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INDEPENDENT STATE AUDITOR'S REPORT ON CERTAIN ACTIVITIES OF LIFELINKS, INC.

JULY 1, 2004 THROUGH FEBRUARY 29, 2008

OFFICIAL AUDIT REPORT
OCTOBER 15, 2008

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In April 1955, the Lowell Association for Retarded Children, Inc., (LARC) was incorporated under the provisions of Chapter 180 of the Massachusetts General Laws as a not-for-profit organization for the purposes of providing a wide variety of programs and services for people with disabilities, ranging from education to rehabilitation. In April 1997, LARC changed its name to LifeLinks, Inc., (LifeLinks).

Currently, LifeLinks provides rehabilitation, residential, and respite care services to developmentally disabled individuals of all ages and their families and operates multiple independent living, assisted living, and group home locations in the Greater Lowell and Merrimack Valley area. Additionally, LifeLinks operates a yearlong educational program conducted at Middlesex College (Lowell Campus), a Respite Care Facility called the "Woodland Inn" located in Lowell, and a "Community Center" located in Chelmsford.

The scope of our audit included an examination of certain administrative and operational activities of LifeLinks during the period July 1, 2004 through February 29, 2008. Our audit was conducted in accordance with applicable generally accepted government auditing standards for performance audits issued by the Comptroller General of the United States. The objectives of our audit were to (1) determine whether LifeLinks had implemented effective internal controls and (2) assess LifeLinks' business practices and its compliance with applicable laws, rules, and regulations and the various fiscal and programmatic requirements of its state contracts.

Our audit identified $286,661 in unallowable expenses that LifeLinks billed to its state-funded contracts during the audit period. We also found inadequate internal controls over three aspects of LifeLinks operations.

We found that during our audit period, LifeLinks leased two properties from related parties and used these properties to provide residential services to some of its consumers. We determined that, contrary to state regulations, LifeLinks used state funds to make payments for these two rental properties that exceeded the amounts allowed by state regulations by at least $90,794. According to state regulations, these related-party costs are unallowable and nonreimbursable under state-funded contracts.

We found that LifeLinks had not developed and implemented an adequate system of internal controls over certain aspects of its operations. Specifically, we found that LifeLinks did not have an established, written accounting manual, did not establish adequate documentation requirements for expenses incurred in its Northeast Family Partnership Program, and did not establish an effective inventory system for its fixed assets, which as of June 30, 2007 totaled $2,883,353. As a result, the Commonwealth cannot be assured that all of LifeLinks' public funds were properly safeguarded against loss, theft, and misuse and were expended for their intended purposes.

We found that LifeLinks gave its employees bonuses during fiscal year 2007 totaling $195,867, which it charged to its state-funded programs. However, contrary to Operational Services Division (OSD) guidelines, LifeLinks did not have an established, written employee morale, health, and welfare policy in place at the time it awarded these bonuses. LifeLinks' Executive Director stated that the agency did have board approval, but there was no documentation to substantiate this assertion. Without an established, written employee morale, health and welfare policy in place, the bonus expenses that LifeLinks billed against its state contract during the fiscal year are nonreimbursable according to state regulations.

INTRODUCTION

Background

In April 1955, the Lowell Association for Retarded Children, Inc., (LARC) was incorporated under the provisions of Chapter 180 of the Massachusetts General Laws as a not-for-profit organization for the purposes of providing a wide variety of programs and services for people with disabilities that range from education to rehabilitation. In April 1997, LARC changed its name to LifeLinks, Inc., (LifeLinks).

LifeLinks provides rehabilitation, residential, and respite care services to developmentally disabled individuals of all ages and their families and operates multiple independent living, assisted living, and group home locations in the Greater Lowell and Merrimack Valley area. Additionally, LifeLinks operates a yearlong educational program conducted at Middlesex College (Lowell Campus), a Respite Care Facility called the "Woodland Inn" located in Lowell, and a "Community Center" located in Chelmsford.

The scope of our audit was to examine various administrative and operational activities of LifeLinks for the period of July 1, 2004 through February 29, 2008. The objectives of our audit were to (1) determine whether LifeLinks had implemented effective internal controls and (2) assess LifeLinks' business practices and its compliance with applicable laws, rules, and regulations and the various fiscal and programmatic requirements of its state contracts.

During our audit period, LifeLinks received the majority of its revenue from the Massachusetts Department of Mental Retardation (DMR). The following table details LifeLinks' funding during fiscal years 2005, 2006, and 2007.

LifeLinks Funding

	Fiscal Year 2005	Fiscal Year 2006	Fiscal Year 2007
Contributions	$ 142,221	$ 129,498	$ 150,303
Grants	46,775	51,500	32,264
Dept. of Mental Retardation (DMR)	7,585,360	7,948,970	8,441,440
Mass. Comm. for the Blind (MCB)	250,196	265,451	251,357
Mass. State Agency Non-POS	542,621	362,192	19,872
Mass. Local Government	157,987		
Medicaid	2,251,662	2,276,727	2,425,982
Client Resources	721,182	960,237	782,681
Mass. Publicly Sponsored Client Offsets	143,988	247,844	229,826
Federated Fundraising	33,300	33,300	33,300
Commercial Activities	5,575	7,750	7,430
Investment Revenue	85,012	99,901	227,623
Other Revenue	3,810	16,797	54,876
Private Client Fees	3,910	2,158	0
Mass. Rehabilitation Commission	0	8,506	8,863
POS Sub Contract	0	22,611	9,275
Other State Agency POS	0	90,244	149,634
Released Net Assets	61,547	12,500	0
Stipends	0	0	38,532
Totals	$12,035,146	$12,536,186	$12,863,258

Audit Scope, Objectives, and Methodology

The scope of our audit was to examine various administrative and operational activities of LifeLinks during the period July 1, 2004 through February 29, 2008. Our audit was conducted in accordance with applicable generally accepted government auditing standards for performance audits issued by the Comptroller General of the United States. 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 LifeLinks 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 Massachusetts laws, rules, and regulations; and that resources are safeguarded and efficiently used.

- An assessment of LifeLinks' 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 LifeLinks 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 LifeLinks' accounting system. We used this assessment in planning and performing our audit tests. We then held discussions with LifeLinks' officials, obtained written communication from a Board of Director member and former employee, and reviewed organization charts and internal policies and procedures, as well as all applicable laws, rules, and regulations. We also examined LifeLinks' financial statements, budgets, cost reports, invoices, and other pertinent financial records to determine whether expenses incurred under its state contracts were reasonable, allowable, allocable, properly authorized and recorded, and in compliance with applicable laws, rules, and regulations.

Our audit was not made for the purposes of forming an opinion on LifeLinks' financial statements. We also did not assess the quality and appropriateness of all program services provided by LifeLinks under its state-funded contracts. Rather, our report was intended to report findings and conclusions on the extent of LifeLinks' compliance with applicable laws, regulations, and contractual agreements, and to identify services, processes, methods, and internal controls that could be made more efficient and effective.

AUDIT RESULTS

1. UNALLOWABLE RELATED-PARTY LEASE PAYMENTS TOTALING $90,794

During our audit period, LifeLinks, Inc., (LifeLinks) leased two properties from related parties and used these properties to provide residential services to some of its consumers. However, we determined that, contrary to state regulations, LifeLinks used state funds to make payments for these two rental properties that exceeded by at least $90,794 the amount allowed by state regulations. According to state regulations, these related-party costs are unallowable and nonreimbursable under state-funded contracts.

The state's Operational Services Division (OSD), the agency responsible for regulating and overseeing the activities of contracted service providers such as LifeLinks, has promulgated regulations relative to related-party transactions. OSD defines a related party in 808 Code of Massachusetts Regulations (CMR) 1.02 as follows:

> *Any person or organization satisfying the criteria for a Related-party published by the Financial Accounting Standards Board in Statement of Financial Accounting Standards No. 57 (FASB 57).*

FASB 57, in turn, defines a related party as follows:

> *Affiliate of the enterprise; entities for which investments are accounted for by the equity method by the enterprise; trust for the benefit of employees, such as pension and profit sharing trusts that are managed by or under the trusteeship of management; principal owners of the enterprise; its management; members of the immediate families of principal owners of the enterprise and its management; and other parties with which the enterprise may deal if one party controls or can significantly influence the management or operating policies of the other to an extent that one of the transacting parties might be prevented from fully pursuing its own separate interests. Another party also is a related party if it can significantly influence the management or operating policies of the transacting parties or if it has an ownership interest in one of the transacting parties and can significantly influence the other to an extent that one or more of the transacting parties might be prevented from fully pursuing its own separate interests.*

Specifically, 808 CMR 1.05(8) defines the following costs as being unreasonable and therefore nonreimbursable under state contracts:

> *Related Party Transaction Costs. Costs which are associated with a related party transaction are reimbursable only to the extent that the costs do not exceed the lower of either the market price or the related party's actual cost.*

As previously noted, during our audit LifeLinks was leasing two properties from related parties and using these properties to house some of its consumers. However, the rental costs that it paid to lease these two properties exceeded the amounts allowed by state regulations, as detailed in sections (a) and (b), below:

a. The Lease for Property Located on Middlesex Street in North Chelmsford, Exceeded Allowable Related-Party Costs by $60,890

On January 1, 2003, LifeLinks entered into a 10-year lease agreement with Chelmsford Holdings, Inc., to lease 24,500 square feet of space in a 260,900 square foot total area mill complex located on Middlesex Street in North Chelmsford. LifeLinks uses this space to operate six day programs, including its Community Center and educational and recreational activities. In return for this space, LifeLinks agreed to pay rent in amounts that began at $18,055 per month during calendar year 2003 but will escalate to $21,961 per month during calendar year 2012. In addition, under this lease LifeLinks is responsible for its electricity, gas, and telephone costs, as well as any repairs that need to be made to the property. According to LifeLinks officials, a member of LifeLinks Board of Directors is a partial owner of this company; therefore, this lease agreement represents a related-party transaction that is subject to OSD regulations.

We attempted to determine whether the lease payments that LifeLinks made for this property during our audit period were in accordance with OSD regulations by comparing the lease payments that LifeLinks was making under this lease agreement to a property market analysis that was prepared by a private company, EPA Westford. According to this analysis, the rental costs that LifeLinks agreed to pay under this lease agreement were within the fair market rental (FMR) costs for similar properties that were identified in this analysis. We then requested from the board member in question a description of the actual costs he incurred relative to the operation of the property during the period covered by our audit. In response to our request, the board member provided us with a list of the costs that he claimed to have incurred during calendar year 2007 relative to the operation of this property, information that he stated was from his federal income tax returns.

Expense Description	Amount
Administration	$3,703
Insurance	4,400
Professional Fees	2,874
Repairs and Maintenance (common areas)	36,907
Snowplowing	918
Property Taxes	6,156
Telephone	644
Waste Disposal	833
Management Fee	30,540
Depreciation/common area costs	80,502
Mortgage Interest	43,376
Total Expenses	$210,853

However, the board member did not provide us with any supporting documentation to substantiate these costs or any other cost data for calendar years 2005 and 2006. Rather, the board member stated that the 2007 amounts reflected the average actual costs for the whole audit period. If this information is accurate, then the excessive lease payments that LifeLinks paid to this board member in accordance with OSD regulations would total $60,890, as follows:

Fiscal Year	Lease Payments	Actual Costs	Amount over Actual Costs
2007	$233,386	$210,853	$22,533
2006	228,787	210,853	17,934
2005	231,276	210,853	20,423
Totals	$693,449	$632,559	$60,890

We brought this matter to the attention of LifeLinks officials, who stated that they were unaware of the OSD regulations regarding related-party transactions. Further, these officials stated that since the agency had used a market analysis which indicated that the total amount of rental payments was comparable to market costs for such a property, and that since LifeLinks officials were unaware of OSD limitations on related-party expenses, the agency believed that it was appropriate to charge the full amount of these lease payments to its state contracts.

b. The Lease for Property on Judith Road in Chelmsford Exceeded Allowable Related-Party Costs by $29,904

According to the agency's fiscal year 2006 Uniform Financial Statements and Independent Auditors' Report (UFR), LifeLinks' former Chief Information Officer (CIO) purchased a property located on Judith Road in Chelmsford, and in September 2003 entered into a 10-year lease with LifeLinks for this property. Under the terms and conditions of this lease, which extends until August 31, 2013, LifeLinks is responsible for a monthly rental payment of $2,450 (annual payment of $29,400) and bi-annual payments for taxes, repairs, and utilities. Since LifeLinks reported this transaction as a related-party transaction in its UFR, it was required to adhere to OSD regulations relative to the allowable costs associated with such transactions.

In order to assess the reasonableness of the costs associated with this transaction, we first attempted to obtain documentation from the agency's former CIO to substantiate the actual costs incurred relative to the operation of this property for the period in question. In response to our request, the former CIO stated that the costs associated with the operation of this property were $31,498 per year, an average of $2,625 per month, but she did not provide us with any documentation supporting this amount. We then obtained an assessment of the property from the Chelmsford Assessor's Office and noted that the property was classified as a three-bedroom residence. We then used the Federal Register[1] to determine the FMR for this three-bedroom property. We analyzed the FMR, the monthly rent payments, and the excess amounts paid during our audit period, as follows:

[1] The Federal Register is maintained by the U.S. Department of Housing and Urban Development (HUD), which annually sets fair market rents that are used for assessing public housing units. The fair market rents, as defined by 24 Code of Federal Regulations (CFR) Ch. 1X, is the "rent, including the cost of utilities (except telephone), as established by HUD for units of varying sizes (by number of bedrooms), that must be paid in the housing market area to rent privately owned, existing, decent, safe and sanitary rental housing of modest (non-luxury) nature with suitable amenities."

Fiscal Period	Monthly FMR Per Federal Register	Monthly Rent Per Lease	Excess Rent over FMR Per Month	Excess Rent Over FMR Fiscal Year
July 1, 2004 to June 30, 2005	$1,316	$2,450	$1,134	$13,608
July 1, 2005 to June 30, 2006	$1,355	$2,450	$1,095	13,140
July 1, 2006 to September 30, 2006[2]	$1,398	$2,450	$1,052	3,156
Total				$29,904

As previously noted, the annual costs associated with operating this property were $31,498, an average of $2,625 per month, consisting of $2,450 monthly rent plus additional payments for taxes, repairs, and utilities. As indicated in the table above, our analysis of Fair Market Rent and actual rent paid revealed that, contrary to OSD regulations, LifeLinks' rental costs associated with this property exceeded estimated market value by $29,904 from the period July 1, 2004 through September 2006, when the CIO resigned. Consequently, this $29,904 represents nonreimbursable expenses under LifeLinks' state contracts.

We brought this matter to the attention of LifeLinks officials, who stated that at the time this property was leased by the agency, LifeLinks was in immediate need of a location to relocate a group home. These officials stated that although Judith Road was an appropriate location, they were unable to purchase the property themselves due to various financial constraints. In addition, LifeLinks officials stated that when the individual in question first purchased this property, she was not the CIO, but only an Information Technology Specialist for the agency. Consequently, agency officials did not believe that this transaction was a related-party transaction, so no market analysis had been performed. When this individual was promoted to CIO, LifeLinks disclosed this related-party transaction in its UFR; however, LifeLinks officials indicated that they were unaware that a market analysis should then have been conducted to determine whether the payments they were making for this property were in accordance with OSD regulations.

[2] The CIO resigned in September 2006; therefore, the related-party transaction ceased to exist at this time.

Recommendation

In order to address our concerns relative to this matter, LifeLinks should conduct cost and market analyses for all present and future related-party transactions. Further, LifeLinks should amend its UFRs to reflect any costs that exceeded those allowed by OSD regulations as being nonreimbursable to the state.

Auditee's Response

In response to this audit result, LifeLinks provided comments, which are excerpted below:

> *Chelmsford Holdings has made a scheduled "donation" to LifeLinks annually equaling one month's rent. This amount has been considered a discount that Chelmsford Holdings has provided LifeLinks every year, effectively reducing the net profit for Chelmsford Holdings to a net loss annually. This amount should be reflected in the calculation for the lower of actual costs or market.*

Auditor's Reply

Although LifeLinks asserts that Chelmsford Holdings makes an annual donation equal to one months rent, the agency does not credit this donation in its financial records to the lease expense the agency incurred relating to this property. Therefore, there was no reduction to the lease costs that LifeLinks charged to its state contracts. Consequently, we believe our calculation in this audit result is accurate.

2. INADEQUATE ADMINISTRATIVE AND INTERNAL CONTROLS OVER CERTAIN AGENCY OPERATIONS

We found that LifeLinks had not developed and implemented an adequate system of internal controls over certain aspects of its operations. Specifically, we found that LifeLinks did not have an established, written accounting manual, did not establish adequate documentation requirements for expenses incurred in its Northeast Family Partnership Program, and did not establish an effective inventory system for its fixed assets, which as of June 30, 2007 totaled $2,883,353. As a result, the Commonwealth cannot be assured that all of LifeLinks' public funds were properly safeguarded against loss, theft, and misuse and were expended for their intended purposes.

According to Generally Accepted Accounting Principles (GAAP), entities such as LifeLinks should establish and implement an adequate internal control system within the organization to ensure that goals and objectives are met; resources are used in compliance with laws, regulations, and policies; and assets are safeguarded against waste, loss, and misuse. In order to comply with GAAP, LifeLinks should have a documented comprehensive plan of internal controls describing its goals and objectives that are to be achieved. An effective internal control system should be supported by a set of detailed subsidiary policies and procedures that would communicate responsibilities and expectations to subordinate staff throughout the organization. These policies and procedures would provide direction to employees on how to complete the various business functions, such as accounting, billing and receiving, accounts payable, human resources, and payroll.

However, during our review, we found that LifeLinks had not established adequate controls over certain aspects of its operations, as detailed below:

- No Documentation of Accounting System: Sound business practices advocate that entities such as LifeLinks establish a proper accounting system that is documented in formal policies and procedures and a written accounting manual that describes the accounting system and the policies and procedures utilized in the agency's accounting process. Such a manual not only maintains the integrity of the accounting process and its continuity in case of staff turnover, but also establishes accountability for various operations. However, during our review we noted that LifeLinks had not established formal written accounting procedures or an accounting manual.

- Inadequate Accounting Controls over Certain Northeast Family Partnership Program Expenditures: In this program, which provides flexible support and resource services to families with children who are medically fragile as well as cognitively disabled, LifeLinks incurred expenses totaling $5,833 during fiscal year 2007 for various gift cards but did not maintain a record of who received these gift cards. LifeLinks indicated that this program was administered by family members of consumers in the program, was governed by a council of parents with medically fragile and disabled children who determined how to document the program's expenses, including those associated with these gift cards. Consequently, although this program's staff maintained gift card receipts, they did not maintain names of the families who received these gift cards or require families to sign documentation that they had received the cards.

- Controls Over Inventory Could Be Improved: The 808 CMR 1.04, promulgated by OSD, states the following with regard to inventory of equipment and furnishings and other goods: "Any Contractor in possession of Capital Items . . . shall maintain and keep on file a written inventory of the property in accordance with generally accepted accounting principles." During our audit, we found that the agency did maintain a listing of fixed assets (nonexpendable items with a useful life of more than one year) that, according to its fiscal year 2007 financial statements, had a value of $2,883,353. However, this listing was used primarily for determining the agency's depreciation costs and not for inventory control purposes. Further, the agency does not routinely conduct a physical inventory of its fixed assets.

Regarding these matters, LifeLinks officials indicated that discussions have taken place as to the documentation requirements that would be necessary for the establishment of a written, detailed accounting and operation manual, but no steps have been taken by the agency towards documenting the existing system of internal controls or the development of such a manual. In addition, LifeLinks officials stated that they are in the process of establishing an inventory system. With respect to the Northeast Family Partnership, LifeLinks officials told us that as of January 1, 2008, the agency has enhanced its financial controls over this program to provide better controls over expenditures.

Recommendation

LifeLinks should continue its efforts to implement adequate internal controls over all aspects of its operations.

3. UNALLOWABLE EMPLOYEE BONUSES TOTALING $195,867

We found that LifeLinks gave its employees bonuses during fiscal year 2007 totaling $195,867, which it charged to its state-funded programs. However, contrary to Operational Services Division (OSD) guidelines, LifeLinks did not have an established, written employee morale, health, and welfare policy in place at the time it awarded these bonuses. LifeLinks' Executive Director stated that the agency did have board approval for these bonuses, but there was no documentation to substantiate this assertion. Without an established, written employee morale, health and welfare policy in place, the bonus expenses that LifeLinks billed against its state contract during the fiscal year are nonreimbursable according to state regulations.

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

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

Further, 808 CMR 1.05 promulgated by OSD identifies the following as nonreimbursable costs:

> *(9) Certain Fringe Benefits.*
>
> *(a) 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. Disparities in benefits among employees attributable to length of service, collective bargaining agreements or regular hours of employment shall not result in the exclusion of such costs.*

Despite these requirements, during fiscal year 2007, LifeLinks provided all of its employees with a one-time bonus based on their length of service with the agency, as follows:

- Employees with one year or less of employment with LifeLinks as of the June 30, 2007 will be paid a maximum of $500, prorated by their regularly scheduled weekly work hours.
- Employees with one but less than two years of continuous service as of June 30, 2007 will be paid a maximum bonus of $600, prorated by their regularly scheduled weekly work hours.
- Employees with two or more years of continuous service as of June 30, 2007 will receive an additional $100 bonus for each subsequent full year of service completed as of June 30, 2007. This additional $100 for each year of continuous service will continue to be calculated for up to twenty full years of completed service resulting in a maximum individual bonus cap of $2,500. Individual bonus calculations will be prorated by an employees regularly scheduled work hours excluding overtime.

We determined that LifeLinks did not have an established written policy regarding bonuses and that, accordingly, the $195,867 in bonuses represent nonreimbursable expenses under LifeLinks' state contracts. Moreover, LifeLinks did not properly report these costs as nonreimbursable expenses on its fiscal year 2007 UFR that it filed with OSD. Finally, we found that LifeLinks paid these bonuses to its employees through its regular payroll service, and at that time did not distinguish this expense as a separate compensation item in its accounting records.

Regarding this matter, LifeLinks officials indicated that they sought and received approval for these bonuses from the agency's Board of Directors. However, our review of the agency's board meeting minutes revealed no indication that the entire board was aware of and had approved these bonuses. Further, these officials stated that they were unaware that they were required to separately disclose these bonus expenses as a nonreimbursable item on the agency's UFRs.

Recommendation

To address this matter, LifeLinks should amend its fiscal year 2007 UFR to disclose the $195,867 in bonuses as being nonreimbursable under its state contracts. In the future, if LifeLinks wants to provide bonuses to its staff members, it should establish a formal, written employee morale, health, and welfare policy that is consistent with OSD guidelines for this purpose.