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

*Making government work better*

Official Audit Report – July 17, 2013

# Horace Mann Educational Associates, Inc. Administration of Limited Unit Rate Service Agreements

For the period July 1, 2008 through June 30, 2011

# TABLE OF CONTENTS

# INTRODUCTION AND SUMMARY OF FINDINGS AND RECOMMENDATIONS

On April 3, 2013, the Office of the State Auditor (OSA) issued an audit report (No. 2012-0234-3C) on the Department of Developmental Services' (DDS's) administration of its Limited Unit Rate Service Agreements (LUSAs). LUSAs are a form of a master contract agreement that can be used by DDS to purchase services from a preapproved contractor on an intermittent, limited-time basis for clients who are not already covered through an existing contract. Our overall audit of DDS's administration of LUSAs included a review of $16.6 million in LUSA funding provided to 15 human-service contractors during fiscal years 2009 through 2011. Those transactions were a subset of the approximately $62.2 million in total DDS LUSA expenditures for the three-fiscal-year period covered by our audit. The primary focus of our overall audit was to examine transactions processed during the accounts-payable period[1] at the end of each fiscal year, which disproportionately involved over half of all LUSA funding. As part of this audit, OSA engaged each of the 15 contractors, including Horace Mann Educational Associates, Inc. (HMEA), for on-site testing. HMEA received approximately $847,705 of the above-stated $62.2 million in total DDS LUSA payments. Approximately $473,133 (55.8%) of the payments to HMEA was processed during the accounts-payable periods for fiscal years 2009 through 2011. The overall audit of DDS was conducted as part of OSA's ongoing efforts to audit human-service contracting activity by state agencies and to promote accountability, transparency, and cost effectiveness in state contracting.

This supplemental report presents the results of our testing specific to HMEA's accounts-payable-period LUSA transactions and should be read in the context of our overall report on DDS's administration of LUSA agreements. That report presents our system-wide audit, which determined that, although LUSA funding is supposed to be used for intermittent unanticipated services to clients as needed, DDS is not properly administering these contracts. Instead DDS Regional and Area Office staff have used LUSA contracts to provide additional year-end funding to some DDS human-service contractors for various purposes, many of which are not consistent with the intended use of these funds and resulted in unnecessary and excessive compensation to contractors. That report also documents other significant administrative problems, including improper retroactive

[1] The Commonwealth's fiscal year is divided into 13 accounting periods: one for each calendar month of the fiscal year ending June 30, and a thirteenth period known as the accounts-payable period. During the accounts-payable period, payments are processed for services provided during the fiscal year but not submitted and approved for payment before the June 30 fiscal year-end date. Accounts-payable-period processing generally continues through the end of August each year.

service authorization; irregularities in pricing, encumbering, and accounting for LUSA funding; and documentation at numerous contractors that was often inaccurate, misleading, missing, or otherwise deficient. DDS's practice of improperly administering and using LUSAs has led to the problems with the administration and use of these funds at various DDS contractors, such as HMEA.

#### *Highlight of Testing Results Specific to Horace Mann Educational Associates, Inc.*

We found problems with all $473,133 of HMEA's accounts-payable-period LUSA transactions, including inadequate documentation to substantiate that LUSA services were properly authorized, inadequate documentation to support LUSA billings, and LUSA contract funding not being used for its intended purposes, as follows:

- For $187,935 in payments to HMEA of $351,326 subject to DDS service authorization requirements, DDS and HMEA retroactively processed the authorization, in violation of DDS requirements.

- We found additional documentation problems for all of the above $351,326 in LUSA payments to HMEA, including $134,545 in payments for which required service authorization documentation was absent. These problems included service documentation deficiencies and missing or inadequate documentation of client service delivery. The lack of adequate documentation violated provisions of the Commonwealth Terms and Conditions for Human and Social Services, and as a result, there was insufficient evidence to show that these LUSA payments had been properly authorized and accounted for; that they were not duplicative or excessive; and that the contractor had actually provided the LUSA services billed. In fact, HMEA eventually acknowledged that, despite authorization and invoicing documentation to the contrary, these LUSA payments had actually been for the purpose of covering organizational overtime costs rather than for providing additional units of client services.

- DDS used additional LUSA funding to pay HMEA $121,807 for transactions that should have been processed through non-LUSA contracts; this resulted in a variety of procurement, service utilization, and accounting problems. These transactions included $21,875 identified as Personal Support Services (PSS) paid as a matter of administrative convenience for year-end reconciliation payments involving PSS provided through regular contract programs, and $99,932 identified by DDS as Transitional Services that should have been competitively procured but were not. For the entire amount of these PSS and Transitional Services payments, service delivery documentation by HMEA was also absent and HMEA acknowledged that despite invoicing documentation to the contrary, these LUSA payments had actually been for the purpose of covering organizational overtime costs rather than for providing additional units of client services. Thus, it appears that none of these payments were for appropriate LUSA purposes and that DDS's payment description entries in the Commonwealth's Massachusetts Management Accounting and Reporting System did not accurately reflect the true purpose of the payments.

### *Recommendations of the State Auditor*

OSA's overall audit report on DDS's administration of LUSA contracts recommended that responsible oversight agencies, including the state's Operational Services Division and the Office of the State Comptroller, review the issues detailed in the report and take whatever actions they deem appropriate to address those issues, including strengthening their oversight over these DDS transactions. The payments to HMEA are covered by that recommendation. In accordance with the recommendations of the overall report and the testing results specific to HMEA, HMEA should implement appropriate control measures to ensure that all LUSA services are performed, documented, billed, and accounted for in compliance with applicable requirements.

# OVERVIEW OF AGENCY

Horace Mann Educational Associates, Inc. (HMEA), with its administrative office located in Franklin, Massachusetts, was incorporated on September 9, 1961 as a nonprofit corporation providing children's, residential, special education, day, vocational, family, and other types of services to children and adults with developmental disabilities. It serves approximately 2,700 children and adults in 110 communities in central, southeastern, and eastern Massachusetts.

HMEA annually receives over $17.3 million in contract payments from the Department of Developmental Services (DDS). Revenues and support from other state agencies and public and private sources raise total revenues for HMEA and its affiliated entities to approximately $29 million per year. DDS's Limited Unit Rate Service Agreement (LUSA) contract payments to HMEA, including the accounts-payable-period transactions covered by our testing for fiscal years 2009 through 2011, were as follows:

**Fiscal Year 2009 through 2011 LUSA Funding**

| Fiscal Year | Total LUSA Payments for Fiscal Year | LUSA Payments Processed During Accounts-Payable Period | Accounts-Payable-Period Percent of Annual Total |
|---|---|---|---|
| 2009 | $ 483,114 | $ 284,831 | 59.0% |
| 2010 | 269,119 | 119,038 | 44.2% |
| 2011 | 95,472 | 69,264 | 72.5% |
| | $ 847,705 | $ 473,133 | 55.8% |

## SCOPE, OBJECTIVES, AND METHODOLOGY

In accordance with Chapter 11, Section 12, of the Massachusetts General Laws, the Office of the State Auditor (OSA) conducted an audit of the Department of Developmental Services' (DDS's) administration of Limited Unit Rate Service Agreement (LUSA) contracts for the period July 1, 2008 through June 30, 2011 (No. 2012-0234-3C). The scope of that audit included an assessment of the process and related internal controls DDS has established over its administration of LUSA contracts and the use of LUSA funding at 15 selected DDS contractors, together accounting for approximately $16.6 million (26.7%) of the $62.2 million in LUSA payments for the three-fiscal-year period covered by our audit. Based on our analysis of data contained in the Massachusetts Management Accounting and Reporting System, we determined that during our audit period, 12% of all LUSA payments, which are supposed to be provided on an as-needed basis, had been processed during the last month of the fiscal year and that an additional 51% of all LUSA payments had been processed during the Commonwealth's accounts-payable period. This expenditure pattern for LUSA services was in marked contrast to the pattern for DDS's non-LUSA contractor payments, for which fewer than 4% were processed during the accounts-payable period and fewer than 5% were processed during the last month of the fiscal year. Based on this analysis and the results of prior audits that identified issues with LUSA transactions, we concluded that LUSA payments processed late in the year, particularly during the accounts-payable period, might pose disproportionately high risks of improper use or other irregularities. Horace Mann Educational Associates, Inc. (HMEA) was one of the 15 contractors selected for on-site testing as part of the overall DDS audit. HMEA accounted for approximately $847,705 in LUSA payments for the three-fiscal-year period. Approximately $473,133 of HMEA's LUSA payments was processed during the Commonwealth's accounts-payable periods.

The procedures completed at HMEA were performed as part of the overall DDS audit, which was conducted in accordance with generally accepted government auditing standards. Our overall objectives for the DDS audit were to:

- Obtain information required to assess the system of internal controls DDS has established over its administration of LUSA contract funding.
- Determine whether LUSA funding is being used as intended and in compliance with applicable laws, regulations, policies, and procedures by conducting audit testing of a

judgmental sample of DDS human-service contractors that received significant LUSA funding.

Our audit testing at DDS and selected contractors, such as HMEA, produced evidence that certain data involving the classification of DDS LUSA expenditures did not reliably represent the actual agreement between DDS and contractors regarding the true purpose and use of the state funding. We provide a complete description of our data reliability and methodology in our overall DDS audit report, No. 2012-0234-3C.

We selected HMEA for on-site testing, focusing on accounts-payable-period transactions; conducted interviews with management and staff; reviewed prior audit reports where available; and reviewed applicable laws and regulations. We also obtained and reviewed policies and procedures, accounting records, and supporting source documents and performed tests of these records and transactions, where necessary. We performed testing on all identified accounts-payable-period LUSA transactions, so our findings do not involve the use of projections based on samples. At the conclusion of field work, we met with HMEA managers to discuss testing results pertaining to HMEA. We also solicited HMEA information and input regarding DDS system-wide LUSA issues for use in the overall LUSA audit project.

# TESTING RESULTS

## 1. QUESTIONABLE USE OF $473,133 IN LUSA FUNDS

Our testing identified a number of problems with the granting, receipt, and use of Limited Unit Rate Service Agreement (LUSA) funds that the Department of Developmental Services (DDS) provided to Horace Mann Educational Associates, Inc. (HMEA). These included DDS and HMEA retroactively processing service authorization approval for $187,935 in LUSA transactions, contrary to DDS requirements; HMEA maintaining insufficient authorization, invoicing, and service delivery documentation for $351,326 in transactions; and DDS improperly using $121,807 of LUSA funding to pay HMEA for transactions that should instead have been processed through other payment mechanisms. In many instances, the same transaction was associated with multiple problems. The unduplicated amount of questioned funding is $473,133.

LUSA contractual agreements are designed to be relatively flexible in order to address client service needs. DDS's Purchase of Service Manual states that LUSA contracts are "for purchasing intermittent, as-needed services for developmentally disabled individuals needing limited time placements." The LUSA's purpose is to provide a contract that can be accessed at any time during its multiyear term to pay for unexpected services for clients authorized by DDS where, because of special circumstances, services have not been included within the scope of an existing state-funded program contract. DDS has established separate categories for LUSA agreements (residential, day, work, and support service), and LUSA services may only be provided within the scope of the categories for which a contractor has been approved.

DDS requires that in order to obtain funding to pay for LUSA services, DDS managers and contractors such as HMEA complete an Authorization for Services process before services begin. The process uses an Authorization for Services Form (ASF) signed by a DDS manager, typically an Area Director, to establish the specific type of service, service date ranges, appropriation source, and amount of LUSA funding that will reimburse the contractor for services provided to the client.[2]

[2] Certain exceptions to this authorization requirement involve DDS's use of LUSA funds for transactions that should instead have been processed through other payment mechanisms as described in Section c. of this finding. DDS has not uniformly required use of ASFs for those transactions.

In addition to obtaining ASF approval, contractors must maintain service delivery and related documentation as required by Section 7 of the Commonwealth Terms and Conditions for Human and Social Services, which specifies that:

> *The Contractor shall maintain records, books, files and other data as required by 808 CMR 1.00 and as specified in a Contract and in such detail as shall properly substantiate claims for payment under a Contract, for a minimum retention period of seven (7) years beginning on the first day after the final payment under a Contract, or such longer period as is necessary for the resolution of any litigation, claim, negotiation, audit or other inquiry involving a Contract.*

It is essential that, in addition to authorization, invoice, and accompanying summary service delivery reports, contractors maintain documentation sufficient to verify that invoiced services were actually delivered and to establish that the services rendered were not within the scope of activity already covered and reimbursed by regular, non-LUSA, program contracts. Documentation of compliance with the activity and reimbursement restriction is of particular concern, since DDS's regular non-LUSA contracts have typically been established using payment rates that have been increased by as much as 17.6% to ensure that contractors are appropriately reimbursed for full program costs where programs are underutilized for legitimate reasons such as unanticipated vacancies or client hospitalizations. As explained by applicable Operational Services Division (OSD) policy:[3]

> *The inclusion of a utilization factor in unit rate contracts may result in a situation where a specific contractor is serving consumers at a higher utilization level than negotiated or anticipated and thus reaches the maximum obligation of the contract (or "bills out") before the end of the contract period. In this case, the contractor is required to provide services up to the total capacity purchased by the contract . . . for the remainder of the contract period with no additional funding. The application of a utilization factor does not result in the contractor delivering "free" services; rather, in these cases, a contractor has merely been fully reimbursed for the costs associated with the program in a shorter period of time than the full contract duration . . . .*

As a result, if a LUSA agreement is erroneously used to pay for services that have already been effectively reimbursed through a regular contract, the contractor may improperly receive excessive or duplicative reimbursement of program costs.

The subsections below describe the HMEA-related issues identified as part of testing procedures performed.

[3] OSD Procurement Policies and Procedures, "How to Draft a Request for Response" (issued November 1, 2005, revised August 13, 2007).

### a. Retroactive Authorization of LUSA Services Totaling $187,935

Despite the above-described ASF processing requirement established by DDS, of $351,326 in accounts-payable-period LUSA payments to HMEA that were subject to service authorization requirements, $187,935 had been paid for services that DDS and HMEA had retroactively authorized, in violation of the requirements. Retroactive authorizations had been processed in each year of the testing period as follows.

**Retroactive Authorization Amounts**

| | Fiscal Year 2009 | Fiscal Year 2010 | Fiscal Year 2011 | Total |
|---|---|---|---|---|
| Retroactive Authorization | $92,971 | $65,991 | $28,973 | 187,935 |

As described in the next section, these amounts exclude payments totaling $134,545 for which documentation available at HMEA was not sufficient to determine whether authorization had been properly processed in a timely manner.

### b. Inadequate Documentation Related to $351,326 in LUSA Service Authorizations and Payments

We found additional documentation problems for all of the above $351,326 in accounts-payable-period LUSA payments to HMEA. These problems included ASF documentation deficiencies and missing or inadequate documentation of client service delivery. The lack of adequate documentation violated the previously quoted provisions of the Commonwealth Terms and Conditions for Human and Social Services, and as a result, there was insufficient evidence to show that these LUSA payments had been properly authorized and accounted for; that they were not duplicative or excessive; and that the contractor had actually provided the LUSA services billed.

Documentation inadequacies were identified for each year of the testing period, as follows:

**Service Authorization and Documentation Deficiencies**

| | Fiscal Year 2009 | Fiscal Year 2010 | Fiscal Year 2011 | Total |
|---|---|---|---|---|
| Major Documentation Deficiencies | $167,958 | $114,121 | $69,247 | $351,326 |

ASF documentation was missing for $134,545 in payments. Even when ASF documentation was present, it was not always possible to determine when, or even whether, the service authorization process had been completed for individual clients. For example, an ASF might be present but documentation might not identify individual clients to be served. And for $1,125 in payments, the ASF documentation was present but had not been signed by an authorized DDS manager. Required documentation of actual service delivery was also absent or so ambiguous as to be questionable. Examples of the type of documentation that should be maintained include contemporaneously prepared daily program attendance sheets signed by employees present at the program site and time/service documentation records for one-on-one services to individual clients. However, HMEA typically retained only copies of invoices and Service Delivery Reports, which are monthly calendars listing individual clients and the days or hours for which they were being billed. Those documents are prepared by administrative support personnel who themselves lack the personal knowledge necessary to attest to the accuracy of the billing submissions, and the billing documents are therefore insufficient for compliance assurance purposes. Contemporaneously prepared service delivery documentation necessary to verify the accuracy of HMEA's invoices and service delivery reports was not made available for audit testing. However, audit testing determined that, even when present, the additional documentation was often too ambiguous to clearly substantiate the accuracy of invoices and to verify that activity was within the scope of authorized LUSA services and outside the scope of regular contract services. In fact, HMEA eventually acknowledged that, despite authorization and invoicing documentation to the contrary, these LUSA payments had actually been for the purpose of covering organizational overtime costs rather than for providing additional units of client services.

Documentation in HMEA's year-end financial report filings with OSD[4] was also not sufficient to adequately correlate to service delivery information, DDS LUSA payments, and service delivery costs to the organization's operational programs as needed to ensure that LUSA payments were outside the scope of regular DDS contracts and did not result in excessive or duplicative reimbursement. HMEA's reported information often indicated that the programs for which supplemental LUSA funding was reported were not operating beyond the capacity reimbursed by their regular contracts and that they would have generated surpluses even without

[4] Uniform Financial Statements and Independent Auditor's Reports, also known as UFRs.

the additional LUSA payments. Certain programs also appeared to have been incorrectly reported, containing apparently questionable program budget and service statistic information. As a result, it was not possible to perform the analysis and testing required to reasonably estimate the extent to which the compensation DDS provided to HMEA was excessive.

### c. Inappropriate Use of LUSA Funds Totaling $121,807 to Pay for Personal Support and Other Service Transactions and Inadequate Documentation of These Services

During our testing period, DDS used LUSA funding to pay HMEA $121,807 for transactions that should have been processed through non-LUSA contracts; this resulted in a variety of procurement, service utilization, and accounting problems. These transactions included $21,875 identified as Personal Support Services (PSS) and $99,932 identified by DDS, possibly improperly, as Transitional Services.

Specifically, we found that DDS used $21,875 in LUSA funding to make year-end reconciliation payments to HMEA for PSS provided through regular residential contract programs. PSS cover preauthorized staffing hours needed to provide MassHealth- (Medicaid-) eligible DDS clients with instrumental activities of daily living (IADL) assistance that has been contracted for through regular DDS human-service-program contracts. Because authorized service levels are routinely underutilized, only approximately 88% of the authorized PSS reimbursement is incorporated into each contractor's regular program contract. As a matter of administrative processing convenience, DDS has used LUSA payments for the purpose of making supplemental year-end reconciliation payments to contractors for any amounts determined to be owed where actual utilization is claimed to exceed 88%. Those payments were made through LUSAs even though the terms of LUSA agreements do not provide for the reconciliation process. DDS policies governing the use of LUSAs and DDS policy and contract language instead provide for the use of amendments to regular DDS contracts to address such situations. Based on the nature of the transactions as presented by DDS and HMEA in invoices and Massachusetts Management Accounting and Reporting System (MMARS) accounting records, DDS should have processed the payments to HMEA through other, non-LUSA, means, such as year-end amendments to HMEA's regular non-LUSA contracts.

DDS accounting records identified $99,932 in LUSA payments as being for institutional-to-community-living Transitional Services, part of a special DDS initiative that was mandated by a legal settlement agreement resulting from a federal lawsuit. As detailed in our full report on DDS's administration of LUSA agreements, the Transitional Service transactions with HMEA were part of a larger set of transactions that apparently should have been competitively procured and reimbursed through regular contracts rather than through LUSAs.

The table below breaks out these transactions with HMEA by category and fiscal year.

**Inappropriate LUSA PSS and Transitional Service Transactions**

| | Fiscal Year 2009 | Fiscal Year 2010 | Fiscal Year 2011 | Total |
|---|---|---|---|---|
| Personal Support Services | $ 16,941 | $4,917 | $ 17 | $ 21,875 |
| Transitional Services | 99,932 | 0 | 0 | 99,932 |
| Total | $ 116,873 | $4,917 | $ 17 | $ 121,807 |

For both the PSS and Transitional Service transactions, HMEA did not provide us with documentation necessary to provide assurance that the invoiced services had actually been delivered. As required by the previously quoted contracting terms and conditions, HMEA should have maintained service-specific detailed timesheets documenting the delivery of PSS and Transitional Services provided on a supplemental one-one-one employee-to-client basis. In conjunction with the communication described in Section b. above, HMEA eventually acknowledged that, despite invoicing documentation to the contrary, these LUSA payments had actually been for the purpose of covering organizational overtime costs rather than for providing additional units of client services. Thus it appears that none of these payments were for appropriate LUSA purposes and that DDS payment description entries in the Commonwealth's MMARS accounting system did not accurately reflect the true purpose of the payments.

### *Recommendations*

OSA's overall audit report on DDS's administration of LUSA contracts recommended that responsible oversight agencies, including OSD and the Office of the State Comptroller, review the issues detailed in the report and take whatever actions they deem appropriate to address those issues, including strengthening their oversight over these DDS transactions. The payments to HMEA are covered by that recommendation. In accordance with the recommendations of the overall report and the testing results specific to HMEA, HMEA should implement appropriate control measures to ensure that all LUSA services are performed, documented, billed, and accounted for in compliance with applicable requirements.

### *HMEA's Response*

In response to the issues presented in this report, HMEA's President and CEO provided the following comments:

> *As your document points out, HMEA did receive payments retroactively, as instructed by DDS during the audit period, for services rendered.*
>
> *A majority of HMEA's billings detailed in the report pertain to residential contracts, which have not received rate increases for decades and frequently do not cover all of the costs of providing services. HMEA serves people with developmental disabilities, many of whom are aging, have multiple chronic health care conditions and/or behavioral health needs. People need immediate increased direct support services during hospitalizations, acute medical episodes, and behavioral crises, in addition to other emergency situations. Current contracts do not cover all of these costs, including cases when people must stay home from Day Services because of illness. Staffing patterns under residential contracts do not provide for 24 hour coverage or the associated overtime costs that result when people are unable to attend every week day of their Day Services Programs.*
>
> *As a result of lack of rate increases leading to inadequate funding for providing critical services, HMEA has incurred a 3.4 million dollar surplus revenue retention* deficit *over the past 20 years, as indicated in the most recent HMEA UFR. The provider community is hopeful that the full implementation of Chapter 257 will remediate this pattern of chronic underfunding.*
>
> *Since your audit of DDS over a year ago, HMEA was not asked to use the LUSA process during FY'13, and instead filed amendments during the fiscal year for cost overruns. Recently, HMEA did bill for time limited services via a LUSA contract in compliance with applicable regulations described in your report. We will ensure that all future LUSA services are performed, documented, billed, and accounted for according to standard. HMEA will also ensure that both PSS and Transitional Services are processed using the appropriate funding mechanism.*