

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. 2004-0157-3S

**INDEPENDENT STATE AUDITOR'S REPORT ON
CERTAIN ACTIVITIES OF THE
DEPARTMENT OF EDUCATION'S
SCHOOL BUILDING ASSISTANCE PROGRAM
JULY 1, 1999 TO DECEMBER 31, 2003**

**OFFICIAL AUDIT
REPORT
AUGUST 23, 2004**

TABLE OF CONTENTS/EXECUTIVE SUMMARY**INTRODUCTION****1**

The School Building Assistance Program (SBA) was established by Chapter 645 of the Acts of 1948 and placed within the Department of Education (DOE) in 1965 under the control of the Board of Education (Board). The program was established for the purpose of aiding cities, towns, and regional schools with state grants that defray a portion of the costs associated with school construction. The SBA program was established as a temporary program with an expiration date, which was extended by the Legislature eight times before Chapter 159, Section 140, of the Acts of 2000 included it in the Massachusetts General Laws as Chapter 70B. The SBA program has evolved over the years in both scope and extent of financial support. At the time of its enactment, the SBA program was directly linked to regionalization efforts and was limited to new school construction costs only. The state encouraged the creation of regions so cities and towns could merge resources and build one school to cover the needs of several cities and towns. From the initial reimbursement rate of 20% to 55% of construction costs only, the SBA program presently reimburses 50% to 90% of total debt service for all project costs, including architect/engineering fees, site development, and original equipment expenses. The SBA program also funds additions, renovations, and major repairs, as well as modular construction, tuition arrangements, and leasing expenses.

School building construction has been and continues to be a high investment of state and local funds whose purpose is to provide adequate educational facilities throughout the Commonwealth. The state's commitment to this program has been significant, with over 750 approved school projects over the last 20 years. In the last five years alone, state appropriations totaled \$1.7 billion to fund initial and continuous payments for new and ongoing projects (see Appendix III). The state's remaining financial obligations for the existing 753 projects it has already begun paying for totals \$5.5 billion. Further, the current waiting list of approved projects will cost the state an estimated additional \$7 billion. Considering the magnitude of the state's commitment and obligation to this program, adequate monitoring and oversight is essential to ensure program integrity. Also, changes in law enacted in July 2004 will make significant modifications in both the management of the program, creating a School Building Authority, and the financial structure of the program, by considering additional revenue sources and restructuring and extending borrowing terms, thereby reducing the state's financial participation for future projects. These proposed changes will allow the program to begin funding the 420-project waiting list in the next three to five years. As a result of Chapter 208 of the Acts of 2004, which created the new Massachusetts School Building Authority, all references to the Board of Education concerning recommendations in this report are now directed to the Authority.

In accordance with Chapter 11, Section 12, of the General Laws, the Office of the State Auditor (OSA) conducted an audit of the SBA program for the period July 1, 1999 to December 31, 2003. The purpose of our review was to determine whether (1) corrective action has been taken and recommendations have been implemented regarding prior audit issues; (2) the SBA program is providing proper oversight of local school construction projects; (3) the SBA program is ensuring that municipalities adhere to regulations regarding bond refinancing, interest costs, and the maintenance of adequate project records and

documentation; and (4) municipalities are accurately projecting costs and filing timely cost reports.

AUDIT RESULTS	8
1. PRIOR AUDIT RESULTS - UNRESOLVED	8

During our follow-up of prior audit results, we determined that the board had not taken measures to adequately address the SBA program issues noted in our prior audit report (No. 97-0157-3) with regard to (a) complying with final project cost regulations, (b) ensuring that municipalities adhere to regulations covering bond refinancing, interest costs, and project records and documentation; and (c) changing its approval process and regulations to include all areas of income to affect project costs.

a. Improvements Needed Regarding Municipality Compliance with Final Project Cost Regulations

Our prior audit disclosed that many municipalities utilizing the SBA program did not comply with SBA program regulations regarding the timely filing of final project costs. In addition, we found that municipalities routinely overestimated the interest costs for the project. Nineteen municipalities in our sample overestimated the interest cost in the amount of \$2,206,860, of which the Commonwealth's portion was \$1,523,329, or 69%. Our follow-up review disclosed that the SBA program still does not require municipalities utilizing the program to comply with regulations regarding the timely filing of final project costs. In fact, we found that final costs for 169 projects were not filed with the SBA program as required by regulations. As part of our audit, we reviewed the results of the 177 final project cost submitted by municipalities and audited by the SBA program for the period September 20, 2000 to December 16, 2003 (the last final project cost submitted by the SBA program to the Board). Payments to the municipalities were lowered in 104 or 58.8% of these projects, for a savings of \$12,177,881. Because the SBA program grant payments are based on the estimated cost of a project, the actual reimbursement amount cannot be determined and the appropriate payment adjustments cannot be made until the final cost amount is reported to the SBA program.

b. DOE Did Not Adequately Ensure That Municipalities Adhere to SBA Program Regulations Regarding Bond Refinancing, Interest Costs, and the Maintenance of Adequate Project Records and Documentation

10

Our prior audit noted that final costs were not submitted in a timely manner by municipalities, audits were not completed by SBA program in a timely manner, and documentation could not be found for some audited costs. It was noted that, in our sample of 25 projects, 16, or 64%, did not have complete financing information, and that 10 of those projects were between 19 months and 11 years late in filing final costs. It was also noted that six (24%) of the municipalities did not comply with regulations requiring the retention of certain records. Our follow-up review of documentation at the SBA program disclosed that municipalities were still not in compliance with applicable SBA laws and regulations. Moreover, the SBA program does not make project cost adjustments as a result of interest

refinancing by municipalities, and the only time payments are adjusted is when final costs are audited. Therefore, municipalities that refinance and receive lower rates continue to receive payments from the SBA program based on the higher estimated costs.

c. Changes Needed Regarding Approval Process and Regulations to Include All Areas of Project Income

11

Our prior audit disclosed that one municipality received a grant amount of \$2,258,100 for a project that was partially covered by insurance. Specifically, one municipality received \$2,018,113 from insurance as a result of a fire at the school, and used a portion of this amount to finance the project. However, the SBA program calculated the grant amount on the basis of total project costs without taking into consideration the insurance proceeds, which resulted in an overpayment to the municipality in excess of \$1,500,000. We recommended that the Board review its regulations and include provisions that clearly define and include all the areas of income that must be used to offset project cost. In addition, the approval process should include a requirement that municipalities affirm that any such funds will be used to reduce the overall cost of the project. Our follow-up disclosed that, contrary to our recommendation, the Board did not revise its approval process and regulations. As a result, the potential still exists for overpayment for projects currently being approved and funded.

2. PROGRAMMATIC AND FINANCIAL OVERSIGHT OVER BILLIONS OF DOLLARS IN SCHOOL CONSTRUCTION PROJECTS NEEDS IMPROVEMENT

12

The SBA program does not provide sufficient monitoring over billions of dollars in school construction project funding to ensure that projects are completed in accordance with approved plans, and that funds are managed appropriately and are expended for only eligible purposes. Moreover, the current process utilized to conduct audits of final costs and follow up on untimely submissions by municipalities is inadequate. As a result, the SBA program has 169 projects whose required final cost information has not been received, and an additional 129 projects whose final cost information, although received by the SBA program, has not been fully reviewed. Although SBA program regulations allow for the suspension of payments if final costs are not received by the required timeframes, payments have not been suspended for any of the 169 municipalities, some of which have received as many as 11 payments. SBA program management indicated that there has been significant staff turnover during the past several years. We estimated that the inability of the SBA program to conduct timely close-out reviews resulted in missed opportunities to lower payments by as much as \$20,502,873. Further, our evaluation of the SBA program's final cost audit procedures indicated that they need to be strengthened, and that a field audit function should be established, to improve oversight of the significant investment of public funds dedicated to this program. An improved audit function would provide increased assurance that program funds are being expended for their intended purposes.

We also determined that the SBA program does not adequately monitor and provide the necessary technical support for ongoing school projects. Such project management, considering the magnitude of the public funds invested and the limited capacity of local governments to manage these projects, requires a stronger state involvement in school

construction management. The Board should seek the funds necessary to provide the SBA program with the resources to manage its programmatic and fiscal oversight functions and to be in full compliance with its internal regulations and Chapter 70B of the General Laws. This enhanced oversight and technical support becomes even more important as legislation has recently been signed into law that provides funding to start the 420 projects on the waiting list.

3. AUTOMATED PROJECT TRACKING AND PLANNING NEEDS IMPROVEMENT IN ORDER TO EFFICIENTLY AND EFFECTIVELY MANAGE THE SBA PROGRAM 19

The SBA program currently is responsible for managing approximately 1,200 projects, either ongoing or on the current priority list. To manage such a large volume of information and data, an up-to-date, automated system is necessary. Further, the SBA program is required under Chapter 70B, Section 17, of the General Laws to maintain a comprehensive data base on all current projects as well as information on all school buildings in the Commonwealth, including data on size, capacity, age, and maintenance of each building. The lack of an adequate automated system precludes the SBA program from maintaining this information, which is necessary to perform adequate planning, analysis, and decision-making tasks to best manage the school construction program, as well as monitor facility maintenance efforts.

4. DOCUMENTATION OF POLICIES AND PROCEDURES NEEDS IMPROVEMENT 19

The SBA program has not documented its policies and procedures relating to the operations of the program. In response to our request for policies and procedures, the SBA program management provided us only with copies of policy advisory memorandums that were sent to "Superintendents and Mayors/Boards of Selectmen" by the Commissioner. Written policies and procedures would allow the SBA program to provide guidance and direction relative to the program's management and operations and to assess risk within a certain function. A lack of written policies and procedures prevents management from performing adequate risk assessments and providing an environment in which management can be assured that operations are being performed in compliance with applicable laws, rules, and regulations.

APPENDIX I	22
Department of Education School Building Assistance Response	22
APPENDIX II	23
Department of Education School Building Assistance Program Five-Year Project Trend Analysis	23
APPENDIX III	24
Department of Education Appropriations for the School Building Assistance Program Fiscal Years 2000 to 2004	24

APPENDIX IV	25
Chapter 647, Acts of 1989, An Act Relative to Improving the Internal Controls within State Agencies	25
 APPENDIX V	 28
Chapter 647 Awareness Letter from the State Auditor and the State Comptroller	28

INTRODUCTION

Background

The School Building Assistance (SBA) program was established by Chapter 645 of the Acts of 1948 and placed within the Department of Education (DOE) in 1965 under the control of the Board of Education (Board). Chapter 159, Section 140, of the Acts of 2000 included the SBA program in Chapter 70B of the Massachusetts General Laws, which states, in part:

There is hereby established, within the department of education, a school building assistance program. . . .

The board, shall establish general policy and review standards regarding school building construction, renovation, maintenance and facility space, administer the school building assistance program in accordance with this chapter and coordinate the distribution of school facilities grants in accordance with this chapter. The board shall be responsible for the oversight and management of the school building assistance program as established herein and referred to hereafter as the "program". In carrying out its duties, the board shall be guided by the following principles: preservation of open space and minimization of loss of such open space; emphasis on thoughtful community development; and project flexibility that addresses the needs of individual communities and municipalities.

DOE is also under the control of the Board of Education in accordance with Chapter 15, Section 1, of the General Laws, which states, in part:

There shall be a department of education. . . which shall be under the supervision and control of a board of education.

Further, Chapter 15, Section 1F, of the General Laws states:

The board of education shall by a two-thirds vote of all its members appoint a commissioner of education . . . and may in its discretion by majority vote of all its members remove him. He shall be the secretary to the board, its chief executive officer and the chief state school officer for elementary and secondary education. The commissioner shall receive a salary to be determined by the board.

The SBA program was established for the purpose of aiding cities, towns, and regional schools with state grants that defray a portion of the costs associated with school construction. The SBA program was established as a temporary program with an expiration date, which was extended by the Legislature eight times before Chapter 159, Section 140, of the Acts of 2000 included it in Chapter 70B of the General Laws. The SBA program has evolved over the years in both scope and extent of financial support. At the time of its enactment, the SBA program was directly linked to regionalization efforts and was limited to new school construction costs, only. Prior to the

enactment of Chapter 645 of the Acts of 1948, most of the 351 cities and towns had their own schools. The regional school effort is contained in Chapter 71, Sections 14 through 16I, of the General Laws. The state encouraged the creation of regions so that cities and towns could merge resources and build one school to cover the needs of several cities and towns. Presently there are 26 vocational regions and 54 academic regions. From the initial reimbursement rate of 20% to 55% of only construction cost, the SBA program presently reimburses 50% to 90% of total debt service for all project costs, including architect/engineering fees, site development, and original equipment expenses. The SBA program also funds additions, renovations, and major repairs, as well as modular construction, tuition arrangements, and leasing expenses.

Because of funding constraints, the Board attempted to limit or eliminate applications from municipalities for school building assistance twice during fiscal year 2003. An administrative advisory memorandum to municipalities dated February 11, 2003 imposed a moratorium on the acceptance or review of project applications by the SBA program until at least June 30, 2003. Also, in a memorandum dated April 4, 2003, the Board indicated that only 28 of 63 applications for capital construction grants would be approved. Chapter 26, Section 668, of the Acts of 2003 placed a moratorium on new applications for assistance; however, due to the demands of local officials for consideration of projects in the planning stage, this provision reversed the attempt by the Board to limit approvals, as follows:

All school facilities' capital or major reconstruction projects, which received final municipal approval by a favorable vote by the legislative body of any municipality, subject to its charter, on or before June 30, 2003, shall be placed on the priority waiting list for reimbursement... The board of education shall not accept any application for the school building assistance program established in said chapter 70B of the general laws, until after July 1, 2007.

At the time of our audit, the SBA program was funding 753 projects at a cost of approximately \$401.3 million in fiscal year 2004 (See Appendix II). There were 420 projects on the waiting list, and the cost to fund only the first year payments for these projects would be approximately \$360.6 million. The Commonwealth's total potential liability for future payments, including current as well as projects on the waiting list, exceeds \$11 billion.

The SBA program operates under an annual authorization and appropriation to DOE. (See Appendix III for Fiscal Years 2000 to 2004 appropriations) There are five SBA program appropriations, as follows:

- First annual payments for projects to relieve racial imbalance – Account Number 7052-0003
- First annual payments for all other projects – Account Number 7052-0004
- Ongoing payments (2 through 20 years) – Account Number 7052-0005
- Other reimbursable costs-Regional School District buy-in – Account Number 7052-0006. The SBA program makes a special request to the Legislature for other costs associated with the program. The 603 Code of Massachusetts Regulations (CMR) 38.08 describes reimbursable costs for regional school districts as follows:

(1) Any city or town newly admitted to an existing regional school district may be reimbursed for part of the buy-in amount that the city or town is required to pay for admission to the regional school district.

The SBA program will reimburse some of the cost to the city or town to join an existing regional school district and the cost associated with the changes in the agreement between municipalities, usually over 10 years.

- Emergency safety issues – Account Number 7052-0007. This appropriation, which has not been funded by the Legislature since fiscal year 2001, is for emergency repairs within the school districts.

Most projects are financed through the issuance of bonds by the municipalities and are financed over a maximum 20-year period. Because projects are approved for equal annual payments, when a project is funded it requires a commitment by the state of 20 years.

All applicants for a capital construction project grants are required to go through an application process to ensure the educational and structural integrity of the resultant school facility. Chapter 70B, Section 2, of the General Laws, defines a “Capital Construction Project” as follows:

Any capital project, other than a major reconstruction project, for the construction, the enlargement or original equipping of any public schoolhouse in any city or town, or a project for the renovation or partial renovation of an existing structure for use as a schoolhouse; or the renovation or partial renovation of an existing schoolhouse. . . .

The following types of capital projects are eligible for SBA program grants:

1. Projects to eliminate serious structural safety hazards
2. Projects to eliminate existing severe overcrowding
3. Projects to prevent loss of accreditation
4. Projects to prevent overcrowding from increased enrollment

5. Projects for short-term enrollment growth
6. Projects to replace and upgrade obsolete facilities

Chapter 70B, Section 3, of the General Laws directs the Board to administer the SBA program and states that the Board shall be responsible for its oversight and management. Therefore, during the application process, it is the Board that provides the applicants with the following three acknowledgements:

1. **Preliminary Project Approval.** This approval indicates that the proposed project, including site, type of construction, schematic drawings, and educational specifications, meets the objectives of the SBA program and will be eligible for funding if and when all remaining procedural steps are completed. The preliminary approval may take the form of several letters which will include:
 - the required Building Needs Conference has been held with SBA program staff
 - the required site visit has been conducted by SBA program staff
 - a list of work elements eligible for reimbursement for renovation work
 - the maximum project cost
 - whether an outside construction manager will be required
 - the priority category to which the project is assigned
 - the project's statutory reimbursement rate
2. **Final Project Approval** pursuant to 603 CMR 38.10(8). This approval indicates that all of the required documents have been submitted in a satisfactory form to the SBA Program. All projects receiving project approval are placed on the priority waiting list until such time as funding is available for a grant award. At this time, applicants may start construction provided they submit to the SBA program a resolution acknowledging that there may be a delay in state funding. This resolution must be voted on by any one of the following: town meeting, city council, town council, board of selectmen, or school committee.
3. **Notice of Grant Award.** The Board makes Grant awards to projects on the priority waiting list as funding is authorized by the Legislature. Construction must begin by June 30 of the fiscal year in which the grant is awarded. The first state-grant payment will be made in the fiscal year following the year in which the grant is awarded.

In addition to Capital Construction Projects, Chapter 70B of the General Laws defines a “major reconstruction project” as:

Any capital school facilities projects or extraordinary maintenance project including, but not limited to, the replacement of a roof or heating plant. . . .

Moreover, Chapter 70B, Section 14, of the General Laws requires the following:

For approved projects that are an alternative to construction or renovation, the board shall establish eligible cost criteria, and on a case-by-case basis, shall determine the allowable cost of the project. Eligible cost may include but shall not be limited to furnishings and equipment, lease cost, rental fees, tuition costs and transportation costs. In no event shall an alternative project be reimbursed if it is determined by the board to be more costly than construction necessary to achieve the same end.

The SBA program has a different application and process for major repairs and alternative projects. After establishing the need for the project, the SBA program is required to determine whether the cost of and reimbursement amount for an alternative project exceeds the cost of construction to achieve the same end. In the case of major repairs, the SBA program must determine whether the project has not been necessitated, in whole or in part, by an eligible applicant not making adequate and prudent provisions for the care and maintenance of the school.

The Executive Office for Administration and Finance in January 2000, issued a policy report: Reconstructing the School Building Assistance Program. The report offered 34 recommendations to change the fundamental structure of the SBA program in order to create a flexible program that, if implemented, would ensure the long-term viability of the school construction program, which would have a positive effect on the education of the children in the Commonwealth. The report emphasized that funds expended on the SBA program must be appropriate and cost effective.

Most significantly, the State Legislature has passed, and the Governor recently signed into law, school building assistance reform legislation. Three new laws enacted last month make significant changes to the existing program, and are summarized below.

Chapter 201 of the Acts of 2004:

1. Authorizes \$1 billion of 20-year Commonwealth general obligation bonds to fund initial deposits to the School Modernization and Reconstruction Trust Fund.
2. Debt Service on these bonds will be paid from the General Fund.

Chapter 208 of the Acts of 2004:

1. Creates the Massachusetts School Building Authority to take over administration of the program from the Board of Education.
2. Authorizes the Authority to issue bonds, subject to a \$10 billion debt limit.

3. Does not change reimbursement rate for current projects, however, the Commonwealth's share of future projects will be reduced.
4. Authorizes local governments to issue 25-year bonds for local share of costs.

Chapter 210 of the Acts of 2004:

1. Creates a School Modernization and Reconstruction Trust Fund to be expended by the Authority.
2. Dedicates one cent of the sales tax to the fund, which will be phased in incrementally over several years.
3. Provides for \$150 million transfer from the General Fund to the trust fund.

As a result of Chapter 208, which created the new Massachusetts School Building Authority, all references to the Board of Education concerning recommendations in this report are now directed to the Authority.

Audit Scope, Objectives, and Methodology

In accordance with Chapter 11, Section 12, of the General Laws, the Office of the State Auditor conducted an audit of the SBA program for the period July 1, 1999 to December 31, 2003. Our audit was conducted in accordance with applicable generally accepted government auditing standards. The purpose of our review was to determine whether (1) corrective action has been taken and recommendations have been implemented regarding prior audit issues (Audit Report No. 97-0157-3); (2) the SBA program is providing proper oversight of local school construction projects; (3) the SBA program is ensuring that municipalities adhere to regulations regarding bond refinancing, interest costs, and the maintenance of adequate project records and documentation; and (4) municipalities are accurately projecting costs and filing timely cost reports.

Our audit procedures consisted of the following:

1. Reviewed applicable laws, regulations, reports, and information related to the SBA program, including Chapter 70B of the General Laws.
2. Created a five-year project trend analysis with information developed from SBA program records, showing the number of projects approved, funded, and unfunded and their related costs from fiscal year 2000 through fiscal year 2004.
3. Interviewed employees at the SBA program and the DOE internal audit division to determine the policies and procedures used to review and monitor the SBA program.

4. Reviewed applicable laws, rules, and regulations and SBA program audit procedures (dated November 2001 and listed on the SBA program Website).
5. Reviewed information from SBA program records, information provided to municipalities, and information and reports presented to the Board.
6. Reviewed the Executive Office for Administration and Finance Policy Report: Reconstructing the School Building Assistance Program, issued in January 2000.
7. Followed up on prior results to determine the extent to which the SBA program has taken corrective action.

Based on our review, we have determined that, except as discussed in the Audit Results section of this report, the SBA program has complied with applicable rules, laws, and regulations for the areas tested.

AUDIT RESULTS

1. PRIOR AUDIT RESULTS - UNRESOLVED

During our follow-up of prior audit results, we determined that the School Building Assistance (SBA) program had not taken measures to adequately address issues noted in our prior audit report (No. 97-0157-3) with regard to (a) complying with SBA program final project cost regulations; (b) ensuring that municipalities adhere to SBA program regulations regarding bond refinancing, interest costs, and project records and documentation; and (c) changing its approval process and regulations to include all areas of income to affect project costs.

a. Improvements Needed Regarding Municipality Compliance with Final Project Cost Regulations

Our prior audit disclosed that many municipalities utilizing the SBA program did not comply with SBA program regulations regarding the timely filing of final project costs. Also, we found that municipalities routinely overestimated the interest costs for the projects. In fact, 19 municipalities in our sample overestimated the interest cost in the amount of \$2,206,860, of which the Commonwealth's portion was \$1,523,329, or 69%

Our prior audit recommended that the SBA program should utilize its authority under the regulations that govern its program. Specifically, the SBA program should withhold annual payments for municipalities that do not submit the required information by the prescribed time to ensure that municipalities submit their final project cost information by the deadline. We found no reason why municipalities cannot either submit their final cost information by the deadline or request an extension due to litigation or other reasonable causes.

Our follow-up review disclosed that the SBA program still did not require municipalities utilizing the program to comply with regulations regarding the timely filing of final project costs. In fact, the required final cost information for 169 projects were not filed by municipalities with the SBA program. Because SBA program grant payments are based on the estimated cost of a project, the actual reimbursement amount cannot be determined, and the appropriate payment adjustments cannot be made, until the final cost amount is reported to the SBA program. SBA program regulation, 603 Code of Massachusetts Regulations (CMR) 38.12, Payment Requirements and Procedures, states, in part:

(b) The Board [of Education] shall determine the final approved project cost within two years of the occupancy of new space, or in the year of the third payment, whichever occurs later. This audit shall be performed by Department staff. Subsequent payments will be adjusted to reflect the actual approved project cost on an equal annual payment schedule to begin in the fiscal year following the fiscal year in which the audit is performed. Audit materials are due in the Department by December 1 of the fiscal year in which the audit is scheduled.

(c) Failure of the grant recipient to provide the Department with satisfactory audit materials will result in the suspension of the payment schedule effective July 1 of the fiscal year following the year in which the audit is due.

(d) Suspended payment schedules shall not be reinstated until the fiscal year following the fiscal year in which the audit is performed.

Moreover, we found that the SBA program has not suspended any payments for the 169 projects that had not submitted final cost information. Our audit disclosed that municipalities have received up to 11 payments based on their estimated cost. As a result, when a municipality has construction costs lower than it originally estimated, it will continue to receive payments based on the higher estimated cost. As part of our audit, we reviewed the results of the 177 final project cost submitted by municipalities and audited by the SBA program for the period September 20, 2000 to December 16, 2003 (when the last final project cost was submitted by the SBA program). Payments to the municipalities were lowered in 104, or 58.8% of these projects, for a savings of \$12,177,881.

DOE officials stated that they have implemented a system for tracking audit submissions and sending follow-up notices as needed, and acknowledge that there is a sizeable backlog of audits awaiting review, but they have made progress in reducing the backlog. Four years ago, some projects received as many as 16 payments before being audited. Today most projects are audited within the first four years, and even when there is a delay in completing an audit, the remaining grant payments are adjusted to reflect any and all overpayments.

However, by not receiving final cost from municipalities in a timely manner, the SBA program cannot determine the actual cost of projects, which in turn may decrease the amount of funds that could be available for projects on the waiting list.

Recommendation

The SBA program should more closely monitor grant recipient compliance with cost submission requirements and, if necessary, utilize its authority under the regulations that govern its program.

Specifically, the SBA program should withhold annual grant payments from municipalities that do not submit the required information by the prescribed time to ensure that municipalities submit their final cost information by the deadline. In addition, the SBA program should enhance its process to more aggressively follow-up with municipalities for final costs that are not submitted in accordance with regulations.

b. DOE Did Not Adequately Ensure That Municipalities Adhere to SBA Program Regulations Regarding Bond Refinancing, Interest Costs, and the Maintenance of Adequate Project Records and Documentation

Our prior audit noted that final costs were not submitted in a timely manner by municipalities, audits were not completed by DOE in a timely manner, and documentation could not be found for some audited costs. It was noted that in our sample of 25 projects, 16, or 64%, did not have complete financing information, and that 10 of these projects were between 19 months and 11 years late in filing final costs. It was also noted that six (24%) of the municipalities did not comply with regulations requiring the retention of certain records.

Our prior audit report recommended that the SBA program ensure that municipalities submit the financing information at the required time, which would allow the SBA program to conduct its audit in a timely manner and make appropriate adjustments to grant amount to reflect the actual costs of the projects. Our prior report also recommended that if the information is not submitted by the deadline, the SBA program should require that final project costs be submitted.

Our follow-up review disclosed that municipalities and the SBA program were not in compliance with Chapter 70B, Section 19, of the General Laws, which requires the submission of the actual interest rate paid, as follows:

The board shall require school districts to notify the board of the actual interest rate obtained for any bond issuance for which the municipality or district will receive state reimbursement under provisions of chapter 645 of the acts of 1948, as amended, or this chapter, within 30 days of initial bonding. The board shall reimburse municipalities or districts at the actual interest rate obtained.

SBA program officials indicated that payments are adjusted only when the final costs are submitted and an audit is conducted. Therefore, municipalities that refinance and receive a lower rate continue to receive payments from the Commonwealth based on the higher estimated cost. Without proper oversight and timely submission of the actual costs of projects, it is likely that the Commonwealth is paying municipalities amounts greater than the actual costs for

projects that have not been adjusted for refinancing and for final construction costs. SBA officials also indicated that they have recently started collecting information on project refinancings annually as part of the End of Year Financial Returns (new schedule S).

Officials further stated that adjustments of grant payments to reflect bond refinancings are only permitted by law for projects approved in 1995 or later. Most of the audits completed to date were projects grandfathered under the old law, so no adjustment for refinancing was permitted. However, as noted in Chapter 70B, Section 19, above, the Board must be notified by the municipality or district within 30 days of refinancing. Therefore, no adjustments have been made for projects that were approved after 1995 and refinanced at a lower rate of interest.

Recommendation

The SBA program should ensure that municipalities submit the required refinancing information in the prescribed time and take advantage of funds that may become available due to adjustments to payments. This would allow the Board of Education (Board) to conduct its audit to make appropriate adjustments to grant amounts to reflect the actual costs of the project. If information is not submitted by the deadline, the Board needs to take appropriate action.

c. Changes Needed Regarding Approval Process and Regulations to Include All Areas of Project Income

Our prior audit disclosed that one municipality received a grant amount of \$2,258,100 for a project that was partially covered by insurance. Specifically, one municipality received \$2,018,113 from insurance as a result of a fire at the school, and used a portion of this amount to finance the project. However, the SBA program calculated the grant amount on the basis of total project costs, without taking into consideration the insurance proceeds. This resulted in an overpayment to the municipality in excess of \$1.5 million. We recommended that the SBA program review its regulations and include provisions that clearly define and include all the areas of income that must be used to offset project costs. In addition, we recommended that the approval process include a requirement that municipalities affirm that any such funds will be used to reduce the overall cost of the project. Our follow-up audit disclosed that the SBA program did not change its approval process and regulations.

Chapter 70B, Section 10, of the General Laws excludes project income and bases reimbursement on construction costs only, as follows:

The total facilities grant to be paid to eligible applicants on account of projects approved after the effective date of this chapter . . . no grant shall be approved for any amount less than fifty percent nor greater than ninety percent of total Construction cost. . . .

Recommendation

The SBA program should review and revise its laws and regulations to include provisions that clearly define and include all income sources that must be used to offset project costs. In addition, the SBA program approval process should include a requirement that municipalities affirm that any such funds will be used to reduce the overall cost of the project.

2. PROGRAMMATIC AND FINANCIAL OVERSIGHT OVER BILLIONS OF DOLLARS IN SCHOOL CONSTRUCTION PROJECTS NEEDS IMPROVEMENT

The SBA program does not provide sufficient monitoring of billions of dollars in school construction project funding to ensure that projects are completed in accordance with approved plans, and that funds are managed appropriately and are expended for only eligible purposes.

School building construction has been and continues to be a huge investment of state and local funds whose purpose is to provide adequate, new and improved educational facilities throughout the Commonwealth. The state's commitment to this program has been significant, with over 750 approved school projects over the last 20 years. In the last five years alone, state appropriations totaled \$1.7 billion to fund initial and continuous payments for new and ongoing projects (see Appendix III). The state's remaining financial obligations for 753 projects currently being funded totals \$5.5 billion. Further, the current waiting list of approved projects will cost the state an additional \$7 billion.

Considering the magnitude of the state's commitment and obligation to this program, adequate monitoring and oversight is essential to ensure program integrity. However, because of the large number of ongoing projects and the lack of resources necessary to monitor their progress, the SBA program has been unable to conduct site reviews to assess whether facilities are being built as planned and approved, and whether projects, when completed, meet the requirements of the authorized project.

In its February 2003 report to the Board, the SBA program, in a section titled Project Oversight, indicated its need for more resources to oversee the program, as follows:

The SBA currently has two project managers assigned to oversee more than 200 projects in planning, design, or construction, which limits the amount of state involvement in any individual project. Additional resources are needed to allow the Commonwealth to more closely scrutinize enrollment projections; conduct independent analysis of site and design options; ensure compliance with design and construction standards; and provide training and technical assistance to volunteer members of school building committees.

SBA program management indicated that although the site visits and inspections listed in SBA project applications are being done, no resources are available for follow-up or continuing visits. Instead, the SBA program must rely on the information and documentation sent to the SBA program with the final cost submission.

The lack of adequate construction oversight could prevent the SBA program from being aware of problems that may exist as construction progresses, thereby preventing timely evaluation and resolution of problems and disputes. Such matters could have significant cost consequences to both the Commonwealth and municipalities. Further, final review and sign-off by the SBA program would ensure that projects are completed in accordance with approved design plans. The SBA program also needs to improve its financial monitoring of school construction projects to ensure that funds are spent in accordance with approved plans. In addition, the SBA program should ensure that project administrators have adequate systems of accounting and internal controls concerning construction and financial management.

Also, the lack of adequate monitoring and oversight of projects is compounded by the fact that many municipalities have limited technical expertise in managing a major school construction project. The Executive Office for Administration and Finance report, Reconstructing the School Building Assistance Program states, in part:

Municipalities often have limited technical expertise in managing a major construction project such as the construction of a new school building. In many towns, the amount of time that the building committee can spend overseeing a project is limited. This combination of municipal inexperience and time limitations can result in higher project costs, especially when change orders are produced by the contractor. A change order is an amendment to the original construction contract . . .

During the school building construction process, there is an opportunity for costs to rise due to: failure to use experienced project managers; the use of inadequately qualified

contractors; a lack of peer review for designers; and the inefficiencies created by Massachusetts public construction law.

The extent of SBA program financial monitoring consists of a close-out audit, which is a desk review of information and documentation contained in a project's final cost submission. This process serves as an important function in helping determine allowable costs and identifying ineligible project costs; however, it is not sufficient to provide adequate oversight in these large construction projects.

The SBA program has no process to ensure that documentation received from the municipalities relating to final project costs is complete and accurate. In addition, the process to conduct reviews of final costs and follow up on untimely submissions by municipalities is inadequate. The SBA program has not been able to complete these timely project close out reviews due to a lack of resources. The SBA program has 169 projects for which municipalities have not submitted final project costs, and 129 projects where costs have been submitted but not completed. Therefore, a final audit of project costs can not be conducted by the SBA program in order to adjust estimated payments to municipalities. Although SBA program regulations allow for the suspension of payments if final costs are not received by the required timeframes, payments have not been suspended for any of the 169 municipalities, some of which have received as many as 11 payments.

SBA program management indicated that there has been significant staff turnover during the past several years. Specifically, in fiscal year 2000, the SBA program lost three staff members: the program manager, a senior auditor, and a project coordinator, who collectively had over 90 years of experience. In November 2001, the SBA program was able to hire a senior auditor after two years without this position.

Further, our review also disclosed that because the SBA program lacked the necessary resources to provide the required oversight, it missed opportunities to lower annual payments to municipalities by as much as \$20,502,873. During the audit, we reviewed the final costs submitted to the SBA program from municipalities for the period September 2000 through December 2003. The SBA program revised 177 cost submissions, which resulted in a reduction in payments of \$12,177,881. The SBA program currently has 298 audits pending (169 final cost submissions not received and 129 that have been received but not fully completed). If the

results for the 177 completed audits were applied to the 298 audits pending, the savings would total \$20,502,873.

The 603 CMR 38.12(3)(b) requires the Board to determine final approved project costs, as follows:

(b) The Board shall determine the final approved project cost within two years of the occupancy of new space, or in the year of the third payment, whichever occurs later. This audit shall be performed by Department staff. Subsequent payments will be adjusted to reflect the actual approved project cost on an equal annual payment schedule to begin in the fiscal year following the fiscal year in which the audit is performed. Audit materials are due in the Department by December 1 of the fiscal year in which the audit is scheduled.

The SBA program Audit Procedures dated November 2001 (listed on the SBA program Website) are meant to serve as a guide to municipalities in completing and submitting their final cost information. The following is a summary of the audit material required:

1. All appropriations. This would include investigating, planning and other expenses incurred prior to the vote for bond issue or acquiring funds in any other manner for the project, as well as subsequent appropriations for the completion of the project. This would include town meeting votes, school committee minutes for use of operating money or other transfers, letters recording gifts, and written documentation of all sources of funds.
2. All originally signed copies of every contract, change order, specification, and purchase order (per 2.d. below):
 - a. A signed copy of every architectural and construction contract.
 - b. A signed copy of every change order to the architectural and construction contract.
 - c. A copy of the specifications for all prime contracts.
 - d. A copy of every purchase order for equipment and furnishings unless invoices properly describe the items furnished.
3. A Final Form F (Financial form) detailing the actual cost of the project and the method of financing signed by the city or town treasurer.
4. A debt schedule issued and signed by the bank where any of the bonds were issued supporting the actual interest costs as reported on Form F Schedules and interest expenses should be submitted for all bond anticipation notes (BANS), as well as bonds.
5. A Schedule of Bills Paid supporting the actual cost claimed on Form F.

- a. Invoices should be listed separately by vendor and by classification as listed on Form F.
 - b. The classification sub-totals must equal amounts claimed on Form F.
 - c. Copies of vendor invoices must be arranged in order of appearance on the Schedule of Bills Paid.
6. A vote of the School Committee accepting the project for school purposes.
7. Verification of conformity with original approved project submission or approved amendments.
- a. Copy of final Educational Specifications.
 - b. Architect certification that building dimensions, including room sizes, corridor dimensions, offices, and core area dimensions, are as documented in the approved educational specifications.
 - c. Description of play areas, parking, and fields corresponding to original approval.
 - d. Description of work relating to renovation or replacement of major building components (e.g., roofs, HVAC, energy efficiency, building accessibility, structural or environmental hazards) corresponding to original approval.
 - e. Description of specific site related work corresponding to a waiver granted by the Board.
 - f. Upon request, district must provide as-built drawings.

As part of our review, we interviewed two employees involved in the completion of final cost audits. The employee who was performing the final cost audits presented us with his own handwritten listing of his duties. When asked whether any guidelines were provided for his use in performing audits to determine final cost, he stated that he uses and follows the SBA program audit procedures posted on the SBA program Website. We also interviewed the SBA program employee responsible with reviewing all final cost audits completed by the SBA program staff, who stated that his assignment to this review function was due to the current moratorium on accepting new applications. In the completion of his reviews, he stated that he follows Chapter 70B of the General Laws and the SBA program Audit Procedures posted on the Website. When asked whether a checklist was used by the SBA program to determine if municipalities had submitted the appropriate information and documentation, SBA program management provided us with a copy of a standard memorandum sent to municipalities to request information that was

not submitted. The memorandum lists the following eight standard items of information that have not been submitted:

1. Town votes pertaining to projects, including town meetings and school committee meetings
2. Final Form F (SBAB-3.17) actual cost and plan for financing
3. Interest debt schedule for bonding
4. G1 sheets filled out by expense classification
5. Copy of all contracts, signed (or copy of contractor's proposal if contract cannot be found)
6. Copy of all change orders.
7. Copy of all vendor invoices approved for payment and purchase orders if invoices do not give a clear description of items
8. Copy of school committee vote accepting project

However, this memorandum does not include all the information that is required to be submitted by the municipalities. SBA officials indicated that in cases where items were not listed on the form letters, a separate letter is prepared and sent to the municipality. These letters are used as guidances for the municipalities.

The SBA program was unable to demonstrate any process that would ensure the final project costs received from the municipalities are complete and accurate. SBA does not have 1) documented policies and procedures, 2) checklist to identify which items have been received, 3) instructions as to what is to be done with the items on the Website and 4) guidance to provide consistency and assistance in training new staff. This could result in the misuse of funds, cost overruns, and missed opportunities for the SBA program to take advantage of costs savings.

At a minimum, necessary and adequate oversight would provide enhanced monitoring of municipality procurement practices; change order management; and accounting and financial practices, including cost estimates, ongoing revision of project timelines, and the overall management of the project.

Recommendation

The Board should seek the funds necessary to manage its final cost audit function and fully comply with its internal regulations and Chapter 70B of the General Laws, including but not limited to timely completion of final cost audits; site visits before, during, and at the completion of a project; and follow up and payment suspensions on overdue audits. In addition, sufficient resources should be provided to institute a more effective audit function. If the Board is unable to obtain adequate resources to institute an audit function for conducting field audits, the Board should consider contacting appropriate state officials, including the Comptroller, to determine if designating a portion of each grant for the cost of a construction audit during construction phase, and a final cost audit at its completion, is permissible under state finance law. If this option is permissible, the SBA program should consider this and funds should be earmarked as part of the grant, based on a percentage of the total grant amount. The SBA program should then be responsible for ensuring the completion of the required audits. In addition, the SBA program should implement a documented process to ensure the completeness and accuracy of all information received from the municipalities.

Further, the Board must dedicate additional resources to adequately monitor and provide the necessary technical support to ongoing school projects. Specifically, we recommend that the SBA program take steps to provide increased project management and oversight in the areas of competitive bidding requirements and compliance; accounting and financial management procedures and controls; and ongoing construction project reviews to verify work progress, assess potential construction disputes and problems, and assist local project managers in completing projects timely and in accordance with specifications and cost estimates.

Such project management is essential considering the magnitude of the public funds invested in this program and the limited capacity of local governments to manage these projects. Also, providing the SBA program with the resources necessary to provide technical assistance and oversight becomes more important with the signing of Chapter 208 of the Acts of 2004, which will significantly expand the number of projects to be funded, and will place an additional burden on the SBA program.

3. AUTOMATED PROJECT TRACKING AND PLANNING NEEDS IMPROVEMENT IN ORDER TO EFFICIENTLY AND EFFECTIVELY MANAGE THE SBA PROGRAM

The SBA program currently is responsible for managing approximately 1,200 projects, either ongoing or on the current priority list. To manage such a large volume of information and data, an up-to-date, automated system is necessary. Further, the SBA program is required under Chapter 70B, Section 17, of the General Laws to maintain a comprehensive data base on all current projects, as well as information on all school buildings in the Commonwealth, including data on size, capacity, age, and maintenance of each building. The lack of an adequate system precludes the SBA program from maintaining this information, which is necessary to perform adequate planning, analysis, and decision-making tasks to best manage the school construction program. Further, monitoring of school maintenance efforts is critical to ensure that the significant investment of public dollars in these buildings is not being wasted.

Chapter 70B, Section 17C requires the Board to maintain electronic data as follows:

The board shall collect and electronically maintain data on all school buildings in the commonwealth, including data on the size, capacity, age and maintenance of each school building.

SBA program management indicated that its inability to comply with these requirements was attributable to a lack of resources and that additional funding would be required. In its February 2003 report to the Board of Education, the SBA program reported to the Board that it lacked the necessary resources, as follows:

A new MIS system, with detailed and accessible information on all school buildings and construction projects, is also needed to replace the twenty-year old legacy system currently in use.

Recommendation

The Board should provide the SBA program with the resources needed to be in compliance with all sections of Chapter 70B, Section 17C, of the General Laws.

4. DOCUMENTATION OF POLICIES AND PROCEDURES NEEDS IMPROVEMENT

We reviewed the SBA program's regulations and its Audit Procedures dated November 2001 to determine the adequacy of the project close-out procedures and whether the SBA program is in compliance with its procedures. Our review disclosed that improvements are needed in the documentation of its policies and procedures.

The SBA program has not documented its policies and procedures relating to the operations of the program. In response to our request for policies and procedures, the SBA program management provided us with copies of policy advisory memorandums that were sent to "Superintendents and Mayors/Boards of Selectmen" by the Commissioner. However, there are no policies and procedures regarding the financial and programmatic operation of the SBA program. Chapter 647 of the Acts of 1989, An Act Relative to Improving Internal Controls Within State Agencies, states, in part:

(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.

Written policies and procedures allow the SBA program to provide guidance and direction relative to the program's operation and management, and to assess risk within a certain function. A lack of written policies and procedures prevents management from performing adequate risk assessments and providing an environment in which management can be assured that operations are being performed in compliance with applicable laws, rules, and regulations.

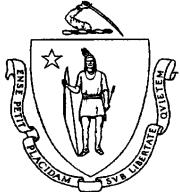
For example, the SBA program's policies and procedures should be documented to include, but not be limited to, the following:

- Administration of the program
- Municipality application process
- SBA program application review process
- Audit process
- Financial process

Recommendation

The Board should require the SBA program to document in writing policies and procedures for all functions performed, as required by Chapter 647 of the Acts of 1989, in order to provide

consistency in the program process and to help ensure compliance with applicable laws, rules, and regulations.

APPENDIX I**Department of Education School Building
Assistance Response**

David P. Driscoll
Commissioner of Education

**The Commonwealth of Massachusetts
Department of Education**

350 Main Street, Malden, Massachusetts 02148-5023

Telephone: (781) 338-3000

May 31, 2004

Hon. A. Joseph DeNucci
Auditor of the Commonwealth
State House
Boston, MA 02133

Dear Auditor DeNucci:

I fully concur with your office's recommendation that the state needs to increase its monitoring and oversight of local school construction projects. We have made significant progress since your last audit in 1998, both in reducing the backlog of projects awaiting final audit and in documenting our management procedures, but much work still remains to be done. As your report correctly noted, more resources at the state level are needed to address these issues. The Legislature is currently considering statutory changes to the SBA program, and I urge them to include a provision which would allow a small portion of the program funds to be used for improved oversight.

Thank you for your constructive criticisms, and I look forward to working with you and with the Governor to strengthen the SBA program so that it can continue to serve the needs of students in Massachusetts public schools.

Sincerely,
A handwritten signature in black ink, appearing to read "David P. Driscoll".
David P. Driscoll
Commissioner of Education

APPENDIX II

**Department of Education
School Building Assistance Program
Five-Year Project Trend Analysis**

	Fiscal Year 2000	Fiscal Year 2001	Fiscal Year 2002	Fiscal Year 2003	Fiscal Year 2004	Percentage Change Fiscal Years 2000/2004
Total number of projects that had not received funding at start of fiscal year (Waitlist).	181	201	231	300	347	91.7%
Percentage of increase over previous fiscal year.	1.7%*	11.0%	14.9%	29.9%	15.7%	
Number of projects that were funded during the fiscal year. (Received initial payment).	(57)	(63)	(58)	(18)	(19)	
Fiscal year appropriation to fund initial payments	\$43.2Million	\$51.1Million	\$54.8Million	\$21.5Million	\$21.9Million	
Projects left unfunded (Subtotal)	124	138	173	282	328	
Projects that were added during the fiscal year but did not receive funding	<u>77</u>	<u>93</u>	<u>127</u>	<u>65</u>	<u>92</u> **	
Total number of projects that had not received funding at end of fiscal year (Waitlist)	<u>201</u>	<u>231</u>	<u>300</u>	<u>347</u>	<u>420</u>	109.0%
Percentage of increase over previous fiscal year	11.0%*	14.9%	29.9%	15.7%	21.0%	
Cost to fund first-year payments for projects waiting to be funded (Waitlist)	\$140.5Million	\$188.9Million	\$231.2Million	\$294.7Million	\$360.6Million	
Percentage of annual increase over previous fiscal year	7.7%	34.4%	22.4%	27.5%	22.4%	156.7%
Total number of projects receiving continuing payments. (2 nd payment through end of grant)	650	688	677	725	734	
Fiscal year appropriation for continuing payments	\$227.5Million	\$264.9Million	\$310.5Million	\$361.6Million	\$379.4Million	
Percentage of annual increase	7.1%*	16.4%	17.2%	16.5%	4.9%	66.8%
Total number of projects receiving first-year and continuing payments	707	751	734	743	753	
Fiscal year appropriation for initial and continuing payments	\$270.7Million	\$316.0Million	\$365.3Million	\$383.1Million	\$401.3Million	
						48.2%

*Percentage figures for fiscal year 2000 shows increase over fiscal year 1999.

**The Board imposed a moratorium on review or approval of pending school construction projects in an advisory dated February 11, 2003. Chapter 26, Section 668, of the Acts of 2003 lifted the moratorium. In the fiscal year 2004 budget, language was adopted that stated that all school facilities capital or major reconstruction projects that received final municipal approval by June 30, 2003 could be placed on the waitlist. As a result, 92 applications were accepted.

APPENDIX III

**Department of Education
Appropriations for the School Building Assistance Program
Fiscal Years 2000 to 2004**

Account Number	Description	Fiscal Year 2000	Fiscal Year 2001	Fiscal Year 2002	Fiscal Year 2003	Fiscal Year 2004	Total
7052-0003	First annual payments for projects to relieve racial imbalance	\$10,254,854	\$10,510,945	\$16,727,942	\$7,303,260	\$7,043,760	\$51,840,761
7052-0004	First annual payments for all other projects	\$35,941,156	\$46,015,190	\$34,152,013	\$12,948,960	\$14,935,322	\$143,992,691
7052-0005	Ongoing payments	\$227,881,436	\$268,117,348	\$310,574,323	\$361,596,898	\$379,358,606	\$1,547,528,611
7052-0006	Other reimbursable costs – Regional School District buy-in	\$276,652	\$46,206	\$43,921	\$43,921	\$19,076	\$429,776
7052-0007	Emergency safety issues	<u>\$1,680,514</u>	<u>\$755,695</u>	-	-	-	\$2,436,209
	Total	<u>\$276,034,612</u>	<u>\$325,445,384</u>	<u>\$361,498,199</u>	<u>\$381,893,039</u>	<u>\$401,356,764</u>	<u>\$1,746,227,998</u>

APPENDIX IV

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

H.S

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

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

H 5

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

H. S.

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.

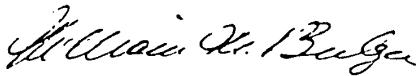
Passed to be enacted,



George K. Curran, Speaker.

In Senate, December 22, 1989.

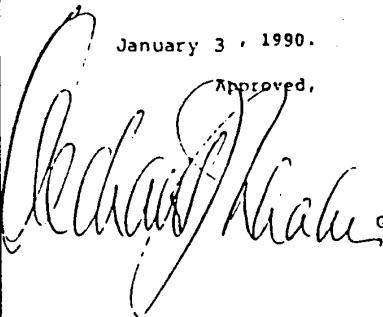
Passed to be enacted,



William F. Bulger, President.

January 3, 1990.

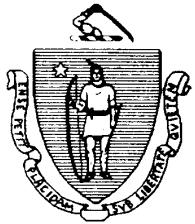
Approved,



Richard J. Celeste Governor.

APPENDIX V

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:

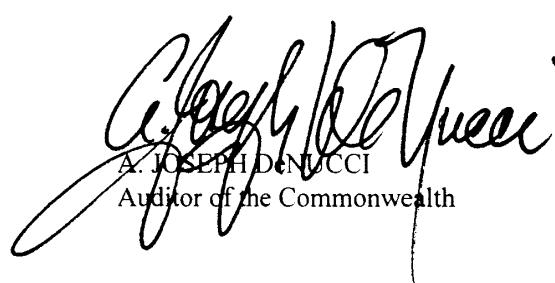
- ◆ The Office of the Comptroller offers departments free monthly training on internal controls. These classes are listed in the *OSC Training Bulletin*.
- ◆ The Office of the Comptroller provided a new document entitled the *Internal Control Guide for Managers* on the Office of the Comptroller's Web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



MARTIN J. BENISON
State Comptroller