



Commonwealth of Massachusetts  
Office of the State Auditor  
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*Making government work better*

Official Audit Report –October 18, 2012

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## Close-Out Audit of Agencies and Authorities Combined into the Massachusetts Department of Transportation

For the period July 1, 2009 through October 31, 2009



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## TABLE OF CONTENTS/EXECUTIVE SUMMARY

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### INTRODUCTION

1

The Massachusetts Department of Transportation (MassDOT) was created by Chapter 25 of the Acts of 2009, An Act Modernizing the Transportation Systems of the Commonwealth. MassDOT is governed by an independent five-member Board of Directors appointed by the Governor; however, it is subject to state finance laws, including Chapters 7, 7A, 10, and 29 of the Massachusetts General Laws, and uses the Massachusetts Management Accounting and Reporting System (MMARS), the state accounting system, to process transactions. MassDOT's board also governs the Massachusetts Bay Transportation Authority, and the Commonwealth's 15 regional transit authorities and one transportation association are also under the jurisdiction of MassDOT. A Secretary appointed by the Governor serves as the Chief Executive Officer of MassDOT.

MassDOT was formed through the merger of four former state agencies: the Massachusetts Highway Department (MHD), the Registry of Motor Vehicles (RMV), the Massachusetts Aeronautics Commission (MAC), and the Executive Office of Transportation and Public Works (EOT) and its divisions. MassDOT also absorbed the assets, liabilities, and equities of the former Massachusetts Turnpike Authority (MTA). In addition, the Tobin Memorial Bridge, formerly owned by the Massachusetts Port Authority, was transferred to MassDOT, as were certain roads and bridges under the jurisdiction of the Department of Conservation and Recreation).

In accordance with Chapter 11, Section 12, of the General Laws and as required by Chapter 25, Section 155, of the Acts of 2009, the Office of the State Auditor (OSA) conducted a close-out audit of each agency or authority combined into MassDOT. Section 155 further required that this audit include a catalogue of any issues relating to MassDOT's current and future finances and operations, debt structure, and internal policies and procedures that are not consistent with financial accounting standards of practice or that may violate the General Laws.

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### AUDIT RESULTS

9

#### 1. REVIEW OF AGENCY AND MTA ACCOUNTS AND MASSDOT'S AUDITED FINANCIAL STATEMENTS REVEALED NO PROBLEMS

9

We reviewed the spending accounts<sup>1</sup> of MassDOT's legacy state agencies (EOT, MHD, MAC, and the RMV) and identified 262 accounts classified by these agencies as being operating, capital, federal, or trust accounts. We then queried the MMARS accounting system and obtained or calculated the balances in these 262 accounts as of October 31, 2009 and verified that these balances were transferred to new MassDOT capital, federal, and trust accounts and that the operating accounts of the legacy agencies being combined into MassDOT were properly closed.

To ensure that the ending balances and the transfer amounts in these accounts were reliable, we tested a judgmental sample of transactions for the period July 1, 2009

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<sup>1</sup> A spending account is an account within the MMARS system from which payments are made.

through October 31, 2009. Similarly, we reviewed the compilation of cash balances at the MTA as of October 31, 2009 that was performed by a private accounting firm and verified that these balances were credited to MassDOT. Our close-out audit of EOT, MHD, MAC, the RMV, and MTA as of October 31, 2009 revealed no material deficiencies.

We also verified the accuracy of the initial MassDOT audited financial statements by reviewing MMARS records, accountants' worksheets, adjusting entries, and other information. Our review of MassDOT's initial audited financial statements disclosed no exceptions.

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**2 MASSDOT'S INTERNAL CONTROLS NEED IMPROVEMENT****11**

Chapter 25, Section 155, of the Acts of 2009 also required that the OSA's close-out audit include a catalogue of any issues relating to MassDOT's current and future finances and operations, debt structure, and internal policies and procedures that are not consistent with financial accounting standards of practice or that may violate the General Laws. Our audit work in this area disclosed one issue with MassDOT's internal controls. Specifically, Generally Accepted Accounting Principles advocate that entities such as MassDOT establish and implement an adequate internal control system. Moreover, Chapter 647 of the Acts of 1989, An Act Relative to Improving the Internal Controls within State Agencies, states that "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." However, we found that MassDOT had not developed a comprehensive internal control plan based on a risk assessment but instead relied on the internal control policies, if any, of the entities it subsumed. Regarding this matter, MassDOT indicated that it has taken steps to create an internal control plan, including implementing a risk assessment program and an anti-fraud program.

## INTRODUCTION

### *Background*

The Massachusetts Department of Transportation (MassDOT) was established by Chapter 25 of the Acts of 2009, An Act Modernizing the Transportation Systems of the Commonwealth. Chapter 25, also known as the Transportation Reform Act, created Chapter 6C of the Massachusetts General Laws. MassDOT is governed by an independent five-member Board of Directors appointed by the Governor; however, it is subject to state finance laws, including Chapters 7, 7A, 10, and 29 of the General Laws, and uses the Massachusetts Management Accounting and Reporting System (MMARS), the state accounting system, to process transactions. The MassDOT board also governs the Massachusetts Bay Transportation Authority (MBTA), and the Commonwealth's 15 Regional Transit Authorities (RTAs) and one transportation association are also under the jurisdiction of MassDOT. A Secretary appointed by the Governor serves as the Chief Executive Officer of MassDOT.

MassDOT oversees more than 10,000 employees, of whom 6,000 are employed at the MBTA. During the eight-month period November 1, 2009 (the effective date of the creation of MassDOT) through June 30, 2010, MassDOT had an operating budget of approximately \$475 million and a capital budget of \$1.15 billion.

MassDOT was formed through the merger of four former state agencies: the Massachusetts Highway Department (MHD), the Registry of Motor Vehicles (RMV), the Massachusetts Aeronautics Commission (MAC), and the Executive Office of Transportation and Public Works (EOT) and its divisions. MassDOT also absorbed the assets, liabilities, and equities of the former Massachusetts Turnpike Authority (including both the Metropolitan Highway System and the Western Turnpike). In addition, the Tobin Memorial Bridge, formerly owned by the Massachusetts Port Authority, was transferred to MassDOT, as were certain roads and bridges under the jurisdiction of the Department of Conservation and Recreation (DCR). As a result of the merger, all roads and bridges of the Commonwealth and the former Massachusetts Turnpike Authority (MTA) have been transferred to MassDOT; however, the Commonwealth continues to hold current and future debt for the construction, repair, improvement, and replacement of those assets. Debt of the MTA, however, became MassDOT's debt upon consolidation and, although technically not

Commonwealth debt, is guaranteed by the Commonwealth. In accordance with Chapter 25, Section 17(a), of the Acts of 2009, MassDOT is only allowed to issue bonds to refinance this existing debt.

Through this merger, the Commonwealth also assumed the liability for the pensions of the former 1,200 active MTA employees as well as 730 retirees. It is estimated that the pension cost assumed by the Commonwealth as a result of this merger totals \$325 million; however, the MTA also transferred \$189 million in assets to the Commonwealth that are available to offset this liability. In addition, the Commonwealth also assumed the liability for Other Post-Employment Benefits (OPEB), primarily health and life insurance, for former MTA employees of approximately \$179.5 million. The MTA had established an OPEB trust with assets totaling \$54.9 million as of June 30, 2010, which has been retained by MassDOT and not transferred to the Commonwealth. However, MassDOT is annually assessed a fringe benefit charge payable to the Commonwealth to cover the pension and OPEB trust fund costs of its employees.

Pursuant to Chapter 6C, Sections 29 and 30, of the General Laws, MassDOT created the Office of Planning and Programming (OPP), which operates under the supervision, direction, and control of the Secretary of MassDOT and contains MassDOT's administrative divisions. OPP serves as the principal office with respect to developing, coordinating, administering, and managing transportation policies, planning, and programs and coordinating roadway, transit, airport, and port programs. MassDOT is also currently composed of the following four operating divisions, which share administrative functions, including human resources, financial and management operations, information technology, and planning:

- **The Highway Division** includes the roads, bridges, tunnels of the former MHD and MTA, and certain assets of DCR. The division, which has six regional districts, is responsible for the design, construction, and maintenance of the Commonwealth's state highways and bridges. The division is also responsible for overseeing traffic safety, engineering activities, and snow and ice removal to ensure safe road and travel conditions.
- **The Rail and Transit Division** is responsible for all transit, freight, and intercity rail initiatives and oversees the MBTA and all RTAs of the Commonwealth. The MassDOT Board of Directors serves as the governing body of the MBTA, which itself remains a separate organization within MassDOT.
- **The Aeronautics Division** has jurisdiction over the Commonwealth's public-use airports, private-use landing areas, and seaplane bases. It is responsible for airport development and improvements, aviation safety, aircraft accident investigation, navigational aids, and statewide aviation planning. The division certifies airports and heliports, licenses airport managers,

conducts annual inspections, and enforces safety and security regulations. The division does not have jurisdiction over Logan Airport.

- **The Registry of Motor Vehicles Division** is responsible for vehicle operator licensing and vehicle and aircraft registration. The RMV also oversees commercial and non-commercial vehicle inspection stations.

As part of Transportation Reform Act, the state's Highway Fund, which was used to finance highway maintenance and safety services and provide support for RTAs, was closed with a zero balance and a new fund, the Commonwealth Transportation Fund (CTF), was created. The tax and non-tax revenues (e.g., gasoline taxes, RMV fees) previously deposited into the Highway Fund are now deposited into the CTF. In addition, beginning in fiscal year 2011, .385% of the Massachusetts sales tax is deposited into the CTF, with a guaranteed minimum floor amount of \$275 million. Of the \$275 million, \$160 million is dedicated to funding the operations of the MBTA, whereas an additional \$15 million is dedicated to funding the operations of the RTAs. The remaining \$100 million is transferred from the CTF to the newly created Massachusetts Transportation Trust Fund (MTTF) for the repayment of old MTA debt.

The major funds that comprise MassDOT include the MTTF, Capital Projects Funds (principally state and federally funded highway capital projects and the Central Artery Statewide Road and Bridge Infrastructure Fund), the Central Artery Repair and Maintenance Fund, and the Motor Vehicle Safety Inspection Trust Fund. MassDOT also operates an Internal Service Fund known as the Owner Controlled Insurance Program and a Fiduciary Fund known as the Other Post-Employment Benefits Trust. MassDOT's financial statements also include the financial activity of the MBTA and the RTAs, which are considered component units of MassDOT. MassDOT financial statements were prepared by a private accounting and consulting firm, and included the audited information of its component units. Subsequently, MassDOT financial statements were audited by an independent public accounting firm that had also audited the financial statements of the MBTA and the Commonwealth of Massachusetts. A description of each fund follows:

- **Massachusetts Transportation Trust Fund:** The MTTF, which is the general fund of MassDOT, receives transfers of appropriated funds from the CTF; bond proceeds; tolls from the Metropolitan Highway System (MHS), Western Turnpike, and Tobin Bridge; Turnpike lease/rental income; investment revenue; and other departmental revenue. Funds are spent on debt service, capital needs, and operations of the MHS, Western Turnpike, and Tobin Bridge; statewide road and bridge improvements; and snow and ice removal. Funds are also spent on the administration and operational expenses of the RMV, the Highway Division, the

Aeronautics Division, and OPP. Once money is transferred to the MTF, it is not subject to legislative appropriation. Spending is authorized by the MassDOT Board of Directors, but budgetary information must be submitted to the Legislature on a regular basis.

- **Capital Projects Fund:** The activity in this fund consists of MassDOT highway projects that are reimbursable by the Commonwealth and/or the federal government and activity in the Central Artery Statewide Road and Bridge Infrastructure Fund (also known as the Transportation Infrastructure Fund), the purpose of which is to meet the additional costs of the Central Artery/Ted Williams Tunnel and the costs of the statewide road and bridge program. Capital Projects Fund activity is shown in the Highway Capital Projects Fund in MassDOT's audited financial statements.
- **Central Artery Repair and Maintenance Fund (CARM):** CARM accounts for costs incurred in connection with repairs and maintenance of the Central Artery/Ted Williams Tunnel that are paid from settlements and related investment earnings arising from the project. CARM is shown in the "Other Governmental Funds" group in MassDOT's audited financial statements.
- **Motor Vehicle Safety Inspection Trust Fund:** This fund receives revenue from motor vehicle inspections that are passed through the CTF and used for the administration and operation of safety inspection programs. The Motor Vehicle Safety Trust Fund is shown in the "Other Governmental Funds" group in MassDOT's audited financial statements.
- **Owner-Controlled Insurance Program (OCIP):** In 1992, the Commonwealth determined that it was more cost-effective for it to assume the responsibility of providing workers' compensation and general liability insurance for the Central Artery/Ted Williams Tunnel Project rather than for individual contractors to purchase such insurance and include the insurance costs in their bids. As a result, the OCIP program and related trust fund were established. As a result of the Transportation Reform Act, MassDOT assumed responsibility for this fund from the defunct MHD and MTA. On March 10, 2008, at the request of the Commonwealth, the trustee of OCIP agreed to transfer assets in excess of estimated future liabilities to the Commonwealth. The transfers, which were made in installments, totaled \$43,600,000 and were completed on April 1, 2010. In fiscal year 2010, \$14,200,000 was transferred to the Transportation Infrastructure Fund, with \$4,400,000 transferred after November 1, 2009. As of June 30, 2010, the fund had a balance of approximately \$7.9 million to meet future claims. The records of OCIP are maintained by a trustee, audited as a separate entity, and included in MassDOT's audited financial statements as an Internal Service Fund within the Proprietary Fund Group.
- **Other Post-Employment Benefits Trust Fund (OPEB):** The OPEB trust fund was established by the MTA to help fund health and life insurance for its retirees. OPEB assets were transferred to MassDOT, which has fiduciary responsibility for these assets. However, the transportation reform legislation required that the liability for the payment of OPEB benefits is an obligation of the Commonwealth. It has not been determined whether OPEB assets can be legally transferred to the Commonwealth to help pay for retiree benefits. The OPEB trust fund is therefore classified as a fiduciary fund in MassDOT's audited financial statements.

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***Significant Financing Activities Affecting MassDOT****Swaption Termination Avoidance*

The MTA was able to avoid a \$261 million termination payment on “swaption”<sup>2</sup> deals. In 1997 and 1999, the MTA issued \$2.4 billion in fixed-rate bonds to fund the Central Artery/Ted Williams Tunnel (CA/T) project, with annual interest averaging approximately 4.8%. The bonds were structured to prevent refinancing for 10 years. In 2001, interest rates were at record lows, and the MTA wanted to refinance its debt in order to raise funds for the CA/T and other operational costs.

In May 2001, the MTA entered into five swaption contracts with financial services company UBS that allowed it to receive net installment payments totaling \$22.97 million (after payment of swap insurance of \$6.15 million), which was approximately the savings it would have received over time if the bonds could have been refinanced. The original plan was that upon exercise of the swaptions, the MTA would immediately refund the fixed-rate bonds with auction-rate securities insured with pre-paid bond insurance from the Ambac Assurance Corporation. Also, per the swaption contract, the MTA would pay interest payments (on a notional amount of \$800 million) to UBS at a rate lower than the original fixed rate on the refunded 1997 bonds. The MTA, in an effort to offset the 2001 UBS swaptions, also entered into five swaption contracts with Lehman Brothers Holdings Inc. Under the terms of these agreements, Lehman Brothers would pay the MTA a fixed rate and the MTA would pay Lehman Brothers a variable rate on the same \$800 million. Lehman Brothers paid the MTA an initial payment of \$6.4 million and then \$28.8 million in a series of installments from 2003 through 2008. In total, the MTA received \$64.32 million in return for entering into the 10 swaption contracts. In September 2008, Lehman Brothers filed for bankruptcy, and the MTA paid \$3.2 million to terminate the swaptions.

Between January 1, 2008 and January 1, 2009, UBS exercised its swaptions and, as a result, the MTA needed to refund the related fixed-rate bonds. The poor market conditions caused by the

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<sup>2</sup> A swaption is an option on an interest rate swap. An interest rate swap is an agreement between two parties where one stream of future interest payments is exchanged for another. Swaps are used to limit or manage exposure to fluctuations in interest rates or to obtain a lower interest rate than an entity might otherwise have been able to get without the swap. The buyer of the swaption has the right to enter into an interest rate swap at a specific date in the future. In consideration for executing the swaption, the seller receives a payment either up front or over time.



mortgage loan crisis and the resulting general downgrading of debt insurers, combined with the MTA's weak underlying credit status, made it impossible for the MTA to issue auction-rate or variable-rate demand bonds.

In June 2008, Moody's and Standard and Poor's downgraded Ambac Assurance Corporation and gave it a negative outlook. The downgrading of Ambac Assurance Corporation and the consequential lowering of the MTA's bond rating meant that UBS was entitled to exercise a terminating event clause in its swaption contract with the MTA and to demand from the MTA a swap termination payment. In August 2008, the Legislature enacted Chapter 304, Sections 26 and 27, of the Acts of 2008, which authorized the Commonwealth to guarantee the debt service on any refunding bonds the MTA issued and to guarantee the MTA's payment obligations under the swaption termination clause. On June 24, 2009, UBS notified the MTA of its intent to terminate the swaps and demanded a termination payment now valued at \$261 million. The termination clause gave the MTA 30 days to resolve the termination event, which it could achieve by obtaining an "A" credit rating on all of its outstanding bonds. In response, the Commonwealth enacted Chapter 27 of the Acts of 2009, which provided \$100 million in annual contract assistance from sales tax dollars to the MTA for the next 30 years totaling \$3 billion. The law included provisions that the \$100 million in payments will continue each year until the contract expires after the existing or refinanced bonds mature in 2039. Also, in accordance with Chapter 235 of the Acts of 1998, the MTA (and its successor, MassDOT) continues to receive \$25 million in contract assistance from the state for the operation and maintenance of the Central Artery. As a result of these payments and guarantees, the MTA's bond rating and credit-worthiness increased, averting the swap termination payment.

#### *Metropolitan Highway System Debt Restructuring*

As explained above, the Commonwealth's guarantee of \$100 million in annual payments to the MTA or its successor improved the MTA's bond rating and credit-worthiness. This allowed MassDOT to refinance two bond issues totaling \$1.8 billion during the spring of 2010. The interest rate on these new bonds was reduced from approximately 9.6% to 6%.

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

In accordance with Chapter 11, Section 12, of the General Laws and as required by Chapter 25, Section 155, of the Acts of 2009 (the Transportation Reform Act), the OSA conducted a close-out

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audit of each agency or authority combined into MassDOT. Section 155 further requires that the audit shall include a catalogue of any issues relating to MassDOT's current and future finances and operations, debt structure, and internal policies and procedures that are not consistent with financial accounting standards of practice or that may violate the General Laws.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

To achieve the statutory requirement mandating a closeout audit of each agency, we reviewed the accounts of the former EOT, MHD, MAC, RMV, and MTA prior to the merger. Section 15 of Chapter 25 required MassDOT to use MMARS, the state's accounting system, to process transactions. Several of the combined state agencies, EOT, MHD, MAC, and the RMV were already using MMARS prior to the merger date, which was changed by Chapter 26 of the Acts of 2009 from July 1, 2009 to November 1, 2009. For these agencies, we reviewed account activity from July 1, 2009 through October 31, 2009 and verified or computed the ending balances in each of the 262 accounts being maintained by these four state agencies from information obtained from MMARS. We also tested financial activity in the post-merger accounts to determine whether transactions were properly recorded.

The objective of our work at the MTA, which maintained its own accounting system prior to the merger, was primarily focused on an examination of the movement of its cash into the MassDOT accounts and a determination of whether correct recordings or postings were made to the MMARS accounting system. The MBTA and the RTAs are considered component units of MassDOT and, although subject to oversight by MassDOT, are still considered separate legal and accounting entities that are not subject to state finance laws. As a result, the MBTA and RTAs were not part of our review of legacy entity accounts.

To address the financial, operational, and policy matters described in Section 155 of Chapter 25, we reviewed MassDOT's initial audited financial statement and supporting documentation provided by MassDOT's consultant. We also reviewed internal control memoranda provided by MassDOT for

compliance with Chapter 647 of the Acts of 1989, An Act Relative to Improving Controls within State Agencies. Lastly, we analyzed information relative to MassDOT's current and future finances and operations, including its overall debt structure.

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## AUDIT RESULTS

### 1. REVIEW OF AGENCY AND MTA ACCOUNTS AND MASSDOT'S AUDITED FINANCIAL STATEMENTS REVEALED NO PROBLEMS

During our audit, we reviewed the spending accounts of the Massachusetts Department of Transportation's (MassDOT) legacy state agencies (the Executive Office of Transportation and Public Works [EOT], the Massachusetts Highway Department [MHD], the Massachusetts Aeronautics Commission [MAC], and the Registry of Motor Vehicles [RMV]) and identified 262 accounts that were classified by these legacy agencies as operating, capital, federal, or trust accounts. We then queried the Massachusetts Management Accounting and Reporting System (MMARS) and obtained or computed the balances in these accounts prior to the merger and verified that these balances were properly transferred to new MassDOT capital, federal and trust accounts and that the operating accounts of the agencies being combined into MassDOT were properly closed.

To ensure that ending balances and transfer amounts were reliable, we tested a judgmental sample of transactions for the period July 1, 2009 through October 31, 2009. We also reviewed activity in the new MassDOT accounts to ensure that post-merger financial activity was being posted correctly. We verified appropriation transfers of approximately \$133 million from the Commonwealth Transportation Fund (CTF) to operating accounts within MassDOT that funded payroll and fringe benefits, snow and ice removal costs, rent and utilities, consultant costs, office and administrative expenses, and miscellaneous costs. We reconciled approximately 250 revenue accounts by type (e.g., tolls, RMV fees, rental income, earned interest, operating transfers) to a trial balance of accounts for the Massachusetts Transportation Trust Fund.

The objective of our work at the MTA was primarily focused on an examination of the movement of cash into the MassDOT accounts and a determination of whether correct postings relative to these transfers were made to the MMARS accounting system. We were aided in this endeavor by a private accounting and consulting firm hired by MassDOT that had already begun a detailed cash review. The MTA maintained 123 bank accounts prior to its consolidation into MassDOT, as follows:

- Fourteen revenue sweep accounts for electronic and manual tolls and parking receipts
- Three operating accounts for payroll and accounts payable

- Sixteen other accounts used for capital reserves, operations and maintenance, and insurance or collateral reserves
- Eleven trustee accounts maintained by a fiscal agent (bank) for debt service related to bonds sold for the Metropolitan Highway System or the Western Turnpike
- Seventy-nine escrow accounts holding private deposits related to construction or land development along the Turnpike

The general scheme of revenue flow prior to the merger was that toll and other MTA revenues were deposited and swept into a revenue fund maintained by a bond trustee; deductions for operating and maintenance reserves and insurance were forwarded to the MTA; and the remaining funds were deposited into various trustee debt service reserves used by the MTA for general, operating, and capital reinvestment needs. Starting in November 2009, the “sweep accounts” were taken over by the Office of the State Treasurer (OST) and swept into a central account at the OST. Transfers for debt service are made to a fiscal agent, and the remaining funds are transferred into Commonwealth operating or investment accounts. We analyzed transfers or sweeps made after November 1, 2009 for balances that related to transaction on or before October 31, 2009. Cash transfers to fund the final MTA payroll and vendor payables were removed from bank balances, as were remaining bank balances in payroll and payables accounts that should have zero balances based upon outstanding checks. The MTA’s \$616,513,380 cash balance as of October 31, 2009 was recorded in MMARS in the Massachusetts Transportation Trust Fund (\$325,876,442 reserved for debt service and \$290,636,938 classified as undesignated). In addition, MTA escrow accounts totaling \$6,915,841 were credited to the MassDOT Escrow Fund.

In order to verify the accuracy of MassDOT’s financial statements for the eight-month period November 1, 2009 through June 30, 2010, we obtained the worksheets of the private accounting and consulting firm and:

- Confirmed that beginning worksheet account balances agreed with MMARS trial balance reports;
- Reviewed all adjustments for accounting logic;
- Confirmed that adjusted balances agreed with the financial statement balances shown in MassDOT’s audited financial statements and the MassDOT presentation in the Commonwealth’s audited Comprehensive Annual Financial Report (CAFR);

- Requested additional documentation and explanations for all adjustments that required changing the Commonwealth’s accounting records;
- Reviewed documentation on a test basis to verify generally accepted accounting principles (GAAP) adjustments made for report purposes only;
- Reviewed and tested the accountant’s compilation of the financial statements for the Other Post-Employment Benefits (OPEB) trust fund;
- Reviewed the Owner-Controlled Insurance Program (OCIP) financial statements accompanying the separate independent auditor’s report for the period July 1, 2009 through June 30, 2010 and its conversion to the eight-month period ended June 30, 2010; and
- Confirmed that the amounts from the MBTA financial statements, which were audited separately, agreed with the amounts shown in the “business type activity” section of MassDOT’s financial statements.

Our review of the MTA and legacy agency accounts and MassDOT’s initial audited financial statements disclosed no exceptions.

## **2. MASSDOT’S INTERNAL CONTROLS NEED IMPROVEMENT**

As required by Chapter 25, Section 155, of the Acts of 2009, we also catalogued any issues we identified relating to MassDOT’s current and future finances and operations, debt structure, and internal policies and procedures that are not consistent with financial accounting standards of practice or that may violate the General Laws.

Our audit work in this area disclosed one issue with MassDOT’s internal controls. Specifically, Generally Accepted Accounting Principles advocate that entities such as MassDOT establish an internal control system. Further, Chapter 647 of the Acts of 1989, An Act Relative to Improving the Internal Controls within State Agencies, states that “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.” These guidelines specifically provide that “All operating departments in Massachusetts state government are required to develop and document departmental internal controls, which must be prioritized and summarized into a departmental internal control plan based on a risk assessment” and that the plan “should be reviewed and updated as conditions warrant, but at least annually.” The Office of the State Comptroller (OSC) guidelines specifically define an internal control plan as “a high-

level department-wide summarization of the department's risks and the controls used to mitigate those risks, supported by lower-level detail including departmental policies and procedures." The guidelines further provide that a risk assessment is integral to an internal control plan, which in turn must be based on the established mission and goals of the organization. The guidelines also require that each department's internal controls be clearly documented and readily available for examination. Although it may be argued that MassDOT is an independent authority and therefore not subject to the requirements of Chapter 647, the Transportation Reform Act provides that, "The department shall, for the purposes of compliance with state finance law, operate as a state agency as defined in section 1 of chapter 29 and shall be subject to the provisions applicable to agencies under the control of the governor." Moreover, the Regulations and Guidance appendix to MassDOT's Internal Audit Unit's Internal Audit Charter specifically cites Chapter 647 and notes that this law requires that the departmental internal control structure be developed in accordance with OSC guidelines.

However, our audit disclosed that MassDOT had not developed a comprehensive internal control plan based on a risk assessment but instead relied on the internal control policies, if any, of the entities it subsumed. In response to our request for MassDOT's internal control plan, MassDOT provided us with an undated risk assessment for the former EOT, an internal control plan dated April 2009 for the former MHD, and an internal control plan dated 2008 for the RMV. However, MassDOT did not provide internal control plans for either the MTA or MAC, the other agencies merged into MassDOT. Without a comprehensive and documented internal control plan, there is inadequate assurance that agency goals and objectives are met; resources are used efficiently, effectively, and in compliance with applicable laws, rules, and regulations; assets are safeguarded against potential waste, loss, and misuse; and financial data is maintained, reported, and fairly disclosed in reports.

The audit report from MassDOT's private accounting firm specifically emphasized the need for internal controls and found that the lack thereof at MassDOT seriously impeded its audit. In fact, in a letter to MassDOT's Board of Directors dated January 10, 2011, the accounting firm noted that it had encountered significant difficulties during the conduct of its audit of MassDOT and that "Many of these difficulties were attributed to the migration of the former Massachusetts Turnpike Authority operations to MassDOT, the lack of established internal control policies, procedures and processes within MassDOT, as well as the inability of

MassDOT and OSC personnel to generate auditable data from MMARS.” The report further found that internal controls at MassDOT were so lacking that they constituted a material weakness, stating “We consider the deficiencies, collectively, in MassDOT’s internal controls over financial reporting described in the accompanying schedule of findings and responses as Finding 2010-1 to be a material weakness.” The independent auditor’s report further stated, “Now that MassDOT has passed its first anniversary, it is critical that management focus its attention on developing, documenting and implementing adequate internal manual and automated systems and processes to support an entity as large, complex and diverse as MassDOT.”

During our audit, MassDOT’s Controller told us that MassDOT had developed an overall mission statement (Vision, Mission, Values, Goals, and Critical Success Factors for MassDOT) and that each division had developed operating plans supporting the overall MassDOT mission. The Controller added, “We are in the process of building on those Operating Plans to create Internal Control Plans that identify the risks associated with the goals and objectives, and documents the internal controls that mitigate risks.” Finally, the Controller stated that, as a component unit of the Commonwealth, MassDOT will prepare its internal control plans in accordance with Chapter 647 of the Acts of 1989 and OSC guidelines and that the plan will include MassDOT’s financial functions.

### ***Recommendation***

MassDOT should review its operations and identify areas of inherent risk and vulnerability, including those activities with potential for loss from fraud, waste, unauthorized use, or misappropriation. MassDOT should then prepare an internal control plan in accordance with OSC guidelines. In addition, MassDOT should conduct annual risk assessments and revise and update its internal control plan as necessary based on their results.

### ***Auditee’s Response***

In response to this issue, MassDOT stated, in part:

*We agree with your recommendation and in fact, MassDOT has already begun the creation of a set of internal control plans for the Department. . . . Additionally, MassDOT has taken a series of other steps to improve the focus of the Department on internal controls, fraud, waste and abuse and the MassDOT internal audit function. First, MassDOT has established an Internal Controls working group that includes the senior*



*fiscal team members of MassDOT, as well as the MBTA. The group meets at least monthly to discuss issues relating to the development and implementation of Department-wide internal controls and audit issues. Second, in the fall of 2010 MassDOT began a three-part effort to improve its fraud prevention program: (a) on October 8, 2010, MassDOT and the MBTA jointly adopted MassDOT's first anti-fraud policy; (b) this past spring, MassDOT established a joint MassDOT/MBTA fraud hotline and has publicized the telephone number throughout the Department; and (c) this spring, the Office of the Comptroller in conjunction with MassDOT Legal and Internal Audit staff provided mandatory training on fraud prevention and detection to all MassDOT managers and supervisors. Third, the MassDOT Internal Audit Unit has implemented a continuous risk assessment program.*