accounts and inadequate monitoring of account activity leave UMass's cash vulnerable to possible misuse or misappropriation. In response to our audit, the UMass OT has begun to take steps to address improvements needed in internal controls over bank reconciliation processes and imprest fund maintenance.

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Our audit found that the operation of UMass's Unpaid Check Fund, established and maintained by the UMass OT, needed improvements. The UMass OT established the Unpaid Check Fund during the late 1970s and operated it without any written policies and procedures (although draft procedures dated July 1, 2002 were eventually finalized and approved on May 1, 2004). The UMass OT was not in compliance with Chapter 200A (Abandoned Property Law), Sections 7 and 7A, and Chapter 29, Section 32 (Unclaimed Check Fund), of the General Laws. Specifically, we found that \$3.9 million in funds, comprising over 32,000 unpaid checks, issued and not claimed, moreover, these funds were due to the Commonwealth, UMass, and others. Our review of the unpaid check records maintained by the UMass OT disclosed that about 17,000 unpaid payroll and vendor checks, valued at \$1.8 million, were on hand as of September 30, 2003. In addition, over 15,000 unpaid vendor checks totaling \$2.1 million had been transferred to the OST during November 2002 as abandoned property. In response to our audit, the UMass OT has taken action to update its Unpaid Check Fund by issuing revised procedures in July 2004 and instituting ongoing enhancements to existing procedures in this area. In addition, the UMass OT has "again sought guidance from the Office of the State Treasurer regarding Abandoned Property rules and regulations."

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Our review found that improvements are needed in controls over bid and payment processes concerning UMass banking services. We found that the UMass OT (1) did not enter into a written contract for its 1996 Banking Services Request for Bid (RFB); (2) did not bid its 1999 agreement for banking services after the expiration of the prior RFB; and (3) paid for banking services from its investment earnings, which may be in conflict with one of two BOT policies. As a result, UMass has limited assurance that it is getting the best value for its banking services averaging \$151,000 annually and estimated for 7 years at \$1.1 million or that campuses are receiving the full benefit of investment earnings. Provisions of UMass BOT policy require competitive bidding, formalized by contracts, for services projected to cost more than \$25,000 annually, and they restrict the use of investment income for either development purposes of the President's office or for refunds to the campus that generated it. In response to the audit, the UMass OT executed a contract with Bank of America in April 2004. In addition, clarification will be sought to resolve conflicts between existing policies in regard to the investment earnings and banking fees for contracted banking services.

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Our audit disclosed that in June 2000, the UMass OT transferred custody and fiduciary responsibility of all UMass endowments, having a market value of \$34.3 million, to the UMass Foundation (Foundation). This transfer was done without the benefit of any written agreement between the two agencies specifying how the funds were to be administered and at what cost. The lack of a written contract leaves the issue of endowment management subject to interpretation and dispute. Moreover, the UMass OT needs a written agreement and adequate internal controls in order to fulfill its fiduciary responsibility. Board of Trustees (BOT) policy T97-014 assigns custody and fiduciary responsibility of UMass endowment funds to the UMass OT. In response to our audit, the University and the University Foundation executed a formal written agreement that defines the responsibilities of both parties in the handling of UMass endowments.

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We found that improvements are needed in UMass investment practices. BOT policy document 92-031, Appendix F, sets forth policies to be followed by the UMass Treasurer in the day-to-day administration of all UMass investment activities. These policies contain concise statements of direction and required action. We found that the UMass OT did not always comply with the BOT policies, in that it selected or retained external equity investment managers whose performance and investment strategies did not adhere to BOT investment guidelines. We also noted that the UMass OT did not develop written procedures to clarify BOT policy for the management of UMass funds. Moreover, we identified instances of fixed income investments in corporations in excess of the maximum allowed by BOT policy. According to BOT policies, preservation of capital and liquidity of investments through prudent management and compliance with all BOT policies, guidelines, and procedures are the most important factors when considering the investment of UMass funds. According to the June 30, 2003 UMass OT investment reports, equity investments and fixed income investments had a total book value of \$58.2 million, and \$340.3 million, respectively. In response to our audit, the University Board of Trustees has approved a revised Investment Policy and has agreed with the need to update its policies and procedures on a regular basis to reflect the current intentions of UMass, and the UMass investment committee now monitors the performance of all managers on a quarterly basis.

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## INTRODUCTION

### *Background*

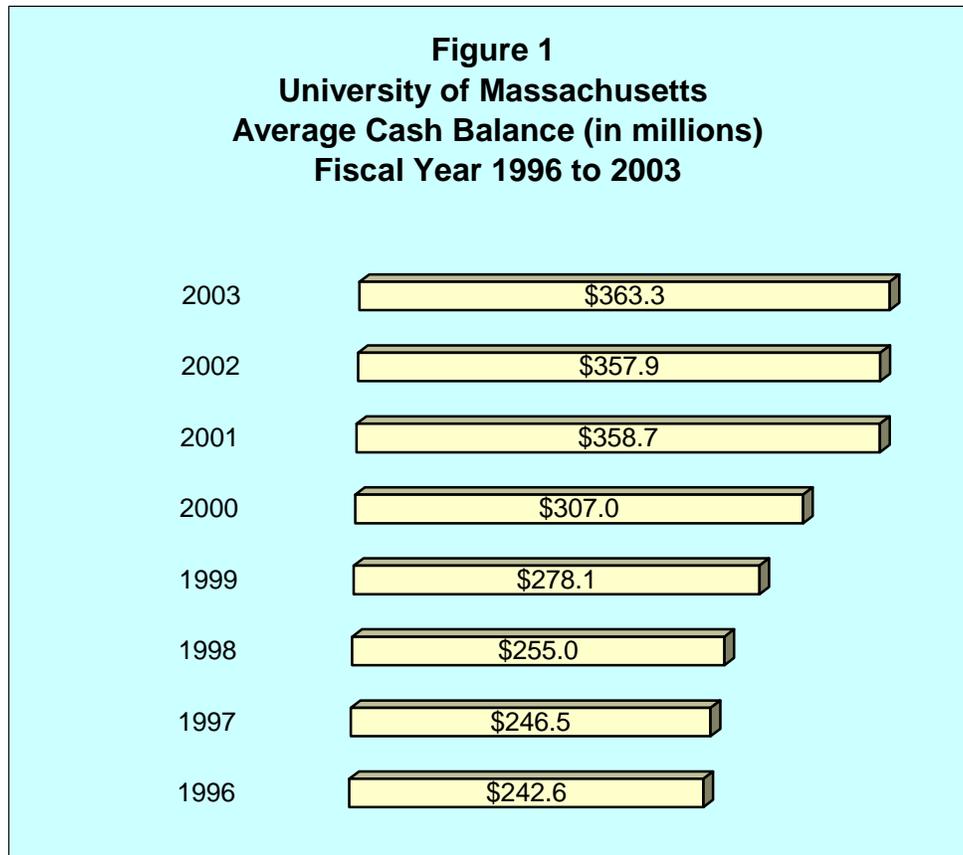
The University of Massachusetts (UMass) is organized pursuant to Chapter 15A of the Massachusetts General Laws, with the purpose of providing, fostering, and supporting public higher education of the highest quality throughout the Commonwealth. Chapter 75, Section 1, of the General Laws established UMass, consisting of campuses to be maintained in Amherst, Boston, Dartmouth, Lowell, and Worcester. UMass operates under the oversight of the Board of Higher Education, which is responsible for monitoring each campus to ensure that state funds support measurable performance, productivity, and results.

UMass has a Board of Trustees (BOT), consisting of 22 appointed members, including five students. The Board of Trustees establish UMass administrative policies, and the UMass officers and campus chancellors implement the policies of the Board. One such policy affirms that the UMass Treasurer, under the general oversight of the President, be the general contracting officer of UMass; have custody of and fiduciary responsibility for UMass's endowment funds; ensure that UMass cash is invested in accordance with the BOT-approved Investment Policy; be the official signatory for UMass checks; be a contract and grant signatory; and manage UMass banking relationships, including control of opening, closing, and reconciling bank accounts.

The UMass Office of the Treasurer (OT) is responsible for all traditional treasury functions of UMass and its five campuses. During fiscal year 2003, the Treasurer's Office processed in excess of \$1.4 billion in transactions. One of its primary functions is the investment and reconciliation of funds held by UMass. The average amount of operating funds available to UMass for investment exceeded \$363.3 million in fiscal year 2003<sup>1</sup>; over the last eight years, the average yearly amount has increased 50%, from approximately \$242.6 million in fiscal year 1996 to \$363.3 in 2003 (see Figure 1).

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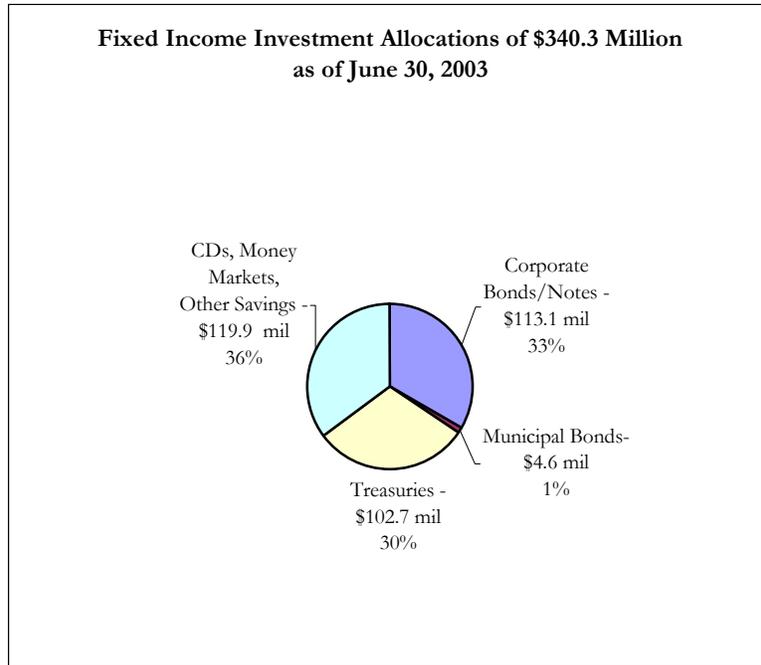
<sup>1</sup> Average based on the first six months of fiscal year 2003



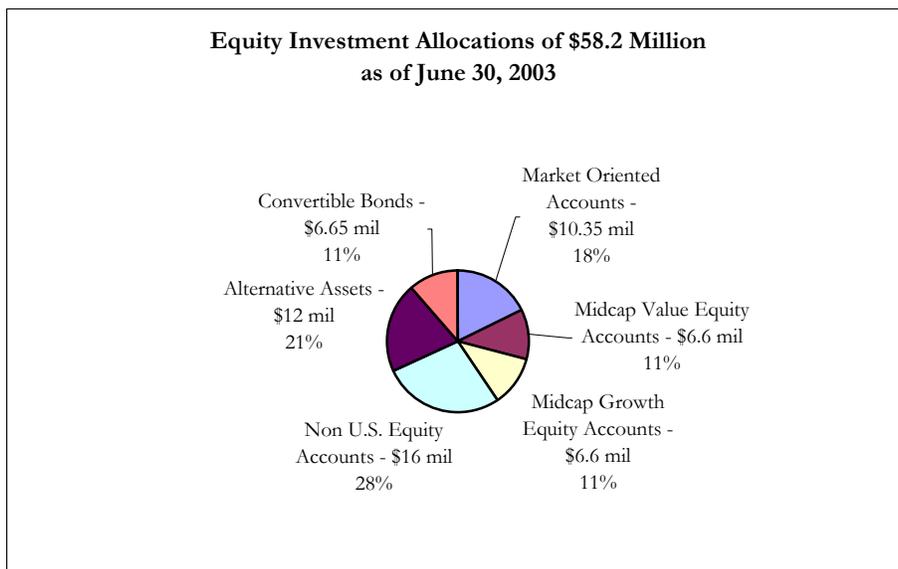
UMass funds are invested to help insure the long-term viability of UMass. Accordingly, the UMass OT invests UMass funds in a variety of instruments, with the objective of preserving capital and liquidity while attaining the highest levels of income. Preservation of capital and liquidity requires a certain amount of diversification of investments, and UMass funds are placed in a variety of fixed income and equity investment products. As of June 30, 2003, UMass's investment portfolio, valued at \$398.5 million, consisted of approximately \$340.3 million (85%) of fixed-income products and \$58.2 million (15%) of equity investments.

Under the general direction of the UMass Treasurer, the Associate Treasurer is responsible for keeping abreast of the investment market on a day-to-day basis in order to evaluate the investment options available to UMass. The Associate Treasurer makes all investment choices related to fixed-income transactions and uses external investment managers to administer the equity portion of UMass's investment portfolio. UMass's fixed-income portfolio consists primarily of corporate bonds, treasury notes, municipal bonds, and banking products such as money market accounts,

certificates of deposit, and savings accounts. This portion of the portfolio was valued at approximately \$340.3 million and invested in the following fixed income components:



External investment managers, selected with the assistance of an investment consultant, have administered UMass’s equity portfolio since January 1995 as a result of BOT modifications to UMass’s investment strategy. The equity portfolio holdings are diversified to limit market exposure and risk; they consist of \$58.2 million (book value), allocated as follows:



To prudently manage investments, the UMass OT has maintained a relationship with its investment consultant to assist in the evaluation of the equity manager's performance. The investment consultant assists the University, including the Trustee Committee and the UMass OT, with selection of equity investment managers and provides quarterly performance analysis of externally managed investments. The investment consultant also works with the UMass OT and campus procurement offices when soliciting proposals for equity investment management services.

As part of UMass's fund management process, UMass OT personnel are responsible for the reconciliation of all investment and other bank accounts, including UMass's Unpaid Check Fund. The UMass OT has recordkeeping responsibility for stale-dated checks, which after six months are transferred to the UMass Unpaid Check Fund. These are uncashed payroll and vendor checks.

Endowment-fund administration was transferred to the UMass Foundation, Inc. in June 2000. As of June 30, 2003 endowment funds had a market value of approximately \$27.7 million.

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

In accordance with Chapter 11, Section 12, of the General Laws, the Office of the State Auditor conducted an audit of the financial and management controls over certain operations of the UMass OT. The scope of our audit included the UMass OT's controls over administrative and operational activities, including cash management, investments, endowments, the Unpaid Check Fund, and contract management, for the period July 1, 2002 to September 30, 2003.

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

Our audit objectives were to (1) assess the adequacy of UMass's internal controls over cash management, investments, endowments, the Unpaid Check Fund, and contract management, and (2) determine the extent of the controls for measuring, reporting, and monitoring effectiveness and efficiency regarding UMass's compliance with applicable state laws, rules, and regulations; other state guidelines; and UMass policies and procedures.

Our review centered on the activities and operations of the UMass OT. We reviewed contracts relating to banking services, UMass investment consultants, and endowments. We also reviewed

cash management activities and transactions involving imprest fund transactions, the Unpaid Check Fund, and endowments at the various UMass campuses and related organizations to determine whether policies and procedures are being adhered to.

To achieve our objectives, we reviewed applicable state laws, rules, and regulations; evaluated internal policies and procedures; interviewed selected agency personnel; tested and reviewed accounting records and transactions; analyzed various administrative, personnel, budgetary, and related activity reports and other documents; examined source documents; reviewed vendor contracts; and performed audit tests of bank reconciliations, imprest fund transactions, investments, the Unpaid Check Fund activity, and contract awards. The specific purpose of our review was to determine whether adequate and proper controls existed over the UMass OT operations to ensure that investments are procured and funds are managed in a proper and reasonable manner and consistent with applicable state laws, rules, and regulations.

Except as noted in the Audit Results section of this report, we have determined that the UMass OT (1) maintained adequate internal controls over investment procurement, fund management, endowments, its Unpaid Check Fund, and contract management, and (2) complied with applicable laws, rules, and regulations, for the areas tested.

Our recommendations are intended to assist UMass in developing, implementing, and improving internal controls and overall financial and administrative operations to ensure that the UMass Treasurer's systems covering investments and cash management, endowments, the Unpaid Check Fund, and contracts operate in an economical, efficient, and effective manner, and in compliance with applicable laws, rules, and regulations.

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## AUDIT RESULTS

### 1. IMPROVEMENTS NEEDED IN INTERNAL CONTROLS OVER BANK RECONCILIATION PROCESSES AND IMPREST FUND MAINTENANCE

Our audit found that the UMass OT generally had adequate policies and procedures in place for controlling UMass transactions, which exceed \$1.4 billion annually. We also found, however, that improvements are needed in certain areas. We determined that the UMass OT reconciled the activity in UMass's credit card bank accounts and its investment accounts to the transactions posted in its accounting records on a regular basis; however, our review of other bank reconciliations for which the UMass OT is responsible found that it was not in compliance with UMass requirements and proper internal controls. Specifically, for fiscal year 2003, reconciliations of other monthly bank statement activities to entries in UMass accounting records were being performed late, OT officials did not prepare overall (summary) reconciliations that balanced bank and investment account balances to the recorded cash balance in the accounting records on a monthly basis, and the UMass OT did not adequately monitor or provide sufficient oversight of banking activity involving UMass's imprest bank accounts. Without a timely, adequate, and effective monthly reconciliation process, there is limited assurance that UMass's bank balances agree with its recorded cash balance. Furthermore, delayed reconciliations of cash accounts and inadequate monitoring of cash account activity leave UMass's cash vulnerable to misuse or misappropriation.

According to a draft summary reconciliation prepared by the UMass OT (the draft is a work in progress) as of June 30, 2003, UMass and bank records were not in balance, differing by some \$7 million; moreover, unresolved reconciling items totaling approximately \$2.1 million were carried over for an extended period of time during the audit period. In addition to the summary reconciliation, OT officials also verified activity in UMass investment accounts to the accounting records on a monthly basis (which UMass refers to as a Schedule A reconciliation) for certain components of the cash balances. UMass OT considers the Schedule A reconciliation as a significant component of the overall reconciliation, since it makes up the largest portion of cash balances. According to the provisions of the Office of State Comptroller (OSC) Internal Control Guide for Managers, Volume I, and UMass's own requirements, control activities such as performing, monitoring, and reviewing monthly reconciliations provide reasonable assurance that irregular activities are prevented and ensure that there is adequate transaction accountability.

The UMass OT is responsible for all banking relationships, including opening and closing all bank accounts and reconciling bank accounts on a monthly basis. Although UMass campuses are responsible for the daily collection of receipts, their deposit into designated bank accounts, and the recording of information into UMass's accounting system, the UMass OT is responsible for reconciling the monthly banking activity of all UMass campuses. The various campuses and UMass OT have established bank accounts to handle day-to-day operational activities and investing. Campuses typically have separate bank accounts for credit card transactions, cash receipts processing, and imprest accounts; the UMass OT has bank accounts for investments, clearing, and disbursements. The imprest accounts are checking accounts authorized and set up for a campus by the UMass OT, to make a specific category of expenditures that cannot be made efficiently by the central accounting system. An imprest fund is an account maintained at a predetermined, fixed level and is replenished by regular reimbursements from campus funds for the exact amount of checks written from the account. Activity from UMass bank accounts is eventually processed through the UMass OT's clearing account, either by transfer or sweeping those accounts; that activity consists of transfers to investments or to disbursement bank accounts to cover payrolls and accounts payable. During fiscal year 2003, 86 bank accounts that required monthly reconciliation were maintained for all campuses and the UMass OT. On December 31, 2002, these accounts had bank statement balances that totaled \$58.5 million.

The UMass Board of Trustees (BOT) has promulgated policies delegating specific responsibilities to the UMass Treasurer. In turn, the UMass OT has issued a mission statement, which states, in part:

*The Treasurer's Office has sole responsibility for all traditional treasury finance functions of the University of Massachusetts, including securities investment, cash management, debt management and bank reconciliations.*

BOT document T94-031B provides for the establishment of imprest accounts and assigns responsibility for them to the UMass Treasurer. The policy states, in part:

***Imprest Checking Account***, hereafter referred to as an imprest checking account; checking accounts established by or under the control of the University Treasurer at various campuses for purposes as defined by University Treasurer's Policy/Procedures as amended from time to time. [Note: As of September 1994, the effective Treasurer's Policy/Procedures were 89-3, adopted effective date 7/15/88.]...

Imprest Checking Administration and Control

I. Administration

A. *In order to provide imprest checking accounts as may be needed to meet operating needs, the Treasurer of the University is authorized and empowered by the Board of Trustees to establish all bank accounts, to make deposits in and withdrawals from said accounts and to sign or endorse in the name of the University of Massachusetts or the Board of Trustees such official documents and vouchers, including checks, drafts, letters of credit and the like as require the signature of the financial officer of the University and is authorized to designate personnel to sign or endorse checks for special program checking accounts both here and abroad.*

B. *Primary signatory authority will be the Treasurer and the Associate Treasurer.*

II. Control

*The University Treasurer is responsible for imprest checking accounts. The University Treasurer will develop and implement appropriate policies and procedures to insure the integrity, responsibility and accountability of the accounts. [Note: As of September 1994, such procedures were contained in University Treasurer's Policy/Procedure 89-3, effective date 7/15/88.]*

The UMass OT further defines its role in performing monthly reconciliations through the responsibilities listed in its job descriptions for the Associate Treasurer, Director of Cash Management Operations, and Bookkeeper II. The following are excerpts from those job descriptions:

*(Associate Treasurer) Responsible for the reconciliation of all University bank accounts.*

*(Director of Cash Management Operations) Oversees the smooth operation and activities of the Cash Management area which includes personnel having the following functional responsibilities:*

*bank reconciliations*

*credit card account reconciliations*

*banking activity statement*

*prepares as necessary all reports and reconciliations for the external auditors*

*monitors imprest accounts and maintenance of signature authorization file*

*(Bookkeeper II) Maintains the records for the system wide reconciliation of University bank accounts. This includes the AD010 reconciliation, journal entries and suspense.*

*Prepares the monthly reconciliation of more than 10 bank accounts by analyzing all receipt and disbursement activities university wide. Approximately \$500,000,000 flows through these accounts annually.*

*Prepares adjusting entries to the accounting system on each account as necessary each month. This activity requires a thorough understanding of the banking and accounting system.*

*Reconcile payroll and cash disbursements activity to bank activity on a monthly basis. This reconciliation is the basis for verification of bank transfer activity.*

*Reconciliation of all imprest accounts and "Returned Checks" accounts. Currently there are 10 imprest and 1 returned check accounts*

*Ability to work independently and efficiently in order to keep all reconciliations up to date.*

In addition, the UMass OT is required to prepare an overall monthly reconciliation to reconcile the balances of cash recorded in the accounting records to the bank and investment account balances. The overall monthly reconciliation considers the reconciled balances in all UMass bank and investment accounts—except for imprest checking accounts—including all receipt bank accounts, credit card bank accounts, disbursement bank accounts, money market bank accounts, and clearing bank accounts.

Our review of monthly reconciliations disclosed that the UMass OT had not completed any overall monthly reconciliations for fiscal year 2003 and was not current on several of its monthly individual bank reconciliations. While we were conducting audit fieldwork, on October 1, 2003, the UMass OT provided a draft overall monthly reconciliation for June 2003. The draft is a work in progress, prepared by the UMass OT staff. To clarify the purpose of the draft reconciliation, UMass OT provided the following comments:

*The draft reconciliation that you reviewed was intended for the (name of external auditors) as a status report as to where we stood with the reconciliation of the converted balances as of the request date. It was by no means intended to indicate that the University Treasurer's Office has either given up or reduced the importance of this overall reconciliation....*

Prior to this draft overall monthly reconciliation, other than the investment portion of the reconciliation that verifies the investment activity on the statements to that recorded in the accounting records (Schedule A reconciliation), the last completed overall monthly reconciliation for all bank accounts was for June 2002.

Further analysis of the overall monthly reconciliation during fiscal year 2002 disclosed that they were also not being completed timely. Our tests for fiscal year 2002 identified delays of up to

five months in performing and approving the overall monthly reconciliation of cash and investments to recorded balances, as detailed in the following table:

**Overall Monthly Reconciliations  
Fiscal Year 2002**

Month	Completion Date	Approval Date	Delay (in Months)
July	December 6, 2001	December 10, 2001	4
August	December 10, 2001	December 10, 2001	3
September	February 15, 2002	May 21, 2002	4
October	March 1, 2002	May 21, 2002	4
November	May 20, 2002	May 21, 2002	5
December	May 21, 2002	Not Available	4
January	May 21, 2002	May 21, 2002	3
February	July 22, 2002	July 28, 2002	4
March	July 24, 2002	Not Available	3
April	August 12, 2002	August 14, 2002	3
May	August 30, 2002	Not Available	3
June	September 10, 2002	September 10, 2002	2

Our audit tests of the December 2002 individual monthly bank reconciliations (as of March 2003) found that the UMass OT was also not current on its fiscal year 2003 monthly reconciliations of individual UMass disbursements and certain receipt bank statements. Delays in reconciling individual bank statements preclude the effective completion of UMass's overall monthly reconciliation. For example, as of March 2003, timely reconciliations still had not been completed for UMass's disbursements bank account and the Amherst Campus Center receipts bank account for fiscal year 2003. The disbursements account, last reconciled for June 2002, is the central processing account for most of UMass's accounts payable for all campuses; according to the December 2002 bank statement, over \$50 million of checks were paid from that account in December. The Amherst Campus Center receipts bank account is used to deposit revenues collected primarily from its restaurant, hotel, and conference functions and student group activities; according to the December 2002 bank statement, receipts of \$497,303 were deposited into the account in December. This account was last reconciled in August 2002.

As a result of UMass performing its Schedule A reconciliation, which is a component of the overall reconciliation, and not performing a complete monthly reconciliation of its accounts on a regular monthly basis, there is inadequate assurance that its cash and investments are in balance with amounts recorded in its accounting records; therefore, UMass's cash is vulnerable to misuse or misappropriation.

According to the draft reconciliation for June 30, 2003 prepared by the UMass OT, there was \$7 million more in the bank than recorded in UMass accounts. The most recently completed overall reconciliation, as of June 30, 2002, contained numerous adjusting and outstanding reconciling items—some that were 3-10 years old—that have not been resolved. The absolute value<sup>2</sup> of those items is approximately \$1.7 million. They include \$513,753 of “ADO 10 errors,” which occur when cash on hand locally is erroneously offset by entries affecting appropriations in the custody of the State Treasurer. An “ADO 10 error” occurs when either a cash receipt or a disbursement is posted to a non-cash account—an appropriation account. The “ADO 10 errors” further increased by \$962,427 as of August 30, 2003, and had not been corrected as of November 2003. We also found that disbursement, payroll, and imprest reconciliations contain numerous adjustments, totaling \$407,639, over a year old—and some as many as 15 years old (see Appendix I). These adjustments included old outstanding checks of \$134,942 that should have been transferred to UMass's Unpaid Check Fund, and subsequently to the Office of the State Treasurer. Carrying adjusting and reconciling items for over 10 years is not an efficient or effective method of managing bank accounts. These adjusting entries and reconciling items have not been timely mainly due to staffing shortages. Also, write-offs cannot be made without adequate research on the origin and history of why these items have remained outstanding.

Our review of UMass's imprest bank statement reconciliations found that accounts were reconciled to the checkbook balances, but there was no system in place to ensure that (1) the account balances are maintained at the correct pre-established levels, (2) funds are used for intended imprest purposes, and (3) specific imprest fund policies are being followed and are current. We found that imprest accounts were sometimes replenished above the limits allowed, and payment documents from the accounts did not always contain the required authorizing signatures to either expend from the account or pay for items above fund limits. Our audit tests

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<sup>2</sup> The numerical value, without regard to whether the number is positive or negative—i.e., the \$1.7 million is an accumulation of additions and subtractions.

of five of six imprest bank accounts generally found that policies were either too vague or out of date. For example, the Amherst Bursar's imprest account policy, which was either established or last updated on August 1, 1978, did not reflect the type of activity being processed through the account. According to Policy/Procedure No. 78-102, the purpose of the Amherst Bursar's imprest fund is the payment of amounts due to students when funds are needed for excess loan awards, check exchange for foreign students, Massachusetts Rehabilitation Commission reimbursements, scholarships, and special student refunds and cash advances. Also, the Amherst Bursar's Use of Funds policy requires pre-numbered checks for amounts in excess of \$100 only, and procedures stipulate that checks are not to be issued for less than \$100. We found, however, that the account was used to make advances to employees, and numerous checks were written to students for less than \$100. Also, the Amherst Bursar's imprest fund policy did not contain a balance limitation, which is a defining imprest-fund criterion. Furthermore, although the Dartmouth Campus-Emergency Imprest Checking Account policy (No. 02-07) allowed payments only for emergency travel, fees and emergency vendor payments, the fund administrator did not follow the established guidelines and used the account to settle four litigation settlement claims to employees totaling \$39,213. We noted other discrepancies in our tests of imprest accounts, including the following: the Boston Campus Imprest Checking Account processed an imprest payment for \$31,749 without the proper authorization signature, and a retirement payout of \$15,250 was made from the Dartmouth Campus Emergency Payroll Advance Checking Account that was not in compliance with fund guidelines.

The OSC's Internal Control Guide for Managers, Volume I, discusses the importance of having adequate internal controls and management's role in developing, implementing, and monitoring internal controls to ensure adequate supervision. Control activities prevent and detect errors and irregularities in a timely manner. By not effectively monitoring and providing oversight of the imprest fund reconciliation and payment process, the UMass OT has allowed payments to be made that are not in compliance with BOT imprest guidelines. This noncompliance is the result of not updating specific imprest fund policies and procedures on a regular basis and monitoring the activity in these accounts as part of the monthly reconciliation process.

The UMass OT officials confirmed that the overall reconciliation of all UMass bank accounts to the general ledger had not been completed on a timely basis. OT officials stated that many factors influence this activity, including the resignation or placement on maternity leave of

individuals key to the reconciliation process; in addition, UMass had just completed an effort of more than two years to migrate four accounting systems into one accounting and banking system; furthermore, processes for reconciliation and accounting for activity were different at each campus and conversion into a common way to reconcile accounts encountered difficulties. Also, the OT officials stated that it was difficult to get the campuses to focus on reconciliation issues while they were still learning to use the new system. Although the UMass OT's goal was to have everything fully reconciled for the annual audit, unfortunately it was not able to pull the pieces together to its satisfaction.

UMass OT officials stated that reconciliations fell behind because of staffing shortages caused by employees' retiring or being on extended leave. Also, a contributing factor was that the staff members who were cross-trained to serve as backup to the employees who left were unable to fulfill the additional job requirements.

UMass OT officials stated that they are in the process of amending outdated imprest fund policies to better reflect the current uses and spending allowances of the accounts and to establish greater accountability for the accounts at the campus level.

***Recommendation***

The UMass OT should complete monthly reconciliations of UMass bank accounts and comply with policies and procedures governing imprest fund operations. The UMass OT should continue its efforts to complete the overall reconciliation in a timely manner. In doing so, all unresolved adjustments should be written off only after a thorough review and approval by the UMass BOT, to ensure that established policies are adhered to. All checks outstanding for more than six months should be transferred to UMass's Unpaid Check Fund. Consideration should be given to devote adequate resources to this important task, including cross-training staff, and supervisory oversight to ensure the timely completion of reconciliations. Also, the UMass OT should continue to review and, when necessary, amend imprest fund guidelines. It should also provide for better monitoring, analysis, and oversight review of imprest account activity to ensure compliance with established policies and procedures.

**Auditee's Response**

*The University agrees with the recommendation that bank reconciliations need to be completed on a timely basis. As of June 30, 2005 the UMass OT has completed summary reconciliations through April 2005. In addition, all imprest accounts have been reconciled through May 2005. All credit card accounts and receipt accounts have been reconciled through April 2005. Additionally several reconciliations including Schedule A have been completed through May 2005. The accounts payable and payroll deductions reconciliations have been completed through May 2005.*

*The University will continue with cross-training efforts in the belief that supervision over these processes is appropriate. The University agrees to review its write-off policies and Senior University Administration will give final approval of any future write-offs. The University completed appropriate write-offs in January 2005 and will continue to review additional items in the future. The University Treasurer's Office has updated and reissued the Treasurer's Imprest Account Fiscal Procedures.*

*In addition to the work done by the UMass OT, the University Controller independently reconciles cash and investments. This independent analysis is performed on a quarterly basis. This activity is validated annually by the University's external auditor.*

**2. IMPROVEMENTS NEEDED IN THE OPERATION OF THE UNPAID CHECK FUND**

Our audit found that the operation of UMass's Unpaid Check Fund, established and maintained by the UMass OT, needed improvements. The UMass OT established the Unpaid Check Fund during the late 1970s and operated it without any written policies and procedures (draft procedures dated July 1, 2002 were eventually finalized and approved on May 1, 2004). The UMass OT did not comply with the Massachusetts General Laws, Chapter 200A (Abandoned Property Law), Sections 7 and 7A, and Chapter 29 (Unclaimed Check Fund), Section 32. Specifically, we found that \$3.9 million in funds, comprising over 32,000 unpaid checks, were not turned over to the Office of the State Treasurer (OST) on a timely basis. As a result, the rightful owners of these funds may have been deprived of the opportunity to claim their money more timely. Moreover, it should be noted that these checks were written to the Commonwealth, UMass, and others. Our review of the unpaid check records maintained by the UMass OT disclosed that about 17,000 unpaid payroll and vendor checks, valued at \$1.8 million, were listed as outstanding in UMass's database as of September 30, 2003. In addition, over 15,000 unpaid checks, totaling \$2.1 million, had been transferred to the OST during November 2002 as abandoned or unclaimed property. The causes for the conditions we found can be attributed to the UMass OT not developing and maintaining adequate policies and implementing procedures and practices to control unpaid checks. Adequate internal controls would have provided increased assurance that the \$3.9 million in unpaid checks was timely addressed by the

UMass OT and processed through the OST, to help expedite the return of these funds to the rightful owners.

Our audit tests of the fund's purged check database found conditions that affected the proper operation of and control over the fund. The UMass OT maintains three databases for UMass's stale-dated outstanding checks, (1) for vendor checks, including payments for vendor invoices, employee travel, or other reimbursement; (2) for employee payroll checks; and (3) for Lowell campus payroll and vendor checks. (Lowell switched its database on July 1, 2003 to UMass upon the PeopleSoft conversion). Stale-dated checks are outstanding checks that have not been cashed by the bank within six months of their issue date. If still outstanding on the seventh month, checks are purged from UMass's outstanding check listing and added to its Unpaid Check Fund. If a stale-dated check had been issued for payment of a vendor invoice or employee travel or other reimbursement, the information on the purged check would be entered into the purged unpaid vendor check database. If the purged check was an employee payroll check, its information would be entered into the purged unpaid payroll check database. However, payments that originated from the University's Lowell campus that have been purged would be recorded in the purged Lowell accounts unpaid check database.

In setting up the UMass Unpaid Check Fund, UMass officials cited Chapter 200A, Section 7A, of the General Laws as the foundation for the establishment and updating of the fund. Section 7A states:

*If the person in possession of property in an amount of one hundred dollars or more presumed abandoned under this chapter has the last known address of the apparent owner which the person's records do not disclose to be inaccurate, the holder shall at least sixty days before filing the annual report send a notice by first class mail to inform the owner of the process necessary to rebut the presumption of abandonment.*

Chapter 200A of the General Laws also requires the holder of such property (i.e., abandoned and unclaimed for over three years) to turn it over to the OST on prescribed forms and in a manner established by the OST. Section 7 of Chapter 200A states, in part:

- (a) Every person holding property declared by this chapter to be presumed abandoned shall report to the treasurer as provided in this section.*
- (b) The report shall be on a form prescribed by the treasurer and shall include:*

- (1) *Except with respect to traveler's checks, registered checks and money orders, the name, if known, and last known address, if any, of each person appearing from the records of the holder to be the owner of any property of the value of one hundred dollars or more presumed abandoned under this chapter....*
  - (3) *The nature and identifying number, if any, or description of any intangible property and the amount appearing from the records to be due, except that items of value under one hundred dollars each shall be reported in aggregate....*
  - (5) *Other information which the treasurer prescribes by rule as necessary for the administration of this section.*
- (c) *If the holder is a successor to other persons who previously held the property for the owner, or if the holder has changed his name while holding the property, he shall file with his report all prior known names and addresses of each holder of the property.*
  - (d) *The report shall be filed no later than November first of each year as of June thirtieth or the end of the fiscal year next preceding but the report of life insurance companies, and persons holding unclaimed proceeds from the demutualization or related reorganization of a life insurance company shall be filed before May first of each year as of December thirty-first next preceding.*
  - (e) *The report shall be made under penalty of perjury, and if made by an individual, by the individual; if made by a partnership, by a partner; if made by an unincorporated association or private corporation, by an officer; and, if made by a public corporation, by its chief fiscal officer.*

However, Chapter 29, Section 32, of the General Laws requires that checks issued by an agency that are outstanding over one year be transferred to the OST's Unpaid Check Fund, as follows:

*Any check issued by the State Treasurer or by any agent or agency of the Commonwealth other than checks issued in payment of obligations of the State Board of Retirement and the Teachers' Retirement Board, which is not presented for payment within one year from its date shall be payable only at the Office of the State Treasurer. On the thirtieth day of June in each year the Comptroller shall transfer to the abandoned property funds all funds which are identified by the State Treasurer as funds of the Commonwealth which have remained in the unclaimed check fund for a least one year....*

UMass considers outstanding checks to be classified as abandoned property and has been transferring them to the OST's Abandoned Property Fund.

Our review of UMass's purged-check records found that the UMass OT transferred approximately \$2.1 million to the OST as abandoned property in November 2002. That transfer represented 15,861 purged vendor unpaid checks from all campuses; they were originally issued between January 1984 and May 1998, and many should have been transmitted to the OST as long as 15 years ago. Included in the transfer were unpaid vendor checks payable to the

Commonwealth, including payments to the OST, Department of Revenue, and Office of the Attorney General; on some checks, UMass was listed as co-payee. The purged-check database also included check records with the vendor name left blank, but other references in the database indicated that some of those checks represented excess student account balances—i.e., the balance remaining in student accounts after payment of tuition, fees, and other costs to UMass. Some of those balances may consist of student financial aid awarded to students (UMass directly credits student accounts with financial aid awards). The following table summarizes the various categories of unpaid vendor checks transferred to the OST as abandoned property:

Category	Number of Records	Value
Commonwealth Is Payee	26	\$ 79,693
UMass Is Co-payee	2,025	91,625
Vendor Name Field Is Blank	12,374	824,513
Other	<u>1,436</u>	<u>1,124,289</u>
Total	<u>15,861</u>	<u>\$2,120,120</u>

The “other” category includes unpaid vendor checks made to former UMass employees, as well as businesses and agencies with which UMass continues to do business. The following table shows some of those businesses and agencies, according to UMass’s records, that did not cash checks issued to them within six months of the issue date, and the unpaid checks were among those transferred to the OST (the oldest was issued in May 1990; the most recent, October 1997):

Vendor Name	Amount
Massachusetts Electric Company	\$47,297
United States Post Office	\$54,000
Boston AIDS Consortium	\$10,000
Internal Revenue Service	\$ 7,418
Board of Regents Trust	\$ 9,220
American Express	\$ 5,278

Our audit tests disclosed that UMass may not have adequately notified property owners prior to its transfer of unpaid vendor checks to the OST in accordance with Chapter 200A, Section 7A,

of the General Laws. Under the guidelines established for the Unpaid Check Fund, the UMass OT is required to notify payees whose check is \$100 or more that they must claim their funds or they will be transferred to the OST. According to data provided by the UMass OT, 3,550 payees who were due \$100 or more should have been notified through the procedures established for these transactions. However, the database identified only 575 records of notification; thus, there is no substantiation that 2,975 payees (84%) had been given proper notice. In addition, the UMass OT was not able to obtain from the various campuses those source documents that supported the original vendor payments (vendor invoices, employee travel reimbursement and student billing records) because in many cases the records were so old. Each UMass campus retains the source documents for vendor payments affecting that campus, and the campuses have archived many of those old source documents.

UMass's November 2002 transmittal of checks to the OST did not include approximately 17,000 unpaid checks totaling \$1.8 million; among them, checks totaling more than \$650,000 were more than three years old and were still being kept at UMass in the Unpaid Check Fund, contrary to the required processing procedures. Those omitted checks were recorded in the purged vendor and payroll check databases. Also, we found that the Unpaid Check Fund database contained duplicate entries. As a result, the database total was overstated by \$206,829. Although duplicative entries were known to the UMass OT, which has maintained a supporting paper file, they were not dealt with in a timely manner prior to being transferred to the Unpaid Check Fund. These duplicative entries have been in the database since it was created (in 1999) and have not been corrected to bring it into agreement with the general ledger. OT officials stated that the duplicate items would be removed from the database.

The OSC Internal Control Guide for Managers, Volume I, emphasizes the importance of adequate internal controls over transactions and stresses that management directives and administrative and accounting policies and procedures exist to ensure that transactions are properly recorded, documented, and classified and are in compliance with applicable laws and regulations.

According to UMass officials, in the late 1980s UMass sought guidance from the OST regarding the UMass OT's role and its authority to manage the Unpaid Check Fund, but did not receive a response. Correspondence provided by the UMass Treasurer also documented attempts by

UMass, in 1995, to obtain guidance from legal counsel and the OST regarding how to handle these funds; in response, it received conflicting guidance, according to UMass officials. In a letter from its General Counsel to the OST General Counsel on March 13, 1995, UMass stated its understanding that checks drawn on trust funds should not be treated “as abandoned property under Chapter 200A of the Massachusetts General Laws.” However, UMass did not dispute that “checks drawn on accounts funded by legislative appropriation may be treated as presumptively abandoned property if they are not claimed within an appropriate time.” UMass’s officials stated that over the years UMass attorneys had initiated several attempts to clarify UMass’s role and proper procedures regarding unclaimed checks and abandoned property.

UMass officials also pointed to (1) inadequate levels of cooperation and lack of prioritization on the part of staff at various campuses in administering the process, (2) staff shortages, and (3) consolidation of duties as contributing to the conditions we have cited. According to UMass officials, starting in 1999 the UMass OT took a more active role in administering the Unpaid Check Fund. A person was hired to clean up historical files, automate the manual recordkeeping process, and formalize procedures to return funds to their rightful owners. To validate the historical records and automate the process, the UMass OT sought assistance from staff at the various campuses. Staff at some of the campuses cooperated in providing information on unpaid checks, whereas others did not. UMass officials further informed us that OT staff sends notices to the owners of record but does not maintain copies of those notices (unless they are returned undelivered by the postal service), nor does it always indicate in the database that a letter was sent. Also, letters are sent only after the respective campus validates that the checks in question are unpaid. If a campus does not respond to the UMass OT’s request for information, the UMass OT makes no follow-up attempts.

Because UMass did not have in place adequate controls over its Unpaid Check Fund and did not follow the provisions of the Abandoned Property statute and UMass Unpaid Check Fund requirements, the return of property to its rightful owners has been delayed.

### ***Recommendation***

To ensure that the Unpaid Check Fund is properly administered, the UMass OT should review and revise its policies, procedures and practices governing UMass’s Unpaid Check Fund. Each

responsible party—members of the UMass OT staff or the UMass staff at individual campuses—should thereafter have a clear understanding of the process that needs to be employed to help ensure that these funds are returned to their rightful owners. The revised policies and procedures should also ensure that funds are transferred to the OST in a timely manner. Furthermore, the UMass OT has improved the administration of recent activity in its Unpaid Check Fund and should continue to address the old items in its database and either return the money to the rightful owners or transmit the balance to the proper fund at the OST. Moreover, UMass should contact the OST to ascertain whether unpaid funds should be transferred to the OST's Unpaid Check Fund or Abandoned Property Fund.

### ***Auditee's Response***

*The University appreciates the OSA efforts to recognize the improvements made in administering the Unpaid Checks Fund. The University also appreciates the OSA recognition of our ability to manage the Unpaid Checks Fund. The University Treasurer's Office issued revised procedures in July 2004 and agrees to continue its ongoing review and enhancement of existing procedures in this regard. The University has again sought guidance from the State Treasurer's Office regarding the Abandoned Property rules and guidelines. The University has enhanced the communication between the University Treasurer's Office and the campuses in an effort to make these processes more timely. The University will continue its process to transfer purged checks to the University's Unpaid Checks database after the purge date at the bank.*

*The University Treasurer's Office has remitted abandoned property funds to the State Treasurer on two separate occasions (November 2003 and November 2004) since the OSA finished field work. The total funds remitted to the Abandoned Property Fund of the Commonwealth including the November 2002 remittance amounted to \$3,459,868 and 28,541 items. Since 1999, approximately 13,073 letters have been sent by the University Treasurer's Office to payees of record and approximately 6,894 checks have been returned to the original payee. At no time during the audit period nor subsequent to finalization of field work has the UMass OT discovered that any vendor or employee has been denied access to their funds.*

*As of June 1, 2005, the balance in the University's Unpaid Checks Fund consisted of 3,355 vendor checks in the amount of \$696,540 and 1,451 payroll checks in the amount of \$250,927. These balances represent approximately 0.13% (.001386) of the total payroll and accounts payable checks issued annually. Of the 4,806 checks remaining in the Fund on June 1, 2005, as many as 3,303 were originally issued for less than \$100.*

### **3. IMPROVEMENTS NEEDED IN BANKING SERVICES ARRANGEMENT**

Our review found that improvements are needed in controls over bid and payment processes concerning UMass banking services. We found that UMass OT (1) did not enter into a written contract for its 1996 Banking Services Request for Bid (RFB); (2) did not bid its 1999 agreement for banking services after the expiration of the prior RFB; and (3) paid for banking services from

its investment earnings, which may be in conflict with one of two BOT policies. As a result, UMass has limited assurance that it is getting the best value for its banking services (average cost of \$151,000 annually and estimated for 7 years at \$1.1 million through September 30, 2003), or that campuses are receiving the full benefit of investment earnings. Provisions of UMass BOT policy require competitive bidding, formalized by contracts, for services projected to cost more than \$25,000 annually, and they restrict the use of investment income for either development purposes of the President's office or for refunds to the campus that generated it.

Based on our review of UMass-provided data (January 1996 RFB for banking services, March 1996 response to the RFB by the bank that has subsequently provided the services, and the May 1996 bid award letter), UMass OT did not formalize by contract its banking services arrangement, which under the terms of the RFB automatically disqualified the banking institution from providing the banking services requested by UMass in its RFB. Specifically, the RFB stated, in part:

*Exhibit A is a standard contract for services which must also be completed. Failure to complete the standard contract for services will result in the rejection of the response.*

UMass continued its banking arrangement without the benefit of receiving bids for the service in 1999, after the expiration the initial agreement for banking services, contrary to BOT policy. BOT document T92-031, Appendix A, sets forth UMass's purchasing policy for obtaining goods and services and states the importance of the public bid/advertisement process to promote open competition, as follows:

*Operational Services: Those services that are required for the routine operation of the University or maintenance and repair of University property or facilities but that cannot be provided by University employees and are instead provided by independent contractors. Operational services are to be distinguished from Consultant Services of a professional advisory nature.*

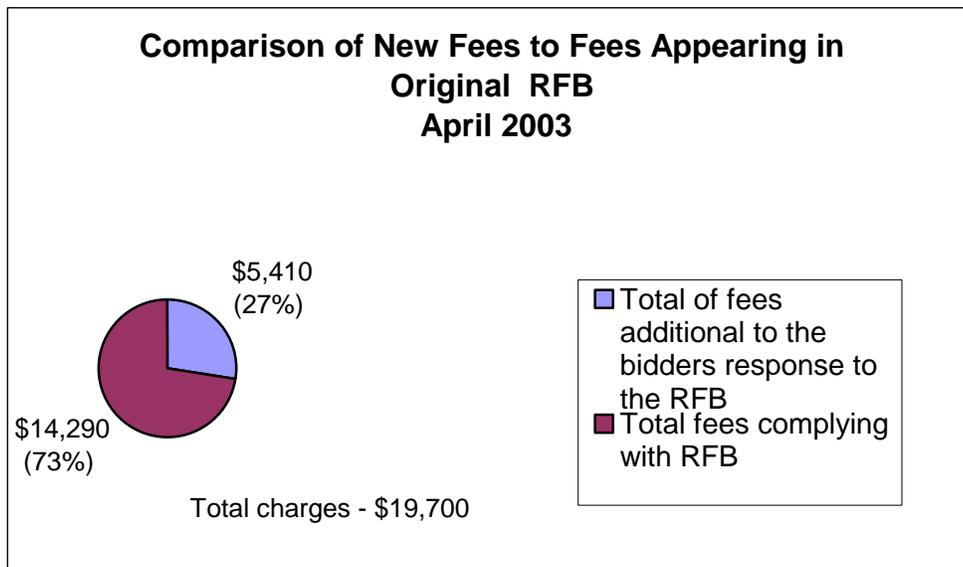
*Advertisement for and receipt of competitive bids shall be used whenever practicable, or when required by law. Invitations to bid shall be posted on a publicly displayed bulletin board at the respective University campus, and when deemed desirable, or as required by law, may be advertised in newspapers and trade journals in the state.*

*Bid forms and specifications shall be drawn on a basis to encourage open competition; provided, however, that the specifications shall be written so as to assure the quality and features of the using departments of the University.*

*Contracts for Operational Services (not to be confused with Consultant Services—See Appendix D) shall be subject to competitive bidding whenever practicable, when the*

*projected fee is more than twenty-five thousand (\$25,000) or shall require sole source justification.*

Based on our review of the April 2003 banking services invoice, we determined that of the \$19,700 monthly banking service fees, approximately 27%, (or \$5,410), were for services not included in the RFB. The projected annual total of these new service fees would be roughly \$65,000; therefore, according to BOT policy T92-031, Appendix A, competitive bidding is required for the provision of the services corresponding to those fees. The following chart represents the breakdown of banking service fees between those initially bid and those added subsequent to the RFB:



Based on our audit tests of the fees defined in the original RFB (totaling \$14,290), we identified the following examples of fees paid for inactive or infrequently used accounts, or fees that could have been avoided. Those fees totaled \$971, or approximately 7% of the monthly banking services expense, as follows:

Description	April 2003 Banking Service Fees	Number of Bank Accounts
UMass Lowell Campus bank accounts that stopped being used by the campus in July 2002, after the accounting system conversion took place. The UMass OT closed these accounts during May and June 2003.	\$ 613	4

Various campus bank accounts that are not active. In one case, the account has not been active since June 28, 2002—the date it was opened. Another account has not been active in over 13 years. The UMass OT has subsequently closed or is in the process of closing these accounts.	<u>\$ 358</u>	<u>11</u>
Total	<u>\$971</u>	<u>15</u>

Although the procurement policy required that the UMass OT bid for banking services, the UMass OT believed that it was exempt, since University policy allowed the university to continue with its existing provider when bidding the services is impractical. UMass OT officials further stated that UMass was in the middle of a major financial and human resource system conversion that made it impractical and bad business practice to bid the services at that time. However, we were not provided documentation to support UMass' contention that to follow procurement rules would have been impractical and unnecessary at the time. Furthermore, our review indicated that the major system conversion phase began July 1, 2002, three years after the period of the contract for banking services expired.

The UMass Treasurer stated that the UMass OT is closely looking at this issue—that it is in the process of hiring a consultant to begin the RFB process for banking services and is planning to have a banking services agreement in place beginning fiscal year 2004.

In addition, our audit disclosed that the UMass OT paid for banking services from the university's investment earnings, possibly in noncompliance with one of two UMass BOT policies, and that it has been doing so since the banking service arrangement began in 1996.

The BOT requires that funds be encumbered in advance to ensure that sufficient funds exist to meet UMass obligations. The BOT also places restrictions on how some UMass funds can be distributed and ultimately used. BOT document T92-031, Section 12, Trust Fund Interest, establishes the following policy for the Trust Fund Income (TFI) account:

*The Board of Trustees for the University of Massachusetts collects funds which are deposited and invested by the University Treasurer. Annually on June 30 one percent (1%) of the book value of the quasi-endowment will be set aside from the Trust Fund interest earnings for use by the President of the University for development efforts. All remaining investment income generated from all University funds will be returned to the campus from which it was generated.*

However, UMass OT officials considered these expenses to be a cost of investment, and therefore deductible according to BOT document T92-031, Appendix F, Section X, which states:

*All earned income shall be deposited to the Trust Fund Interest Revenue account in the University's accounting system. Fees and service charges will be accounted for separately. Net Earnings will be distributed to the campuses annually.*

As a result, UMass campuses may have been entitled to approximately \$151,000 in investment income annually (an estimated \$1.1 million worth of investment income since 1996) that could have been used for development purposes or returned to the campuses that earned it. The expenses of bank accounts used for daily operating activity are separate and distinct from accounts used for investment purposes.

### ***Recommendation***

The UMass OT should continue its efforts to have a new banking services contract in place to ensure that UMass is receiving the best value, and it should review its contracts to ensure that they are current. Banking services that have been allowed to roll over without renewal should be put up for competitive bid. The UMass OT should also review its bank accounts and determine whether they are cost effective to operate; if they are not, it should consider alternatives, including closing unnecessary bank accounts. In addition, the UMass OT should review its two policies and clarify whether banking services expenses should be deducted from the TFI account.

### ***Auditee's Response***

*In 1996, the University formally bid banking services. This process resulted in 25 financial institutions being asked to propose their best business solutions. Of the 25 requests for service, 8 responded officially. An official response would generally include a signed RFP cover page and a signed bid offer sheet signed by a senior bank official. The University's terms and conditions to enter this financial relationship are contained in these documents. After formal presentations by the top three bidders, FleetBank was selected to provide banking services through this formal process.*

*The University has subsequently bid Banking Services through a formal Request for Proposals process dated 2/3/2004. Approximately thirty financial institutions received copies of the RFP. A University wide committee reviewed all responses and selected Bank of America (successor to FleetBank) as provider. A contract was executed with Bank of America on 4/20/2004.*

*The University respectfully disagrees with the OSA observations regarding bank charges. Per Appendix F (Investment Policy) of the above cited T92-031, Section X reads, "All earned income shall be deposited to the Trust Fund Interest Revenue account in the*

University's accounting system. Fees and service charges will be accounted for separately. Net earnings will be distributed to the campuses annually." *However, we agree with the OSA that if a conflict exists in the text of Board of Trustee Policy, we will clarify it.*

*The University Treasurer's Office periodically reviews its bank account structure not only for potential cost savings measures but also to determine whether the structure can be enhanced to streamline the reconciliation process. The structure in place does require the use of additional bank accounts, but this structure lends itself to a more streamlined reconciliation process and limits the number of staff required to perform the reconciliation.*

### **Auditor Reply**

Regarding paying for banking services from investment earnings, two UMass BOT policies may be in conflict. UMass should review these policies and make the appropriate clarification and changes regarding how it intends to distribute investment earnings to the campuses (i.e., net income or gross earnings).

## **4. IMPROVEMENTS NEEDED IN INTERNAL CONTROLS OVER ENDOWMENT FUNDS**

Our audit disclosed that in June 2000, the UMass OT transferred custody and fiduciary responsibility of all UMass endowments, having a market value of \$34.3 million, to the UMass Foundation (Foundation). This transfer was done without a written agreement between the two agencies specifying how the funds were to be administered and at what cost. The lack of a written contract leaves the issue of endowment management subject to interpretation and dispute and may lead to potential misuse or loss of funds. Moreover, the UMass OT needs a written agreement and adequate internal controls in order to fulfill its fiduciary responsibility. BOT T97-014 assigns custody and fiduciary responsibility of UMass endowment funds to the UMass OT.

Our review noted that no documentation exists of a formal BOT vote specifically authorizing the multimillion dollar transfer of approximately 193 endowment accounts in June 2000, nor is there a written agreement detailing each party's expectations for the proper administration of those UMass endowment funds. UMass did not save records relating to the endowments transfer, including all financial records, individual endowment agreements, and other related documentation. The UMass OT turned these records over to the Foundation at the time of the funds transfer. We reviewed documentation provided by the Foundation and other UMass departments, and we concluded that the transfer was the result of a 1998 Foundation-

commissioned study by a consulting group hired to assess UMass's and the Foundation's role in endowment management. The study found that fragmented responsibilities made endowment management more complex; its recommendations included (1) reassigning organizational responsibilities (e.g., reconciliations, spending-rate calculations, unitization, etc.) from the UMass OT to the Foundation, (2) writing and clearly communicating the policy for endowment management, and (3) transferring, for management purposes, all endowment accounts to the Foundation. At that time, the Associate Treasurer sought legal advice from UMass's General Counsel, whose opinion was that UMass could appoint the Foundation as UMass's agent for investment purposes. According to the General Counsel, UMass was "authorized to enter into an agency agreement with the foundation for the investment and reinvestment of UMass funds represented by gifts, the nature and extent of the agreement would be a proper subject of negotiation, and at a minimum, UMass need have ultimate control of funds and a right to terminate the agency."

Prior to initiating and securing an agreement with the Foundation, the UMass OT initiated and transferred endowment funds in June 2000 without the benefit of the agreement earlier recommended by the General Counsel. Subsequent to the decision to transfer, the UMass Treasurer on June 12, 2001 notified the Foundation of concerns he had with the transfer and UMass's relationship with the Foundation. In the letter, the following concerns were raised:

*The purpose of this letter is to officially inform you that the UMass Foundation must develop and install a separate accounting system distinct from the University, as soon as possible. Effective no later than March 1, 2002 the University will no longer support the Foundation's accounting and financial management needs.*

*As you know, there has been an expectation for many years that the Foundation would develop an operational separateness from the University to preserve your independent legal status and to more clearly differentiate the Foundation's business from that of the University. Please inform me as soon as possible when you will be switching over to your own financial accounting system.*

*This decision is driven by the inability and inappropriateness of the new University administrative system to support the UMass Foundation. Please feel free to request whatever assistance you need to make this transition. This eight-month notice is to assure that you have sufficient time to plan for the future. I realize this may be difficult but this change was inevitable.*

*Obviously this decision in no way changes the agreements between the University and the Foundation related to your custodianship of University funds and the responsibility to distribute proceeds from Foundation investments to the appropriate University offices and departments.*

The absence of a written agreement to manage UMass endowments was of concern to UMass's independent auditor. On January 3, 2002, in correspondence to the Associate Treasurer, the independent auditor wrote, in part:

*This relationship has been in existence for some time, and our understanding is that upon demand, the University has the ability to withdraw its investments for the UMass Foundation, Inc. at their fair market value. In addition, our understanding is that a formal custodial type agreement between the University and UMass Foundation, Inc has not been prepared.*

*To enable [name of independent auditor] to complete an audit of the University's financial statements for the year ended June 30, 2002, the University and UMass Foundation, Inc., will need to execute a custodial type agreement that defines the terms and conditions applicable to the University's investments held by the UMass Foundation, Inc. (i.e. ultimate control of the funds, rights to termination, etc....).*

According to Foundation annual audit reports, the Foundation assesses a 1% management fee for the administrative services it provides regarding UMass investments. The fee is based on the average portfolio balance over the previous 12 months. This means that the Foundation annually receives approximately \$277,000 for administrative services of UMass endowments, which as of June 30, 2003 had a market value of \$27.7 million. That fee is in addition to those charged by the external investment firms hired to administer the UMass endowments held by the Foundation; such fees typically range between 0.7% and 2.25% of the investment's market value.

BOT document T97-014, Treasurer's Delegations, affirms that the UMass Treasurer, under the general oversight of the President, is the general contracting officer and specifically has "custody and fiduciary responsibility of the University endowment funds...."

An official from the UMass OT stated that this BOT policy appears to be outdated, and that the UMass OT would propose an amendment to policy at an upcoming BOT meeting. He also stated that the multimillion-dollar transfer was "consistent with Trustee votes authorizing that all new endowment funds be established with the Foundation." The OT provided us with copies of BOT votes. One of those votes had occurred after the BOT approval, in 1997, of the policy delegating to the UMass OT custody and fiduciary responsibility for UMass endowments; the other two votes had occurred 11-12 years earlier. The later vote was specific to delegating authority to campus Chancellors to (1) establish new endowments in amounts less than \$500,000 and (2) request that the Foundation manage the investment of those endowments. The earlier

votes (1) delegated to the Foundation the investment management of UMass endowments and (2) authorized the transfer, to the Foundation, of gifts of whatever kind donated to UMass. The sequence of votes appears to indicate that the BOT's intentions were not to relieve the UMass OT of its custodial and fiduciary responsibilities for UMass endowments.

### ***Recommendation***

The UMass OT should comply with the BOT policy or have the policies amended to reflect the current intentions of UMass. The UMass OT should, at a minimum, formalize its arrangement with the Foundation through a written contract that identifies the responsibilities of each party. The UMass OT should not transfer the administration of other UMass funds of substantial value without (1) the approval of UMass's BOT and (2) a formal written contract signed by the parties and specifying in detail the scope of services to be provided and at what cost.

### ***Auditee's Response***

*The University and the University of Massachusetts Foundation, Inc. executed a formal written agreement which encapsulates the responsibilities of both parties. The University Board of Trustees reaffirmed this relationship at its May 5, 2004 meeting.*

*It should be noted that the University of Massachusetts Foundation, Inc. is certified under the provisions of Massachusetts General Laws, Chapter 15A, Section 37. The UMass BOT certified the University of Massachusetts Foundation, Inc. under T-Doc 99-005 approved February 3, 1999.*

## **5. IMPROVEMENTS NEEDED IN INVESTMENT PRACTICES**

We found that improvements are needed in UMass investment practices. BOT policy document 92-031, Appendix F, sets forth policies to be followed by the UMass Treasurer in the day-to-day administration of all UMass investment activities. These policies contain concise statements of direction and required action.

We found that the UMass OT did not always comply with BOT policies, in that it selected or retained external equity investment managers whose performance and investment strategies did not adhere to BOT investment guidelines. We also noted that the UMass OT did not develop written procedures to clarify BOT policy for the management of UMass funds. Moreover, we identified instances of fixed income investments in corporations that exceeded the maximum limit allowed by BOT policy. According to BOT policies, preservation of capital and liquidity of investments through prudent management and compliance with all BOT policies, guidelines, and

procedures are the most important factors when considering the investment of UMass funds. According to the June 30, 2003 UMass OT investment reports, equity investments and fixed income investments had book values of \$58.2 million and \$340.3 million, respectively.

BOT document T92-031, Policy for the Management of University Funds, requires that the UMass President, after consultation with Vice-Presidents, Chancellors and others, establish procedures to implement BOT policy. Specifically, BOT document T92-031, Appendix F, Investment Policy, states, in part:

*This Investment Policy of the University of Massachusetts sets forth procedures and guidelines to assist in the day-to-day administration of all University investment activities.*

*The Board hereby delegates to the University Treasurer the authority to make specific investments and to execute day-to-day investment decisions in accordance with the provisions of this policy....*

*The provisions of this policy shall apply to all funds invested by the University.*

*Unless otherwise provided by this policy, university investments as a whole shall be undertaken in accordance with the following objectives:*

**Preservation of Capital**—*Preserve the capital investment of its assets through prudent management and compliance with all existing Board of Trustee policies, guidelines and procedures covering the use and stewardship of University funds.*

**Liquidity**—*Maintain a reasonable amount of portfolio liquidity.*

**High Yield**—*Attain the highest possible level of current income consistent with the objectives of preservation of capital and liquidity.*

**Marketability**—*Maintain at least 20% of the portfolio in marketable government or agency instruments.*

**Risk**—*Purchase fixed income investments with a low degree of default risk and an acceptable degree of price risk resulting from changes in the level of interest rates.*

*These characteristics limit the types of investments which may be purchased by the University. For fixed income investments, the emphasis is on liquidity and the safety of principal with respect to default risk and interest rate risk. The yield on investments is secondary to liquidity and safety....*

Our review of UMass records supporting the selection of external equity managers noted that in 1994, 2000, and 2002 managers were hired as a result of an RFB process. In 1994, UMass mailed 79 RFBs that generated 112 responses. In 2000 and 2002, an investment consultant prescreened 21 and 29 external equity managers, respectively. However, we found two instances

where UMass funds were invested without benefit of an RFB process as required by BOT document T92-031, Appendix F, Section VIII, Equities: Investment Management, which states, in part:

*This segment of the portfolio will be managed by the following guidelines:*

*A. External Managers*

*Investment managers will be appointed following a systematic search for those with demonstrated ability in the style desired. To optimize access to such managers, while minimizing management fees and transaction costs, no-load mutual funds and pooled funds may be considered together with separate account management. Managers are given discretion to manage funds entrusted in accordance with the style for which they are employed provided they comply with the restrictions and limitations as may be determined by the University from time to time.*

*B. Evaluation and Retention of Managers*

- *Performance Objectives for Active Management*

*External equity managers/fund(s) will be expected to achieve an annualized total rate of return over a three-to five year period which exceeds an appropriate market index rate of return by 1.5 percentage points compounded annually, net of cost and fees. Total return is defined as dividend or interest income plus realized and unrealized capital appreciation or depreciation at fair market value.*

*The managers/fund(s) will also be expected consistently to achieve a total rate of return which is equal to or above the median return in a universe of peers with comparable investment styles or portfolio objectives.*

*The managers/fund(s) will also be expected to have an annualized standard deviation not greater than 115 percent of the benchmark index.*

- *Investment Style*

*The managers/fund(s) will maintain a portfolio for the University characterized by their respective traditional management styles and, if a change in such style is contemplated, the manager is required to make advance written notification to the University. A change in style may reduce or eliminate the effect of diversification and therefore, may result in a change of manager by the University.*

- *Change in Objectives or Asset Allocation*

*A change in objectives or asset allocation strategy may require that funds be transferred between asset classes, to new asset classes, or among styles within asset classes. These changes may result in increases decreases or elimination of funds under management by a specific manager.*

- *Change in Principals*

*The historical investment performance of an investment management firm may be attributable to a specific person or person at the firm. A change in key individuals will be taken into consideration in the evaluation of an investment management firm and any decision affecting the continuation of the firm.*

- *Criteria for Selecting Managers*

*The addition of a management firm will be decided by the specific needs and objectives of the University through a formal RFP process. In considering a new firm, the same evaluation criteria will apply as presented above. Firms not satisfying these criteria will not be considered by the University.*

Our audit tests of UMass's selection process for external equity investment managers found that the University did not always use an RFP process when selecting its external equity investment managers. We identified five instances where the UMass OT sought the services of external equity managers for the investment of UMass funds. On three occasions, UMass funds were invested as a result of a formal RFB process, either through issuance of an RFB by the University or a prescreening process conducted by a UMass investment consultant. However, for the equity investments occurring in April 1998 and March 1999, UMass did not seek bids and encourage competition. Ultimately, UMass invested \$11,733,563 in these funds, as follows:

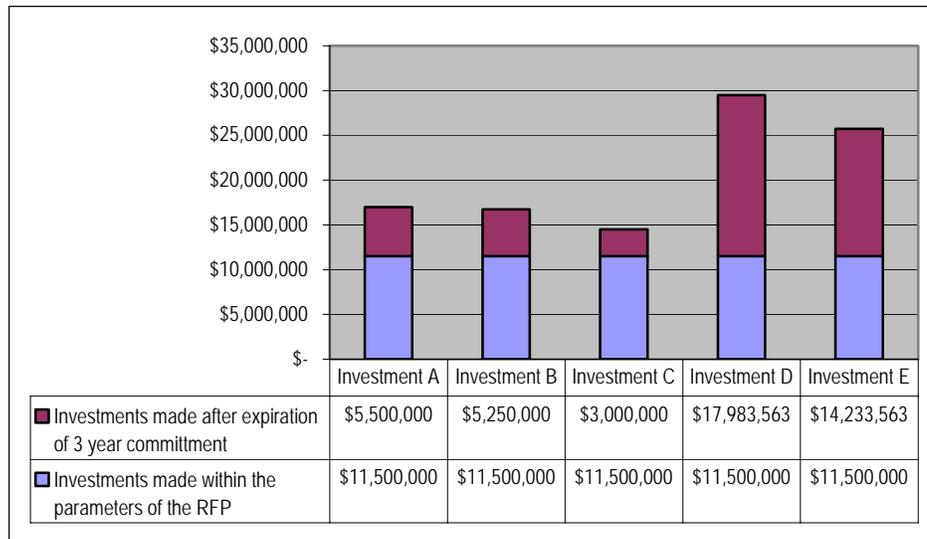
**UMass Principal Funds Invested in Equities without RFB Process**

Account	Initial Investment		Principal Invested through April 2002
	Date	Principal	
Fund A	April 1998	\$ 3,000,000	\$ 5,133,563
Fund B	March 1999	<u>5,000,000</u>	<u>6,650,000</u>
		<u>\$8,000,000</u>	<u>\$11,783,563</u>

UMass officials stated that, in one case, they used an external investment manager who was already investing funds for another, UMass-related operation. University officials did not provide information regarding their selection of the other external equity investment manager.

Regarding the five investments it made in 1995, after the 1994 RFB selection process, UMass continued to invest and reinvest with the same companies even though the maximum three-year

investment commitment had expired. In these instances, \$46 million was invested after expiration of the RFB maximum three-year commitment, as shown in the following chart:



UMass OT stated that it was never its intention to limit the length of time equity investments could be managed, and that leaving that formulation in the RFB had been an oversight.

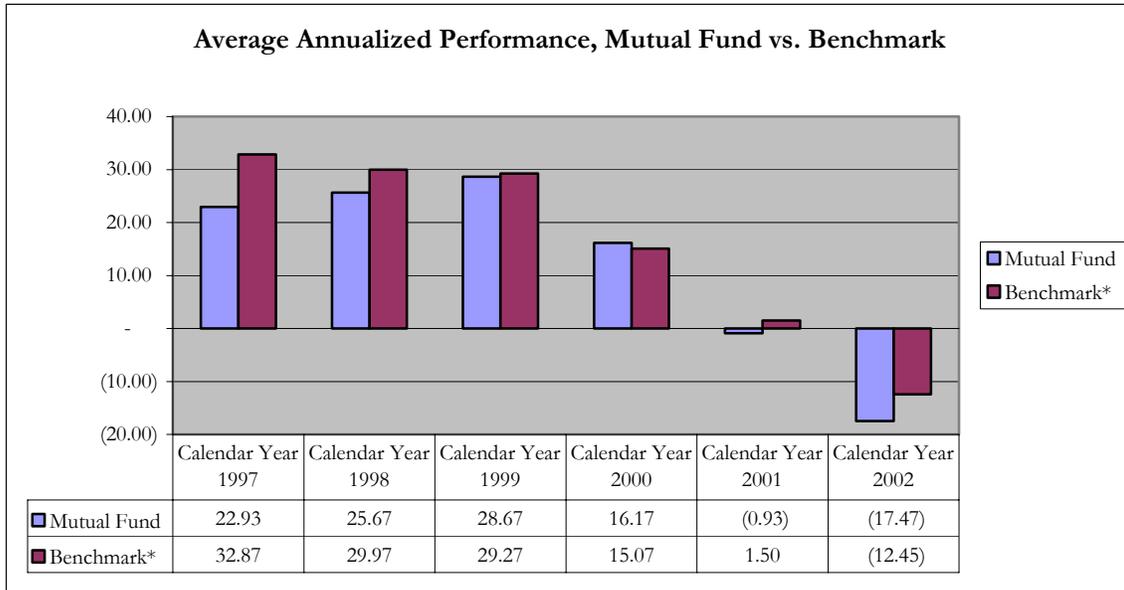
UMass also invested funds with external equity managers whose investment strategy was not in compliance with BOT policy regarding acceptable types of investment. In April 2002, the UMass OT invested \$12 million in two funds that use nontraditional investing strategies, known as alternative investing. An additional \$1.8 million was subsequently invested in one of these funds, which use capital structure arbitrage, event-driven trading, fixed income arbitrage, and long/short equity products. These strategies involve futures trading and short selling, which are expressly prohibited by BOT document T92-031, Appendix F, Section VI, Prohibited Transactions and Investments, which prohibits or restricts certain investment transactions or policies, as follows:

1. *Futures Contracts. A Futures contract is an agreement calling for a fixed-price, future delivery of standardized securities, usually Treasury and Agency issues and is a prohibited investment....*
4. *Short Sales. This is the sale of a security that is not owned by the University. This is a prohibited activity.*

Regarding investing the equity portfolio in short sales and futures, OT officials stated that the prohibited transactions and investments section of the BOT investment policy was not intended to apply to equity investments; rather, it was to guide the OT on proper investments for its fixed income portfolio.

UMass funds also remained invested with external managers whose fund performance did not always meet BOT performance standards (see previous excerpt of BOT document T92-031, Appendix F, Section VIII, Performance Objectives for Active Management).

Our sample tests of equity investment performance found that investments did not always achieve the average annualized rate of return, contrary to UMass's investment policy. Moreover, UMass funds remained in some of those underperforming investments, and additional funds were invested in them, while performance standards were consistently not being achieved. For example, the largest proportion of UMass funds is invested with Fidelity, the total rate of return for which has trailed the appropriate market index; however, the UMass OT reinvested approximately \$18 million with the mutual fund company during the period of its underperformance. The following chart reflects the mutual fund performance measured against the policy standard:



\*Benchmark adjusted to include market index rate of return by 1.5 percentage points compounded annually per BOT policy standard.

Regarding selecting and retaining equity investment managers whose investment performance did not meet the required benchmarks of the BOT investment policy, OT officials stated that the BOT investment policy regarding performance standards is merely a guideline, and it would not have been prudent to eliminate managers because of negative performance during the market downturn.

Our review of UMass’s fixed income investments found that the UMass OT had investments in corporations in excess of the amounts allowed by BOT policy. BOT document T92-031, Appendix F, Section V, Diversification of Investments, states, in part:

*To avoid unwarranted concentration of funds in a single entity that is subject to default risk, diversification requirements are imposed as follows:...*

**Corporate Securities.** *The combined position of any individual corporate name shall be limited to 5% of the portfolio.*

For example, our audit tests of monthly balances of UMass’s fixed income portfolio found that holdings in one individual corporation were at times nearly \$11.3 million more than they should have been. The following table shows excessive holdings in this corporation during months selected:

---

	July 2002	September 2002	December 2000	June 2003
Amount Invested	\$19,662,200	\$21,779,260	\$25,192,820	\$17,578,870
Investment Limit Set by BOT	<u>14,771,932</u>	<u>11,851,575</u>	<u>13,919,440</u>	<u>16,916,967</u>
Excess Amount	<u>\$ 4,890,268</u>	<u>\$ 9,927,685</u>	<u>\$11,273,380</u>	<u>\$ 661,903</u>

We also found that the UMass OT did not have written procedures detailing the process it uses for investing in fixed income products. Moreover, we found that UMass did not retain supporting documentation for the fixed income investment choices it made. Furthermore, brokers used by UMass to purchase fixed income products were not chosen in a public competitive process. According to the OT, there is no formal process for making fixed income investments because it is a dynamic process: Information on fixed income investments flows into the UMass OT at various times during the day, and because it deals in the live market and prices and yields can change within the day, side-by-side comparisons may not accurately reflect or support decisions being made. As of June 30, 2003, UMass's fixed income portfolio made up 85% of its investments and cash balance. During fiscal year 2003, the UMass OT purchased, on average, \$15 million of fixed income products per month—or approximately seven monthly trades.

BOT document T92-031, Appendix D, Consultant Services, requires UMass departments to publicly and competitively bid for services whenever practical, and document the arrangement in a contract to be reviewed by legal counsel and signed by the UMass Treasurer.

Also, the formal RFB process used to select the original external equity investment firms limited the term of the investment management service commitment to a maximum of three years. The original RFB, issued in fiscal year 1995, states, in part:

*The proposing firm must be prepared to commit to a one-year term with an option to renew, upon mutual agreement of the parties, for two additional one-year periods.*

Regarding the selection of external managers for equity investments without an RFB process, the OT stated that because UMass had an existing relationship with an external equity manager for another group of funds, and the UMass OT was satisfied with that manager's performance, UMass chose to invest funds with that equities manager rather than go through the formal RFB process.

The lack of minutes detailing the BOT's Investment Subcommittee's meetings, where equity investment decisions are made after thorough discussion, and not incorporating changes or specific interpretations in the BOT investment policy, contributed to these various areas of noncompliance.

In response to various other concerns, OT officials stated that the office has become sensitive to the issue of investments and that a recent meeting of the Investment Subcommittee had determined that UMass would reevaluate its investment process. As a result of certain new governance initiatives (Sarbanes-Oxley), trading activity in the mutual fund business (Putnam Investments), and a genuine belief that the University needs to be more independent from the process of selecting specific investments, the Trustee Committee decided to transfer all investment activity to portfolio managers independent of the University.

The UMass OT stated that as a result of the recent BOT decision it would immediately begin liquidating its fixed income portfolio and begin a search for an investment consultant. The UMass OT is in the process of evaluating, with BOT input, UMass's investment strategy through the transition date. Once the new investment consultant is hired, the UMass Investment Policy will be revised in consultation with the BOT and the investment consultant, and investment firms will be hired to manage the various investment disciplines set forth as part of the asset allocation process that would be defined in the new investment policy.

### ***Recommendation***

The UMass OT should comply with BOT policies on UMass fund management or have those policies amended to reflect the current intentions of UMass. The UMass OT should adopt written procedures for fixed income transactions. In addition, the investment subcommittee of the BOT should fully document, in written form, its discussions and votes on matters relating to UMass investments.

### ***Auditee's Response***

*The University agrees with the OSA in that policy and procedure should be updated on a regular basis to be consistent with best and current practice. The University Board of Trustees has approved a revised Investment Policy. The University Investment Committee is keeping minutes of the decisions made at its meetings*

*The University Investment Committee at its April 2004 meeting selected New England Pension Consultants as Investment Consultant. The University Investment Committee at*

*its September 2004 meeting retained Mellon Trust as custodian of operating cash funds. The Committee also hired Western Asset Management as short duration manager and Income Research & Management as intermediate duration manager at the same meeting. The University Investment Committee at its March 8, 2005 meeting selected INTECH as manager of the S&P 500 Enhanced Index Fund replacing a previously terminated Large Cap manager. The University Investment Committee at its June 14, 2005 meeting selected Colchester Global Investors as global bond manager replacing a previously terminated bond manager. All manager selections were the result of a competitive RFP selection and interview process. The selection committee is comprised of several Board of Trustee members and University Administration.*

*The Committee monitors all manager performance quarterly by reviewing with the Investment Consultant the quarterly report of performance and reviews on the same schedule the asset allocation structure and any recommendations for manager changes.*

*The full Board of Trustees confirms the selections made by the University Investment Committee through the acceptance of the University Treasurer's Report annually.*

*The decisions of the University Investment Committee are the result of a well designed plan to have approximately 80% of the University's Operating Cash Portfolio managed by external managers. Contracts with these firms are finalized following selection and appointment by the Committee.*

*The average aggregate annual return for the Operating Cash Portfolio for the 10 year period ended June 30, 2003 was approximately 5.92%, resulting in approximately \$159,200,000 being made available to the campuses as Trust Fund Interest*

## APPENDIX I

### Summary of Reconciling Items by Account Reconciliation

	July 1, 2002 Month Reviewed	June 30, 2003 Old Reconciling Items Affecting Cash	Old Reconciling Items Include Outstanding Checks over 6 Months Old
Overall Account Summary	June 2002	<u>\$1,706,271</u>	Data Unavailable
Disbursements	September 2002	\$ 131,272	Data Unavailable
Payroll	June 2003	20,970	Data Unavailable
Medical School Imprest	December 2002	7,526	\$ 7,526
UMass Medical Center Bursar	December 2002	2,068	2,068
Athletic Department Imprest	December 2002	4,411	4,410
Food Services Imprest	December 2002	878	878
Continuing-Ed Imprest	December 2002	2,512	2,500
Bursar Imprest Accounting	December 2002	21,745	21,745
Treasurer's Manual Checking Imprest	December 2002	3,203	3,203
Bursar's ARP Imprest	December 2002	<u>213,054</u>	<u>92,612</u>
Subtotal		<u>\$ 407,639</u>	<u>\$134,942</u>
Total		<u>\$2,113,910</u>	<u>\$134,942</u>

## APPENDIX II

### Monthly Banking Service Charges

Source: UMass April 2003 Banking Invoice

Service Activity	Units	Price	Amount	Banking Services	
				Included in Original RFB	Offered After RFB
<u>Account Basic Services</u>					
Monthly Maintenance	64	\$ 10.000	\$ 640	\$ 640	-
Checks Paid	309	0.140	43	43	-
Deposits Made	1,038	0.750	779	779	-
Checks Deposited	31,746	0.080	2,540	2,540	-
Checks Dep-Non-Local	7,037	0.080	562	562	-
Return Item Redeposit - Reclear	211	1.250	264	264	-
RDI Spec Handling - Monthly Fee	2	30.000	60	-	\$ 60
Return Dep Item - Chargeback	139	3.000	417	417	-
Checkbook Order Charges	3	-	293	293	-
Overdraft Charges	3	25.000	75	75	-
Electronic and Other Debits	46	0.150	7	7	-
<u>Account Reconciliation</u>					
Basic Recon - Monthly Maint	2	10.000	20	20	-
Full Outst Recon - Mo Maint	1	10.000	10	10	-
Full Outst Recon - Micr-Per Item	143	0.100	14	14	-
ARP Check Fine Sort - Per Item	143	0.015	2	2	-
ARP Paid Tape or Transmission	1	15.000	15	15	-
ARP Sub - Accounting	1	10.000	10	10	-
ARP Paper Input - Key Entry	1	25.000	25	25	-
<u>ACH Origination Services</u>					
ACH Returned Item - Treas Exp	108	1.250	135	-	135
TX - TDR ACH Trans Rptd	230	0.075	17	17	-
TX ACH Trans Initiated	548	0.750	411	411	-
ACH Delete Changes Event Chrg	2	0.500	1	1	-
Direct Send ACH File Input Fee	5	10.000	50	-	50
Direct Send ACH Credit Orig	61	0.075	5	5	-
Direct Send ACH Credit Orig	44,913	0.050	2,247	2,247	-
<u>Automated Transfer - ZBA</u>					
ZBA Master Acct Maintenance	1	40.000	40	-	40
ZBA Sub-Acct Maintenance	9	40.000	360	-	360
<u>Automatic Investment</u>					
Auto Invest - Mutual Funds	1	165.000	165	-	165
<u>Cont Disb\Check Draft</u>					
Cont Disb Paid Item	20,810	0.095	1,977	1,977	-
Cont Disb Reporting	4	100.000	400	400	-
CD Serial Sorting	20,335	0.015	305	305	-
CD Microfiche	8	15.000	120	120	-
CD S. Term Image Archive - Export	20,829	0.030	625	-	625
CDS Returned Drafts	5	2.000	10	10	-

**APPENDIX II (CONTINUED)**  
**Monthly Banking Service Charges**

Source: UMass April 2003 Banking Invoice				Banking Services	
<u>Service Activity</u>	<u>Units</u>	<u>Price</u>	<u>Amount</u>	<u>Included in</u>	<u>Offered After</u>
				<u>Original RFB</u>	<u>RFB</u>
<u>Account Basic Services</u>					
<u>Deposit Reconciliation</u>					
Fleet Track Daily Rpts - Paper	1	40.000	\$ 40		40
Fleet Tract Monthly Reporting	5	75.000	375		375
<u>Electronic Data Interchange</u>					
EDI Remittance Advice - Paper	17	5.000	85	-	\$ 85
EDI Mthly Subscrip - Receipt	2	30.000	60	-	60
<u>Information Reporting</u>					
BTR - Per Account Per Day	748	3.000	2,244	-	2,244
BTR Detail Transactions Rptd	12,421	0.050	621	-	621
Treas Exp Monthly Fee	1	500.000	500	-	500
Tres Express Fax	1	50.000	50	-	50
<u>International Services</u>					
Int'l - Can Checks Under \$500.00	14	3.000	42	\$ 42	-
Int'l - Can Checks Over \$500.00	3	3.000	9	9	-
<u>Miscellaneous Services</u>					
AMSA	1	450.000	450	450	-
Brink's Inc Invoice 4/1/03	1	443.080	443	443	-
AMSA	1	275.000	275	275	-
AMSA	1	220.000	220	220	-
<u>Funds Transfer Services</u>					
FT Advice Telex	46	4.000	184	184	-
FT Incoming Repair CR	6	8.000	48	48	-
FT Incoming ST CR	61	8.000	488	488	-
FT TX-WC Intraday Details Rptd	128	1.250	160	160	-
FT Phon Intrntl USD Non - Rpt DB	3	20.000	60	60	-
FT Phon Intl FX Non - Rpt DB	9	20.000	180	180	-
FT Phon Domestic Non - Repeat DB	16	9.000	144	144	-
FT Stndng Order Domestic DB	1	10.000	10	10	-
FT TX Domestic ST DB	46	8.000	368	368	-
Service Total			<u>\$ 19,700</u>	<u>\$ 14,290</u>	<u>\$ 5,410</u>

## APPENDIX III

## Chapter 647, Acts of 1989, An Act Relative to Improving the Internal Controls within State Agencies

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Chapter 647

THE COMMONWEALTH OF MASSACHUSETTS

*In the Year One Thousand Nine Hundred and Eighty-nine*

AN ACT RELATIVE TO IMPROVING THE INTERNAL CONTROLS WITHIN STATE AGENCIES.

*Be it enacted by the Senate and House of Representatives in General Court assembled, and by the authority of the same, as follows:*

Notwithstanding any general or special law to the contrary, the following internal control standards shall define the minimum level of quality acceptable for internal control systems in operation throughout the various state agencies and departments and shall constitute the criteria against which such internal control systems will be evaluated. Internal control systems for the various state agencies and departments of the commonwealth shall be developed in accordance with internal control guidelines established by the office of the comptroller.

(A) Internal control systems of the agency are to be clearly documented and readily available for examination. Objectives for each of these standards are to be identified or developed for each agency activity and are to be logical, applicable and complete. Documentation of the agency's internal control systems should include (1) internal control procedures, (2) internal control accountability systems and (3), identification of the operating cycles. Documentation of the agency's internal control systems should appear in management directives, administrative policy, and accounting policies, procedures and manuals.

(B) All transactions and other significant events are to be promptly recorded, clearly documented and properly classified. Documentation of a transaction or event should include the entire process or life cycle of the transaction or event, including (1) the initiation or authorization of the transaction or event, (2) all aspects of the transaction while in process and (3), the final classification in summary records.

(C) Transactions and other significant events are to be authorized and executed only by persons acting within the scope of their authority. Authorizations should be clearly communicated to managers and employees and should

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include the specific conditions and terms under which authorizations are to be made.

(D) Key duties and responsibilities including (1) authorizing, approving, and recording transactions, (2) issuing and receiving assets, (3) making payments and (4), reviewing or auditing transactions, should be assigned systematically to a number of individuals to ensure that effective checks and balances exist.

(E) Qualified and continuous supervision is to be provided to ensure that internal control objectives are achieved. The duties of the supervisor in carrying out this responsibility shall include (1) clearly communicating the duties, responsibilities and accountabilities assigned to each staff member, (2) systematically reviewing each member's work to the extent necessary and (3), approving work at critical points to ensure that work flows as intended.

(F) Access to resources and records is to be limited to authorized individuals as determined by the agency head. Restrictions on access to resources will depend upon the vulnerability of the resource and the perceived risk of loss, both of which shall be periodically assessed. The agency head shall be responsible for maintaining accountability for the custody and use of resources and shall assign qualified individuals for that purpose. Periodic comparison shall be made between the resources and the recorded accountability of the resources to reduce the risk of unauthorized use or loss and protect against waste and wrongful acts. The vulnerability and value of the agency resources shall determine the frequency of this comparison.

Within each agency there shall be an official, equivalent in title or rank to an assistant or deputy to the department head, whose responsibility, in addition to his regularly assigned duties, shall be to ensure that the agency has written documentation of its internal accounting and administrative control system on file. Said official shall, annually, or more often as conditions warrant, evaluate the effectiveness of the agency's internal control system and establish and implement changes necessary to ensure the continued integrity of the system. Said official shall in the performance of his duties ensure that: (1) the documentation of all internal control systems is readily available for examination by the comptroller, the secretary of administration and finance and the state auditor, (2) the results of audits and recommendations to improve departmental internal controls are promptly evaluated by the agency management, (3) timely and appropriate corrective actions are effected

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by the agency management in response to an audit and (4), all actions determined by the agency management as necessary to correct or otherwise resolve matters will be addressed by the agency in their budgetary request to the general court.

All unaccounted for variances, losses, shortages or thefts of funds or property shall be immediately reported to the state auditor's office, who shall review the matter to determine the amount involved which shall be reported to appropriate management and law enforcement officials. Said auditor shall also determine the internal control weaknesses that contributed to or caused the condition. Said auditor shall then make recommendations to the agency official overseeing the internal control system and other appropriate management officials. The recommendations of said auditor shall address the correction of the conditions found and the necessary internal control policies and procedures that must be modified. The agency oversight official and the appropriate management officials shall immediately implement policies and procedures necessary to prevent a recurrence of the problems identified.

House of Representatives, December 21, 1989.

Passed to be enacted, *George Luvaan*, Speaker.

In Senate, December 22, 1989.

Passed to be enacted, *William W. Budge*, President.

January 3, 1990.

Approved, *Richard K. Hahn*, Governor.

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## APPENDIX IV

### Chapter 647 Awareness Letter from the State Auditor and the State Comptroller



## The Commonwealth of Massachusetts

Office of the State Auditor  
State House  
Boston, MA 02133

Office of the Comptroller  
One Ashburton Place  
Boston, MA 02108

September 19, 2000

Legislative Leadership  
Judicial Branch Administrators  
Elected Officials  
Secretariats  
Department Heads

The State Auditor and the Comptroller are both committed to departmental improvements in the Internal Control structure of the Commonwealth. A good system of controls, as you know, assists management in meeting objectives while avoiding serious problems. Chapter 647 of the Acts of 1989, *An Act Relative To Improving Internal Controls Within State Agencies*, establishes acceptable Internal Control systems for state government operations and constitutes the criteria against which we will evaluate internal controls. With the passage of this law, we began a campaign to educate all department staff on the significant role of internal controls in department operations.

In the past few years, departments have made significant progress in the area of internal controls. Every department has certified that they have documented internal controls in the form of an Internal Control Plan. In Fiscal Year 2001, we are focusing our Internal Control Campaign on the review of department risk assessments, as documented within the departments' internal control plans. Internal control plans must, of course, include all aspects of a department's business, programmatic operations as well as financial.

A major requirement of Chapter 647 is that "an official, equivalent in title or rank to an assistant or deputy to the department head, shall be responsible for the evaluation of the effectiveness of the department's internal controls and establish and implement changes necessary to ensure the continued integrity of the system". This official, whom we refer to as the Internal Control Officer, is responsible for ensuring that the plan is evaluated annually or more often as conditions warrant.

During this annual Statewide Single Audit, we continue with our review of the Commonwealth's internal controls. We analyze and evaluate information obtained during the audit process in our continuing effort to educate agencies regarding both the need for internal controls and the risks of not having adequate internal controls in place.

To assist departments with this effort, we provide the following support activities:

- ◆ The Office of the Comptroller offers departments free monthly training on internal controls. These classes are listed in the *OSC Training Bulletin*.
- ◆ The Office of the Comptroller provided a new document entitled the *Internal Control Guide for Managers* on the Office of the Comptroller's Web page: <http://www.osc.state.ma.us/>. Part II of the guide will be available shortly and will replace the current *Internal Control Guide for Departments*, currently available on the Web.
- ◆ Upon request, the Office of the Comptroller provides assistance to departments in the process of redefining or reviewing their internal control plans.
- ◆ As part of the Statewide Single Audit, auditors will review and comment upon departments' internal control plans, risk assessments, and the reporting level of the Internal Control Officers.
- ◆ We have updated and automated the Internal Control Questionnaire (ICQ) for easier submission. These changes to the ICQ will enable OSA and OSC to evaluate department internal controls and monitor their progress.

Chapter 647 also requires that "all unaccounted for variances, losses, shortages, or thefts of funds or property be immediately reported to the Office of the State Auditor" (OSA). The OSA is required to determine the amount involved and the internal control weaknesses that contributed to or caused the condition, make recommendations for corrective action, and make referrals to appropriate law enforcement officials. In order to comply with this law instances must be reported on the *Report on Unaccounted for Variances, Losses, Shortages, or Thefts of Funds or Property* and be submitted to the OSA. Reporting forms can be obtained by contacting the Auditor's office, Room 1819, McCormack State Office Building, or Web Site:

<http://www.magnet.state.ma.us/sao/>.

In conjunction with the above requirement, please note that management is responsible for financial records and systems and must inform, disclose and make representations to the auditors with regards to their management of funds, account activities, programs and systems.

The Offices of the State Comptroller and the State Auditor are committed to the goal of improving the Internal Control structure of the Commonwealth. Thank you for your cooperation and attention on this worthwhile task. Please do not hesitate to call upon the staff of either office for assistance.



A. JOSEPH D. NUCCI  
Auditor of the Commonwealth



MARTIN J. BENISON  
State Comptroller