



Commonwealth of Massachusetts
Office of the State Auditor
Suzanne M. Bump

Making government work better

Official Audit Report-Issued October 10, 2013

Office of the Attorney General

For the period July 1, 2010 through June 30, 2012





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Office of the State Auditor
Suzanne M. Bump

Making government work better

October 10, 2013

The Honorable Martha Coakley
Attorney General of the Commonwealth
One Ashburton Place
Boston, MA 02108

Dear Attorney General Coakley:

I am pleased to provide this performance audit of the Attorney General's Office. This report details the audit objectives, scope, methodology, findings, and recommendations for the audit period, July 1, 2010 through June 30, 2012. My audit staff discussed the contents of this report with management of the Attorney General's Office, and their comments are reflected in this report.

I would also like to express my appreciation to the Attorney General's Office for the cooperation and assistance provided to my staff during the audit.

Sincerely,

A handwritten signature in blue ink, appearing to read "SMB", written over a light blue circular watermark.

Suzanne M. Bump
Auditor of the Commonwealth

TABLE OF CONTENTS

INTRODUCTION AND SUMMARY OF FINDINGS AND RECOMMENDATIONS 1

OVERVIEW OF AUDITED AGENCY 4

AUDIT SCOPE, OBJECTIVES, AND METHODOLOGY 6

AUDIT FINDINGS 9

1. CONTROLS OVER USER ACCOUNT MANAGEMENT NEED IMPROVEMENT 9

2. PRIOR AUDIT RESULTS PARTIALLY RESOLVED 11

 a. Filing-Fee Operations of the Not-for-Profit Organizations / Public Charities Division11

 b. Fixed-Asset Management14

INTRODUCTION AND SUMMARY OF FINDINGS AND RECOMMENDATIONS

The Attorney General's Office (AGO), which was established by Chapter 12, Section 1, of the Massachusetts General Laws, is a constitutional office of the Commonwealth under the supervision of the Attorney General, an independently elected executive officer. The AGO is responsible for representing the Commonwealth in all lawsuits and civil proceedings in which the Commonwealth is an interested party. The AGO maintains a main office in Boston and three regional offices in western, central, and southeastern Massachusetts. Organizationally, the AGO is composed of the Executive Bureau, the Business and Labor Bureau, the Criminal Bureau, the Government Bureau, and the Public Protection and Advocacy Bureau. The AGO received a total state appropriation of \$37.1 million for fiscal years 2011 and 2012.

Our audit was initiated to determine whether the AGO's internal control structure was suitably designed and to assess the adequacy of controls over its operations, including internal controls over financial records pertaining to revenue and expenditures. Further, we performed a follow-up review of issues identified during our prior audit of the AGO (No. 2003-0072-2S), which disclosed certain deficiencies in revenue and fixed-asset management controls.

Highlight of Audit Findings

Our test of system access security controls revealed that 143 former AGO employees, including 56 with high-level access privileges to the AGO's case-management database system, remained on the active user list. Despite there being no external or remote access to the AGO case-management system and no evidence of any unauthorized access, the AGO should strengthen its access security controls by deactivating individuals who are no longer authorized to have access to its systems to prevent any internal unauthorized access.

Prior Audit Results Partially Resolved

- Our prior audit report disclosed that inadequate administrative controls and an outmoded public-charities database had hindered the Not-for-Profit Organizations / Public Charities Division's (NPO/PCD's) enforcement of Massachusetts laws requiring accountability by all public charities engaging in charitable work or fundraising in the Commonwealth. Additionally, our prior report noted that the NPO/PCD did not adequately track or account for presumed public charities operating in the Commonwealth that did not respond or return required filings to the NPO/PCD. Our current audit found that the AGO has made improvements related to its filing-fee operations. Specifically, the NPO/PCD improved the availability of annual filing forms to public charity organizations by providing the forms online. Also, our audit determined that the NPO/PCD maintained effective internal controls related to its logging and reconciliation of

checks received as payment for annual filing fees. However, our examination of filing-fee cash receipts showed that improvements are needed over the timely processing of filing fees to comply with both the AGO's and the Office of the State Comptroller's (OSC's) policies. Specifically, our audit testing identified 15 annual filing-fee transactions consisting of 1,704 checks, totaling \$249,620, that had not been processed and forwarded to the AGO's Budget Division for deposit within the required one-business-day period. Although there was no evidence of misplacement or loss of checks found, not adhering to these policies increases the risk of checks being misplaced or lost and the potential loss of revenue due the Commonwealth.

- Our prior audit report disclosed that the AGO had not conducted annual physical inventories and reconciliations or ensured that its inventory records were complete by including total costs and asset identification numbers, as required by the OSC. Further, our prior audit found that acquisitions and disposals of generally accepted accounting principles (GAAP) fixed assets were not recorded in the Commonwealth's Fixed Asset Subsystem on a timely basis and that the AGO internal control plan (ICP) relating to inventory did not include current OSC fixed-asset policies. During our current audit, AGO officials stated that the agency uses a perpetual inventory and reconciliation system. However, we were not provided with documentation to substantiate this assertion and further noted that contrary to the OSC's policies, the AGO did not conduct an annual physical inventory and reconciliation of its fixed assets. In addition, we found that the AGO did not consistently assign each GAAP and non-GAAP fixed asset an identification number for tracking and control purposes and that controls still needed strengthening to ensure that GAAP fixed-asset determinations for leased fixed assets are properly and promptly completed, recorded, and presented in the Commonwealth's Comprehensive Annual Financial Report financial statements. Finally, we found that the AGO submitted inaccurate OSC-required midyear and annual inventory reviews and reconciliations of GAAP fixed assets and related confirmation forms. Without the AGO's performing an annual physical inventory and reconciliation and adhering to the OSC Fixed Asset Accounting and Management Policy, there is the potential for Commonwealth assets to be improperly safeguarded against loss, theft, or misuse and the inability to verify that its inventory system of record and the Fixed Asset Subsystem are complete, accurate, and up to date.

Recommendations of the State Auditor

- The AGO's Information Technology Division (ITD) should perform an immediate review of the status of all active users of its case-management system and other application systems and deactivate access privileges for individuals who no longer require, and/or are not authorized to have, access to these systems. System access controls should (1) delegate authority and responsibilities to ensure that the AGO's ITD meets the objectives of its ICP, (2) identify and assess how changes in office employment could affect access security, (3) establish control activities to ensure that the directives detailed in the AGO's ICP are effectively carried out and system access properly secured, (4) develop documented policies and procedures requiring that the Human Resources Division notify the AGO's ITD security administrator of any changes in employee status that would warrant a change or deactivation of access privileges to the AGO's case-management system and other systems as necessary, and (5) require periodic (e.g., quarterly) reviews of user access lists to ensure that specific access privileges are appropriate and up to date.
- NPO/PCD should more closely monitor established control procedures to ensure that checks (fees) collected are sent to the Budget Division within one business day of their receipt in

accordance with AGO and OSC policies and procedures. If the volume of checks received and the necessary processes in place make it difficult for the AGO to meet the requirement of depositing checks within one business day, the AGO should consider asking the Executive Office of Administration and Finance and the Office of the State Treasurer for an exception to the requirement of daily cash-receipt remittance.

- The AGO should develop and implement the necessary policies and procedures and related internal controls to ensure that an annual physical inventory and reconciliation are properly conducted and documented on or around June 30 of each fiscal year in compliance with OSC policies and procedures.
- The AGO should assign unique asset identification numbers to all GAAP and non-GAAP fixed assets to better track and control fixed assets.
- The AGO should establish and implement the necessary internal controls to ensure that it follows the existing OSC inventory and reporting policies regarding fixed assets, particularly as they relate to GAAP fixed assets, and should record GAAP fixed assets in the Fixed Asset Subsystem within seven days of acquisition. Moreover, the AGO should review its policies and procedures regarding oversight of the OSC's midyear and annual fixed-asset inventory review and reconciliation requirement and determine whether additional controls are needed to ensure that confirmation forms submitted to the OSC accurately report GAAP fixed-asset data.

OVERVIEW OF AUDITED AGENCY

The Attorney General's Office (AGO) was established by Chapter 12, Section 1, of the Massachusetts General Laws and is a constitutional office of the Commonwealth under the supervision of the Attorney General, an independently elected executive officer. The AGO is responsible for representing the Commonwealth in all lawsuits and civil proceedings in which the Commonwealth is an interested party. The AGO maintains a main office in Boston and has three regional offices in western, central, and southeastern Massachusetts. As of our audit period, the AGO was composed of the following bureaus and divisions.

The Executive Bureau

The Executive Bureau provides administration, public information, and policy development support, as well as operational, information technology, human resources, and fiscal management services for the AGO. The Executive Bureau includes the following divisions: the General Counsel's Office, the Policy and Government Division, the Community Information and Education Division, the Information Technology Division, the Human Resources Division, the Communications Division, the Budget Division, the Public Inquiry and Assistance Center, the Law Library, and the Victim Services Division.

The Business and Labor Bureau

The Business and Labor Bureau provides investigative, reporting, and enforcement services to provide certainty and equality in the marketplace and includes five divisions: the Energy and Telecommunications Division; the Fair Labor Division; the Medicaid Fraud Division; the Not-for-Profit Organizations / Public Charities Division; and the Business, Technology and Economic Development Division.

The Criminal Bureau

The Criminal Bureau investigates and prosecutes a wide range of criminal cases and includes the following eight divisions: the Public Integrity Division, the Fraud and Financial Crimes Division, the Appeals Division, the Cyber Crime Division, the Insurance and Unemployment Fraud Division, the Environmental Crimes Strike Force, the Financial Investigations Division, and the Enterprise and Major Crimes Division.

The Government Bureau

The Government Bureau represents the Commonwealth, its agencies, and officials in civil litigation and defends Commonwealth employees from civil claims made against them as a result of the performance of their duties. The Government Bureau also enforces the state's Open Meeting Law and reviews and approves town bylaws. The Government Bureau includes the following four divisions: the Administrative Law Division, the Division of Open Government, the Trial Division, and the Municipal Law Unit.

The Public Protection and Advocacy Bureau

The Public Protection and Advocacy Bureau enforces laws protecting the Commonwealth through investigation, litigation, and other forms of advocacy and includes the following six divisions: the Consumer Protection Division, the Civil Rights Division, the Environmental Protection Division, the Health Care Division, the Insurance and Financial Services Division, and the Antitrust Division.

During our audit period, the AGO received a total of \$255,730,681 in funding from the following sources.

Revenue Source	Fiscal Year 2011	Fiscal Year 2012
State Appropriation	\$ 37,173,732	\$ 37,190,571
One-Time Settlement ¹	14,993,360	0
Agency Refund Receipts	14,419,084	56,411,818
False Claims Recoveries	13,060,220	11,395,645
Trust Contributions	9,919,361	13,573,246
Miscellaneous	9,166,869	4,217,111
Federal Operations Reimbursement	3,761,745	3,705,814
Fines and Penalties	2,855,921	8,356,292
Fees	2,555,570	4,835,723
Assessments	929,307	803,450
Disability Adjudication	169,247	160,888
Crime Victim Compensation	911,315	1,165,502
Unemployment Insurance Administration	403,498	425,204
Reimbursements – Civil Action	516,632	2,108,900
Other (Interest, Licenses, and Other Income)	<u>327,976</u>	<u>216,680</u>
Total	<u>\$ 111,163,837</u>	<u>\$ 144,566,844</u>
Total for Fiscal Years 2011 and 2012	<u>\$ 255,730,681</u>	

¹ The one-time settlement accepted in fiscal year 2011 represents payments received from a settlement reached between a financial-service company, UBS, and the AGO and 24 other state attorneys general as part of an investigation of anticompetitive and fraudulent conduct.

AUDIT SCOPE, OBJECTIVES, AND METHODOLOGY

In accordance with Chapter 11, Section 12, of the Massachusetts General Laws, we conducted a performance audit at the Attorney General's Office (AGO) for the period July 1, 2010 through June 30, 2012.² The scope of our audit included a review of the AGO's internal control structure in place to support its operations, an examination of controls over the administration of public charities, and an examination of expenditures and revenues. We also evaluated system access security controls over the AGO's mission-critical database application system. Further, we performed a follow-up review of issues identified in our prior audit report of the AGO (No. 2003-0072-2S), which noted deficiencies in the areas of public-charity filing fees, revenue, and fixed-asset management.

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. Our audit objectives were to determine whether:

- The AGO took appropriate corrective action regarding the following deficiencies disclosed in our prior audit report (No. 2003-0072-2S):
 - Revenue controls and registration and filing-fee operations of the Not-for-Profit Organizations / Public Charities Division (NPO/PCD):

In order to achieve this objective, we examined (1) the NPO/PCD's controls for the processing and reconciliation of checks received as payment for fees, (2) logs maintained by the NPO/PCD (the receiver of the checks) and the Budget Division (the depositor of the checks) to ensure that the checks were being recorded and deposited in a timely manner, and (3) the NPO/PCD's ability to make annual filing forms readily available to organizations.

- Controls over fixed-asset management:

In order to achieve this objective, we examined the AGO's current internal controls over fixed assets to ensure that they complied with the Office of the State Comptroller's (OSC's) Fixed Asset Accounting and Management Policy and Fixed Assets – Acquisition Policy and the approval process required by the Operational Services Division for surplus-property disposal. We also reviewed the AGO's inventory listings to determine whether the AGO performed annual physical inventories and reconciled the results to the system of record. Further, we ascertained whether inventory records contained important data fields, including location, tag numbers, historical cost data, and acquisition dates. Finally, we sought to

² In some cases, it was necessary for the OSA to test current data that fell outside this audit period.

determine whether the AGO accurately recorded inventory acquisitions and dispositions in the Massachusetts Management Accounting and Reporting System (MMARS) on a timely basis.

- The AGO’s overall internal control structure was suitably designed and implemented to support its operations. In order to achieve this objective, we examined the AGO’s internal control plan (ICP) and supplemental policies that support the ICP’s objectives. These policies included, but were not limited to, the Employee Manual, the Budget Manual, the Revenue Control Manual, policies for fixed-asset management, and the internal policies and procedures of the NPO/PCD and the AGO’s Information Technology Division.
- The NPO/PCD has established and implemented adequate internal controls over its program operations. In order to achieve this objective, we tested the NPO/PCD’s oversight procedures regarding charities to ensure compliance with applicable laws and regulations. For the purposes of our audit, we tested a statistical sample of 64 randomly selected charities from a population of 26,572 active charities, as well as a judgmental sample of 4 from a population of 1,586 out-of-compliance charities, to determine compliance with applicable laws and regulations.
- The AGO has adequate internal controls to ensure that the financial records pertaining to expenditures and revenue are accurate, up to date, and maintained in accordance with OSC guidelines. Specifically, we:
 - Examined expenses to determine whether they were reasonable, necessary, and supported by sufficient documentation; recorded in a timely and accurate manner; and paid in compliance with applicable laws, regulations, and contract terms. In order to perform this objective, we categorized the AGO’s expenditure classifications and assessed risk for each expenditure classification as “high,” “slightly above moderate,” “moderate,” or “low” based on our assessment of internal controls and total expenditures during the audit period. For the purposes of this audit, we tested a judgmental sample of 70 transactions from the expenditure classifications that were assessed a control risk of “moderate” to “high,” as well as 5 transactions from expenditure classifications that were assessed a control risk of “low.”
 - Examined revenue to determine whether amounts received were correct; were recorded accurately, in the proper account period, and in a timely manner; and complied with applicable laws, regulations, and agreements. In order to perform this objective, we categorized revenue sources and assessed control risk for each revenue source. For the purposes of this audit, we tested a judgmental sample of 76 transactions for those revenue sources that exceeded 4% of total revenue collected during fiscal years 2011 and 2012. Accordingly, our sample included revenue from the following categories: Settlements, False Claims Recoveries, Trust Contributions, Agency Refund Receipts, Fees, Fines and Penalties, and Miscellaneous.
- System access security controls over the case-management application database were suitably designed and implemented to ensure that access privileges to the application system were being properly safeguarded and restricted to authorized users. We reviewed control policies regarding login ID and password administration and composition and evaluated the appropriateness of documented policies. To determine whether adequate controls were in place to ensure that

access privileges to the case-management system were granted only to authorized users, we reviewed and evaluated procedures for authorizing, activating, and deactivating access to the application. To verify that all users were current AGO employees, we compared a system-generated user account list, dated August 31, 2012, to an AGO payroll list, dated August 26, 2012.

To accomplish our objectives, we also analyzed AGO payment information and state accounting records in MMARS to identify payments made by the Commonwealth for the purposes of funding the AGO's operations. The electronic data sources used for this analysis constitute the official procurement and accounting records of the Commonwealth, are widely accepted as accurate, and form the basis for the Commonwealth's audited annual financial statements. Accordingly, our audit did not involve a comprehensive assessment of the reliability of source Commonwealth data. However, we did perform analytical procedures, such as comparisons and reconciliations to available revenue and expenditure summary totals in the AGO's accounts, to confirm that the Commonwealth database information we used was consistent with other available information. Based on that analysis, we concluded that the data used were of sufficient reliability for the background information, sampling methodology, and other purposes of our audit.

Except for the issues addressed in the Audit Findings section of this report, for the period July 1, 2010 through June 30, 2012, the AGO maintained adequate internal controls over its financial operations and program activities and complied with applicable laws, rules, and regulations for the areas tested.

AUDIT FINDINGS

1. CONTROLS OVER USER ACCOUNT MANAGEMENT NEED IMPROVEMENT

Our audit found no evidence that the Attorney General's Office's (AGO's) case-management system had been improperly accessed externally or remotely, and we did find that the AGO had documented certain information technology (IT) policies and procedures; assigned responsibility for system access security controls over its case-management database system; and instituted appropriate controls for user account activation, password composition, and frequency of password changes. However, access security controls need to be strengthened to ensure that only authorized users have access to the AGO's case-management system and that user privileges of all unauthorized individuals are deactivated in a timely manner.

The AGO's case-management system consists of separate application modules used to manage information related to civil and criminal cases. Accordingly, the applications contain confidential and sensitive data. Our tests of system access security indicated that authorized user accounts belonging to individuals no longer employed by the AGO had not been deleted. Our examination of these accounts indicated that 143 (27%) of the 531 individuals who were assigned user accounts were not classified as employees on the AGO's official payroll records as of August 31, 2012. Furthermore, our audit determined that there were a total of 56 individuals with "Super User"³ access privileges who remained on the active user list, including one individual whose employment with the AGO had terminated in July 2009. Although we found no evidence that user accounts had been accessed after the termination dates, generally accepted IT security practices require immediate deactivation of access privileges once an individual's employment is terminated.

We found that although the AGO's internal control plan (ICP) states that when an employee is separated from the AGO, the employee's access to IT systems and resources should be rescinded immediately, there were no documented policies or procedures in place requiring the AGO's Human Resources Division to notify its Information Technology Division (ITD) to initiate the removal of access privileges to the case-management system for individuals whose employment with the AGO has been terminated. In addition, we found no evidence that the

³ According to the AGO's Chief Information Officer, a Super User has the ability to create cases, update cases, attach files, and generate case letters; Super Users cannot delete cases.

AGO was periodically performing a reconciliation of the active user account list to a list of authorized employees to ensure that specific access privileges continue to be appropriate (no more than what each employee needs to perform his or her duties).

Our audit disclosed that increased monitoring of user accounts was required to evaluate user account access and identify user accounts that should be deactivated to ensure that only authorized individuals had access privileges to the AGO's automated systems. Not acting in a timely manner to deactivate or delete user accounts that are no longer required could allow a current user to gain higher access privileges than are currently authorized. As a result, information could have been vulnerable to unauthorized internal access.

The Control Objectives for Information and Related Technology (COBIT), issued by the Information Systems Audit and Control Association, is a generally applicable and accepted standard for IT security and control that provides a control framework for management, individuals responsible for overseeing business processes, and IT functions. Additional controls recommended by the COBIT control framework include implementing procedures to ensure timely action for requesting, activating, suspending, and closing user accounts and a control process to periodically review and confirm access rights. COBIT also calls for regular scheduled comparisons of resources with recorded accountability to help reduce the risk of errors, fraud, misuse, or unauthorized change.

Our testing of system access security controls maintained by the AGO's ITD indicated that the controls were not effectively designed to support the AGO's objective, noted in its ICP, of immediately rescinding privileges of terminated employees.

Recommendations

The AGO's ITD should perform an immediate review of the status of all active users of its case-management system and other application systems and deactivate access privileges for individuals who no longer require, and/or are not authorized to have, access to these systems. We further recommend that system access controls (1) delegate authority and responsibilities to ensure that the AGO's ITD meets the objectives of the AGO's ICP, (2) identify and assess how changes in office employment could affect access security, (3) establish control activities to ensure that the directives detailed in the AGO's ICP are effectively carried out and system access

properly secured, (4) develop documented policies and procedures requiring that the Human Resources Division notify the AGO's ITD security administrator of any changes in employee status that would warrant a change or deactivation of access privileges to the AGO's case-management system and other systems as necessary, and (5) require periodic (e.g., quarterly) reviews of user access lists to ensure that specific access privileges are appropriate and up to date.

Auditee's Response

In response to this finding, AGO officials provided comments that are excerpted below.

The AGO has deactivated the accounts of former employees and has created a periodic review and reconciliation procedure which is also now reflected in the AGO's ICP.

Auditor's Reply

Based on its response, we believe that, by strengthening internal controls over its system user accounts, the AGO is taking appropriate measures to address concerns we identified. We believe that the AGO's periodic reviews of active user accounts will significantly strengthen the security of its application systems. Also, although it is not specifically addressed in the AGO's written response, we continue to emphasize the importance of having policies and procedures documented in writing in order to formally establish appropriate accountability and to ensure that the requirements of such policies and procedures are effectively communicated and followed. For this reason, we continue to urge that the AGO develop and implement the recommended written policies and procedures and other system access controls noted in our report.

2. PRIOR AUDIT RESULTS PARTIALLY RESOLVED

a. Filing-Fee Operations of the Not-for-Profit Organizations / Public Charities Division

Our prior audit report (No. 2003-0072-2S) disclosed that inadequate administrative controls and an outmoded public-charities database had hindered the Not-for-Profit Organizations / Public Charities Division's (NPO/PCD's) enforcement of Massachusetts laws requiring accountability by all public charities engaging in charitable work or fundraising in the Commonwealth. Additionally, our prior report noted that the NPO/PCD did not adequately track or account for presumed public charities operating in the Commonwealth that did not respond or return required filings to the NPO/PCD.

Our current audit revealed that the AGO has made improvements related to its filing-fee operations. Specifically, our audit determined that the NPO/PCD maintained effective internal controls related to its logging and reconciliation of checks received as payment for annual filing fees. Also, the NPO/PCD improved the availability of annual filing forms to public charity organizations by providing the forms online. The ability to access the forms online should increase compliance with annual filing requirements and enhance annual filing-fee revenue. Our examination of annual filing fees for 64 public charity organizations during the audit period indicated that the NPO/PCD effectively collected the appropriate filing-fee amounts and followed up with organizations that failed to submit their annual filings.

However, our examination of filing-fee cash receipts showed that improvements are needed over the timely processing of filing fees to comply with both the AGO's and the Office of the State Comptroller's (OSC's) policies. Our analysis of filing fees (checks) received by NPO/PCD during the period July 1, 2010 through June 30, 2012 indicated that filing fees were not always processed and forwarded to the Budget Division within the AGO's required one-business-day period. Although our analysis indicated that the Budget Division was making daily deposits, our testing of 19 filing-fee transactions (2,119 checks), totaling \$306,320, found that only four transactions (21%), totaling \$56,700 (415 checks), were forwarded to the Budget Division for deposit within one business day. However, 15 transactions (79%), totaling \$249,620 (1,704 checks), were forwarded to the Budget Division after the required one-business-day time limit. These 15 filing-fee transactions were forwarded by the NPO/PCD to the Budget Division as follows: 10 after two days (1,291 checks, totaling \$199,665), 4 after three days (351 checks, totaling \$40,850), and 1 after five days (62 checks, totaling \$9,105).

In accordance with the requirements of the AGO's internal controls, the NPO/PCD is required to deliver checks to the Budget Division one business day after they are received:

At the end of every day, checks are compiled and given to the Administrative Assistant. . . . On the following day . . . the checks are separated by check amount and are sent to the Budget Division via hand delivery. . . .

Furthermore, the OSC's Cash Recognition and Reconciliation Policy requires the following:

All cash receipts must be deposited within a designated and authorized [Office of the State Treasurer] location, within one business day of receipt.

Although there was no evidence of misplacement or loss of checks found, not adhering to these policies increases the risk of checks being misplaced or lost and the potential loss of revenue due the Commonwealth, given the high volume of filing fees (checks) being handled daily by the NPO/PCD. Inadequate monitoring of the filing-fee process contributed to the noncompliance with the AGO's and OSC's policies.

AGO staff told us that they were contemplating seeking an exception from this requirement from the Office of the State Treasurer (OST) because of the volume of checks received and the requirements of the division's filing-fee operations.

Recommendations

We recommend that NPO/PCD more closely monitor established control procedures to ensure that checks (fees) collected are sent to the Budget Division within one business day of their receipt in accordance with AGO and OSC policies and procedures. In the OSA's opinion, greater management oversight will serve to better ensure that fees are processed and deposited daily. However, if the volume of checks received and the necessary processes in place make it difficult for the AGO to meet the requirement of depositing checks within one business day, the AGO should consider asking the Executive Office of Administration and Finance (EOAF) and the OST for an exception to the requirement of daily cash-receipt remittance. Exceptions to the daily remittance of cash receipts are provided if the EOAF and OST determine that it is in the interest of the Commonwealth to allow payments to be made weekly.⁴

Auditee's Response

In response to this finding, AGO officials provided comments that are excerpted below.

Significant improvements and enhancements have been made by the AGO to the NPCD's internal controls relating to its logging and reconciliation of checks received as payment for annual filing fees. It is precisely these security enhancements to the processing of the payments of filing fees, the sheer volume of checks received on a daily basis, and the fact that two divisions each have processing and accounting responsibilities with respect to the checks that have caused an occasional inability to deposit a batch of checks within one business day of their receipt. . . . The AGO is seeking from the State Treasurer an exception from the requirement per the same statute that establishes the requirement, M.G.L. c. 30, § 27.

⁴ Chapter 30, Section 27, of the Massachusetts General Laws.

Auditor's Reply

We agree that internal controls in the NPO/PCD have improved and that the AGO should consider asking the EOAF and OST for an exception to the requirement of daily cash-receipt remittance. However, in the meantime, until such approval is received, the AGO should, to the extent practical, do its best to adhere to its prescribed daily deposit requirements.

b. Fixed-Asset Management

Our prior audit report disclosed that the AGO had not conducted annual physical inventories and reconciliations or ensured that its inventory records were complete by including total costs and asset identification numbers, as required by the OSC. Further, our prior audit found that acquisitions and disposals of generally accepted accounting principles (GAAP) fixed assets⁵ were not recorded in the Commonwealth's Fixed Asset Subsystem on a timely basis and that the AGO ICP relating to inventory did not include current OSC fixed-asset policies.

Our current audit found that the AGO needs to strengthen internal controls over its fixed assets to ensure that an annual physical inventory and reconciliation are conducted in accordance with OSC policies and procedures that require an inventory and reconciliation of GAAP and non-GAAP fixed assets⁶ to take place on or around June 30 of each fiscal year. In addition, our audit found that of the 169 fixed assets listed on the AGO's property inventory records, 104, including 12 of 21 non-GAAP fixed assets, were not assigned a unique identification number, such as a bar code or serial number. Furthermore, our tests of GAAP fixed assets revealed that controls still need strengthening to ensure that GAAP fixed-asset determinations for leased fixed assets are completed properly and in a timely manner, recorded in the Commonwealth's Fixed Asset Subsystem, and accurately presented

⁵ The Commonwealth defines GAAP fixed assets as all tangible property (real and personal) such as land, buildings, computer software and systems, landmarks, infrastructure and equipment, etc., with a useful life of more than one year. The following acquisitions must be recorded: all land and landmarks, regardless of cost; all buildings and roads that cost more than \$100,000; and equipment, vehicles, and other fixed-asset types with an original cost of (in most cases) \$50,000 or more.

⁶ Non-GAAP fixed assets include buildings, vehicles, infrastructure, and equipment, including computer software, with a useful life of more than one year and a historical unit cost between \$1,000 and \$49,999, including all electronic and computer components.

in the Commonwealth's Comprehensive Annual Financial Report (CAFR)⁷ financial statements. Moreover, we found that OSC-required midyear and annual inventory reviews and reconciliations of GAAP fixed assets and related confirmation forms did not identify and report GAAP fixed assets acquired in prior fiscal years but not yet accounted for in the Massachusetts Management Accounting and Reporting System (MMARS).

i. Administration and Oversight of Fixed Assets

During our audit, AGO officials stated that the agency uses a perpetual inventory and reconciliation system. However, we were not provided with documentation to substantiate this assertion. Further, we found that the AGO was not conducting an annual inventory and reconciliation of its GAAP and non-GAAP fixed assets as required by the OSC and could not provide us with supporting documentation regarding the last time an annual physical inventory and reconciliation had been performed. By conducting an annual physical inventory and reconciliation, the AGO will be able to ensure that the Commonwealth's fixed assets are being properly safeguarded against loss, theft, or misuse and that the AGO's inventory system of record is complete, accurate, and current.

OSC's Fixed Assets – Accounting and Management Policy, revised November 1, 2006, sets forth the following requirements for departments.

Chief Fiscal Officer

The Chief Fiscal Officer of each department is responsible for the management of fixed assets. Management includes an annual physical fixed asset inventory, the reconciliation of the results of that inventory, [and] reporting the results of that inventory to the proper authorities. Department staff shall be properly trained on the workings on the Fixed Asset components of MMARS.

Annual Inventory

There shall be an annual inventory taken of fixed assets owned by every Department. This inventory shall include, at a minimum, a verification of the existence and location of fixed assets owned by a Department. . . .

⁷ A CAFR is an audited annual financial report of the Commonwealth prepared on the GAAP basis of accounting. It shows the financial position of the state entity as a whole, including certain independent authorities, as component units for a given fiscal year.

Reconciliation of Fixed Asset Inventory

There shall be a reconciliation of the fixed asset inventory against the books and records maintained by the Department. . . . This reconciliation is to be done, at a minimum, on an annual basis. This reconciliation shall be available for audit either by the department's internal auditors, the State Auditor's Office or the Commonwealth's external auditors. Internal records must reconcile to the records available on the Fixed Asset Subsystem. A Department will maintain supporting documentation of fixed asset transactions available for examinations by appropriate audit organizations.

The OSC's policies require state agencies to perform an inventory and reconciliation of their GAAP and non-GAAP fixed assets at least annually. Further, although the OSC has set its non-GAAP fixed-asset threshold at \$1,000, agencies are permitted to lower this amount for their management and inventory of fixed assets. AGO officials told us that it is the agency's policy to maintain a perpetual inventory system of all of its fixed assets, including those that fall below the OSC \$1,000 threshold, and that it believes its perpetual inventory system meets OSC's annual fixed-asset inventory and reconciliation requirements. However, we did not find sufficient evidence of fixed-asset additions and deletions being continually updated on the AGO's fixed-asset inventory records, as would occur in a properly maintained perpetual inventory system, or evidence of periodic verifications of the system to ensure that it continued to function as designed. Further, we found no evidence that OSC's required annual fixed-asset inventory and reconciliation had been performed, but AGO management indicated that this was being done continually. While a well-designed and properly maintained perpetual inventory system can relieve an entity of the burden of performing an annual inventory, no inventory system is so reliable as to eliminate completely the need for a periodic physical inventory. Also, although the AGO had internal control policies and procedures regarding fixed assets, these controls did not align with the requirements outlined in the OSC Fixed Asset Accounting and Management Policy, which include the performance of an annual inventory and reconciliation on or around June 30.

Our examination further revealed that the AGO did not consistently assign unique asset identification numbers, such as bar codes, serial numbers, or asset tag numbers, to its fixed assets as required in its ICP. Despite the AGO's ICP requirement, our analysis of AGO fixed-asset inventory records revealed that of the 169 fixed assets recorded, 104 (62%), including 12 of 21 non-GAAP fixed assets, were not assigned a unique asset

identification number. The absence of unique asset identification numbers hinders the AGO's ability to properly track and control its fixed assets.

Recommendations

The AGO should, at a minimum:

- Develop and implement the necessary policies and procedures and related internal controls to ensure that an annual physical inventory and reconciliation are properly conducted and documented on or around June 30 of each fiscal year in compliance with OSC policies and procedures.
- Assign a unique asset identification number to each GAAP and non-GAAP fixed asset to better track and control fixed assets.

Auditee's Response

In response to this finding, AGO officials provided comments that are excerpted below.

During the period covered by the audit, the AGO, on its inventory of property, used the term "desks" to refer to individual furniture components that when assembled, constitute variously configured workstations having a total value (when assembled) of over \$1,000. No component ("single item") (work surface, corner unit, filing cabinet, overhead storage compartment), however, has a value over \$1,000 and so the AGO did not assign a unique asset tag to the workstations. In the AGO's new electronic inventory system, the AGO has changed the label from "desk" to "component" and lists the components individually to eliminate any question whether an asset is a non-GAAP fixed asset (single item having a value of \$1,000 or more).

With respect to the Auditor's recommendation, the AGO believes its perpetual inventory system and its tagging system meets or exceeds state requirements. After meeting with the Auditor's team, the AGO researched and purchased a new asset inventory system called "Mobile Asset "by WASP Barcoded Technologies in late 2012. The AGO will run a report based on its perpetual inventory system and reconcile physically its fixed assets to the report on or about June 30 of each year. Although the AGO believes it is complying with its ICP and OSC policies, the AGO has updated its ICP to reflect that in addition to its perpetual inventory system, an annual report and reconciliation will be conducted and documented on or about June 30 of each year. In fact, the AGO conducted a physical reconciliation of its non-GAAP fixed assets on June 30, 2013.

Auditor's Reply

Based on its response, we are pleased that the AGO is taking measures to improve its classification of fixed assets and strengthen internal controls by conducting and documenting an annual physical inventory and reconciliation process. In addition,

although it is not specifically addressed in their response, we further encourage the AGO to establish and implement the necessary policies and procedures and related internal controls to ensure that all non-GAAP and GAAP fixed assets are assigned unique asset identification numbers to better track and control its fixed assets.

ii. Acquisitions of GAAP Fixed Assets

We found that the AGO did not ensure the proper fixed-asset determination for leased equipment and record its GAAP fixed assets in MMARS in the appropriate fiscal year and therefore did not adhere to OSC policies and procedures designed to ensure the timely recording of GAAP fixed-asset acquisitions, transfers, and disposals in MMARS. Not recording such assets in the proper fiscal year causes the value of fixed assets to be understated and depreciation expenses to be distorted in the statewide CAFR.

The OSC's Fixed Asset Accounting and Management Policy states, in part,

All assets, regardless if they are fixed or not, must be accounted for, managed, and reported in accordance with all applicable laws and regulations of the Commonwealth. All fiscal officers of the Commonwealth have this duty. None of the aforementioned items is more important than the other. They are all part of a singular system called "management and responsibility". Departments shall verify all acquired assets entered into the Fixed Asset component of MMARS. This verification must include a check that the information entered into the system is correct and appropriate for that particular asset. The initial entry of a fixed asset record should be verified against the supporting documentation within seven (7) business days of its entry into the system. Any changes needed shall be made on or before that time in the system. If a department needs a waiver from this verification period, submit a request for a waiver, in writing, to the Office of the Comptroller [CTR]. CTR has sole discretion in granting this waiver.

The above-mentioned policy also requires that an annual inventory be performed as follows:

[O]n or about June 30th of each year for GAAP and non-GAAP assets. All changes needed to assets shall be entered into MMARS not later than 7 business days after June 30th of each year.

In addition, the OSC's Fixed Assets – Acquisition Policy states,

Regardless of the acquisition method, departments are responsible for recording fixed assets with a value of \$50,000 or greater for equipment.

The Fixed Asset Subsystem is a component of MMARS whose purpose is to provide a uniform and fully automated vehicle to account for and report on GAAP (Governmental Generally Accepted Accounting Principles) fixed assets owned by the Commonwealth's departments. Departments must record GAAP fixed assets on the Fixed Asset Subsystem. This recording of these assets allows CTR to incorporate this information into the Commonwealth's Annual Comprehensive Financial Report.

To address the timely and accurate recording of GAAP fixed assets, the OSC instituted a midyear (December 31) and an annual (June 30) GAAP fixed-asset inventory review that requires departments to review their inventory records; reconcile them to the departmental MMARS Capital Asset Inventory Report NGA155SG; and complete, certify, and submit a confirmation form to the OSC, signed by the department's Chief Fiscal Officer, attesting to the accuracy and completeness of the department's review and the data reported in MMARS, including any variances identified during the review (e.g., additions, disposals, transfers).

Our examination identified two AGO-reported GAAP fixed assets for IT equipment – an EMC data-storage unit and a telecommunications system, totaling \$691,337 in value – that the AGO had entered as GAAP fixed assets in MMARS on October 11, 2012 and October 18, 2012, though their leases had begun on July 1, 2011 (fiscal year 2012) and August 8, 2008 (fiscal year 2009), respectively. Not ensuring that its leased equipment complied with GAAP fixed-asset-determination requirements⁸ and not recording GAAP assets in a timely manner understates the value of Commonwealth-owned fixed assets in MMARS and distorts the presentation of fixed assets and depreciation expenses reported in the statewide CAFR financial statements. Moreover, our examination of midyear and annual confirmation forms submitted by the AGO to the OSC during fiscal years 2009 through 2012 revealed that the AGO did not identify and report these leased GAAP fixed assets. The OSC initiated its midyear and annual fixed-asset inventory review policy in an effort to mitigate department recording of fixed assets in the wrong fiscal years. We question the thoroughness and effectiveness of the AGO's review and reconciliation of midyear and annual GAAP fixed-asset inventories.

⁸ The Office of the State Comptroller's Fixed Assets – Acquisition Policy states, "Departments must . . . determine if a lease is GAAP fixed asset, whether it is a capital lease or a term lease, and are responsible for any required reporting and proper coding of transactions in MMARS."

These instances of noncompliance primarily resulted from a lack of internal controls to ensure that GAAP fixed assets are recorded in the MMARS Fixed Asset Subsystem within seven days of acquisition and that midyear and annual reviews and reconciliations of GAAP fixed assets are properly conducted and accurately reported.

Recommendation

The AGO should establish and implement the necessary internal controls to ensure that it follows the existing OSC inventory and reporting policies regarding fixed assets, particularly as they relate to GAAP fixed assets, and should record GAAP fixed assets in the MMARS Fixed Asset Subsystem within seven days of acquisition. Following the OSC's fixed-asset policies will enable the AGO to properly account for and record Commonwealth-owned items and incorporate them into the Commonwealth's CAFR financial statements. Moreover, the AGO should review its policies and procedures regarding oversight of the OSC's midyear and annual fixed-asset inventory review and reconciliation requirement and determine whether additional controls are needed to ensure that confirmation forms submitted to the OSC accurately report GAAP fixed-asset data.

Auditee's Response

In response to this finding, AGO officials provided comments that are excerpted below.

With respect to the Auditor's finding that the AGO did not timely record and report two GAAP fixed asset acquisitions, the AGO notes that with respect to the capital lease of telecommunications equipment (a "TELP" lease from the statewide contract), the AGO had attempted to enter the capital lease into MMARS when it was executed, but due to a technical malfunction in MMARS (which was later identified and fixed by the OSC) the system did not generate the fixed asset ("FA") shell necessary to enter the lease as a fixed asset. The AGO assumed incorrectly that the TELP lease did not have to be entered as a capital lease and going forward, did not list it as such on the mid-year and annual GAAP fixed asset inventory reviews. The telecommunications equipment lease has now been entered into MMARS with an adjusted value. With respect to the second GAAP fixed asset, the EMC storage unit lease, the AGO did not enter the lease within seven days of its acquisition because it initially identified the lease as an operating lease. Subsequently, during the audit, the AGO reconsidered whether the lease should have been entered as a GAAP fixed asset and entered it as such. The AGO had at the time of purchase considered the lease to be an operating lease, not a GAAP fixed asset and therefore it was not entered in the Commonwealth's MMARS Fixed Asset Subsystem. Subsequent to

the audit the OSC reviewed the AGO entry and determined that the entry of the lease as a GAAP fixed asset was incorrect.

Auditor's Reply

With regard to the AGO's telecommunications system, we recognize that on occasion technical malfunctions can take place that may prevent the timely recording of transactions in MMARS. For this reason, we advise the AGO to promptly seek guidance from the OSC if such malfunctions occur in the future. In addition, although we believe that the action taken regarding this matter is appropriate, we continue to urge the AGO to review its policies and procedures regarding its oversight of the OSC's midyear and annual GAAP fixed-asset inventory review and reconciliation and determine whether additional controls are needed to ensure that confirmation forms submitted to the OSC accurately report GAAP fixed-asset data.

With respect to the EMC data-storage unit, we agree that the AGO entered lease encumbrance information into MMARS in a timely manner; however, the AGO did not make its fixed-asset determination in accordance with OSC's Fixed Assets – Accounting and Management Policy, which states, “The initial entry of a fixed asset record should be verified against the supporting documentation within seven (7) business days of its entry into the system. Any changes needed shall be made on or before that time in the system.” Moreover, OSC's fixed-asset acquisition policy requires agencies to determine whether a lease is a GAAP fixed asset, i.e., whether it is a capital lease or a term lease. Therefore, before the AGO can conclude that it properly reported and coded the storage unit as a term lease, the AGO must first determine whether the lease period was equal to or more than 75% of the data-storage unit's useful life or whether total lease payments were equal to or greater than 90% of its fair market value. In both cases, the data-storage unit would need to be recorded as a fixed (capital) asset (if its cost exceeded \$50,000) because the majority of its value is being paid for by the department, and that qualifies it as a purchase. This is a determination the AGO should have made and documented within the initial seven-day time period. To that end, we advocate that the AGO gather all available lease information regarding its data-storage unit's useful life and fair market value and make it available to the OSC so an appropriate fixed-asset determination can be made regarding this leased equipment. Moreover, because the AGO was unclear

about OSC's fixed-asset determination requirements, particularly as they relate to leased equipment, we recommend that the AGO seek guidance and additional training from the OSC to ensure that GAAP fixed assets are reported in an accurate and timely manner and in compliance with OSC's fixed-asset acquisition policy.