



# The Commonwealth of Massachusetts

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INDEPENDENT STATE AUDITOR'S REPORT ON  
CERTAIN ACTIVITIES OF THE  
HUMAN RESOURCES UNLIMITED, INC.  
JULY 1, 2001 TO JUNE 30, 2006

OFFICIAL AUDIT  
REPORT  
DECEMBER 2, 2008

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### INTRODUCTION

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Human Resources Unlimited, Inc. (HRU), formerly known as Carval Workshop, Inc., was founded in 1970 as a private, not-for-profit organization for the purposes of evaluating and training handicapped adults residing at Belchertown State Hospital. Today, HRU provides an array of employment training, vocational and practical skill-building services, and community rehabilitation services to adults with developmental and psychiatric disabilities. HRU works in partnership with area employers to meet their business needs while opening up employment opportunities for its program members. Moreover, HRU offers program members individual, flexible options to build upon their strengths and pursue their own goals. During the period covered by our audit, HRU employed approximately 100 full-time staff and an average of 11 employees assigned by the Department of Mental Retardation (DMR) to serve approximately 1,200 people with disabilities in Western and Central Massachusetts.

The scope of our audit was to examine various administrative and operational activities of HRU during the period July 1, 2001 to June 30, 2006. Our audit was conducted in accordance with 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 we considered necessary to meet these standards. Our audit procedures consisted of: (1) determining whether HRU had implemented effective internal controls over its operations; and (2) assessing HRU'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 found that HRU did not appropriately allocate common costs between two of its programs, which resulted in unnecessary costs to the Commonwealth totaling \$92,504 during the audit period.

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### AUDIT RESULTS

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#### **HRU DID NOT ALLOCATE ITS COMMON COSTS IN ACCORDANCE WITH OSD GUIDELINES**

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HRU operates a commercial, non-state-funded division entitled Carval Assembly & Packaging (Carval), and a state-funded program entitled ETS Career Services. Both share common staff and operate from the same warehouse facility. The costs shared by these programs totaled approximately \$4,096,849 during the audit period; however, HRU did not allocate these common costs to the Carval and ETS programs in compliance with OSD guidelines. Instead, HRU attributed the total common costs of both programs to its ETS (state-funded) program in the Uniform Financial Statements and Independent Auditor's Reports (UFRs) it submitted to the Commonwealth.

## INTRODUCTION

### *Background*

Human Resources Unlimited, Inc. (HRU), formerly known as Carval Workshop, Inc., was founded in 1970 as a private, not-for-profit organization for the purposes of evaluating and training handicapped adults residing at Belchertown State Hospital. Today, HRU provides an array of employment training, vocational and practical skill-building services, and community rehabilitation services to adults with developmental and psychiatric disabilities. HRU works in partnership with area employers to meet their business needs while opening up employment opportunities for its program members. Moreover, HRU offers program members individual, flexible options to build upon their strengths and pursue their own goals. During the period covered by our audit, HRU used 100 full-time staff and, on average, 11 employees assigned by the Department of Mental Retardation (DMR) to serve approximately 1,200 people with disabilities in Western and Central Massachusetts.

During our audit period, HRU received funding that totaled \$31,576,020. The majority of this funding, \$25,381,383, or 80.38%, represents state program revenues that included state purchase of services (POS) contracts and subcontracts, state in-kind services, and state Medicaid payments. The remaining balance, \$6,194,637, or 19.62%, was provided primarily through federal Medicaid payments, contributions, commercial activities, investment income, and local government payments. The table below details HRU's funding during the five fiscal years ended June 30, 2006.

<u>Source</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>Total</u>
Dept. of Mental Health	\$1,939,929	\$1,987,106	\$2,027,259	\$2,078,156	\$2,172,424	\$10,204,874
Dept. of Mental Retardation	1,603,541	1,812,930	1,672,775	1,712,631	1,841,104	8,642,981
Mass. Rehabilitation Comm.	131,401	69,908	141,253	126,918	75,855	545,335
Dept. of Transitional Assist.					70,799	70,799
Other Mass. State Agency				41,070	40,542	81,612
Mass. In-Kind Services	468,824	450,707	424,017	364,473	377,641	2,085,662
POS Subcontract	223,535		389,969	409,806	463,278	1,486,588
Medicaid	723,689	699,582	892,255	849,600	1,163,882	4,329,008
Local Govt./Quasi Govt.	132,414	197,781	213,345	229,025	217,713	990,278
Commercial Activities	374,013	342,508	312,564	366,553	302,978	1,698,616
Investment Income	(230,526)	17,391	218,664	138,730	232,266	376,525
Other Income	74,331	168,858	234,579	135,891	190,446	804,105
Contributions	<u>69,377</u>	<u>16,997</u>	<u>99,877</u>	<u>50,329</u>	<u>23,057</u>	<u>259,637</u>
Total	<u>\$5,510,528</u>	<u>\$5,763,768</u>	<u>\$6,626,557</u>	<u>\$6,503,182</u>	<u>\$7,171,985</u>	<u>\$31,576,020</u>

***Audit Scope, Objectives, and Methodology***

The scope of our audit was to examine various administrative and operational activities of HRU during the period July 1, 2001 to June 30, 2006. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence 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 HRU had implemented effective internal controls, including:

- 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; and
- An assessment of HRU's business practices and its compliance with applicable laws, rules, and regulations, as well as the various fiscal requirements of its local service contracts.

In order to achieve our objectives, we first assessed the internal controls established and implemented by HRU over its operations. The purpose of this assessment was to obtain an understanding of management's attitude, control environment, and the flow of transactions through HRU's accounting system. We used this assessment in planning and performing our audit tests. We then held discussions with HRU officials and reviewed organization charts; internal policies and procedures; and applicable laws, rules, and regulations. We also examined HRU's financial statements, budgets, cost reports, and invoices to determine whether expenses incurred were reasonable, allowable, allocable, properly authorized and recorded, and in compliance with applicable laws, rules, and regulations.

Our audit was not conducted for the purposes of expressing an opinion on HRU's financial statements. We also did not assess the quality and appropriateness of program services provided by HRU under its state human service contracts. Rather, our objective was to report findings and conclusions on the extent of HRU's compliance with applicable laws, rules, regulations, and

contractual agreements and identify processes, methods, and internal controls that could be made more efficient and effective.

## AUDIT RESULTS

### HRU DID NOT ALLOCATE ITS COMMON COSTS IN ACCORDANCE WITH OSD GUIDELINES

HRU operates a commercial, non-state-funded division entitled Carval Assembly & Packaging (Carval), and a state-funded program entitled ETS Career Services. Both share common staff and operate from the same warehouse facility. The costs shared by these programs totaled approximately \$4,096,849 during the audit period; however, HRU did not allocate any of these common costs to the Carval and ETS programs in compliance with OSD guidelines. Instead, HRU attributed the total common costs of both programs to its ETS (state-funded) program in the Uniform Financial Statements and Independent Auditor's Reports (UFRs) it submitted to the Commonwealth.

HRU operates Carval from a locally leased warehouse, and utilizes clients from its ETS program to work in this program. Carval contracts with outside companies that need assistance assembling, packaging, and bulk-mailing consumer products. Clients working in the Carval program receive a per unit wage, which is based upon the federal minimum wage laws and production time studies performed by Carval staff. During the audit period, the Carval program generated commercial revenue and operating expenses that averaged \$335,312 and \$320,772 per year, respectively. As detailed in the table below, the Carval program operated profitably during the audit period.

#### Carval Program Operating Results

##### Fiscal Years 2002 through 2006

Fiscal <u>Year</u>	Total <u>Revenues</u>	Total <u>Expenses</u>	Operating <u>Results</u>
2002	\$370,332	\$346,993	\$23,339
2003	342,508	332,280	10,228
2004	312,564	332,366	(19,802)
2005	363,132	340,513	22,619
2006	<u>288,027</u>	<u>251,709</u>	<u>36,318</u>
Total	<u>\$1,676,563</u>	<u>\$1,603,861</u>	<u>\$ 72,702</u>

As part of the audit, we analyzed HRU's financial reports to ensure that costs which were common to both the Carval and ETS programs were properly allocated and reported to the Commonwealth. In this regard, human service providers such as HRU frequently incur costs that apply to more than one program. In such cases, it becomes necessary to allocate these common costs among programs because their degree of usage cannot be readily and specifically identified within each program. Examples include salaries of staff that perform more than one type of service, rental of a building used for various program services, shared utilities, insurance premiums, etc.

Moreover, under 808 CMR 1.00, OSD published the UFR Auditor's Compliance Supplement (Compliance Supplement) that provides specific instructions relative to allocating common costs, including the following:

*Compliance Requirement: Contractor organizations must maintain financial books and records which distinguish the direct expenses of each program receiving Commonwealth funds and which make a reasonable allocation of the organization's costs which pertain to various functions to such programs...*

In addition, the UFR Manual provides human service providers such as HRU with specific instructions relative to allocating costs that pertain to various functions. In this regard, under the Section entitled "Statement of Functional Expenses," the UFR Manual states, in part:

*Many organizations incur costs that apply to more than one functional purpose. The Contractor and Subcontractor is required by 808 CMR 1.04 (1) to maintain and utilize a written cost allocation plan as part of its documentation efforts for demonstrating that costs applying to more than one functional purpose are directly attributable or allocable to the functional purpose. Some expenses are directly related to, and can be assigned to, a single major program or service or a single supporting activity. Other expenses are related to more than one program or supporting activity, or to a combination of programs and supporting services. These expenses should be allocated among the appropriate functions. Examples include salaries of persons who provide more than one kind of service and the rental of a building is used for various programs and supporting functions.*

Despite these requirements, HRU did not allocate costs that were common to its Carval and ETS programs in compliance with OSD guidelines. Specifically, these two programs shared staff and operated from the same building during the audit period. The cost of these resources totaled \$4,096,849. However, although the Carval program clearly incurred a portion of these common costs, HRU submitted UFRs to the Commonwealth that attributed the total costs of both programs to its ETS program. The table below details the costs that were common to the

ETS and Carval programs during the audit period, but were not allocated between the two programs in a reasonable manner.

**ETS and Carval Program**

**Unallocated Common Costs**

**Fiscal Years 2002 through 2006**

<u>Fiscal Year</u>	<u>Direct Program Staff</u>	<u>Total Occupancy</u>	<u>Total Unallocated Costs</u>
2002	\$671,462	\$98,396	\$769,858
2003	698,566	95,617	794,183
2004	731,431	101,091	832,522
2005	654,966	106,941	761,907
2006	<u>817,032</u>	<u>121,347</u>	<u>938,379</u>
Total	<u>\$ 3,573,457</u>	<u>\$ 523,392</u>	<u>\$4,096,849</u>

Clearly, since the Carval and ETS programs utilize the same staff and facilities to serve program clients, HRU should allocate these common costs between the two programs in a reasonable manner. This proper allocation is important since the Carval program is not a state-funded program; therefore, any surplus revenues generated in this program are not subject to the retention limitation imposed by the Commonwealth's Surplus Revenue Retention Policy. Moreover, if HRU had correctly allocated these expenses between these two programs, HRU's financial statements would have provided the Commonwealth with a significantly different financial picture during the audit period. Specifically, the Carval program would have incurred additional operating expenses, while the ETS program would have incurred less salary and facility expenses, thus reducing program costs to the Commonwealth.

***Recommendation***

Any reasonable allocation of the \$4,096,849 in common costs to the Carval program would have resulted in significant costs savings to the ETS program, and ultimately the Commonwealth. However, because we do not have data available to calculate an exact adjustment, we recommend that the Commonwealth recover \$92,504 from HRU. This amount is equal to the surpluses accrued within the Carval program during fiscal years 2002, 2003, 2005, and 2006, and represents approximately 2.5 percent of the total unallocated costs within these programs. We



did not deduct from this recoupment amount the \$19,802 loss that HRU reported it incurred in the program during fiscal year 2004 because doing so would allow HRU to fund this loss with surplus funds it owes the Commonwealth.

***Auditee's Response***

*In fact, 100% of the costs reported by HRU in its ETS program were budgeted for in contracts for that program issued by DMR. All staff of that program would be needed if HRU did not operate its Carval Assembly and Packing program. That program is, in substance, an account used by HRU to receive commercial revenues and pay ETS clients. The cost of administrative staff are properly allocated to that program. It is important to note that if HRU did not seek out commercial revenues, payroll costs for ETS clients would have to be absorbed by the Commonwealth as part of the ETS program.*

***Auditor's Reply***

Human service providers such as HRU are required to report actual, not budgeted, program expenses on UFRs they submit to the Commonwealth. Moreover, within these UFRs, providers are required to make a reasonable allocation of common costs between programs that operate with shared resources, e.g. direct care staff, facilities, etc. However, as noted in our report, HRU did not allocate the costs that were common to the Carval and ETS programs in accordance with state regulations. Consequently, HRU's financial reports overstated expenses attributable to the ETS program, which were ultimately funded by the Commonwealth.

In addition, HRU's response identifies certain hypothetical changes to the ETS and Carval programs that could have impacted the Commonwealth's financial interest in the past or in the future. While program services and state funding are certainly subject to change, our audit focused solely on the actual financial results of HRU's programs during the audit period. To speculate about the financial impact of hypothetical changes to the Carval and ETS programs is irrelevant to the results of our audit.