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INDEPENDENT STATE AUDITOR'S REPORT ON CERTAIN ACTIVITIES OF THE EAST MIDDLESEX ASSOCIATION FOR RETARDED CITIZENS, INC. JULY 1, 2000 THROUGH JANUARY 31, 2003

OFFICIAL AUDIT REPORT

JANUARY 21, 2004

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The East Middlesex Association for Retarded Citizens, Inc. (EMARC) was founded in 1955 and incorporated in 1957 as a not-for-profit organization to provide and promote services for people with mental retardation.

EMARC provides employment services to adults and assistance to families with children at home who have developmental disabilities. EMARC's programs include information and referral services, education and training, recreation, respite care, residential services and support groups.

The scope of our audit included the various administrative and operational activities of EMARC during the period July 1, 2000 to January 31, 2003. Our audit was conducted in accordance with applicable generally accepted government auditing standards for performance audits issued by the Comptroller General of the United States. The objectives of our audit were to (1) determine whether EMARC had implemented effective management controls and (2) assess EMARC's business practices and its compliance with applicable laws, rules, and regulations as well as the various fiscal and programmatic requirements of its state contracts.

Our audit identified undocumented, unallowable, or unnecessary expenses totaling at least $469,235 involving the activities of the Department of Mental Retardation (DMR) and EMARC. During our audit, EMARC officials took measures to address the issues that we had identified during our audit.

We found that contrary to the General Laws of Massachusetts, Chapter 29, Section 29B, and state regulations, DMR used a Family Support Contract with EMARC as a fiscal conduit to pay as much as $355,297 of DMR's expenses from July 1, 1996 through January 31, 2003. We were particularly concerned that some of these expenses were improperly documented and that the contracting process was compromised. For example, DMR expended more than $115,000 for food and space rental for various conferences, weekend meetings, and training primarily for its staff. On six occasions, DMR spent more than $3,000—and as much as $7,646—per event for food, space, and catering. In addition, we found that although this funding was provided to EMARC for family support services to EMARC's clients, DMR authorized EMARC to process $38,063 in DMR employee and intern payroll expenses out of these funds. Furthermore, we found that DMR used these funds to pay 1 full-time employee, 5 interns and 22 consultants a total of $80,955 but failed to report those income amounts to the appropriate taxing authorities.

In return for EMARC's processing of these bills, DMR paid EMARC administrative fees totaling $18,553. Because DMR's own accounting staff should have processed those payments, that $18,553 represents an unnecessary expense to the Commonwealth. By processing expenses in this manner, DMR failed to comply with state law and various regulations, resulting in inaccurate reporting of both its and EMARC's total operating expenses to the Commonwealth for the period of our review, and did not ensure that adequate controls were in place to protect these funds from abuse or misuse.

EMARC used state funds that it received from DMR to award employee longevity bonuses totaling $41,269 and $48,501 for fiscal years 2001 and 2002, respectively. However, contrary to state regulations, these bonuses were issued without an approved morale, health, and welfare policy in place and without EMARC's having received prior approval from DMR. As a result, these expenses are unallowable and nonreimbursable under EMARC's state contracts. During our audit, EMARC developed a morale, health, and welfare policy that DMR subsequently approved.

Contrary to state regulations, EMARC charged various non-program expenses to its state contracts during the audit period. These expenses totaled $5,615 and included flowers, gifts, lottery tickets, and gift certificates for employees. According to state regulations, such expenses, which are not directly related to the social-service purposes of EMARC's state-funded programs, are unallowable and nonreimbursable under state contracts.

INTRODUCTION

Background

The East Middlesex Association for Retarded Citizens, Inc. (EMARC) was founded in 1955 and incorporated on October 14, 1957 as a not-for-profit organization to provide and promote services for people with mental retardation in several communities north of Boston, including Melrose, Reading, North Reading, Stoneham, Everett, Malden, Wakefield, and Medford. EMARC provides employment services to adults and assistance to families with children at home who have developmental disabilities. EMARC's programs include information and referral services, education and training, recreation, respite care, residential services, and support groups. EMARC also operates residential programs for more than 60 individuals in Melrose, Reading, Wakefield, Saugus, and Lynn.

EMARC conducts business with two related organizations: Reading Residential Programs, Inc. (RRP) and Hopkins Street Housing, Inc. (HSH). RRP is a not-for-profit organization established in 1994 to purchase, refurbish, and manage properties for EMARC. RRP operates two residences for EMARC in Reading that have a total of 12 units. HSH is a not-for-profit organization established in 1997 to also purchase, refurbish, and manage properties for EMARC. HSH operates a residence for EMARC in Reading occupied by five mentally retarded clients living in four units. The RRP and HSH housing units are operated under Section 811 of the Cranston-Gonzales National Affordable Housing Act and are regulated by the U.S. Department of Housing and Urban Development (HUD) with respect to rental charges and operating methods.

During our audit period, EMARC received funding from various governmental and private sources, which are detailed in the following table:

EMARC
Summary of Revenue by Fiscal Year
July 1, 1996 through June 30, 2002

	1997	1998	1999	2000	2001	2002
Department of Mental Retardation	$2,276,831	$2,509,701	$2,728,913	$2,912,258	$3,108,008	$3,561,944
Department of Mental Health	-	-	-	-	5,000	-
Department of Social Services	-	-	-	-	3,868	32,342
Mass. Commission for the Blind	10,885	10,555	10,863	10,649	9,989	9,989
Mass. Rehabilitation Commission	-	-	-	7,525	9,244	624
Office of Child Care Services	-	-	2,500	2,500	3,875	3,875
Other Mass.-POS	19,062	44,030	-	-	6,000	4,500
Mass. Local Government/Quasi-Governmental Entities	31,842	45,082	24,840	56,594	-	108,923
Non-Mass. Local Government	31,005	49,067	38,833	21,430	47,947	-
Client Fees and Resources	241,315	237,001	250,941	228,496	274,622	387,542
Donations and In-Kind Contributions	67,171	55,774	13,397	138,666	209,718	184,488
Federal Grant	280	596	1,190	-	7,500	-
Commercial Activities	84,497	137,654	19,292	-	131,317	78,739
Other Revenue	12,568	35,027	144,457	110,274	41,545	38,140
Total	$2,775,456	$3,124,487	$3,235,226	$3,488,392	$3,858,633	$4,411,106

Audit Scope, Objectives, and Methodology

The scope of our audit included the various administrative and operational activities of EMARC during the period July 1, 2000 to January 31, 2003. However, to adequately examine certain transactions selected for testing, it was sometimes necessary to go beyond the audit period.

Our audit was conducted in accordance with applicable generally accepted government auditing standards for performance audits issued by the Comptroller General of the United States and included such audit procedures and tests as considered necessary to meet these standards.

Our audit objectives consisted of the following:

1. Making a determination as to whether EMARC had implemented effective management controls, including the following:

- Processes for planning, organizing, directing, and controlling program operations

- Policies and procedures to ensure that resource use is consistent with laws and regulations

- Policies and procedures to ensure that resources are safeguarded and efficiently used

2. Conducting an assessment of EMARC's business practices and compliance with applicable laws, rules, and regulations as well as various fiscal and programmatic requirements of its state contracts

To achieve our objectives, we first assessed the management controls established and implemented by EMARC over its operations. The purpose of this assessment was to obtain an understanding of management's attitude, the control environment, and the flow of transactions through EMARC's accounting system. We used this assessment in planning and performing our audit tests. We then held discussions with EMARC and DMR officials and reviewed organizational charts and internal policies and procedures as well as all applicable laws, rules, and regulations. We also examined EMARC's financial statements, budgets, contracts, invoices, and other pertinent financial records to determine whether expenses incurred under its state contracts were reasonable, allowable, allocable, properly authorized and recorded, and in compliance with applicable laws, rules, and regulations. Moreover, we reviewed various documents provided by DMR officials regarding certain DMR activities conducted through EMARC.

Our audit was limited to a review of the activities of EMARC. Although we reviewed various documents regarding certain activities of EMARC's subsidiaries, we did not conduct any audit work at those entities. Our audit was not conducted for the purpose of forming an opinion on EMARC's financial statements. We also did not assess the quality and appropriateness of program services provided by EMARC under its state-funded contracts. Rather, our report was intended to (1) report findings and conclusions on the extent of EMARC's compliance with applicable laws, regulations, and contractual agreements, and (2) identify services, processes, methods, and internal controls that could be made more efficient and effective.

AUDIT RESULTS

1. CONTRARY TO STATE LAW AND REGULATIONS, DMR USED EMARC AS A CONDUIT TO PAY $355,297 IN INADEQUATELY DOCUMENTED DMR EXPENSES AND AS A RESULT ALSO INCURRED UNNECESSARY ADMINISTRATIVE EXPENSES TOTALING $18,553

We found that contrary to the General Laws of Massachusetts, Chapter 29, Section 29B, and state regulations, DMR used a Family Support Contract with EMARC as a fiscal conduit to pay as much as $355,297 of DMR's expenses from July 1, 1996 through January 31, 2003. We were particularly concerned that some of these expenses were improperly documented and that the contracting process was compromised. For example, DMR expended more than $115,000 for food and space rental for various conferences, weekend meetings, and training primarily for its staff. On six occasions, DMR spent more than $3,000—and as much as $7,646—per event for food, space, and catering. In addition, we found that although this funding was provided to EMARC for family support services to EMARC's clients, DMR authorized EMARC to process $38,063 in DMR employee and intern payroll expenses out of these funds. Furthermore, we found that DMR used these funds to pay 1 full-time employee, 5 interns and 22 consultants a total of $80,955 but failed to report those income amounts to the appropriate taxing authorities.

In return for EMARC's processing of these bills, DMR paid EMARC administrative fees totaling $18,553. Because DMR's own accounting staff should have processed those payments, that $18,553 represents an unnecessary expense to the Commonwealth. By processing expenses in this manner, DMR failed to comply with state law and various regulations, resulting in inaccurate reporting of both its and EMARC's total operating expenses to the Commonwealth for the period of our review, and did not ensure that adequate controls were in place to protect these funds from abuse or misuse.

During fiscal years 1997 through 2003, DMR awarded contracts to EMARC to provide family support services to EMARC's clients. The total maximum obligations of these contracts were as follows:

	1997	1998	1999	2000	2001	2002	2003
Maximum Obligation	$377,854.00	$477,489.00	$530,306.77	$583,827.00	$590,466.00	$649,258.50	$557,643.00

These family support contracts contained the following program narrative:

> *The program serves 200+ families in the Northeast Region with a focus on the Metro North area. The primary goal of this service is to help families whose children are developmentally delayed to maximize the supports available to them by tapping into existing community resources and by encouraging families to explore support options. Service elements include traditional respite, flexible funding, information and referral, support groups, recreation, educational advocacy and training.*

During our audit, we initially selected EMARC's fiscal year 2001 family support contract with DMR for testing. We reviewed all the expenses that EMARC charged against the contract line item titled "provider reimbursement/stipends."

Based on our review and our discussions with EMARC staff, we found that many of the expenses that EMARC had billed against this contract line item did not have adequate documentation (i.e., only facsimile copies of invoices were available) and did not appear to be related to EMARC's program activities. For example, an expense totaling $869 was for a DMR (rather than an EMARC) diversity conference. EMARC officials stated that to their knowledge no EMARC staff or clients attended this conference. They also stated that DMR routinely used funding under this contract to pay for DMR-sponsored events that did not normally include any EMARC staff or clients.

As a result, we expanded our testing to include all of the 524 expenses that EMARC had billed against the "provider reimbursement/stipends," "staff training," and "agency administrative support" line items, which totaled $355,297, in its family support contracts during the period July 1, 1996 through January 31, 2003. We also reviewed the $18,553 fee that DMR paid EMARC to administer the payment of expenses during the same period. The following table summarizes the expenditures by cost category and fiscal year.

Regional Training Fund Expenditures
Fiscal Years 1997 through 2003

	1997	1998	1999	2000	2001	2002	2003	Total
Food & Space Rental	$3,551	$16,028	$20,452	$29,496	$27,583	$17,334	$647	$115,091
Student Interns	-	-	-	8,695	2,890	-	1,872	13,457
Consultants	2,923	10,905	16,220	15,446	10,217	5,959	1,436	63,106
Training	4,911	12,905	8,589	10,758	20,718	17,684	1,016	76,581
Trainers	-	300	-	3,100	12,857	5,893	3,480	25,630
Supplies & Misc.	3,172	1,506	9,037	8,486	6,114	7,812	699	36,826
DMR Employees	660	2,172	8,576	5,817	4,904	2,139	338	24,606
Total	$15,217	$43,816	$62,874	$81,798	$85,283	$56,821	$9,488	$355,297
Administration Fee	$1,192	$2,807	$3,866	$2,625	$5,269	$2,794	-	$18,553
Total	$16,409	$46,623	$66,740	$84,423	$90,552	$59,615	$9,488	$373,850

Our review identified several issues with the expenses that EMARC had billed under its DMR contracts, as detailed in the following sections.

a. DMR Used EMARC as a Fiscal Conduit to Pay $355,297 in DMR Expenses and Incurred Unnecessary Administrative Costs Totaling $18,553

Chapter 29, Section 29B, of the Massachusetts General Laws prohibits state agencies from using contracts with human service providers as fiscal conduits; it states, in part:

> *Such contracts [with human services providers] shall not be written or used by any department, office, agency, board, commission or institution of the commonwealth to procure full or part-time personal services, or equipment to be used by such department, office, agency, board, commission or institution, or any goods or services not required in the direct provision by the contractor of social, rehabilitative, health, or special education services to populations being served by the contracting department, office, agency, board, commission, or institution.*

Furthermore, when these contracts were initially awarded by DMR to EMARC, 808 Code of Massachusetts Regulations (CMR) 2.03 (06), promulgated by the state's Operational Services Division (OSD), the agency responsible for regulating and overseeing contracted human services providers such as EMARC, was in effect and stated the following, in part:

<u>Fiscal Conduits Prohibited</u>. No procuring Department shall award a Contract:

(a) to acquire any goods for the Procuring Departments use;

(b) to defray the expenses of services rendered by individuals hired or supervised in the daily performance of their work by personnel in the classified service of the Commonwealth; or

(c) solely to acquire payroll or fiscal management for a Program of Client services operated by the Commonwealth or any third party.

We determined through our review of EMARC's documentation regarding the $355,297 in expenses and our discussion with agency officials that although those funds were provided to EMARC for program purposes, some of these expenses were not incurred by EMARC, which did not provide any direct program services in relation to these expenses. Rather, EMARC officials stated, DMR incurred these expenses and DMR officials simply instructed EMARC to pay these bills. In return, DMR paid EMARC an administrative fee equal to a percentage of expenses billed against this contract. The percentage amount varied from year to year, but during our audit period the administrative fees that DMR paid to EMARC totaled $18,553.

During our audit, we met with officials from DMR's Region III office who had awarded this contract to EMARC. The officials stated that they included this funding in this contract as part of the Department's regional training initiative. DMR officials stated that they thought this was acceptable because the expenses they paid for using this contract with EMARC were related to providing family support to consumers. For example, they stated that DMR used some of this funding to pay for regional training costs, including the training of contracted services provider staff other than EMARC's, on family support issues. However, during our audit, these officials were not able to provide adequate documentation to substantiate this assertion. Moreover, to ensure that the Department had established adequate controls to protect these funds from abuse or misuse, we asked DMR officials to provide copies of their policies and procedures for the processing of these expenditures. However, during our audit, the officials stated that they had no formal policies or procedures regarding approval of such expenses.

During our audit, we determined that DMR had an accounts payable department that could have processed these expenditures. Consequently, the $18,553 in administrative fees that DMR paid EMARC to process these expenses represents an excessive and unnecessary expense to the Commonwealth. In addition, since these expenditures were not direct service-program expenses incurred by EMARC, they were misreported by EMARC and DMR. Moreover, by using state funding in this manner, DMR not only failed to comply with the requirements of state law and regulations but also failed to properly safeguard these funds against abuse and misuse.

b. Inadequate Documentation Exists Regarding $355,297 in Expenses Billed Against EMARC's Family Support Contract

According to regulations promulgated by the Office of the State Comptroller (OSC) with which all state agencies such as DMR must comply, state agencies are required to maintain adequate documentation for all expenses paid with state funds. Specifically, 815 CMR 10.00 states, in part:

> *Departments shall maintain the Record Copy of the following documents in accordance with 815 CMR 10.00 and any policies and procedures issued by the Office of the Comptroller:*
>
> *(a) all Bills and Vouchers on which money has been paid or will be paid from the Treasury upon the certificate of the Comptroller or warrant of the Governor; and*
>
> *(b) all Contracts under which money may be payable from the Treasury....*
>
> *Departments shall maintain Record Copies of the documents identified under 815 CMR 10.03(1) at:*
>
> *(a) a central Department location, or*
>
> *(b) if the Department maintains Record Copies at multiple locations, the Department shall maintain a centralized list of the repository location of all Record Copies.*

Similarly, 808 CMR 1.05 requires all contracted human services providers such as EMARC to maintain adequate supporting documentation for all expenses and further identifies the following as being nonreimbursable expenses under state contracts:

> *(26) <u>Undocumented Expenses.</u> Costs which are not adequately documented in the light of the American Institute of Certified Public Accountants statements on auditing standards for evidential matters.*

According to EMARC officials, during fiscal years 1997 through 1999, whenever DMR wanted a bill paid, it would simply fax to EMARC a form that identified a specific vendor and the amount to be paid, with no supporting documentation. EMARC officials stated that they would simply issue a check to the vendor for the amount indicated on the faxed form and charge the expense against the agency's family support contract.

During our audit, we reviewed all of the supporting documentation that EMARC was maintaining regarding the $355,297 in expenses at issue. Our review found that for fiscal years 1997 through 1999 EMARC had only facsimile copies of the forms from DMR and no other documentation (e.g., invoices or receipts) to document the reasonableness or business nature of the $121,907 in expenses charged against EMARC's family support contract. Beginning in fiscal year 2000, EMARC developed a form titled Regional Training Funds Voucher (RTFV) that it asked DMR to use to process its expenses. The RTFV contained a listing of all the expense types that DMR processed through this contract, including for regional staff, interns, consultants, ethics committee, space/food, regional staff recognition, and legislative breakfast. Our review also found that beginning in fiscal year 2000 EMARC maintained facsimile copies of RTFVs for payment as well as some other supporting documentation, such as facsimile copies of invoices. However, those were not original invoices and did not indicate how the expenses related to the social service program purposes of EMARC's programs. In all instances, the documentation EMARC was maintaining regarding these expenses was inadequate. For example, to document a training expense, EMARC would have a training registration form but no record of who attended the training or the purpose of the training.

We also reviewed the documentation that DMR was maintaining regarding these expenses. We found that for fiscal years 1997 through 1999, DMR had no documentation other than what it had sent to EMARC. DMR officials stated that during this period the requisition and payment of these expenses had been handled by DMR's Director of Training and Staff

Development, and were not processed through the Department's regional business office. The officials also stated that because the Director was no longer employed by DMR, it was unlikely that any additional documentation regarding these expenses would be found.

Our review of DMR's documentation for the expenses it had sent to EMARC for payment during fiscal year 2000 through January 31, 2003 revealed that the supporting documentation was inadequate in some cases. Specifically, although the department had original copies of the invoices it had sent to EMARC for payment, there was inadequate documentation to substantiate the business purpose of some of the expenses, who received the benefits of the purchases, or, in some instances, who attended specific events. Although DMR officials did provide several conference brochures and attendance records, we were unable to substantiate their accuracy because the documentation was not maintained in a central location, the attendance listings were provided subsequent to the end of our audit filed work, and in some cases, these listings were not the original attendance records taken at the specific events. Furthermore, although these funds were intended to be used to provide family support services to EMARC's clients, the conference attendance information that DMR was able to provide indicated that these events were primarily attended by DMR employees, and were not attended primarily by EMARC staff or clients.

For example, DMR paid $3,336 and $992 to Classic Cooks Catering and the Yankee Clipper Inn, respectively, for food and space rentals on May 15 and 16, 2002, respectively, for a "Rockport Retreat." DMR officials produced an agenda for the training event, which indicated that the event was a full-day training event for Regional staff in long-term planning for community placements, discussions concerning clinical and legal supports in guardianship cases, and notably, the 8th Annual Family Workshop. DMR officials provided a list of DMR employees who attended the event. Because this event apparently benefited only DMR employees, we question why this expense was paid with funds that DMR provided to EMARC for family support services.

Regarding this matter, DMR officials stated that they were unaware what supporting documentation was required for these expenses. They added that the expenses were processed outside of DMR's normal accounts payable department because payment would be more expeditious.

c. DMR Expended $161,082 in Questionable Costs through EMARC

The Executive Office for Administration and Finance (EOAF) has promulgated 801 CMR 21.08 (1), with which all state agencies must comply; which states that "the Contractor shall only be compensated for performance delivered to and accepted by the Department in accordance with the specific terms and conditions of a properly executed Contract."

Moreover, 808 CMR 1.05 (promulgated by OSD), which applies to all contracted human services providers such as EMARC, identifies the following costs as nonreimbursable under state contracts.

> *Unreasonable Costs. Any costs not determined to be Reimbursable Operating Costs as defined in 808 CMR 1.02 or any amount paid for goods or services which is greater than either the market price or the amount paid by comparable Departments or other governmental units within or outside of the Commonwealth.*

In addition to the inadequately documented expenses that we reviewed in EMARC's family support contract, we found at least $161,082 in expenses that seemed not to be related to the provision of family support services under EMARC's contract and therefore should have been paid for directly by DMR.

For example, DMR expended a total of $115,091 on 148 occasions for food and space for various conferences and trainings. In 26 of these occasions, over $1,500 was spent on food/space rental for an event. In fact, on six occasions, DMR spent more than $3,000, and as much as $7,646, per event for food and space rental. Many of these events provided breakfast and lunch as well as a snack for attendees. According to DMR officials, most of the attendees at these functions were DMR employees.

DMR also processed at least $26,316 in its own payroll expenses through EMARC's contract. Included were the salaries of three interns and three full-time DMR employees. According to DMR's Region III Regional Director, two of these employees were paid though the EMARC contract until the position that they had been hired for became available within the Department, and the third was a temporary employee who was paid through EMARC because no funding was left in DMR's appropriated funds. In addition, we found that in 10 instances DMR used this money for contributions/donations or sponsorships totaling $16,300. For example, DMR made five contributions totaling $9,100 to the North Shore Community College for a program called Project Access, and one contribution to Turning Point, Inc., a nonprofit human services provider, for the Urban Youth Program. DMR officials stated that they believed these contributions to fall within the concept of family support and therefore all those expenses were reasonable on that basis. However, DMR officials were not able to provide adequate documentation to substantiate their assertions.

We also found at least five occasions on which EMARC made duplicate payments, totaling $3,125, for various training and conference expenses. Three of these double payments were for translation/transportation expenses for a conference. In one case, DMR issued a $250 check to an individual, but there was no supporting documentation regarding the nature of this expense. According to DMR's Regional Director, the payment was for an upset woman who called the Director because she could not afford diapers for her child. According to the Director, the woman did not subsequently provide evidence that she purchased diapers with the money.

d. DMR Failed to Comply with State and Federal Requirements Regarding Consultant Services and the Reporting of $80,955 in Employee and Consultant Compensation

Contrary to state and federal tax regulations, during calendar years 1999 through 2002 DMR paid one of its full-time employees and five of its interns through EMARC and did not issue an Internal Revenue Service (IRS) Form W-2 to these individuals. In addition, during calendar years 1997 through 2002, DMR paid several consultants through EMARC and did not issue IRS Form 1099 to these individuals. Moreover, DMR did not follow state procurement regulations when hiring these consultants and did not keep adequate documentation of consultant services, including consultant contracts.

IRS regulations require that all taxable wages be reported to the IRS on Form W-2. General instructions issued by the IRS for Form W-2 indicate who must report wages:

> *Employers must file W-2 for wages paid to each employee from whom:*
>
> - *Income, Social Security, or Medicare taxes were withheld or*
> - *Income tax would have been withheld if the employee had claimed no more than one withholding allowance....*
>
> *Also, every employer engaged in a trade or business who pays remuneration for services preformed by an employee, including noncash payments, must furnish a W-2 to each employee even if the employee is related to employer.*

Code of Federal Regulations (CFR), Title 26, Chapter 24, section 3401 (a), identifies wages as follows:

> *The term wages means all remuneration (other than fees paid to a public official) for services performed by an employee for his employer, including the cash value of all remuneration (including benefits) paid in any medium other than cash.*

Regarding the issuance of IRS Form 1099 to consultants, CFR, Title 26, Chapter 1, Section 6041, titled "Return of information as to payments of $600 or more," states, in part:

> *(i) Payments required to be reported. Except as otherwise provided in Secs. 1.6041-3 and 1.6041-4, every person engaged in a trade or business shall make an information return for each calendar year with respect to payments it makes during the calendar year in the course of its trade or business to another person of fixed or determinable income described in paragraph (a)(1)(i) (A) or (B) of this section. For purposes of the regulations under this section, the person described in this paragraph (a)(1)(i) is a payor.*
>
> *(A) Salaries, wages, commissions, fees, and other forms of compensation for services rendered aggregating $600 or more....*

Additionally, the Massachusetts Department of Revenue has similar requirements governing the reporting of compensation to individuals and identifies the following as being income that must reported by individual:

> *All compensation to an employee for services performed. Payments subject to Massachusetts withholding include wages, salaries, tips, commissions, bonuses, fees or any other item of value paid to an individual for services performed as an employee.*

During calendar years 1999 through 2002, DMR paid six employees salary expenses totaling $26,315 through its contract with EMARC and failed to issue Form W-2s to these individuals, as indicated in the following table:

DMR Employees Paid Through EMARC
And Not Issued Form W-2
Calendar Years 1999 Through 2002

Year	Number of Employees	Amount Paid
1999	2	$11,468
2000	2	10,825
2001	1	2,151
2002	1	1,871
Total	6	$26,315

Note: Amounts include funds paid to DMR employees and interns, less reimbursements for business expenses.

In addition, during calendar years 1997 thorough 2002, DMR through EMARC paid 22 consultants a total of $54,640 and failed to issue IRS Form 1099 to these individuals, as indicated in the following table:

DMR Consultants Paid Through EMARC
And Not Issued Form 1099
Calendar Years 1997 Through 2002

Year	Number of Consultants	Amount Paid
1997	4	$4,323
1998	1	3,629
1999	3	18,068
2000	3	4,836
2001	11	15,534
2002	5	8,250
Total	27	$54,640

Note: The actual number of consultants who should have received 1099s is 22; however, several consultants provided services during multiple calendar years.

In addition, regarding the procurement of consultant services, state agencies such as DMR must comply with procurement requirements. EOAF has issued regulations regarding competitive procurement, specifically 801 CMR 21.06, which states the following:

> *<u>Competitive Procurement Standards</u>:*
>
> *All acquisitions of Commodities or Services, or both, must be competitively procured unless the acquisition qualifies as an exception under 801 CMR 21.05. A Procuring Department shall be responsible for conducting a Procurement for single or multiple Contracts for Commodities or Services, or both, in accordance with 801 CMR 21.00 and policies and procedures issued by ANF, OSD and CTR. The policies and procedures shall address, but shall not be limited to, the following Procurement standards:*
>
> *(1) <u>Procurement File</u>. A Procuring Department shall maintain a paper or electronic Procurement file for each Procurement of Commodities or Services, or both. The file shall contain the original, copies or the file location of the RFR and data or other information relevant to the Procurement and selection of a Contractor, the executed Contract form(s), correspondence with the Contractor and any applicable approvals or justifications.*
>
> *(2) <u>Duration</u>. The duration of any Contract procured or executed under 801 CMR 21.00 shall include the initial duration of a Contract, either less than one Fiscal Year, a single Fiscal Year or multiple Fiscal Years, and any options to renew beyond the initial duration of the Contract. The duration established for a Contract shall be the period determined by the Procuring Department to be reasonably necessary to obtain the required Commodities or Services, or both, at the Best Value for the Procuring Department and the State and shall be subject to Available Funding for the Contract….*
>
> *(3) <u>Scope of Contract Participants</u>. A Procuring Department may draft a Request for Response (RFR) for specified Commodities or Services, or both, to include an option for additional Departments to purchase under the same terms of the RFR and may require Bidders to provide Responses specify their ability to provide the specified Commodities or Services, or both, to other Departments in addition to the Procuring Department and the rates that will be used for the additional business given to the Contractor.*

Based on our review of DMR's documentation regarding the 22 consultants whom the Department paid through EMARC's family support contract, we noted the following instances of DMR's failing to comply with the aforementioned state regulations:

1. DMR did not maintain various required consultant documentation, including the following, for any of the 22 consultants:

- Formal contracts, which should have specified the rate of compensation, scope of services, contract length, etc.
- Evidence of competitive bidding process
- Evidence that the services were actually performed
- Credentials (i.e., resume, certifications, qualifications, etc.)
- Documentation to establish a need for these services

2. All the consultant invoices we reviewed were inadequate because they did not specify a rate, date of service, and a description of the services provided.

Regarding this matter, DMR officials stated that because these consultant expenses were not processed through DMR's business office, they were unaware that they needed to obtain and maintain consultant documentation. Regarding the issuance of Form 1099s and Form W2s, DMR's Regional Director stated that because these expenses were not paid through DMR's business office, these tax-reporting forms were not automatically generated by the Department.

Recommendation

As a result of our audit, DMR officials stated that they have ceased processing such expenditures through EMARC. In the future, DMR should not process any of its expenses in this unallowable manner and should take measures to ensure that it complies with state procurement regulations when purchasing goods and services. Furthermore, the Executive Office of Health and Human Services and OSD should (1) review the expenses that DMR paid for using funding it provided to EMARC and (2) require DMR to take the corrective action necessary to address these issues. Moreover, DMR should issue Forms 1099s to the individuals in question for calendar years 1998 through 2002.

Auditee's Response

In response to this issue, DMR provided the following comments:

> *The Department of Mental Retardation...takes seriously the issues raised in your report. In fact, corrective action has already been taken on several of the issues you note.*
>
> *Specifically, since the completion of fiscal year 2002, DMR has ceased processing bills for regional training activities through the EMARC contract. Moreover, beginning in fiscal year 2003, DMR's Budget Office issued a policy and procedures manual to ensure future compliance with statutory requirements and Operational Services Division regulations. The manner in which attendance at training is documented will also be reviewed and standardized. Lastly, in compliance with Internal Revenue Service requirements, DMR contacted each of the interns cited in the report and confirmed that they declared the income they earned from their internships on their returns.*
>
> *While it is evident from your report that the expenditures were made in an inappropriate manner, they were targeted to meet important goals that are related to family support. The Northeast Region of DMR serves thousands of families from an array of ethnic backgrounds. Many of the expenditures relate to training and outreach efforts that would allow DMR staff to be more sensitive to issues facing persons and families from different cultural backgrounds.*
>
> *The staff that incurred the expenses did so with a good faith intention of enhancing DMR's ability to serve families from all cultures. In accordance with your recommendations, future efforts shall strictly adhere to state procurement regulations and provide more accurate records of attendance at all training events.....*

Auditor's Reply

DMR acknowledged the existence of the problems we identified in this audit result and indicated that it has taken measures to address them. Because of the lack of documentation DMR maintained regarding these expenses, we are not able to comment on whether the expenses in question were related to family support services and were, therefore, appropriate expenditures to be billed through EMARC.

2. EMARC PAID UNALLOWABLE EMPLOYEE LONGEVITY BONUSES TOTALING $89,770

EMARC used state funds that it had received from DMR to award employee longevity bonuses totaling $41,269 and $48,501 during fiscal years 2001 and 2002, respectively. However, contrary to state regulations, these bonuses were issued without an approved morale, health, and welfare policy in place and without prior approval from DMR for the expenditure of these funds. As a result, these expenses are unallowable and nonreimbursable under EMARC's state contracts. During our audit, EMARC developed a morale, health, and welfare policy that was subsequently approved by DMR.

The 808 CMR 1.05 (a), promulgated by OSD, identifies the following as nonreimbursable under state contracts:

> *Fringe benefits determined to be excessive in light of salary levels and benefits of other comparable Contractors and fringe benefits to the extent that they are not made available to all employees under an established policy of the Contractor. Disparities in benefits among employees attributable to length of service, collective bargaining agreements or regular hours of employment shall not result in the exclusion of such costs.*

In August 1997, OSD provided the following additional guidance concerning staff bonuses and fringe benefits:

> *Bonuses are not considered a fringe benefit; rather, they are properly classified as a salary allowance when attributable to services rendered by an employee. Bonuses are a negotiable item, which are added to salaries in the budget and in the financial statements. The net salary amounts must not exceed what is considered reasonable compensation to be reimbursable. There are two ways to furnish bonuses to employees: one is a fixed bonus as part of an employee's salary based on terms incorporated into his or her written employment agreement, and the second is through a Contractor's written employee morale, health and welfare policy, which makes available bonuses to all employees based on exceptional employee performance. See section 162 of the Internal Revenue Code and 808 CMR 1.05(20) for further guidance.*
>
> *A Contractor's employee morale, health and welfare policy is also frequently confused with and inappropriately budgeted and/or reported as fringe benefits. Costs associated with the Contractor's employee morale, health and welfare policy are not budgeted and/or reported on the UFR separately, as fringe benefits, but rather under Administrative Support, Direct Care or Occupancy costs, as applicable. However, unlike fringe benefits, the Contractor's employee morale, health and welfare policy may exclude members of management from benefiting or participating in the employee morale, health and welfare activities of the Contractor. Bonuses that are provided to management in addition to a fixed bonus awarded pursuant to the terms of an employment agreement and not as part of a Board approved employee morale, health and welfare plan are not reimbursable. Further information concerning the reimbursement of employee morale, health and welfare activities is available in the DPS publication "Additional Questions and Answers on Audit and Preparation of the UFR for Contractors and Their Independent Auditors" issued May 1995, and in OMB Circular A-122.*

EMARC officials stated that they did not have written policies and procedures for the awarding of bonuses but these longevity bonuses were available to all employees who had been employed in good standing for more than one year. The bonus was calculated based on a percentage of each employee's salary and was capped at 6% for fiscal year 2001 and 5% for fiscal year 2002. We audited all of EMARC's longevity bonus documentation for fiscal year 2001 and 2002 and found it adequate and in agreement with the verbally established policy. However, we determined that contrary to OSD regulations and guidelines, EMARC did not have an established, written employee morale, health, and welfare policy in place at the time of the awarded longevity bonuses. Furthermore, contrary to OSD guidelines, EMARC did not obtain the pre-approval of its principal purchasing agency or OSD. Without an established, written employee morale, health, and welfare policy in place, the longevity bonus expenses that EMARC billed against its state contracts during fiscal years 2001 and 2002 are nonreimbursable according to state regulations.

OSD has established guidelines for the proper reporting of nonreimbursable costs by human services providers such as EMARC. Specifically, OSD's Uniform Financial Statements and Independent Auditors' Report (UFR) Audit and Preparation Manual states, in part:

> *The existence of non-reimbursable costs, as contained in 808 CMR 1.05 (Effective 2/1/97, 808 CMR 1.05) and OMB Circulars A-21 and A-122, must be itemized by natural classification and disclosed in the component and program as applicable. Non-reimbursable costs that exist and have not been disclosed are presumed to have been defrayed using Commonwealth and Federal funds….*
>
> *This information, taken together with the auditor's compliance testing of non-reimbursable costs, provides UFR report users with a measure of assurance that all non-reimbursable costs have been defrayed with revenues not derived from public funds or designated by donors for other purposes.*

We determined that EMARC did not properly report these $41,269 and $48,501 in non-reimbursable expenses on its fiscal year 2001 and 2002 UFRs that it filed with OSD.

Regarding this matter, EMARC officials stated that they were not aware of this requirement and had not wanted to establish a policy of providing bonuses to staff in case funds were unavailable some fiscal years. EMARC officials stated that they would establish a written employee morale, health, and welfare policy that would incorporate the distribution of longevity bonuses and submit this written policy to DMR for approval. Subsequent to our audit, EMARC established such a policy, titled "Employee Morale, Health and Welfare Activities Policy," which was approved by its Board of Directors on October 30, 2002 and submitted to DMR for approval. On March 5, 2003, EMARC received written confirmation that DMR was informed and DMR officials "do not see anything in the Policy that would prompt us to disapprove it."

Recommendation

Subsequent to our audit fieldwork, EMARC officials provided documentation to substantiate that the agency had submitted a written employee morale, health, and welfare policy to DMR, which approved the policy. Consequently, we recommend that OSD, in conjunction with DMR, review the expenses that EMARC charged against its state contracts during the audit period and take whatever action they deem necessary. EMARC should continue to inform its principal purchasing agency and OSD regarding expenditures of this nature.

3. EMARC CHARGED NONREIMBURSABLE EXPENSES TOTALING $5,615 TO ITS STATE CONTRACTS

Contrary to state regulations, during the period July 1, 2000 through June 30, 2002, EMARC charged various non-program-related expenses to its state contracts. These expenses, which totaled $5,615, included flowers, gifts, lottery tickets, and gift certificates for employees. According to state regulations, expenses that are not directly related to the social service purposes of EMARC's state-funded programs are unallowable and nonreimbursable under EMARC's state contracts.

The 808 CMR 1.05, Section 12, identifies the following costs as nonreimbursable under state contracts:

> *Non-Program Expenses. Expenses of the Contractor, which are not directly related to the social service Program purposes of the Contractor.*

During fiscal year 2001, EMARC had two corporate credit cards, a First USA Visa card and a Fleet gas card. During fiscal year 2002, EMARC opened two additional credit card accounts: one with American Express and one with Target, Inc. During our audit, we judgmentally reviewed the documentation for the administrative expenses that EMARC charged against its state contracts during fiscal years 2001 and 2002, totaling $411,018 and $407,561, respectively. Our review identified 15 credit card expenses totaling $5,615 charged to administration that appeared to be non-program related. These expenses are detailed in the following table:

Summary of Nonreimbursable Credit Card Expenditures
Fiscal Years 2001 and 2002

Expenditure	2001	2002
Flowers	$ 125	$ 70
Movie Tickets	1,147	-
Gift Certificates	1,500	1,515
Lottery Tickets	-	50
Miscellaneous Gifts	361	847*
Total	$3,133	$2,482

*This amount consists of $750 charged as an administrative expense and $97 charged as a program expense.

Regarding this matter, EMARC officials stated that these gifts were given to EMARC employees to boost morale and therefore they believed these expenses to be normal and allowable business expenses. Clearly, however, using contract funds intended for program purposes for such expenses is not an allowable use of those funds.

EMARC officials stated that to maintain staff morale they would establish a written procedure to recognize staff achievement through the distribution of small tokens of recognition (e.g., lottery tickets, gift certificates, and flowers) and submit the written policy to DMR for approval. Subsequent to our audit, EMARC established such a policy, titled "Employee Morale, Health and Welfare Activities Policy," which was approved by its Board of Directors on October 30, 2002 and submitted to DMR for approval. On March 5, 2003, EMARC received written confirmation that DMR was informed and DMR officials "do not see anything in the Policy that would prompt us to disapprove it."

Recommendation

EMARC's principal state purchasing agency should determine how much of the $5,615 in non-program expenses that EMARC charged against its state contracts during the audit period should be recovered. In the future, EMARC should take measures to ensure that such expenses are not charged against its state contracts.

Auditee's Response

In response to issues discussed in our report, EMARC's Executive Director provided general comments, in part stating:

> *Thank you for sending EMARC the draft audit report covering period July 1, 2000 through January 31, 2003. I have reviewed the document and found it to be both accurate and complete.... We were pleased that the auditors made note that EMARC was a fiscally responsible agency...[that] ran [an] excellent program. They also noted that we maintained documentation and records of all reimbursements we were asked to make on behalf of DMR.... We viewed the audit as an opportunity to improve our business practices. As a result, EMARC has made every change that was...required and recommended.*