

The Commonwealth of Massachusetts

AUDITOR OF THE COMMONWEALTH

ONE ASHBURTON PLACE, ROOM 1819
BOSTON, MASSACHUSETTS 02108

A. JOSEPH DeNUCCI
AUDITOR

TEL. (617) 727-6200

NO. 2005-0065-7S

INDEPENDENT STATE AUDITOR'S REPORT ON
CERTAIN ACTIVITIES OF THE
SOLDIERS' HOME IN MASSACHUSETTS—
CHELSEA
NOVEMBER 1, 2003 TO SEPTEMBER 30, 2004

OFFICIAL AUDIT
REPORT
MARCH 1, 2005

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The Soldiers' Home in Massachusetts—Chelsea (SHC) was founded in 1883 and is one of the oldest and largest veterans' homes in the country. Authorized by Chapter 115A of the Massachusetts General Laws, SHC is a state-funded agency under the Executive Office of Health and Human Services. SHC's mission is to care for and provide medical services to honorably discharged Massachusetts veterans who have served during a period of war. SHC is also charged with educating health professionals and participating in research to advance medical science.

SHC is governed by a seven-member Board of Trustees appointed by the Governor to oversee the management of the organization. SHC provides inpatient services for approximately 500 male and female war veterans and accounts for 18,000 outpatient visits per year. It is located on a 17-acre campus that consists of nine buildings, including the 189-bed Quigley Memorial Hospital and the LPN School of Nursing. A five-year Massachusetts residency is required for eligibility for inpatient services.

In fiscal year 2004, SHC received state appropriations of \$22,948,306, of which \$22,469,514 was expended for its daily operations.

In accordance with Chapter 11, Section 12, of the Massachusetts General Laws, the Office of the State Auditor conducted an audit of SHC for the period November 1, 2003 to September 30, 2004. The objective of this follow-up audit of SHC was to determine the status of issues identified in our prior audit (No. 2004-0065-3S)—specifically, whether steps were implemented to strengthen the system of internal controls over financial and program operations and to review the management of accounts receivable for compliance with Commonwealth regulations.

Our prior audit disclosed weaknesses in SHC's internal control system that had led to various financial issues, including shortcomings in fixed asset management and reporting, inadequate Generally Accepted Accounting Principles (GAAP) reporting, miscellaneous income not being remitted to the Commonwealth, and other internal control deficiencies. Our follow-up review determined that miscellaneous income is being remitted to the Commonwealth and some improvements were made to fixed asset management, but improvements are still needed in various administrative, accounting, operations, and internal control areas.

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Our prior audit of SHC found that in several instances income was received from license agreements for communication equipment, vending-machine commissions, and laundry-machine use, but those receipts were deposited into the Donation or Legacy Accounts, contrary to Chapter 29, Section 2, of the General Laws, which requires that such income be deposited into the Commonwealth's General Fund. Our follow-up review disclosed

that SHC has taken corrective action and has properly handled miscellaneous income totaling \$66,670.

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Our prior audit disclosed that improvements were needed regarding fixed asset management and reporting responsibilities. Our follow-up review revealed that although SHC has taken some corrective action by preparing an inventory listing of non-GAAP assets, tagging all new equipment purchases, and beginning the task of tagging all existing equipment on site, it needs to take additional corrective action.

SCH purchased \$184,326 in assets during the audit period; we selected 10 invoices, for 27 items totaling \$116,272 purchased during our audit period and consisting of snowblowers, a dishwasher and dishtable, refrigerators, wheelchairs, computers, copier, oven, and hematology system. We were able to locate all of the items. However, when we checked them for an inventory identification tag and listing on the inventory report, we found that 18 of the 27 (67%) were not tagged or listed. In addition, during a site survey, we randomly selected 26 tagged items to determine whether they were listed on the inventory report; we found that four of the 26 (15%) were not properly listed and six were listed twice.

b. Improvements Needed in GAAP Reporting **5**

Our prior audit disclosed that SHC had not properly reported all required information on the fiscal year 2003 GAAP report submitted to the Office of the State Comptroller (OSC). Our follow-up review found that although a minor adjustment had been made, essentially the same deficiencies existed.

Specifically, the Patients Fund account balances were understated by \$179,466; the Legacy Fund checking account balance was understated by \$47,697; the Donation Fund accounts were understated by \$147,006; the Legacy Fund Investment Account balance of \$8,578,248 was not reported; the Accounts Receivable balance of \$93,057 was not supported by detailed documentation; and a Billing and Accounts Receivable Subsystem adjustment totaling \$475,620 was not supported by detailed documentation. Also, the Materials and Supplies Inventory balance was again reported as "not applicable," without supporting documentation to verify that designation.

c. Internal Control Improvements Needed over Administrative, Accounting, and Operations Functions **10**

Our prior audit disclosed that SHC's internal controls over some of its administrative, accounting and operations functions needed improvement. Our follow-up review found that SHC (a) did not reconcile the Resident/Patient Investment Account balance—the amount reported to the Chief Financial Officer—

with the balance maintained by the facility Treasurer, resulting in a discrepancy of \$148,073; (b) transferred an inactive Patients Fund savings account totaling \$95,574 to the Donation Fund rather than remit it to the State Treasurer as unclaimed patients' funds; and (c) did not ensure that all of its bank deposit balances, totaling \$276,021 as of September 30, 2004, were covered by Federal Deposit Insurance Corporation insurance.

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Our review of SHC's newly implemented billing system disclosed many operational weaknesses, which resulted in that billing system's inability to produce reliable information required for GAAP financial reporting and the potential for lost revenue. The information provided by SHC regarding billing for medical services was incomplete, inaccurate, and dated, and it was improperly reported to and reconciled with the Commonwealth's Billing and Accounts Receivable Subsystem.

Specifically, SHC could not provide documentation detailing billings, adjustments, and cash receipts for three months during the audit period. In addition, accounts receivable ending balances were brought forward incorrectly; as a result, prior months' ending balances did not agree with the subsequent months' beginning balances.

Also, we noted substantial write-off activity, totaling over \$781,000 during the review period, for which there was no supporting documentation. SHC has no policy and procedure regarding write-offs, and no authorization was documented for those entries.

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INTRODUCTION

Background

The Soldiers' Home in Massachusetts—Chelsea (SHC) was founded in 1883 and is one of the oldest and largest veterans' homes in the country. Authorized by Chapter 115A of the Massachusetts General Laws, SHC is a state-funded agency under the Executive Office of Health and Human Services. SHC's mission is to care for and provide medical services to honorably discharged Massachusetts veterans who have served during a period of war. SHC is also charged with educating health professionals and participating in research to advance medical science.

SHC provides inpatient services for approximately 500 male and female war veterans and accounts for 18,000 outpatient visits per year. It is located on a 17-acre campus that consists of nine buildings, including the 189-bed Quigley Memorial Hospital and the LPN School of Nursing. A five-year Massachusetts residency is required for eligibility for inpatient services.

SHC is governed by a seven-member Board of Trustees appointed by the Governor to oversee the management of the organization. As of our audit date, there were two vacancies on the Board of Trustees. One position has been vacant since October 1998, and the other since October of 2003. In addition, three trustees' terms had more recently expired, but they were still functioning as active board members pending reappointment.

In fiscal year 2004, SHC received state appropriations of \$22,948,306, of which \$22,469,514 was expended for its daily operations.

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 SHC for the period November 1, 2003 to September 30, 2004. Our audit was conducted in accordance with applicable Generally Accepted Government Auditing Standards. The scope of our audit consisted of a follow-up review of the issues identified in our prior audit (No. 2004-0065-3S) to (1) determine whether steps were implemented to strengthen the system of internal controls over financial and program operations and (2) review the management of accounts receivable.

Specifically, our objectives were to

- Determine whether SHC took corrective action regarding fixed asset management, miscellaneous income, Generally Accepted Accounting Principles (GAAP) reporting, and internal control improvements over administrative, accounting, and operations functions
- Determine SHC's compliance with Commonwealth regulations regarding management of accounts receivable

To achieve our audit objectives, we conducted interviews with management and staff and reviewed prior audit reports. In addition, we obtained and reviewed policies and procedures, accounting records, and other source documents. Our assessment of the internal controls over financial operations at SHC was based on those interviews and our review of documents.

During our audit, we met with officials and staff to discuss issues that had arisen during the audit and requested clarification and confirmation regarding those issues. On February 2, 2005, we met with the Commandant and the Chief Financial Officer to discuss our draft audit results. The officials stated that they would look into the issues we had noted.

Our review found that SHC had corrected the issue concerning miscellaneous income identified in our prior audit. However, we determined that SHC had not taken measures to adequately address the weaknesses found in fixed asset management, GAAP reporting, and internal controls over administrative, accounting, and operations functions. In addition, we found weaknesses in billing for medical services, which resulted in the lack of valid accounts receivable and the potential loss of revenue.

AUDIT RESULTS

1. PRIOR AUDIT RESULTS RESOVED: MISCELLANEOUS INCOME

Our prior audit of the Soldiers Home in Massachusetts—Chelsea (SHC) found that in several instances income was received from license agreements for communication equipment, vending-machine commissions, and laundry-machine use, but those receipts were deposited into the Donation or Legacy Accounts, contrary to Chapter 29, Section 2, of the Massachusetts General Laws, which requires that such income be deposited into the Commonwealth’s General Fund.

Our follow-up review found that SHC properly handled antenna lease income of \$29,604 by depositing it into the General Fund. For antenna lease income of \$28,993, an in-lieu-of payment for goods and services that directly benefit the facility, SHC did not accept direct payment; rather, payment was made to the specific vendor.

Also, SHC has entered into a formal agreement with the vending-machine company serving its premises; the agreement lists the number and locations of the machines, the percentage of sales to be received as commission, and the payment schedule for those commission payments. Income of \$3,143 derived from commissions were then deposited into the General Account and forwarded to the Commonwealth’s General Fund.

Concerning laundry-machine revenue of \$4,930, SHC officials stated that the laundry machines were purchased through the Donation Fund Account and all maintenance and servicing of the machines is paid for through the same account; therefore, any laundry revenue derived from the laundry machines rightfully belongs to SHC and is deposited into its Donation Fund Account.

2. PRIOR AUDITS NOT RESOLVED

During our follow-up audit, we determined that SHC had not taken measures to adequately address issues identified during the prior audit regarding SHC’s management of fixed assets, Generally Accepted Accounting Principles (GAAP) reporting, and internal controls over administrative, accounting, and operations functions.

a. Improvements Needed in Fixed Asset Management

Our prior audit disclosed that SHC did not comply with fixed asset management and reporting responsibilities, including conducting an annual physical inventory; preparing a

current, complete fixed asset report based on the results of that inventory; and tagging all equipment purchases with an individual property control identification number. Our prior-audit recommendation was that SHC take the necessary corrective action regarding fixed asset management and reporting to ensure compliance with Office of the State Comptroller (OSC) guidelines, including conducting a physical inventory, preparing a complete and accurate fixed asset report each fiscal year, and accurately recording and reporting all equipment purchases. We also recommended that SHC strengthen its policies and procedures to ensure adequate internal control over fixed assets.

Our follow-up audit disclosed that SHC appointed a fixed-asset manager responsible for internal controls. Although SHC has taken some corrective action by preparing an inventory listing of non-GAAP assets, tagging all new equipment purchases, and beginning the task of tagging all onsite equipment, it still needs to take additional corrective action. As in the prior audit, SHC provided an inventory report; however, because it does not prepare or perform physical inventories, has only recently begun to tag equipment, and does not report all equipment purchases from the Legacy Fund and Donation Fund, SHC cannot assure the accuracy and completeness of its inventory report. For the period November 1, 2003 through September 30, 2004, asset purchases made from SHC's appropriation, Legacy Fund, and Donation Fund totaled \$184,326, as follows:

| | |
|------------------------|------------------|
| Appropriation Accounts | \$132,167 |
| Legacy Fund | 41,679 |
| Donation Fund | <u>10,480</u> |
| Total | <u>\$184,326</u> |

For the management of fixed assets, the OSC provides guidance in the form of publications, including the Internal Control Guide (Volume II, Appendix 3: Internal Controls for Fixed Assets); Comptroller Policy Memo 310—Fixed Asset Policies; and Comptroller Policy Memo 313—Fixed Asset Subsystem Policy Manual and User Guide. Specifically, the Massachusetts Management Accounting and Reporting System (MMARS) Policy titled Fixed Assets—Accounting and Management, issued March 22, 2004, states, in part:

- *The CFO is responsible for the management of fixed assets.*

- *There shall be an annual physical inventory of fixed assets, including at a minimum a verification of the existence and location of fixed assets owned by a department.*
- *There shall be a reconciliation of the results of that inventory. A department will maintain supporting documentation of fixed asset transactions.*
- *All fixed assets shall be reported in accordance with the requirements as they relate to each group of fixed assets. These groups are GAAP Fixed Assets and Non-GAAP Fixed Assets.*

We selected 10 invoices, totaling \$116,272, for 27 items purchased during our audit period. These items included snowblowers, a dishwasher and dishtable, refrigerators, wheelchairs, computers, copier, oven, and hematology system. Although we were able to locate all of the items, we found that 18 of the 27 (67%) did not have inventory identification tags or were not listed on the inventory report. In addition, during a site survey, we randomly selected 26 tagged items to determine whether they were listed on the inventory report; we found that four of the 26 (15%) were not properly listed and six were listed twice.

Because SHC did not conduct a physical inventory and the required reconciliation, it exposed its property to possible loss, theft, or misuse.

Recommendation

SHC should continue to take the necessary corrective action regarding fixed asset management to ensure compliance with the OSC's guidelines, including conducting an annual physical inventory, preparing a complete and accurate fixed asset report each fiscal year, and accurately reporting all equipment purchases. SHC should strengthen its policies and procedures to ensure adequate internal controls over fixed asset management. These policies should require that all departments work cooperatively with the fixed asset manager to control the acquisition, recording, transfer, and disposal of fixed assets, and to insure that all requirements of fixed asset management are met.

b. Improvements Needed in GAAP Reporting

Our prior audit disclosed that SHC had not properly reported all required information on its fiscal year 2003 GAAP report submitted to the OSC. Specifically, we found that the Patient Accounts' balance was incorrect, Assets Held In Trust was incomplete, Materials and

Supplies Inventory was omitted, and Accounts Receivable was not reconciled and did not have supporting documentation.

We recommended that SHC (1) ensure that future GAAP reports reflect, in accordance with GAAP and OSC requirements, all revenues, receivables, expenditures, obligations, and assets held by SHC and (2) establish policies and procedures in its internal control plan to provide for the accurate collection of all financial information required for the submission of the annual GAAP reports.

Our follow-up review found that SHC did not take corrective action to address the prior-audit issues. Specifically, we noted the following:

- Patients Accounts, as reported on the Assets Held In Trust schedule, still did not include the Insured Money Market Account balance of \$31,393.
- Patients Accounts, as reported on the Assets Held In Trust schedule, still did not report the Resident/Patients Fund Investment Account balance at the fair market value, thereby underreporting the balance by \$148,073.
- The Resident/Patients Fund Investment Account book balance is still not being reconciled with the fair market value of the account.
- Although the Legacy Fund checking account balance was included as an Asset Held In Trust, it was understated by \$47,697.
- The Legacy Fund Investment Account balance of \$8,578,248 was still not included on the Assets Held In Trust schedule.
- Although the Donation Fund checking account and investment account balance was reported as an Asset Held In Trust, it was understated by \$147,006.
- Materials and Supplies Inventory balance was again reported as “not applicable,” without supporting documentation to verify that designation.
- Accounts Receivable balances, as reported through the Commonwealth’s Billing and Accounts Receivable Subsystem (BARS), were again unsubstantiated and without supporting documentation.

OSC Memorandum FY 2002-26, issued on May 23, 2003, states, in part:

The Comptroller's Office is responsible for publishing annual financial reports of the Commonwealth. It is important that the information about revenues, receivables,

expenditures, obligations and assets owned are reported consistently and uniformly to meet financial reporting requirements.

Moreover, the OSC's fiscal year 2004 GAAP instructions provided detailed reporting requirements for all state entities, including for the following areas:

Accounts Receivable—On a statutory basis, revenue is generally recorded when the confirming cash is collected. Under GAAP, revenue is measured when earned. In this context, "accounts receivable" (A/R) represent additional revenue earned, but not yet measured on the statutory basis, for services performed or goods provided on or before year-end. Under GAAP, the receivable exists if the service was performed or the goods were provided on or before the June 30 year-end cut-off, regardless of when the department posts the transactions to MMARS or sends its bills.

Assets Held In Trust—"Assets held in trust" are the cash and other assets which the Commonwealth holds in a trustee capacity for third parties. Examples include patient or inmate canteen and gift funds, property and bank accounts.... In accordance with GAAP, the Commonwealth reports both the assets and the corresponding third-party liabilities. It also reports additions to, and deletions from, assets held during the fiscal year, in order to adequately disclose changes in its custodial responsibilities. Special GAAP reporting is needed only for those assets that are held at the department or facility, or at a local bank, and not accounted for through MMARS...

Materials and Supplies—Materials and supplies are consumable items used in department operations.... On a statutory basis, they are recorded as expenditures when purchased. For GAAP, however, any materials and supplies on hand at year-end, and intended for use in future operations, are considered assets. Special GAAP reporting is necessary to adjust expenditures and report these assets.

SHC's fiscal year 2004 GAAP report listed the Patients Account, with a balance of \$1,548,832 as of June 30, 2004, as an Asset Held In Trust. This balance consisted of the cash-on-hand balance, the checking account balance, and the book balance of the investment account. However, our review of the cash accounts disclosed that the Insured Money Market Savings Account, with a balance of \$31,393, was not included on the report. Also, the Resident/Patients Fund Investment Account was reported at book value rather than fair market value, and without any footnote to explain the reporting method, thus resulting in an understatement of \$148,073. As a result, the Patients Accounts balance reported in the GAAP report was understated by \$179,466, as detailed in the following table:

| | Cash Balance/ Statement Balances | GAAP Report | Variance |
|--------------------------------------|-------------------------------------|--------------------|------------------|
| Cash on Hand | \$ 37,725 | \$ 37,725 | - |
| Residents Fund Checking Account | 119,680 | 119,680 | - |
| Insured Money Market Savings Account | 31,393 | - | \$ 31,393 |
| Resident/Patient Investment Account | <u>1,539,500*</u> | <u>1,391,427</u> | <u>148,073</u> |
| Total | <u>\$1,728,298</u> | <u>\$1,548,832</u> | <u>\$179,466</u> |

*Market value as of June 30, 2004.

A further review of the Assets Held In Trust, as reported on the fiscal year 2004 GAAP report, disclosed that several additional accounts for which SHC is the custodian were again omitted or under-reported, resulting in a further understatement of \$8,772,951, as detailed in the following table:

| | Cash Balance/ Statement Balances | GAAP Report | Variance |
|--|-------------------------------------|------------------|--------------------|
| Donation Fund Checking Account and Investment Accounts | \$ 930,730* | \$783,724 | \$ 147,006 |
| Legacy Fund Checking Account | 208,586 | 160,889 | 47,697 |
| Legacy Fund Investment Account | <u>8,578,248*</u> | <u>-</u> | <u>8,578,248</u> |
| Total | <u>\$9,717,564</u> | <u>\$944,613</u> | <u>\$8,772,951</u> |

*Market value as of June 30, 2004.

The Legacy Fund consists of money, stocks, and bonds that have been bequeathed to the SHC, funds of former patients and residents that have remained unclaimed and have been returned to SHC by the Office of the State Treasurer, and interest earned by the investment of these funds.

The Donation Fund consists of unrestricted and restricted funds donated by organizations and individuals. Unrestricted donations are given in general support of the activities of SHC, and it is the Board of Trustees' responsibility to determine how they will be spent. Restricted donations are given for a specific purpose, and it is the Board's responsibility to ensure that they are spent in accordance with the wishes of the donors.

The above-noted omissions and miscalculations totaled \$8,952,417, and again resulted in the substantial understatement of the Assets Held In Trust as reported on the fiscal year 2004

GAAP report. Since our prior audit report informed SHC of its reporting obligation, the noncompliance noted in this follow-up review indicated a deliberate decision by the prior CFO to avoid disclosure of these assets. However, the new CFO acknowledged the omission and stated that he would ensure compliance.

The Materials and Supplies Inventory balance was reported as “not applicable” on the fiscal year 2004 GAAP report. However, SHC was unable to provide inventory reports for food and dining supplies, pharmacy and medical supplies, clothing, and office/maintenance supplies to support its assertion that the total value of these items as of June 30, 2004 was less than \$500,000—the only instance, per OSC regulation, whereby reporting on the GAAP report would be not applicable. SHC had the following materials and supplies expenditures for fiscal year 2004:

| | |
|--------------------------|--------------------|
| Food and Dining Supplies | \$ 918,680 |
| Pharmacy | 469,722 |
| Central Services | 732,222 |
| Other | <u>242,903</u> |
| Total | <u>\$2,363,527</u> |

Although SHC did not comply with materials and supplies inventory requirements for its fiscal year 2004 GAAP report, it has since provided current inventory reports listing items totaling approximately \$225,000. SHC officials stated that these reports will be maintained and physical inventories conducted as required, and they will be used to support the Materials and Supplies schedule submitted in future GAAP reports.

Accounts Receivable balances detailed on the GAAP report reflect financial information supplied by state agencies through BARS. SHC’s outstanding BARS receivable, as attached to the fiscal year 2004 GAAP report, showed the following balances:

| | |
|-------------------------|-----------------|
| Medicare | \$55,338 |
| Blue Cross/Blue Shield | 1,347 |
| Third-Party Payments | 1,960 |
| Direct Patient Payments | <u>34,412</u> |
| Total | <u>\$93,057</u> |

Although SHC's control accounts had been maintained during fiscal year 2004, no supporting documentation was available for review; therefore, SHC could not substantiate these balances. In addition, SHC could not provide details to support the numerous adjustments, including a year-end adjustment to MMARS totaling \$475,620, of which \$453,609 was an adjustment to the Medicare balance. Although BARS was used to post billings, collections, and monthly account receivables, SHC could not provide documentation to support those charges.

Proper submission of the GAAP Reporting Transmittal is required of all departments so that the Commonwealth's Comprehensive Annual Financial Report meets the highest standards for financial accounting and reporting. SHC must improve its GAAP reporting and supply the Commonwealth with accurate and complete information to help meet that standard.

Recommendation

SHC should ensure that future GAAP reports properly reflect all revenues, receivables, expenditures, obligations, and assets held by SHC in accordance with GAAP and OSC requirements. Also, SHC should establish policies and procedures in its internal control plan to provide for the accurate collection and supporting documentation of all financial information required for the submission of annual GAAP reports.

c. Internal Control Improvements Needed over Administrative, Accounting, and Operations Functions

Our prior audit noted shortcomings in SHC's internal controls over some of its administrative, accounting and operations functions. Specifically, SHC (a) did not reconcile the Resident/Patient Investment Account balance—the amount reported to the Chief Financial Officer (CFO)—with the balance maintained by the facility Treasurer; (b) transferred an inactive Patients Fund savings account to the Donation Fund rather than remit it to the State Treasurer as unclaimed patients' funds; and (c) did not ensure that all of its bank deposit balances were covered by Federal Deposit Insurance Corporation (FDIC) insurance.

We recommended that the SHC:

- Reconcile the Resident/Patients Fund Investment Account balance with the book balance reported to the facility Treasurer, and include the reconciled balance on the GAAP report
- Submit the inactive Patients Fund Savings Account to the State Treasurer as unclaimed patient funds
- Strengthen its policies and procedures to ensure adequate internal control over fixed assets, at a minimum requiring that departments work cooperatively to control the management of fixed assets
- Develop and implement policies and procedures to ensure FDIC insurance coverage of all SHC bank balances

According to Chapter 647 of the Acts of 1989, An Act Relative to Improving the Internal Controls within State Agencies, it is the responsibility of agency management to establish and maintain an effective internal control structure. Sound internal controls are essential to maintaining full accountability for resources and achieving management objectives in the most effective and efficient manner.

Our follow-up review disclosed three issues, which are discussed in the following sections:

SHC Did Not Reconcile the Resident/Patients Fund Investment Account Balance with the Book Balance Reported by the Facility Treasurer

The Resident/Patients Fund Investment account balance (fair market value) as of June 30, 2004, as reported to the CFO by UBS Financial, was \$1,539,500. The same investment account balance as reported by the facility Treasurer was \$1,391,427, which represents the initial investment plus the accumulation of 6% annual earned interest, posted monthly. That rate of return was arbitrarily established by SHC and was consistently applied, regardless of economic conditions. Actual revenue realized (dividends or capital gains) was not recorded by the Treasurer because the quarterly activity of the investment account was not made available to the Treasurer by the CFO. As a result, the Treasurer was unable to perform any reconciliations of these two figures on a quarterly basis, and over time the discrepancy grew to \$148,073. Although the investment account balance was reported by the CFO to the Board of Trustees at fair market value, no other internal control mechanism was in place to monitor this financial activity.

The OSC's Internal Control Guide for Managers states, in part:

Departments must periodically compare the physical resources and the accounting records to reduce the risk of unauthorized use of loss of resources and protect against wasteful and wrongful acts.

Proper internal controls would require that SHC reconcile its Resident/Patients Fund Investment Account balance with the book balance as reported by the SHC Treasurer.

An Inactive Patients Fund Savings Account Was Transferred to the Donation Fund

The Residents Money Market Savings Account had a balance of \$95,574 as of October 31, 2003. This account was originally established many years ago from patients' funds, and other than accruing interest on a monthly basis it was inactive. SHC could not provide documentation identifying the specific patients to whom those funds actually belonged. The Board of Trustees approved the transfer of the funds into the Donation Account, as a bookkeeping convenience. However, since these funds constitute actual patients' funds interest rather than donations, they should be considered unclaimed patients funds. Chapter 115A, Section 6, of the General Laws states, in part:

So much of any funds known as "Patients Funds" as represents monies belonging to, or deposited for the benefit of, patients or members who have been discharged or voluntarily departed from, or died at, either of said Homes, which shall have remained unclaimed for more than three years, shall be paid by the commandant or superintendent thereof to the state treasurer to be held subject to be paid to the person establishing a lawful right thereof, with interest at the rate of three per cent per annum from the time when it was so paid to the state treasurer to the time when it is paid by him to such person.... After six years from the date when such monies were paid to the state treasurer the same or any balances thereof then remaining in his hands shall be transferred to the trustees of said Home for deposit in its legacy fund or legacy account.

SHC Did Not Ensure That the Bank Deposit Balances, Totaling \$276,021 as of September 30, 2004, Were Covered by FDIC Insurance

The FDIC insures bank deposits, helps maintain sound conditions in our banking system, and protects the nation's money supply in case of financial-institution failure. All depositors have FDIC insurance on deposits up to \$100,000 at any FDIC-insured institution. Our audit disclosed that SHC is custodian of and maintains four bank accounts at a local bank. The total balance of these accounts was \$276,021 as of September 30, 2004. Since the FDIC guarantees a depositor's balances up to \$100,000 at each institution, \$176,021 of the SHC's funds is not covered by FDIC insurance and is therefore at risk in the event of financial-institution failure. This condition applies to the Legacy and Donation Accounts, since the

Patients Funds Account is considered to be a fiduciary account (i.e., deposit accounts owned by one party but held in a fiduciary capacity by another party) according to FDIC guidelines, and would not be subject to the \$100,000 limit. SHC is researching the classification of the Legacy and Donation Accounts as “public unit” accounts (deposit accounts of any state), and hopes to determine whether the checking and savings accounts would each be subject to the insured limit. SHC officials have stated that they will take the necessary steps to ensure that all funds are adequately insured.

Recommendation

The SHC should take the following actions:

- Reconcile the Resident/Patients Fund Investment Account balance with the book balance reported by the facility Treasurer, and include the reconciled balance on the GAAP report
- Submit the inactive Patients Fund savings account balance to the State Treasurer as unclaimed patient funds
- Develop and implement policies and procedures to ensure FDIC insurance coverage on all SHC bank deposit balances

3. IMPROVEMENTS NEEDED OVER BILLINGS AND ACCOUNTS RECEIVABLE SYSTEMS

In March 2003, SHC entered into a Services and Software Purchase Agreement with Core Health, Inc. to implement a comprehensive healthcare information software and supporting services package. The agreement included the purchase and installation of HomeSys Information System (HomeSys) to replace the software package used by SHC. HomeSys is a fully integrated Windows-based healthcare management system for healthcare delivery networks. The HomeSys financial information system modules include billing, accounts receivable and reporting, electronic claims management, electronic remittance notification, intake, patient trust accounting, and outpatient scheduling. There were three elements to implementing this software package: the software itself; staff and site preparation, installation, and training for the new software; and the purchase and installation of the hardware and technical platform to support and deliver the software.

During implementation, the management of the billing operation for SHC was assumed by the University of Massachusetts Medical School (UMMS) as part of a reorganization within the

Executive Office of Health and Human Services, and resulted in offsite supervision of the SHC billing office.

Our review of the newly implemented billing system for SHC disclosed many operational weaknesses, which resulted in that billing system's inability to produce reliable information required for financial reporting under GAAP (see Audit Result 2b). The information provided by SHC regarding billing for medical services was incomplete, inaccurate, and dated and was not properly reported to and reconciled with BARS. Specifically, SHC could not provide documentation detailing billings, adjustments, and cash receipts for three months during the audit period. In addition, accounts receivable ending balances were brought forward incorrectly; as a result, prior months' ending balances did not agree with the subsequent months' beginning balances.

To test the billing/receivable cycle at SHC, we selected January 2004, the most current month available for review. Billings for the month totaled approximately \$137,000. Our review disclosed the following:

- There was a serious time lag in preparing and submitting bills for reimbursement (11 months) and entering receipts into the system (12 months). If this trend continues, SHC runs the risk of being denied Medicare reimbursement due to the time lapse between the date of service and the submission of the claim.
- The information provided to us was limited and incomplete. SHC could provide no trial balance, because no activity was posted to the subsidiary ledger. As a result, there is no reconciliation of the accounts receivable balance, with supporting documentation, as required by the OSC. There is also no summary reporting to encompass all the sources of billing.
- The information that was available for review was inaccurate. Because SHC was experiencing difficulty with HomeSys, it used the new system only for limited functions and resorted to using a manual system in some cases. Also, SHC was experiencing a high rate of rejected claims from Medicare due to improper submission of the data, which also contributed to the lack of accurate information.
- We noted substantial write-off activity during the review period, totaling over \$781,000, for which there was no supporting documentation. SHC has no policy and procedure regarding write-offs, and no authorization was documented for those entries.
- There is no attempt at collection of outstanding claims for third-party payers other than commercial insurance.

- Management has not prepared an internal control plan or documented the billing operation policies and procedures.

SHC is required to comply with BARS, a statewide, centralized subsystem used for billing and collections. Full accounting, recording, and reporting of earned revenue/accounts receivable due the Commonwealth are accomplished by using BARS. OSC Policy Memorandum No. 315, issued August 28, 2001, states, in part:

Detailed Reporting

Departments are required to utilize BARS to record all detailed transactions related to an Earned Revenue/Accounts Receivable event. Only departments with previously Comptroller- approved delegated billing and accounts receivable systems are exempted from the requirement. BARS summary reporting of receivable events is required for all categories of earned revenue/accounts receivable that are not otherwise recorded through detail reporting.

Summary Reporting

Departments are required to utilize BARS to maintain one summary receivable, across fiscal years that accurately represent the net value of the Earned Revenue/Accounts Receivable by revenue source code. When recording earned revenue/receivables at a summary level on BARS, departments are required to maintain their approved delegated accounts receivable system at a sufficient level of detail to verify the accuracy of summary reporting. By the close of each accounting period it is a requirement that the summary receivable amount be adjusted by the department.

The accounts receivable amounts, as reported in the fiscal year 2004 GAAP report, could not be substantiated because they lacked any supporting documentation. There was also a lack of supporting documentation for the write-off activity during the audit period; SHC could not detail the specific amounts of the write-off total.

The operations problems of the SHC billing and receivable system can be attributed, at least in part, to the lack of knowledge over the functionality of HomeSys on the part of both SHC and UMMS staff. Those receiving the initial training on the system are no longer employed by SHC due to turnover and retirement, moreover, the UMMS staff supervising the SHC billing was not trained on the system and has no familiarity with it. The implementation of the new system did not take place with the parallel operation of the old system for a designated period of time as is customary for system conversion. Therefore, there was no old system to fall back on when the new system was not successfully implemented. Over time, the billing operation fell further behind, because the system problems could not be addressed quickly enough to keep up with the

monthly billings. In addition, management oversight over the implementation of the HomeSys system was insufficient. No SHC official took responsibility for (1) ensuring that the contractor fulfilled its contractual responsibilities and (2) overseeing SHC's billing unit to ensure continuity during HomeSys implementation. As a result, SHC has a system that does not provide reliable information for medical services billings and accounts receivable, and incorrect financial information appears on SHC's GAAP report. Consequently, the inefficient operation of the HomeSys system may result in the potential loss of revenue due the Commonwealth.

Recommendation

The SHC should

1. Appoint a member of senior management to oversee the review and follow-up of the contractor's responsibilities in the implementation of HomeSys
2. Review departmental needs to determine whether additional training is needed, or system adjustments are necessary to HomeSys, to ensure the efficient operation of SHC's billing department
3. Establish a reasonable schedule for departmental activity to ensure timely billings and other financial information, including a timetable for bringing prior billing data to current status

APPENDIX I

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

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

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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.

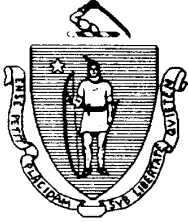
Passed to be enacted, *William W. Budge*, President.

January 3, 1990.

Approved, *Richard H. Kiah* Governor.

APPENDIX II

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.

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

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

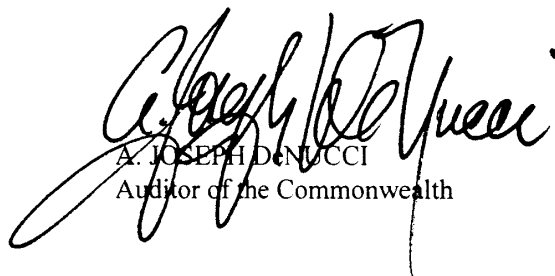
- ◆ The Office of the Comptroller offers departments free monthly training on internal controls. These classes are listed in the *OSC Training Bulletin*.
- ◆ The Office of the Comptroller provided a new document entitled the *Internal Control Guide for Managers* on the Office of the Comptroller's Web 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:

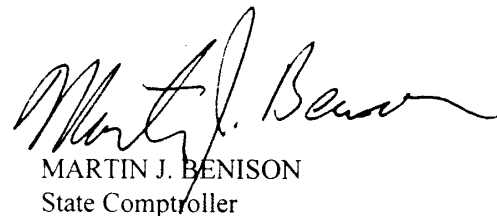
<http://www.magnet.state.ma.us/sao/>.

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