



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. 2006-4500-3C

INDEPENDENT STATE AUDITOR'S REPORT ON
CERTAIN ACTIVITIES OF THE
FREDERIC L. CHAMBERLAIN CENTER, INC.
SEPTEMBER 1, 2003 THROUGH AUGUST 31, 2006

OFFICIAL AUDIT
REPORT
MARCH 18, 2008

TABLE OF CONTENTS/EXECUTIVE SUMMARY

INTRODUCTION

1

The Frederic L. Chamberlain Center, Inc. (FLC) was organized and founded in 1976 under the provisions of Chapter 180 of the Massachusetts General Laws (MGL) as a not-for-profit charitable corporation for the purposes of operating a private school for both day and residential students with special educational, developmental, communicative, and other learning disabilities. In 1992, FLC formally restated its Articles of Organization to specifically include the language that the corporation be formed for “All charitable, educational and scientific purposes within the meaning of Section 501(c)(3) of the Internal Revenue Code.”

The scope of our audit was to examine various administrative and operational activities of FLC during the period September 1, 2003 to August 31, 2006. However, in some instances it was necessary for us to extend the period covered by our audit in order to adequately examine certain transactions that were selected for testing during our review.

Our audit was conducted in accordance with generally accepted government auditing standards for performance audits issued by the Comptroller General of the United States.

Our audit procedures consisted of the following:

- A determination of whether FLC had implemented effective internal controls, including:
 - a. Processes for planning, organizing, directing, and controlling program operations;
 - b. Policies and procedures to ensure that resource use is consistent with laws and regulations; and
 - c. Policies and procedures to ensure that resources are safeguarded and efficiently used.
- An assessment of FLC’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 several problems within FLC's operations, as detailed below:

AUDIT RESULTS

5

- 1. DURING CALENDER YEAR 2004, FLC PROVIDED ITS EXECUTIVE DIRECTOR AND ANOTHER MEMBER OF ITS ADMINSTRATIVE STAFF WITH COMPENSATION TOTALING \$254,384 IN EXCESS OF THE AMOUNT ALLOWED BY OSD REGULATIONS AND DID NOT REPORT AT LEAST \$64,781 OF THESE EXPENSES AS BEING NON-REIMBURSABLE**

5

During calendar year 2004, FLC provided compensation to its Executive Director and Chief Operating Officer (COO) that exceeded the amounts allowed by state regulations

by \$254,384. Although the agency identified \$189,603 of these expenses as being non-reimbursable in the financial statements it filed with the Commonwealth, it did not properly disclose the remaining \$64,781 of this compensation as being non-reimbursable.

2. UNDOCUMENTED AND NON-REIMBURSABLE CREDIT CARD EXPENSES TOTALING \$225,476 **9**

During the fiscal years 2004 through 2006, FLC permitted eleven staff members to use its corporate credit cards. However, our review of the credit card expenditures made by these staff members during this period revealed that 1,767 expenditures totaling \$337,335 were questionable in that they were either inadequately documented or did not appear to be directly related to the FLC's program-related activities. According to state regulations, expenses such as these are non-reimbursable under state-funded contracts. Although FLC reported \$111,859 of these expenses as being non-reimbursable in the financial statements it filed with the Commonwealth for these fiscal years, it did not report the remaining \$225,476 as being non-reimbursable.

3. FLC DID NOT REPORT NON-REIMBURSABLE EXPENSES TOTALING \$15,403 RELATIVE TO ITS OPERATION OF A PROPERTY IN BERMUDA **15**

During our audit period, FLC's Director of Marketing and Development leased a house in Bermuda, which was paid for by FLC. Between fiscal years, 2004 and 2006, the agency incurred expenses totaling at least \$294,484 relative to the operation of this property. According to FLC officials, the agency rented this space as part of what it calls its "Bermuda Project," which these officials told us involved broadening FLC's services and referral sources and developing a base for international marketing. Based on the documentation we reviewed relative to FLC's operation of this property, we determined that no students ever used this property, and that FLC was primarily using this property for business versus programmatic purposes. Also, although FLC identified most of the expenses associated with the operation of this property as being non-reimbursable, we determined that the agency did not identify \$15,403 of the expenses associated with this property as being non-reimbursable.

4. NONCOMPLIANCE WITH BOARD GOVERNANCE STANDARDS APPLICABLE TO NON-PROFIT HUMAN SERVICE CONTRACTORS **18**

During our audit period, FLC did not comply with various board governance guidelines issued by the state's Office of the Attorney General (OAG) and with related requirements of the terms and conditions of its state contracts. Rather, up until fiscal year 2006, FLC operated under the control of its Executive Director and related individuals without the necessary independent Board oversight.

INTRODUCTION

Background

The Frederic L. Chamberlain Center, Inc. (FLC) was organized and founded in 1976 under the provisions of Chapter 180 of the Massachusetts General Laws (MGL) as a not-for-profit charitable corporation for the purposes of operating a private school for both day and residential students with special educational, developmental, communicative, and other learning disabilities. In 1992, FLC formally restated its Articles of Organization to specifically include the language that the corporation be formed for “All charitable, educational and scientific purposes within the meaning of section 501(c)(3) of the Internal Revenue Code.” In August of 2006, FLC again restated its Articles of Organization to specifically add the language that the corporation “is formed to receive and administer funds exclusively for educational and charitable purposes without pecuniary gain or profit, incidental or otherwise.”

FLC emphasizes a co-educational model of education with psychological and therapeutic treatment components for male and female adolescents ages 11 through 18. The school’s stated philosophy is based on the belief that “all children are capable of achieving success in vital areas of their lives no matter how adverse their lives may have been thus far.” Students are primarily placed at FLC as a result of a school district’s determination that conventional in-district public school program offerings were deemed insufficient to accomplish the goals set forth in the child’s individualized education plan (IEP). While FLC’s day academic program is approved and monitored by the Commonwealth’s Department of Education (DOE), its 98-bed residential program is licensed by the state’s Department of Early Education and Care (DEEC), formerly known as the state’s Office of Child Care Services.

During the period covered by our audit, FLC employed approximately 45 full-time staff in addition to approximately 95 staff members serving in a part-time capacity. In fiscal year 2006, the school served approximately 20 students in its Day Program and approximately 90 students in its Residential Program from Massachusetts cities and towns, other states, and the country of Bermuda.

Although DOE is responsible for approving the operation of private special education schools like FLC, the Commonwealth’s Operational Services Division (OSD) is responsible for regulating the

operations and activities of all such private special education schools and is responsible for establishing each school's tuition rates for Massachusetts students.

Once a program is established and is approved by DOE to function as a special education school, it can then submit a detailed budget to DOE that shows its anticipated expenses and enrollment figures. DOE reviews this budget and makes any adjustments it deems appropriate. For example, if DOE believes that more staffing is needed, it will adjust the school's operating budget accordingly to reflect the costs associated with adding higher staffing levels. DOE then sends the final adjusted budget along with its approval to OSD. OSD reviews these documents, and in accordance with its regulations, 808 Code of Massachusetts Regulations (CMR) 1.06, establishes an authorized price for the school. This price, which is essentially calculated by OSD by dividing the school's budgeted costs by its expected enrollment, is the annual rate that the school can charge Massachusetts municipalities and state agencies for each student who attends the school. Once this authorized price is established, neither OSD nor DOE typically initiate any changes to this rate. Rather, any rate changes have to be initiated by the school itself, otherwise its authorized price will remain unchanged. During fiscal year 2006, the tuition rate that had been established by OSD for FLC's residential program was \$270 per student per day. Although OSD establishes FLC's in-state residential rate, FLC can and does establish a separate tuition rate for out-of-state and private pay students, which according to OSD regulations must be at least the Massachusetts rate. During fiscal year 2006, the residential tuition rate established by FLC for out-of-state and private pays was \$318 per student per day.

The majority of FLC's funding is derived from student tuition payments that its receives on behalf of the students from a variety of sources, including Massachusetts state and local government entities, other state and local government entities, the government of Bermuda, and private payees. Local cities and towns that enroll students at schools like FLC pay for the tuition costs through a variety of sources, including local appropriations and state-funding sources (i.e. MGL Chapter 70 funding for primary and secondary education and MGL Chapter 71B and Circuit Breaker Special Education funding), as well as indirectly through various federal grant programs. During the period of our audit, FLC received funding from a variety of sources, as indicated in the table below:

Summary of Revenue*

Revenue Source	Fiscal Year	Fiscal Year	Fiscal Year
	2004	2005	2006
Contributions and Gifts	\$0	\$6,416	\$5,850
Mass. Gov. Grant	100,935	132,535	141,383
Dept. of Mental Health	68,649	221,141	204,586
Dept. of Education	322,128	19,688	0
Massachusetts Local Govt.	4,195,365	4,701,306	4,857,356
Non-Mass. State Local Govt.	3,022,098	3,116,619	3,034,130
Private Client Fees (excluding 3 rd party)	566,955	1,067,153	1,244,168
Investment Revenue	23,642	32,819	15,032
Other Revenue	<u>687,657</u>	<u>666,811</u>	<u>628,730</u>
Total Revenues	<u>\$8,987,429</u>	<u>\$9,964,488</u>	<u>\$10,131,235</u>

* This information was extracted from FLC's Uniform Financial Statements and Independent Auditor's Reports (UFRs) that it filed with OSD. Further, unlike the state's fiscal year, FLC's fiscal year runs from September 1st to August 31st of each year.

Audit Scope, Objectives, and Methodology

The scope of our audit was to examine various administrative and operational activities of FLC during the period September 1, 2003 to August 31, 2006. However, in some instances it was necessary for us to extend the period covered by our audit in order to adequately examine certain transactions that were selected for testing during our review.

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

Our audit procedures consisted of the following:

- A determination of whether FLC had implemented effective internal controls, including:
 - a. Processes for planning, organizing, directing, and controlling program operations;
 - b. Policies and procedures to ensure that resource use is consistent with laws and regulations; and

- c. Policies and procedures to ensure that resources are safeguarded and efficiently used.
- An assessment of FLC'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.

In order to achieve our objectives, we first assessed the internal controls established and implemented by FLC 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 FLC's accounting system. We used this assessment in planning and performing our audit tests. We then held discussions with FLC officials who, in some cases, were also members of FLC's Board of Directors, and officials from the OSD and the state's DOE; and reviewed organization charts and internal policies and procedures, as well as all applicable laws, rules, and regulations. We also examined FLC's financial statements, cost reports, invoices, and other pertinent financial records to determine whether the expenses it incurred during the period covered by our audit were reasonable; allowable; properly authorized and recorded; and in compliance with applicable laws, rules, and regulations. Finally, we reviewed various documents that were provided to us by FLC officials relative to certain activities conducted by two of FLC's related-party organizations, Vandewinkel Realty Trust and Edwards Realty Trust.

Our audit was limited to a review of certain activities of FLC. Although we reviewed various documents relative to certain activities conducted by two of FLC's related party organizations, we did not conduct any audit work on site at these entities. Our audit was not made for the purposes of expressing an opinion on FLC's financial statements. We also did not assess the quality and appropriateness of program services provided by FLC in its programs. Rather, our report was intended to report findings and conclusions on the extent of FLC's compliance with applicable laws, rules, regulations, and contractual agreements, and to identify any operational and administrative processes, methods, and internal controls that could be made more efficient and effective.

AUDIT RESULTS

- 1. DURING CALENDER YEAR 2004, FLC PROVIDED ITS EXECUTIVE DIRECTOR AND ANOTHER MEMBER OF ITS ADMINISTRATIVE STAFF WITH COMPENSATION TOTALING \$254,384 IN EXCESS OF THE AMOUNT ALLOWED BY OSD REGULATIONS AND DID NOT REPORT AT LEAST \$64,781 OF THESE EXPENSES AS BEING NON-REIMBURSABLE**

During calendar year 2004, FLC provided compensation to its Executive Director and Chief Operating Officer (COO) that exceeded the amounts allowed by state regulations by \$254,384. Although the agency identified \$189,603 of these expenses as being non-reimbursable in the financial statements it filed with the Commonwealth, it did not properly disclose the remaining \$64,781 of this compensation as being non-reimbursable.

OSD has promulgated regulations that specifically define certain expenses as being unallowable and non-reimbursable under state contracts. In this regard, 808 CMR 1.05(24) identifies the following salary expenses as non-reimbursable costs under state contracts:

Salaries of Officers and Managers. Salaries of officers and managers to the extent they exceed the rate paid to state managers in job group M-XII, step seven [in the schedule contained in MGL C30; Sec.46C. . . .]

During our audit, we reviewed the compensation provided to members of FLC's administrative staff during calendar year 2004, as reported by the agency on these individuals' IRS Forms-W2. Based on our review, we determined that the compensation provided to two individuals exceeded the amount allowed by OSD regulations by \$254,384. However, the agency only reported \$189,603 of these expenses as being non-reimbursable, as indicated in the following table:

Non-Reimbursable Compensation Summary

2004 Staff Person's Title	Compensation	Allowable Rate	Excess Compensation
Executive Director	\$296,980.66	\$128,181.04	\$168,799.62
COO	213,764.92	128,181.04	85,583.88
Excess Amount			<u>254,383.50</u>
Reported Non-Reimbursable			<u>189,602.48*</u>
Total Unreported Non-Reimbursable			<u>\$64,781.02</u>

*The amounts reported by FLC in its UFR's for fiscal years 2004 and 2005 were adjusted to derive this calendar year amount.

Of particular concern is that \$114,957 in questionable bonuses that the Executive Director approved for himself and the COO without any independent oversight was included in the \$254,384.

In this regard, 808 CMR 1.05(9), promulgated by OSD, identifies the following as being non-reimbursable expenses under state-funded contracts:

Certain Fringe Benefits. 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 available to all employees under an established policy of the Contractor....

During our audit, we determined that FLC did not have a formal written policy regarding staff bonuses. Despite this, during fiscal year 2004 the agency's Executive Director and its COO, who are also members of the agency's Board of Directors, voted to give themselves \$114,957 in bonuses. Specifically, at the agency's April 28, 2004 Board meeting, at which only the agency's Executive Director, the COO, and the COO's sister were present, the following action was voted on.

[name of Executive Director] proposed that a bonus of \$70,000 net of taxes to be paid to [name of Executive Director] and [name of COO] for their twenty-six plus years of service to Frederic L. Chamberlain Center, Inc.

The Board voted to pay a \$70,000 net of taxes bonus each to [name of Executive Director] and [name of COO]. Such bonus will be paid as funds allow.

Subsequent to this vote, on April 30, 2004, the agency's Executive Director was issued a bonus check of \$86,452.89 (\$70,000 net of deductions). Subsequently, the COO was issued two bonus checks, one on May 13, 2004 for \$11,111.23 (\$10,000 net of deductions) and another on December 1, 2004 for \$17,393.09 (\$15,000 net of deductions). Given the fact that FLC did not have a policy that provided for these individuals to receive these bonuses and the fact that the agency's Executive Director and the COO authorized these bonuses for themselves in a discriminatory manner without any independent oversight, these bonuses clearly represent non-reimbursable expenses in accordance with state regulations.

Recommendation

In order to address our concerns relative to this matter, FLC should amend its UFR for fiscal year 2004 and declare the aforementioned \$64,781 as non-reimbursable salary expenses. Based on this amendment, if FLC does not have sufficient non-state funds to offset these non-

reimbursable expenses, it should remit to the Commonwealth an amount equal to the amount of the non-reimbursable expenses, which it cannot offset in accordance with OSD regulations. In the future, FLC should take measures to ensure that any compensation it provides to members of its staff is reasonable and allowable in accordance with the established policies and procedures of the agency, as well as state regulations.

Auditee's Response

In response to our draft audit report, FLC officials provided written comments, which are excerpted below:

While FLC paid wages in excess of the OSA guidelines, FLC did not violate any regulation. FLC properly disclosed and reported wages above the OSD guideline as non-reimbursable. OSA's wording implies FLC violated some regulation. . . .

In addition to FLC's comments, a representative of the law firm representing FLC in this matter, provided comments which are excerpted below:

Compensation of officers and employees of non-profit corporations must be reasonable and it is an area that is carefully scrutinized by the IRS. Compensation of officers and employees is also limited by state regulation and reimbursements cannot be sought for compensation exceeding the state regulations. It is not illegal or improper to compensate officers and employees above the amounts authorized under mass regulations provided the amount is reasonable. The question of reasonableness is a federal question and clearly would have been addressed in the federal audit. The IRS did not find any compensation paid to officers and directors as unreasonable and therefore highlighting the non-reimbursable compensation paid to officers and directors serves no legitimate purpose. . . . Discussion of compensation of the officers and employees should be limited to the claimed reimbursable which appear to be at issue.

. . . OSA's recalculation of compensation attempts to convert FLC's Fiscal year reported non-reimbursable amounts to a calendar year basis in order to compare those amounts to calendar year W-2 wages. There are a number of problems with this approach:

- OSA uses W-2 wage information, which is not appropriate for calculating the amount of compensation that is in excess of OSD guidelines.*
- Even though OSA attempts to calculate excess wages on a calendar year basis, OSA used Fiscal Year amounts for the "allowed" wages. Thus, overstating the "excess" amounts.*
- OSA's calculation of excess wages essentially manipulates reported data by including vehicle expense amounts for some years where FLC already reported those vehicle expenses as non-reimbursable. OSA fails to recognize the amounts related to vehicle expenses FLC already reported as non-reimbursable. OSA compares (total 1) the W-2 wages (which include taxable vehicle use) to (total 2) the non-reimbursable wages reported on FLC's UFR (which do not include vehicle use).*

FLC suggests the correct method to determine excess wages is to perform the calculation on a fiscal year basis per OSD guidelines. FLC suggests that the amounts reported on its UFRs are the correct and appropriate way to calculate and report non-reimbursable wages.

Upon review of FLC's Fiscal Year 2005 UFR, we found we used an incorrect amount for the "allowed" wages. FLC used \$136,316 instead of \$132,667.38. As a result FLC under reported non-reimbursable wages by \$7,291. . .

Auditor's Reply

Contrary to what FLC states in its response, the agency did not in fact comply with OSD regulations when it did not report \$64,781 of the excessive compensation in question as being non-reimbursable. Consequently, it is necessary and proper for us to report this issue in our report. We agree with the assertion that FLC makes in its response, that compensation provided to officers and employees of non-profit corporations should be reasonable. It is for that reason that OSD has promulgated 808 CMR 1.05(24), which limits the amount of salary that can be provided to certain executives of non-profit corporations with state funds. Regardless of what the IRS may deem to be reasonable, the maximum rate of compensation that can be paid to certain executives using state funds is established by OSD through its regulations. This is the criteria that is used by our auditors during each and every audit of the Commonwealth's contracted human service providers to determine the reasonableness of the compensation provided to certain executives.

Our audit report does not state or even imply that it is illegal or improper to compensate officers of a corporation in amounts above those allowed by state regulations. Rather, our report clearly states that when compensation above this amount is provided to executives of a non-profit corporation, the excess amount cannot be paid with state funds, and the amounts and sources of non-state funding used to provide this level of compensation needs to be properly disclosed.

We disagree with FLC's assertion that it was inappropriate to use information from these individuals' IRS W-2 Forms in our analysis. While fiscal year information reported in the agency's UFR's would show the salary provided to certain staff members, it was necessary for us to determine the total compensation, including taxable fringe benefits, provided to these individuals in order to perform an accurate analysis. The amount of compensation that could be charged to state funding that we used in our analysis did not vary from fiscal year to fiscal year during our audit period, so FLC's concern that we used a fiscal year "allowable amount" as

opposed to a calendar year “allowable amount” is not relevant. Finally, contrary to what FLC asserts in its response, our analysis did in fact include non-reimbursable compensation, including personal use of vehicles provided to the individuals in question.

2. UNDOCUMENTED AND NON-REIMBURSABLE CREDIT CARD EXPENSES TOTALING \$225,476

During the fiscal years 2004 through 2006, FLC permitted eleven staff members to use its corporate credit cards. However, our review of the credit card expenditures made by these staff members during this period revealed that 1,767 expenditures totaling \$337,335 were questionable in that they were either inadequately documented or did not appear to be directly related to the FLC’s program-related activities. According to state regulations, expenses such as these are non-reimbursable under state-funded contracts. Although FLC reported \$111,859 of these expenses as being non-reimbursable in the financial statements it filed with the Commonwealth for these fiscal years, it did not report the remaining \$225,476 as being non-reimbursable.

808 CMR 1.05 identifies the following as being non-reimbursable costs:

(12) Non-Program Expenses. Expenses of the Contractor which are not directly related to the social service Program purposes of the Contractor.

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

Further, 808 CMR 1.04 establishes the following recordkeeping and reporting requirements with which all contracted human service providers such as FLC must comply:

(1) Recordkeeping. The Contractor and its Subcontractors shall keep on file all data necessary to satisfy applicable reporting requirements of the Commonwealth (including DPS, the Division of Health Care Finance and Policy and Departments), and financial books, supporting documents, statistical records, and all other records which reflect revenues associated with and costs incurred in or allocated to any Program of services rendered under the Contract. The Contractor and its Subcontractors shall maintain records of all types of expenses and income or other funds pertaining to the Program paid to the Contractor by every source, including from each Client...

During the period September 1, 2003 through August 31, 2006, FLC permitted its Executive Director, Chief Operating Officer, Director of Admissions, Program Director, and seven other members of its staff to use its corporate credit cards. During this period, 2,335 purchases

totaling \$491,093 were charged on FLC's corporate credit cards, and FLC used funds that it received from tuition payments to pay for these purchases. Our assessment of FLC's internal controls over these credit card expenditures indicated that FLC had established written policies and procedures relative to the use of these credit cards, including requiring staff members to provide original receipts, a description of each expense, an indication of the business purpose of each expense, and the name of the individual for whom the expense was incurred. However, we noted many instances where the agency was not monitoring and enforcing compliance with its own policies and procedures relative to the use of its corporate credit cards. Additionally, we found that no member of FLC's staff performed an independent review of these credit card expenditures to assess their reasonableness.

Based on these internal control problems, we reviewed all the documentation FLC maintained relative to the \$491,093 in credit card expenses it incurred during fiscal years 2004 through 2006 and found that the agency paid for \$337,335 in credit card expenses that were either inadequately documented or appeared to be non-program-related. The inadequately documented expenses included expenses for which FLC lacked invoices, receipts, or other documentation to substantiate the nature or business purpose of the expenses. A summary of the questionable expenses we identified appear in the table below:

Expenditure Deficiency	Fiscal Year 2004	Fiscal Year 2005	Fiscal Year 2006	Total 2004 - 2006
No Receipt	\$43,781	\$22,337	\$29,049	\$95,167
Inadequately Documented	24,108	44,968	83,473	152,549
Non-Program	<u>55,254</u>	<u>22,187</u>	<u>12,178</u>	<u>89,619</u>
Total	<u>\$123,143</u>	<u>\$89,492</u>	<u>\$124,700</u>	<u>\$337,335</u>

Examples of the non-program-related expenses include the following:

- Alcohol purchases totaling \$955, including a \$634 charge on June 9, 2005 for catering at a Marriott Hotel in Colorado.
- Gift purchases totaling \$714, including a \$609 charge on September 22, 2003 for a necklace given to a temporary consultant.
- Various out of the country trips (Europe, Japan, Canada) totaling \$10,077 where the business purpose of the trip was not indicated.

Usage of corporate credit cards, and the amounts of inadequately documented expenses and non-program-related expenses incurred by staff members for fiscal years 2004 through 2006, are as follows:

Summary of Questionable Credit Card Expenses and Usage by Staff Members

Fiscal Years 2004 through 2006

<u>Staff Member</u>	<u>Number of Charges</u>	<u>No Receipt</u>	<u>Inadequately Documented</u>	<u>Non-Program</u>	<u>Total Fiscal Years 2004-2006</u>
Executive Director	524	\$58,164	\$39,112	\$1,404	\$98,680
Chief Operation Officer	37	3,441	300	19,840	23,581
Director of Admissions	582	16,967	54,114	1,051	72,132
Program Director	565	12,392	53,075	66,751	132,218
Other Staff	<u>59</u>	<u>4,203</u>	<u>5,948</u>	<u>573</u>	<u>10,724</u>
Total	<u>1,767</u>	<u>\$95,167</u>	<u>\$152,549</u>	<u>\$89,619</u>	<u>\$337,335</u>

Regarding this matter, FLC officials stated that the information provided to us relative to these expenses may be incomplete, and that they would continue to look for other supporting documentation. However, to date, FLC has not provided us with any additional documentation to substantiate the reasonableness of the questioned expenses.

Recommendation

According to the UFRs that FLC filed with OSD during fiscal years 2004 through 2006, the agency did identify \$111,859 of its credit card expenses as being non-reimbursable. Consequently, in order to address our concerns relative to this matter, FLC should amend its fiscal years 2004 through 2006 UFRs and accurately report the remaining \$225,476 in non-reimbursable credit card expenses. Based on these amendments, if during any fiscal year FLC does not have sufficient non-state funds to offset these non-reimbursable expenses, it should remit to the Commonwealth an amount equal to the amount of non-reimbursable expenses, which it cannot offset in accordance with OSD regulations. In the future, FLC should take measures to ensure that agency staff comply with its policies and procedures relative to the use of its credit cards, and that all expenses be reviewed by an independent member of FLC's administrative staff to ensure that any non-reimbursable expenses are identified and reported as such by the agency.

Auditee's Response

In response to our draft audit report, FLC officials provided written comments, which are excerpted below:

. . . . While FLC recognizes there have been problems with documentation of credit card transactions, it has adopted policies and procedures to address them.

The OSA stated "we found that no member of FLC's staff performed an independent review of these credit card expenditures to assess their reasonableness"

- On a weekly basis FLC's controller, Executive Director, and Chief Operating Officer review the documentation status of any credit card transaction, this procedure was in effect at the time of the OSA field audit.*
- All invoices and expenditure requests (including the credit card statements) are approved by two authorized signers. This procedure was also in effect at the time of the OSA field audit.*

. . . . FLC has reviewed the list provided by OSA and questions why OSA labeled charges as "inadequately documented" when in the notes shown on OSA's worksheet describe the purpose of the charge. In other cases the purpose of the transaction is obvious.

- For example there were several charges for a conference in Glasgow Scotland, a charge for a flight to London and another for a flight from London to Glasgow. While the two charges are listed below each other, OSA identified the flight from London to Glasgow "no purpose indicated". It would seem logical that for a conference in Glasgow that one might fly to London then to Glasgow.*
- Another example, again from the OSA list of "inadequately Documented CC Charges (Out of Country) FY04-FY06. . . . the list OSA lists airline tickets for students and staff with a GL description of Europe trip and an OSA note "airfare student trip". The OSA knows FLC students and staff took educational trips to Europe. OSA was even provided with a list of staff and students that participated. Furthermore, the parents of the students that participated paid for the student trip costs. So these costs were covered by related income.*

OSA provided FLC worksheet "FY04-FY06 Inadequately Documented CC Expenditures Charged to State Contracts". FLC reviewed those schedules and notes the "GL Description" and the "Note/Quote" associated with the transaction to be clear as to the purpose of the transactions.

- All of the transactions the OSA categorized as "inadequately documented" have receipts.*
- The majority of the 763 transactions the OSA categorized as "inadequately documented", have a written indication of the purpose for the charge.*
- A number of the charges were for "gas" used in FLC vehicles and charged by the employees who were assigned those vehicles. . . .*

- *A number of the charges were clearly for attendance at conferences (travel expenses, meals, and lodging). Yet the OSA chose to define them as inadequately documented.*
- *OSA chose to define transactions as inadequately documented simply because the transaction took place outside of Middleboro. . . .*

. . . . While FLC recognizes the receipt for the transaction was not provided, the purpose of the transaction is clearly demonstrated as supported by the notes on OSA's worksheet.

MGL 808 CMR 1.05 states:

26. Undocumented Expenses. Costs that are not adequately documented in the light of the American Institute of Certified Public Accountants statements on auditing standards for evidential matters.

The AICPA standards on evidential matter and SAS #106 on audit evidence insist that "sufficient appropriate audit evidence" is a matter of professional judgment. There is no written criterion one must have in order to be adequately documented.

FLC cannot say that it has complete documentation for all the charges OSA summarized, but we question the validity of the [totals of the non-reimbursable and unsupported expenses.]

Auditor's Reply

In its response, FLC contends that during the period covered by our audit, certain members of FLC's staff routinely reviewed and approved all credit and transactions. However, the agency does not dispute the fact that during our audit period, it did not have any formal written policies or procedures that required these activities to be conducted. Further, based on the agency's credit card records that we reviewed, there was no evidence that indicated that any independent review or approval of agency credit card expenditures was being conducted. By FLC's own admission, "there have been problems with documentation of credit card transactions. . . ." If the credit card review procedures that FLC talked about in its response actually existed during our audit period, we question how such documentation issues could exist. For example, there was no documentation for approximately 28% of all the credit card expenses we reviewed. Moreover, even if such a review process as described by FLC in its response did exist and was being followed by the agency, one would have to question how independent such a process could be, given the fact that the individuals (e.g., FLC's Executive Director and Chief Operating Officer) who were purportedly conducting these reviews were actually the individuals incurring a significant amount of the expenses.

As stated in our report, credit card expenses totaling \$95,167 had no documentation, and in our opinion, additional credit expenses totaling \$152,549 were inadequately documented. In many cases the only source documentation FLC had to support credit card expenditures was a credit card statement. FLC is correct in stating that based on the credit card statements and other agency records, it was possible to identify the nature of the transactions in question. However, while we were able to determine the nature and amount of many expenditures, there was no documentation that indicated the business nature of these expenses, and consequently, we deemed them to be inadequately documented. For example, although a credit card statement could identify a flight to London or Glasgow, there was no other documentation as to who went on the trip or the business nature of the trip. Further, a number of the travel expenses charged on agency credit cards listed meal charges with no indication as to who attended the meal or the business nature of this expense.

We acknowledge the fact that all of the inadequately documented expenses had receipts. Otherwise, they would have been properly characterized by the audit team as “undocumented” as opposed to “inadequately” documented expenses. However, while a receipt may document the amount of the expense, in our opinion additional information is needed to document the reasonableness and allowability of each expense. FLC is correct in its assertion that determining whether or not an expense is adequately documented is a matter of professional judgment. In this regard, we do not believe that it is unreasonable for us to expect every organization that receives state funds to be able to document that all expenses paid for with state funds were actually incurred, and that the business nature of each expense is clearly identifiable. In our professional judgment, when documentation does not meet these standards, the auditee has not met its contractual and regulatory obligations to the Commonwealth to maintain documentation for all expenses that clearly demonstrates that they are reasonable and allowable, and it is therefore our obligation to report on this matter. It is not for the audit team to decide or surmise that an expenditure is business related based solely on the nature of the expense. Rather, it is clearly the responsibility of the agency to maintain sufficient documentation to demonstrate the reasonableness and allowability of its expenses.

3. FLC DID NOT REPORT NON-REIMBURSABLE EXPENSES TOTALING \$15,403 RELATIVE TO ITS OPERATION OF A PROPERTY IN BERMUDA

During our audit period, FLC's Director of Marketing and Development leased a house in Bermuda which was paid for by FLC. From fiscal year 2004 through 2006, the agency incurred expenses totaling at least \$294,484 relative to the operation of this property. According to FLC officials, the agency rented this space as part of what it calls its "Bermuda Project," which these officials told us involved broadening FLC's services and referral sources and developing a base for international marketing. Based on the documentation we reviewed relative to FLC's operation of this property, we determined that no students ever used this property, and that FLC was primarily using this property for business versus programmatic purposes. Also, although FLC identified most of the expenses associated with the operation of this property as being non-reimbursable, we determined that the agency did not identify \$15,403 of the expenses associated with this property as being non-reimbursable.

808 CMR 1.05, promulgated by OSD, identifies the following as non-reimbursable costs under state contracts:

(12) Non-Program Expenses. Expenses of the Contractor which are not directly related to the social service Program purposes of the Contractor.

Since 1999, FLC has paid for rented property in Bermuda. According to the agency's Chief Operating Officer, from 1999 through 2002 the agency rented an apartment that cost FLC approximately \$3,300 per month. However, in 2002, the agency began leasing a much larger property in the agency's Program Director/Vice President name from REGO Realtors (Bermuda) Limited. According to the lease for this property, this new property consisted of a house that contains three bedrooms, a den, a kitchen with a breakfast area, a living room with a fireplace, a laundry area, and a swimming pool. Under the terms and conditions of the most current lease for this property (which covered the period June 1, 2004 through May 31, 2005, with an optional one-year renewal), the tenant (FLC's Program Director/Vice President) was responsible for furnishing the property, paying all the utility costs associated with the property, maintaining the pool, and paying a monthly rent of \$7,500. During the period covered by our audit, FLC incurred at least \$306,475 in expenses associated with the operation of this property, as indicated in the table below:

Summary of Bermuda Expenses

Expense Item	Fiscal Year			Total
	2004	2005	2006	
Rent	\$ 98,923	\$ 97,438	\$66,675	\$263,036
Advertising	0	2,226	4,359	6,585
Meals and Travel	<u>14,799</u>	<u>14,627</u>	<u>7,428</u>	<u>36,854</u>
	<u>\$113,722</u>	<u>\$114,291</u>	<u>\$78,462</u>	<u>\$306,475</u>

According to documentation provided to us by FLC officials, the agency rented this space as part of what it calls its “Bermuda Project.” In a January 25, 2006 memorandum from FLC’s Program Director/Vice President to the agency’s Board members, the Director stated that she and the agency’s COO initiated the project in 1998 for “the purpose of broadening our services and referral sources, as well as to develop a base for international marketing.” According to this memorandum, the activities that would be conducted in the Bermuda Project would include: (1) marketing FLC to the Bermuda Government and private agencies to attract Bermuda students, (2) conducting conferences in Bermuda to expand the agency’s exposure in the country, (3) importing mental health providers into Bermuda to provide services, (4) using Bermuda for educational trips for some students, and (5) developing a program for up to 10 students to essentially spend their freshman year of college at the Bermuda College, where they would receive transferable credits.

Based on the documentation we reviewed, it did not appear that FLC ever used this property to house any of its students. In fact, only certain members of FLC’s staff, including its Program Director/Vice President, ever used this property. Since this property was not used to benefit any of its Massachusetts-funded students, none of the expenses associated with the operation of this property represent reimbursable expenses in accordance with OSD regulations.

FLC does take some students on educational trips to Bermuda. However, the students do not stay at the house; in fact, FLC charges the parents of the students who attend this trip a fee to cover the cost of the trip.

FLC stopped leasing this property in March 2006. In its financial statements, FLC acknowledges the fact that most of the expenses related to its Bermuda property were non-reimbursable. However, we found that FLC did not identify \$15,403 in expenses associated with

the operation of this property during fiscal years 2004 through 2006 as being non-reimbursable, as indicated in the table below:

Fiscal Year	Unreported Non-Reimbursable Expenses
2004	\$721
2005	10,274
2006	<u>4,408</u>
Total	<u>\$15,403</u>

Recommendation

In order to address our concerns relative to this matter, FLC should amend its UFR's to identify an additional \$7,513 in Bermuda-related expenses as being non-reimbursable, as follows:

Fiscal Year	Amount
2004	\$34
2005	3,072
2006	<u>4,407</u>
	<u>\$7,513</u>

This amount represents the difference between the total non-reimbursable Bermuda expenses of \$15,403 and the non-reimbursable expenses totaling \$7,890 which were already identified as questionable credit card expenses in Audit Result No. 2. Based on these amendments, if FLC does not have sufficient non-state funds to offset these non-reimbursable expenses, it should remit to the Commonwealth an amount equal to the amount of non-reimbursable expenses, which it cannot offset in accordance with OSD regulations. In the future, FLC should ensure that any expenses that are not directly related to its state-funded program activities are properly identified as being non-reimbursable expenses in its UFRs.

Auditee's Response

In response to our draft audit report, FLC officials provided written comments, which are excerpted below:

OSA's work sheet demonstrates that OSA already included \$86,925.44 identified as "Bermuda (non-program)" in determining the total non-reimbursable credit card charges

of \$256,982 OSA. . . . Thus, the OSA's recommendation for audit result would require FLC to pay for the same non-reimbursable amounts twice. . .

. . . Contrary to OSA's audit result, FLC's activities in Bermuda did benefit all our students including Massachusetts' students.

FLC realized \$935,166 in tuition revenue and \$40,700 in other revenue from Bermuda during the audit period. This revenue helped FLC to subsidize Massachusetts' students by funding quality teaching, nursing clinical and residential staff and paying for increased costs not covered by the Massachusetts tuition rate.

Our work with the Bermuda government and agencies enhanced FLC's reputation as a school and built relationships that continue to provide a source of students. . . .

In addition to FLC's comments, a representative of the law firm representing FLC in this matter provided comments which are excerpted below:

. . . . None of the contractual obligations involve the Bermuda property. Chamberlain is legally permitted to conduct numerous activities to further its educational and charitable purposes. Chamberlain is not contractually obligated to use the Bermuda property for "the benefit of Massachusetts students." . . .

Auditor's Reply

In our recommendation to this issue, all Bermuda-related expenses paid for by credit card have been removed from our recommended UFR adjustment amounts. Consequently, our report does not duplicate the amounts identified as unreported non-reimbursable expenses.

In its response, FLC contends that this Bermuda property did in fact benefit its Massachusetts students, and supports this assertion by stating that it received over \$975,000 in Bermuda-related tuition that was used to fund expenses not covered by Massachusetts' tuition. However, the fact that FLC identified most of its Bermuda expenses as being non-reimbursable to the Commonwealth is a clear indication that the agency did not truly believe that these expenses benefited Massachusetts students. Their assertion is, in our opinion, unfounded, since clearly if FLC had filled the slots utilized by its three students from Bermuda with local students, it would have generated approximately the same amount of revenue without incurring hundreds of thousands of dollars of additional expenses relative to its Bermuda-related activities.

4. NONCOMPLIANCE WITH BOARD GOVERNANCE STANDARDS APPLICABLE TO NON-PROFIT HUMAN SERVICE CONTRACTORS

During our audit period, FLC did not comply with various board governance guidelines issued by the state's Office of the Attorney General (OAG) and with related requirements of the terms

and conditions of its state contracts. Rather, up until fiscal year 2006, FLC operated under the control of its Executive Director, his ex-wife, and his ex-wife's sister without the necessary independent Board oversight.

The state's Executive Office for Administration and Finance (EOAF), Office of the State Comptroller (OSC), and OSD have jointly issued Commonwealth Terms and Conditions for Human and Social Services (General Contract Conditions) with which all human service contractors such as FLC must comply. Regarding an organization's Board of Directors, these General Contract Conditions state the following:

11. Human and Social Services Contracting Provisions: a. Board of Directors Standards. *If a non-profit organization, the Contractor shall comply with the principles in the Massachusetts Attorney General's "Guide for Board Members of Charitable Organizations" [Guide] and with the standards for boards contained in the American Institute of Certified Public Accountants (AICPA)'s statements on auditing standards, as may be amended from time to time. Further, the Contractor specifically agrees that: i) members of the Contractor's management and immediate family (as defined in the AICPA's Financial Accounting Standards Board Statement number 57) will not comprise more than 30% of the voting members of the Contractor's board or any of the board's committees or subcommittees; and, ii) the Contractor's Board of Directors will approve the selection of the Contractor's audit firm, will annually review its executive director's or other more senior manager's performance and set that person's compensation by formal vote, and will meet as frequently as necessary to fulfill the Contractor's obligations under this section. Where the board meets less than two times during its fiscal year, the Contractor shall submit a description of its board structure and the dates of each board and subcommittee meeting with its Uniform Financial Statements and Independent Auditor's Report (UFR).*

The OAG's Guide for Board Members of Charitable Organizations (OAG Guide) identifies the following financial responsibilities of charitable organizations' Board members:

As a board member you have primary responsibility for making sure that the charity is financially accountable, has mechanisms in place to keep it fiscally sound, operates in a fiscally sound manner, and is properly using any restricted funds it may have. The board shall be involved in all aspects of the finances of the charity....

The budget should be developed early enough so that the entire board can be involved in its review and approval before the beginning of the fiscal year.

The board should be sure that the charity has adequate internal accounting systems.

Board members should expect management to produce timely and accurate income and expense statements, balance sheets and budget status reports and should expect to receive these in advance of board meetings.

The board should require periodic confirmation from management that all required filings (such as tax returns and the Massachusetts Form PC) are up-to-date and that employee withholding taxes and insurance premiums are being paid when due.

During our audit, we reviewed all of the provided minutes of the meetings of FLC's Board of Directors during our audit period. Based on our review, we found that through the end of fiscal year 2005, FLC's Board composition and activities were not in compliance with the OAG Guide or the state's General Contract Conditions, in that from the beginning of our audit period through the end of fiscal year 2005, the agency Board was comprised completely of agency-related employees. During fiscal year 2006, the composition of the Board changed; as new people were added and one resigned. However, two of the five Board members, or 40%, were still staff members, and therefore the agency was still not in compliance with the General Contract Conditions. In essence, throughout our audit period FLC management employees and their immediate family members effectively controlled FLC's governance process, with minimum participation by unrelated independent individuals. This Board composition, in our opinion, impaired the ability to provide the independent oversight called for by the OAG Guide. Examples of this include the following:

- The OAG Guide charges the full Board with responsibility for setting the Executive Director's entire compensation package based on an annual evaluation. However, FLC's Board, given its composition, could not have performed an independent evaluation of the performance of the agency's Executive Director. Consequently, there is no assurance that the pay increases and bonuses that were given to the Executive Director during our audit period were reasonable.
- Regarding conflict-of-interest situations, the OAG Guide:
 1. Calls for strong formal conflict-of-interest policies, including annual written disclosures by all members to the entire Board of all business involvements with the charity and involvement with other charitable and for-profit entities and the establishment of procedures for disclosure of financial interest and withdrawal from discussion and voting in conflict-of-interest situations.
 2. Recommends the use of outside evaluations and greater than majority votes in conflict-of-interest situations.
 3. States that transactions should not occur unless the Board determines them to be clearly in the best interest of the charity. However, FLC's Board has not established conflict-of-interest policies, and we noted one instance in which certain Board members voted to give themselves significant bonuses, and many other instances in which the Board allowed the use of agency funds to fund non-agency related activities.

4. The OAG Guide assigns the Board primary responsibility for ensuring fiscal accountability and sound operation, calling on the Board to review and approve the budget before the start of each fiscal year. The OAG Guide also states the expectation that Board members receive timely and accurate income and expense, balance sheet, and budget status reports in advance of meetings. However, we found no documentation to substantiate that FLC's Board ever formally reviewed or approved any of FLC's budgets or reviewed any of FLC's financial reports during the period covered by our audit.

Regarding this matter, FLC officials told us that they are in the process of expanding their Board.

Recommendation

In order to address our concerns relative to this matter, we recommend that FLC continue to reconstitute its Board so that it is in compliance with OAG and state contract requirements. Further, the agency's Board should adopt a conflict-of-interest policy that requires Board members to abstain from voting on issues which could benefit the members or their relatives.

Auditee's Response

In response to our draft audit report, FLC officials provided written comments, which are excerpted below:

FLC has expanded its board and reduced the number of related parties on the board. During various points of fiscal year 2006 the board was comprised of up to eight members with as little as two related parties.

The non-related parties of the board set the Executive Director and Chief Operating Officer's compensation package based upon an independent salary study.

...Prior to fiscal year 2006 the Board was comprised of individuals who were directly involved in the operation, financial reporting, and programmatic aspects of FLC. The OSA ignores the fact that two of the Board members met weekly on the financial and operational status of FLC and thus had direct knowledge and approval of FLC's budget and annual audit.

Furthermore, as FLC's UFR filings demonstrate, the Board met each year and formally recognized and accepted the representations of management and independent auditor's opinion.

Auditor's Reply

According to FLC's response, the agency is taking measures to continue to reconstitute its Board so that it is in compliance with OAG and state contract requirements. We believe such measures

are necessary and should serve to better ensure the proper governance of the agency. However, we again recommend that the agency's Board formally adopt a conflict-of-interest policy that requires Board members to abstain from voting on issues which could benefit the members or their relatives.

Contrary to what FLC states in its response, our report does not ignore the fact that two of the agency's Board members may have met weekly on the financial and operational status of FLC, and thus had direct knowledge and approval of FLC's budget and annual audit. However, if this is in fact the case, there were no written records (e.g., minutes of such meetings), to substantiate this assertion. Further, it would be more appropriate for such matters to be discussed at formal Board meetings, so that the agency's entire Board, and not just certain members, are aware of and approve of such actions, and that Board approvals could be formally noted in the minutes of the Board meetings. As noted above, the OAG Guide assigns the Board primary responsibility for ensuring fiscal accountability and sound operation, calling on the Board to review and approve the budget before the start of each fiscal year. The OAG Guide also states the expectation that Board members receive timely and accurate income and expense, balance sheet, and budget status reports in advance of meetings. However, we found no documentation to substantiate that FLC's entire Board ever formally reviewed or approved any of FLC's budgets or reviewed any of FLC's financial reports during the period covered by our audit.